ECONOMIC VIEWPOINT

StatCan's New Population Projections Point to Larger Federal Deficits Ahead

By Randall Bartlett, Senior Director of Canadian Economics

Highlights

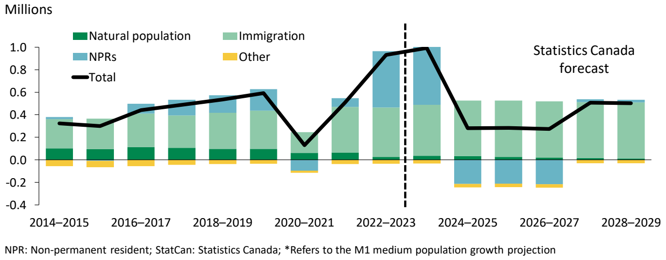
- Statistics Canada's latest population projections raised some eyebrows thanks to downward revisions resulting from a sharp reduction in non-permanent residents (NPRs).
- Assuming the federal government is successful in reducing the number of NPRs in Canada's total population over the next three years, working-age population growth would be much lower than expected in Budget 2024.
- According to our research, slower population growth due to fewer NPR admissions will reduce both real GDP growth and inflation, thereby weighing on nominal GDP—the broadest measure of the tax base.
- If the federal government reaches its intended goal of fewer NPRs, the resulting lower revenues should lead to larger deficits and higher debt. Indeed, the federal debt-to-GDP ratio could end the next five years at a higher level than in Budget 2024's downside scenario.
- Add to this additional spending not included in Budget 2024, such as the recently announced increase in defence spending, and the federal government's fiscal anchors are very much at risk.

In late June, Statistics Canada (StatCan) published new population projections that raised some eyebrows. The main reason was the dramatic downward revision to the population growth forecast relative to the previous outlook. This change largely reflects a much dourer accounting for net non-permanent resident (NPR) admissions to Canada (graph 1).

Popping the Population Growth Bubble

Comparing StatCan's new population forecasts with our own, the statistical agency's medium[1] or baseline scenario is for much weaker population growth in 2025 and 2026 (graph 2 on page 2). StatCan seems to assume that the federal government will be successful in reaching its stated objective of reducing

Graph 1
StatCan Is Projecting Weaker Population Growth on Fewer NPRs



NPR: Non-permanent resident; StatCan: Statistics Canada; *Refers to the M1 medium population growth projection
Statistics Canada and Desjardins Economic Studies

[1] This refers to Statistics Canada's M1 medium scenario specifically.

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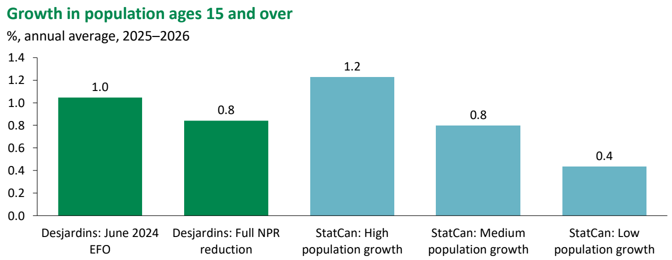
Graph 2
The Plan to Reduce NPRs Will Slow Working-Age Population Growth

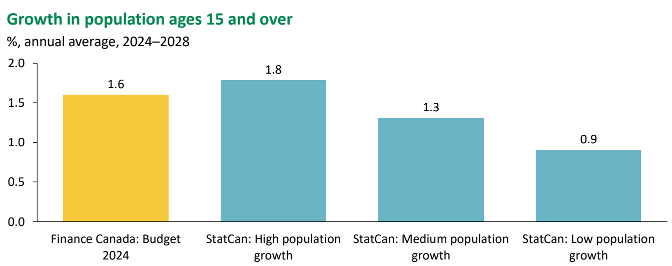


EFO: Economic and Financial Outlook; NPR: Non-permanent resident; StatCan: Statistics Canada
Statistics Canada and Desjardins Economic Studies

the number of NPRs to 5% of the total population over the next three years. In contrast, our baseline population forecast is closer to StatCan's high-growth scenario, which assumes the federal government only partially succeeds in limiting the number of NPRs in Canada. That said, when we assume the federal government reaches its intended goal, we get similar numbers to StatCan's medium scenario.

Looking to the five-year time horizon used for federal fiscal planning, we see that Budget 2024 assumed average population growth of 1.6% annually from 2024 through 2028, roughly the midpoint of StatCan's medium and high population growth scenarios (graph 3). This suggests some downside risk to the federal government's real GDP growth forecast over the next five years, particularly as Budget 2024 didn't explicitly incorporate the planned reduction in NPRs.

Graph 3
Budget 2024 Assumed High Population Growth in the Medium Term

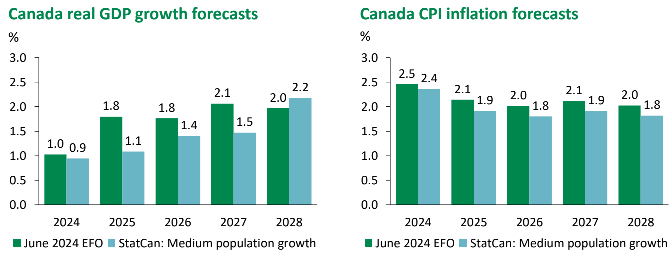


StatCan: Statistics Canada
Statistics Canada and Desjardins Economic Studies

How Low Could Economic Growth Go?

Of course, more goes into the real GDP forecast than just population. Per our earlier research on the economic impact of reduced NPRs, real GDP growth and inflation would be lower over the medium term due to a reduction in NPR admissions (graph 4) despite higher growth in real GDP per capita and wages.

Graph 4
The Drop in NPRs Should Lower the Real GDP and Inflation Forecasts



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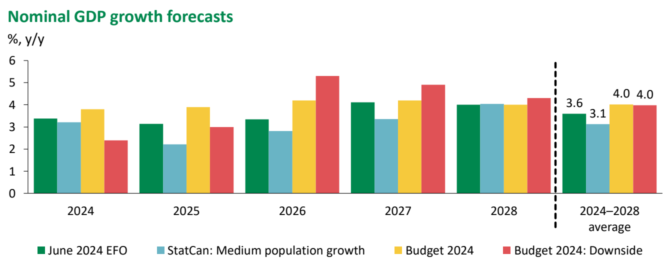
A slower pace of real GDP growth and inflation means that growth in nominal GDP—the broadest measure of the tax base—will be lower as well. This is why our June 2024 baseline economic outlook for nominal GDP growth is less rosy on average than the Budget 2024 baseline or downside scenarios (graph 5). If we assume population growth consistent with StatCan's new medium population projection, the nominal GDP outlook is even more bleak.

Graph 5
The Federal Government's Economic Forecast Looks Optimistic



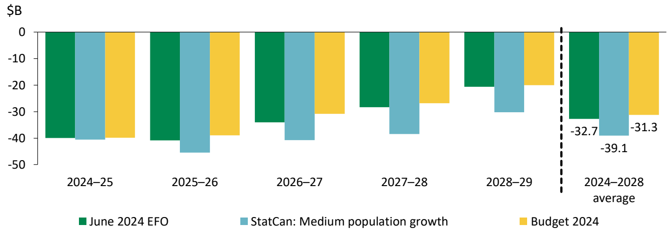
EFO: Economic and Financial Outlook; StatCan: Statistics Canada
Statistics Canada, Department of Finance Canada and Desjardins Economic Studies

As Goes the Economy, So Goes the Deficit

The Department of Finance Canada helpfully includes the fiscal sensitivities to changes in real GDP growth and inflation in the budget, which can then be used to back out the fiscal impact of different economic scenarios. Applying these fiscal sensitivities to our baseline economic forecast yields a deficit forecast that is larger but close to the official outlook (graph 6 on page 3). However, when we incorporate the lower population growth forecast from StatCan, the outlook is for much more substantial deficits, at nearly $8B larger on average annually than the deficits in the Budget 2024 baseline. Of course, offsetting savings could be found by reducing spending. But this could be easier said than done.

Graph 6
Federal Deficits Are Likely to Be Larger Due to Reduced NPRs

Government of Canada budget balance forecasts
$B



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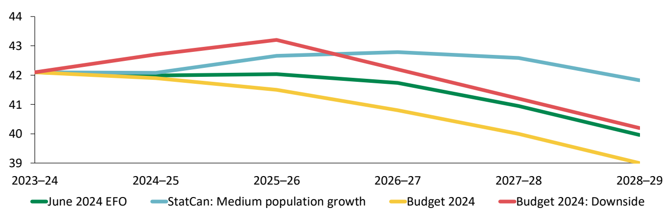
Unfortunately, Budget 2024 doesn't include an annual deficit forecast for the federal government's downside scenario. But it does say the deficit would be $7.9B larger on average annually than in the baseline fiscal forecast. That would put the average annual deficit at about $39B, in line with the deficit derived using StatCan's medium population growth scenario. As such, the Budget 2024 downside scenario may provide a better basis for comparison than the current baseline for fiscal planning. And indeed, the federal debt-to-GDP ratio rises for at least the next two years under both the federal government's downside scenario and the economic scenario using StatCan's medium population projection (graph 7).

Graph 7
Larger Deficits Due to Fewer NPRs Should Boost the Federal Debt

Federal debt (accumulated deficit)
% of nominal GDP



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Notably, the federal debt-to-GDP ratio remains elevated in the economic forecast scenario using StatCan's medium population projection. In contrast, it falls quickly after the 2025–26 fiscal year in Budget 2024's downside scenario. This can partly be explained by the budget's nominal GDP forecast, where the levels in 2028 are nearly identical in the budget's baseline and downside scenarios (graph 8). On the other hand, both Desjardins's nominal GDP forecast from the June 2024 EFO and the other forecast based on StatCan's medium population projection show GDP ending 2028 below even Budget 2024's most bearish outlook.

Graph 8
Even the Federal Government's Downside Forecast Looks Optimistic

Nominal GDP forecasts
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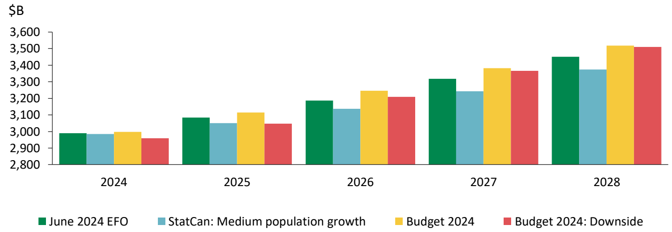

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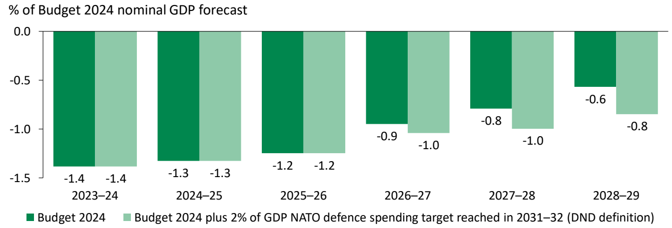
But the fiscal outlook could look worse still. Balancing necessary expenditure increases with fiscal responsibility will be challenging in the absence of new revenue raising measures. Take the recent defence spending commitment, with the pledge to increase expenditures to 2% of GDP by 2032. Even if this level of spending is gradually reached, it would add about 0.2% of GDP to the deficit every fiscal year after 2025–26 (graph 9). That would make it more difficult for the federal government to achieve all of its fiscal anchors in the Budget 2024 baseline scenario, let alone the downside.

Graph 9
Deficits May Violate the Fiscal Anchors If the NATO Spending Target Is Met

Federal budget balance
% of Budget 2024 nominal GDP forecast



DND: Department of National Defence
Government of Canada and Desjardins Economic Studies

Conclusion

Statistics Canada's latest population projections raised some eyebrows given the extent of the drag coming from NPR reductions. As we have demonstrated previously, lower NPR admissions will weigh on real GDP growth and inflation. Federal deficits are likely to be larger as a result, leading to a higher debt level that is on par with the downside economic scenario in Budget 2024. Indeed, the risks to the fiscal forecast could be even more skewed to the downside, particularly if new spending is added on top. This may put the federal government's fiscal anchors in peril if revenues don't come in strong enough to offset this dismal deficit and debt dilemma.