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David Dodge Praises Long-Term Inflation-Targeting Role for Central Bank; Recommends Policy Responses to Credit Crisis: C.D. Howe Institute

Toronto, Nov. 19 – The Bank of Canada must remain focused on its long-term monetary framework of inflation-targeting and a flexible exchange rate, which has served the country well, as it makes shorter-term policy responses to the credit crisis, according to David Dodge, former Governor of the Bank. In *Central Banking at a Time of Crisis and Beyond: A Practitioner's Perspective*, the C.D. Howe Institute's 2008 Benefactors Lecture, David Dodge argues this framework is ideally suited to achieving both price stability and a sustainable economic outlook.

Dodge, who served as governor from 2001 to 2008, makes recommendations for domestic and international policy reforms in response to the credit crisis. Among them:

- Prudential regulators need better tools for tuning financial institutions' regulatory capital requirements as market conditions change. They need to be able to increase required capital when spreads narrow and leverage increases, and to reduce required capital when spreads widen and leverage contracts dramatically.
- The zeal with which accounting standards bodies have pushed rules requiring financial institutions to mark assets to market, for reporting purposes, has become a major contributor to volatility. Financial institutions should have some ability to smooth profits, by setting aside reserves during good times when market prices are likely to exceed the long-run value of assets, and vice versa in bad times.
- Securities regulators will need to establish rules for structured products and derivatives, to bring about much greater transparency with respect to the underlying risks.

- The Department of Finance and Canada Mortgage and Housing Corporation should assume some responsibility for stabilization of the housing and mortgage markets, by automatically adjusting terms and conditions for insurance in such a way as to dampen exuberant markets – not to add fuel to the fire as they have done.
- Central banks should better monitor financial market developments, including market and institutional liquidity issues, and review developments with relevant agencies.

International co-operation will also be required in forging these reforms, says David Dodge. Central banks and prudential regulators have the Bank for International Settlements to foster and support effective co-operation. This forum could usefully be expanded to include securities regulators, such as the International Organization of Securities Commissions. The IMF, too, has an important role to play, for it brings together finance ministers and central bankers.

Dodge also notes that financial institutions themselves need to improve their risk management and credit practices.

During a distinguished career in the federal public service, Mr. Dodge has held senior positions in the Canada Mortgage and Housing Corporation, the Anti-Inflation Board, and the Department of Employment and Immigration. After serving in a number of increasingly senior positions at the Department of Finance, including that of G-7 Deputy, Mr. Dodge was appointed Deputy Minister of Finance in 1992. In that role, he served as a member of the Bank's Board of Directors until 1997. In 1998, Mr. Dodge was appointed Deputy Minister of Health, where he served until the announcement of his appointment, for a term of seven years effective February 1, 2001, as Governor of the Bank of Canada.

The 2008 Benefactors Lecture, *Central Banking at a Time of Crisis and Beyond: A Practitioner's Perspective*, is sponsored by Scotiabank Group. The study is available at www.cdhowe.org.

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