Jean-Claude Trichet: The growing importance of the Asia-Pacific region

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the New Year's Reception Asia-Pacific 2008 of the German-Asian Business Circle, Frankfurt am Main, 25 February 2008.

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I. Introduction

Ladies and gentlemen,

It is my pleasure to be with you today a few days after the celebration of the Chinese New Year. Let me take this occasion to wish you and all our Chinese friends a happy and prosperous year of the rat! I have been told that the rat, the first sign of the Chinese zodiac, was considered in ancient times as a protector and bringer of material prosperity. What better symbol than this to describe the giant steps made in recent years by China – and, along with China, by the whole of the Asia-Pacific region[1] – towards greater prosperity!

As you perhaps know, one of the most famous historians of my home country, Fernand Braudel, is celebrated for having developed the concept of "economie-monde" ("world-economy"), namely that of a centre of gravity for the global economy[2]. Arguably, this centre of gravity has shifted several times over the last four hundred years in the western world. From Antwerp in the sixteenth century to Amsterdam in the seventeenth century, to London in the nineteenth century and, finally, to New York in the twentieth century. There is now talk of an "Asian century" based on the belief that, if ongoing demographic and economic trends persist, the twenty-first century will see a shift in the centre of gravity of the global economy to Asia. I leave it up to you to assess which city in this vast region might become the capital of the new "economie-monde", should this development materialise. To be sure, there would be several candidates!

I would like today first to offer some reflections on the growing role of the Asia-Pacific region in the global economy in an attempt to understand how the world is changing and what it might be like tomorrow. I would then like to offer some reflections on the implications of these changes. The Asia-Pacific region is becoming a larger player in the global economy, which has an impact on the rules of the game. This is notably reflected in important developments in the international financial architecture, the network of institutions and fora involved in the governance of the world economy in macroeconomic and financial matters.

II. The growing role of the Asia-Pacific region in the global economy

Let me therefore briefly elaborate on the first of these two aspects: the growing role of the Asia-Pacific region in the global economy, which is evident in both demographic and economic terms.

Consider first demography. The Asia-Pacific region is home to about half of the world's population. China and India, with a combined population of 2.4 billion, are evidently two population giants. But we all know very well that the region includes other countries with large numbers of consumers and investors, such as Indonesia (with a population of over 200 million) or the Philippines and Vietnam, whose populations (around 90 million) are

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[1] For the purposes of this speech, the term "Asia-Pacific" refers to a group of economies in littoral East Asia, Southeast Asia and Australasia near the Pacific Ocean, as well as to the states in the ocean itself (Oceania).

[2] Fernand Braudel, La dynamique du capitalisme, conférences prononcées à l'université Johns Hopkins en 1976 ; Champs Flammarion, No 778.

comparable to that of Germany. The ASEAN countries as a whole represent more than 500 million inhabitants. The largest cities in the world can also be found in the Asia-Pacific region. At present, nine of the twenty largest metropolitan areas are located in this region. And some of these cities have grown considerably in size in recent years as a result of profound economic transformations and massive migrations from rural areas.

The numbers are even more impressive in economic terms. The Asia-Pacific region accounts for almost 37% of world GDP at purchasing power parity. Moreover, it also comprises some of the most dynamic economies in the world. The contribution to global growth of emerging Asia alone, perhaps the most dynamic economic area of the world, reached around 40% last year. Admittedly, the Asia-Pacific region as a whole remains diverse in terms of standards of living. Mature economies, such as Australia or Japan, with GDP per capita of, respectively, USD 42,000 and USD 34,000 in 2007 at market rates, remain, of course, well ahead.[3] But what is striking is that the vigour of growth in the last few years has helped to lift millions of citizens in the region's emerging economies out of poverty. Take China, for instance, where people have reaped the benefits of their country's rapid development through a doubling of GDP per capita since the turn of the millennium, to about USD 2,400 in 2007.

The remarkable pace of growth in the Asia-Pacific region is good news for all of us. The region, which has an immense potential, is contributing to global prosperity. The euro area has the potential to take advantage of the new opportunities that this rapid development creates. In 2006, emerging Asia accounted for about 10% of euro area exports and 18% of its imports. It also accounted for about 6% of the euro area's stock of foreign direct investment.

Importantly, the world economy might be better able to rely on the dynamism of the Asia-Pacific region should growth in other regions lose some momentum. This is particularly important at the current juncture. However, it is equally important not to forget one caveat. We are in a universe of interdependence. If one economy slows down, it has an influence on all other economies. Since we are all interdependent, the key question is how, and to what extent, a possible slowing down in some mature economies might be partially offset by stronger growth in other regions, notably in emerging Asia, also bearing in mind differences in cycles and drivers of growth.

III. Implications for the international financial architecture

It is evident that the developments we have been witnessing have called for systemic changes in the global policy framework. New players in the Asia-Pacific region are gaining in importance and reaching out to more established players. This means that they also have more responsibilities in the global arena and that the rules of the game need to adapt in order to keep pace. This is why the governance of the world economy in macroeconomic and financial matters has been changing in terms of both format and substance.

Consider first format. The various international institutions and fora which are involved in international policy dialogue on macroeconomic and financial affairs have strived over the past ten years to better integrate new players from the Asia-Pacific region, alongside those already involved. Let me briefly take some examples.

One of the most important of these fora is the Group of Seven or G7. Finance ministers and central bank governors of the seven most industrialised nations of the world, including of course Japan, meet several times a year to discuss issues of mutual interest. My experience is that the G7 meetings have proven an invaluable forum for cooperation on macroeconomic policies and for giving, when appropriate, signals to market participants. An important step

[3] Based on projections published by the International Monetary Fund in October 2007 in its World Economic Outlook.

was made a few months ago when the G8 committed in Heiligendamm to embark on a high-level dialogue with important emerging economies, among which are Asia's two population giants, China and India. This dialogue will focus on issues of global dimension which will be at the top of the agenda in the years ahead. These include, for instance: cross-border investment; research, innovation and intellectual property rights; climate change; energy efficiency; and development, particularly in Africa.

A related example is the creation of the Group of Twenty, or G20. The G20 is an international policy forum for dialogue and consensus-building among systemically important countries, both industrialised and emerging. It was created a decade ago in the aftermath of the Asian crisis, together with the Financial Stability Forum. In the early years of its existence indeed, the G20 – one-third of which comprises countries from the Asia-Pacific region – put special emphasis on financial stability and crisis prevention, including aspects such as prudent debt management, domestic financial deepening and exchange rate regimes. Its agenda has widened since then. It now includes some of the most important global policy challenges ahead of us, such as development, energy and climate change.

Last, significant reform efforts are under way at the International Monetary Fund to adapt the institution to a new environment and a new set of players, notably in terms of quota and voice, two important elements defining the representation of Fund members.

The international community did a very good job in my opinion, in drawing the lessons from the Asian crisis. It is equally important that we draw all lessons from the ongoing process of significant market correction that global finance has been experiencing for several months, with its episodes of high market volatility and financial turbulence.

As I said already, the last G7 meeting in Tokyo was a good occasion to exchange views on the underlying causes of the recent turbulence and on the areas where significant improvements will have to be brought about in global finance. At present we have a large consensus on both the methodology and the six domains where we agree action will be necessary. This large consensus is very important because the challenges that we have to cope with are global and the solutions themselves can be nothing but global and very closely harmonised between the economies that make up the global economy.

On top of stressing the absolute necessity of working very actively, and very much united together with the Asia Pacific region, to draw the right lessons from the present market correction – which, according to our agreed methodology, we will do when we receive the definitive report of the Financial Stability Forum on the occasion of the next spring meetings of the Bretton Woods institutions in Washington – I will make three remarks.

First, the international community is able to produce a right and pertinent diagnosis of the situation of global finance. As chairman of the Global Economy Meeting which takes place every two months in Basel, with a very important and active contribution of governors of central banks from the Asia-Pacific region, I mentioned regularly in 2006 as well as in the first months of 2007 that my colleagues and I judged that there was a significant underpricing of risks in global finance. This situation was substantiated by a very low level of spreads, a very low level of risk premia, an abnormally low level of volatility in a large number of markets. We explicitly and publicly called for institutions and markets to prepare themselves for a correction that was both unavoidable and necessary to pave the way for more sustainable path of global finance. Such analysis and diagnosis were reflected pretty well in most financial stability reviews published by central banks, not the least in the European Central Bank publication a long time before the market correction.

Second, a good analysis and a pertinent diagnosis are a necessary condition for future necessary market corrections to be as smooth and as orderly as possible. But they are not a sufficient condition per se as is clearly demonstrated in the present episode of turbulence and as was regularly observed in the previous periods of sharp and abrupt market corrections. And that is the reason why it is so important, so decisive that we draw all the lessons from the present episode, across the board, without any prejudices, without giving any privilege of untouchability to any part of global finance. From that standpoint I think the work of the Financial Stability Forum – scrutinising liquidity risk management as well as credit rating agencies, analysing without complacency the weakness in the structure of incentives of the "originate to distribute" model as well as the monitoring of the off-balance sheet vehicles, examining the implementation of the Basel II agreement as well as the arrangement for dealing with in particular weak cross-border financial institutions – is of the essence.

Third, even with a right and pertinent diagnosis, and appropriate significant improvements in benchmark voluntary principles and codes of conduct for the private sector, as well as substantial progress in rules and regulations and in cooperation and coordination between authorities where needed, my understanding is that we could not be sure that the "unavoidable and necessary market corrections" of the future would be reasonably "smooth and orderly".

For a higher likelihood of that to happen, we need probably simultaneously what I would call a further significant change of culture at national as well as at global level. I would sum up this change in our overall approach with these words: transparency, holism and anticyclicality. Transparency because enhanced public information on institutions as well as on financial instruments is the only way we have to avoid contagion and herd behaviour in times of difficulty. Holism because, with technology and globalisation helping, we have progressively built global finance on the basis of the very close interconnection of all markets, all institutions, all economies. We must continue to improve our full understanding of the functioning of the financial system as a whole. The Financial Stability Forum, gathering together banking, insurance and market surveillance authorities, central banks, international financial institutions, treasuries etc., was the first major illustration of this need to address the global financial system as a whole. We have to reinforce considerably this holistic approach. And anticyclicality because a number of rules and regulations, on the one hand, and of behaviours of public and private institutions as well as of markets, on the other hand, have a tendency to be largely procyclical, amplifying the booms as well as the busts in the cycle. We must look at all parts of global finance with a view to diminishing progressively their procyclical components, which implies, in particular but certainly not exclusively, eliminating as much as possible asymmetry in the treatment of booms and busts and extending as much as possible, where needed, the time horizon adopted by all the institutions concerned.

IV. Conclusions

Ladies and gentlemen,

As I said at the beginning of my remarks, the centre of gravity of the global economy has been shifting westwards over the last four hundred years, from Antwerp to Amsterdam, from Amsterdam to London, from London to New York.

The world economy is changing constantly. The Asia-Pacific region occupies a far more important place today than it did only a decade ago, but one which will likely be exceeded in importance by its role in the future.

Since the world economy is evolving constantly, the rules of the game have to be continuously adapted. International institutions and fora are changing and adjusting. Many initiatives have been taken. Altogether this should help make the global economic and financial system more resilient.

But we have also learned that it is never time for complacency. Efforts to ensure global stability and prevent crises have to be made constantly by all of us without exception.

In this context, I am confident that the euro area and the economies of the Asia-Pacific region will continue to work in close cooperation in the years ahead to ensure that these important goals are met.

I thank you for your attention.