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Emerging market resilience to risk-off shocks: Good luck, but mostly good policies

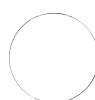
Marijn Bolhuis, Francesco Grigoli, Marcin Kolasa, Roland Meeks, Andrea Presbitero, Zhao Zhang / 15 Dec 2025

Emerging markets used to be hit hard whenever global investors turned nervous. This column analyses how emerging markets have managed output and inflation during global risk-off episodes over the past three decades. It shows that stronger policy frameworks – from credible inflation targeting to tighter macroprudential rules – now help countries keep growth steadier and inflation contained during risk-off shocks. These reforms matter at least as much as supportive global conditions. This new resilience suggests emerging markets are moving closer to real monetary policy independence.

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Emerging markets have long been highly exposed to swings in global risk sentiment. During periods of heightened risk aversion – so-called ‘risk-off’ episodes (Caballero and Kamber 2019) – investors typically retreat from emerging market assets, driving capital outflows, sharp currency depreciations, and tighter financial conditions (Chari et al. 2023, Goldberg and Krogstrup 2023). The Asian crisis is a classic

example of this. These shocks often act like supply shocks, causing output losses and inflation pressures, and policymakers face a familiar dilemma between easing, which risks further depreciation and instability, and tightening, which can deepen the downturn and fuel ‘fear of floating’.

Recent experience shows a clear shift: many emerging markets have become far more resilient to external shocks than in the past (Hardy et al. 2024). During the 2018-19 US-China trade tensions, several major emerging markets saw only moderate currency depreciation despite substantial global uncertainty. Even at the onset of the COVID-19 pandemic, when global risk aversion surged and portfolio outflows reached record levels, most large emerging markets avoided disorderly balance-of-payments adjustments, maintained market access, and relied primarily on exchange rate flexibility, supported in some cases by swap lines and regional safety arrangements. Two broad explanations help explain this improved performance.

First, favourable external conditions – the *good luck* explanation. The period after the global crisis (GFC) was marked by relatively strong global growth, supportive terms of trade, and prolonged low interest rates. Even after the pandemic, despite rapid tightening in advanced economies, global financial conditions remained more accommodative than many had anticipated. This environment allowed emerging market sovereigns and corporates to secure long-term financing at relatively low cost.

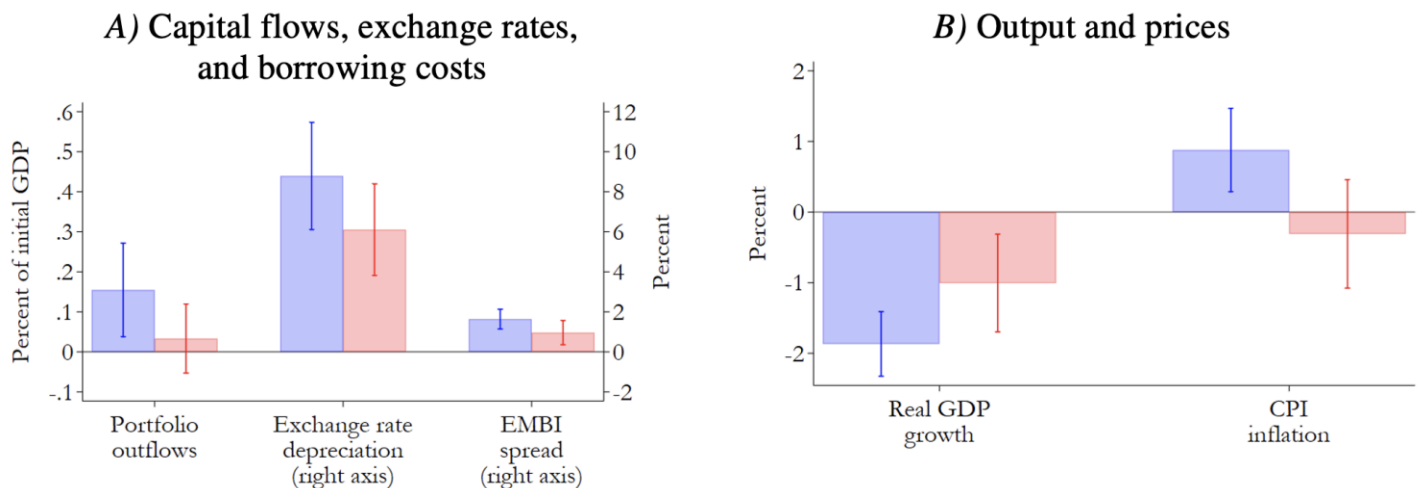
Second, stronger domestic policy frameworks – the *good policies* explanation. Over the past two decades, emerging markets have substantially upgraded their policy institutions. The adoption and maturation of inflation-targeting regimes, coupled with increased exchange-rate flexibility, strengthened monetary policy credibility, anchored long-term inflation expectations, and improved transmission to financial and macroeconomic conditions (Obstfeld et al. 2019, Checo et al. 2023). As a result, currency depreciations have had a smaller and less persistent impact on domestic prices (Campa and Goldberg 2005, Bems et al. 2021). At the same time, macroprudential measures reduced foreign exchange mismatches and improved financial stability (Sandri et al. 2020, Kalemli-Ozcan and Unsal 2023). Improvements in fiscal credibility further reduced vulnerabilities and capital flow management (CFM) measures have been applied more selectively.

Taking stock of emerging market resilience

In practice, both explanations contributed to creating a markedly more resilient landscape – one in which emerging markets are better equipped to manage the next episode of global financial stress.

To answer the question of “good luck or good policies?” (Easterly et al. 1993), in our recent work (Bolhuis et al. 2025) we review how emerging markets have managed output and inflation during global risk-off episodes over the past three decades. We identify risk-off episodes using an algorithmic method and assess whether emerging markets have become more resilient – across both real and financial indicators – compared with earlier periods. Figure 1 shows that emerging markets have historically been quite vulnerable to global risk-off shocks. Yet, since the global crisis, many have demonstrated substantially greater resilience. Even though the size and duration of risk-off events have not changed much – and the underlying drivers remain similar – most emerging markets have experienced smaller output losses and minimal inflationary pressures during recent episodes.

Figure 1 Macroeconomic effects of risk-off episodes (percent)



Notes: The figures report the coefficients (and the associated 90% confidence bands) of regressions of the six-month change in portfolio outflows, the nominal exchange rate depreciation, and the EMBI spread in panel (a); and the real GDP growth and CPI inflation in panel (b). The change in portfolio flows is expressed in percent of initial GDP. All regressions include controls for real GDP growth, inflation, the lags of the dependent variable, and country fixed effects. The pre-GFC period is 1997-2009 and the post-GFC period is 2010-24. See Bolhuis et al. (2025) for details.

Central bank credibility, independence, and autonomy

We next examine how monetary, macroprudential, and capital flow management frameworks have evolved in terms of implementation, credibility, and actual outcomes. Evidence shows that the effectiveness and credibility of monetary policy in emerging markets have strengthened steadily. Countries with more robust frameworks rely less on foreign exchange intervention, and monetary policy reacts increasingly to domestic economic conditions rather than exchange rate pressures. Estimated reaction functions indicate that central banks have shifted their focus toward output stabilisation, supported by better-anchored inflation expectations. Financial market expectations have also become more aligned with policy decisions, reflecting greater confidence in the policy framework. These credibility gains matter

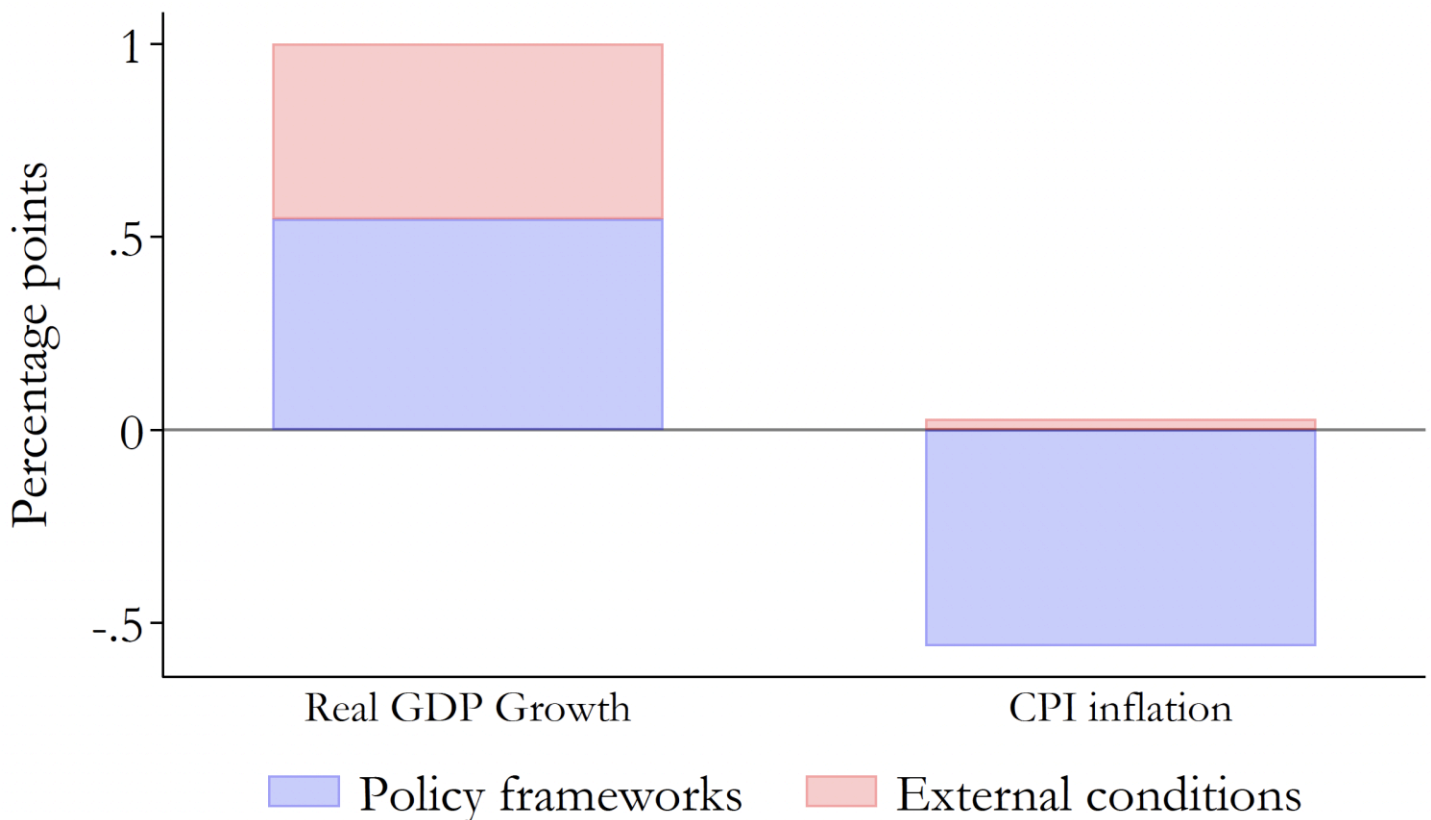
for external shocks. Emerging markets with well-anchored inflation expectations intervene less in foreign exchange markets and resort less frequently to capital flow management measures during risk-off episodes, because exchange rate pass-through is lower and fear of floating is reduced. Stronger macroprudential regulation reinforces this dynamic by limiting foreign exchange borrowing and reducing financial stability risks.

Our results also highlight improvements in the interaction between fiscal and monetary policy. Before the global crisis, increases in government spending often resulted in looser monetary policy and rising inflation expectations. Since then, however, spending shocks have typically been met with policy tightening, and long-term inflation expectations have remained anchored – an indication of stronger central bank independence. In addition, domestic monetary policy retains meaningful traction over short-term yields, although US monetary policy continues to influence longer-term yields and riskier asset classes.

Quantifying good luck and good policies

In our paper, we provide an illustrative quantification of the extent to which emerging market resilience is rooted in enhanced policy frameworks, or the result of favourable yet changing external conditions. Comparing typical post-GFC risk-off events with those from earlier decades, our analysis suggests that stronger policy frameworks raised growth by about 0.5 percentage point and lowered inflation by roughly 0.6 percentage point during these episodes. Favourable global conditions also supported activity – adding another 0.5 percentage point to growth – but did little to alleviate inflation pressures.

Figure 2 Factors contributing to emerging market resilience during risk-off episodes (percentage points)



Notes: The figure plots the contributions of policy frameworks and external conditions for the median emerging market in the post-GFC period relative to the pre-GFC period. Variables proxying for external conditions include real GDP growth in advanced economies, changes in commodity terms of trade, and US financial conditions. The pre-GFC period is 1997-2009 and the post-GFC period is 2010-24. See Bolhuis et al. (2025) for details.

Trade-offs, costs of delaying tightening, and use of foreign exchange interventions

Lastly, we analyse the benefits of improved policy frameworks by calibrating the quantitative model for the Integrated Policy Framework (Adrian et al. 2021) to capture the typical characteristics of emerging markets before and after the global crisis. The post-GFC calibration reflects the improvements observed in many emerging markets, including lower foreign-exchange mismatches and better-anchored inflation expectations.

Model simulations highlight the importance of these stronger policy frameworks. When a risk-off shock leads to a 10% exchange rate depreciation, economies with stronger frameworks experience output contractions that are about 85% smaller than those in economies with weaker frameworks. Better balance sheets – particularly reduced foreign exchange mismatches – also cut the probability of sudden stops by half and lessen their severity.

We then consider a scenario where a risk-off shock coincides with an inflationary cost-push shock, reflecting recent post-pandemic dynamics. In this case, emerging markets with weak frameworks face clear risks from delaying monetary tightening. If such economies hesitate to act, they ultimately need to raise policy rates by up to 1.4 percentage points more than emerging markets that follow a standard Taylor-rule response, leading to output losses that are 0.7 percentage point larger.

Finally, we use the structural model to assess the role of foreign exchange interventions. In emerging markets with weak frameworks, foreign exchange interventions that limit the exchange rate depreciation from 10% to 5% reduce the need for aggressive rate hikes and lower output losses by about 0.9 percentage point two years after the shock. However, the gains from foreign exchange intervention are minimal for emerging markets with strong frameworks, where well-anchored inflation expectations already temper inflationary pressures and a weaker currency supports external adjustment. These findings underscore that foreign exchange intervention can be a useful complement to policy, but not a substitute for credible and robust policy frameworks.

Moving back towards the 'trilemma'

Taken together, our results revamp the debate about the dilemma versus trilemma in international macroeconomics. Resilience to risk-off episodes, the diminished need for foreign exchange interventions and capital controls in the presence of strong policy frameworks, and the evidence of autonomy of domestic monetary policy are suggestive of a progressive transition toward a world that, while unequal across countries, appears to be characterised by the trilemma of the classic Mundell-Fleming framework and less by the dilemma described by Rey (2013), in which monetary policy independence is limited unless capital controls are used.

Authors' note: The views expressed in this paper are those of the authors and do not necessarily represent those of the International Monetary Fund, its Executive Board, or its management.

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