



Dodge Says Rate Cuts May Not Have Fixed `Overshoot' (Update1)

By Greg Quinn

Dec. 6 (Bloomberg) -- Bank of Canada Governor David Dodge said the Canadian dollar was in "overshoot" last month when markets weren't working properly, and earlier rate cuts might have just led to higher inflation without helping the economy.

"There has been a bit of overshoot," Dodge, 64, told the Senate banking committee in Ottawa today. "We at the bank could have come in and dramatically reduced interest rates, kept our interest rates very much lower than what we did, but we would then simply have inflation very much higher."

The central bank unexpectedly cut its benchmark interest rate two days ago for the first time in more than three years, citing the Canadian dollar, which reached an all-time high of 90.58 Canadian cents per U.S. dollar on Nov. 7. The currency's advance this year slowed the exports that make up 30 percent of Canada's economic output, and pushed the bank's preferred inflation measure below a 2 percent target.

"We have never experienced this sort of gyration before where intraday and intraweek we get movements of 3 and 4 percent in the value of the currency," Dodge said. "That's obviously a market at least for a period of time that wasn't really functioning very well."

Today the currency strengthened 0.4 percent to C\$1.0082 per U.S. dollar at 4:24 p.m. in Toronto.

The bank lowered its benchmark interest rate a quarter point to 4.25 percent on Tuesday, citing the currency and credit-market distress. Today, Dodge repeated language from the rate announcement, saying the high currency and financial-market volatility had combined to brake inflation. He did not signal if he'll cut rates again at the next meeting on Jan. 22.

`Shift to Downside'

"There has been a shift to the downside in the balance of risks," Dodge said. "At our next interest-rate decision in January, we will assess all economic and financial developments and the balance of risks."

Fourteen of 16 economists surveyed by Bloomberg two days ago said the central bank will cut rates again next month.

Dodge repeated a call for Asian countries to allow their currencies to trade more freely, in order to resolve large U.S. trade deficits mirrored by surpluses across the Pacific Ocean. Asian economies also need to boost domestic spending to narrow the imbalances, he said.

"We are probably taking a little more of the adjustment than is appropriate," Dodge said of the Canadian dollar's appreciation. Still, fixing Canada's currency to the U.S. dollar isn't likely for "the foreseeable future," because that would require open labor, capital and goods markets between the two countries, Dodge said.

China's `Intent'

And in China, Dodge said, the government has the right "intent" and is trying to encourage consumers to save less and spend more by improving pension and health-care programs.

Separately, the central bank said today in its Financial System Review that global credit market shortages don't pose a "systemic risk" to Canada's banking system. Some re-pricing of credit was needed after a period where investors took bigger risks to boost their returns, the report said.

Consumer and business spending is threatened by the collapse of the U.S. subprime mortgage market, which has driven up borrowing costs worldwide, the report also said. Canada's subprime market is smaller than in the U.S. and has more "conservative" lending contracts, which suggests those loans won't cause as much trouble, according to the report.

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