ECONOMIC VIEWPOINT

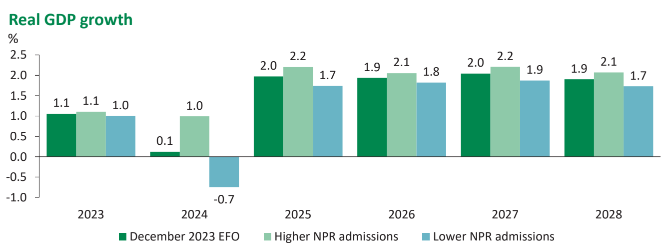
How Much Will Canada's Population Grow? Nobody Knows, but We Can Predict Where It Goes

By Randall Bartlett, Senior Director of Canadian Economics

Highlights

- The population projection is foundational to Canada's economic outlook, as it's made up of the consumers and workers who will drive future economic activity and government revenues. Once taken for granted, the population growth forecast is now more uncertain than ever.
- Canada's population has surged recently, largely driven by a sharp increase in net non-permanent residents (NPRs), such as temporary foreign workers and foreign students. Assuming future immigration is in line with federal government plans, NPRs will be the primary driver of population growth going forward.
- The forecast for the working-age population (people ages 15 and over) we used in our recent Economic and Financial Outlook is roughly consistent with the projection through 2025 in the Bank of Canada's October 2023 Monetary Policy Report. It suggests working-age population growth could average about 1.8% annually from 2023 through 2028. Over the same period, we expect real and "trend" or potential GDP growth to average 1.5% and 1.7%, respectively.
- Looking at alternative scenarios for NPR admissions, closing the door to temporary newcomers would deepen the recession expected in 2024 and blunt the subsequent recovery (graph 1). It would similarly lower potential GDP. Our provincial analysis came to a similar conclusion. In contrast, materially increasing the pace of NPR admissions would likely raise real GDP growth to the point of possibly preventing a recession in the near term and improving long-run economic outcomes.
- While the pace of NPR admissions should slow naturally with the economy, changes in federal government policy could cause them to fall even faster. A sharp drop-off could deepen the recession expected in early 2024. As such, caution is warranted on the part of policymakers to minimize the economic downside of slowing newcomer arrivals too quickly. But it's not an easy balance to strike, as sustained high NPR admissions could further strain provincial finances and housing affordability.

Graph 1
Closing the Door to NPRs Would Deepen the Recession Expected in 2024



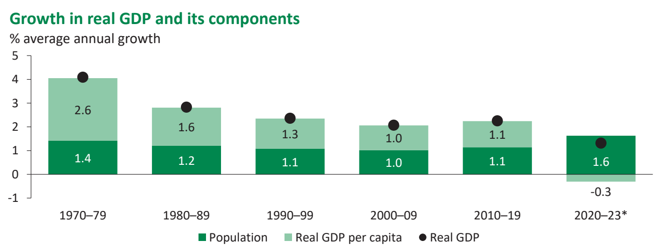
NPR: Net non-permanent resident, EFO: Economic and Financial Outlook
Statistics Canada and Desjardins Economic Studies

A lot of ink has been spilled analyzing Canada's recent population surge. We wrote about the economic considerations around different levels of international migration last summer. The Bank of Canada published similar but more in-depth analysis following its December 2023 interest rate decision. These concluded that immigration boosts potential GDP but exacerbates the housing affordability crisis in the absence of a meaningful increase in the supply of homes. But it is largely net non-permanent residents (NPRs) that have driven population growth recently. This begs the question: how would different levels of NPRs impact the economic outlook?

Population Is the Foundation on Which a Forecast Is Built

Underpinning our latest Economic and Financial Outlook (EFO) is our forecast for population growth. The group that is especially relevant to the economic outlook is people ages 15 years and over—the working-age population—as they form the backbone of Canada's labour market. And when we look at the data, it's clear that much of real GDP growth can be chalked up to the rise in population, particularly recently (graph 2). (See our report for more information on the drivers of real GDP per capita growth in Canada.)

Graph 2
Population Growth Has Become the Main Driver of Real GDP Growth

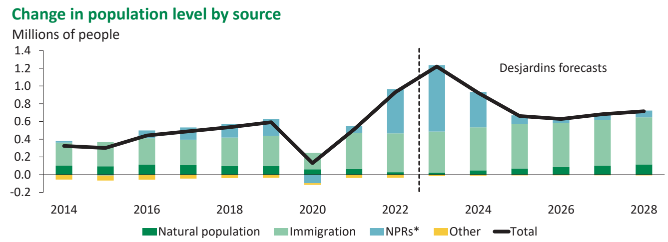


*2023 data is through Q2 2023
Statistics Canada and Desjardins Economic Studies

To determine the outlook for population growth there are a few considerations. The first is the change in the natural population, which is assumed to occur in the absence of international migration. Then there is immigration, for which we use the federal government's annual targets for admission of permanent residents (PRs). The final consideration is net non-permanent residents, which include temporary foreign workers and foreign students. NPRs have been driving recent population growth in The Great White North—the strongest since the 1950s. In 2022, NPR admissions outpaced PR admissions for the first time on record (graph 3). And this trend looks to have accelerated in 2023.

There are a couple of reasons so many NPRs are coming to Canada. The first is demand for workers. Coming out of the

Graph 3
Canada's Population Has Boomed Due to Sharply Higher NPRs

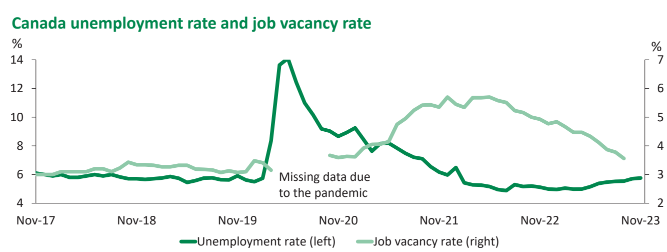


NPRs: Non-permanent residents
Statistics Canada and Desjardins Economic Studies

pandemic, job vacancies skyrocketed while Canadians looking for work plummeted (graph 4). The number of NPRs was further boosted by the introduction of the International Mobility Program. It has parallels to the more well-known Temporary Foreign Worker Program, but with fewer hurdles for employers to jump over. As such, it became easier than in the past to bring workers to Canada on a short-term basis to meet acute job shortages. This helped to ease labour market pressures following the pandemic, thereby preventing even higher wage growth.

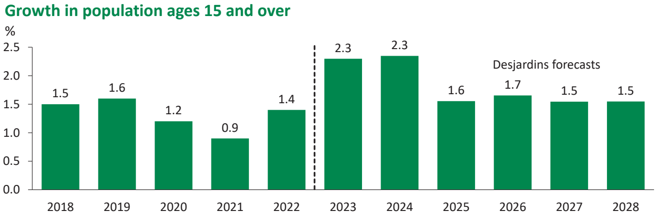
Where international migration goes from here is highly uncertain. Our December 2023 Economic and Financial Outlook assumes there will be roughly half as many NPRs in 2024 as there were this year, and then half as many again in 2025. It eventually bottoms out in 2026 before gradually rising. That leads to growth in the working-age population of 2.3% in 2024 and 1.6% in 2025 (graph 5 on page 3). Those rates are broadly in line with the population growth inferred from the Bank of Canada's October 2023 Monetary Policy Report. After that, working-age population growth averages around 1.6% annually through 2028. To reach this result, we assumed that the age distribution of individuals coming from abroad will be similar to past patterns. From 2023 through 2028, we expect the working-age population to grow an average of 1.8% annually, 0.2 percentage points more than the figure in the latest federal Fall Economic Statement (FES).

Graph 4
The Job Vacancy Rate Has Fallen Faster than the Unemployment Rate Has Risen



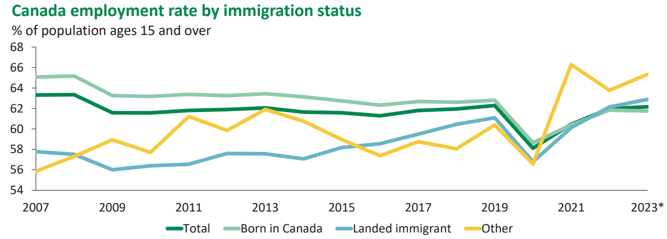
Statistics Canada and Desjardins Economic Studies

Graph 5
Working-Age Population Growth Is Expected to Slow Sharply after 2024



Note: This analysis refers to population data from the Labour Force Survey
Statistics Canada and Desjardins Economic Studies

Graph 7
Newcomers to Canada Are Increasingly Likely to Be Working



*Average of the first three quarters of 2023
Statistics Canada and Desjardins Economic Studies

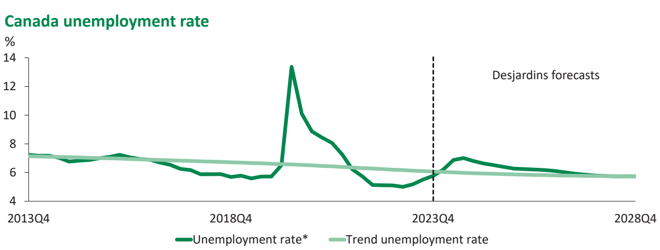
Using this baseline population forecast, we determined that the trend unemployment rate should move gradually lower to about 5.7% by the end of 2028. And while the unemployment rate itself is expected to keep rising over the near term as the economy slows, it is projected to reach its long-run trend by the end of our forecast (graph 6).

This doesn't just speak to the aging of Canada's population. It also reflects the outlook for employment and participation rates among various demographic groups. Prime-age women have become increasingly attached to the labour force, and recent declines in childcare costs across Canada will only further this trend. Many older Canadians are also working longer or re-entering the labour force after retirement. And then there are newcomers to Canada. For instance, landed immigrants are now more likely than adults born in Canada to be employed. And for workers who are neither born in Canada nor landed immigrants, the majority of whom are non-permanent residents, the employment rate is even higher coming out of the pandemic (graph 7). However, history has shown us that this strength likely won't last.

When combined with assumptions for productivity going forward, the labour market projection is a key input into our "trend" or potential GDP forecast. Our long-run assumption for annual productivity growth is about 0.2%, roughly one quarter the pace of the past two decades. It's similarly below the average annual pace from 2023 to 2028 assumed by the federal government in its recent FES. That said, it would be a marked improvement over recent productivity growth in Canada (graph 8).

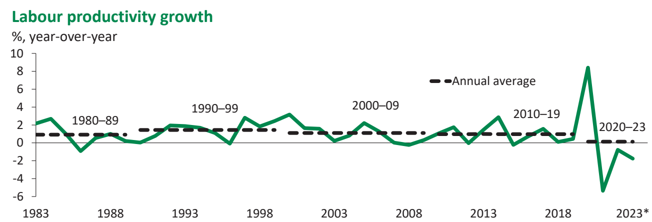
With this in mind, our real GDP growth forecast averages 1.5% annually from 2023 to 2028, whereas the FES 2023 projection averages 1.7%. Our higher population projection offsets some, but not all, of the more substantial productivity weakness. We expect average real GDP growth to also lag potential GDP growth from 2023 to 2028 (graph 9). That's because Canada

Graph 6
Canada's Unemployment Rate Is Gradually Trending Lower



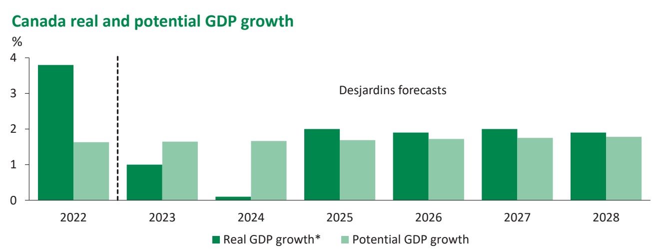
*Forecast is from Desjardins's December 2023 Economic and Financial Outlook
Statistics Canada and Desjardins Economic Studies

Graph 8
Productivity Growth Has Been the Worst on Record Recently



*Reflects Q1 to Q3 2023
Statistics Canada and Desjardins Economic Studies

Graph 9
Potential GDP Growth Is Expected to Outpace Real GDP Growth over the Outlook



*Forecast is from Desjardins's December 2023 Economic and Financial Outlook
Statistics Canada and Desjardins Economic Studies

started 2023 from a position of excess demand, characterized by a positive output gap—defined as the percent difference between real and potential GDP. The output gap—which estimates the degree to which the economy is running too hot or too cold—is projected to be closed by the end of the forecast horizon.

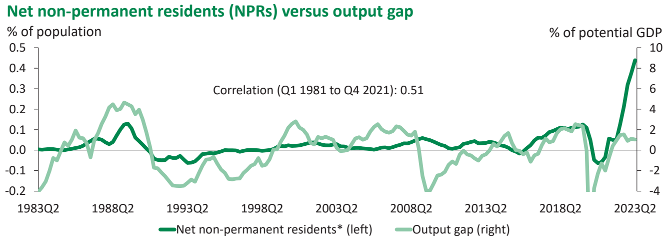
What If Population Growth Isn't What We Expect?

When you're a forecaster, the one thing you can be certain of is that the economy will evolve differently than your outlook suggests. You just hope to be reasonably close. It is therefore key to examine alternative scenarios and what they could mean for the future.

Like previous work we've done at the provincial level, one can compare the impact of a drop in NPR admissions to our December 2023 EFO baseline outlook. And given we're expecting a short and shallow recession in the first half of 2024, looking to past economic downturns and the years that followed—as indicated by the output gap—may be a good starting point. Of course, no one recession is like another when it comes to the number of NPRs coming to Canada (graph 10). That said, taking the median of these impacts would suggest a decline of about 30,000 NPRs in the first year of an economic downturn.

Alternatively, we can look at the relationship between NPR admissions and the output gap. Historically, it has been a pretty good bellwether of NPR admissions. But recently that relationship has broken down (graph 11). Further, the baseline population projection is used in our current forecast for the output gap. As such, our existing output gap forecast doesn't provide an unadulterated view of how the level of NPRs could evolve going forward. That said, just for reference, the forecast for the output gap from our December 2023 EFO suggests the level of NPRs could fall to around 10,000 in 2024 as demand for labour from employers falls. It would then rise to nearly 50,000 in 2028 as the economy returns to trend. These levels of NPR admissions would be well below those observed before the COVID-19 pandemic, when the economy was operating above its potential.

Graph 11
NPRs Are Arriving More Quickly than Suggested by the State of the Economy

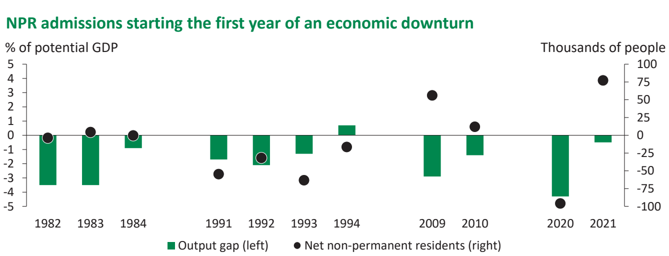


*Uses a 4-quarter moving average of NPRs
Statistics Canada and Desjardins Economic Studies

Given the present uncertainty around NPR admissions, the easiest thing to do is to provide broad upside and downside scenarios for comparison. Indeed, the number of NPRs coming to Canada can move abruptly due to changes in federal government policy as well as economic conditions. Some of this is playing out in real time now, with new restrictions on foreign student admissions and work permits announced recently. As such, we selected two straightforward scenarios around the baseline: one where NPRs fall to zero in each year of the projection and another where NPRs are admitted at double the pace assumed in our December 2023 baseline (graph 12).

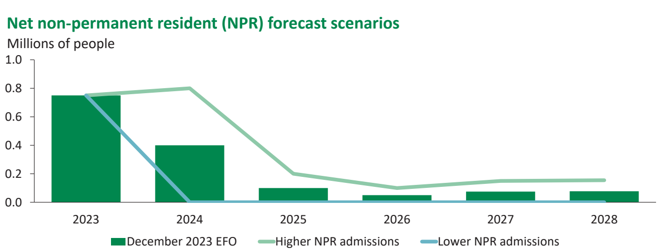
In the scenario where NPR admissions grind to a halt, population growth would average a modest 1.5% from 2023 to 2028 (graph 13 on page 5). This is down from 1.8% in the baseline outlook and just a tick below the federal government's 1.6% average annual forecast over the same period. Assuming productivity doesn't improve any more than in the baseline, potential GDP growth would remain steady at an average of about 1.6% annually over the outlook (graph 14 on page 5). Real GDP itself would fall considerably below the baseline outlook, leading the anticipated recession in the first half of 2024 to double in length (graph 15 on page 5). Real GDP growth would remain more muted in the recovery than in the baseline scenario as well, helping to keep inflation more contained than in the baseline December 2023 EFO forecast.

Graph 10
Every Recession Is Different When It Comes to NPR Admissions



NPR: Net non-permanent resident
Statistics Canada and Desjardins Economic Studies

Graph 12
Number of NPRs Coming to Canada Is Expected to Fall Sharply



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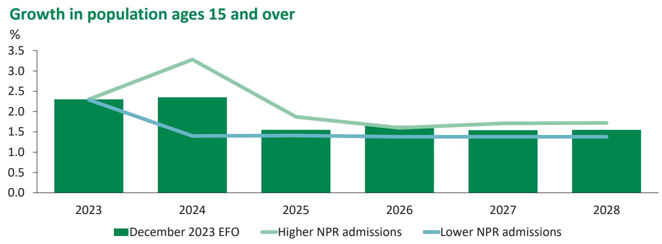
Graph 13
Population Growth Differs the Most in 2024 in Our Scenarios



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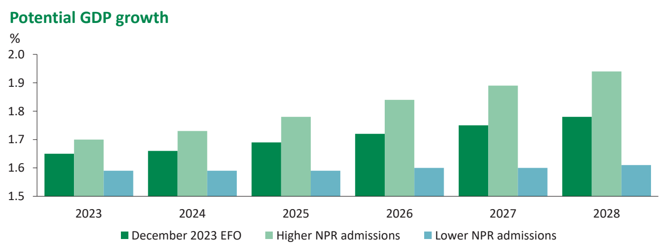
Graph 14
More NPRs Means Higher Potential GDP Growth



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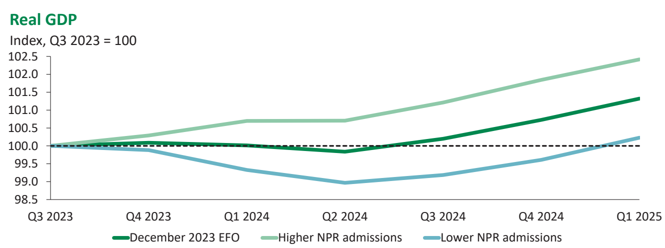
Graph 15
Closing the Door to NPRs Would Dramatically Slow Economic Activity



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Contrast this dour outlook with one where NPR admissions remain elevated relative to the baseline. In this case, population growth would average 2.1% annually from 2023 through 2028, up from 1.8% in the baseline outlook (graph 12 on page 4). Assuming no change in productivity growth from the baseline, potential GDP would accelerate from 1.6% in 2023 to 1.9% in 2028, averaging 1.8% annually over the outlook (graph 13). Real GDP itself would rise above the baseline projection, which would lead to a milder economic slowdown than currently anticipated, possibly avoiding a recession altogether (graph 14). Inflation would likely also be more elevated, complicating the Bank of Canada's job and probably keeping rates higher for longer than they would be otherwise.

Economic Implications of Canada's Demographic Growth Approach

It's anyone's guess how population growth will advance in Canada. In our opinion, the big wildcard is net non-permanent residents, who have been the primary driver of the recent surge in Canada's population. While we anticipate the flow of these newcomers to slow, how much it slows will have material impacts for Canada's economic growth, both in the near and long term. The pace of arrivals should diminish naturally along with the anticipated slowing of the economy, but additional constraints put in place by the federal government could accelerate that decline. As such, caution is warranted on the part of policymakers to minimize the economic downside of slowing the pace of newcomer arrivals too quickly.

But it's not an easy balance to strike. An extraordinarily high level of newcomers arriving in Canada has implications beyond just their impact on real GDP, the labour market and inflation. The boost to output and inflation has helped to fill government coffers coming out of the pandemic. But inflation is insidious, pushing the cost of delivering services higher even as the tailwind to revenues fades. Provincial and municipal governments are particularly vulnerable to elevated inflation and population growth given their more direct role in delivering services to the population. (See our recent note outlining this and other provincial fiscal considerations.) And as we've discussed elsewhere, maintaining the current pace of newcomer arrivals will erode housing affordability further in the absence of a monumental increase in the supply of homes.