PETER PRAET

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Ladies and Gentlemen, [1]

It is a real pleasure to be here in Vienna to exchange views on the future of global governance. Vienna is certainly a city with a long tradition of discussing issues with a global dimension. Following my invitation to speak at this conference, I remembered that, almost 200 years ago, it was here that the famous Congress of Vienna attempted to forge what came to be known as the "Concert of Europe". This marked the creation of a new global order and a major turning point in world history.

The global economy today is also at a turning point. What we have been observing since the unprecedented financial market tensions in mid-2007, is not merely the unfolding of a global financial and economic crisis. We have been observing the emergence of a new global order, which is occurring at a faster pace than was anticipated prior to the crisis.

The exact form this new world will take is unclear. But the need for sound global governance, which we will discuss today and tomorrow, is becoming ever more apparent. On the economic front, several important changes have already occurred. The G20 has replaced the G7 as prime forum for international economic cooperation. The Financial Stability Board has been established to address vulnerabilities and develop regulatory and supervisory policies conducive to global financial stability. Bodies based at the Bank for International Settlements in Basel, which are of keen interest to the central banking community, have also been reformed and their membership enlarged to relevant emerging market players.

In assessing the state of the global economy today, I would like to emphasise that we are at a crossroads. In this respect, I would like to make three specific points. Firstly, I will describe the outlook and risks for the global economy and euro area. I will then discuss the interplay between the current prospects and key policy challenges: namely global real and financial imbalances as well as liquidity and capital flow volatility. Finally, I will briefly comment on major governance challenges in the Eurozone.

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Let me commence by depicting how I see the outlook and key risks for the global economy and euro area at this juncture. Against a background of heightened uncertainty and rising stresses in financial markets, global sentiment has further deteriorated in recent months. It now appears that some of the downside risks which had been previously identified have materialised. Looking ahead, short-term indicators as well as the latest survey data suggest that global growth is expected to remain sluggish.

However, looking at the global economy as a whole masks the considerable degree of heterogeneity which prevails. Indeed, a key characteristic of the global economy relates to the divergence in global growth patterns not only between advanced and emerging economies but also within these country groupings. In advanced economies, growth sapping headwinds persist with annual GDP growth expected below potential. In particular, these headwinds relate to the continued need for public and private sector deleveraging as well as the persistent weaknesses in labour and housing markets in some advanced economies. These factors, combined with the ongoing tensions in financial markets, are expected to restrain global growth over the medium term.

Conversely, in emerging economies, growth has remained relatively robust. While growth has recently experienced some moderation, largely on account of weaker external demand, this should assist in alleviating some of the overheating pressures. The resilience of emerging economies throughout the crisis has been impressive. However, emerging economies are not immune to developments in other parts of the globe.

More than four years after the beginning of the financial crisis, uncertainty continues to remain high, with substantial downside risk to the economic outlook notably for the euro area. Downside risks in particular relate to a further intensification of tensions in euro area financial markets and their potential spillover into the real economy. Additional downside risks also relate to the global economy, which may turn out to be weaker than expected, as well as protectionist pressures and the possibility of a disorderly correction of global imbalances.

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I would like to focus now on key global policy challenges confronting the global economy.

The first of these challenges is the persistence of large real and financial imbalances at the global level, which is a key source of vulnerability in the medium term. A few figures are worth recalling. Combined together, the current account deficits and surpluses of the main systemic economies are projected to stand at roughly 2% of world GDP over the next five years. This is less than before the crisis (3% of world GDP in 2007), but twice as much as in the late 1990s. A large share of the adjustment in external imbalances since the crisis has been cyclical, not structural. According to the IM, the US current account deficit is projected to reach about 3% of GDP in 2011, against surpluses of roughly 5% and 9% of GDP for China and oil exporters respectively. They are a source of tensions that could ultimately lead to protectionist pressures. However, the euro area as a whole has a balanced current account position.

Global fiscal imbalances remain significant, with a marked degree of heterogeneity between advanced and emerging economies. Consolidation efforts required to bring public finances to a sustainable path are a key priority for advanced countries.

Efforts made to adjust these imbalances remain clearly insufficient. This raises the risk, which I referred to earlier, of a disorderly unwinding down the line, with significant potential fallouts for global financial markets and the global economy.

At their Cannes Summit on 3-4 November 2011, G20 Leaders agreed on an Action Plan to lay the foundations for strong, sustainable and balanced global growth in the medium-term. This is welcomed. All G20 members made commitments, but they are sometimes imprecise. It is often unclear as to how these commitments can genuinely contribute to a rebalancing of global demand patterns. For instance, only a few of the G20 members explicitly reaffirmed their support to the solemn pledge by their Leaders in Toronto last year to halve fiscal deficits by 2013 and stabilise public debt ratios by 2016. Large emerging markets have announced that they would enhance the flexibility of their exchange rate regime, but without indicating a specific time-frame when this would occur. Europe is doing its share in committing to accelerate and further deepen the Single Market.

More decisive policy measures to rebalance global demand patterns are still required, in particular to raise savings in deficit economies and increase domestic demand in surplus economies. All systemic economies could benefit from effective multilateral surveillance along with their international responsibilities. Now is not the time to lose sight of the need to correct imbalances globally although our attention is –for good reasons– more focused on immediate challenges!

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The second and related key global policy challenge relates to how best to address global liquidity conditions and volatile capital flow constellations. Ample global liquidity conditions have the potential to push volatile capital flows into emerging economies. If they respond by accumulating reserves to cap exchange rate appreciation, this widens global imbalances. While this is an issue which was already discussed before the crisis, some argue it might have been exacerbated as a result of policy responses to the crisis.

Indeed, some of the policy responses have been sub-optimal from a global vantage point. Many countries have continued to accumulate large reserve holdings to limit currency appreciation. For instance, China's reserve holdings now exceed USD 3 trillion; those of Russia USD 400 billion; those of Brazil, Korea or Taiwan USD 300 billion. Others have adopted capital flow management measures, including higher reserve requirements and –sometimes– outright controls on capital inflows. Some observers have claimed that "currency wars" might break out.

This is why the efforts from the international community to better understand global liquidity developments, as well as how to deal with global liquidity shortages, in particular during crises, by the G20, the IMF and by the central banking community at the Bank for International Settlements in Basel are valuable undertakings. The agreement by G20 Leaders on actions and principles that could help reaffirm the benefits from financial integration and increase resilience against volatile capital flows is commendable. This agreement provides coherent conclusions to guide countries in the management of capital flows.

The first line of defence against excessive capital flow volatility should comprise sound domestic macroeconomic policy frameworks and institutions as well as appropriate exchange rate regimes, financial regulation and supervision. Capital control measures should be temporary in nature and only used as a last resort, given that they may delay the necessary domestic policy implementation and distort the distribution of capital flows across countries.

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Ladies and gentlemen,

When delegates to the Congress of Vienna first met in 1814, the new world that was about to emerge and which would last for almost another century was only barely discernible. The outbreak of the global economic and financial crisis is putting us in a similar situation today. Throughout the world, citizens call upon policy-makers to act decisively to resolve the crisis and help the global economy turn a corner. All relevant authorities have to take their responsibilities.

To ensure that this crisis can be fully addressed will require an ambitious strengthening of economic governance. Significant reforms in this direction are taking place in Europe. The EU Council and European Parliament have agreed on a legislative package that significantly limits the discretion of national authorities. This includes a framework for monitoring a wide range of macroeconomic imbalances, also backed by sanctions. Countries are expected to anchor fiscal prudence in national rules. All these measures were unthinkable four years ago.

Today, Euro area Heads of States or Government agreed in Brussels to move towards a stronger economic union. This implies measures in two directions, namely: a new fiscal compact and strengthened economic policy coordination and the development of the euro area stabilisation tools to face short term challenges. In the view of the ECB's Governing Council, a new fiscal compact comprising a fundamental restatement of the fiscal rules, together with the fiscal commitments that euro area governments have made, is the most important precondition for restoring the normal functioning of financial markets. To accompany fiscal consolidation, bold and ambitious structural reforms are essential. They should be immediately carried out to help the euro area countries improve competitiveness, increase the flexibility of their economies and enhance their longer-term growth potential.

We at the ECB take our responsibilities. Monetary policy in the euro area will remain dedicated to our mandate, which is to maintain price stability over the medium term. The policy measures taken by the ECB have resulted in the Governing Council's outstanding record during the past 13 years in terms of price stability and anchoring of inflation expectations.

The ECB will continue to remain an anchor of confidence and stability, in a global economy characterised by marked uncertainties. This is the central contribution we can make to foster sustainable growth, job creation and financial stability in the euro area as whole.

Thank you for your attention and I wish you all a fruitful and enriching conference.

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[1]I would like to thank for John Hutchinson and Arnaud Mehl for their contributions in the preparation of this speech

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