Economics

IN FOCUS

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Are new immigration targets really an economic gamechanger?

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Since the Federal government announced new, lower, immigration targets, we've been reading headlines of economists having to "rip-up" their prior forecasts for the Canadian economy. However, while the new targets will have an impact, they are not the game-changer that these headlines suggest — at least not in terms of the near-term trajectory for growth, inflation and interest rates.

While lower targets for permanent immigration will result in modestly lower population growth, the main determinant of this will be how successful (or otherwise) the government is at reducing the proportion of non-permanent residents. Moreover, even if slower population growth leads to a weaker increase in the economy's non-inflationary potential, evidence of slack within the labour market shows that there is room to grow before this limit is reached, and further out there would be time to adjust policy if need be.

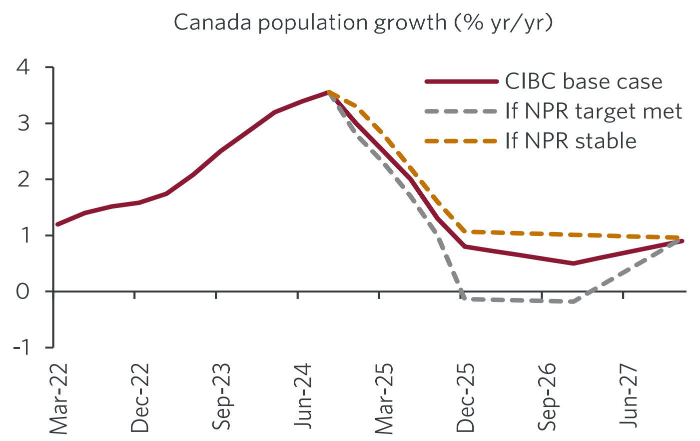
The here and now

Over the coming years, population growth in Canada will slow substantially, although that was also the case before the new, lower, targets for permanent immigration were announced. The reductions in these targets to 395K in 2025, 380K in 2026 and 365K in 2027, represent on average a 120K reduction compared to the prior targets. This reduces population growth by a modest 0.3%-pts a year.

The biggest determinant of just how much population growth in Canada slows in the coming years is how far the proportion of non-permanent residents retreats back to 2019 levels. If the target of matching that 2019 proportion over two years is met, as stated by the government, the population in Canada could shrink slightly in 2025 and 2026 (Chart 1).

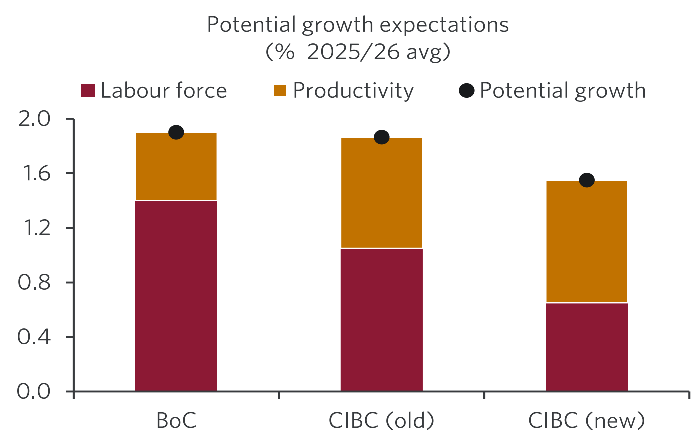
However, delays in people on existing work and study permits leaving the country, combined with a rise in asylum seekers as stricter measures on students and temporary workers have come into effect, suggest that this may be a difficult target to

Chart 1: NPR assumptions the key to how much population growth will slow



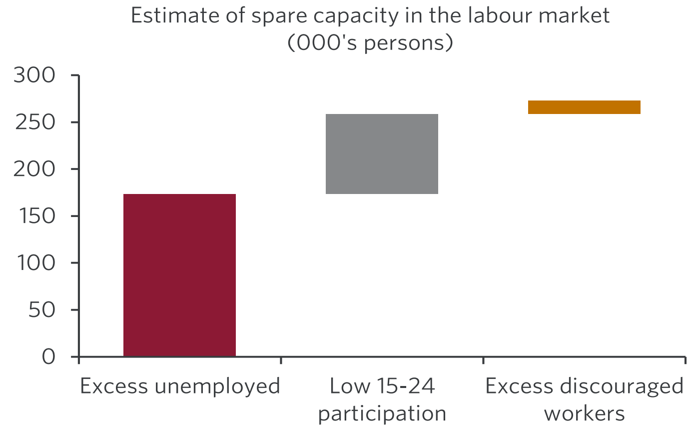
Source: Statistics Canada, Immigration Canada, CIBC

Chart 2: Potential growth will be modestly lower



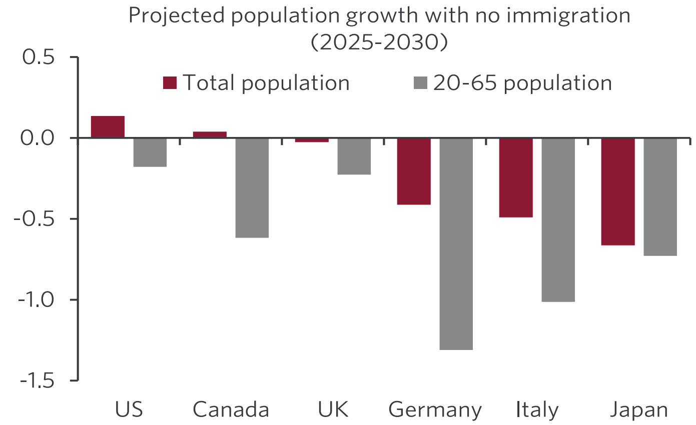
Source: Bank of Canada, CIBC

Chart 3: There is plenty of excess supply in the labour market currently



Source: Statistics Canada, CIBC

Chart 5: Working age population growth in Canada would drop sharply with no immigration



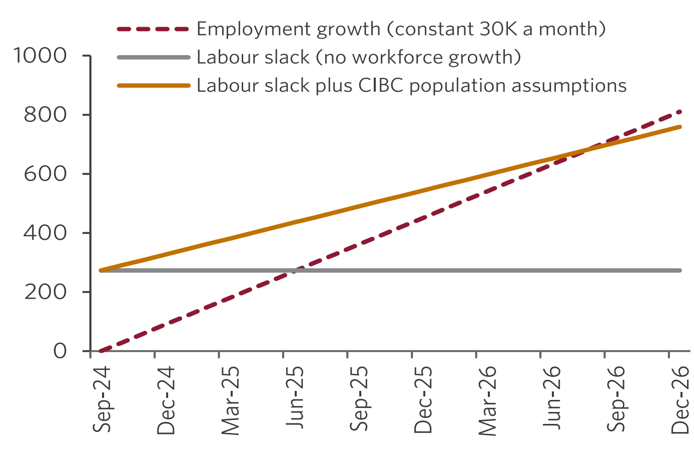
Source: United nations, CIBC

meet in such a short timeframe. We continue to forecast a more gradual reduction in the proportion of non-permanent residents, which will mean we see some (albeit modest) population growth over the next few years.

Due to the reduced targets for permanent residents, potential growth will be lower in 2025 and 2026 than our prior forecast, which already captured the changes for temporary workers and students. But the reduction, of roughly 0.3%-pts a year, is fairly modest. While the Bank of Canada may need to make a larger reduction to its population growth assumptions, we continue to think that it is being too pessimistic regarding the ability of productivity to improve as interest rates come down and spur activity in higher value-add areas of the economy (Chart 2). A potential growth rate of 1.6% on average would still leave room for the economy to accelerate relative to its current pace, primarily due to evidence of slack already present within the economy.

That slack can be seen in the labour market, and goes beyond simply the rise in the jobless rate above what we consider its

Chart 4: It will take some time for labour market slack to be absorbed even as population growth slows



Source: Statistics Canada, CIBC

non-inflationary rate. The decline in the 15-24 participation rate suggests that the tough conditions for new graduates are preventing some from even looking for work. These people could re-enter the market as conditions improve, and even just allowing for a partial recovery in that participation rate would add about 30% to the total pool of excess labour (Chart 3).

Even if labour force growth were to stall immediately, at the current pace of hiring (roughly 30K a month on average in the past 6 months) it would take until the middle of next year to absorb this excess labour supply. However, that calculation includes the unrealistic assumptions that labour slack doesn't increase any further ahead and that population growth stalls immediately. Based on our assumption for labour force growth, it would take until the second half of 2026 at the current pace of hiring for this slack to be absorbed (Chart 4).

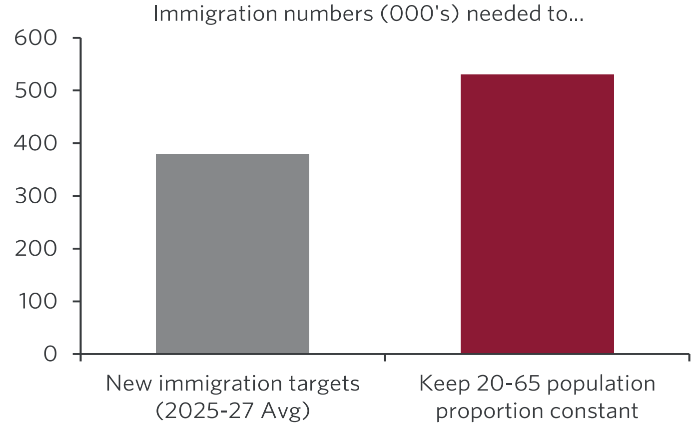
Admittedly, this is a quarter or two earlier than our prior forecast and could necessitate a downgrade to our 2026 GDP figure when we next update these projections. However, for the here and now we shouldn't face the kind of labour shortages that could prove inflationary and be a headwind to the Bank of Canada cutting interest rates below neutral in 2025. Our GDP forecast for next year will remain unchanged. Indeed, a slowdown in population growth should actually help one of the only remaining sources of inflation in Canada (rents), something we will be writing about in a separate article.

A future rethink may be needed

Longer-term, though, the lower immigration targets could prove a headache for businesses seeking workers. While Canada's demographics don't appear as bad as other countries on a total population basis, for working age (20-65) persons this isn't necessarily the case due to how past peaks in birth rates and immigration have lined up (Chart 5).

This creates a potential problem once the current labour market slack is absorbed. A still rising population (albeit only marginally if immigration were flat) suggests an increase in

Chart 6: Immigration targets may need to rise again in the future to prevent labour shortages



Source: United nations, Immigration Canada, CIBC

demand for goods and services within the economy, but a declining 20-64 population points to fewer available workers on the supply side. To keep the ratio of working age people in the population constant, a return of annual immigration to the previous 500K target may be appropriate (Chart 6). However, that is a decision that can and should be made at a later date once some of the labour market slack already present has been absorbed.

An economic gamechanger?

Lower immigration targets will slow population and potential growth more than we previously anticipated, although the bigger determinant remains how successful (or otherwise) the government is at reducing the number of non-permanent residents within the economy.

However, the amount of slack currently within the economy suggests that slower labour force growth shouldn't be a headwind to efforts to accelerate GDP in 2025. We still believe that the Bank of Canada should continue to cut interest rates quickly, and will ultimately need to take rates below neutral to reduce slack in the economy.

Issues of labour shortages may return in 2026 or beyond, but there is time between now and then for whoever's in government to reassess the situation and potentially reset targets if appropriate. For the near-term, lower immigration targets are not a game changer for the path of GDP growth and interest rates.

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