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**Taming Canadian population growth; be prepared to take the good with the bad**

by Andrew Grantham [andrew.grantham@cibc.com](mailto:andrew.grantham@cibc.com)

What started out as an advantage for the Canadian economy spiraled out of control as 2023 progressed. Population growth led by non-permanent residents initially helped to fill elevated job vacancies coming out of the pandemic, but the surge since mid-2022 has also resulted in housing shortages and rent price inflation.

The Federal government is now taking steps to tame population growth. While Canada is still targeting 500K permanent immigrants a year in 2025 and 2026, targets will also be set for non-permanent residents with the aim of reducing this group to 5% of the total population (Chart 1). While progress towards taming NPR numbers may be slow at first due to commitments already in place, achieving a target of 5% will eventually require a decline in this population. If met, that would see overall population growth decelerate markedly (Chart 2).

However, while that should help ease pressure in housing costs, we also have to consider the needs of the labour market against the backdrop of an aging domestic population. We estimate that while the population has risen by roughly 1.1 million (approximately 35%) more than housing availability could accommodate since 2019, the increase has eclipsed

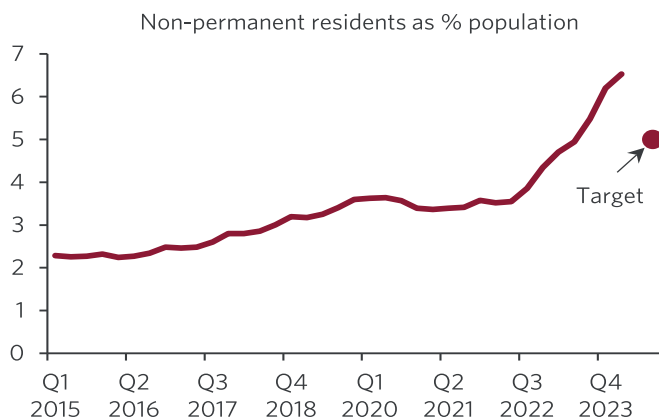
labour force needs by “only” between 200-700K (5-20%). That suggests a careful balance exists between taming population growth to ease housing inflation and potentially exaggerating issues of labour shortage and thereby creating inflationary pressures in other areas.

**Easing but not solving**

Since population growth first accelerated above 1% year-over-year in 2016, household formation has picked up sharply. Census data pointed to a 6.5% increase in the number of private households between 2016 and 2021, eclipsing the 5.5% rise in the population. The leaning of population growth towards non-permanent residents, and in particular students, may have helped lower the average size of Canadian households to further exacerbate housing shortages.

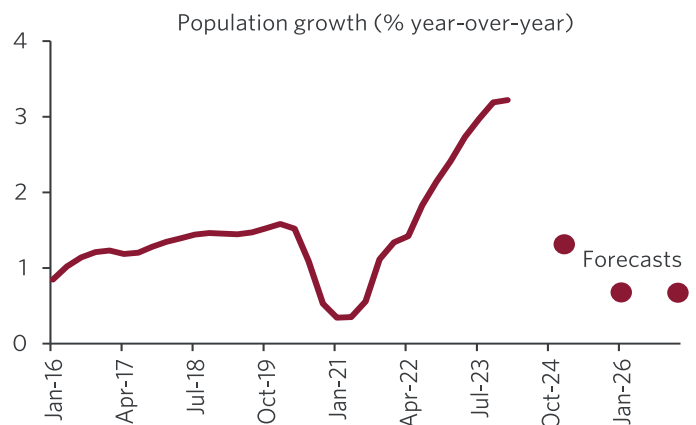
The surge in population growth since 2021 will clearly have accelerated household formation further, particularly given the continued leaning towards non-permanent residents. With little-to-no acceleration in the rate of growth of the housing

**Chart 1: Planned reduction in non-permanent residents**



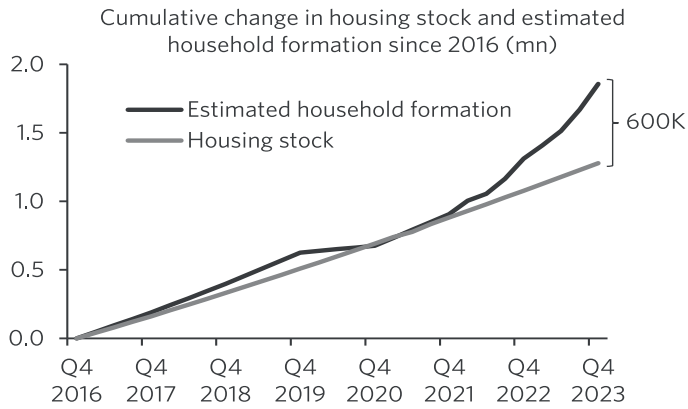
Source: Statistics Canada, CIBC

**Chart 2: Potentially large deceleration in overall population growth**



Source: Statistics Canada, CIBC

**Chart 3: Population growth has eclipsed housing availability**



Source: Statistics Canada, CIBC

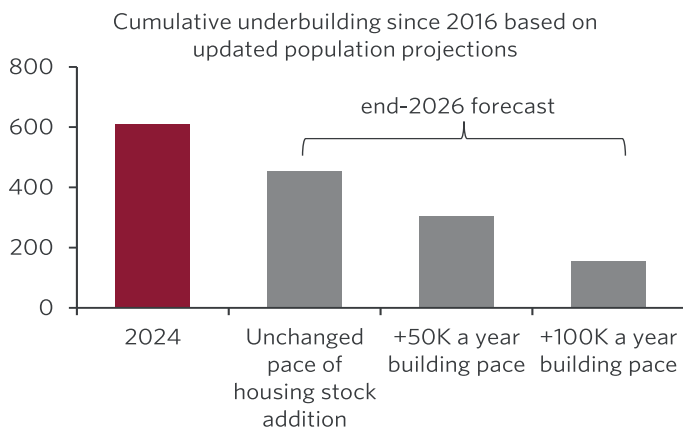
stock, there has been an accumulated 600K underbuilding relative to estimated household formation since 2016 (Chart 3).

While new targets to restrict non-permanent residents are expected to dramatically slow population growth, they will not, by themselves, quickly offset this underbuilding. Indeed, if the pace of homebuilding doesn't pick up, the accumulated underbuilding since 2016 would still be 450K by 2026 even if population growth slows dramatically (Chart 4).

As such, a combination of longer restrictions on non-permanent resident numbers, and a pick-up in homebuilding as interest rates fall and new incentives for building take hold, will be needed to offset the accumulated underbuilding of the past few years. And because the housing market in Canada was already fairly tight prior to population growth surging, simply offsetting the recent underbuilding shouldn't necessarily be considered a return to balance.

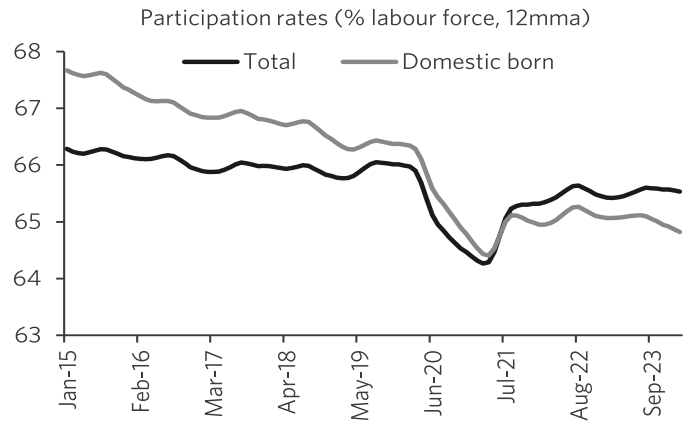
## Workers wanted

**Chart 4: Restricting population growth won't by itself solve housing issues**



Source: Statistics Canada, CIBC

**Chart 5: Newcomers to Canada have helped slow decline in labour force participation**



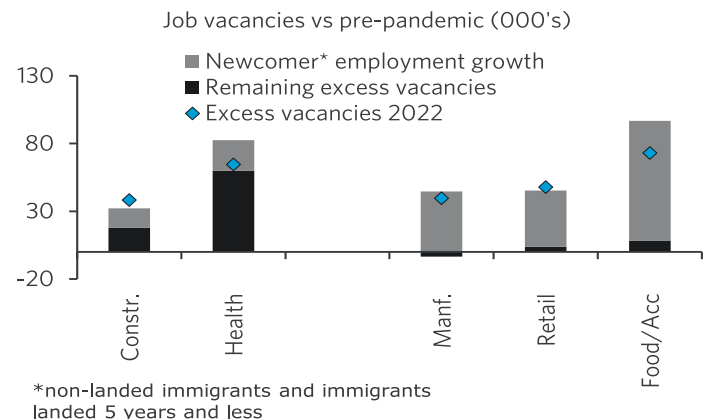
Source: Statistics Canada, CIBC

With so much attention focused on the link between immigration, population growth and housing affordability, it is easy to lose sight of the positive impact that newcomers into the country are having, particularly in the labour market.

As the domestic workforce has aged, participation rates have understandably fallen. For persons born within Canada, the participation rate has declined by almost 3% since 2015 (Chart 5). More than half of this drop has come since 2019. However, the increased numbers of newcomers into the country, combined with improved participation rates among that group, has meant that the overall participation rate has fallen much more slowly.

Increased numbers of non-permanent residents and new immigrants were important in reducing elevated levels of job vacancies coming out of the pandemic. Indeed, increased employment levels for newcomers into Canada within the manufacturing, retail and food & accommodation sectors have almost exactly matched the decline in job vacancies from their peak in 2022 (Chart 6). In contrast, sectors where newcomers

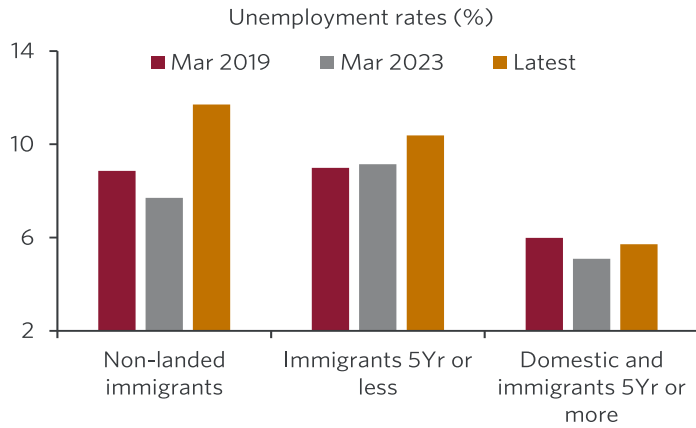
**Chart 6: Largest drops in job vacancies linked to employment of newcomers to Canada**



\*non-landed immigrants and immigrants landed 5 years and less

Source: Statistics Canada, CIBC

**Chart 7: Unemployment rates of newcomers to Canada have surged in past year**



Source: Statistics Canada, CIBC

to Canada haven't had as much success in gaining employment (either because of skills shortages or issues recognizing licenses gained in other countries), such as construction and healthcare, still have elevated vacancy levels. Without this boost to labour supply, wage pressures may have proved even more persistent than they already were.

### Too much, too fast

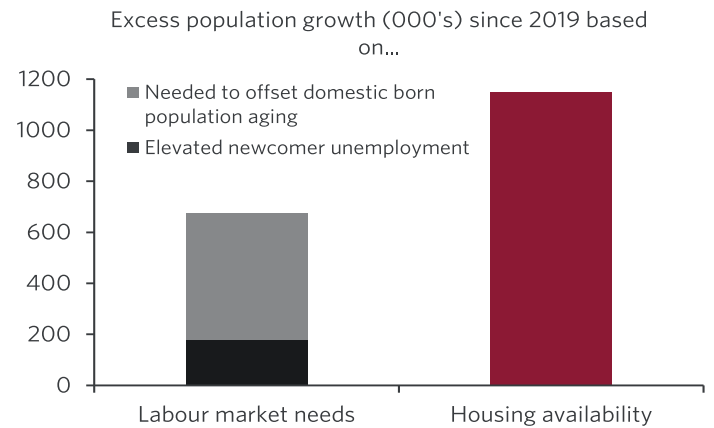
However, even in the labour market, there are now signs that the surge in population may have been a case of too much, too soon. Coming out of the pandemic, participation, employment and unemployment rates for newcomers to the country were all better than they were pre-pandemic. However, as the economy has slowed and demand for labour has eased, this group has been the most negatively impacted.

Nationally the unemployment rate rose above 6% in March, with the jump relative to a year ago driven largely by non-landed immigrants and immigrants who moved to the country less than 5 years ago. Unemployment rates for these two groups are now also well above where they stood in 2019, while the rate of joblessness for the rest of the population remains slightly below that mark (Chart 7).

Based on the labour force survey data, we estimate that the newcomer population in Canada has risen by roughly 140K more than was needed to offset the decline in domestic born employment and participation rates due to population aging. However, this is likely an underestimation because the labour force survey generally undercounts the number of non-landed immigrants, and this undercounting appears to have widened as the non-permanent resident population has risen. While labour force data point to a 600K increase in the non-landed immigrant population since 2019, quarterly estimates of non-permanent residents point to a nearly 1.5mn increase over the same period.

Adjusting for this undercounting and assuming similar participation rates among those not covered in the labour force

**Chart 8: Excess population growth smaller relative to labour market needs than relative to housing availability**

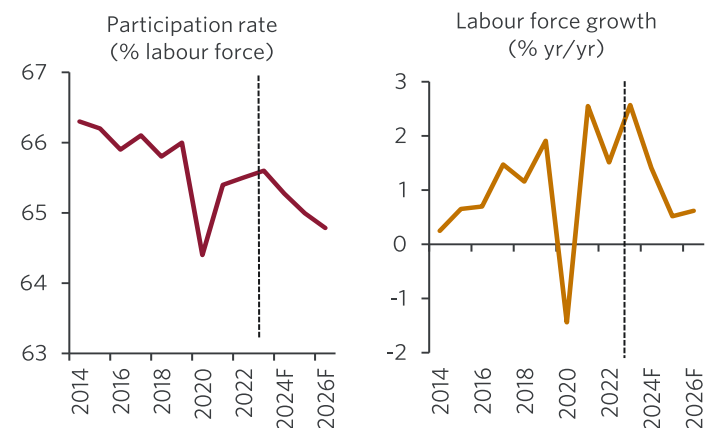


Source: CIBC

survey, population growth in Canada since 2019 is estimated to have been nearly 700K (20%) more than was needed to offset an aging domestic labour force. However, as these newcomers themselves bring demand as well as supply, this may be an overestimation of the excess growth in the labour force. Judging instead by how much the unemployment rate of newcomers has risen (and again adjusting for undercounting), provides an estimate of excess labour force growth of around 200K.

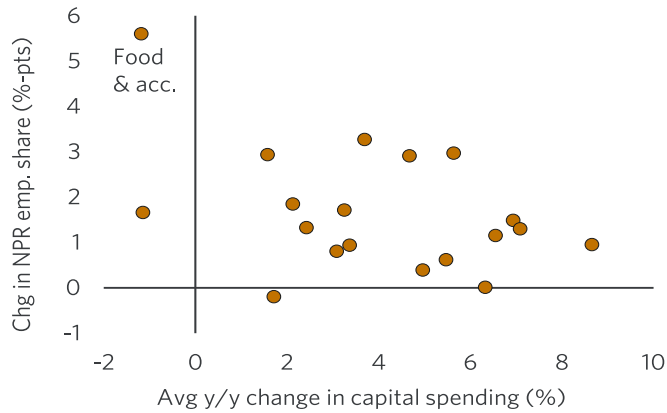
While the range between these two estimates is large, on both measures the estimated excess population growth based on labour market needs is well below the excess seen based on housing availability (Chart 8), suggesting that if population growth slowed too much then labour shortages and inflationary pressures could crop up in other areas. The restrictions on non-permanent resident numbers will likely bring an acceleration in the rate of decline of aggregate participation in the coming years (Chart 9, left), and see the pace of labour force growth ease to below 1% (Chart 9, right).

**Chart 9: Decline in aggregate participation to accelerate (L), and labour force growth to slow (R)**



Source: Statistics Canada, CIBC

**Chart 10: Little correlation between non-landed immigrant employment and capital spending weakness**



Source: Statistics Canada, CIBC

Hopefully an easing in interest rates and strengthening in demand will improve employment prospects for persons already in the country at the same time, which will limit the impact on employment growth. But it's also possible that higher wages will need to be offered to increase participation among the labour force already in Canada.

## Population measures won't solve productivity puzzle

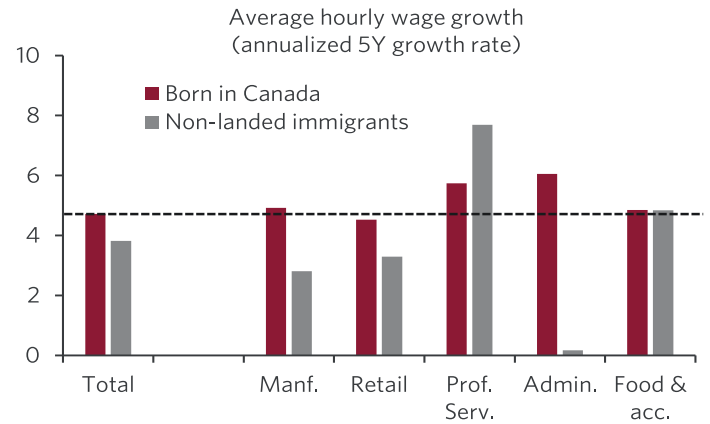
With labour force growth set to slow markedly by 2025/26, the growth potential of the economy will rely on a turnaround in productivity. While we expect productivity to improve at the same time as population growth weakens, that will at least partly be due to the impact of lower interest rates benefitting high value-add areas of the economy such as homebuilding and real estate. Rapid population growth may have contributed to recent sluggishness in productivity as new hires needed training, but Canada's underperformance predates this recent

**Chart 11: Even less correlation between non-landed immigrant employment and productivity**



Source: Statistics Canada, CIBC

**Chart 12: Use of non-landed immigrant employment hasn't had a big impact on wage growth for domestically born workers**



Source: Statistics Canada, CIBC

surge and so we doubt NPR-led population growth is the main reason.

There doesn't appear to be a clear correlation between the increased use of non-landed immigrant employment and capital spending on an industry basis (Chart 10). The exception to this is in food & accommodation services, however there is little evidence that this is resulting in even weaker productivity than in other areas of the economy (Chart 11). We seem to be a long way away still from the mass rollout of robo-waiters and cooks.

There is also little evidence that the employment of non-landed immigrants in various sectors is negatively impacting wage growth for other employees (Chart 12), suggesting that the jobs being done by newcomers into the country are not necessarily substitutes for those worked by the domestically-born population. In sum, the productivity problem within Canada needs a deeper look and cannot just be blamed on the availability of cheap non-resident labour, even if reducing the share of jobs in these generally lower productivity sectors supports aggregate productivity somewhat in the years ahead.

## Taking the good with the bad

If met, new targets on non-permanent resident numbers will dramatically reduce population growth in Canada, from more than 3% today to less than 1% in 2025/26. While that won't, by itself, solve the shortfall in new homebuilding relative to population growth, it will help ease some of the most acute pressure and reduce rental price inflation within the Canadian CPI.

However, it is possible that slowing labour force growth could result in worker shortages and create inflationary pressures in other areas as a partial offset. The inflation rate in domestic services (ex shelter) has eased quicker in Canada relative to the US, due not just to weaker demand caused by high interest rates but also a quicker easing in job vacancies back to (or

even below) pre-pandemic norms in areas such as food & accommodation.

While limiting the availability of labour should, in theory, encourage investment and raise productivity, there is no clear evidence at the sector level that the greater use of non-permanent resident labour is correlated with low productivity. Instead, restrictions on population growth could result in companies having to offer higher wages to encourage persons to remain in, or rejoin, the workforce. We could lose some firms that are simply not profitable if they are unable to tap low paid foreign workers.

The wider implication of slowing population growth will therefore be a lower rate of potential growth within the economy. While the slack that is currently being built up in the labour market suggests that the economy could grow above potential for a little while as interest rates start to come down, by the end of next year and certainly by 2026 the economy could struggle to grow by more than 1.5% without inflationary pressures starting to creep higher. That said, it could still be the case that per capita growth, the ultimate driver of living standards, might end up being stronger if the mix of employment tilts towards more productive sectors.

## Contacts:

Avery Shenfeld  
[avery.shenfeld@cibc.com](mailto:avery.shenfeld@cibc.com)

Benjamin Tal  
[benjamin.tal@cibc.com](mailto:benjamin.tal@cibc.com)

Andrew Grantham  
[andrew.grantham@cibc.com](mailto:andrew.grantham@cibc.com)

Ali Jaffery  
[ali.jaffery@cibc.com](mailto:ali.jaffery@cibc.com)

Katherine Judge  
[katherine.judge@cibc.com](mailto:katherine.judge@cibc.com)

CIBC Capital Markets  
PO Box 500  
161 Bay Street, Brookfield Place  
Toronto, Canada, M5J 2S8  
[Bloomberg @ CIBC](#)

[economics.cibccm.com](http://economics.cibccm.com)

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