PRESS POINTS FOR CHAPTER 4:
RESILIENCE IN EMERGING MARKET AND DEVELOPING ECONOMIES: WILL IT LAST?
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- **The resilience of emerging market and developing economies—measured by their ability to sustain economic expansions and recover quickly from downturns—has increased markedly. The past decade was the first time that these economies spent more time in expansion, and had smaller downturns, than advanced economies.**

- **The increased duration of expansions is explained by both good policies and a lower incidence of external and domestic shocks: better policies account for about three-fifths of the improvement, and less frequent shocks account for the rest.**

- **But the relative calm in these economies over the past two years could well be temporary. There is a significant risk that advanced economies could experience another significant downturn, or that domestic vulnerabilities could reemerge.**

- **More policy room for maneuver has played a major role in buffering external shocks. To guard against new shocks, these economies will need to rebuild their buffers to ensure that they again have ample space to respond to them.**

Many emerging market and developing economies have done well over the past decade and through the global financial crisis, but the question on policymakers' minds now is whether this strong performance will last. There are reasons for optimism, including improved policymaking and greater "policy space"—room to respond to shocks without undermining sustainability. But the recent good performance has also been supported by factors which are fickle, such as strong capital inflows, rapid credit growth, and high commodity prices. This chapter helps shed light on the past, present, and prospective resilience of these economies. It examines how the duration of expansions and the speed of recoveries have evolved, in more than a hundred emerging market and developing economies over the past six decades.

The resilience of emerging market and developing economies has increased markedly during the past two decades. They are spending more time in expansion, and downturns and recoveries have become shallower and shorter. The performance of the past decade was particularly good—it was the first time that emerging market and developing economies spent more time in expansion, and had smaller downturns, than advanced economies.

These economies have not become immune to shocks, however. Various shocks, both external and domestic, are associated with the end of expansions in these economies. Among external shocks, sudden stops in capital flows, advanced economy recessions, spikes in global uncertainty, and terms-of-trade busts all increase the likelihood that an expansion will end. Among domestic shocks, credit booms double and banking crises triple the probability that an expansion will shift into a downturn by the following year.

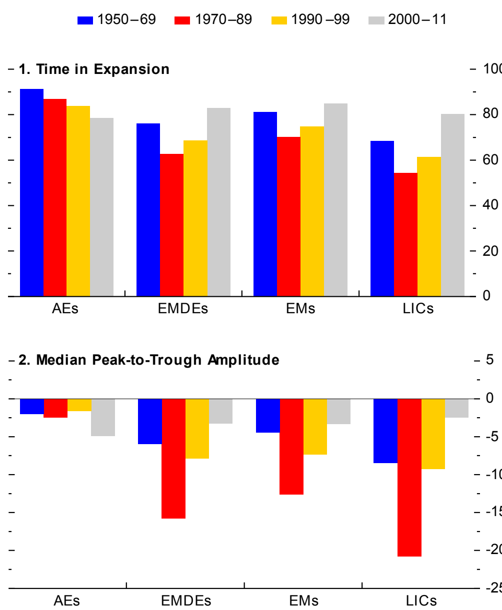
Better policymaking and increased policy space account for the bulk of their improved performance; less frequent shocks accounts for the remainder. These economies now have better economic policies: more of them have adopted inflation targeting and flexible exchange rates, for example, and fiscal and monetary policies are now more "countercyclical" than in the past—they stimulate or rein in the economy as needed. They also have more room to maneuver, thanks to lower inflation and better fiscal and external positions than in the past. Better policies and greater policy space account for three-fifths of the increased duration of their expansions. Less frequent shocks accounts for the remainder: while some shocks such as spikes in global uncertainty have become more frequent, other shocks such as banking crises and credit booms have become less frequent in these economies.

But the relative calm these economies enjoyed the past two years could well be temporary. There is a significant risk that advanced economies could experience another downturn, and in such an event emerging market and developing economies will likely end up "recoupling" with advanced economies, much as they did during the global financial crisis. Domestic vulnerabilities could also reemerge, as strong credit growth in some emerging market and developing economies, which likely supported domestic demand, raises concerns about financial stability.

To guard against such risks, these economies will need to rebuild their policy space to respond to shocks. In response to the global downturn, policy space has rightly been used to support activity. These economies will be more resilient to new shocks if recent improvements in their policy frameworks—including greater exchange rate flexibility and more countercyclical macroeconomic policies—are maintained, while policy buffers are being rebuilt.

Figure 1. The Rising Resilience of Emerging Market and Developing Economies
(Percent)

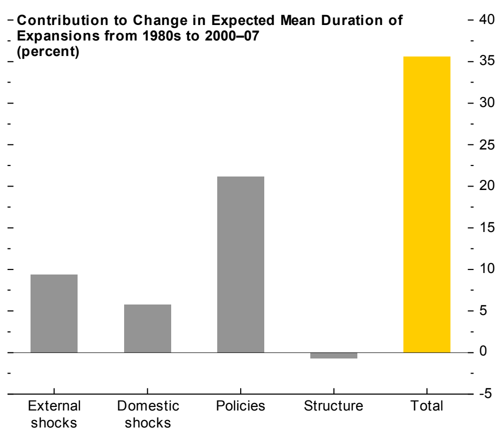
Emerging market and developing economies are now spending more time in expansion, and have had shallower downturns, than in past decades. The 2000s have been particularly good—for the first time, these economies spent more time in expansion and had shallower downturns than advanced economies.



Source: IMF staff calculations.

Figure 2. Improved Performance Mainly Due to Better Policies and Greater Policy Space

Improved performance mainly reflected improvements in policymaking, as well as greater policy space to respond to shocks. But fewer and less intense external and domestic shocks also played a role.



Source: IMF staff calculations.