

Templeton Global Macro

Global Macro Shifts

Can emerging markets navigate a fragmented world?



Global Macro Shifts

Global Macro Shifts is a research-based briefing on global economies featuring the analysis and views of Dr. Michael Hasenstab and senior members of Templeton Global Macro (TGM). Dr. Hasenstab and his team manage Templeton's global bond strategies, including unconstrained fixed income, currency and global macro. This economics team, trained in some of the leading universities in the world, integrates global macroeconomic analysis with in-depth country research to help identify long-term imbalances that translate to investment opportunities.



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Summary

- Emerging markets (EMs) have generally shown significant resilience over the past five years, facing down a series of shocks arising from the COVID-19 pandemic, the inflationary outcome of the Russia-Ukraine war and the US Federal Reserve hiking interest rates sharply within an 18-month period. Not only did EMs survive this period, but in some ways they have thrived. Indeed, as the world fragments and realigns geopolitically, EMs have found themselves generally well-placed to benefit from these global shifts—including some that are likely to benefit under the new tariff regime. This compares to earlier years when EMs would often face crises (whether debt, balance of payments and/or in banking systems) from global shocks. That EMs are in a favorable position now is no accident, and this report identifies and examines the developments that have enabled the current resilience in EMs.
- **Trade diversification** has made EMs less reliant on individual trading partners. While the United States and China remain the two largest trading hubs around which most world trade takes place, most EMs have not singularly aligned with one of these, thus enabling them to trade in whichever way is most advantageous to them. In addition, trade between EMs has generally increased as well. EMs have thus become less vulnerable to shocks emanating from a particular trading partner—including the effects of tariffs.
- **Reshoring** has boosted prospects in a number of EMs, whether that comes from “China plus one” diversification, friendshoring or nearshoring. These EMs have become (or are in the process of becoming) more embedded in global supply chains, supporting their balance of payments both through inward investment flows into production facilities flows and as they export the products. We also believe that tariff imposition is likely to underpin the shift to reshoring already underway globally.
- **Policy responses** with respect to both monetary and fiscal policy have improved significantly across EMs over the past couple of decades. Adoption of sound, credible policies and nurturing of institutions (such as inflation targets, fiscal rules and independent central banks) have helped policy formulation and improved the market’s perception of the credibility of policymakers.
- **Financing flows into EMs** have improved markedly compared to previous years, with much of the flow now being longer-term (such as for fixed investment) rather than “hot money” (short-term, easily reversible flows such as portfolio flows) that previously characterized inflows. In addition, as local financial markets have deepened, EMs have been able to source a greater portion of their funding domestically, leaving them less vulnerable to a balance of payments shock.

- **Structural reforms** to foster growth and/or attract foreign investment have further entrenched progress and boosted structural growth rates.
- **In sum**, we see that the current strong position of EMs in a geopolitically fragmenting world is the result of some decades of consistent commitment to reforms, as well as savvy positioning within a multipolar world. We expect certain EMs to be able to continue to benefit as global realignment of political and trading blocs continues.
- Even with this stronger basis, there are **risks** to EMs, some within their control and some not. A potential global trade war poses a risk to growth in many of these countries. In addition, some of the outcomes of structural improvements (such as higher reserves and fiscal space) depleted somewhat during the pandemic shock and have not yet fully recovered, limiting EM's ability to deal with potential future adverse events.

Introduction

EMs have generally shown significant resilience over the past five years, facing down a series of shocks arising from the COVID-19 pandemic, the inflationary outcome of the Russia-Ukraine war and the US Federal Reserve hiking interest rates sharply within an 18-month period. Not only did EMs survive this period, but in some ways they have thrived; as the world fragments and realigns geopolitically, EMs have found themselves generally well-placed to benefit from these global shifts. We identify a number of developments that we believe have contributed to this outcome and which continue to portend positive signs for EMs.

In the first part of this report, we discuss the current situation of EMs with respect to global trade—where most EMs have expanded their presence in the past few decades—and, related to this, where EMs are able to reap benefits in the midst of ongoing global reshoring.

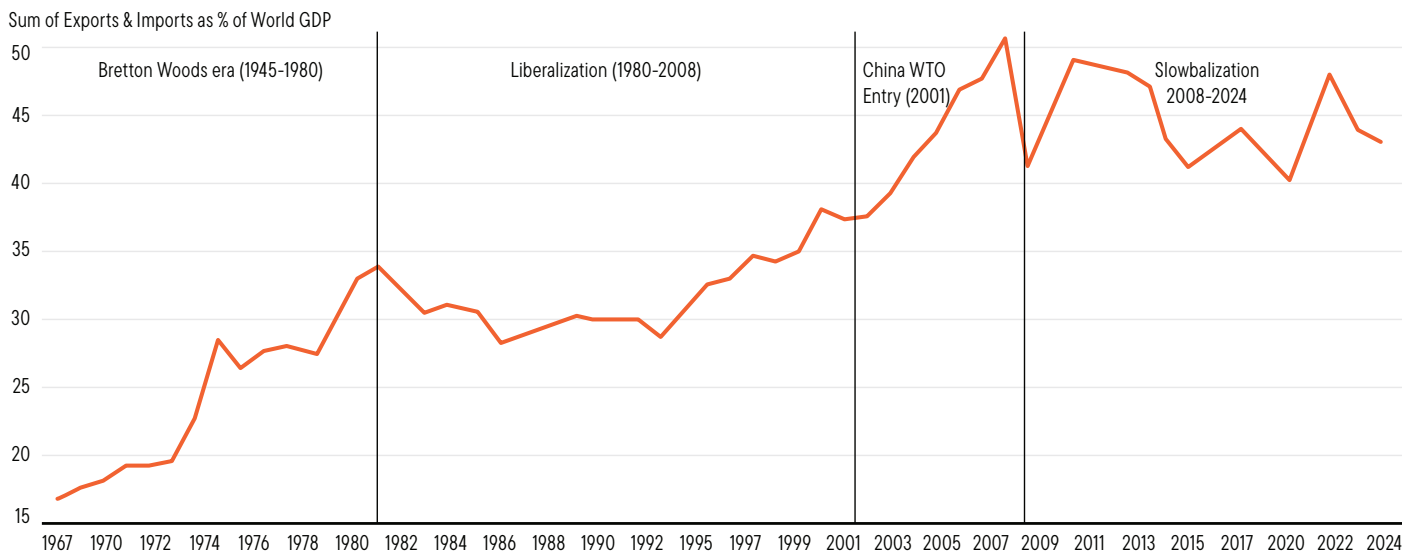
EMs in a world of fragmenting trade flows

A long era of globalization, characterized by an increase in world trade, spanned the period following World War II (WWII) until approximately 2008. Developments supporting the expansion of trade during this time included the post-WWII Bretton Woods exchange rate system, trade liberalization measures from 1980 and China's accession to the World Trade Organization (WTO) in 2001 (Exhibit 1). However, this expansionary momentum stalled after the global financial crisis (GFC) in 2008, since which time global trade has moved largely sideways relative to global output. That said, it remains at noticeably higher levels than in the pre-globalization era. Looking into some of the details behind this broad overview, we find that EMs have been doing well despite this “slowbalization.”

“Slowbalization”—A Shift from the Rapid Global Trade Growth of Previous Decades

Exhibit 1: Exports Plus Imports as a Percentage of World Gross Domestic Product (GDP)

December 31, 1967–December 31, 2024



Sources: IMF, World Bank.

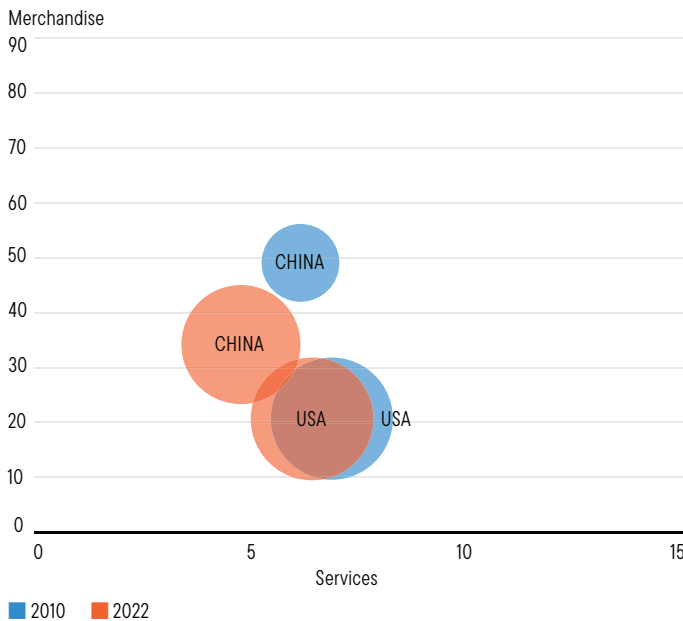
Despite the headlines, most countries are trading more, not less

Economic theory posits that trade is generally beneficial, implying that globalization through increasing trade is beneficial, with the corollary that deglobalization is economically suboptimal. Although terms like “deglobalization” have been making headlines for the past few years, trade fragmentation is largely a story about the United States and China. The share of most other major countries' trade in goods and services as a share of GDP has actually increased in the past 20 years, while those of China and the United States have declined. These increasing shares align with economic theory that international trade supports domestic economic growth. The United States and China, however, have worked against this idea in favor of national security and protectionist policies. Exhibit 2 shows how the United States and China experienced a decline in trade as a percentage of GDP over the past two decades, whereas many other countries increased their shares, as illustrated in Exhibit 3.

Both the United States and China Have Seen Trade Fall Relative to GDP Over the Past Two Decades

Exhibit 2: United States and China, Trade Shares as a Percentage of GDP, 2010 and 2022

Merchandise and Services Trade as a Share of GDP. Point Size Represents Real GDP

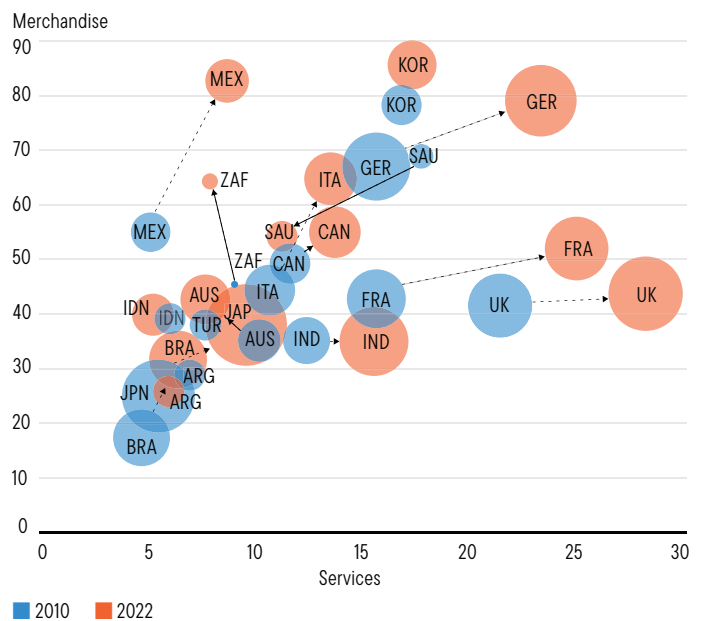


Source: World Bank.

In Other Countries, by Contrast, Trade Has Risen as a Share of GDP

Exhibit 3: Selected Countries—Trade Shares as a Percentage of GDP

Merchandise and Services Trade as a Share of GDP. Point Size Represents Real GDP



Source: World Bank.

EMs are benefiting from realignment of the global trade network

Increased connectedness among trading partners stemming from improved logistics infrastructure and the emergence of low-cost exporting hubs has resulted in a network that is no longer the US-dominated hub-and-spoke structure it had been in much of the second half of the 20th century. Countries now trade with whomever can best maximize profit, which, in many cases, is China. This is due to several factors, including:

1. Demand from China's industrial sector for raw materials, bolstered by the Chinese government's preference for domestic refining;
2. Demand from China's large consumer base for foreign goods—China's middle class is the largest in the world; and
3. Expanded Chinese business involvement in other countries, driven by Jiang Zemin's "Go Out Policy" in the 2000s and the Belt and Road Initiative in the 2010s.

As a result, China currently operates the largest total trade balance in the world and has joined the United States at the center of the global trade network. Despite the political tension between the two hubs, most peripheral countries are agnostic about political issues with regard to trading partners—they simply want to trade with the country that maximizes profit. This approach has opened up opportunities for EMs within the global trade context. We highlight that such opportunities are not driven by any one country—in other words, it is not just China's emergence as a hub that presents opportunities, but the fact that many EMs are now trading with each other as well. That said, growing trade with China over time presents risks (in the event of Chinese economic slowdown) as well as opportunities for EMs.

Countries with diversified trading partners and increasing trade are well positioned for a multipolar world

Box 1: A framework for analyzing trade diversification in countries

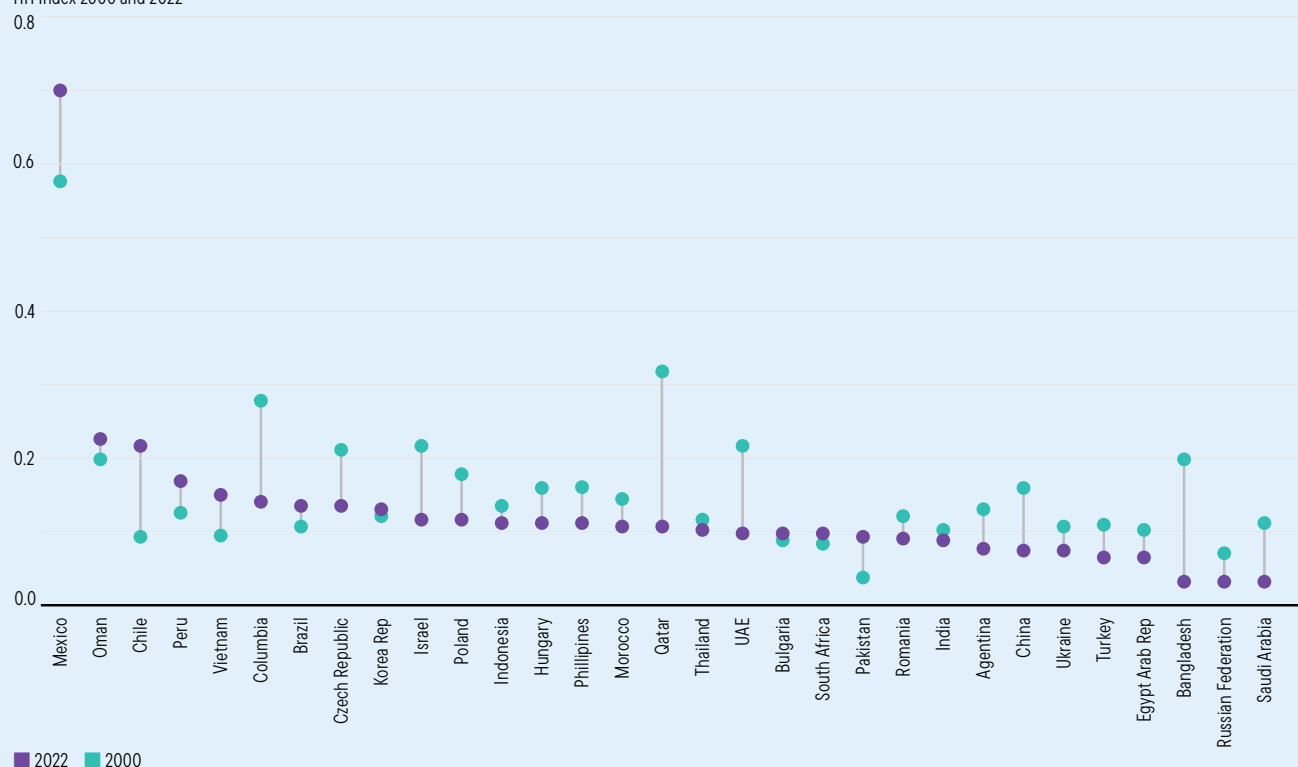
We can measure a country's level of trade diversification by calculating its Herfindahl-Hirschman index (HH Index),¹ with index levels between 1 and 0 where a high score indicates that a country is mostly reliant on one or two main trading partners and a low score indicates that trade is diversified across several partners. A decrease in the index signals that a country's export relationships are becoming more diversified.

Most EMs' HH Index scores fell considerably between 2000 and 2022, suggesting increased diversification in trade partners (see Exhibit 4). Mexico, with the highest score in both 2000 and 2022, remains highly dependent on the United States for its exports, though the index fell over this period due to increased exports to Asia and Europe. By contrast, Saudi Arabia's scores are the lowest in the sample as a result of oil exports going to a wide variety of countries. China has one of the most diversified export destinations. That, along with its own decreasing share of exports in GDP, indicates that it is increasingly less reliant on exports to any one country. However, not all EMs have exhibited increased diversification of trading partners. Index scores in Chile, Peru and Vietnam increased between 2000 and 2022, all driven by increased exports to China. That said, these three countries' overall scores still suggest diversified export relationships.

Analyzing Trade Diversification across EMs Over Time

Exhibit 4: Herfindahl-Hirschman Index (0-1 scale), 2000 and 2022

HH Index 2000 and 2022



Source: World Bank.

We believe countries that have increased their share of trade relative to GDP as well as increased their level of export partner diversification are best positioned for a multipolar environment. These countries will have the benefit of choice when trade tensions between global powers arise, allowing them to minimize trade disruptions. Eastern European countries are notable examples where trade has both increased and become increasingly diversified, which in their case can be attributed to joining the European Union (EU), which granted them access to streamlined trade with several new trade partners. In Latin America, Argentina and Colombia increased trade and export partner diversification as they added China and other Asian markets as key export destinations. In Asia, ASEAN² trade has remained highly interdependent despite strong links to both China and the United States. In 2000, ASEAN countries primarily traded with each other and the United States. Since then, China's rapid growth in both imports from and exports to ASEAN has boosted total trade and outpaced that of the United States, but it has not overshadowed the strong inter-ASEAN trade linkages. This can be attributed to the bloc's longstanding efforts to reduce trade barriers between member countries and develop streamlined production linkages across member states.

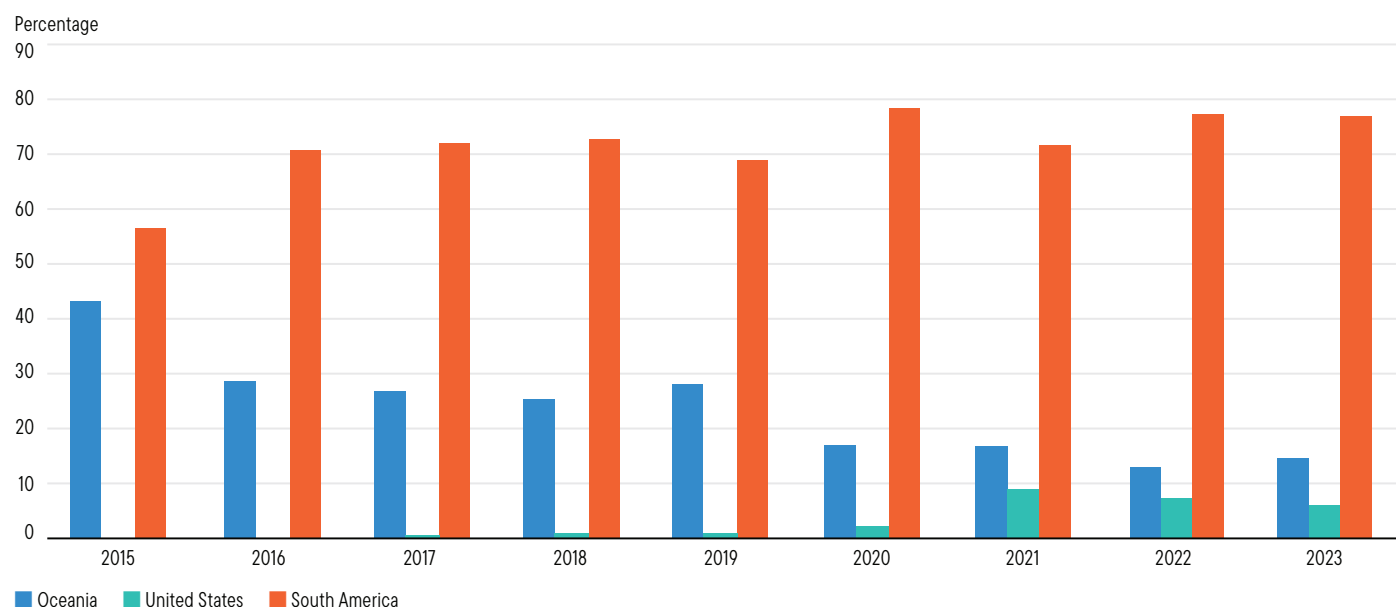
Case studies: Taking advantage of geopolitical realignment

China's beef imports present an example of how EMs can be well-positioned to take advantage of changes in trade patterns, and more specifically how small countries may be able to take advantage when trade tensions arise elsewhere.

Beef is China's most-imported meat commodity, with import volumes growing 513% between 2015 and 2023 (approximately 25% annually). Australia's share of this market, however, declined dramatically since 2015, from nearly half to under 10%, as a result of Chinese efforts to diversify imports away from a nation it saw as aligned with an opposition bloc. The process accelerated in 2020, when China imposed de facto sanctions on commodity imports from Australia following a severe deterioration in diplomatic relations between the two countries. Beef exporters in the Americas have subsequently benefited from replacing Australian producers in the growing Chinese market. Brazilian, Argentine and Uruguayan beef exports to China expanded 892%, 587% and 1226% (in inflation-adjusted terms) respectively between 2015 and 2023 (Exhibit 5).

Latin America Has Benefited from Lower Australian Market Share in Chinese Beef Imports

Exhibit 5: Share of China's Bovine Imports by Region (Volume, Percentage of Total), 2015-2023



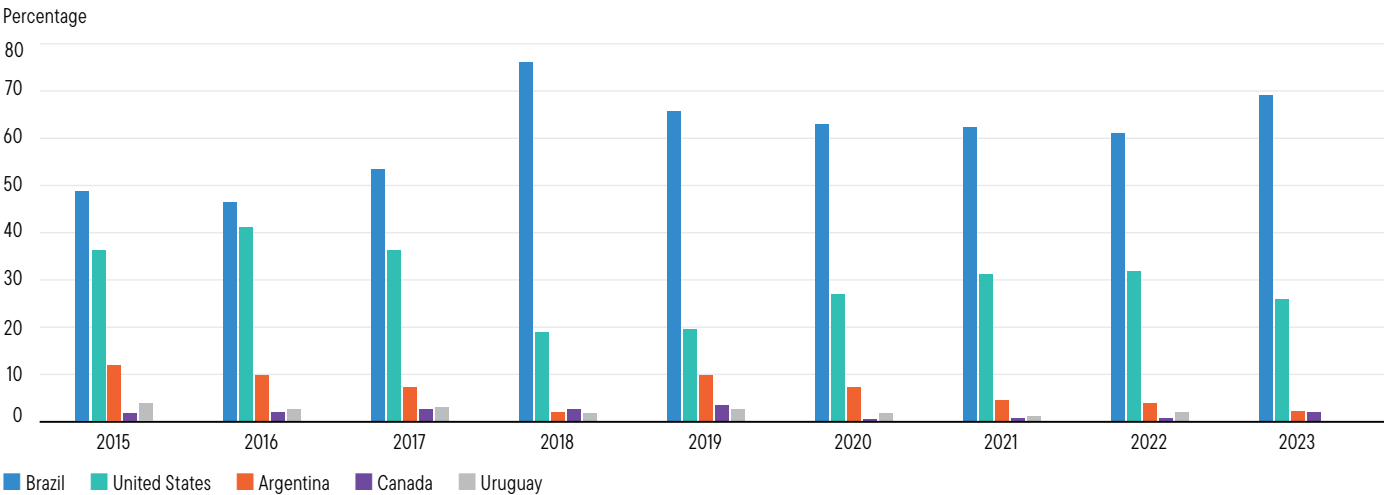
Source: World Bank. Analysis by Templeton Global Macro.

This case study therefore demonstrates how geopolitically induced trade fragmentation can present idiosyncratic opportunities for emerging economies. In this instance, a number of smaller EMs were able to benefit from a trade dispute by being able to access a new market. Argentina’s role in this also supports the notion mentioned earlier—that benefit to the country will generally trump political alignments to either the United States or China (given that current Argentine President Milei is a noted proponent of free markets, seemingly at political odds with China). A multipolar world order can thus reshuffle trade and investment flows to benefit individual emerging economies.

Another, more recent, example concerns **China’s soybean imports**. Following the recent announcement of US tariffs on China and China’s countermeasures, it appears that a casualty will be US exports of soybeans to China. There are already indications that Brazil and potentially other Latin American countries will step in to benefit from the gap being left from that. Exhibit 6 indicates that Brazil has already been taking some market share from the United States, while there appears to be scope for Argentina to revert to prior higher levels of its share of China’s soybean imports. There are also potential gains to be made by Argentina replacing the United States with respect to **wheat** imports. This is an evolving situation, and we will continue to monitor developments.

Latin American Countries May Step in to Replace Chinese Soybean Imports from the United States

Exhibit 6: Share of China’s Soybean Imports by Selected Source Country (Volume, Percentage of Total), 2005-2023



Source: World Bank. Analysis by Templeton Global Macro.

Reshoring trends and their implications for EMs

While EMs have been increasingly integrating into global trade systems for some time, we are also seeing a deepening trend of integration into global supply chains. The shift from earlier globalization (where companies chased the cheapest production costs) has started morphing as geopolitics becomes chillier on the global stage. Rather than “deglobalization,” which would imply countries bringing production back home, we are seeing reshoring take place—including “China plus one,” where countries diversify their supply chains away from reliance on China, “friendshoring,” where production is shifted to political allies, and “nearshoring,” where production is shifted to countries in close geographical proximity to help smooth logistics issues. Certain countries stand to benefit significantly here, as foreign direct investment (FDI) flows in to establish the production facilities and as exports from these new facilities subsequently expand.

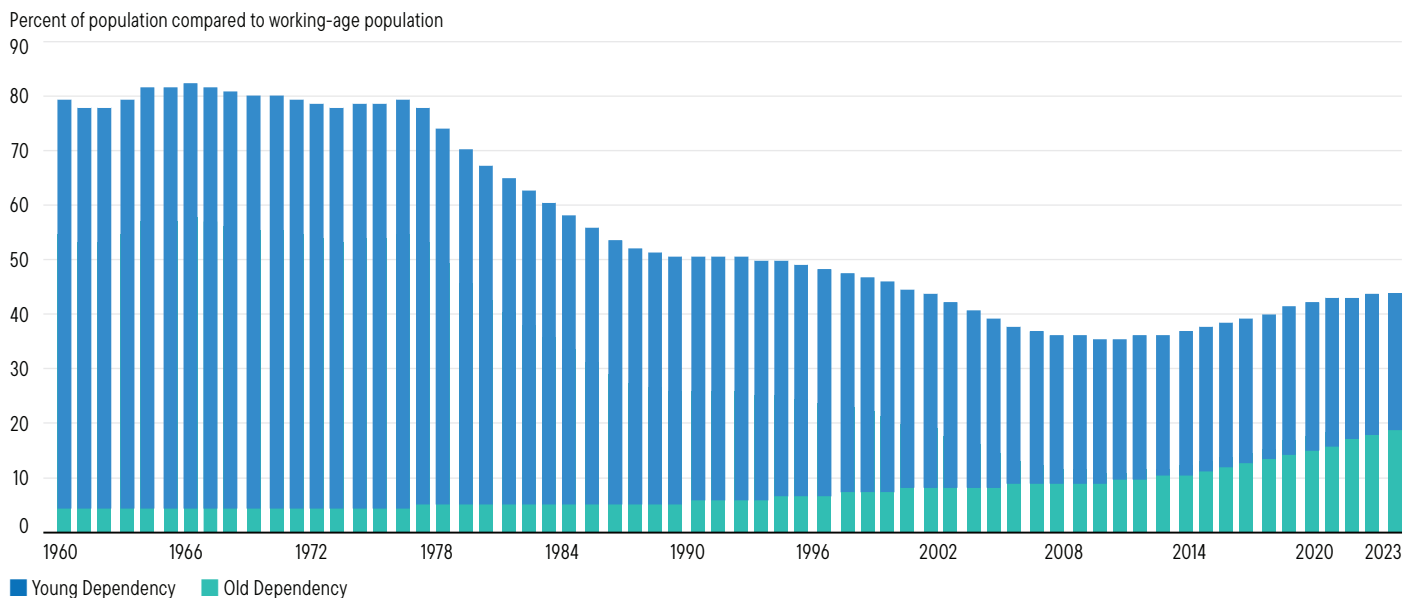
China plus one

As Chinese manufacturing production has moved up the value-added ladder and as the increase in Chinese income has driven its domestic costs higher, new opportunities for other EMs to expand their own manufacturing industries have emerged. Geopolitical risk considerations have also led to some companies wanting to diversify their production bases away from China.

Demographics have largely driven the shift in labor costs in China. Chinese labor was cheap initially due to a large working-age population. However, that peaked around 2011, with the decline since then driven by the aging of the population—the elderly population is increasing rapidly, while the young population has been declining due to low fertility rates (Exhibit 7). Consequently, China’s unit labor costs have risen more than 300% since 2000, making Chinese labor now more expensive compared to other EMs. Indeed, even as Chinese costs have risen in this period, other countries such as Brazil, Malaysia, India and South Africa have generally seen unit labor costs fall (Exhibit 8).

China’s Elderly Population Is Rising Even As its Youth Population Falls...

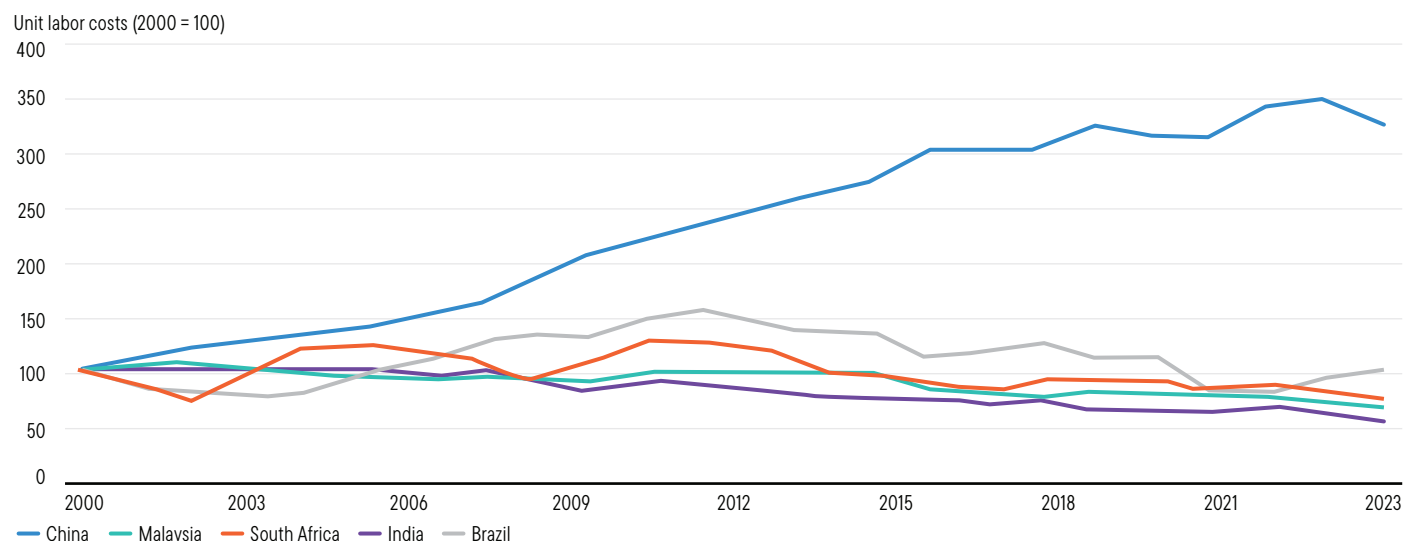
Exhibit 7: Old and Young Dependency Ratios in China, 1960-2023



Source: World Bank.

...Leading to Rising Costs in the Labor Market as the Working-Age Population Declines

Exhibit 8: Unit Labor Costs in China and Select EMs (Index, 2000 = 100), 2000–2023

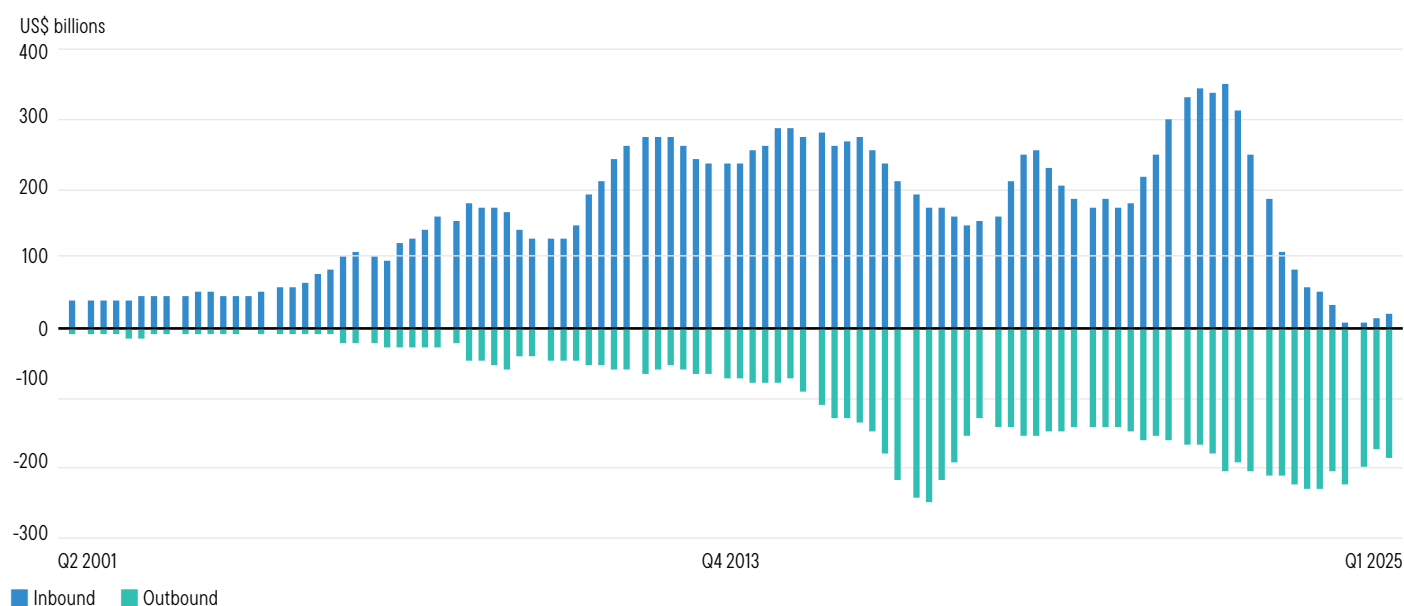


Source: Oxford Economics. Analysis by Templeton Global Macro.

On the geopolitical front, increasing tensions between China and other major trading partners such as the United States and the EU have led to some reallocation of FDI and/or trade diversion. Greater domestic economic uncertainty and a less friendly attitude toward private sector activity have also impacted confidence. These have increased the risks of investment in China. Consequently, inbound investment has plunged from a peak of US\$344 billion per year in 2021 to just US\$4.5 billion in 2024. China's outbound investment is around US\$200 billion (Exhibit 9); thus combined, these imply around US\$550 billion of capital opportunities annually for other countries.

China's Foreign Investment Balance Has Been Declining in Recent Years

Exhibit 9: Inbound and Outbound Direct Investment in China, Q4 2000–Q1 2025 (US\$ Billions, Four-Quarter Rolling Average)



Source: China State Administration of Foreign Exchange. Analysis by Templeton Global Macro.

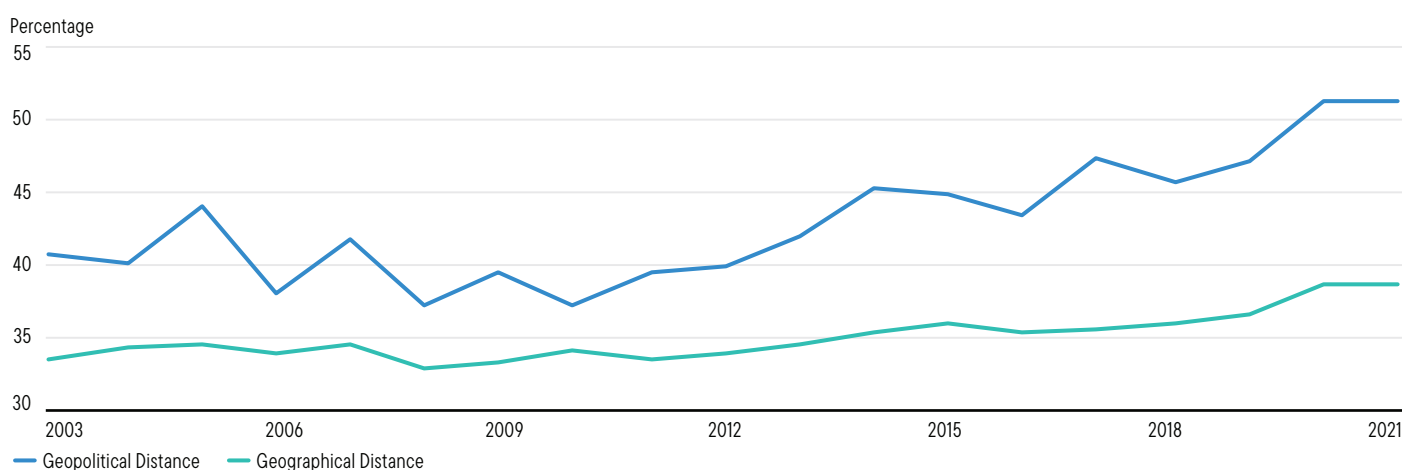
Nearshoring and friendshoring

Strategic alliances have underpinned the momentum seen in nearshoring and friendshoring. The “old” globalization model of offshoring meant that companies tended to relocate production to wherever production costs were lowest. As geopolitical tensions intensify, concerns have increased about issues such as reliability of supply as well as the physical location of production technology. This has resulted in considerations beside cost factoring into decisions about where to locate production.

Nearshoring refers to production facilities being situated in a location of geographic proximity—for example, US manufacturers with facilities in Mexico. This can help reduce risks associated with physical transport of goods (for instance, it is easier to find a new truck than a new ship in case of a transport issue). Friendshoring, meanwhile, refers to the reallocation of various parts of the supply chain to strategic allies where geopolitical risks are reduced, whether situating production facilities in a friendly country or sourcing critical raw materials or other inputs from one. These shifts will cause new advantages or disadvantages for countries. Exhibit 10 illustrates how geopolitical alliances increasingly appear to be outstripping geographic proximity as a driver of FDI, even as both have been rising in the post-pandemic period. Countries that lose production facilities on this basis and cannot replace them with investment from their own strategic allies will be disadvantaged. Meanwhile, countries that are not only allies, but have more efficient production generally, are likely to gain the most.

Friendshoring: FDI Is Increasingly Directed Toward Geopolitical Allies

Exhibit 10: Share of Total FDI between Geopolitically Friendly Countries vs Geographically Nearby Countries (%), 2003-2021



Source: International Monetary Fund. Note: Figure shows the annual share of total foreign direct investments between country pairs that are similarly distant (defined as the same quintile of distance distribution) geopolitically and geographically from the United States.

EM policy responses to macro shocks

In all, many EMs are in a comfortable position globally. Being in a position of relative strength in the contexts of trade, investment and global supply chains when the globe has experienced a series of shocks (the pandemic, wars and US interest rate increases) over the past few years is, perhaps, a little surprising given the history of these countries. Broadly, EMs have reached this point through a series of macro-policy reforms arising from taking on board the lessons of past crises. This is crucial, because economies that are more structurally sound (rather than simply reaping cyclical benefits when they come around) are more likely to stay strong and—given that policies may still have some way to go in many countries—improve from here. In this section, we examine some of the history of how EMs have changed their policy approach over the years to reach this stage of resilience. First we look at monetary and fiscal policy, then at how EMs have evolved in managing their balance of payments and the effect this has had on financing flows.

Policy reforms have made EMs more resilient

The reforms and better policy approaches that EMs have undertaken over the past few decades arose from learning the lessons of both the EM crisis periods of the 1980s and 1990s as well as those of global crises, including the GFC of 2007–2009.

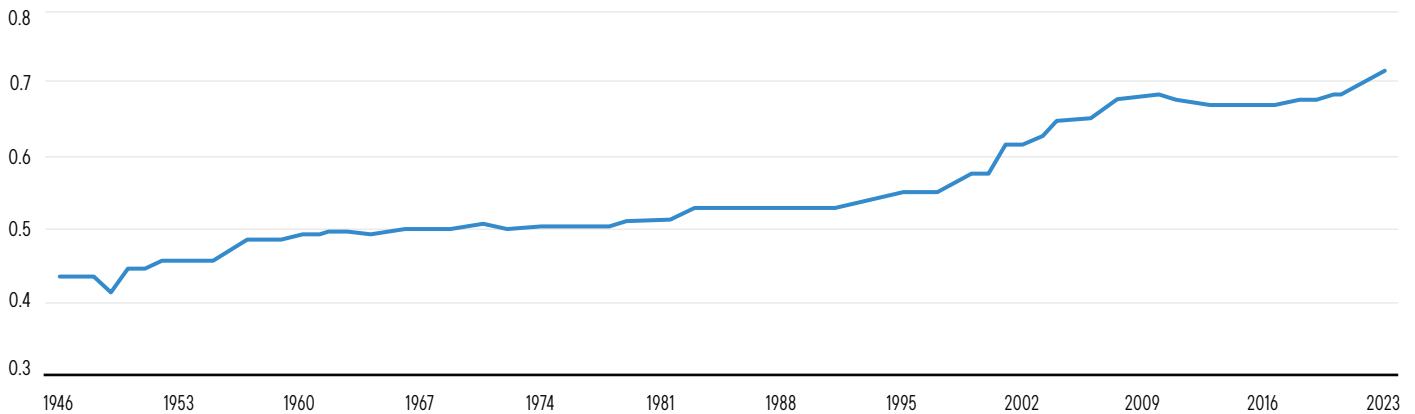
Prior to the late 1990s, most EMs were yet to adopt inflation targeting or fiscal rules. On the external front, they generally lacked substantial foreign exchange reserves and many still had some form of fixed exchange rate. As a result of these structural vulnerabilities, exchange-rate shocks and fiscal shocks tended to lead to episodes of domestic disruption and crisis. Addressing these vulnerabilities through various reforms—including inflation targeting frameworks and independent central banks with respect to monetary policy, fiscal rules and fiscal councils for fiscal policy, and significantly higher foreign-exchange reserves and floating exchange rates to reduce external vulnerability—substantially improved EMs' resilience. We discuss the evolution of these factors below, with a particular focus on how these economies have improved since the GFC.

Monetary policy

Central bank independence—meaning that the central bank is not subject to political influence over monetary policy decisions—is generally seen as critical for being able to implement appropriate monetary policy. However, legal independence does not always translate into de facto independence. To assess this, independence can be quantified using a Central Bank Independence (CBI) score,³ which illustrates that independence has indeed been steadily increasing in EMs for some time, picking up noticeably in the 1990s and early 2000s (Exhibit 11). Between 2008 and 2020 CBI scores moved largely sideways but recently have picked up again.

EM Central Banks Have Become More Independent Over Time

Exhibit 11: Median EM Central Bank Independence Scores, 1946-2023



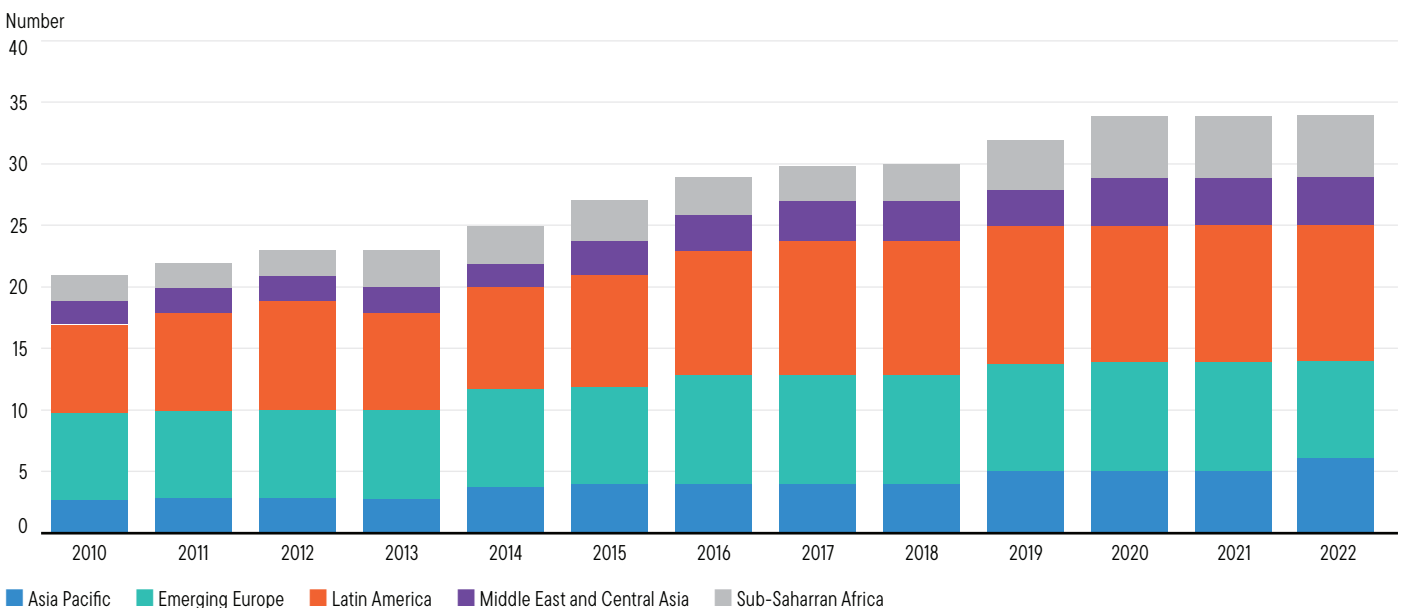
Source: Romelli, D. "The Political Economy of Reforms in Central Bank Design: Evidence from a New Dataset." *Economic Policy*, 37, 112, Oct. 2022.— The CBI index is based on 42 criteria of central bank institutional design across six dimensions: 1) Governor and central bank board, 2) Monetary policy and conflict resolution, 3) Objectives, 4) Limitations on lending to the government, 5) Financial independence and 6) Reporting and disclosure.

Inflation targeting was initially adopted by smaller open advanced economies, first by New Zealand in 1990, followed by Canada, the United Kingdom, Australia and Sweden between 1991 and 1993. Later, a range of both developed countries and EMs embraced it. Some EMs across various regions—including Central and Eastern European countries then in transition to a market economy, a number of Latin American countries and South Africa—adopted inflation targets in the late 1990s and early 2000s. The number of inflation targeters around the world, including EMs, has continued to increase since then.

Inflation targeting can lend credibility to policymakers. It is often seen as a complement to central bank independence as it presents an objective measure by which to assess whether the central bank is implementing appropriate monetary policy. The bulk of inflation-targeting EMs are in Latin America and the Europe, Middle East and Central Asia region.⁴ Other than South Africa, African countries have only recently started adopting inflation targeting. Exhibits 12 and 13 show the number of inflation-targeting countries in EMs, as well as the share of each region that adheres to inflation targeting as a policy.

Increasing Adoption of Inflation Targets by Emerging Markets

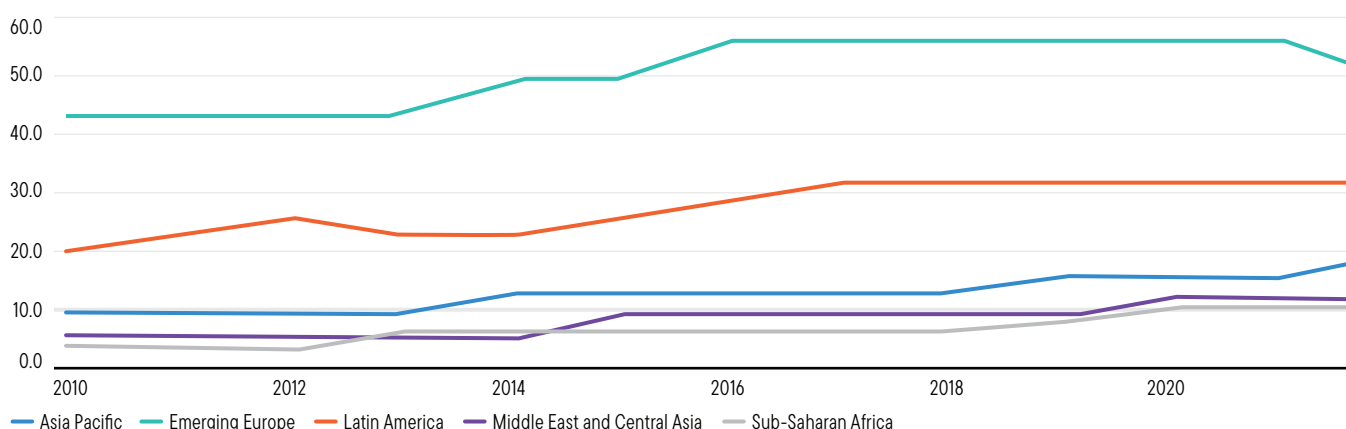
Exhibit 12: Number of Inflation Targeters by Region, 2010-2022



Source: International Monetary Fund. Note: the number of inflation targeters in Europe dropped as Ukraine abandoned its inflation target in 2022 due to the war.

Emerging Europe and Latin America Have the Highest Regional Shares of Inflation Targeters

Exhibit 13: Percent Share of Inflation Targeters by Region, 2010-2022



Source: International Monetary Fund. Note: the number of inflation targeters in Europe dropped as Ukraine abandoned its inflation target in 2022 due to the war.

Monetary policy transparency describes a situation where a central bank openly shares information about how it interprets its monetary policy mandate and the considerations and processes it follows to meet that. In tandem with the trend of more independent, inflation-targeting central banks, monetary policy transparency in EMs has improved over the years as well. This is an important factor as it reduces uncertainty among market participants and, often, will increase confidence in the central bank and its decision-making.

The fruits of these improvements are seen in more recent laudable monetary policy implementation in EMs, with a recent example being proactive monetary policy as inflation threats arose in 2021 after the COVID-19 pandemic. Exhibit 14 illustrates how emerging economies increased policy rates during the GFC (2007-2009) and, more recently and more sharply, when the pandemic-related inflation cycle began.

EM Monetary Policy Has Become More Proactive Over Time

Exhibit 14: Median Policy Rate by EM Region (Percent Per Annum), January 2000-December 2024



Source: International Monetary Fund.

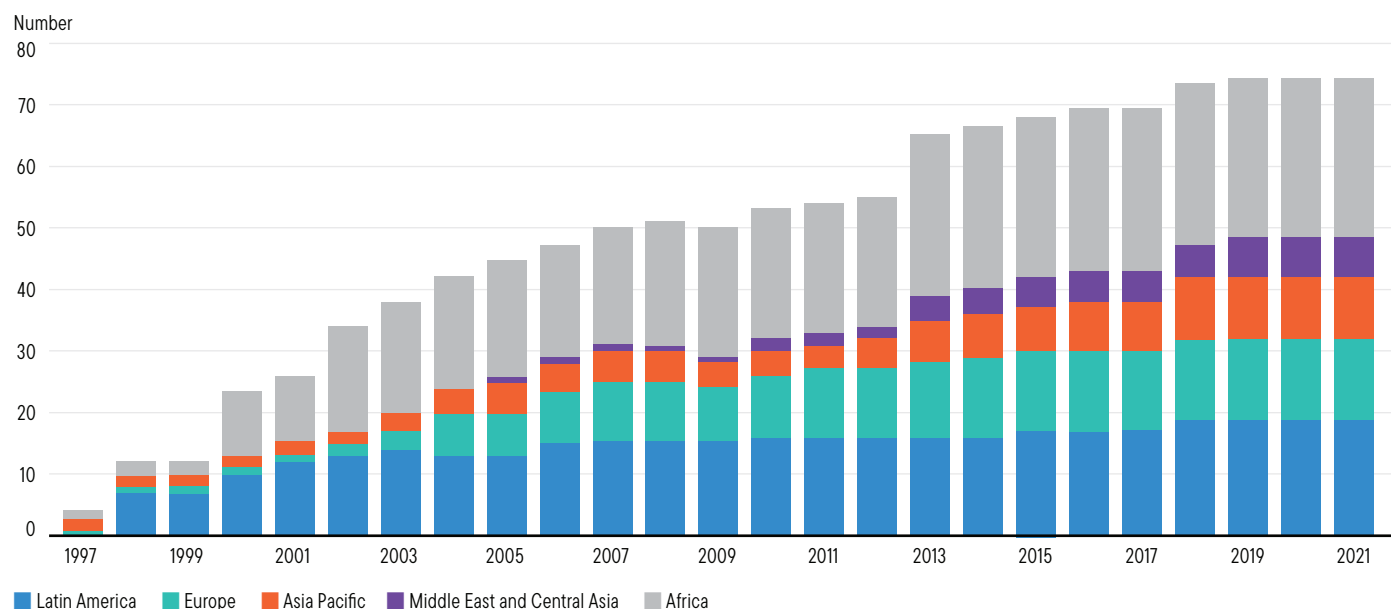
Fiscal policy

Historically, EMs faced various problems in managing their fiscal accounts, including excessive spending (leading to large budget deficits), high debt levels and the inflationary mechanism of central bank financing. As with monetary policy, fiscal policy management has generally improved over the years to a point where the fiscal situation is seldom a trigger for economic instability as it might have been in the past. In this section, we look at some reforms to fiscal institutional arrangements, including fiscal rules and fiscal councils, and describe their outcomes in terms of how they improved fiscal policy in EMs.

Fiscal rules are probably the most important tool for prudent fiscal management. A fiscal rule is a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates. Fiscal rules typically aim at correcting distorted incentives and containing pressures to overspend, particularly in buoyant economic times, in order to ensure fiscal responsibility and debt sustainability.⁵ Fiscal rules may prescribe one or more of the overall budget balance, government expenditure, government revenue and government debt. EMs started adopting fiscal rules in 1997 and by now, EMs from all regions have adopted fiscal rules, with the number increasing over time (Exhibit 15). Importantly, simply having a fiscal rule does not guarantee it will be adhered to, so other criteria need to be assessed as well.

EMs Have Increasingly Embraced Fiscal Rules

Exhibit 15: Number of Countries with at Least One Fiscal Rule, by EM Region (1997-2021)

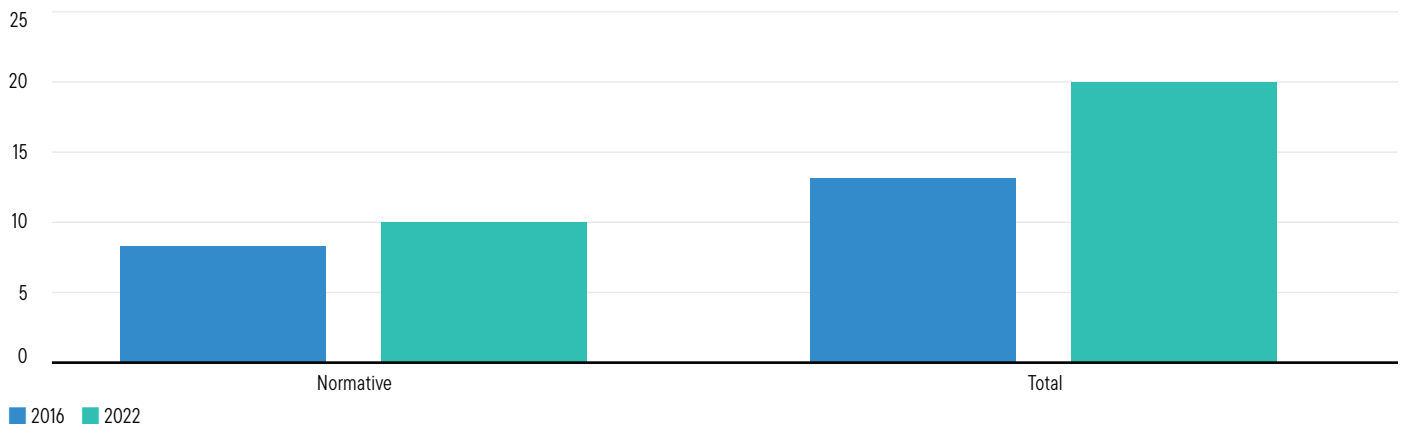


Source: International Monetary Fund.

Fiscal councils are another way for countries to signal that they have sound fiscal policy management, as fiscal councils usually provide analyses about the fiscal situation and can warn if it is deteriorating. Some fiscal councils engage in normative analysis, meaning that they can suggest an appropriate future fiscal path to the government (whereas other fiscal councils may simply report on what is happening). As with other signifiers of reforms, the number of countries with fiscal councils has been increasing, including those with normative fiscal councils (Exhibit 16). As with fiscal rules, we caveat that the mere existence of a fiscal council does not guarantee that politicians will heed their advice or analysis.

The Number of EM Fiscal Councils, Including Normative Ones, Has Also Been Rising

Exhibit 16: Total and Normative Fiscal Councils in EMs (Number), 2016 vs. 2022



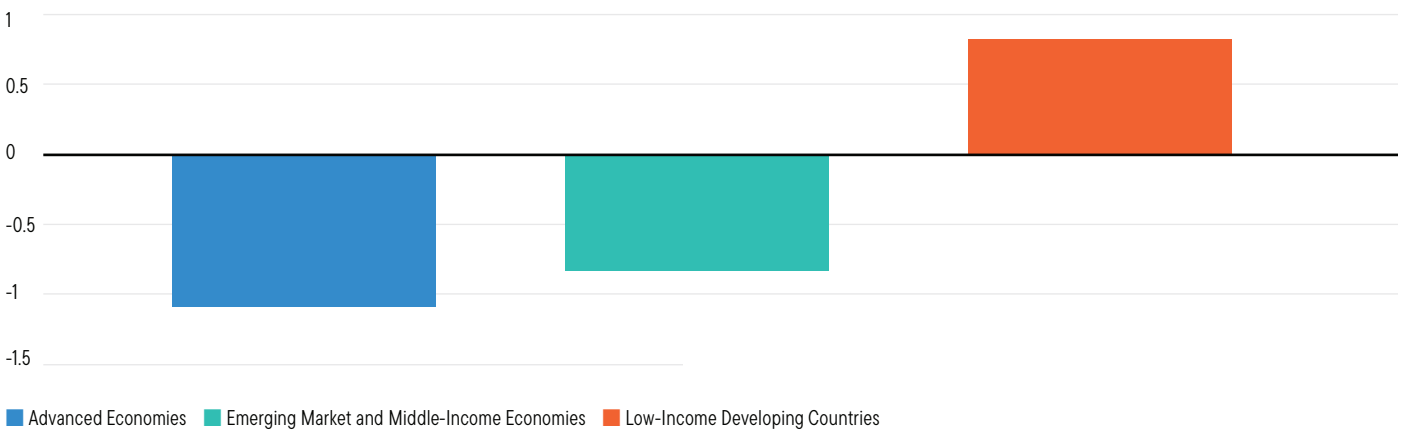
Source: International Monetary Fund.

Fiscal situations in many countries across the globe worsened following the COVID-19 pandemic, though this was more pronounced in advanced economies than in EMs—in other words, this was a situation where EMs outperformed advanced economies. Between 2019 and 2024, the average primary deficit was around 0.3% of GDP worse in advanced economies than in EMs, and fiscal slippage—when actual fiscal outcomes are worse than budgeted ones—was significantly larger in advanced economies than EMs after 2019 (the immediate COVID-19 fiscal response) (Exhibit 17). Moreover, EMs have since been more proactive in repairing their fiscal situation than advanced economies—between 2022 and 2024, the average primary deficit increased by 1.1% of GDP more in advanced economies than in EMs. Exhibit 18 shows the relatively rapid repair to primary balances in EMs, after both the GFC and the COVID-19 pandemic.

Fiscal Slippage Post-Pandemic Was Worse in Advanced Than Emerging Economies

Exhibit 17: Fiscal Slippage by Country Grouping (% of GDP), 2019-2024

Fiscal Slippage since 2019

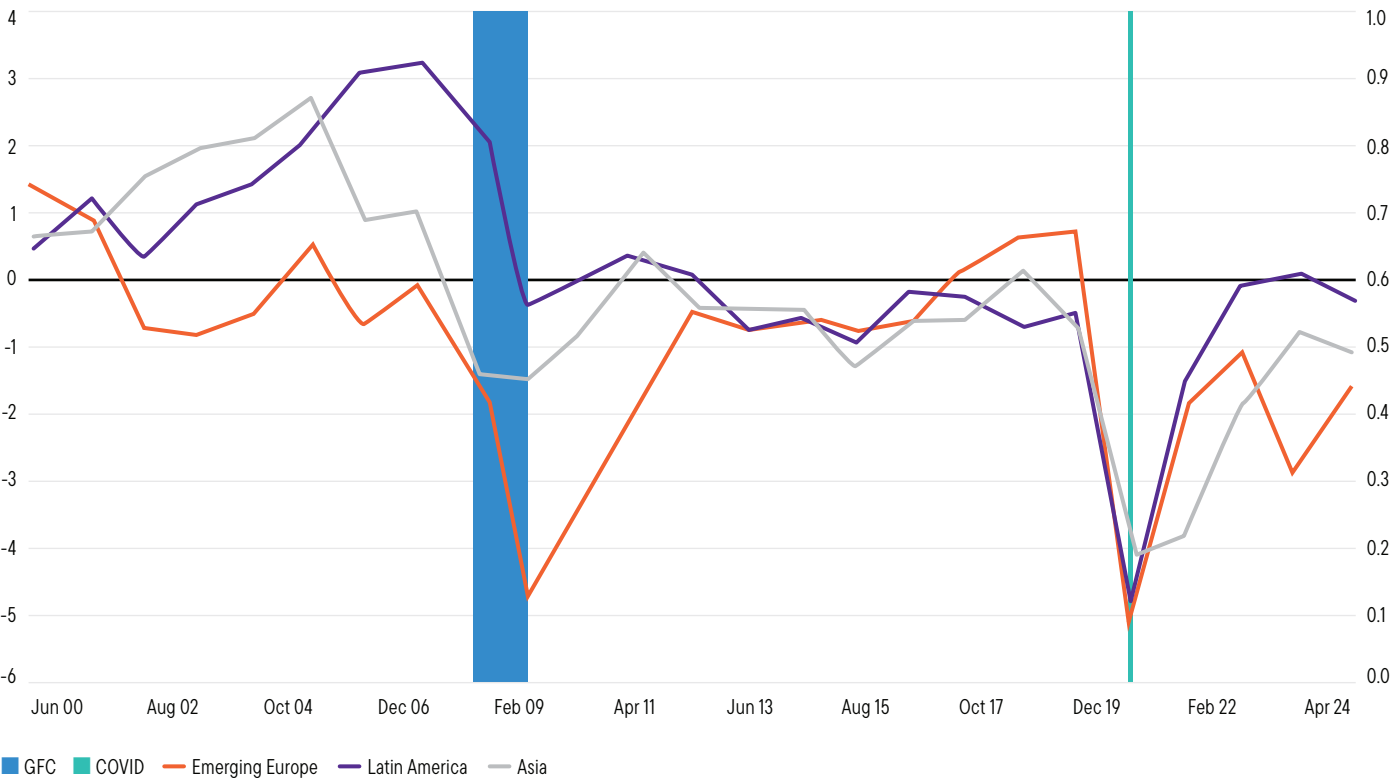


Source: International Monetary Fund. Fiscal slippage refers to actual fiscal outcomes being worse than budgeted outcomes.

Emerging Economies Generally Worked Hard to Quickly Repair their Primary Balances Post-Crises

Exhibit 18: Primary Balance by Country Grouping (Median % of GDP), June 2000-June 2024

Fiscal Years 2000-2023



Source: International Monetary Fund.

In discussing fiscal reforms, it is worth highlighting that no major EM has had a sovereign default since the 1990s. This indicates that in general, the lessons of past crises have been learned and implemented.

The evolution of funding in EMs

Current account financing

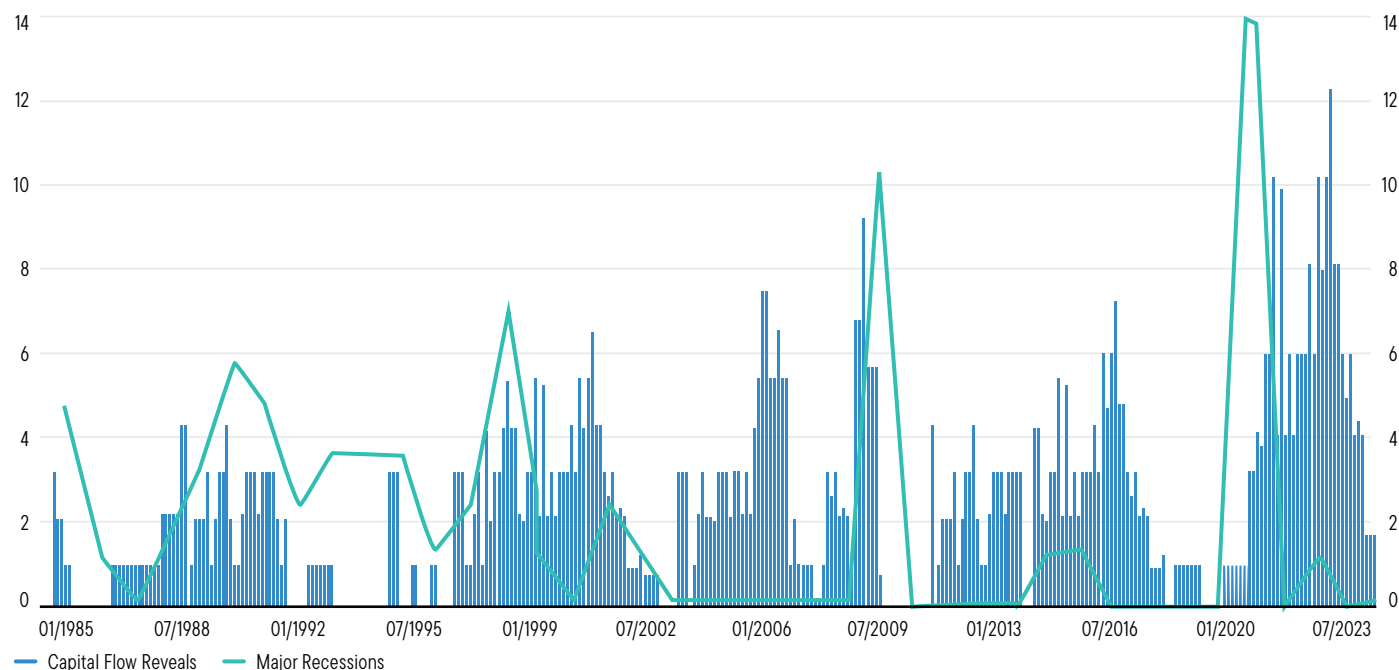
The history of external financing for EMs has been turbulent and marked by balance of payments crises. The Latin American crisis of the 1980s—when Latin American countries found themselves unable to repay their foreign debt—and its subsequent “Lost Decade” spurred reforms to try avoid a repeat. In earlier periods, rapid declines in capital inflows due to external shocks led to “systemic sudden stops.”⁶ These episodes were characterized by a sudden reversal of capital flows (represented by the current account deficit narrowing suddenly due to a loss of external financing and decline in international reserves) together with a significant output contraction (averaging 10% in one study).⁷ Recovery to pre-crisis output tended to be swift but without any significant recovery in domestic or external credit.

Governments used domestic and foreign capital markets to gain access to foreign currency to defend currency pegs. This made their fixed exchange-rate systems vulnerable if a government lost access to capital markets for any reason. After many EMs liberalized their financing systems following the 1980s crisis, balance of payments crises (the sudden stops) began to generally coincide with banking crises.⁸ This followed banks being allowed to extend credit more freely at market rates, in domestic and foreign currencies. The goal was to broaden domestic financial markets, but regulators were slow to prevent growing mismatches in domestic/foreign currency exposure, leading to banking crises, especially as the foreign exchange loans were often funded through short-term borrowing. In these situations, the banking crisis generally predated the balance of payments crisis, such as in the peso crisis (Mexico, 1994) and the Asian crisis (Indonesia, Malaysia, Philippines and Thailand, 1997), both of which were triggered by governments trying to defend fixed exchange rates. The balance of payments crisis then exacerbated the banking crisis, and the twin crises in turn worsened the impact on economic activity.

Compared to those episodes, we see fewer crises associated with capital flow reversals now, with a recent example being the experience of many EMs that experienced rapid reversals of capital flows during the COVID-19 shock and the aftermath of the Russian invasion of Ukraine.⁹ Except for the COVID-19 shock, those were not associated with sharp economic contractions typical of sudden stops. Exhibit 19 shows the frequency of capital flow reversals across the sample we cover; note the spikes beginning in 2020 and peaking in 2022. While the COVID-19 shock was associated with a sharp contraction in economic activity for most countries in the sample (and around the world) due to lockdowns, economic activity in 2021 and 2022 was generally increasing. In 2022, only two countries experienced economic contractions greater than 1%—Russia and Ukraine, resulting from the war rather than a typical sudden stop, and in 2023 and 2024 only one country, Argentina, which had been virtually excluded from capital markets for years before. Moreover, no EM experienced a banking crisis either during the pandemic or after, so there were no twin crises.

Despite the Large Capital Flow Reversals in the 2000s, EMs Did Not Experience the Same Kinds of Crisis as in Earlier Periods

Exhibit 19: Number of EMs Experiencing Capital Flow Reversals vs. Number of EMs Experiencing a Major Recession Each Year, January 1985–October 2024



Sources: International Monetary Fund and US Bureau of Labor Statistics. Analysis by Templeton Global Macro. Notes: Major recessions are defined as an annual GDP decline of over 4.4%. Capital flow reversals are defined in Box 2. Both are computed over a sample of 32 major EMs.

Box 2: Proxy capital flows methodology

We analyze a proxy for capital flows when we discuss these in the text.

We develop a proxy of monthly capital flows for 33 EM economies in a similar vein to Calvo, Izquierdo and Talvi (2006), covering the period from 1980 to September 2024. Monthly capital flows are proxied by the 12-month sum of the merchandise trade balance and the change in foreign exchange reserves over the period. All data is converted into real dollars by deflating it by the Consumer Price Index. A reversal of capital flows is identified in the data when there is a sudden drop in capital flows (either as a result of a sudden improvement in the trade balance or a drop in international reserves). The threshold for capital flow reversals is when capital inflows drop by more than two standard deviations from their mean (standard deviations and means are calculated over rolling four-year windows).

As in Calvo, Izquierdo and Talvi, a sudden stop occurs when there is a sudden drop in capital flows and a sharp output contraction. (We want to exclude episodes of sudden stops in capital inflows that may happen for “good reasons,” such as a sudden improvement in the terms of trade that reduces a country’s need to borrow from abroad.) Calvo et al use a 4.4% GDP decline as a threshold.

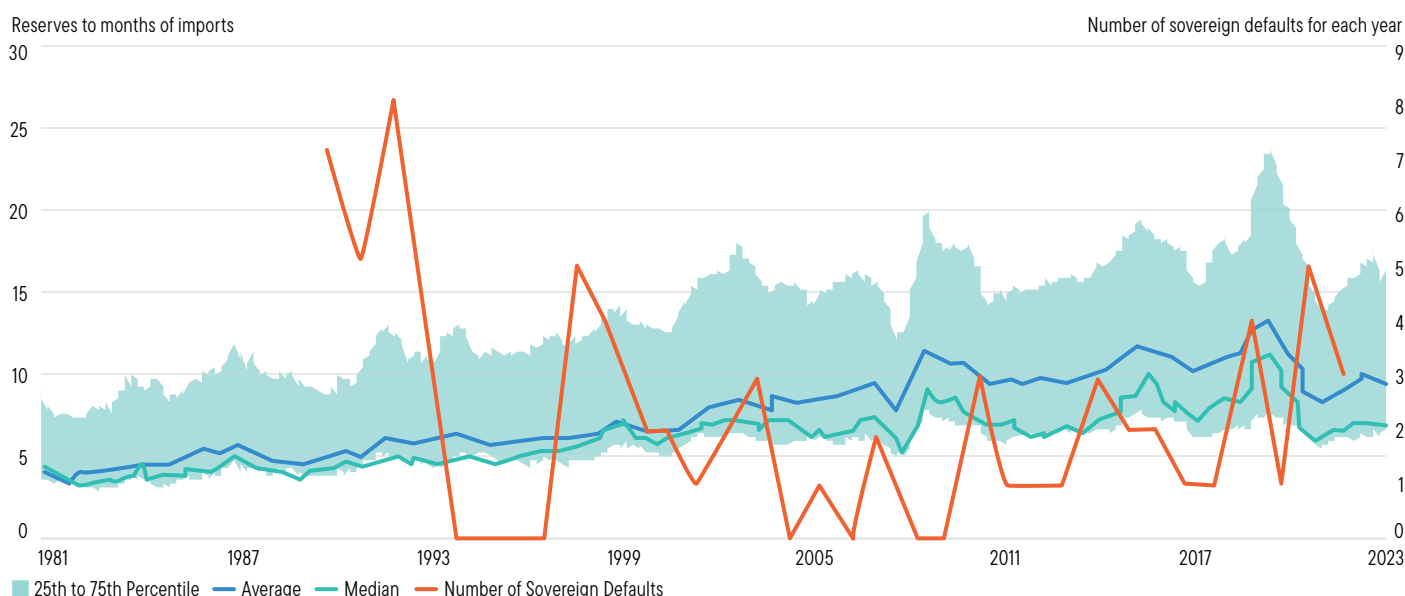
These findings illustrate that EMs now show greater resilience to external shocks than in the past. We examine here the reasons for this in terms of how EMs have improved management of their balance of payments.

EMs have adopted somewhat more flexible currency regimes. In 2002, Calvo and Reinhart described EMs as exhibiting a “fear of floating,” but they have since moved more toward more flexible regimes,¹⁰ even if most fall short of fully embracing completely floating regimes.¹¹ Consequently, reserves do not drop sharply as they used to when authorities were spending reserves defending currency pegs. More recently, improved macroeconomic policy management as discussed above has meant that many EM currencies are less subject to a large and persistent loss of value. One significant reason for this development is that EMs have built up foreign reserves to manage external shocks and smooth out large externally-induced shocks.

Exhibit 20 shows that since the 1980s, EMs accumulated reserves at a rapid pace. An often-used rule of thumb for reserves adequacy is that a country should have about three months’ worth of merchandise imports covered by reserves. Many EMs were not comfortably adequate in this regard in the early 1980s. For example, in 1982, average import cover was only 3.8 months, and the median only 3.3. Furthermore, 41% of the countries in our sample had reserves below the three-month import cover threshold in that year. However, by the 12-month period ending October 2024, average import cover was 9.6 months, the median was 7.0 months, and only one country had gross reserves below three months for part of the time. Exhibit 21 also illustrates how the pace of sovereign defaults has slowed over time as reserves adequacy has improved.

As Reserves Adequacy of EMs Compared to Imports Has Improved Significantly Since the Crisis Periods, Sovereign Defaults Have Slowed

Exhibit 20: Select EM Foreign Reserves Ratios to Imports (Months, Left Axis) vs. Number of Sovereign Defaults in EMs Per Year (Right Axis), January 1981–October 2024

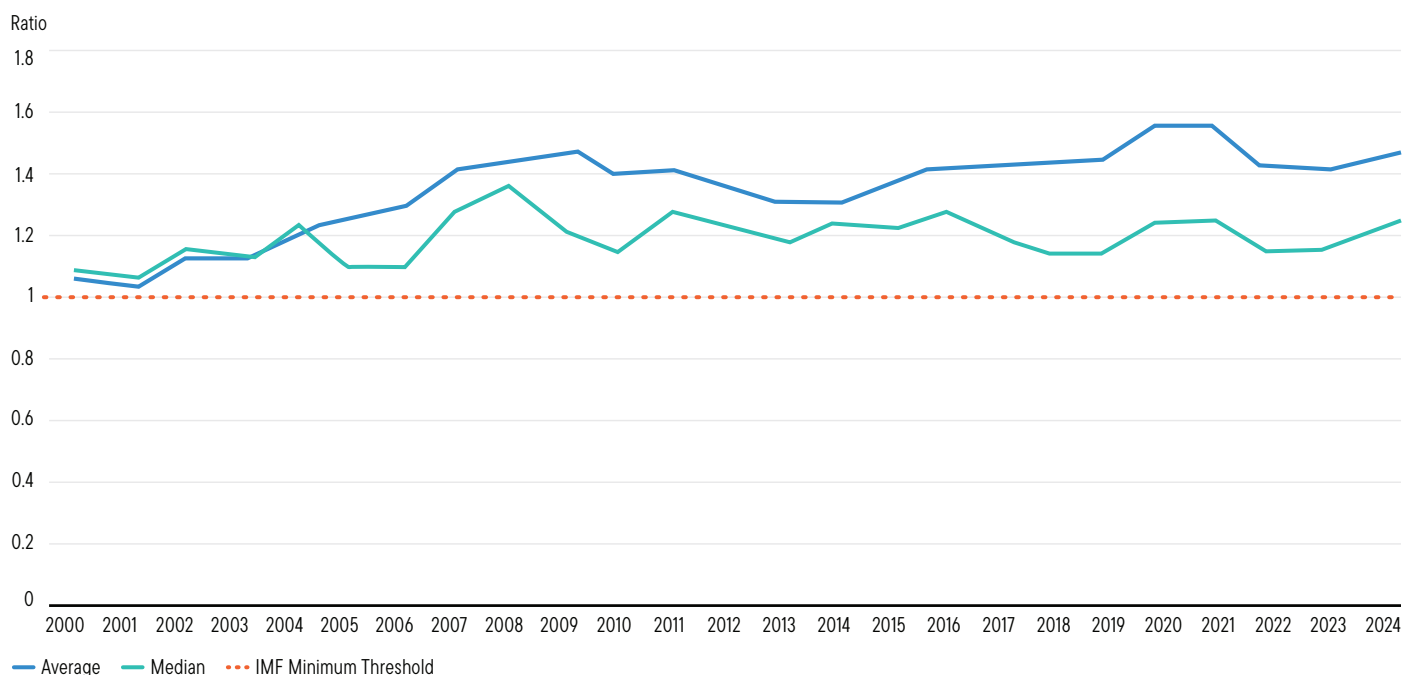


Source: International Monetary Fund and Christoph Trebesch. Analysis by Templeton Global Macro.

While this rule of thumb measure of reserves is often used, it is also simplistic because reserves might be needed to cover capital outflows as well as trade-related ones. The IMF has therefore developed a more comprehensive measure of reserves adequacy that also factors in a country’s short-term external debt needs as well as the overall monetary environment.¹² The composite index has a value of one for adequate reserves; the more reserves a country holds relative to this minimum threshold, the further above one the index will be. As with the data on import coverage of reserves, Exhibit 21 shows that EMs have significantly increased their reserve holdings, thus reducing vulnerability to external shocks.

A Broader Reserves Adequacy Measure Factoring in Debt and Other Considerations Has Also Improved Over Time

Exhibit 21: IMF Comprehensive Measure of Reserves Adequacy in Major Emerging Markets (IMF-Computed Reserves Ratio), 2000-2024



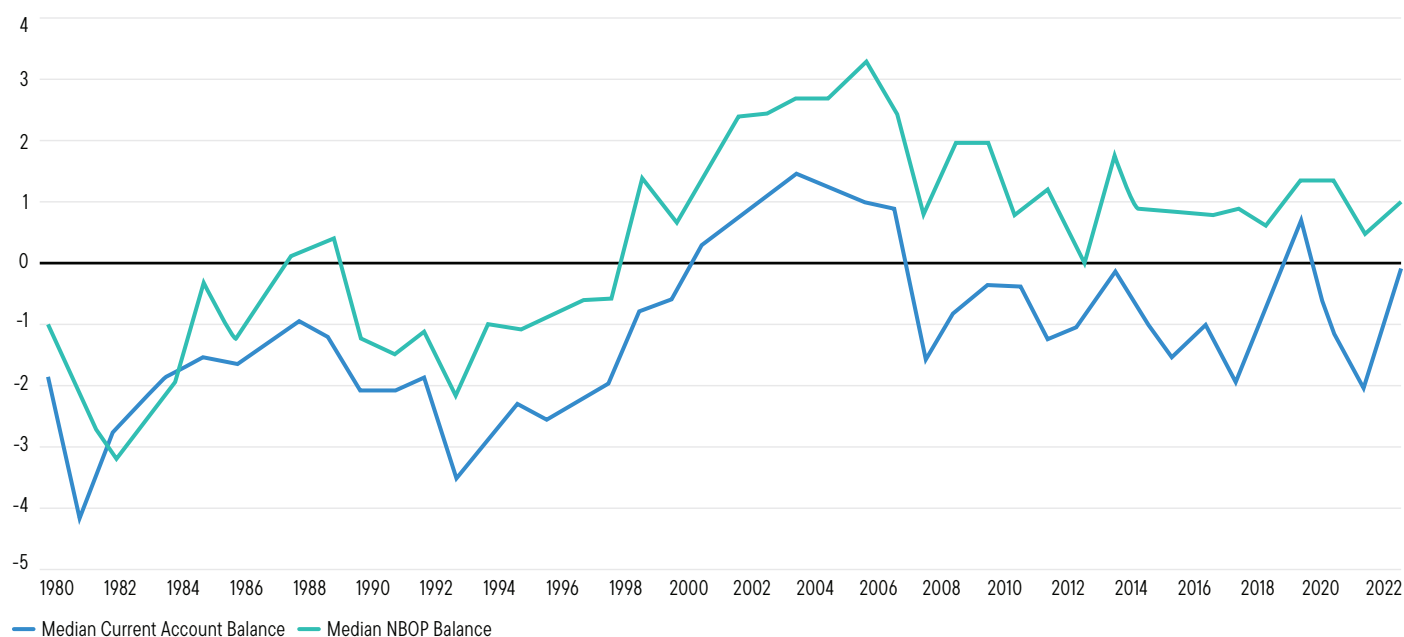
Source: International Monetary Fund.

EMs have also improved banking supervision to reduce banks' asset-liability duration and foreign exchange mismatches, two factors which had been leading causes of the interplay between banking and balance of payments issues in a twin crisis. This change has strengthened banks' resilience to foreign exchange shocks, leading to the reduction in the occurrence of twin crises.

Current account management has generally improved over time, with current account financing generally now relying more on persistent types of capital flows (mostly FDI) compared to "fast money" flows, such as portfolio investment, which can move rapidly in and out. The current account represents the amount of financing a country needs to pay for its deficits in trade and income balances. Exhibit 22 shows the average and median current account deficit over our sample of 33 EM economies. While most EMs experienced persistent current account deficits prior to the 1980s and 1990s, current accounts subsequently have tended to be closer to balance. Significantly, EMs are not only borrowing less on a net basis from the rest of the world, but the composition of financing is also changing. The "narrow balance of payments" (NBOP) shows the sum of the current account balance and the net FDI financing a country receives (inflows-outflows, also shown in Exhibit 22). A positive NBOP means that, net of FDI financing, a country is investing in (lending to) other countries. While EMs were largely recipients of fast money flows during the 1980s and 1990s, more recently they have become net lenders of these types of flows.

EM Balance of Payments Positions Have Generally Been in Surplus Since the Early 2000s

Exhibit 22: Current Account and Narrow Balance of Payments (% of GDP)



Sources: International Monetary Fund, World Bank. Note: Narrow Balance of Payments (NBOP) = Current Account Balance (% of GDP) + Net Foreign Direct Investment (FDI) Inflows (% of GDP).

There are still balance of payments concerns for EMs. They have to borrow to finance investment in their economies, and as debt burdens in certain countries have risen, so has the cost of servicing that debt. In particular, lower-income countries are paying more of their current account receipts to service external debts. Interest payments on external debt as a percentage of other current account components have risen across all country income groups since 2022. Since 2015, lower-income countries have been paying more relative interest on their external debt than middle-income countries. Total debt servicing relative to current account receipts has also risen, with the exception of least-developed and lower-income countries (Exhibit 23).

EM Debt Servicing Costs Have Been Rising Over the Past Decade

Exhibit 23: Total Debt Servicing (% of Exports of Goods, Services and Primary Income), 2005-2023



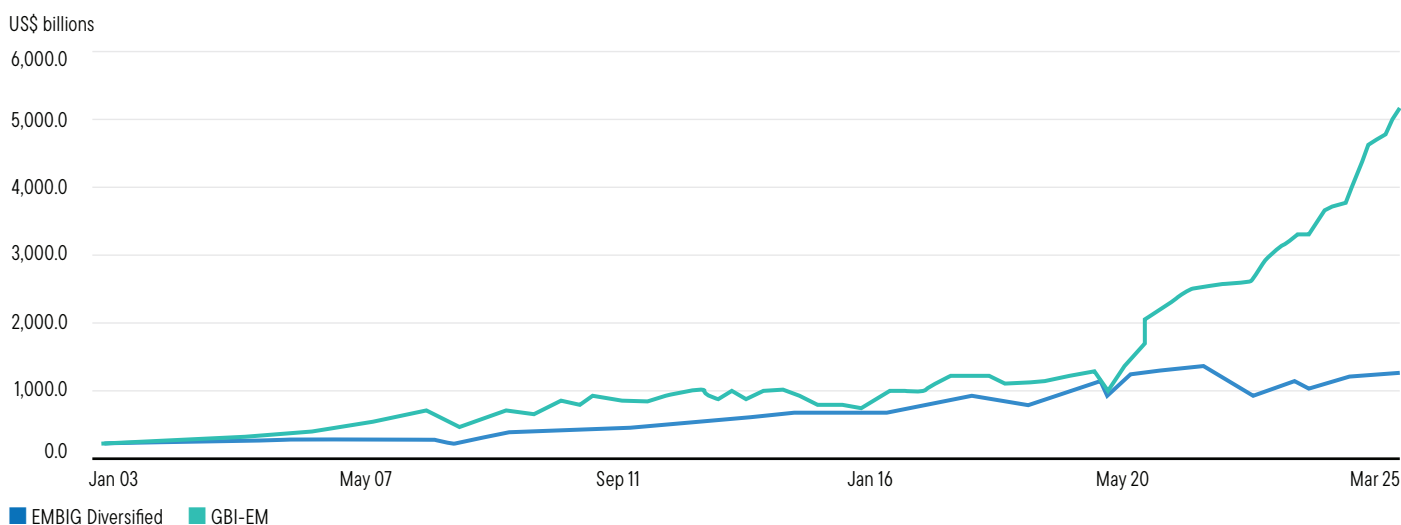
Source: World Bank.

Local markets development in EMs

Governments have become less reliant on foreign currency financing as local financial markets have deepened, enabling governments to increase the share of local currency financing. This means that if the exchange rate depreciates sharply, debt burdens do not surge due to the foreign exchange revaluation effect the way they used to in the past. Furthermore, if external financing dries up, they can rely on domestic sources of funding. Exhibit 24 shows how local currency debt issuance (financing of government) has increased over time, significantly outpacing that of hard-currency denominated debt. For most large EMs, local currency issuance has been rising over time and is now more than 50% of total debt outstanding (Exhibit 25). This is another layer of protection against externally-induced crises.

EM Local Currency Sovereign Debt Issuance Has Greatly Outpaced External Debt in Recent Years

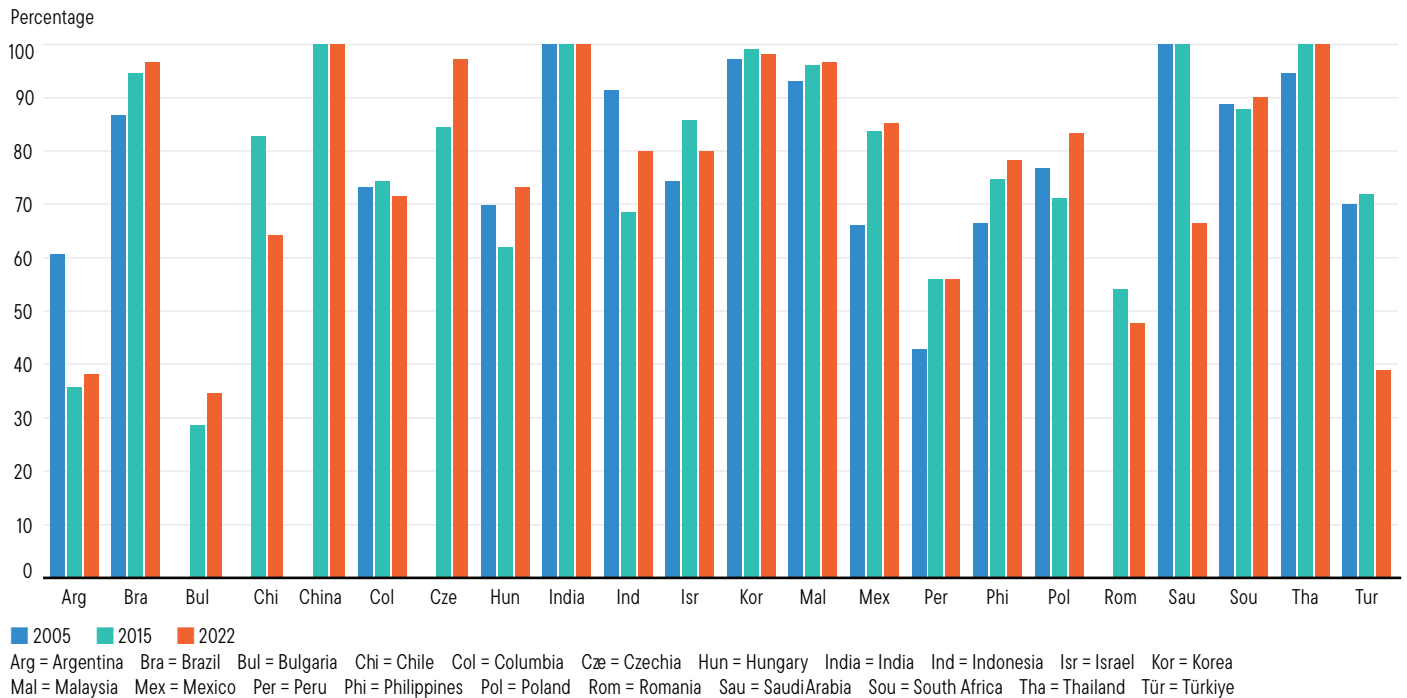
Exhibit 24: EM Bond Indexes Market Value: Local Currency (GBI-EM) vs. Hard Currency (EMBIG Div), January 2003-March 2025



Source: JP Morgan. As of April 28, 2025.

EM Local Currency Issuance Accounts for an Increasingly Large Share of Government Debt

Exhibit 25: Local Currency Share of Government Debt (Percent of Total), Select EM, 2005, 2015 and 2022



Source: Bank for International Settlements.

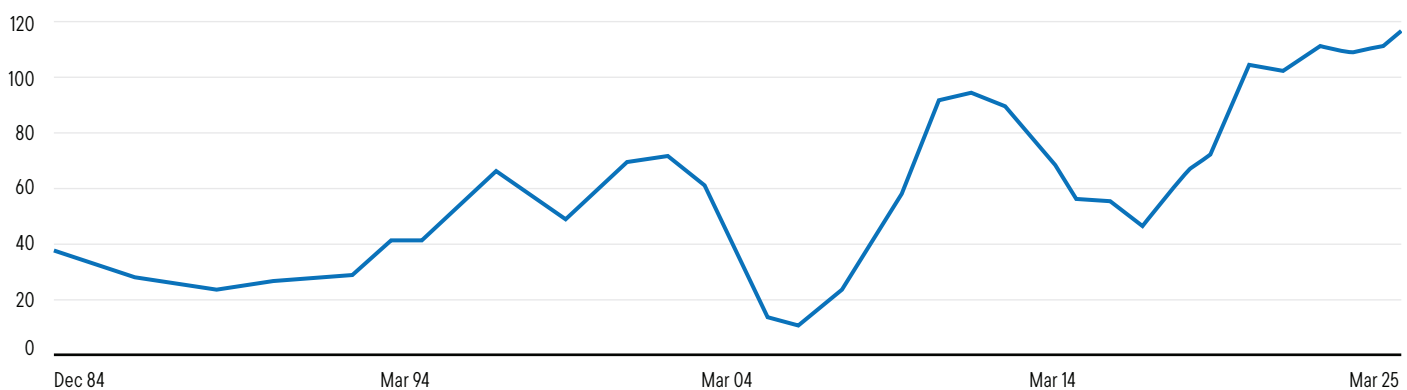
The role of international financial institutions in financing

Many lower-middle-income and lower-income countries still do not have ready access to international capital markets, particularly during times of distress. However, crises in these countries have been mitigated by increased funding from international financing institutions. There is a risk to these countries if such funding decreases substantially, as may be the case under the new presidential administration in the United States.

The volume of funding by IFIs across institutions, including the International Monetary Fund (IMF), International Bank for Reconstruction and Development and International Development Association has increased over time (Exhibit 26 shows IMF disbursements). This increase can be associated with policy reforms being undertaken by EMs, as such reforms are often a prerequisite for funding packages. In addition, certain IMF packages can be seen as recognition of such progress—for example, Colombia qualified for an IMF flexible credit facility because of strong economic fundamentals and its policy track record. Despite the increase in IMF funding over time, the institution still has significant capacity for further financing.

International Financial Institutions Have Increased EM Funding Over Time

Exhibit 26: Total IMF Credit Extended (Special Drawing Rights, in Trillions), Year-Ends 1984-2024



Source: International Monetary Fund. As of April 2025.

Structural reforms have supported growth

In addition to the fundamental monetary and fiscal reforms described above that provide a strong macro foundation, a number of EMs have implemented various other policies to strengthen their economies, often targeted to specific idiosyncratic factors and specifically targeted at trade and/or attracting FDI. In most cases, it is a “package” of reforms rather than any single one that has supported growth. We discuss some case studies below in terms of how reforms and policies have benefited the structural growth outlook.

Case studies: Policies and reforms have supported growth and reduced vulnerability

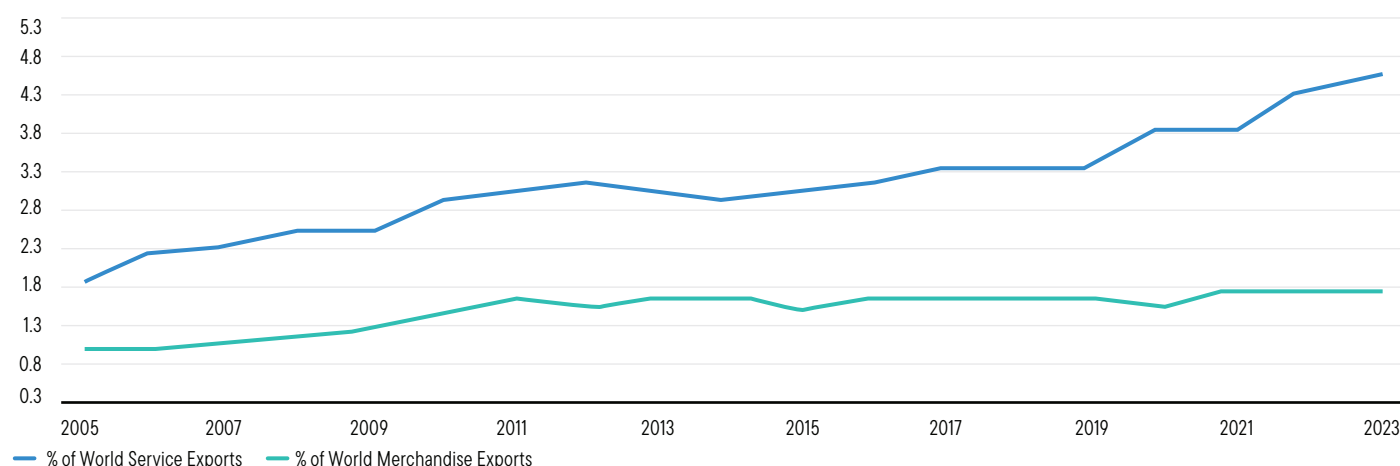
India—reforms supporting a robust growth story

India has become the new engine of global growth with its youthful demographics, improving physical and digital infrastructure and, especially, an enabling policy environment. Policy has focused on strengthening macroeconomic fundamentals and continued structural reforms; these have combined to see India stand out globally in terms of growth outcomes. Real GDP growth has averaged over 6% since 2000 and continues to grow around these rates. Various structural reforms covering fiscal reforms, banking sector reforms, liberalization of foreign direct investment and initiatives such as “*Make in India*” have been pivotal in driving growth. Additionally, emphasis on digitalization and innovation led to a rise in startups and expanded the digital economy, with initiatives like “*Digital India*” enhancing technology access. Furthermore, the focus on renewable energy underscores India's commitment to sustainable development.¹³

Policy initiatives to attract investment encompass both the manufacturing and services sectors. In the manufacturing sector, the “*Make in India*” initiative has significantly reshaped the manufacturing landscape. Outcomes include enhancing domestic production capacity, attracting investment and boosting India's export competitiveness across multiple sectors, including electronics, telecoms, pharmaceuticals and automobiles. The focus on high-value manufacturing sectors has both created jobs and positioned India as a dependable player in the global supply chain. In the technology and services sector, gradual liberalization helped develop ICT infrastructure and incentivized higher internet penetration. Modern market services (IT and IT-enabled services, financial services and other business services) have grown by almost 13% annually in real terms since 2000. These services have largely been exported. Exhibit 27 illustrates India's consequent increasing penetration into global exports, especially in services.

Structural Improvements Have Boosted India's Role in World Trade

Exhibit 27: India's Share of World Exports in Goods and Services, % of Total, 2005-2023



Source: The Economic Survey 2023-24. Indian Ministry of Finance, Indian Ministry of Commerce and Industry.

The focus on the manufacturing and services sectors enabled India's FDI inflows to increase approximately 20-fold between 2000-2001 and 2023-2024. We can also ascribe the increase in FDI to government efforts to improve the ease of doing business and easing of FDI regulations. India was the third-largest recipient of greenfield projects globally, with 1,008 greenfield project announcements (World Investment Report 2023). The number of international project finance deals in India also increased by 64%, making it the recipient of the second-largest number of international project finance deals.

Malaysia—policies lead to a strong value proposition in the global supply chain

Since gaining independence in 1957, Malaysia has undergone a profound economic transformation from a predominantly agricultural- and commodity-based economy to one with robust manufacturing and services sectors. This evolution has positioned Malaysia as a leading exporter of electrical appliances, parts and components, driving remarkable growth that elevated the nation from low-income to upper-middle-income status within a single generation. These achievements can be attributed to strategic development policies focusing on outward-oriented, labor-intensive growth, investment in human capital and credible economic governance to ensure macroeconomic stability. A number of advantages have contributed to Malaysia's success, including a strong focus on education, a multicultural workforce, low productivity-adjusted manufacturing costs (10% to 15% lower than China), and mature infrastructure, including over 140,000km of road network connecting Thailand in the north and Singapore in the south. In addition, Malaysia has signed and implemented various bilateral and regional free trade agreements (FTAs), as well as wider trade partnerships. In all, these have resulted in Malaysia being strongly integrated into the global trade network. Malaysia has fostered a vibrant and competitive business environment that contributes to industry diversification and helps shield the nation from dependence on external factors and shifting geopolitical pressures.

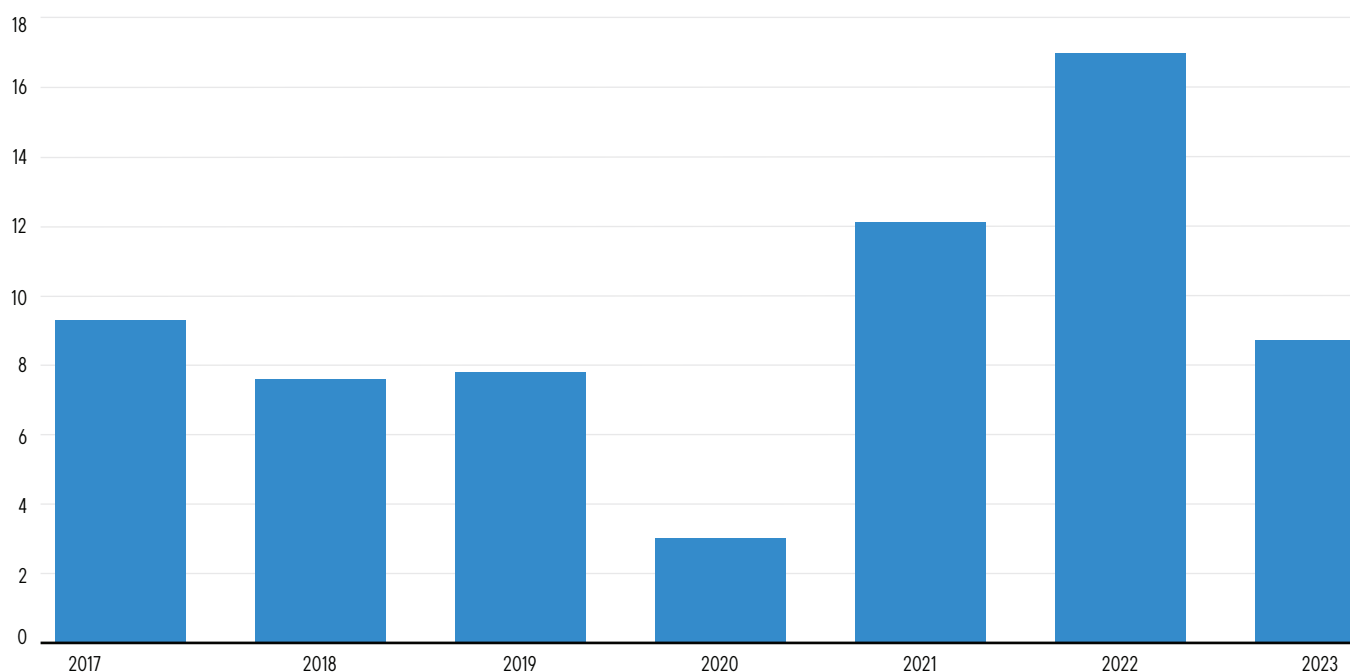
Importantly, Malaysia has been proactive regarding investment regulation. FDI inflows have stepped up compared to the pre-pandemic period and should remain well supported, given the surge in investment approvals. There are a number of recent initiatives that could further strengthen Malaysia's appeal as an investment destination, including the New Industrial Master Plan 2030, aimed at doubling the shares of both production and exports of high-tech manufacturing and services, the National Semiconductor Strategy, aimed at drawing in RM500 billion in semiconductor investments (including domestic investments), and the proposed Johor-Singapore Special Economic Zone (SEZ) between Malaysia and Singapore, which could encompass a land mass almost twice the size of Shenzhen, aimed at catalyzing investments into priority sectors such as electronics, life sciences, advanced manufacturing and digital economy.

Malaysia has a long history and a deep ecosystem to draw on. The semiconductor industry is a striking early example of Malaysia positioning itself to take advantage of global trends. During Malaysia's first economic takeoff in the 1970s, the government had the foresight to introduce incentives that attracted specific steps in the semiconductor value chain. Intel opened its first plant in Penang in 1972 and by the early 1980s there were 14 semiconductor firms operating in Malaysia. Semiconductor industry players looked toward Malaysia when it became necessary to relocate other steps in the value chain, placing Malaysia in an excellent position to benefit from the growth of the semiconductor industry and reshoring. Currently, Malaysia accounts for 13% of the global market for packaging, assembly and testing services for semiconductors, and it is the world's sixth-largest exporter of semiconductors. The semiconductor industry accounts for an estimated 25% of Malaysia's GDP.

All these factors have helped support FDI inflows into Malaysia (Exhibit 28).

Malaysia's Reforms Have Helped Boost Investment Inflows

Exhibit 28: FDI Inflows into Malaysia, US\$ Billions, 2017-2023



Source: United Nations Conference on Trade and Development.

Importantly in the current global context, Malaysia has maintained geopolitical balance. Tensions between the United States and China resulting in economic and technological decoupling are motivating a search for middle-ground alternatives. In that context, Malaysia has put forth a compelling proposition for countries seeking a “neutral and non-aligned location.” Moreover, Malaysia has maintained strong trade linkages with both China and the United States, allowing it to absorb the large benefit of Chinese greenfield supply chain reshuffling in Southeast Asia on one hand, while continuing to be a preferred destination for tech sector diversification for the West on the other.

Eastern Europe—deeper ties with Europe promote energy security and trade integration

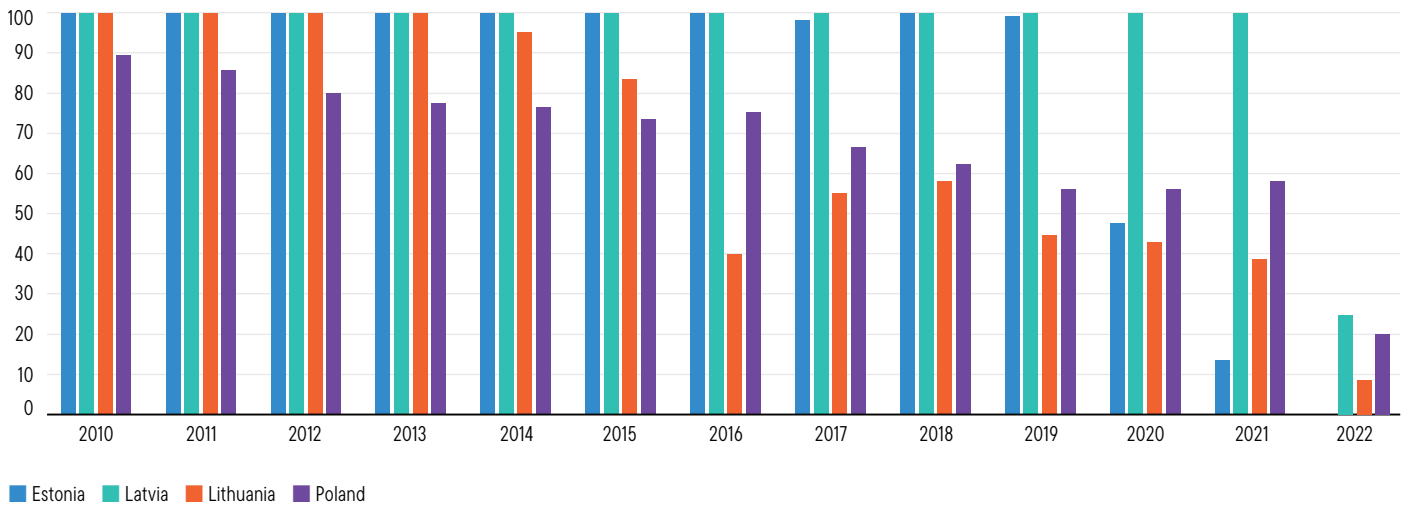
Energy security in Eastern Europe

Geopolitical events have made European countries (in particular, those in the East) leery of their prior reliance on energy from Russia. Several Eastern European states have now achieved independence from Russian gas through a series of pipeline projects that interconnects them to the European gas grid, production facilities in the North Sea, or storage facilities in neighboring countries. These projects, dating back as far as the 2000s, were undertaken with the long-term goal of securing and diversifying the countries’ energy supply away from Russia.

Poland started construction work on the Baltic Pipe project as a joint venture with a Danish oil and gas company in 2001. The project was suspended, then later revived in 2007. It eventually became operational in 2022. Baltic Pipe can carry about half of annual total Polish natural gas demand from Norway to Poland. In addition, the Gas Interconnection Poland-Lithuania, dating back as far as 2008, was finally brought into operation in 2022. In 2014, Lithuania built a liquefied natural gas (LNG) floating storage and regasification unit terminal in the seaport of Klaipeda. The terminal has a maximum supply capacity of more than twice annual demand, as well as a storage unit. In addition, Lithuania has access to an underground storage facility in neighboring Latvia, which has the capacity of almost three times Latvia’s annual gas demand. Estonia and Finland began construction on the Baltic connector gas pipeline in 2018 and started operations in 2020. This pipeline also has access to the Latvian storage facility. Exhibit 29 illustrates how successful these countries have been at reducing their reliance on Russia.

Eastern Europe Has Moved Away From Reliance on Russian Energy Imports

Exhibit 29: CEE Import Share of Russian Gas, %, 2010-2022



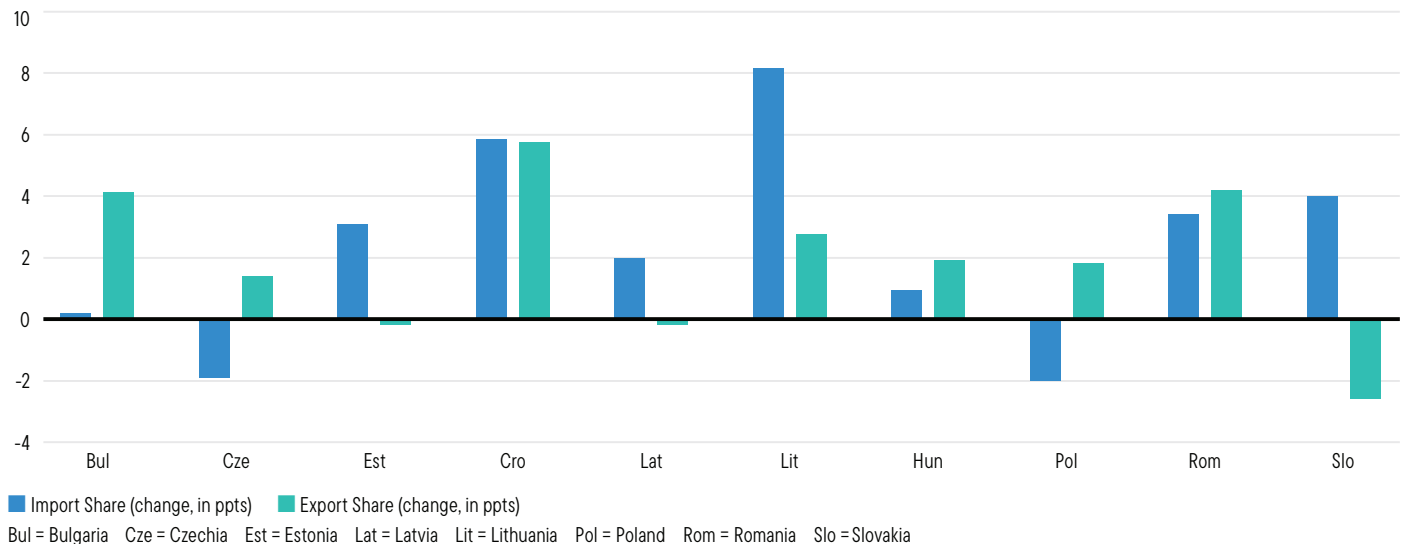
Source: Eurostat.

Trade integration of Eastern Europe

Following EU accession and the process preceding it, Eastern European countries generally deepened their ties with other EU member countries. With very few exceptions, the shares of imports from and exports to other EU member states have risen over the past 20 years (Exhibit 30).

Eastern Europe's Trade in Goods Has Benefited From EU Membership

Exhibit 30: Change in Countries' Average Trade Shares, Percentage, (2020-2023 Average Relative to 2002-2019 Average)



Source: Eurostat.

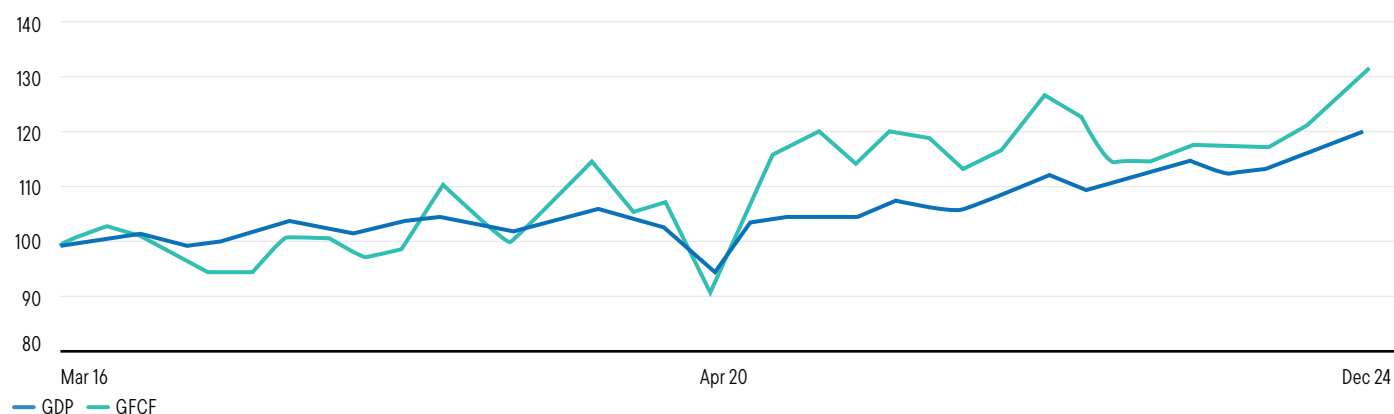
In tandem with deepening ties with the EU, trade relationships have become increasingly diversified over time. HH Index methodology (see Box 1) to quantify market concentration reveals that most Eastern European countries have reduced their degree of export and import concentration, thereby broadening their supplier as well as their customer bases. Delving into the categories of traded products shows that several countries, including the Czech Republic, Hungary, Poland, Romania and the three Baltic countries have significantly increased their imports of mineral fuels, lubricants and related materials, reflecting their integration into the European gas and electricity market and its grid infrastructure. On the exports side, developments show a larger degree of differentiation. Countries have variously significantly increased their exports into the EU of chemicals (Bulgaria, Estonia, Croatia, Hungary, Romania), food (Croatia) and machinery and transport equipment (Lithuania, Hungary, Romania).

Brazil

Brazil's growth has been outperforming recently, with real fixed investment growth outpacing overall GDP growth since the pandemic shock (Exhibit 31).

Growth and Investment Have Been on an Upward Trend in Brazil

Exhibit 31: GDP and Gross Fixed Capital Formation, Index (2016 = 100), Q1 2016–Q4 2024



Source: Brazil Institute of Geography and Statistics (IBGE).

This growth outperformance may be seen as the result of a cumulative reform process. Among the wide-ranging measures were a reduction of labor-market rigidities, pension reform, sanitation reform to foster investment into that sector, and fiscal reform (VAT reform). In addition, the central bank (Banco Central do Brasil, or BCB) gained formal independence in 2021. It has implemented various reforms and financial innovations since 2018, including expanding support for a fintech ecosystem to develop, introducing the “pix” electronic payments system to facilitate transactions, and pursuing Open Finance, an environment that enables the sharing of data, products and services between regulated entities at the (individual or legal entity) customer's discretion as far as their own data is concerned. By early 2024, the system had over 42 million consents. The expansion of this system has, according to local banking association Febraban, made Open Finance in Brazil the largest in the world.

Risks

While EMs have worked hard to place themselves in a good position globally, they remain subject to a number of risks, some of which they have agency over but some of which are out of their control. These include:

- A non-negligible risk of a trade war around the imposition of US tariffs on various countries and their expected retaliation. An escalation in trade wars would, in our view, likely lead to a global slowdown. EM exports in general are less dependent on any one country than they had been in the past, but they are more exposed to trade overall, so a deceleration in global growth would affect EM. China and the United States remain the top export destinations, even where countries have diversified.
- A trade war could also lead to supply chain disruptions, potentially increasing global inflation and inflation expectations as well as having idiosyncratic production and export effects in particular EMs.
- As we have noted, although macro policy management has improved, debt ratios are generally higher than before the pandemic, so there is less fiscal room to deal with adverse events.
- The countries that relied on external reserves to fund needs during the COVID-19 and Russia/Ukraine war shocks may not yet have had the time to replenish those buffers. Reserve levels are better than two decades ago, but they are not as strong as they were in 2019. There may thus be somewhat more external vulnerability than before the pandemic.
- This vulnerability is also revealed in the rising share of debt servicing as a share of export earnings.
- The countries that relied on domestic funding sources have used up some of these savings as well and have not yet been able to fully replenish those (such as the usage of pension fund withdrawals in Chile and Peru).
- Many smaller EMs and frontier countries still rely on IFIs for funding. However, if there is a US funding pullback (such as a reduction in USAID flows) that is not meaningfully filled in by others (such as the BRICS Bank), some frontier economies may face funding issues if the global economy decelerates. That said, bilateral lending may take a more active role if state actors increasingly try to incentivize countries to join their geopolitical “team.”

Conclusion

In sum, EMs have taken on board the lessons learned from past crises and implemented monetary, fiscal and other policy reforms that have greatly stabilized their macro environments. In addition, a variety of pro-growth and efficiency reforms in various EMs appropriate to their individual circumstances has made them attractive to global companies looking to expand or move their supply chains, thereby placing them in a position to benefit from global reshoring trends. Current risks to the outlook mainly stem from the possible effect of tariffs and a potential trade war—an evolving situation as at the time of writing. However, we also believe that a higher global tariff regime would underpin the shift already underway toward regionalization, which would benefit a number of EMs, as would diversification of import sources away from the United States.

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Endnotes

1. The HH Index explains a given country's dependence on its trading partners by summing up the squared shares of each bilateral trade partner.
2. The Association of Southeast Asian Nations (ASEAN) comprises 10 countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.
3. Source: Romelli, D. "The Political Economy of Reforms in Central Bank Design: Evidence from a New Dataset." *Economic Policy*, 37, 112, Oct. 2022.— The CBI index is based on 42 criteria of central bank institutional design across six dimensions: 1) Governor and central bank board, 2) Monetary policy and conflict resolution, 3) Objectives, 4) Limitations on lending to the government, 5) Financial independence and 6) Reporting and disclosure.
4. Source: Jahan, Sarwat. "Inflation Targeting: Holding the Line." *Finance & Development*, International Monetary Fund.
5. Source: Fiscal Rules Dataset 1985–2021. International Monetary Fund. January, 2022.
6. Sources: Calvo Guillermo A., Alejandro Izquierdo and Ernesto Talvi. "Phoenix Miracles in Emerging Markets: Recovering without Credit from Systemic Financial Crises." National Bureau of Economic Research, Working Paper 12101. March 2006. Calvo, Guillermo A., Alejandro Izquierdo and Fernando Mejia. "Systemic Sudden Stops: The relevance of Balance Sheet Effects and Financial Integration." National Bureau of Economic Research, Working Paper 14026. May 2008.
7. Source: Calvo Guillermo A., Alejandro Izquierdo and Ernesto Talvi. "Phoenix Miracles in Emerging Markets: Recovering without Credit from Systemic Financial Crises." National Bureau of Economic Research, Working Paper 12101. March 2006.
8. Source: Kaminsky, Graciela L., and Reinhart, Carmen M. "The Twin Crises: The Causes of Banking and Balance-of-Payments Problems." *American Economic Review*. June 1999.
9. See "Proxy capital flows methodology" section.
10. Source: Obstfeld, Maurice "Exchange rate regimes can give nations varying levels of autonomy over monetary policy." Petersen Institute for International Economics. August 20, 2020.
11. Source: Ilzetzi, Ethan, Carmen M. Reinhart, and Kenneth S. Rogoff. "Exchange Arrangements Entering the 21st Century: Which Anchor Will Hold?" *Quarterly Journal of Economics*. 2019.
12. Source: "Assessing Reserve Adequacy." International Monetary Fund. April 2025.
13. Also see Global Macro Shifts Issue 15, "India: Unlocking the potential," for an in-depth analysis of India.

Notes

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Active management does not ensure gains or protect against market declines.

Equity securities are subject to price fluctuation and possible loss of principal.

Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls.

International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**. The government's participation in the economy is still high and, therefore, investments in **China** will be subject to larger regulatory risk levels compared to many other countries.

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