

CURRENT ANALYSIS

March 2014

Growth in our own backyard...

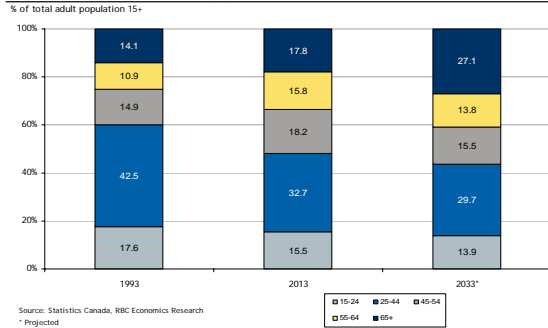
In a speech on March 18, the Bank of Canada Governor Stephen Poloz addressed the factors that are contributing to Canada's weaker than usual economic performance. He pointed to both the cyclical impact of the economy trying to recover following the global financial crisis and the secular influence of Canada's changing demographic backdrop and productivity performance. These latter two factors are key determinants of Canada's standard of living and our research suggests that as the baby boom generation increasingly enters retirement age, without an improvement in productivity gains or an offset elsewhere in the economy, a material slowing in the pace of improvement in Canadians' standard of living is likely inevitable. This note takes a broad look at the changing composition of the Canadian adult population to examine the extent of this slowing as well as factors that could act as potential offsets.

Canada's population is estimated to have surpassed 35 million in 2013, rising 1.2% from the year prior to mark the second fastest annual rate of growth of the past two decades. Beneath the headline growth numbers, however, there continues to be a marked shift in the composition of the population. Notably, the working-age cohort (15-64) grew at the slowest rate in more than four decades. In contrast, the number of Canadians 65 years of age and older increased at a near record pace in 2013, rising by 4.2%. As an increased share of the population enters into retirement, there will be fewer remaining active contributors to overall economic output resulting in output growth slowing more quickly than overall population growth. Based on population projections and some modest underlying assumptions about labour force trends, the overall participation rate in Canada could face a steep decline¹.

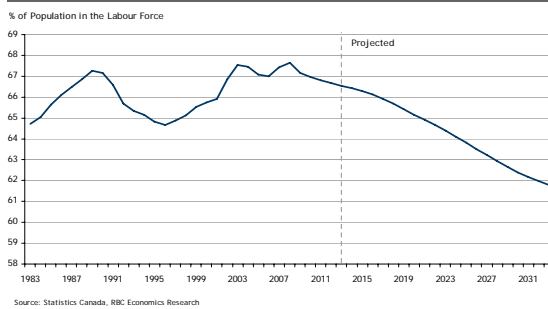
The impact of an aging demographic will be felt to varying degrees across the provinces although all provinces are expected to experience a slowdown of growth in the working age (15-64) population². This shift in age composition across the provinces is highlighted by the old-age dependency ratio; that is, the ratio of the 65+ population to the working age population (15-64). The highest dependency ratios in 2013 were in the Atlantic provinces, Quebec and British Columbia, a trend that is expected to continue through the next decade. With an overall slowing in the working-age population projected in Canada, the dependency ratio is expected to rise to nearly 30 seniors per 100 working-age persons by 2023 from just under 22 in 2013.

Despite a greater share of the population projected to shift into age cohorts that historically have had lower labour force participation rates, currently underutilized resources in Canada may hold the key to dampen, if not offset this decline. It has been well established that various segments of the population face poor labour force outcomes relative to the rest of the population³. The eco-

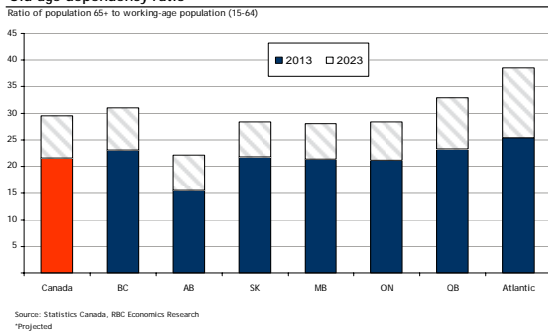
Composition of the Canadian population



Labour Force Participation Rate



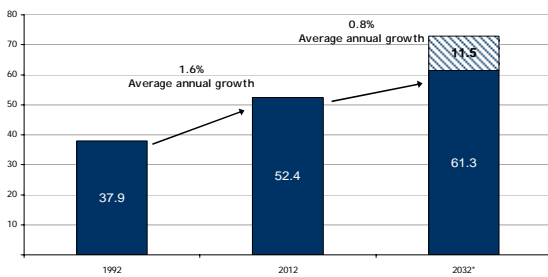
Old-age dependency ratio



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Real gross domestic product per capita

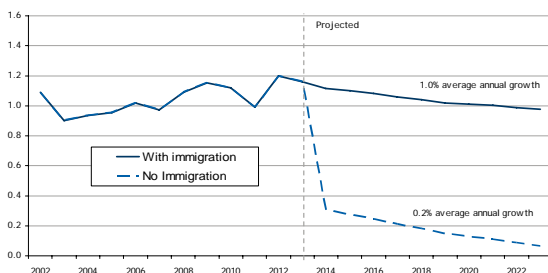
2012 constant \$, Thousands



Source: Statistics Canada, RBC Economics Research
*Projected based on medium growth population projections

Population Growth in Canada

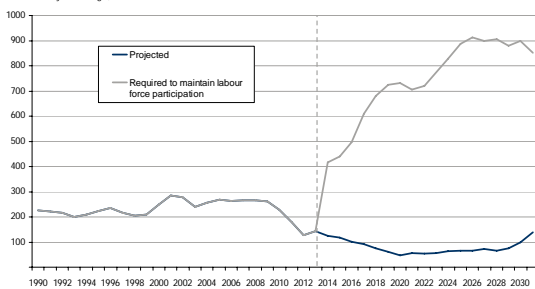
Annual % change in total population



Source: Statistics Canada, RBC Economics Research

Growth in Working-Age Population (15-64): Canada

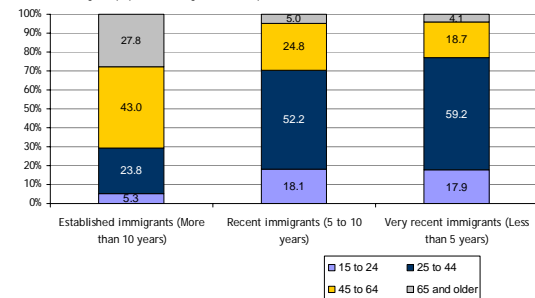
Year-over-year change, Thousands



Source: Statistics Canada, RBC Economics Research

Age composition of immigrants to Canada

% of total immigrant population for given arrival period to Canada



Source: Statistics Canada, RBC Economics Research

economic costs of failing to fully utilize and integrate these groups into the Canadian workplace are significant and are likely to rise as demographic challenges intensify. Our analysis shows that fewer workers contributing to total economic output, holding all else constant, would result in a loss of \$11,500 on a per capita basis in 2032 as measured by gross domestic product⁴.

The negative impact on the economy as a result of diverging growth trends amongst the population leads to questions about what could act as potential offsets. There has been focus on the need for increased immigration to offset a declining working-age population. With an average 250,000 immigrants entering Canada each year, immigration is expected to act as a main support to working age population growth over the next decade; however, the significant number of new Canadians that would be required to offset a growth slowdown is likely not realistic. By our calculation, for immigration to prevent an aging-related decline in the participation rate and maintain per-capita GDP growth, the working age population in Canada would have to increase, on average, by 750K annually over the next two decades; a substantial increase from 230K over the past twenty years. Although increased immigration may provide some offset it cannot on its own provide a full offset. That said, increased levels of immigration will help to close the gap.

A sizeable boost to productivity, a recent laggard on the Canadian economy, could also act as an offset. That said, with average annual productivity gains of only 0.7% over the past decade, a sufficient turnaround may not be achievable in the near-term. To fully offset the projected slowing in economic growth, productivity growth would need to rise to 2.0% annually. However, past difficulties in raising productivity growth provides reason to be wary about counting on this variable alone to close the gap. Countering a drop in per capita output may require a combination of rising immigration and increased productivity growth. As well, there are a number of other factors that potentially can be pursued “within our own backyard” that better utilizes the existing labour force.

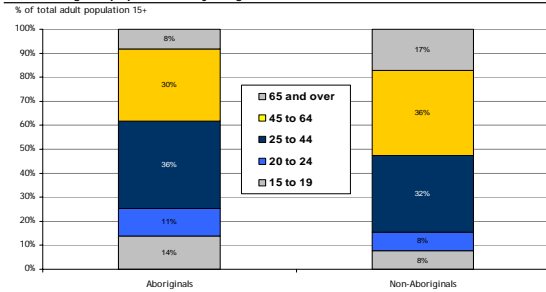
Immigrants

Canada admits 240K-265K new permanent residents each year, an annual rate of approximately 0.7% of the population. Of very recent immigrants who have been in Canada for less than five years, 66% participated in the labour force in 2011 with the rate rising to above 70% for those who arrived over the past 5 to 20 years⁵. On an age cohort basis, the participation rates are broadly in line with the overall participation rates by age cohort in Canada with the exception of those aged 15 to 24 (51% for immigrants compared to 64% for the 15 to 24 population as a whole). It is the case that a higher share of immigrants in this age cohort have attained a certificate or degree indicating enrolment in education may be higher within this group. That said, increasing the participation rates of this segment would bring an additional 72K participants to the labour force.

Beyond labour force participation, the quality of employment and the recognition of foreign credentials may be limiting factors to fully utilizing the

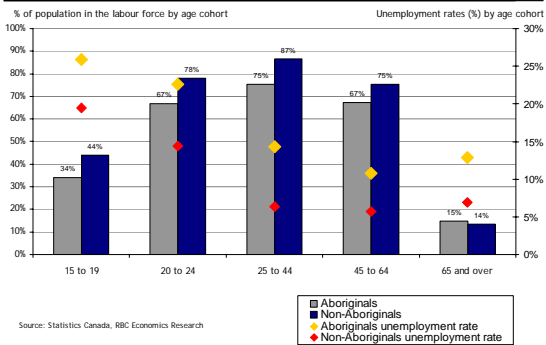


The Aboriginal population is younger in Canada...



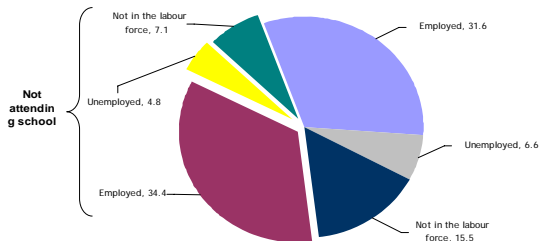
Source: Statistics Canada, RBC Economics Research

Labour force activity



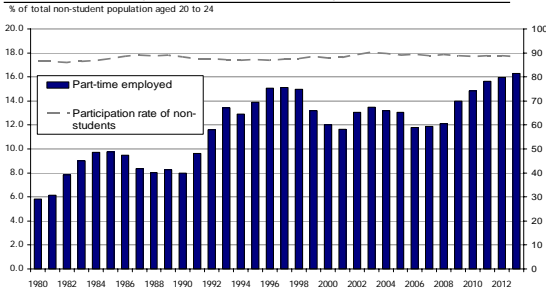
Source: Statistics Canada, RBC Economics Research

2011 Labour force activity: 20 - 24 year olds



Source: Statistics Canada, RBC Economics Research

Labour force activity of non-students: 20 to 24 yrs old



Source: Statistics Canada, RBC Economics Research

contribution of immigrants to economic growth. The current transformation of Canada’s immigration system towards a more efficient and flexible framework, however, may be laying the foundation for immigration to support sustained economic growth going forward. Targeting skilled immigrants to address growing labour shortages in Canada is particularly important given the challenges facing Canada’s aging population. Matching skilled workers in industries where the need is most acute in a timely manner through the Expression of Interest model may help to restrain pressure in labour markets as growing labour force shortages become more of a challenge. Further, the rising share of two-step immigration programs, such as the Canadian Experience class, that emphasize previous Canadian experience could improve the integration of immigrants into Canada’s labour market. That said, these programs are still relatively new and it is likely too soon to gauge the success of these immigrants’ labour market outcomes.

Aboriginals

The Aboriginal population in Canada is younger than the overall population with 1 in 4 between the ages of 15 and 24 compared to less than 1 in 6 for the rest of the population. Over the next decade, as this population shifts into the 25-64 age cohort, it is imperative for sustained growth to ensure these individuals contribute by creating conditions to boost their participation in the labour force. For younger Aboriginals, the labour force participation rates of those 15-24 is 10 percentage points below non-Aboriginals of the same age and the gap persists across age groups. At the same time, Aboriginals face noticeably higher unemployment rates. While geographic restrictions can account for some of the divide, fostering conditions to increase participation within the Aboriginal population is an important supplement to supporting economic growth.

By boosting the participation rates of Aboriginals by age cohort to match those of non-Aboriginals, an additional 93K participants would have been in the labour force in 2011, 45% of which would be those of prime working age, 25-44. Assuming the labour force absorbed this one-time increase and employment rates remain unchanged, the additional workers would lift economic growth by as much as 0.5 percentage points by raising the participation rate above 67%.

Underutilized youth

While high levels of youth unemployment have persisted since the financial crisis, a small subset of the youth population face significant challenges. In Canada, 8.4% of 15-19 year olds and 11.9% of 20-24 year olds are neither in the labour force nor are they enrolled in education⁶. Of those in the latter group, close to 35% have not attained a minimum of a high school education. This poses challenges not only for these individuals and their future potential, but for the economy as a whole. While some of these individuals may be planning to return to school or find themselves temporarily unemployed, there are economic and social costs as a result for those remaining in this position for a prolonged period of time. The economic costs include the lost earnings and lost tax revenue, but also less tangible costs related to a

reduced quality of life and the loss of general economic gains that stem from a more educated workforce such as skills development and experience that will boost earnings in the future.

Underemployment may also be weighing on the ability of youth to fully participate in the labour force, notably for the 20 to 24 age group. While the share of non-students participating in the labour force has held steady, an increasing share of employed non-students in this age cohort are finding employment in part-time positions meaning the share of full-time employment is declining. As well, the percentage of all part-time workers aged 15 to 24 who are working part-time but would prefer full-time has increased, rising by 5 ppts since 2008. Creating the conditions that allow for these individuals to participate in full-time work would provide a boost to hours worked and further contribute to offsetting an easing in economic growth.

...looking ahead leads to looking within...

In Budget 2014, the Government of Canada acknowledged the economic potential of underutilized groups stating that “a number of groups are not being used to their full potential in the labour market”. Aboriginals, less-skilled individuals and recent immigrants were among those cited and accompanied the introduction of initiatives to improve the labour force outcomes of these groups. The *First Nations Control of First Nations Education Act* takes a step towards addressing the educational outcomes of this group by providing \$1.9 billion in part to align on-reserve core curriculum and minimum attendance requirements with provincial standards. The economic and social benefits arising from the program are not expected to materialize in the near-term, however, with the core funding not expected to be administered until 2016/17. The Youth Employment Strategy that provides skills development and work experience to youth is also expected to be revised as the government stated its intention to better align the program with the “evolving realities of the job market”. Additional initiatives focussed on apprenticeship training and the expansion of student loans further promote an improvement in labour market outcomes for the underutilized segments of the population. While it is premature to be able to determine the effectiveness of these initiatives for underrepresented groups, this does mark a step towards addressing the rising labour force challenges facing Canada.

Over the past two decades, the population of those aged 15 to 64 rose by nearly 230K annually. In contrast, just under 90K entrants of working-age are projected on an annual basis over the next twenty years, resulting in a decline in the aggregate participation rate. To keep the participation rate constant at its 2013 level, Canada’s working-age population would need upwards of 750K new entrants on an annual basis, all else equal, over this period. While increased labour force participation on its own cannot fully offset the downward pressure on economic growth, targeting the underutilized segments of the population by creating the conditions to support their labour force participation could temper the decline and help to support sustained economic growth and productivity going forward.

Notes

1. To estimate the aggregate participation rate, we break it down by age cohort. Overall participation rates for those 15-55 have levelled out over the last decade, in part due to a slowing in the rise of female participation rates. We assume these rates will continue to show a moderating trend, remaining around the average levels observed over the last 5 years. In contrast, participation rates rose sharply over the past decade for the older age cohorts (55+). We assume an upward trend will continue, however, with limits on how much further these rates can be expected to rise, we assume a convergence over time to a long-run trend.
2. Depending on the interprovincial migration trend going forward, some provinces are projected to experience a pullback in its working age population over the next ten years. That being said, it is important to note that the projections are meant to serve as a guide and major projects and policy shifts could help to offset the net outflow of migrations from the smaller provinces.
3. For example, [Immigrant labour market outcomes in Canada: The benefits of addressing wage and employment gaps](#) RBC Economics, December 2011.
4. To examine the impact of shifting population demographics on economic growth, we calculate labour force participation rates, average hours worked and unemployment rates by age cohort using assumptions regarding age-specific labour force variables. We then use Statistics Canada medium-growth historical trends population projections to generate a projection for real GDP growth. Using this formulation, GDP is the product of the labour force participation rate (L/P), the unemployment rate (1-(L-E)/L), average hours worked per employee (H/E) and labour productivity (Y/H): $GDP = P(L/P)(1-(L-E)/L)(H/E)(Y/H)$
5. Data from National Household Survey 2011.
6. Using 2011 Statistics Canada's National Household Survey data for consistency. Data from the LFS indicate smaller percentage shares.

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