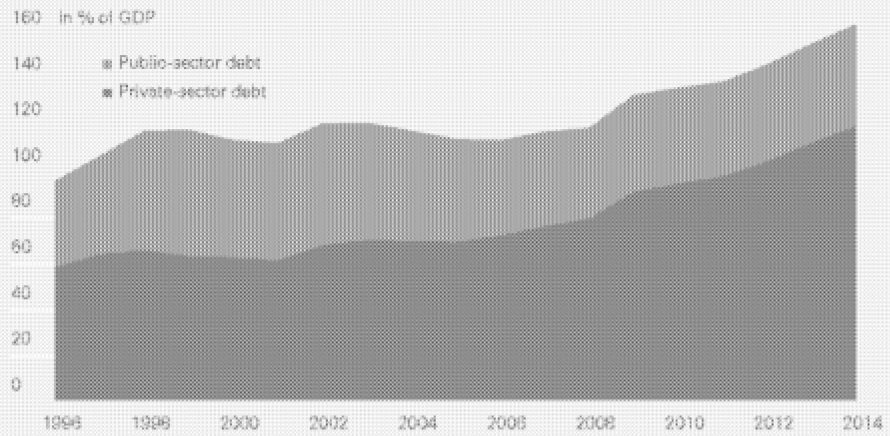
But this will need time. Further market volatility is possible because many EM corporations used the low interest-rate environment of the past few years to borrow money, thereby sharply raising their debt. An appreciating U.S. dollar and rising interest rates should increase the interest and principal payments due on foreign loans. Rising defaults cannot be ruled out, additionally impeding the economic development of emerging markets.

Emerging-market debt

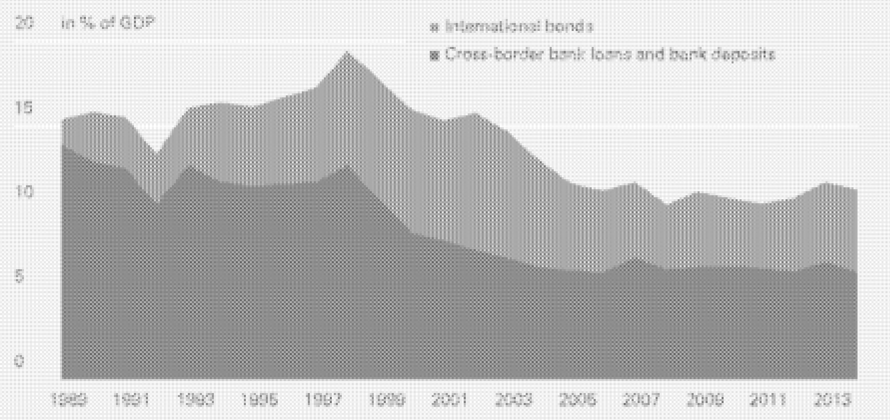


Source: Bank for International Settlements, as of June 2015

Rising private debt

Increasing capital expenditure has helped to keep emerging markets on track during and after the financial crisis. The flip-side of this has been rising private-sector debt. Decelerating growth in the emerging markets moreover indicates that some investment has been misallocated.

Foreign debt of emerging markets



Source: Bank for International Settlements, as of June 2015

Lower foreign dependence

The Asia crisis of 1997 showed how dangerous debt denominated in foreign currencies can be. The devaluation of local currencies increased the value of this foreign denominated debt. From 2000 onwards, emerging markets have reduced their foreign debt as a ratio of gross domestic product, helped by the establishment and expansion of a local financial sector, flexible exchange-rate systems and more balanced current accounts.

The combination of lower growth dynamics and higher debt risk in the corporate sector caused the MSCI Emerging Markets Index to trade sideways for several years. One of the triggers for the emerging markets' recent slide was China's decision to moderately devalue the renminbi versus the U.S. dollar. Many investors regarded this step as an implicit admission of slower economic growth by the Chinese government.