CAPITAL
SLOWDOWN

Investment growth in emerging market and developing economies has been sluggish since 2010

M. Ayhan Kose, Franziska Ohnsorge, and Lei Sandy Ye

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Take-Aways

- Investment growth in the emerging and developing economies has declined from 10% in 2010 to less than 3.5% in 2016, and the slump is widespread.
- Several factors, including low commodity prices and increased market volatility, have contributed to weak investment growth in these nations.
- Economic slowdowns in China and other major economies have had adverse spillover effects on the developing and emerging markets.
- A continuing downturn in their investment growth could affect these economies' ability to accumulate capital, thus hampering their efforts to combat poverty.
- Policy makers must make investments in labor and infrastructure, and attract both domestic and foreign private investors by cutting trade barriers, improving governance and raising financial transparency.

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Recommendation

Investment growth in the emerging and developing economies sank precipitously between 2010 and 2016, and the rate in 2016 fell far short of the double-digit gains posted before the 2008 financial crisis. In this brief but illuminating article, economists M. Ayhan Kose, Franziska Ohnsorge and Lei Sandy Ye explore the reasons for the ongoing low investment, why that development makes it difficult for these countries to reduce poverty and how governments can spur investment. *getAbstract* recommends this expert analysis to investors and executives.

Summary

The annual rate of investment growth in the emerging and developing economies declined from 10% in 2010 to less than 3.5% in 2016. The slump is widespread, occurring in close to two-thirds of those nations. The BRICS – Brazil, Russia, India, China, and South Africa – and countries dependent on commodity exports are especially hard hit. China is responsible for about one-third of the drop in the BRICS' investment growth; both Brazil and Russia account for an additional one-third. In contrast, investment growth rates in the developed nations had recovered to their long-term historical averages by 2014.

"Many emerging market and developing economies have large unmet investment needs."

Several factors contribute to the weak investment in emerging markets: Low borrowing costs and ample market liquidity failed to compensate for the collapse in commodity prices that started in 2014. Importers faced shrinking foreign direct investment amid growing debt and political risks, while the shocks to oil prices directly walloped exporters. European Union policy quandaries curbed investment in trading partners in European and Central Asian developing economies. Increased market risk, "as measured by the VIX Index (which tracks volatility in the US Standard & Poor's 500 Index)," broadly discouraged investment in emerging markets. Economic slowdowns in China, the euro area and other major countries had adverse spillover effects as well.

"By slowing the rate of capital accumulation, a prolonged period of weak investment growth can set back potential output growth in emerging market and developing economies for years."

A continuing downturn in investment growth could affect these economies' ability to accumulate capital, thus hampering their efforts to combat poverty. Productivity could falter as well, as delays occur in the adoption of new technologies. In turn, growth in wages and household incomes could suffer. Many developing nations are ill-prepared to finance urbanization, upgrade worker skills, expand trade and move away from a dependence on commodities to more reliable and growing sources of output.

"Since China is now the largest trading partner of many emerging market and developing economies, its output and investment growth slowdown has weighed on their growth."

Policy makers in developing nations must pursue efforts to make public investments in infrastructure and their labor forces. They also should attract both domestic and foreign private investors by implementing macroeconomic stability policies and making structural reforms such as reducing trade barriers, improving corporate governance and increasing financial transparency.

About the Authors

M. Ayhan Kose is a director at the World Bank, where **Franziska L. Ohnsorge** is a lead economist and **Lei Sandy Ye** is an economist.

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