

2013-09-12

PRESS RELEASE

Decoupled and resilient? The changing role of emerging market economies in an interconnected world

(Article for the September 2013 Economic Review)

For the last two or three decades, the global economy has been going through an extraordinary transition phase. This period has been marked by stronger integration among economies, fuelled by falling trade and communication costs, but above all by the rising prominence of emerging market and developing economies (EMDE), which as a group have enjoyed persistently higher growth than advanced economies (AE) and have shown greater resilience than in the past. This performance has to a large extent resulted from the use of better policy frameworks and institutions as well as the ability to implement counter-cyclical economic policies. While EMDEs were certainly not spared from the 2008/2009 global financial crisis, these features have helped them to limit its adverse impact and handle the crisis better than similar events in the past. Furthermore, and despite some regional exceptions, EMDEs generally bounced back more rapidly and vigorously from the Great Recession than AEs. The article shows how EMDEs' growing weight in the global economy and the multiplication of their connections with other parts of the world have reshaped the global economic landscape. It illustrates how the one-directional influence of AEs on EMDEs' business cycles has gradually diminished. While this does not imply full decoupling, it nevertheless suggests that the interdependence between EMDEs and AEs is becoming increasingly two-sided.

Real growth in EMDEs started to significantly and persistently outpace that of AEs from 2000 onwards. The widening growth differential reflected both faster economic growth in EMDEs, as well as a slowdown in the AEs themselves. The acceleration of growth in EMDEs has been a general phenomenon, despite differences in pace across EMDE regions. Following the outbreak of the worldwide financial crisis in 2008, economic growth dropped in virtually every country around the globe. Unlike the AEs, the EMDEs as a group succeeded in maintaining a positive growth rate of 2.7% in 2009, even though their respective growth collapse was of similar magnitude. They also recovered more vigorously from the crisis: by 2012, their GDP exceeded that of 2007 by 31%, compared to 2.3% for AEs.

The greater economic weight of EMDEs has changed the parameters of the global economic landscape, as their influence on global economic developments and outcomes has risen almost mechanically. This has been evident in the geographical composition of world trade and capital flows and in EMDEs' ability to influence demand, prices and financial stability at the global level. The singular role of China as a driving force behind these developments is worth highlighting in this context. At the same time, the income gap (in terms of GDP per capita) between EMDEs and AEs is still considerable, and while EMDEs account for 85% of world population, they still only contributed 50% of world GDP (in PPP) in 2012. So, there is still great potential for catching-up and this process will likely continue to shape EMDEs' growth path in the future.

The contrasting developments of the two groups of countries have raised questions regarding the possible decoupling of business cycles between AEs and EMDEs. While theory and the available empirical evidence are rather ambiguous on this issue, the one-directional influence of AEs does seem to have been gradually diminishing. The number of examples through which EMDEs have been influencing global economic developments recently points to an increasing two-way interdependence between EMDEs and AEs.

After having gone through some severe financial crises in the 1990s, many EMDEs have overhauled their policy frameworks and institutions, thereby strengthening their macroeconomic fundamentals and the availability of policy space. The article analyses how these features have helped them to become more resilient, i.e. to sustain longer periods of growth and to minimise the recovery duration following an adverse shock. Resilience can never be taken for granted, however, not least since the availability of policy space is generally limited and countries need to permanently demonstrate that they have the flexibility to react to changes in their external environment.

Looking ahead, the relative weight of EMDEs is expected to grow even further. The pace and nature of that process is surrounded by many unknowns, however. While AEs, and most notably the euro area, continue to struggle with the aftermath of the financial crisis, many EMDEs are themselves reviewing their growth model. In the short run, meanwhile, the EMDEs' resilience is likely to be tested further, as suggested by the recent downward revision in growth projections for 2013 and 2014 for both for EMDEs and AEs (IMF WEO, July 2013 update). At the same time, the strong policy response to the crisis by China is now increasingly appearing as a potential source of destabilisation.