HIGHLIGHTS from Chapter 3

From Tailwinds to Headwinds: Emerging and Developing Economies in the Twenty-First Century

Key Points

- *The 21st century has been transformative for emerging market and developing economies (EMDEs). These economies now account for nearly half of global GDP, powered by trade and financial integration. Interdependence among EMDEs has also increased significantly, fostering substantial growth spillovers from the three largest EMDEs—China, India, and Brazil—and the emergence of an EMDE business cycle.*
- *Yet EMDEs now face serious challenges in the form of weakening growth prospects, rising trade tensions and geopolitical fragmentation, increasing effects of climate change, growing debt burdens, and stalled progress on structural reforms.*
- *To accelerate growth and development, EMDEs should prioritize three policy areas: boosting investment and productivity, navigating a difficult external environment, and enhancing macroeconomic stability.*

The role of EMDEs in the global economy has expanded substantially. These economies now account for about 45 percent of global GDP, up from 25 percent in 2000 (figure 1.A). They contributed an average of 60 percent of annual global GDP growth during 2000–24, driven by robust collective growth in the EM3—China, India, and Brazil. About 35 percent of global trade was attributable to EMDEs in 2023, versus about 20 percent in 2000, while EMDEs received about 20 of global capital inflows in 2019–23, compared to 6 percent in 2000–04. Increasingly, they are trading with each other: nearly half of goods exports from EMDEs now go to their peers, compared to one-quarter in 2000. Rising integration has fostered sizable growth spillovers from the EM3 and the emergence of an EMDE business cycle. A 1-percentage-point increase in EM3 output growth is associated with a cumulative 1.9 percent output expansion in other EMDEs after three years (figure 1.B).

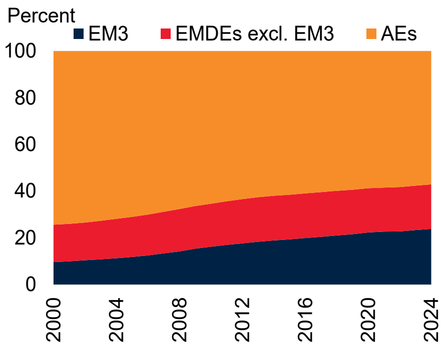
EMDEs face serious headwinds. Despite their growing global influence, EMDEs face a host of challenges. Globally, trade tensions and geopolitical fragmentation have risen sharply, while the number of new trade agreements has declined over time (figure 1.C). Climate-related disasters have become more frequent and costly. Debt burdens in EMDEs have climbed, while progress in implementing structural reforms has stalled. EMDEs' potential growth—the maximum rate at which they can grow without igniting inflation—is projected to slide to 4.1 percent per year in the 2020s, compared to 5.3 percent in the 2010s and 5.9 percent in the 2000s (figure 1.D).

EMDEs should prioritize three fundamental and equally important policy objectives to accelerate growth and development. They need to boost sluggish investment and productivity growth by improving institutional quality, fostering human capital development, and advancing the digital transformation. EMDEs need to mitigate the adverse effects of protectionist policies elsewhere while also seeking opportunities for cross-border cooperation. This includes pursuing strategic trade and investment agreements, reducing trade costs, and diversifying their exports. Finally, EMDEs need to strengthen macroeconomic frameworks to build buffers against adverse domestic and external shocks.

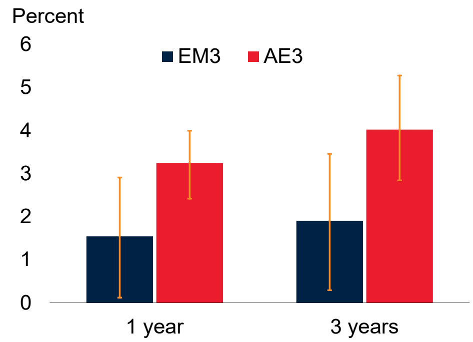
Figure 1. EMDEs in the 21st Century

Emerging market and developing economies (EMDEs) accounted for close to half of global GDP in 2024, up from one-quarter in 2000, powered by rapid trade and financial integration and robust collective growth in the three largest EMDEs—China, India, and Brazil (the EM3). Cross-border business cycle spillovers from the EM3 to other EMDEs are sizable, at about half of the magnitude of spillovers from the three largest advanced economies. Despite their expanded role in the global economy, EMDEs face a host of headwinds, including a challenging trade environment. The frequency of new trade agreements has been substantially lower in the 2020s than in the 2010s or 2000s. EMDEs' potential output growth has weakened and is on track to be about 4 percent in the 2020s, compared to almost 6 percent in the 2000s.

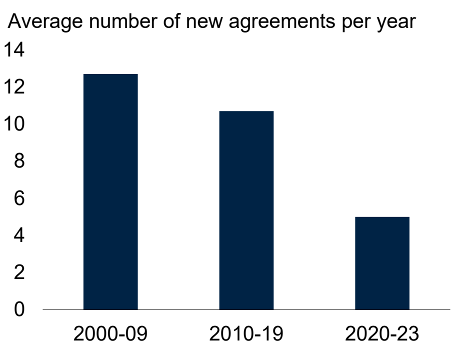
A. Shares of global GDP



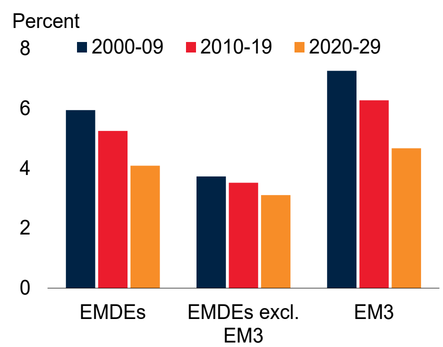
B. Cumulative output responses in other EMDEs from a 1-percentage-point growth increase in the EM3 and AE3



C. Trade agreements



D. Potential output growth



Sources: Haver Analytics; Penn World Tables; United Nations World Population Prospects; World Bank; World Development Indicators (database); World Trade Organization.

Note: AE3 = the United States, the euro area, and Japan. AEs = advanced economies; EM3 = China, India, and Brazil; EMDEs = emerging market and developing economies.

A. Gross domestic product (GDP) is measured in average 2010-19 prices and market exchange rates. Data for all economies in 2024 are estimates. Sample includes 154 EMDEs and 38 advanced economies.

B. Solid bars represent medians from the posterior distribution; error bars show 16-84 percent confidence bands. Bars show the cumulative impulse responses of output in other EMDEs to a 1 percentage point increase in output growth in the EM3 and the AE3. Results are based on quarterly data covering the period 2000Q1-2023Q4 for 34 "other" EMDEs.

C. Bars show simple averages of annual data. Sample excludes agreements signed by the United Kingdom.

D. Potential output growth is the maximum GDP growth rate that can be sustained in the long term at full employment and full capacity without igniting inflation. It is measured using a production function approach as in Kilic Celik, Kose, and Ohnsorge (2024). Sample includes 53 EMDEs and 30 advanced economies.