## Figure 2.11. Decompositions of Declines in Output Volatility Between 1970–86 and 1987–2003[1]

(Percent of change in volatility explained; a positive percentage indicates a reduction in volatility)

Improvements in financial sector development, volatility of fiscal policy, terms of trade volatility, and flexibility of the exchange rate regime have been the main contributors to the trend declines in volatility in emerging market and developing countries, although the relative importance of these factors varies across countries and regions.

- ■ Initial level of financial sector development[2]
- ■ Volatility of fiscal policy[3]
- ■ Terms of trade volatility combined with exchange rate regime flexibility[4]
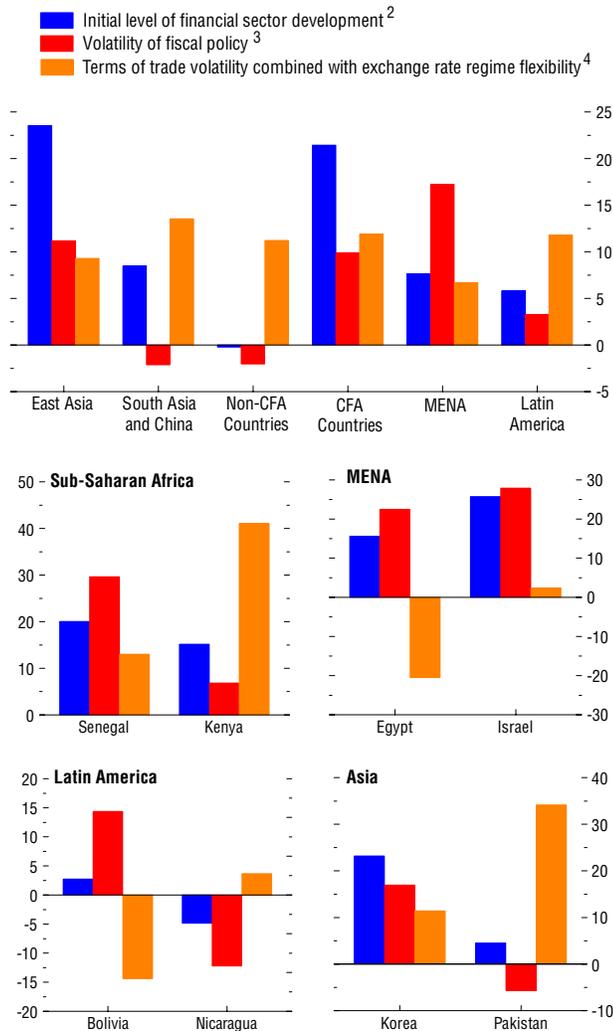
Sources: Beck, Demirgüç-Kunt, and Levine (1999); Fatás and Mihov (2003); Reinhart and Rogoff (2002); and IMF staff calculations.

[1]This figure shows the contribution of key variables to changes in the overall volatility of the country-specific components of output growth between the 1970–86 and 1987–2003 periods that can be explained by the cross-sectional regression estimates.

[2]Initial level of financial development is measured as the ratio of private sector credit to GDP in 1970 and 1987, respectively.

[3]Measured as the standard deviation of the cyclically adjusted government spending estimated for the 1960–86 and 1987–2000 periods, respectively (see Fatás and Mihov, 2003).

[4]Sum of the effects of changes in the terms of trade volatility and the interaction of the terms of trade volatility with exchange regime flexibility.