

### Methodology and Process

The individual economy assessments use a wide range of methods to form an integrated and multilaterally consistent view on economies' external sector positions. These methods are grounded in the latest vintage of the External Balance Assessment (EBA), developed by the IMF's Research Department to estimate desired current account balances and real exchange rates.<sup>1</sup> Model estimates and associated discussions on policy distortions (see Box 3.1 for an example) are accompanied by a holistic view of other external indicators, including capital and financial account flows and measures, foreign exchange intervention and reserves adequacy, and foreign asset or liability positions.<sup>2</sup>

The EBA models provide numerical inputs for the identification of external imbalances but in some cases may not sufficiently capture all relevant country characteristics and potential policy distortions. In such cases, the individual economy assessments may need to be complemented by country-specific knowledge and insights. To integrate country-specific judgment in an objective, rigorous, and evenhanded manner, a process was developed for multilaterally consistent external assessments for the 30 largest economies, representing about 90 percent of global GDP. These assessments are also discussed with the respective authorities as part of bilateral surveillance.

External assessments are presented in ranges, in recognition of inherent uncertainties, and in different categories generally reflecting deviations of the overall

<sup>1</sup>See Cubeddu and others (2019) for a complete description of the EBA methodology and for a description of the most recent refinements.

<sup>2</sup>The individual economy assessments for 2019 are based on data and IMF staff projections as of July 6, 2020, except for cyclical and medium-term variables, which are based on data as of January 31, 2020, preceding the COVID-19 pandemic.

external position from fundamentals and desired policies. As reported in Table 1.4, the ranges of uncertainty for IMF staff-assessed current account gaps are generally about  $\pm 1$  percent of GDP. For the real effective exchange rate (REER), the ranges of uncertainty vary by country, reflecting country-specific factors, including different exchange rate semi-elasticities applied to the staff-assessed current account gaps. Overall external positions are labeled as either "broadly in line," "moderately weaker (stronger)," "weaker (stronger)," or "substantially weaker (stronger)" (see Table 3.A and Box 1.1). The criteria for applying the labels to overall external positions are multidimensional. Regarding the wording to describe the current account and REER gaps: (1) when comparing the cyclically adjusted current account to the current account norm, the wording "higher" or "lower" is used, corresponding to positive or negative current account gaps, respectively; (2) a quantitative estimate of the IMF staff's view of the REER gap is generally reported as  $(-)$  percent "over" or "under" valued. External positions that are labeled as being "broadly in line" are consistent with current account gaps in the range of  $\pm 1$  percent of GDP as well as REER gaps in the range that reflects the country-specific exchange rate semi-elasticity ( $\pm 5$  percent based on an elasticity of  $-0.2$ ).

### Selection of Economies

The 30 systemic economies analyzed in detail in this report and included in the individual economy assessments are listed in Table 3.B. They were generally chosen on the basis of a set of criteria, including each economy's global rank in terms of purchasing power GDP, as reported in the IMF's *World Economic Outlook*, and in terms of the level of nominal gross trade and degree of financial integration.

**Table 3.A. Description in *External Sector Report* Overall Assessment**

CA Gap	REER Gap (Using Elasticity of -0.2)	Description in Overall Assessment
>4%	<-20%	. . . substantially stronger . . .
[2%, 4%]	[-20%, -10%]	. . . stronger . . .
[1%, 2%]	[-10%, -5%]	. . . moderately stronger . . .
[-1%, 1%]	[-5%, 5%]	The external position is broadly in line with fundamentals and desirable policy settings.
[-2%, -1%]	[5%, 10%]	. . . moderately weaker . . .
[-4%, -2%]	[10%, 20%]	. . . weaker . . .
<-4%	>20%	. . . substantially weaker . . .

**Table 3.B. Economies Covered in the *External Sector Report***

Argentina	Euro area	Italy	Poland	Sweden
Australia	France	Japan	Russia	Switzerland
Belgium	Germany	Korea	Saudi Arabia	Thailand
Brazil	Hong Kong SAR	Malaysia	Singapore	Turkey
Canada	India	Mexico	South Africa	United Kingdom
China	Indonesia	Netherlands	Spain	United States

**Box 3.1. Assessing Imbalances: The Role of Policies—An Example**

A **two-country example** is used to clarify how to analyze policy distortions in a multilateral setting and how to distinguish between domestic policy distortions, on which a country might need to take action to reduce its external imbalance, and foreign policy distortions, which require no action by the home country (but for which action by the other would help reduce the external imbalance). Consider a stylized example of a two-country world.

- **Country A** has a large *current account deficit* and a large fiscal deficit, as well as high public and external debt.
- **Country B** has a *current account surplus* (matching the deficit in Country A) and a large creditor position but has no policy distortions.

**Overall external assessment:** The analysis would show that Country A has an external imbalance reflecting its large fiscal deficit. Country B would have an equal and opposite surplus imbalance. Country A's exchange rate would look overvalued and Country B's undervalued.

**Policy gaps:** The analysis of policy gaps would show that Country A has a domestic policy distortion that needs adjustment. The analysis would also show that there are no domestic policy gaps in Country B—instead,

adjustment by Country A would automatically eliminate the imbalance in Country B.

**Individual economy write-ups:** While the estimates of the needed *current account adjustment* and associated *real exchange rate change* would be equal and opposite in both cases (given there are only two economies in the world), the individual economy assessments would identify the different issues and risks facing the two economies.

- In the case of Country A, the *capital flows and foreign asset and liability position* sections would note the vulnerabilities arising from international liabilities, and the *potential policy response* section would focus on the need to rein in the *fiscal deficit* and limit *financial excesses*.
- For Country B, however, as there were no domestic policy distortions, the write-up would find no fault with policies and would note that adjustment among other economies would help reduce the imbalance.

**Implications:** It remains critical to distinguish between domestic and foreign fiscal policy gaps. The elimination of the fiscal policy gap in a systemic deficit economy would help reduce excess surpluses in other systemic economies.

## Abbreviations and Acronyms

Adj.	adjusted
ARA	assessing reserve adequacy
BOP	balance of payments
CA	current account
CFM	capital flow management measure
CPI	consumer price index
Cycl.	cyclically
E&O	errors and omissions
EBA	External Balance Assessment
ECB	European Central Bank
eop	end of period
FDI	foreign direct investment
FX	foreign exchange
HKMA	Hong Kong Monetary Authority
IIP	international investment position
LEBAC	central bank short-term instrument (Argentina)
LEERS	linked exchange rate system (Hong Kong SAR)
Liab.	liabilities
LIBOR	London interbank offered rate
MAS	Monetary Authority of Singapore
NAFTA	North American Free Trade Agreement
NDF	nondeliverable forward
NEER	nominal effective exchange rate
NFC	nonfinancial corporation
NIIP	net international investment position
NPL	nonperforming loan
PBoC	People's Bank of China
QE	quantitative easing
REER	real effective exchange rate
Res.	residual
RMB	renminbi
SOE	state-owned enterprise
ULC	unit labor cost

**Table 3.1. Argentina: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was weaker than the level implied by medium-term fundamentals and desirable policies. Bringing gross external debt and debt service down to sustainable and manageable levels requires a successful debt operation and policies to ensure a sufficiently high CA surplus over the near and medium term while keeping the real exchange rate near 2019 levels.</i>						
<b>Potential Policy Responses:</b> In the near term, policies should balance the need to support the economy during the pandemic while ensuring domestic and external stability in the context of very limited access to financing. Over time, a gradual and growth-friendly fiscal consolidation, combined with prudent monetary policies, is essential to maintain a trade surplus, rebuild international reserves, and ensure debt sustainability, although the path will depend on the evolution of the global pandemic. In addition, structural reforms to boost Argentina's export capacity and measures to encourage FDI in sectors with export potential are required. As stability is established, and the pandemic wanes, a gradual unwinding of CFMs and export taxes will be necessary, provided fiscal consolidation is on track.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> After Argentina regained access to international capital markets in early 2016, its external gross liabilities jumped from 34 percent of GDP at end-2015 to 63 percent at end-2019, the bulk of which was in foreign currency and of a short-term nature (22 percent of GDP came due in 2019). The evolution of the NIIP was less dramatic, as public debt issuances were offset by private capital outflows, with valuation effects resulting from the sharp peso depreciation since mid-2018 playing a mitigating role. Despite the rise in gross indebtedness, the NIIP rose from 2.3 percent in 2017 to about 26 percent of GDP in 2019.</p> <p><b>Assessment.</b> Argentina's public and external debt is unsustainable, and a restructuring with private creditors is ongoing even after a missed payment in May. The debt operation should further raise Argentina's NIIP and reduce external debt service to manageable levels. CFMs introduced in 2019 will remain necessary in the near term to mitigate capital outflow risks. Prospects of market access over the medium term will depend greatly on orderly resolution of the debt problem and implementation of coherent macroeconomic and structural reforms.</p>					
2019 (% GDP)	NIIP: 26.2	Gross Assets: 89.1	Res. Assets: 10.0	Gross Liab.: 62.8	Debt Liab.: 45.6	
<b>Current Account</b>	<p><b>Background.</b> The CA deficit narrowed further to 0.8 percent of GDP in 2019, mainly on account of a sharp import contraction (in line with the recession and sharp peso depreciation) along with a pickup in exports (following the 2018 drought and the anticipated increase in export taxes) and despite higher interest payments abroad. The trade surplus—1.2 percent of GDP through April for goods—is projected to reach 4.2 percent of GDP in 2020 (2.9 percent in 2019), with import compression (aided by a 30 percent tax on imports of services and stringent COVID-19 mitigation measures) more than offsetting lower exports (reflecting COVID-related weakness in external demand and commodity prices).</p> <p><b>Assessment.</b> The EBA CA model estimates a CA norm of about -1.2 percent of GDP, although an upward adjustment of 1.5 percent is necessary to ensure external debt can be brought down to sustainable levels over the medium term. Moreover, with limited access to international capital markets, Argentina cannot sustain CA deficits in the near to medium term. As such, the 2019 cyclically adjusted CA balance of -1.7 percent of GDP is at least 2 percent of GDP weaker than implied by fundamentals and desired policies, a portion of which reflects fiscal policy gaps.</p>					
2019 (% GDP)	Actual CA: -0.8	Cycl. Adj. CA: -1.7	EBA CA Norm: -1.2	EBA CA Gap: -0.5	Staff Adj.: -1.5	Staff CA Gap: -2.0
<b>Real Exchange Rate</b>	<p><b>Background.</b> The official REER depreciated by a further 11 percent on average in 2019 relative to 2018, driven by a sharp nominal depreciation of the peso in the second half of the year (which was only partially offset by an increase in relative prices), reflecting political and policy uncertainty. Through May 2020, the official REER is estimated to have appreciated 18.2 percent relative to the 2019 average, supported by the central bank intervention.</p> <p><b>Assessment.</b> While the CA assessment implies a moderate REER <i>overvaluation</i> (15 percent assuming an elasticity of 0.14), the REER-index model suggests an <i>undervaluation</i> closer to 6.4 percent. Overall, and given the large REER depreciations since early 2018, which are expected to support a rise in the trade balance going forward, the IMF staff assesses the 2019 REER gap to be in the range of -6.5 to +3.5 percent, with a midpoint of -1.5 percent.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Following the August 2019 market turbulence, Argentina lost market access, and capital outflows led to a significant loss of reserves. The authorities introduced CFMs in September 2019 and further tightened them in October and December. Current CFMs include (1) surrender requirement for FX export proceeds, (2) central bank authorization for payment of dividends and profits, and (3) limits on FX purchases by firms and individuals. There are no restrictions on FX deposit withdrawals for individuals or firms. CFMs have been tightened since March 2020, mainly to prevent operations in the parallel exchange rate market, which in May was trading at a premium of 65–80 percent over the official rate.</p> <p><b>Assessment.</b> The CFMs stabilized the peso, contained the reserve loss in 2019, and slowed COVID-triggered capital outflows in 2020. The gap between the official and parallel exchange rates has risen relative to end-2019, reflecting in part a rise in inflation expectations following increased monetary financing for COVID-related fiscal needs. CFMs remain necessary in the near term, but could be gradually unwound as conditions allow, especially to encourage FDI.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Gross international reserves had fallen to US\$44 billion by end-2019, US\$21 billion below end-2018 levels, with the bulk of the decline coming in the months following the primary elections and ahead of the adoption of CFMs. After remaining relatively stable through early March 2020, gross reserves had fallen by US\$1.7 billion through mid-June, reflecting a combination of debt service payments and FX sales (US\$0.7 billion).</p> <p><b>Assessment.</b> Reserve coverage at end-2019 fell to 45 percent of the ARA metric, and net reserves are insufficient to cover FX debt service obligations. Projected trade surpluses, in the context of a successful restructuring of external debt, are necessary to allow a gradual rebuilding of reserve coverage (about ¾ percent of GDP a year initially) and relaxation of CFMs over the medium term. Given low reserve coverage, FX intervention should be limited to softening disorderly conditions.</p>					

**Table 3.2. Australia: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA recorded a surplus of about 0.6 percent of GDP, mainly due to a temporary surge in commodity prices, a ramp-up in resource exports, exchange rate depreciation, and weaker domestic demand, and it is expected to remain in surplus in 2020.</i>						
<b>Potential Policy Responses:</b> The recent substantial monetary policy easing and fiscal stimulus are appropriate to support the economy, which has significantly weakened due to the COVID-19 outbreak. The authorities should stand ready to provide additional stimulus if necessary, and particularly in case of a renewed COVID-19 outbreak. Fiscal and monetary stimulus is supporting domestic demand, thereby limiting the projected increase in the CA balance.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> Australia has a large negative NIIP, which is estimated at about –45.6 percent of GDP in 2019. Liabilities are largely denominated in Australian dollars, whereas assets are in foreign currency. Foreign liabilities are composed of about one-quarter FDI, one-half portfolio investment (principally banks' borrowing abroad and foreign holdings of government bonds), and one-quarter other investment and derivatives. The NIIP rose by about 7.9 percent of GDP in 2019, partially due to the valuation effect of the Australian dollar's depreciation versus other key currencies. The NIIP-to-GDP ratio is expected to stabilize at about –43 percent of GDP over the medium term.					
	<b>Assessment.</b> The NIIP level and trajectory are sustainable. Staff analysis suggests that the NIIP will be stable at about current levels over the medium term, with a CA deficit at about 2.3 percent of GDP. The structure of Australia's external balance sheet reduces the vulnerability associated with its high negative NIIP. With a positive net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector's net foreign currency liability position is mostly hedged. The maturity of banks' external funding has lengthened since the global financial crisis, and in a tail risk event in which domestic banks suffer a major loss, the government's strong balance sheet position would allow it to offer credible support.					
2019 (% GDP)	NIIP: –45.6	Gross Assets: 151.1	Debt Assets: 44.4	Gross Liab.: 196.7	Debt Liab.: 94.8	
<b>Current Account</b>	<b>Background.</b> Australia has run CA deficits for most of its history, reflecting a structural saving-investment imbalance with very high private investment relative to a private saving rate that is already high by advanced economy standards. Since the early 1980s, deficits have averaged about 4 percent of GDP. The CA balance in 2019 risen to a surplus of 0.6 percent of GDP, reflecting mostly strong iron ore prices and a ramp-up in new resource exports, including liquefied natural gas. The CA surplus is expected to widen to about 1.2 percent of GDP in 2020, reflecting resilient foreign demand for Australia's commodity exports and a steep decline in services imports (especially tourism) related to the border closure. While there is significant uncertainty, the CA is expected to return to a deficit over the medium term, albeit at a level lower than the historical average. Key risks are a deeper-than-expected slowdown in Australia's major trading partners and further declines in commodity prices.					
	<b>Assessment.</b> Considering the relative output gaps and the cyclical component of the commodity terms of trade, the EBA model estimates a cyclically adjusted CA balance of 0.3 percent of GDP for 2019. Compared with the EBA CA norm of –0.1 percent of GDP, this suggests a model-based CA gap of 0.5 percent of GDP. However, in the IMF staff's view, two adjustments are warranted: (1) the CA norm for Australia should be adjusted by –1.0 percent of GDP (which implies an adjusted CA norm of –1.1 percent of GDP), reflecting Australia's traditionally large investment needs due to its size, low population density, and initial conditions; and (2) given that the EBA model may be underestimating the cyclical effects related to the temporary surge in iron ore prices, the cyclically adjusted CA balance should be adjusted by –0.7 percent of GDP (iron ore prices increased about 20 percent above medium-term <i>World Economic Outlook</i> commodity price assumptions, and iron ore exports amount to about 3.3 percent of GDP). Taking these adjustments into consideration, the IMF staff-adjusted CA gap would be in the range of 0.3 to 1.3 percent of GDP (with a midpoint of 0.8 percent of GDP).					
2019 (% GDP)	Actual CA: 0.6	Cycl. Adj. CA: 0.3	EBA CA Norm: –0.1	EBA CA Gap: 0.5	Staff Adj.: 0.3	Staff CA Gap: 0.8
<b>Real Exchange Rate</b>	<b>Background.</b> Australia's REER has entered an overall depreciation path since the unwinding of the commodity boom in 2014. The 2019 REER was about 4.5 percent below the 2018 average, partly reflecting uncertainties related to US-China trade tensions, volatile commodity prices, and a narrowing interest rate gap between Australian bonds and US Treasury bills. As of May 2020, the REER had depreciated by about 1.9 percent relative to the 2019 average amid significant financial market volatility and weaker demand and prices for Australia's key commodity and service exports due to the COVID-19 outbreak.					
	<b>Assessment.</b> For 2019, the IMF staff-assessed REER gap is estimated to be in the range of –1.5 to –6.5 percent, with a midpoint of –4 percent, consistent with the staff CA gap. <sup>1</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> The financial account recorded net outflows in 2019, reflecting the rise in the CA balance. FDI continued in 2019 but was offset by portfolio investment outflows, against a backdrop of higher interest rates abroad. The financial account deficit widened in the first quarter of 2020, reflecting the CA surplus amid sizable portfolio investment outflows and weaker FDI inflows due to the COVID-19 shock.					
	<b>Assessment.</b> Vulnerabilities related to the financial account remain contained, supported by a credible commitment to a floating exchange rate.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> The currency has been free floating since 1983. The central bank has not intervened in the foreign exchange market since the global financial crisis. The authorities are strongly committed to a floating regime, which reduces the need for reserve holdings.					
	<b>Assessment.</b> Although domestic banks' external liabilities are sizable, they are either in local currency or hedged, so reserve needs for prudential reasons are also limited.					

**Table 3.3. Belgium: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was weaker than the level implied by medium-term fundamentals and desirable policies.</i>						
<b>Potential Policy Responses:</b> The COVID-19 pandemic prompted a sizable fiscal policy response to bolster the health care system and support affected firms and individuals. In the near term, containing the health and economic impact of the pandemic should remain the overarching policy priority. Uncertainty surrounding the medium-term outlook is unusually large. If the imbalances that existed prior to the COVID-19 outbreak were to persist in the medium term, policies would need to refocus on improving competitiveness by reinvigorating structural reforms and on rebuilding fiscal space once the recovery is secured. These could also help bring the CA more in line with medium-term fundamentals and desirable policies.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP remains strong, at 38 percent of GDP at end-2019, up from 35 percent at end-2018, reflecting the continued positive net financial wealth of households. Gross foreign assets were large at 425 percent of GDP, inflated by intragroup corporate treasury activities. Gross foreign assets of the banking sector stood at 80 percent of GDP, down considerably from the precrisis peak. External public debt was 65 percent of GDP, predominantly denominated in euros. TARGET2 balances averaged –€27.4 billion (–5.8 percent of GDP) in 2019, up from –€9.9 billion in 2018.</p> <p><b>Assessment.</b> Belgium's large gross international asset and liability positions are inflated by the presence of corporate treasury units, which do not appear to create macro-relevant mismatches. Based on the projected CA and growth paths, the NIIP-to-GDP ratio is expected to decline going forward. The large and positive NIIP and its trajectory do not raise sustainability concerns.</p>					
2019 (% GDP)	NIIP: 37.6	Gross Assets: 425.0	Debt Assets: 171.3	Gross Liab.: 387.4	Debt Liab.: 184.2	
<b>Current Account</b>	<p><b>Background.</b> Since the global financial crisis, the CA balance averaged 0.3 percent of GDP during 2010–18, although data have been subject to large historical revisions.<sup>1</sup> The relative stability in the CA masks significant movements in the trade and primary income balances, reflecting large operations of multinationals. In 2019, the CA balance registered a deficit of 1.2 percent of GDP, slightly lower than in 2018 (by 0.2 percent), as imports slowed more than exports, and a decrease in current transfers largely offset a modest decline in net primary income. For 2020, the CA deficit is projected to narrow further, as imports are expected to contract more than exports given depressed domestic and external demand, the large foreign content of exports, and a significant terms-of-trade improvement driven by lower oil prices; the income balance is expected to remain broadly unchanged. Indeed, the first quarter national accounts data confirm that imports contracted more than exports (–4.7 relative to –3.8 percent, quarter over quarter).</p> <p><b>Assessment.</b> EBA model estimates yield a CA gap of –3.5 percent of GDP for 2019, based on a cyclically adjusted CA balance of –1.1 percent (relative to an estimated norm of 2.3 percent). This is within the range estimated by the IMF staff for the CA gap of between –4.5 and –2.5 percent of GDP, which applies a standard range for the CA gap of ±1 percent of GDP.</p>					
2019 (% GDP)	Actual CA: –1.2	Cycl. Adj. CA: –1.1	EBA CA Norm: 2.3	EBA CA Gap: –3.5	Staff Adj.: 0.0	Staff CA Gap: –3.5
<b>Real Exchange Rate</b>	<p><b>Background.</b> The REER (both ULC- and CPI-based) appreciated by nearly 20 percent during 2000–09. Over the past decade the REER has been more volatile, with wage moderation contributing to a 6 percent depreciation of both the ULC- and CPI-based REER in 2014–15, which has since been largely reversed. In 2019, the ULC- and CPI-based REER depreciated by 2.0 and 1.5 percent, respectively, relative to the 2018 average. By end-May 2020, the ULC-based REER had further depreciated by 4.5 percent, while the CPI-based REER appreciated by 0.8 percent, relative to their respective 2019 averages.</p> <p><b>Assessment.</b> EBA model estimates point to an REER overvaluation of between 9 and 17 percent, based on the CPI-based REER index and level models; the REER overvaluation resulting from the IMF staff CA gap is 8.3 percent, using an elasticity of 0.42. The IMF staff assesses the REER to be overvalued in the range of 6 to 11 percent, with a midpoint of 8.5 percent.<sup>2</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Gross financial outflows and inflows were on an upward trend during the precrisis period as banks expanded their cross-border operations. Since the crisis, these flows have shrunk and become more volatile as banks have deleveraged. Short-term external debt accounted for 27 percent of gross external debt at end-2019. The capital account is open.</p> <p><b>Assessment.</b> Belgium remains exposed to financial market risks, but the structure of financial flows does not point to specific vulnerabilities. The large and positive NIIP reduces the vulnerabilities associated with high external public debt.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					



**Table 3.4. Brazil: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. In the wake of the COVID-19 shock, the CA deficit is projected to narrow in 2020 on account of the currency depreciation and weaker domestic demand.</i>						
<b>Potential Policy Responses:</b> If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, efforts to raise national saving remain essential to provide room for a sustainable expansion in investment. Fiscal consolidation, anchored by the federal spending cap, will be needed to boost net public saving. Structural reforms to improve efficiency and reduce the cost of doing business would also help strengthen competitiveness. Foreign exchange intervention, including using derivatives, can be appropriate to alleviate disorderly market conditions in the foreign exchange market.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Brazil's NIIP was –39.8 percent of GDP at end-2019, weaker than the 2013–18 average (about –29 percent of GDP). At end-2019 external debt accounted for about 37 percent of GDP and 264 percent of exports. At the end of the first quarter of 2020, the negative NIIP had shrunk substantially compared with end-2019 due to a combination of exchange rate valuation effects (assets tend to be in FX, while liabilities are concentrated in local currency) and a fall in domestic equity price.</p> <p><b>Assessment.</b> Brazil's NIIP has remained negative since the series was first published in 2001. Short-term gross external financing needs are significant, at about 13 percent of projected 2020 GDP, with capital flows and the exchange rate particularly sensitive to global financing conditions.</p>					
2019 (% GDP)	NIIP: –39.8	Gross Assets: 48.6	Res. Assets: 19.4	Gross Liab.: 88.4	Debt Liab.: 23.1	
<b>Current Account</b>	<p><b>Background.</b> The CA deficit widened from –2.2 percent of GDP in 2018 to –2.7 in 2019 due to a modest pickup in domestic demand, a slowdown in external demand (exports to key trading partners China and Argentina declined by 2 and 34 percent, respectively), and fairly sizable statistical revisions. Relative to last year's ESR assessment, the CA has been revised to show larger deficits for 2018 and 2019 because of statistical revisions to improve data quality.<sup>1</sup> During January–April 2020, the trade balance declined slightly compared with the same period in 2019 on the back of lower manufacturing exports. Over the year, the IMF staff projects a narrowing in the CA deficit to about –1.7 percent of GDP as the sharp currency depreciation boosts the trade surplus and lower service imports and distribution of profits and dividends reduce the service and income deficits.</p> <p><b>Assessment.</b> In 2019, the cyclically adjusted CA deficit was –3.7 percent of GDP, reflecting a still large negative output gap. EBA estimates suggest a CA norm in 2019 of –2.5 percent of GDP. The IMF staff assesses a CA norm between –2 and –3 percent of GDP. Thus, the CA is assessed to have been moderately weaker than the level implied by fundamentals and desirable policies. The medium-term outlook for the CA is difficult to assess given the unfolding COVID-19 crisis and related policy response.</p>					
2019 (% GDP)	Actual CA: –2.7	Cycl. Adj. CA: –3.7	EBA CA Norm: –2.5	EBA CA Gap: –1.2	Staff Adj.: 0	Staff CA Gap: –1.2
<b>Real Exchange Rate</b>	<p><b>Background.</b> After depreciating by about 8 percent in 2018, the REER (Information Notice System) was broadly stable in 2019, depreciating by 1.9 percent relative to 2018. In 2020 the REER has depreciated sharply. As of May 2020, the REER had depreciated by about 26.8 percent relative to 2019 average. Depreciation pressures have subsided since mid-May, but uncertainty remains high.</p> <p><b>Assessment.</b> Based on the results of the EBA CA balance and the REER index and level methodologies, the IMF staff assesses the REER gap at end-2019 to be in the range of –4 to 11 percent, with a midpoint of 3.5 percent.<sup>2</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Net FDI has fully financed CA deficits since 2015 (averaging 3.2 percent of GDP during 2015–19, while CA deficits averaged 2 percent), despite net portfolio outflows of (0.6 percent of GDP on average during 2015–19). In early 2020, however, net portfolio outflows accelerated sharply (1.6 percent of GDP in 2020:Q1) before beginning to ease in late April. FDI inflows have been stronger than in the same period in 2019, supported by high intercompany lending, but portfolio equity investment has declined sharply as foreign investors sold off their shares. Sizable external buffers and a new swap line with the US Federal Reserve for US\$60 billion provide a comfortable cushion against external shocks.</p> <p><b>Assessment.</b> The high degree of uncertainty about the scarring effects of COVID-19 on the global economy makes it challenging to assess the medium-term prospects for capital flows. A renewed spike in international risk aversion, potentially linked to a second wave of COVID-19, could trigger a new bout of capital market volatility.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Brazil has a floating exchange rate. Between August and December 2019, the central bank unwound part of its FX swap position while selling dollars in the spot market in nearly equivalent amounts in response to an increasing demand for spot dollars and decreasing demand for FX hedging in Brazil. Consequently, gross reserves fell by about US\$19 billion in 2019 and ended the year at US\$357 billion—about 19 percent of GDP or 154 percent of the IMF's composite reserve adequacy metric. Gross reserves net of FX swaps stood at US\$322 billion at end-2019. To dampen excess exchange rate volatility during the COVID-19 shock, the central bank sold FX in the spot, repo, and FX swap markets in the year through June 10. Nevertheless, reserves remain adequate at US\$348 billion, while gross reserves net of FX swaps declined to US\$289 billion.</p> <p><b>Assessment.</b> The flexible exchange rate has been an important shock absorber. Reserves are adequate relative to various criteria, including the IMF's reserve adequacy metric, and serve as insurance against external shocks. The authorities should retain strong external buffers, with intervention limited to addressing disorderly market conditions.</p>					

**Table 3.5. Canada: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately weaker than the level implied by medium-term fundamentals and desirable policies, mainly reflecting sustained but declining CA deficits. It will take time for the economy to adjust to structural shifts in the allocation of resources, restore lost production capacity, and address productivity underperformance. The CA deficit is expected to expand in the near term—largely due to the impact of COVID-19 and lower oil prices—but then narrow in the medium term as nonenergy exports gradually benefit from improved price competitiveness.</i>						
<b>Potential Policy Responses:</b> If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, policies should aim to boost Canada's nonenergy exports. These policies include measures geared toward improving labor productivity, investing in R&D and physical capital, promoting FDI, developing services exports, and diversifying Canada's export markets. The planned increase in public infrastructure investment should boost competitiveness and improve the external position in the medium term. The recent sharp increase in government debt that resulted from the government's response to COVID-19 increases the importance of developing a credible medium-term fiscal consolidation plan to support external rebalancing.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> Despite running a CA deficit, Canada's NIIP has risen since 2010, reaching 44.2 percent of GDP in 2019, up from 20.8 percent in 2015 and -18.4 percent in 2010. This largely reflects valuation gains on external assets. At the same time, gross external debt increased to 119.8 percent of GDP, of which about one-third is short term.					
	<b>Assessment.</b> Canada's foreign assets have a higher foreign currency component than its liabilities, which provides a hedge against currency depreciation. The NIIP level and trajectory are sustainable.					
2019 (% GDP)	NIIP: 44.2	Gross Assets: 252.9	Debt Assets: 64.5	Gross Liab.: 208.7	Debt Liab.: 111.7	
<b>Current Account</b>	<b>Background.</b> The CA deficit stood at 2.0 percent of GDP in 2019, down from 2.5 percent of GDP in 2018, reflecting improvements in the trade (merchandise and services) and primary income balances. The CA deficit is expected to widen to 3.7 percent of GDP in 2020, reflecting the impact of COVID-19 and a sharp decline in oil prices. The CA deficit has been financed by non-FDI net financial inflows, which have more than offset net outflows of FDI.					
	<b>Assessment.</b> The EBA estimates a CA norm of 2.2 percent of GDP and a cyclically adjusted CA of -1.9 percent of GDP for 2019. Helped by a narrowing in the CA deficit, the EBA gap shrunk (in absolute value) relative to 2018. The IMF staff assesses the CA gap to be narrower after taking into account (1) CA measurement issues, <sup>1</sup> (2) the authorities' demographic projections and current immigration targets, <sup>2</sup> and (3) the steeper-than-usual discount between Canadian oil prices and international prices. <sup>3</sup> Taking these factors into consideration, the IMF staff assesses the CA to be moderately lower than warranted by fundamentals and desired policies, with a gap ranging between -3.3 and -0.3 percent of GDP.					
2019 (% GDP)	Actual CA: -2.0	Cycl. Adj. CA: -1.9	EBA CA Norm: 2.2	EBA CA Gap: -4.1	Staff Adj.: 2.3	Staff CA Gap: -1.8
<b>Real Exchange Rate</b>	<b>Background.</b> The year average REER depreciated by about 0.5 percent in 2018 and by 1.0 percent in 2019. Relative to the 2019 average, the REER depreciated by 3.6 percent through May 2020.					
	<b>Assessment.</b> The EBA REER index model points to an overvaluation of 2.1 percent in 2019, while the REER level model points to an undervaluation of about 6.0 percent. In the IMF staff's view, the REER level model could overstate the extent of undervaluation. <sup>4</sup> Consistent with the staff CA gap, the IMF staff assesses the REER to be overvalued in the range of 1.5 to 12.6 percent, with a midpoint of 7 percent. <sup>5</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> The CA deficit in 2019 was financed by non-FDI net financial inflows: portfolio (0.2 percent of GDP), other investment (2.8 percent of GDP), and change in reserve assets (0.1 percent of GDP). FDI recorded net outflows of 1.5 percent of GDP (higher than the net outflows of 2018 but lower than those of 2017 and 2016). In 2019, errors and omissions recorded an inflow of 0.4 percent of GDP.					
	<b>Assessment.</b> Canada has an open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> Canada has a free-floating exchange rate regime and has not intervened in the foreign exchange market since September 1998 (with the exception of participating in concerted international interventions). Canada has limited reserves, but its central bank has standing swap arrangements with the US Federal Reserve and four other major central banks (it has not drawn on these swap lines).					
	<b>Assessment.</b> Policies in this area are appropriate to the circumstances of Canada. The authorities are strongly committed to a floating regime, which, together with the swap arrangement, reduces the need for reserve holdings.					



**Table 3.6. China: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA surplus is expected to widen in 2020 amid the pandemic, and trend downward over the medium term in line with rebalancing.</i>						
<b>Potential Policy Responses:</b> Policy reactions have appropriately prioritized support to the most affected households, workers, and firms, with increased focus on further supporting the demand recovery. China has room to provide more policy support if needed, including on green investment and strengthening the public health system and social safety net. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, policies to achieve a lasting balance in the external position should include a gradual fiscal consolidation and successful implementation of the authorities' reform agenda, which addresses distortions and supports rebalancing. Reform priorities include improving the social safety net, SOE reform and opening markets to more competition, attracting more FDI, creating a more market-based and robust financial system, and moving to a more flexible exchange rate along with a more market-based and transparent monetary policy framework.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> The NIIP declined to 14.4 percent of GDP in 2019 from 15.5 percent in 2018, after peaking at 30.4 percent in 2008. This decline reflects lower loans extended abroad and higher securities investment received amid robust GDP growth, despite a higher CA surplus.					
	<b>Assessment.</b> The NIIP-to-GDP ratio is expected to remain positive, with a modest decline over the medium term. The NIIP is not a major source of risk at this point, as assets remain high—reflecting large foreign reserves (US\$3.2 trillion; 21.9 percent of GDP)—and liabilities are mostly FDI related.					
2019 (% GDP)	NIIP: 14.4	Gross Assets: 52.4	Res. Assets: 21.9	Gross Liab.: 37.9	Debt Liab.: 12.2	
<b>Current Account</b>	<b>Background.</b> The CA surplus widened to 1 percent of GDP in 2019, reflecting the economic slowdown arising from continued financial regulatory strengthening and US-China trade tensions. Trade flows (especially those related to the inventory cycle) in 2018–19 shifted in response to expected and realized tariff hikes, contributing to a lower trade balance in 2018 and a higher balance in 2019. Moreover, imported foreign inputs for exports fell with signs of accelerated “onshoring” and adjustments in global value chains, though their long-term effect on the CA balance remains unclear. Lower commodity and semiconductor import prices also boosted the trade balance, while outbound tourism spending declined (by ¼ percent of GDP) following a pronounced slowdown in overseas travel and lower tourism spending. Viewed from a longer perspective, the CA surplus has been trending down from the peak of 10 percent of GDP in 2007, reflecting strong investment growth, REER appreciation, weak external demand, and progress in rebalancing. In the first quarter of 2020, the CA turned to a deficit of 1 percent of GDP, as exports declined sharply due to production disruptions. For the year, the CA balance is expected to post a surplus of 1.3 percent, reflecting the combined effects of weaker demand, lower commodity prices, international travel disruptions, and a higher income deficit. The CA surplus is projected to converge to about 0.5 percent of GDP over the medium term, in line with continued rebalancing.					
	<b>Assessment.</b> The EBA CA methodology estimates the CA gap to be 1.2 percent of GDP. Considering that shifts in timing of trade and the accelerated onshoring raised the CA surplus by about ¼ percent of GDP, the IMF staff assesses the CA gap to range from –0.5 to 2.5 percent of GDP, with a midpoint of 1 percent. This assessment is subject to uncertainties around the degree of the temporary nature of these factors. The EBA identified policy gaps are close to nil on balance, reflecting the impact of loose fiscal policy offsetting that of a relatively closed capital account (in a de jure sense), while the earlier negative credit gap was closed following moderate credit growth. The overall gap is accounted for by the residual, which reflects other factors, including distortions that encourage excessive saving.					
2019 (% GDP)	Actual CA: 1.0	Cycl. Adj. CA: 0.8	EBA CA Norm: –0.4	EBA CA Gap: 1.2	Staff Adj.: –0.2	Staff CA Gap: 1.0
<b>Real Exchange Rate</b>	<b>Background.</b> In 2019, the REER depreciated by 0.8 percent from the 2018 average. The signaling effect from a stronger use of the countercyclical adjustment factor (CCAF) helped counter the depreciation pressure from heightened trade tensions, leading to a moderate NEER depreciation (1.8 percent). As of May, the REER had appreciated by about 1.8 percent from the 2019 average.					
	<b>Assessment.</b> The EBA REER index regression estimates the REER gap to be –1.1 percent and that resulting from the IMF staff CA gap (using an elasticity of 0.23) to be –4.4 percent. Overall, the staff assesses the REER gap to be in the range of –12 to 8 percent, with a midpoint of –2 percent, while noting that the RMB depreciation was driven largely by the escalation of trade tensions. The assessment, in this context, is subject to especially high uncertainty.					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> Capital outflows increased to about US\$160 billion in 2019, up from US\$6 billion in 2018. Benefiting partially from continued opening, despite external pressure and weaker domestic growth, the amount was significantly below the annual outflows of about US\$650 billion in 2015–16. A 20 percent reserve requirement on FX forwards, a CFM, and the CCAF (both reintroduced in 2018) remain in place. Two CFMs were eased in 2020 to attract inflows; the ceiling on cross-border financing under the macroprudential assessment framework was raised by 25 percent and restrictions on the investment quota of foreign institutional investors (QFII and RQFII) were removed.					
	<b>Assessment.</b> While currently absent, substantial net outflow pressures may resurface as the private sector seeks to accumulate foreign assets faster than nonresidents accumulate Chinese assets. Over the medium term, the sequence of further capital account opening consistent with exchange rate flexibility should carefully consider domestic financial stability. Specifically, further capital account opening is likely to create substantially larger two-way gross flows. Hence, the associated balance sheet adjustments and the shifts in market sentiment require prioritizing the shift to an effective float (while using FX intervention to counter disorderly market conditions) and strengthening domestic financial stability prior to a substantial further opening. Efforts should be redoubled to encourage inward FDI, support growth, and improve corporate governance. CFMs should not be used to actively manage the capital flow cycle or substitute for warranted macroeconomic adjustment and exchange rate flexibility.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> FX reserves increased by US\$35 billion in 2019, following a decline of US\$67 billion in 2018, reflecting mainly valuation effects, interest income, and adjustments in net forward positions, with no sign of large FX intervention. FX reserves had declined by US\$6 billion as of May.					
	<b>Assessment.</b> The level of reserves—at 82 percent of the IMF's standard composite metric at end-2019 (89 percent in 2018) and 133 percent of the metric adjusted for capital controls (143 percent in 2018)—is assessed to be adequate. The decline in the ratios reflects higher broad money growth, external debt, and other liabilities that raised the metric.					

**Table 3.7. Euro Area: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately stronger than the level implied by medium-term fundamentals and desirable policies.</i> This year, the impact of the pandemic on the CA balance, which is projected to narrow 2.3 percent in 2020, is highly uncertain amid the collapse in global trade and investment income. In the medium term, the CA surplus is projected to narrow slightly from 2019 levels, although the range of uncertainty around this is very high given the nature of this crisis. Nevertheless, imbalances that existed prior to the COVID-19 outbreak could remain sizable at the national level.						
<b>Potential Policy Responses:</b> Short-term policies should focus on containing the COVID-19 outbreak and its economic consequences and provide relief to households and firms to reduce scarring from the crisis. The recent EU-level COVID-crisis initiatives will support these efforts and potentially help reduce imbalances. While medium-term outcomes are subject to significant uncertainty, monetary policy should remain accommodative until inflation has durably converged to the ECB's medium-term price stability objective. If imbalances in policy gaps that existed prior to COVID-19 were to persist at the national level, then countries with excess CA surpluses should continue to strengthen investment and potential growth, whereas those with weak external positions should undertake reforms to raise productivity and enhance competitiveness as the acute phase of the pandemic recedes. Area-wide initiatives to make the currency union more resilient (for example, banking and capital markets union and fiscal capacity for macroeconomic stabilization) could further reinvigorate investment and, hence, reduce the aggregate CA surplus.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP of the euro area had fallen to about –23 percent of GDP by the end of 2009, but has since recovered, reaching about –51 percent by the end of 2019. The rise was driven by stronger CA balances and modest nominal GDP growth. The increase in the NIIP during 2019 reflects primarily transactions and exchange rate changes, especially the net increase in “other investment” assets. Gross foreign positions were about 243 percent of GDP for assets and 244 percent of GDP for liabilities in 2019. However, net external assets reached elevated levels in large net external creditors (for example, Germany and the Netherlands), whereas net external liabilities remained high in some countries, including Portugal and Spain.</p> <p><b>Assessment.</b> Projections of continued CA surpluses suggest that the NIIP-to-GDP ratio will rise further, at a moderate pace, and the euro area is expected to soon become a net external creditor. The region's overall NIIP financing vulnerabilities appear low. Despite rising CA balances, large net external debtor countries still bear a greater risk of a sudden stop of gross inflows.</p>					
2019 (% GDP)	NIIP: –0.5	Gross Assets: 243.3	Debt Assets: 95.4	Gross Liab.: 243.8	Debt Liab.: 94.7	
<b>Current Account</b>	<p><b>Background.</b> The CA balance for the euro area stood at 2.7 percent in 2019, lower than in 2018, following a steady increase from close to zero in 2011. A stronger goods balance was more than offset by weaknesses in services and investment income balances. Some large creditor countries, such as Germany and the Netherlands, continued to have sizable surpluses, reflecting strong corporate and household saving and weak investment. The CA surplus widened in the first quarter of 2020, year over year, driven by the goods balance.</p> <p><b>Assessment.</b> The EBA model estimates a CA norm of 1.4 percent of GDP, against a cyclically adjusted CA of 2.7 percent of GDP. This implies a gap of 1.3 percent of GDP. IMF staff analysis indicates a higher CA norm than estimated by the EBA model, consistent with the assessed external positions of euro area member countries. The higher CA norm considers policy commitments to reduce the large net external liability positions in some countries (for example, Portugal and Spain) and uncertainty about the demographic outlook and the impact of recent large-scale immigration (for example, Germany). In addition, adjustments to the underlying CA for measurement issues were undertaken in Ireland and the Netherlands. Considering these factors and uncertainties in the estimates, the IMF staff assesses the CA gap to be 1.2 percent for 2019, with a range of 0.4 to 2.0 percent of GDP.</p>					
2019 (% GDP)	Actual CA: 2.7	Cycl. Adj. CA: 2.7	EBA CA Norm: 1.4	EBA CA Gap: 1.3	Staff Adj.: –0.1	Staff CA Gap: 1.2
<b>Real Exchange Rate</b>	<p><b>Background.</b> The CPI-based REER depreciated by 3.1 percent in 2019, reversing the appreciation in 2018. This reflected a nominal depreciation of 1.5 percent in 2019, which was reinforced by weaker euro area inflation relative to its trading partners. The ULC-based REER depreciated by 2.3 percent. Other published REERs based on extra-euro-area trading partners depreciated by 1.6 percent on average. The REER continued to depreciate until February 2020, before reversing course in March. As of May, the REER appreciated by about 0.9 percent from the 2019 average.</p> <p><b>Assessment.</b> The EBA REER index model suggests an overvaluation of 4.2 percent, and the EBA REER-level model implies an undervaluation of 0.7 percent. The REER gap derived from the IMF staff's CA gap assessment, with an estimated elasticity of 0.35, implies that the real exchange rate was undervalued by 3.4 percent in 2019.<sup>1</sup> Given the high uncertainty around these estimates, the staff-assessed REER gap range is –5.7 to 0, with a midpoint of –2.8.<sup>2</sup></p> <p>As with the CA, the aggregate REER gap masks a large degree of heterogeneity in REER gaps across euro area member states, ranging from an undervaluation of 11 percent in Germany to overvaluations of 0 to 9 percent in several small to mid-sized euro area member states. The large differences in REER gaps within the euro area highlight the continued need for net external debtor countries to improve their external competitiveness and for net external creditor countries to boost domestic demand.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Mirroring the 2019 CA surplus, the euro area experienced net capital outflows, driven largely by transactions in direct investment to the United Kingdom and the United States, and other investment outflows as banks reduced external liabilities. These were somewhat tempered by net portfolio debt inflows. In the first quarter of 2020, the euro area experienced net capital outflows, driven mainly by FDI and other investment flows.</p> <p><b>Assessment.</b> Gross external indebtedness of euro area residents decreased by 1.3 percent of GDP as higher external long-term sovereign debt was more than offset by lower other investment liabilities of banks and interoffice FDI debt.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.</p>					

**Table 3.8. France: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.</i>						
<b>Potential Policy Responses:</b> In response to the COVID-19 pandemic, France deployed significant fiscal resources to bolster the health care system and provide targeted support to affected firms and individuals. In the near term, efforts should continue to focus on saving lives and supporting those most affected by the crisis. Uncertainty surrounding the medium-term outlook is unusually large. If the imbalances that existed prior to the COVID-19 outbreak were to persist in the medium term, policies would need to refocus on improving competitiveness by reinvigorating structural reforms and on rebuilding fiscal space once the recovery is secured. These could also help bring the CA more in line with medium-term fundamentals and desirable policies.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> The NIIP stood at –19 percent of GDP at end-2019, slightly below the range observed during 2014–18 (between –15 and –18 percent of GDP). The NIIP had fallen by about 8 percent of GDP since end-2018, largely driven by an increase in banks' and public sector gross debt (11 and 5 percent of GDP, respectively). While the net position is moderately negative, gross positions are large. Gross asset position stood at 299 percent of GDP in 2019, of which banks' non-FDI-related assets account for about 40 percent, reflecting their global activities. On the other hand, gross liabilities reached 318 percent of GDP in 2019, of which external debt is about 218 percent of GDP (53 percent accounted for by banks and 27 percent by the public sector). About three-fourths of France's external debt liabilities are denominated in domestic currency. The average TARGET2 balance in 2019 was only about €100 million.					
	<b>Assessment.</b> The NIIP is negative, but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities coming from large public external debt (58 percent of GDP) and banks' gross financing needs—the stock of banks' short-term debt securities was €83 billion at end-2019 (3.5 percent of GDP), and financial derivatives stood at about 35 percent of GDP.					
2019 (% GDP)	NIIP: –18.7	Gross Assets: 299.2	Debt Assets: 166.6	Gross Liab.: 317.9	Debt Liab.: 212.0	
<b>Current Account</b>	<b>Background.</b> The CA deficit remained broadly stable in 2019, at 0.7 percent of GDP (compared with 0.6 percent in 2018). The modest decline in the primary income surplus (by 0.2 percent of GDP from 2018 to 2019) was broadly offset by a small rise in the goods and services trade balance (by 0.1 percent of GDP). The CA deficit over the four quarters up to 2020:Q1 remained unchanged at 0.7 percent of GDP as a fall in the balance on non-oil goods and in the primary balance was offset by a rise in current transfers. For 2020, the IMF staff projects the CA deficit will narrow slightly to about 0.5 percent of GDP, as the contraction in exports and further fall in the primary income balance are expected to be more than offset by a rise in the oil balance, given lower oil prices, and a significant expected contraction in non-oil imports on the back of depressed domestic activity.					
	<b>Assessment.</b> The 2019 cyclically adjusted CA deficit is estimated at 0.5 percent of GDP, compared with an EBA-estimated norm of a surplus of 0.6 percent. On this basis, the IMF staff assesses that the CA gap in 2019 was between –1.6 and –0.6 percent of GDP.					
2019 (% GDP)	Actual CA: –0.7	Cycl. Adj. CA: –0.5	EBA CA Norm: 0.6	EBA CA Gap: –1.1	Staff Adj.: 0.0	Staff CA Gap: –1.1
<b>Real Exchange Rate</b>	<b>Background.</b> Following a cumulative appreciation of 3.0 and 3.7 percent during 2016–18, mainly due to the appreciation of the euro during that period, the ULC-based and the CPI-based REER depreciated by 3.3 and 1.7 percent, respectively, in 2019. The depreciation of the REER registered in 2019 largely exceeded the depreciation of the euro (the NEER depreciated by only about 1 percent in 2019). Through May 2020, however, the ULC-based REER has appreciated by 9.7 percent with respect to the 2019 average, while the CPI-based REER has depreciated slightly, by 0.2 percent. From a longer perspective, although both REER measures have depreciated by about 9 percent since their peak levels in 2008, France has not managed to regain the loss of about one-third of its export market share registered in the early 2000s (while the export market share of the euro area remained broadly stable between 2000 and 2018).					
	<b>Assessment.</b> The EBA REER-index model points to an REER gap of –2.7 percent, while the EBA REER-level model points to an REER gap of 3.2 percent. Meanwhile, given an elasticity of 0.27, the staff CA gap points to an overvaluation of 2.2 to 5.9 percent. In line with estimates derived from the CA assessment, the IMF staff assesses the REER gap to be in the range of 2.2 to 5.9 percent, with a midpoint of 4.1 percent. <sup>1</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> The CA deficit in 2019 was financed mostly by net portfolio debt inflows (about 3.2 percent of GDP). Outward direct investment flows declined from 4.5 to 2 percent of GDP between 2018 and 2019, falling below inward flows (at about 2.5 percent of GDP) for the first time in six years. Financial derivative flows have grown sizably both on the asset and the liability side since 2008, and especially in 2020:Q1, when asset- and liability-side flows increased to 12 and 18 percent of GDP, respectively, from about 5.5 percent in 2019. The capital account is open.					
	<b>Assessment.</b> France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sectors.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> The euro has the status of a global reserve currency.					
	<b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.					

**Table 3.9. Germany: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was substantially stronger than the level implied by medium-term fundamentals and desirable policies.</i> The IMF staff projects a temporary dip in the CA surplus below trend in the near term as the COVID-19 crisis leads to a severe disruption in world trade. Over the medium term—after the impact of the pandemic has receded—the CA surplus is projected to recover and then resume its modest gradual narrowing, supported by a realignment of price competitiveness and solid domestic demand. As Germany is part of the euro area, the nominal exchange rate does not flexibly adjust to the country's external position, but stronger wage growth relative to euro area trading partners is expected to contribute to realigning price competitiveness within the monetary union. However, the projected adjustment is partial, and additional policy actions will be necessary for external rebalancing.</p> <p><b>Potential Policy Responses:</b> The sizable fiscal stimulus in response to the COVID crisis is a welcome use of Germany's ample fiscal space. In the near term, policies should continue mitigating the outbreak while supporting households and businesses in a way that minimizes economic scarring and facilitates a swift recovery. If imbalances and policy distortions that existed prior to the COVID-19 outbreak persist in the medium term, a growth-oriented fiscal policy, with greater public sector investment in areas such as digitalization, infrastructure, and climate mitigation, would help crowd in private investment, promote potential growth, and make the economy more resilient. Structural reforms to foster entrepreneurship (for example, by expanding access to venture capital, and stronger tax incentives for research and development) would also stimulate investment and reduce external imbalances. Additional tax relief for lower-income households, boosting their purchasing power, and pension reforms prolonging working lives would help reduce excessive saving and ameliorate external imbalances.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Germany's positive NIIP surpassed 70 percent of GDP in 2019, more than doubling over the past five years. The net rise in foreign assets over this period, however, still fell short of the accumulation of CA surpluses. The NIIP of financial corporations other than monetary financial institutions is large and positive (65 percent of GDP), whereas that of the general government is large and negative (26 percent of GDP), partly reflecting Germany's safe haven status. The NIIP is expected to exceed 80 percent of German GDP by 2022, as the projected CA surplus remains large through the medium term but is expected to be partly offset by valuation changes. Foreign assets are well diversified by instrument. The stock of Germany's TARGET2 claims on the Eurosystem has gradually come down, standing at €895 billion at end-2019 (26 percent of GDP), down from a peak of over €976 billion in mid-2018.</p> <p><b>Assessment.</b> With implementation of QE measures by the ECB, Germany's exposure to the Eurosystem remains large.</p>					
2019 (% GDP)	NIIP: 70.7	Gross Assets: 273.4	Debt Assets: 148.6	Gross Liab.: 202.7	Debt Liab.: 118.5	
<b>Current Account</b>	<p><b>Background.</b> The CA surplus has widened significantly since 2001, peaking at 8.6 percent of GDP in 2015 and falling gradually since then. In 2019, the CA surplus decreased slightly to 7.1 percent of GDP (from 7.4 percent of GDP in 2018) despite a rise in the oil and gas trade balance (partly due to energy prices falling from the previous year's spike). The bulk of the CA surplus reflects the large saving-investment surpluses of households and the government; the saving-investment balance of nonfinancial corporations, while still positive, has narrowed. In 2020, the CA surplus is projected to temporarily decline to 5.6 percent of GDP.</p> <p><b>Assessment.</b> The cyclically adjusted CA balance reached 7.3 percent of GDP in 2019, 0.4 percentage point below the 2018 level. The IMF staff assesses the CA norm at 2 to 4 percent of GDP, with a midpoint 0.4 percent of GDP above the 2.5 percent CA norm implied by the EBA model. This upward adjustment reflects uncertainty over the demographic outlook and the impact of recent large-scale immigration on national saving. Taking these factors into account, the IMF staff assesses the 2019 CA gap to be in the range of 3.3 to 5.3 percent of GDP.<sup>1,2</sup></p>					
2019 (% GDP)	Actual CA: 7.1	Cycl. Adj. CA: 7.3	EBA CA Norm: 2.5	EBA CA Gap: 4.7	Staff Adj.: -0.4	Staff CA Gap: 4.3
<b>Real Exchange Rate</b>	<p><b>Background.</b> The yearly average CPI-based REER depreciated by 1.7 percent, while the ULC-based REER appreciated by 3.0 percent in 2019, reflecting the depreciation of the euro against the currencies of key trading partners—most notably the US dollar—amid significant pickup in relative unit labor costs. Through May 2020, the REER has appreciated by 1.0 percent relative to the 2019 average.</p> <p><b>Assessment.</b> The EBA REER-level model yields an undervaluation of 16 percent, whereas the undervaluation implied by the assessed CA gap is in the range of 9 to 14 percent (using an estimated elasticity of about 0.36).<sup>3</sup> Taking these estimates into consideration in conjunction with the 2019 real appreciation in ULC-based terms, the IMF staff assesses the 2019 REER to have been undervalued in the range of 6 to 16 percent, with a midpoint of 11 percent.<sup>4</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> In 2019, net portfolio outflows comprised almost half of the capital and financial accounts balance, with direct investment being the second largest item (27 percent of total). On a destination basis, over 60 percent of the outflows went to other EU countries, with about 23 percent going to the Americas (mostly the United States). Meanwhile, inflows were primarily accounted for by direct investment and portfolio inflows originating in other EU countries, whereas investment by emerging markets and North America declined. FDI inflows and outflows declined sharply, after rising in 2018, driven mainly by slowing flows between Germany and other EU countries.</p> <p><b>Assessment.</b> Safe haven status and the strength of Germany's current external position limit risks.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by euro area countries are typically low relative to standard metrics. The currency floats freely.</p>					



**Table 3.10. Hong Kong SAR: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA surplus widened in 2019, mostly owing to the economic downturn resulting from the domestic social unrest and trade tensions between the United States and China. From a longer-term perspective, the CA surplus remained lower than its pre-2010 level on account of structural factors, including the opening of mainland China's capital account and changes in offshore merchandise trade activities. As a result of Hong Kong SAR's linked exchange rate system (LERS), short-term movements in the REER largely reflect US dollar developments. The credibility of the currency board arrangement is assured by a transparent set of rules governing the arrangement, ample fiscal and FX reserves, strong financial regulation and supervision, a flexible economy, and a prudent fiscal framework.</i></p> <p><b>Potential Policy Responses:</b> In the near term, policies, including expansionary fiscal policy, are needed to cope with the cyclical downturn aggravated by the COVID-19 outbreak and support the recovery. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, fiscal policy should remain expansionary and measures will be necessary to ensure fiscal sustainability given the rapidly aging population. Maintaining policies that support wage and price flexibility is crucial to preserving competitiveness. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the LERS have worked well, and continuation of these policies will help keep the external position broadly in line with fundamentals.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP increased to 427 percent of GDP in 2019 from 354 percent in 2018. Gross assets (1,537 percent of GDP) and liabilities (1,109 percent of GDP) are high, reflecting Hong Kong SAR's status as a global financial center. Valuation changes have been sizable, as the increase in NIIP during 2015–19 (153 percent of 2019 GDP) far exceeded the cumulative financial account balances (21 percent of 2019 GDP).</p> <p><b>Assessment.</b> Vulnerabilities are low given the positive and sizable NIIP and its favorable composition. FX reserves are large and stable (121 percent of GDP), and direct investment accounts for a large share of gross assets and liabilities (36 and 51 percent, respectively), whereas only 14 percent of gross liabilities are portfolio liabilities.</p>					
	2019 (% GDP)	NIIP: 427.4	Gross Assets: 1,536.6	Debt Assets: 527.4	Gross Liab.: 1,109.2	Debt Liab.: 389.0
<b>Current Account</b>	<p><b>Background.</b> The economy fell into a technical recession in 2019, and the CA surplus widened to 6.2 percent of GDP from 3.7 percent in 2018, driven by a sharp narrowing of the trade deficit in goods. This reflects both weakness in domestic demand from the social unrest and lower oil prices, which were partially offset by weak exports resulting from the trade tensions between the United States and China and a lower services balance (by about 3 percentage points of GDP) from the sharp fall in tourism (–14 percent year over year). From a longer-term perspective, the gradual decline in private saving, driven by robust consumption growth, a tight labor market, and wealth effects related to the strong housing market, accounted for most of the drop in the CA surplus from its peak of 15 percent of GDP in 2008. The CA balance turned into a deficit of 1.4 percent of GDP in the first quarter of 2020, driven mainly by declines in the services and income balances amid the COVID-19 outbreak. The CA surplus is projected to fall below 6.0 percent of GDP in 2020 driven by weak tourism flows, with significant uncertainties from US-China tensions and the cyclical positions of the domestic economy and key trading partners. The CA balance is projected to be about 4.0 percent of GDP over the medium term.</p> <p><b>Assessment.</b> The cyclically adjusted CA surplus increased to 5.2 percent of GDP in 2019, which is close to a midpoint of the IMF staff-assessed CA norm range of 2.9 to 5.9 percent of GDP. The staff-assessed CA gap range is hence about –0.7 to 2.3 percent of GDP, with a midpoint of about 0.8 percent. The staff-assessment CA gap reflects mainly the policy gaps related to fiscal policy. Since Hong Kong SAR is not in the EBA sample, the CA norm was estimated by applying EBA-estimated coefficients to Hong Kong SAR and was adjusted for measurement issues related to the large valuation effects in the NIIP and the discrepancies between stocks and flows.<sup>1</sup></p>					
	2019 (% GDP)	Actual CA: 6.2	Cycl. Adj. CA: 5.2	EBA CA Norm: —	EBA CA Gap: —	Staff Adj.: —
<b>Real Exchange Rate</b>	<p><b>Background.</b> Under the currency board arrangement, REER dynamics are largely determined by US dollar developments and inflation differentials between the United States and Hong Kong SAR. In line with the US dollar, after appreciating by about 16 percent during 2012–18, the REER appreciated by another 4 percent in 2019. The REER continued to appreciate by about 3.6 percent in the first five months of 2020 compared with its 2019 average.</p> <p><b>Assessment.</b> The IMF staff assesses the REER gap, based on a midpoint of the staff CA gap, to be in the range of –7½ to 2½ percent, with a midpoint of –2½ percent (based on CA-REER elasticity of about 0.4).<sup>2</sup></p>					
	<p><b>Capital and Financial Accounts: Flows and Policy Measures</b></p> <p><b>Background.</b> As a global financial center, Hong Kong SAR has an open capital account. Nonreserve financial outflows widened in 2019, largely driven by net portfolio outflows, but turned to inflows in the first quarter of 2020 on strong net portfolio inflows. The financial account is typically very volatile, reflecting financial conditions in Hong Kong SAR and mainland China (transmitted through growing cross-border financial linkages),<sup>3</sup> shifting expectations of US monetary policy, and related arbitrage in the FX and rates markets.</p> <p><b>Assessment.</b> Large financial resources, proactive financial supervision and regulation, and deep and liquid markets should help limit the risks from potentially volatile capital flows. The greater financial exposure to mainland China could also pose risks to the banking sector if growth on the mainland slows sharply or financial stress emerges amid increasing tension between the United States and China. However, the credit risk appears manageable given the high origination and underwriting standards of Hong Kong SAR banks.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> As the Hong Kong dollar depreciated to the weak side of convertibility undertaking, the HKMA conducted FX operations as part of the currency board operations, selling US\$2.8 billion in March 2019. As Hong Kong interbank offered rates have gradually caught up with London interbank offered rates since then, the spread has narrowed, and the Hong Kong dollar has traded within the convertibility undertaking range. Total reserve assets increased to about 121 percent of GDP at end-2019 (or twice the monetary base), up from 117 percent in 2018. The strong side of the convertibility undertaking was triggered in April and June 2020—driven mainly by increased carry-trade activities and equity-related demand for Hong Kong dollars—prompting the HKMA to sell HK\$57.6 billion as part of the currency board arrangement.</p> <p><b>Assessment.</b> FX reserves are currently adequate for precautionary purposes and should continue to evolve in line with the automatic adjustment inherent in the currency board system. Hong Kong SAR also holds significant fiscal reserves (about 40 percent of GDP) built through a track record of strong fiscal discipline.</p>					

**Table 3.11. India: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies.</i> India's low per capita income, favorable growth prospects, demographic trends, and development needs justify running CA deficits. External vulnerabilities remain, stemming from volatility in global financial conditions and an oil price surge, as well as a retreat from cross-border integration. Progress has been made on FDI liberalization, whereas portfolio flows remain controlled. India's trade barriers remain significant.						
<b>Potential Policy Responses:</b> Policy priorities in the period ahead need to address the pandemic emergency in a way that preserves lives and the productive capacity in the economy. These include fiscal, monetary, and financial sector policies that especially protect vulnerable households and firms, including those in the informal sector. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, measures to rein in fiscal deficits should be accompanied by efforts to enhance credit provision through faster cleanup of bank, nonbank financial, and corporate balance sheets, and strengthening the governance of public banks. Improving the business climate, easing domestic supply bottlenecks, and liberalizing trade and investment will be important to help attract FDI, improve the CA financing mix, and contain external vulnerabilities. Gradual liberalization of portfolio flows should be considered, while monitoring risks of portfolio flow reversals. Exchange rate flexibility should remain the main shock absorber, with intervention limited to addressing disorderly market conditions.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> As of end-2019, India's NIIP had risen to -15.0 percent of GDP, from -15.9 percent of GDP at end-2018. Gross foreign assets and liabilities were 24.6 and 39.6 percent of GDP, respectively. The bulk of assets are in the form of official reserves and FDI, whereas liabilities include mostly other investments and FDI. External debt amounted to some 20 percent of GDP, of which about 52 percent was denominated in US dollars and another 34.5 percent in Indian rupees. Short-term external debt on a residual maturity basis stood at 42.3 percent of total external debt and 51.8 percent of FX reserves. <b>Assessment.</b> With CA deficits projected to continue in the medium term, the NIIP-to-GDP ratio is expected to fall marginally. India's external debt is moderate compared with other emerging market economies, but rollover risks remain elevated in the short term. The moderate level of foreign liabilities reflects India's gradual approach to capital account liberalization, which has focused mostly on attracting FDI.					
2019 (% GDP)	NIIP: -15.0	Gross Assets: 24.6	Res. Assets: 16.2	Gross Liab.: 39.6	Debt Liab.: 19.9	
<b>Current Account</b>	<b>Background.</b> The CA deficit is estimated to have narrowed to 0.9 percent of GDP in fiscal year 2019/20 from 2.1 percent of GDP in the previous year, due to sharply weaker domestic demand. Despite exports decelerating amid the slowdown in global growth and trade, the contraction in investment goods imports resulted in a narrowing of the trade balance aided by relatively low oil prices. The CA deficit is projected to narrow to 0.3 percent of GDP in 2020/21 driven mainly by lower oil prices and import compression due to weak domestic demand, with unusually high uncertainty, including over the cyclical position of the economy. Over the medium term, the CA deficit is expected to widen to about 2½ percent of GDP, on the back of strengthening domestic demand. <b>Assessment.</b> The EBA cyclically adjusted CA deficit stood at 1.4 percent of GDP in fiscal year 2019/20. The EBA CA regression estimates a norm of -3.0 percent of GDP for India in fiscal year 2019/20, with a standard error of 1.3 percent, thus implying an EBA gap of 1.6 percent. In the IMF staff's judgment, a CA deficit of about 2½ percent of GDP is financeable over time. FDI flows are not yet sufficient to cover protracted and large CA deficits; portfolio flows are volatile and susceptible to changes in global risk appetite, as demonstrated in the taper tantrum episode and again in fall 2018 and more recently due to the COVID-19 outbreak. Thus, with the IMF staff-assessed CA norm, the CA gap would range from 0 to 2 percent of GDP. Positive policy contributions to the CA gap stem from a negative credit gap, an increase in FX reserves, and a relatively closed capital account, partly offset by a larger-than-desirable domestic fiscal deficit.					
2019 (% GDP)	Actual CA: -0.9	Cycl. Adj. CA: -1.4	EBA CA Norm: -3.0	EBA CA Gap: 1.6	Staff Adj.: -0.6	Staff CA Gap: 1.0
<b>Real Exchange Rate</b>	<b>Background.</b> The average REER in 2019 appreciated by about 5.8 percent from its 2018 average. As of May 2020, the rupee had depreciated by about 0.4 percent in real terms compared with the average REER in 2019. <b>Assessment.</b> The EBA REER index and REER level models estimate a REER gap of 13.4 and 10.2 percent, respectively, for 2019. Based on the IMF staff CA gap and semi-elasticity of 0.18, the REER gap is assessed to be in the range of -11.1 to -0.1 percent for fiscal year 2019/20, with a midpoint of -5.6 percent. <sup>1</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> The sum of FDI, portfolio, and financial derivatives flows on a net basis is estimated at 2.3 percent of GDP in 2019, up from 0.8 percent in 2018. Net FDI inflows increased only marginally to 1.4 percent of GDP in 2019, despite investor-friendly reform efforts that could have attracted more investment. After bouts of both equity and debt outflows in 2018, net portfolio flows rebounded (0.9 percent of GDP) in 2019. However, India faced a drastic reversal of portfolio flows US\$15 billion in 2020:Q1 amid the COVID-19 shock, while FDI inflows US\$10.6 billion continued. The authorities responded by allowing exchange rate depreciation and limited FX intervention, and by relaxing measures on debt inflows. <b>Assessment.</b> Yearly capital inflows are relatively small, but, given the modest scale of FDI, flows of portfolio and other investments are critical to finance the CA. As evidenced by the episodes of external pressure, portfolio debt flows have been volatile, and the exchange rate has been sensitive to these flows and changes in global risk aversion. Attracting more stable sources of financing is needed to reduce vulnerabilities.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> With weak domestic demand, relatively low oil prices, and renewed total capital inflows, foreign reserves reached a record high (US\$459.8 billion) in 2019. Spot foreign exchange purchases were US\$40 billion (1.5 percent of GDP), and net forward sales decreased by US\$550 million in 2019. International reserves continued increasing rapidly in the first two months of the year, leaving reserves higher at US\$477.8 billion at end-March 2020. Reserve coverage currently is about 16.4 percent of GDP and about 13 months of prospective imports of goods and services. <b>Assessment.</b> Reserve levels are adequate for precautionary purposes relative to various criteria. International reserves represented about 173 percent of short-term debt and 163 percent of the IMF's composite metric by end-2019.					



**Table 3.12. Indonesia: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies.</i> Exchange rate flexibility and structural policies should help contain the CA deficit over the medium term. External financing appears sustainable. However, it is sizable, and with a large share of foreign portfolio investment, it exposes the economy to fluctuations in global financial conditions, introducing uncertainty in the assessment.</p> <p><b>Potential Policy Responses:</b> Achieving durable external balance will require structural reforms to boost competitiveness. Reforms should include higher infrastructure and social spending aimed at fostering human capital development (while maintaining fiscal sustainability through revenue mobilization), fewer restrictions on FDI and external trade (nontariff trade barriers), and labor market flexibility (for example, streamlining stringent job protection, improving job placement services). Flexibility of the exchange rate should continue to support external stability in a context of increased market volatility associated with the COVID-19 pandemic.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> At end-2019, Indonesia's NIIP was –31 percent of GDP, broadly unchanged since end-2018. Gross external assets reached 33 percent of GDP (of which, 35 percent were reserve assets) and gross external liabilities reached 64 percent of GDP. Despite an influx of foreign capital, Indonesia's gross external debt was moderate at 36 percent of GDP at end-2019, of which 19 percent was denominated in rupiah and 84 percent was maturing after one year.					
	<b>Assessment.</b> The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable and subject to limited rollover risk, but nonresident holdings of rupiah-denominated government bonds, at 39 percent of the total stock (or 6.8 percent of GDP) at end-2019, combined with shallow domestic financial markets, make Indonesia vulnerable to global financial volatility, higher US interest rates, and a stronger US dollar. Since 2015, the IIP has had a positive net foreign currency exposure, based on its currency composition and asset-liability structure. IMF staff projections for the CA suggest that the NIIP as a percentage of GDP will continue to rise over the medium term.					
2019 (% GDP)	NIIP: –31.2	Gross Assets: 32.7	Res. Assets: 11.5	Gross Liab.: 64.0	Debt Liab.: 32.3	
<b>Current Account</b>	<b>Background.</b> Indonesia's CA deficit narrowed to 2.7 percent of GDP in 2019, from a 2.9 percent deficit in 2018, driven mainly by weak import growth. The latter reflected lower prices for imported commodities and, despite this, weaker import volume growth from policy actions and softening domestic demand. The CA deficit is projected to narrow to 1.6 percent in 2020, driven by a contraction in domestic demand and imports, partially compensated for by the negative impact on tourism of the COVID-19 pandemic. Structural policies are expected to help limit the CA deficit in the medium term.					
	<b>Assessment.</b> The IMF staff estimates a CA gap of –1.0 percent for 2019, consistent with an estimated cyclically adjusted CA deficit of 2.7 percent of GDP and a staff-assessed norm of –1.6 percent of GDP. <sup>1</sup> Considering uncertainties in the estimation of the norm, the CA gap for 2019 is in the range of –2.5 percent to 0.5 percent of GDP. <sup>2</sup> Achieving external balance will require structural reforms to strengthen health, education, and infrastructure and increase labor market flexibility, which is consistent with the suggested room for higher fiscal spending identified by the policy gaps.					
2019 (% GDP)	Actual CA: –2.7	Cycl. Adj. CA: –2.7	EBA CA Norm: –0.8	EBA CA Gap: –1.9	Staff Adj.: 0.9	Staff CA Gap: –1.0
<b>Real Exchange Rate</b>	<b>Background.</b> The REER depreciated in 2018 by 6.3 percent relative to the average of 2017 due to tighter global financial conditions. In 2019, the average REER appreciated by 4.3 percent relative to the 2018 average, following an easing of global financial conditions and an inflow of capital. As of May 2020, the REER had depreciated by 0.1 percent compared with the 2019 average.					
	<b>Assessment.</b> The EBA index and level REER models point to 2019 REER gaps of about 2.1 percent to –9.0 percent, respectively, with the upward shift in the range of the estimated gaps, compared with 2018, driven by the appreciation of the REER. Meanwhile, the IMF staff CA gap estimate of –1.0 percent of GDP implies a REER gap of 5.6 percent with standard elasticities. <sup>3</sup> In the staff's assessment, the EBA index and CA models are most relevant for Indonesia. Considering all inputs as well as the REER appreciation in 2019, the IMF staff assesses the REER gap in the –1.2 to 8.9 percent range, with a midpoint of 3.9 percent. <sup>4</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> In 2019, net capital and financial account inflows (3.3 percent of GDP) were sustained by net FDI inflows (1.8 percent of GDP), net portfolio inflows (1.9 percent of GDP), and net other investment inflows of –0.5 percent of GDP. In March 2020, Indonesia faced large capital outflows from the sale of rupiah-denominated securities by nonresident investors, although these outflows were largely offset by inflows from the subsequent issuance of foreign-currency-denominated government bonds.					
	<b>Assessment.</b> Net and gross financial flows continue to be prone to periods of volatility. The broadly contained CA deficit and strengthened policy frameworks, including exchange rate flexibility since mid-2013, have helped reduce capital flow volatility. Continued strong policies focused on strengthening the fiscal position, keeping inflation in check, advancing financial deepening, and easing supply bottlenecks would help sustain capital inflows in the medium term.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> Since mid-2013, Indonesia has had a more flexible exchange rate policy framework. At end-2019, reserves were US\$129.2 billion (equal to 12 percent of GDP, about 119 percent of the IMF's reserve adequacy metric and about 9 months of prospective imports of goods and services), compared with US\$120.7 billion at end-2018. The reserve accumulation reflects mainly the net capital inflows and foreign exchange receipts from oil and gas and other sectors. In addition, contingencies and swap lines amounting to about US\$95 billion are in place. In a context of increased market volatility associated with the COVID-19 pandemic, the Bank of Indonesia intervened in the non-spot and spot FX markets in February and March 2020 and introduced daily FX swap auctions to ensure adequate market liquidity. International reserves recovered in April 2020, reaching US\$127.9 billion.					
	<b>Assessment.</b> While the composite metric may not adequately account for commodity price volatility, the current level of reserves (US\$129.2 billion at end-2019) should provide a sufficient buffer against a wide range of possible external shocks, with predetermined drains also manageable. FX intervention should continue to aim primarily at preventing disorderly market conditions while allowing the exchange rate to adjust to external shocks.					

**Table 3.13. Italy: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The sustained CA surplus reflects structurally weak investment, while gross external liabilities remain high, with a large share of public debt.</i>						
<b>Potential Policy Responses:</b> In the above-mentioned context, once the health crisis has passed, policies to improve competitiveness are necessary to support growth and reduce public debt over the medium term. Even if the external position remains in line with fundamentals, credible medium-term fiscal consolidation as well as efforts to further strengthen bank balance sheets will be necessary to reduce external vulnerabilities and maintain investor confidence. Structural reforms to ensure wages are aligned with productivity at the firm level are also important to boost potential growth and competitiveness and reduce vulnerabilities. The elements of this package of policies would likely have offsetting effects on the CA balance, as they would boost export competitiveness but also raise investment.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Italy's NIIP reached an estimated –1.6 percent of GDP at end-2019, the highest level since Italy adopted the euro. Gross assets and liabilities, however, are estimated at about 163 and 165 percent of GDP (both over 60 percentage points higher than in 2000). TARGET2 liabilities declined to 25 percent of GDP in 2019, partially because of the inflow of reserves to Italian banks following the introduction of tiering by the ECB.<sup>1</sup> The trend, however, reversed in early 2020 on the back of nonresident outflows, Eurosystem asset purchases, and liquidity measures. Debt securities represent about two-thirds of gross external liabilities, half of which are owed by the public sector. High public debt continues to be a key vulnerability for the Italian economy.</p> <p><b>Assessment.</b> Further strengthening of balance sheets would reduce vulnerabilities related to the high public debt and potential negative feedback loops between the debt stock and debt servicing costs, as well as between sovereign debt and the financial system.</p>					
2019 (% GDP) <sup>2</sup>	NIIP: –1.6	Gross Assets: 163.4	Debt Assets: 64.8	Gross Liab.: 165.0	Debt Liab.: 115.5	
<b>Current Account</b>	<p><b>Background.</b> Italy's CA balance averaged –1¼ percent of GDP in the decade following euro adoption. The rise in the CA since 2010 is almost entirely due to the increase in gross national saving, while investment over GDP has remained stagnant. During 2013–18, the CA balance turned positive; about two-thirds of the increase was driven by increasing trade surpluses, supported initially by lower commodity prices and subsequently by a rebound in external demand. The rest of the increase reflected a higher income balance as residents increased net purchases of foreign assets and external liability payments declined, not least due to accommodative monetary policy. The positive primary income balance also reflects a higher weight of equity in foreign assets than in liabilities. In 2019, the CA surplus reached a multiyear record of 3 percent of GDP as weak domestic demand weighed on imports. The CA surplus is projected to rise to 3.6 percent in 2020 as weaker external demand is offset by weaker oil prices, domestic demand, and imports.</p> <p><b>Assessment.</b> The cyclically adjusted CA is estimated at 2.7 percent of GDP in 2019, close to the EBA-estimated CA norm of 2.6 percent of GDP. The IMF staff assesses a CA gap in the range of –1.0 to 1.0 percent of GDP. Despite the CA being in line with fundamentals, Italy's sizable and long-standing structural rigidities hamper its ability to improve competitiveness.</p>					
2019 (% GDP)	Actual CA: 3.0	Cycl. Adj. CA: 2.7	EBA CA Norm: 2.6	EBA CA Gap: 0.0	Staff Adj.: 0.0	Staff CA Gap: 0.0
<b>Real Exchange Rate</b>	<p><b>Background.</b> From 2018 to 2019, the CPI-based and ULC-based REERs depreciated by about 2 percent. Stagnant productivity and rising labor costs led to a gradual appreciation of the REER since Italy joined the euro area, both in absolute terms and relative to the euro area average, which has partially reversed since 2014. As of May 2020, the REER had appreciated by 0.3 percent compared to the 2019 average.</p> <p><b>Assessment.</b> The level and index REER models suggest a modest overvaluation in 2019 of 4.4 percent and 6.8 percent, respectively, which is generally consistent with, but slightly below, the persistent wage-productivity differentials vis-à-vis key partners. The IMF staff CA gap implies a REER gap close to zero.<sup>3</sup> Overall, the staff assesses the REER gap in the range of 0 to 8 percent of GDP, which implies a midpoint of about 4 percent and reflects the dispersion of and uncertainty around the estimates across different models.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Portfolio and other investment inflows have typically financed past CA deficits, despite a modest net FDI outflow, without much difficulty. Italy's financial account posted net outflows of 3 percent of GDP in 2019, reflecting residents' net purchases of foreign assets. In the middle of the year, portfolio investment shifted from outflows to inflows as foreign investors returned to Italian sovereign debt following the ECB's announcement of extended asset purchases. However, the COVID-19 pandemic, tightening of global financial conditions, and concerns over sovereign rating downgrades triggered substantial sales of Italian government securities by foreign investors in early 2020.</p> <p><b>Assessment.</b> While supported by ample monetary accommodation by the ECB, Italy remains vulnerable to market volatility, owing to the large refinancing needs of the sovereign and banking sectors as well as the remaining balance sheet weaknesses in some banks.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					

Table 3.14. Japan: Economy Assessment

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The strong NIIP generates sizable net returns supporting an income balance that is about as large as Japan's CA surplus.</i>						
<b>Potential Policy Responses:</b> Policy priorities in the period ahead should focus on addressing the pandemic emergency to preserve lives and the productive capacity of the economy. Recent fiscal measures and Bank of Japan actions have appropriately prioritized support to vulnerable households, workers, and firms while also maintaining the smooth functioning of financial markets. If the domestic policy distortions that existed prior to the pandemic are to persist in the medium term, a coordinated policy package will be needed to ensure that the external position remains in line with fundamentals. In particular, addressing domestic policy distortions with offsetting effects would require that, whereas fiscal consolidation should proceed in a gradual manner, it will need to be accompanied by a credible medium-term fiscal framework and structural reforms that support domestic demand. These include measures to boost wages, increase labor productivity and labor supply, reduce barriers to entry in some industries, and accelerate agricultural and professional services sector deregulation.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP remained at about 60 percent of GDP during 2015–18, increasing by 7 percentage points between 2018 and 2019, when it reached 67 percent of GDP—as assets increased more than liabilities, recording 198 and 132 percent of GDP, respectively. In the medium term, the NIIP is projected to rise to about 75 percent, with CA surpluses, before gradually stabilizing due to population aging. Japan holds the world's largest stock of net foreign assets, which was valued at US\$3.4 trillion at end-2019.</p> <p><b>Assessment.</b> Foreign asset holdings are diversified geographically and by risk classes. Portfolio investment accounts for 46 percent of total foreign assets, with about 20 percent yen-denominated. However, with about half of portfolio investment denominated in US dollars, negative valuation effects could materialize in the event of yen appreciation against the US dollar. Liabilities' vulnerabilities are limited, with equity and direct investment accounting for 33 percent of total liabilities. The NIIP generated net annual investment income of 3.8 percent of GDP in 2019. The large positive NIIP in part reflects the accumulation of assets for old-age consumption, which is expected to be gradually unwound over the long term.</p>					
2019 (% GDP)	NIIP: 66.8	Gross Assets: 198.3	Debt Assets: 91.7	Gross Liab.: 131.5	Debt Liab.: 81.8	
<b>Current Account</b>	<p><b>Background.</b> Japan's CA surplus reflects high corporate gross saving exceeding domestic investment and a sizable income balance owing to its large net foreign assets position. In line with sustained national saving, the CA surplus has averaged 3.7 percent of GDP since 2015, recording 3.6 percent of GDP in 2019. The income balance continues to contribute most to the CA surplus, at 3.8 percent of GDP in 2019. Lower energy prices supported the average CA balance surplus during 2015–17, while higher energy prices during 2018–19 contributed to a relatively lower CA surplus. The 2019 CA-surplus-to-GDP ratio was unchanged since 2018, as an increase in the services trade balance from higher travel credits was offset by a decline in the goods trade balance as exports to GDP decreased more than imports to GDP due to adverse external conditions. The 2020 CA balance is projected at 3.2 percent of GDP, with unusually high uncertainty, including over the cyclical position of the economy. The ongoing pandemic is expected to significantly depress both exports to GDP and imports to GDP in 2020 due to a collapse in external and domestic demand, and the pandemic is expected to reduce the income balance by a reduction in net credits.</p> <p><b>Assessment.</b> The 2019 CA assessment uses the EBA model, in which the estimated cyclically adjusted CA is 3.5 percent of GDP and the cyclically adjusted CA norm is estimated at 3.5 percent of GDP, with a standard error of 1.2 percent of GDP. The IMF staff estimates a 2019 CA norm range between 2.3 and 4.7 percent of GDP. The 2019 CA gap midpoint is assessed to be 0.0 percent of GDP (with the CA gap range between –1.2 and 1.2). The large unexplained portion of the 2019 EBA CA gap suggests that important bottlenecks to investment and consumption were present, including entry barriers to entrepreneurship and corporate saving's distortions.</p>					
2019 (% GDP)	Actual CA: 3.6	Cycl. Adj. CA: 3.5	EBA CA Norm: 3.5	EBA CA Gap: 0.0	Staff Adj.: 0.0	Staff CA Gap: 0.0
<b>Real Exchange Rate</b>	<p><b>Background.</b> After depreciating by 5.7 percent between 2016 and 2018, the average REER appreciated in 2019 by 2.8 percent. Estimates through May 2020 show that the REER has appreciated by 4.1 percent relative to the 2019 average, although markets remain volatile, reflecting changes in global risk aversion and the monetary policy stances of key central banks in response to the pandemic.</p> <p><b>Assessment.</b> The EBA REER level and index models deliver REER gaps of –12.5 and –18 percent, respectively, for the 2019 average REER. However, the EBA REER level and index models are not used for the assessment because they do not capture well Japan-specific factors. Using the IMF staff 2019 CA gap as a reference and applying a staff-estimated semi-elasticity of 0.14 yields a staff range for the 2019 REER gap between –9 and 9 percent with a midpoint of 0 percent.<sup>1</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Portfolio outflows continued during 2019, although they decreased over the year as institutional investors continued to diversify overseas, and FDI outflows increased, mainly to Europe and the United States. Net FDI and portfolio flows comprise the bulk of the 2019 financial account (4.2 and 1.7 percent of GDP, respectively), whereas other investments (net) recorded inflows (2.1 percent of GDP). Net short yen positions reemerged in late 2019. In the first quarter of 2020, portfolio outflows to the United States and Europe picked up and FDI outflows were stable, while net short yen positions decreased.</p> <p><b>Assessment.</b> Vulnerabilities are limited. Inward investment tends to be equity-based, and the home bias of Japanese investors remains strong. So far there have been no large spillovers from the Bank of Japan's yield curve control to financial conditions in other economies (interest rates, credit growth). If capital outflows from Japan accelerate, they could provide an offset to the effects of tighter domestic financial conditions in the region.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Reserves are about 25 percent of GDP, on legacy accumulation. There has been no FX intervention in recent years.</p> <p><b>Assessment.</b> The exchange rate is free floating. Interventions are isolated (last occurring in 2011), intended to reduce short-term volatility and disorderly exchange rate movements.</p>					

**Table 3.15. Korea: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The change in assessment from 2018, when the external position was assessed to be moderately stronger than fundamentals, is due to the narrowing of the CA gap, which in turn reflects a decline in policy gaps and a deterioration in Korea's terms of trade following a fall in semiconductor prices.</i>						
<b>Potential Policy Responses:</b> Following the COVID-19 outbreak in early 2020, the authorities have deployed additional fiscal and monetary stimulus to support economic activity, most of which is expected to be temporary. Ensuring that the external position remains in line with medium-term fundamentals will require continued accommodative fiscal and monetary policies, as well as structural policies to stimulate investment and facilitate rebalancing of the economy toward services and other new growth drivers. Desirable reforms include reducing barriers to firm entry and investment, deregulating the nonmanufacturing sector, and strengthening the social safety net to lessen the need for precautionary saving across sectors. The exchange rate should remain market-determined, with intervention limited to addressing disorderly market conditions.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP has grown since 2014. Data for 2019 imply that Korea's NIIP was about 30 percent of GDP, with gross liabilities at about 73 percent of GDP, of which about one-third was gross external debt. On the back of CA surpluses and search-for-yield activity by financial institutions, driven by asset accumulation for old-age consumption as Korean society ages, the NIIP is projected to rise to about 50 percent of GDP in the medium term.</p> <p><b>Assessment.</b> The positive NIIP strengthens external sustainability. Foreign asset holdings are diversified, with about 45 percent held in equity or debt securities. About 60 percent of foreign assets are denominated in US dollars, implying that won depreciation has positive valuation effects. Vulnerabilities from the liability side are limited, with equity and direct investment accounting for 40 percent of total liabilities.</p>					
2019 (% GDP)	NIIP: 30.4	Gross Assets: 103.2	Debt Assets: 28.9	Gross Liab.: 72.8	Debt Liab.: 26.3	
<b>Current Account</b>	<p><b>Background.</b> The CA surplus narrowed further to 3.6 percent of GDP in 2019 compared with a peak of 7.2 percent in 2015. The narrowing in the 2019 CA surplus relative to 2018, when it was 4.5 percent of GDP, principally reflects a fall in semiconductor prices. From a saving-investment perspective, the narrowing in the CA reflected a larger fall in saving, particularly for the household sector, relative to the investment-to-GDP ratio. The CA surplus is projected to narrow further to 3.4 percent in 2020, due largely to weak external demand from trading partners being offset by lower imports. Over the medium term, the CA surplus is projected to widen to about 4.3 percent of GDP as global demand recovers, semiconductor prices stabilize, and the service sector balance rises.</p> <p><b>Assessment.</b> The EBA model estimates the cyclically adjusted CA to be 3.3 percent of GDP, while the cyclically adjusted CA norm is estimated at 3.3 percent of GDP, with a standard error of 0.9 percent of GDP. The 2019 CA gap midpoint is assessed to be 0.0 percent of GDP. Policy gaps narrowed compared with 2018, reflecting more expansionary fiscal policy. The policy gap was still positive in 2019, however, reflecting a larger fiscal surplus than the IMF staff's recommended medium-term balance and low social spending. At the same time, the residual component has grown, reflecting a larger drop in Korea's terms of trade than is potentially picked up by the EBA model.</p>					
2019 (% GDP)	Actual CA: 3.6	Cycl. Adj. CA: 3.3	EBA CA Norm: 3.3	EBA CA Gap: 0.0	Staff Adj.: 0.0	Staff CA Gap: 0.0
<b>Real Exchange Rate</b>	<p><b>Background.</b> Following sustained appreciation during 2015–18, the REER depreciated in 2019 by about 4.5 percent, returning to its 2015 level. As of May 2020, the REER had depreciated by an additional 3.6 percent compared to the 2019 average. The Korean won remains sensitive to swings in the semiconductor price cycle, shifts in global risk sentiment, and the monetary policy stances of key central banks.</p> <p><b>Assessment.</b> Using 2019 data, the EBA REER index model reports that the REER was 0.6 percent overvalued; the REER level model reports an 8 percent undervaluation. Overall, the IMF staff uses the CA gap while assuming a trade elasticity of 0.36, which implies a REER gap of –3 percent to 3 percent with a midpoint of 0 percent.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Net portfolio outflows have been on a downward trend since 2017, when outflows peaked at 6.7 percent of GDP. Portfolio outflows were 5.8 percent of GDP in 2019, reflecting further portfolio diversification, and institutional investors continued to search for yield. Net FDI and portfolio flows comprised the bulk of the 2019 financial account (2.2 and 3.6 percent of GDP, respectively), whereas other investments (net) recorded inflows (0.6 percent of GDP). In the first quarter of 2020, net FDI and portfolio outflows moderated, largely driven by portfolio debt inflows and a fall in outward FDI flows.</p> <p><b>Assessment.</b> The present configuration of net and gross capital flows appears sustainable over the medium term. In recent years, including in the context of the ongoing COVID-19 outbreak, Korea has demonstrated significant capacity to absorb short-term capital flow volatility.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Korea has a floating exchange rate. FX intervention appears to have been two-sided since early 2015, based on IMF staff estimates. In 2019 reserves reached 25 percent of GDP, on legacy accumulation. FX intervention data released by the Bank of Korea show that it sold a net US\$6.7 billion (0.4 percent of GDP) in 2019 to help the won adjust in an orderly way in the face of significant won exchange rate pressures. In the first quarter of 2020, reserves declined modestly by US\$7.6 billion in the context of heightened volatility in the exchange rate market following the COVID-19 outbreak. As of end-April, the Bank of Korea had also drawn about US\$20 billion from the US\$60 billion swap line established by the Federal Reserve (US\$60 billion).</p> <p><b>Assessment.</b> Since 2015, intervention appears to have been limited to addressing disorderly market conditions. As of end-2019, FX reserves were about 110 percent of the IMF's composite reserve adequacy metric, which, together with access to the recently established Federal Reserve swap facility, provides enough of a buffer against a wide range of possible external shocks.</p>					



**Table 3.16. Malaysia: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was stronger than the level implied by medium-term fundamentals and desirable policies.</i> Over the past few years, Malaysia's growth model has become increasingly driven by private domestic demand, and its CA surplus has narrowed significantly. Further decline in the surplus is projected over the medium term on the back of policies supporting continued robust domestic private demand.</p> <p><b>Potential Policy Responses:</b> In response to the ongoing COVID-19 shock, policies should continue to focus on providing relief to stressed firms and households and preserving the production capacity of the economy, while maintaining FX market stability. The recent fiscal stimulus and monetary easing were appropriate, and need to be kept under review as the crisis unfolds. If distortions that existed prior to the COVID-19 outbreak persist in the medium term, the planned fiscal consolidation should be accompanied by policies to strengthen the social safety net and continue to encourage private investment and productivity growth, including measures to improve small and medium-sized enterprises' access to credit, promote the quality of education, reduce skills mismatch, and encourage female labor participation. Continued exchange rate flexibility is necessary to facilitate external adjustment, with intervention limited to addressing disorderly market conditions.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Malaysia's NIIP has averaged about 1 percent of GDP since 2010, with changes in recent years reflecting both CA surplus and valuation effects. As of end-2019, the NIIP rose to -1.5 percent of GDP from -5.7 percent of GDP at end-2018, with higher net direct investment liabilities more than offset by the reduction in the net portfolio investment and other investment liabilities.<sup>1</sup> Direct investment abroad and official reserves contribute most to foreign assets, whereas FDI and nonresidents' portfolio investment in Malaysia contribute most to foreign liabilities. Total external debt, measured in US dollars, was about 63.4 percent of GDP at end-2019 (end-2018: 62.3 percent), of which about two-thirds was in foreign currency and 41 percent in short-term debt, by original maturity.</p> <p><b>Assessment.</b> The NIIP should rise gradually over the medium term, reflecting projected moderate CA surpluses. Malaysia's balance sheet strength, along with exchange rate flexibility and increased domestic investor participation, would help support resilience to a variety of shocks, including outflows associated with external liabilities.<sup>2</sup></p>					
	2019 (% GDP)	NIIP: -1.5	Gross Assets: 111.1	Res. Assets: 28.4	Gross Liab.: 112.6	Debt Liab.: 62.6
<b>Current Account</b>	<p><b>Background.</b> Malaysia's CA surplus declined by about 8 percentage points of GDP between 2010 and 2018, primarily driven by lower national saving and a modest rise in investment until 2017. In 2019, the CA surplus increased to 3.4 percent of GDP, driven by a sharp decline in capital imports. The goods balance remained in surplus, whereas the services account and income accounts registered lower deficits. The CA registered a surplus of 2.6 percent of GDP in 2020:Q1. With high uncertainty due to the COVID-19 shock, the CA surplus is projected to decline to 0.5 percent of GDP in 2020, driven by a sharp decline in tourism and external demand, which will outweigh the negative impact of the domestic demand shock on imports. After the COVID-19 shock dissipates, the CA balance is expected to return to a modest surplus but decline over the medium term, driven by lower private sector saving and higher investment.</p> <p><b>Assessment.</b> The EBA CA regression estimates a cyclically adjusted CA of 3.5 percent of GDP and a CA norm at -0.2 percent of GDP for 2019. After factoring in the effect of the postponement of large infrastructure projects (which have relatively high import content) on capital imports (0.4 percent of GDP), which represents a temporary yet protracted shock that would gradually taper off, the preliminary estimate of the IMF staff CA gap is about 3.3 percent of GDP (about 1 percent of GDP). Over half of the CA gap is attributed to policy distortions. Low domestic public health care spending contributes 0.7 percentage point to the CA gap, while looser fiscal policy in the rest of the world, relative to Malaysia, also contributes 0.7 percentage point to the excess surplus. Unidentified residuals potentially reflect structural impediments and country-specific factors not included in the model.</p>					
	2019 (% GDP)	Actual CA: 3.4	Cycl. Adj. CA: 3.5	EBA CA Norm: -0.2	EBA CA Gap: 3.7	Staff Adj.: -0.4
<b>Real Exchange Rate</b>	<p><b>Background.</b> In 2019, the REER depreciated by 1.4 percent relative to the 2018 average. The REER is about 12 percent lower than its 2013 peak, reflecting the impact on the NEER from capital outflows and terms-of-trade shocks, with the latter contributing to a decline in the CA surplus. In May 2020, the REER had depreciated by 3.5 percent relative to the 2019 average.</p> <p><b>Assessment.</b> The EBA REER index and level models estimate Malaysia's REER to be undervalued by about 25 and 38 percent, respectively. However, the usual macroeconomic stresses associated with such undervaluation are absent (for example, high core inflation, sustained wage pressure, or significant FX reserve buildup). Consistent with the IMF staff CA gap, the staff assesses the REER gap in 2019 to be -7.2 percent (about 2 percent).<sup>3</sup></p>					
	<p><b>Capital and Financial Accounts: Flows and Policy Measures</b></p> <p><b>Background.</b> Since the global financial crisis, Malaysia has experienced periods of significant capital flow volatility, largely driven by portfolio flows in and out of the local-currency-debt market, in response to both the change in global financial conditions and domestic factors. Since late 2016, the Financial Markets Committee has implemented measures to develop the onshore FX market.<sup>4</sup> Portfolio capital flows had stabilized in April 2020, after substantial outflows in March.</p> <p><b>Assessment.</b> Continued exchange rate flexibility and macroeconomic policy adjustments are necessary to manage capital flow volatility. CFMs should be gradually phased out, with due regard for market conditions.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Malaysia's official reserves fell by US\$8.1 billion since May 2018 and had stabilized at US\$101.4 billion as of end-2018. The reserve level began to gradually pick up in the first half of 2019 and stood at US\$103.6 billion as of end-2019. The pre-COVID-19 reserve level was sustained throughout April 2020.</p> <p><b>Assessment.</b> Under the IMF's composite reserve adequacy metric (ARA),<sup>5</sup> reserves remain broadly adequate. Gross and net official reserves were about 116 percent and 101 percent of the ARA metric, respectively, as of end-2019. Given limited reserves and the increased hedging opportunities since 2017, FX interventions should be limited to preventing disorderly market conditions. In case of an inflow surge, some reserve accumulation would be suitable to increase the reserve coverage ratio.</p>					
	<p><b>Assessment.</b> Under the IMF's composite reserve adequacy metric (ARA),<sup>5</sup> reserves remain broadly adequate. Gross and net official reserves were about 116 percent and 101 percent of the ARA metric, respectively, as of end-2019. Given limited reserves and the increased hedging opportunities since 2017, FX interventions should be limited to preventing disorderly market conditions. In case of an inflow surge, some reserve accumulation would be suitable to increase the reserve coverage ratio.</p>					

**Table 3.17. Mexico: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA deficit narrowed significantly, on the back of a temporary sharp decline in investments and imports, as well as strong exports and remittances. The assessment remains subject to considerable uncertainty around the degree of the temporary nature of these factors and the impact of developments (notably, COVID-19 and oil prices) in 2020.</i>						
<b>Potential Policy Responses:</b> The focus should be on providing sufficient policy support in the near term in response to COVID-19 and committing to implement pro-growth and inclusive fiscal reforms as well as reinvigorate structural reforms over the medium term, conditional on the post-COVID-19 challenges and environment, to improve competitiveness and the investment climate. The floating exchange rate should continue to serve as the main shock absorber, with FX interventions used to prevent disorderly market conditions. A dollar swap line with the US Federal Reserve and the IMF Flexible Credit Line provide added buffers against global tail risks.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> Mexico's NIIP is projected to remain broadly stable at about –50 percent of GDP over the medium term. Foreign assets mainly consist of direct investment (18 percent of GDP) and reserves (14.5 percent of GDP). Foreign liabilities are mostly FDI (50 percent of GDP) and portfolio investment (41 percent of GDP). Gross public external debt was 25 percent of GDP, of which about one-third was holdings of local currency government bonds.					
	<b>Assessment.</b> Whereas the NIIP is sustainable, and the local currency denomination of a large share of foreign public liabilities reduces foreign exchange risks, the large gross foreign portfolio liabilities could be a source of vulnerability in case of global financial volatility. Exchange rate vulnerabilities are also moderate as most Mexican firms with FX debt have natural hedges and actively manage their FX exposures.					
2019 (% GDP)	NIIP: –52.1	Gross Assets: 48.3	Res. Assets: 14.5	Gross Liab.: 100.4	Debt Liab.: 38.6	
<b>Current Account</b>	<b>Background.</b> In 2019, the CA deficit narrowed sharply to –0.3 percent of GDP from –2.1 percent in 2018, driven by an unexpected sharp contraction in investments and imports (from uncertainty related to the United States-Mexico-Canada Agreement and to policy), strong exports (from trade diversion arising from US-China trade tensions), and workers' remittances. Exports and imports of goods fell by 10.7 and 11.3 percent year over year, respectively, in the first four months of 2020, reflecting the impact of COVID-19 and the fall in oil prices, while remittances increased by 18.4 percent in the first quarter. The 2020 CA is expected to record a moderate deficit of 0.2 percent of GDP subject to a high degree of uncertainty against the backdrop of the collapse of oil prices and a decline in external and domestic demand from COVID-19. Over the medium term, the CA deficit is projected to widen toward the CA norm as a rising oil balance is offset by some decline in the non-hydrocarbon CA.					
	<b>Assessment.</b> The EBA model estimates a cyclically adjusted CA norm of –2.2 percent of GDP in 2019. This implies a CA gap of 1.5 percent of GDP (range of 0.4 to 2.6 percent of GDP). The policy gap contribution is estimated at 1 percent of GDP, mainly driven by loose fiscal policy in the rest of the world and lower-than-desired spending on health. Given an IMF staff adjustment of 0.6 percent of GDP to account for the unexpectedly sharp rise in the CA, which is expected to unwind, reflecting the decline in investment and imports in the context of trade-related and policy uncertainty in 2019, as well as the positive impact of trade diversion and remittances, the IMF staff assesses the CA gap at 0.9 percent of GDP (range of –0.2 to 2.0 percent of GDP).					
2019 (% GDP)	Actual CA: –0.3	Cycl. Adj. CA: –0.7	EBA CA Norm: –2.2	EBA CA Gap: 1.5	Staff Adj.: 0.6	Staff CA Gap: 0.9
<b>Real Exchange Rate</b>	<b>Background.</b> For most of 2019, the peso fluctuated within a relatively narrow range of 19 to 19.5 vis-à-vis the US dollar. The average REER in 2019 was about 3 percent stronger than the 2018 average, mostly driven by a nominal appreciation. In May 2020, the REER was 15.0 percent weaker than the 2019 average, driven by an almost 17 percent depreciation in nominal effective terms.					
	<b>Assessment.</b> The EBA REER level and index models estimate an undervaluation of 3.5 and 15.4 percent, respectively, in 2019. Considering all estimates and the uncertainties around them, the IMF staff's overall assessment, based on the staff CA gap (applying an elasticity of 0.13), estimates Mexico's REER gap to be in the range of –15 to 1 percent, with a midpoint of –7 percent.					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> In 2019, net FDI and portfolio debt flows decelerated but remained positive, while net equity flows were negative. In the first four months of 2020, the sovereign issued around US\$12 billion in FX bonds, exceeding its FX debt financing needs, while there was a decline of almost US\$14 billion in nonresident holdings of peso debt by mid-May. Net FDI flows also declined sharply (by 20 percent), while net equity flows were negative in the first quarter. Going forward, portfolio inflows are unlikely to return to previous high growth rates.					
	<b>Assessment.</b> The long maturity of sovereign debt and high share of local currency financing reduce the exposure of government finances to depreciation risks. The banking sector appears well capitalized, liquid, and resilient. Nonfinancial corporate debt is low, and foreign exchange risks are generally covered by natural and financial hedges. But the strong presence of foreign investors leaves Mexico exposed to capital flow reversals and risk premium increases. The authorities have refrained from capital flow management measures. Capital flow risks are also mitigated by prudent macro policies.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> The central bank remains committed to a free-floating exchange rate, whereas discretionary intervention is used solely to prevent disorderly market conditions. At end-2019, FX reserves amounted to US\$183 billion (14.5 percent of GDP), up from US\$176 billion at end-2018. By mid-June 2020, FX reserves had increased to US\$197 billion, mostly owing to the federal government's debt management operations and valuation changes. In 2018 and 2019, no discretionary interventions occurred. In 2020, two nondeliverable forwards auctions were conducted, alongside further US dollar liquidity provision measures, in response to large external shocks.					
	<b>Assessment.</b> At 117 percent of the assessing reserve adequacy metric and 234 percent of short-term debt (at remaining maturity), the end-2019 level of foreign reserves remains adequate. The IMF staff recommends that the authorities continue to maintain reserves at an adequate level over the medium term. Also, the US\$60 billion swap line with the Federal Reserve, established in March 2020, and the IMF Flexible Credit Line arrangement provide additional buffers.					



**Table 3.18. Netherlands: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was substantially stronger than the level implied by medium-term fundamentals and desirable policies. The Netherlands' status as a trade and financial center and natural gas exporter makes an external assessment particularly uncertain.</i>						
<b>Potential Policy Responses:</b> The authorities' use of their fiscal space and the escape clause to provide crucial support to the health sector and to help households and businesses to face the COVID-19 pandemic is entirely appropriate. Once the pandemic is over, policies should aim at promoting the recovery and supporting investment in physical and human capital to foster robust potential growth.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The Netherlands' NIIP reached 89 percent of GDP at the end of 2019 (with gross assets and liabilities totaling 1,126 and 1,037 percent of GDP, respectively), rising from an almost balanced NIIP at end-2009. The largest component of the NIIP comes from the net FDI stock, about €1,007 billion (124 percent of GDP) at the end of 2019. The Netherlands reported the largest inward and outward FDI positions in the world at end-2018, according to the latest Coordinated Direct Investment Survey. The United Kingdom, the United States, and Luxembourg are the top three partner countries, with gross bilateral stock positions close to US\$1.6, US\$1.2, and US\$0.9 trillion, respectively. TARGET2 assets of the Eurosystem are estimated at about €62 billion. Owing both to the CA surplus and to large denominator effects, the NIIP is expected to increase as a ratio to GDP in 2020, possibly exceeding the 100 percent mark in the absence of large revaluation effects.</p> <p><b>Assessment.</b> The Netherlands' safe haven status and its sizable foreign assets limit risks from its large foreign liabilities.</p>					
2019 (% GDP)	NIIP: 89	Gross Assets: 1,126	Res. Assets: 262.1	Gross Liab.: 1,037	Debt Liab.: 306.6	
<b>Current Account</b>	<p><b>Background.</b> In 2019, the CA surplus decreased slightly to 10.2 percent of GDP (10.5 percent cyclically adjusted). The CA has been in surplus since 1981—a reflection of a positive goods and services balance, largely vis-à-vis EU trading partners. The primary income balance is relatively low despite the large NIIP. Nonfinancial corporate net saving (that is, gross saving minus domestic business investment) has been a main driver of the surpluses since 2000, with large corporate saving financing substantial FDI outflows. Household net saving (that is, gross saving minus residential investment) accounts for a small part of the CA surpluses, reflecting offsetting high mandatory contributions to the second-pillar pension funds and high real estate investment. The Netherlands' status as a trade and financial center and natural gas exporter also contribute to the strong structural position. In 2020, the CA surplus is projected to decline to 8.0 percent of GDP.</p> <p><b>Assessment.</b> The EBA CA model estimates a CA norm of 3.3 percent of GDP and a CA gap of 7.2 percent of GDP in 2019, with an unexplained residual of 4.6 percent of GDP.<sup>1</sup> The large unexplained residual primarily reflects the high gross saving of Netherlands-based multinationals, a fraction of which may reflect measurement errors or biases, as official statistics may overstate the net accumulation of wealth that should be attributed to Dutch residents. This is especially relevant for the Netherlands because the foreign ownership of publicly listed Dutch corporations has been above 85 percent over the past 10 years. An IMF staff adjustment of –2.3 percent of GDP to offset said bias is based on useful data provided by the Dutch central bank. Taking these factors into account, the IMF staff assesses the norm in a range of 1.3 to 5.3 percent of GDP, and a corresponding CA gap of 2.9 to 6.9 percent of GDP.</p>					
2019 (% GDP)	Actual CA: 10.2	Cycl. Adj. CA: 10.5	EBA CA Norm: 3.3	EBA CA Gap: 7.2	Staff Adj.: –2.3	Staff CA Gap: 4.9
<b>Real Exchange Rate</b>	<p><b>Background.</b> The annual average CPI-based REER remained flat, whereas the average ULC-based REER depreciated by about 4 percent in 2019. Euro depreciation together with higher inflation in the Netherlands (due to temporary effects of indirect tax increases) led to an unchanged REER, whereas the Dutch ULC grew more slowly than its trading partners' did. As of May 2020, the REER has appreciated by 1.1 percent relative to the 2019 average.</p> <p><b>Assessment.</b> The EBA REER models indicate an overvaluation between 4.2 percent (level model) and 16.1 percent (index model) in 2019, largely attributable to unexplained residuals. The IMF staff CA gap of 4.9 percent of GDP implies an REER undervaluation of about 7 percent (assuming a semi-elasticity of 0.7). Taking into account all estimates and the uncertainty surrounding the EBA REER results, the IMF staff assesses that the REER remained undervalued by about 4.1 to 9.9 percent, with a midpoint of 7 percent.<sup>1</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Net FDI and portfolio outflows dominate the financial account. FDI outflows are driven by the investment of corporate profits abroad, largely by multinationals. More than half of gross FDI assets and liabilities are attributable to subsidiaries of multinationals.</p> <p><b>Assessment.</b> The strong external position limits vulnerabilities from capital flows. The financial account is likely to remain in deficit as long as the corporate sector continues to invest substantially abroad.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro is a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					

**Table 3.19. Poland: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was stronger than the level implied by medium-term fundamentals and desirable policies.</i> Large depreciation of the REER over the past decade amid resilient external demand caused the CA to transition from a large deficit to a small surplus, reaching 0.5 percent of GDP in 2019. While this evolution is consistent with a maturing FDI cycle, the CA surplus is excessive given that income convergence is incomplete. In the short term, the CA surplus is projected to remain broadly stable as a substantial decline in government net saving should be largely offset by increases in private net saving. Uncertainty is higher over the medium term due to the COVID-19 pandemic; however, as the economy recovers from the COVID-19 crisis, the CA is expected to return to a moderate deficit as private net saving returns to a lower level, more than offsetting an anticipated rise in government net saving. Reserves are adequate to insulate against external shocks and disorderly market conditions.</p> <p><b>Potential Policy Responses:</b> In the short term, fiscal policy should bolster the health system, providing businesses with liquidity and supporting incomes of vulnerable households, including through preserving employment. Monetary and financial policies should prevent a tightening of financial conditions and enable the financial sector to support firms' liquidity. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, policies should aim to boost corporate investment and productivity, while active labor market policies should facilitate access to skilled labor with structural reforms focused on raising potential growth. The fiscal deficit should be reduced after the crisis has abated. Room should be made for priority fiscal spending, especially health care and self-financed public investment, as EU funds are gradually phased out, by better targeting social benefits according to need.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP stood at -50 percent of GDP in 2019, broadly stable since 2018. Gross assets and liabilities reached 49 and 99 percent of GDP, respectively. The stock of net FDI (equity and debt), accounting for 36 percent of gross external liabilities, remains diversified across sectors and source countries. While gross external debt is sizable (62 percent of GDP), 27 percent of the debt is liabilities to direct investors via intercompany loans; 74 percent of the debt is of long-term maturity. Short-term debt (excluding intercompany debt), amounting to 16 percent of GDP, is mainly owed by banks (currency and deposits) and the nonfinancial private sector (trade credit). Automatic debt dynamics are projected to continue to reduce the negative NIIP.</p> <p><b>Assessment.</b> While sizable external debt is a vulnerability, rollover risk is mitigated by the large share of long-term debt as well as intercompany lending that tends to be automatically rolled over. Adequate reserves reduce residual rollover risk from short-term debt (gross reserves at end-2019 were equivalent to 142 percent of short-term debt).</p>					
2019 (% GDP)	NIIP: -50.3	Gross Assets: 48.8	Res. Assets: 21.7	Gross Liab.: 99.2	Debt Liab.: 43.2	
<b>Current Account</b>	<p><b>Background.</b> The CA has moved toward surplus since the 2008 crisis, from large deficits to close-to-balance in recent years. This reflects a larger trade surplus (mainly services), despite sustained high primary income deficits from reinvested earnings and dividend payments to direct investors and net earnings of foreign workers in Poland. Low investment and high saving by the corporate sector have been partially offset by net borrowing by households and the government. Poland's CA swung from a deficit of 1 percent of GDP in 2018 to a surplus of 0.5 percent of GDP in 2019 on further rise in goods and services balances, assisted in part by lower oil prices. In 2020:Q1, the CA surplus increased significantly to US\$6.2 billion (1.1 percent of annual GDP) driven mostly by a large decline in the primary income deficit. For 2020, the CA surplus is expected to reach 1.5 percent of GDP as a projected reduction in the primary income deficit outweighs a decline in the balance of goods and services. Over the medium term, the CA relative to GDP is expected to return to a small deficit as private net saving return to a lower level as the economy recovers, outweighing an increase in government net saving.</p> <p><b>Assessment.</b> For 2019, the EBA CA model estimates a norm of -2.1 percent of GDP against a cyclically adjusted CA of 0.6 percent of GDP. The resulting EBA gap of 2.7 (±1) percent of GDP can be attributed in part to identified policy gaps (1.7 percent of GDP) and an unexplained residual of 0.9 percent of GDP.<sup>1,2</sup></p>					
2019 (% GDP)	Actual CA: 0.5	Cycl. Adj. CA: 0.6	EBA CA Norm: -2.1	EBA CA Gap: 2.7	Staff Adj.: 0.0	Staff CA Gap: 2.7
<b>Real Exchange Rate</b>	<p><b>Background.</b> The REER has depreciated by 18 percent since 2008, including a 1.3 percent real depreciation in 2019. In nominal terms, the zloty has tended to depreciate against the dollar but remain relatively stable against the euro. Over the same period, inflation in Poland has been only slightly higher than in its trading partners. As of May 2020, the REER has depreciated by 2.2 percent relative to the 2019 average.</p> <p><b>Assessment.</b> The REER index model suggests a gap of -2.7 percent.<sup>3</sup> The undervaluation implied by the IMF staff CA gap, along with the assumed CA-REER elasticity of 0.44, is in the range of -4 to -8 percent. Overall, the IMF staff assesses the 2019 REER gap to be -6 percent (±2 percent), consistent with the staff CA gap.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> The capital account, which is dominated by inflows of EU funds for financing investment projects, has averaged about 2 percent of GDP over the past 10 years. In 2019, financial account outflows amounted to 1.7 percent of GDP, mainly due to portfolio investment; net FDI inflows narrowed by 0.5 percentage point from 2018 to 2 percent of GDP, due to both expansion of Polish investment abroad and lower inflows into Poland. In 2020, first quarter financial account outflows increased to US\$8.2 billion (1.5 percent of annual GDP), concentrated in March. The outflows are projected to reach 2 percent of GDP for the year.</p> <p><b>Assessment.</b> Foreign holdings of domestic government securities have declined sharply since 2016 (to 23 percent of the total; 6.9 percent of GDP) as domestic banks have increased their holdings in response to the bank asset tax, which exempts government bonds. Nevertheless, the overall stock remains sizable and could pose risks, although the diversified foreign investor base is a mitigating factor.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Gross international reserves were US\$128 billion at end-2019. Net reserves, which exclude the central bank's repo operations (part of its reserve management strategy) and government FX deposits, were US\$113 billion at end-2019. Net reserves had increased from US\$101 billion at end-2018, reflecting in part the central bank's conversion of a portion of EU funds received by the government to zloty. This is consistent with the central bank's strategy of building an adequate precautionary reserve buffer. Through March 2020, net reserves increased approximately US\$1 billion from end-2019 to US\$114 billion, while gross reserves declined by about US\$8 billion, to US\$121, reflecting a decline in repo operations. The zloty is free floating, and the central bank does not directly intervene in the FX market.</p> <p><b>Assessment.</b> Net reserves were adequate at end-2019, standing at 127 percent of the IMF's composite reserve adequacy (ARA) metric at end-2019. Gross reserves were about 144 percent of the ARA metric.</p>					

**Table 3.20. Russia: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. Oil exports were somewhat affected by moderating oil prices. As a result, the CA surplus narrowed to 3.8 percent of GDP. In the meantime, capital outflows caused by uncertainties surrounding sanctions have declined dramatically.</i>						
<b>Potential Policy Responses:</b> In the short term, fiscal policy should focus on managing the COVID-19 public health emergency and compensating those most affected by it, including self-employed and informal workers as well as small and medium-sized enterprises. If policy distortions and imbalances that existed prior to the COVID-19 outbreak persist in the medium term, fiscal policy should continue to reduce the impact of oil price volatility on the non-oil sector while rebalancing government expenditure toward health, education, and infrastructure. Also, focus should be given to structural reforms aimed at improving the business climate and boosting private sector investment.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> The NIIP had declined slightly to US\$356.5 billion by the end of 2019, which at 21 percent of GDP remains well above the near balance net stock position in 2010. Gross assets rose from 76 percent of GDP in 2018 to 89 percent of GDP; liabilities also increased from 58 percent of GDP to 68 percent. Debt liabilities to nonresidents edged up slightly to 33 percent of GDP. Nonresidents' holdings of ruble-denominated government debt rose marginally to 32 percent of total external debt from 24 percent at end-2018. <sup>1</sup> There are no obvious maturity mismatches between the gross asset and liability positions. Historically, the NIIP position has not kept pace with CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows. <sup>2</sup>					
	<b>Assessment.</b> The projected CA surpluses suggest that Russia will see a gradual rise in its positive NIIP, lowering risks to external stability. Moreover, official external assets have been increasing rapidly since the introduction of the new fiscal rule. The recent COVID-19 shock to oil production and prices, however, could dampen the pace of reserve accumulation in the near term.					
2019 (% GDP)	NIIP: 21.0	Gross Assets: 88.8	Res. Assets: 32.6	Gross Liab.: 67.8	Debt Liab.: 20.6	
<b>Current Account</b>	<b>Background.</b> Reflecting moderating oil prices and commodity exports, the CA balance narrowed to 3.8 percent of GDP in 2019 from 6.8 percent in 2018. The nonenergy CA deficit widened by 1 percentage point to 9.7 percent of GDP, reflecting relatively weak competitiveness in the nonenergy sector. Despite the sharp dip in oil prices, the CA balance still registered a surplus of US\$22 billion in the first quarter of 2020, driven by a trade surplus of US\$32 billion. The CA balance is expected to decline to near zero in 2020 on contracting exports caused by the oil price plunge and weakening global demand as a result of the COVID-19 shock but is expected to recover to above 3 percent of GDP over the medium term as exports rebound.					
	<b>Assessment.</b> The EBA CA model yields a norm of 3.7 percent of GDP for 2019, compared with a cyclically adjusted CA surplus of 3.8 percent of GDP. This implies an EBA CA gap of 0.1 percent of GDP, for which identified policies contributed 2.6 percent of GDP, reflecting sound fiscal and monetary policy, lower-than-desirable health spending, and a continued increase in reserves. The IMF staff assesses the CA gap to be 0.1 percent of GDP in 2019, with a range between -0.9 and 1.1 percent of GDP. Volatility in global commodity markets and uncertainty regarding sanctions complicate this assessment. <sup>3</sup>					
2019 (% GDP)	Actual CA: 3.8	Cycl. Adj. CA: 3.8	EBA CA Norm: 3.7	EBA CA Gap: 0.1	Staff Adj.: 0	Staff CA Gap: 0.1
<b>Real Exchange Rate</b>	<b>Background.</b> The REER appreciated marginally by 2.5 percent in 2019, despite a weaker CA. The REER was generally stable since mid-2017 until recently, when the slump in oil prices put pressure on the currency. By end-May, the REER had depreciated by 5.0 percent from the average in 2019.					
	<b>Assessment.</b> EBA level and index REER models indicate an undervaluation of 14.5 percent and 9.3 percent, respectively. Among the model determinants, the most important contributor to undervaluation is lower-than-desirable health expenditures. Using an elasticity parameter of 0.27 and the IMF staff-assessed CA gap, the staff assesses the 2019 REER gap to be in the range of -5.4 to 4.6 percent, with a midpoint of -0.4 percent. <sup>4</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> Net private capital outflows declined significantly in 2019. The majority of net outflows took place in the first quarter; net flows were insignificant during the rest of the year. The banking sector accounts for the bulk of outflows by reducing foreign liabilities (US\$20.2 billion), while the nonbanking private sector increased both foreign assets (US\$25.3 billion) and foreign liabilities (US\$25.7 billion). In the first quarter of 2020, there were moderate outflows by the private sector in both banking and nonbanking. Pressure on financial flows could stem from volatility in oil prices and global demand as well as geopolitical uncertainty.					
	<b>Assessment.</b> While Russia is exposed to risks of continued outflows due to global and geopolitical uncertainties, the large FX reserves and the floating exchange rate regime provide substantial buffers to help absorb external shocks. The substantial deleveraging in 2018 also helped reduce susceptibility to external shocks.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> Since the floating of the ruble in November 2014, FX interventions have been limited. In 2020:Q1, despite a sharp fall in oil revenue, FX sales have been moderate. International reserves rose to US\$554 billion (more than 19 months of imports) by end-2019 and further edged up marginally in 2020:Q1, largely reflecting FX purchases by the National Wealth Fund under the fiscal rule.					
	<b>Assessment.</b> International reserves at end-2019 were equivalent to 310 percent of the IMF's reserve adequacy metric, considerably above the adequacy range of 100 to 150 percent. Taking into account Russia's vulnerability to oil price shocks and sanctions, an additional commodity buffer of US\$77 billion is appropriate, translating to a ratio of reserves to the buffer-augmented metric to 217 percent.					

**Table 3.21. Saudi Arabia: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was weaker than the level implied by medium-term fundamentals and desirable policies.</i> The pegged exchange rate provides Saudi Arabia with a credible policy anchor. Given the close link between the fiscal and external balance and the structure of the economy, external adjustment will be driven primarily by fiscal policy. The external balance sheet remains very strong. Reserves remain very comfortable when judged against standard IMF metrics, although external savings are not sufficient from an intergenerational equity perspective. Reserves are expected to decline as the CA moves to a deficit and investments overseas by public sector institutions continue.</p> <p><b>Potential Policy Responses:</b> The immediate priority should be fiscal support to the health sector and sectors hit hard by the coronavirus, which will entail running a larger-than-budgeted fiscal deficit this year given the expected decline in oil revenues. To address the imbalances that already existed prior to COVID-19, fiscal consolidation is needed over the medium term to raise the CA and increase saving for future generations. Fiscal adjustment should be based on further energy price reforms, non-oil revenue measures, expenditure restraint, and more efficient spending, supported by reforms to strengthen the fiscal framework. Structural reforms that help diversify the economy and boost the non-oil tradable sector would support a stronger external position over the long term.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Net external assets are estimated at 86 percent of GDP at end-2019, up from 80 percent of GDP in 2018 but down from 105 percent in 2015. Only broad categories are available on the composition of external assets. Portfolio and other investments, reserves, and FDI account for 46 percent, 43 percent, and 11 percent of total external assets, respectively.</p> <p><b>Assessment.</b> The external balance sheet remains very strong. Substantial accumulated assets represent both protection against vulnerabilities from oil price volatility and savings of exhaustible resource revenues for future generations.</p>					
	2019 (% GDP)	NIIP: 86.1	Gross Assets: 146.0	Res. Assets: 63.0	Gross Liab.: 59.9	Debt Liab.: 23.6
<b>Current Account</b>	<p><b>Background.</b> The CA balance registered a surplus of 5.9 percent of GDP in 2019, down from a surplus of 9.2 percent in 2018. The trade balance decreased by 5 percent of GDP as the price and volume of oil exports declined and imports increased. The terms of trade deteriorated by 4.6 percent. The CA is expected to register a deficit of 4.9 percent of GDP in 2020 as oil revenues decline further (the terms of trade are projected to worsen by 42 percent).<sup>1</sup></p> <p><b>Assessment.</b> The reliance on oil subjects the CA to wide swings and complicates the application of standard external assessment methodologies. The CA gap estimated by the EBA-Lite methodology is negative, although the size of the estimated gap varies by approach. The estimated CA gap in 2019 is –2.1 percent of GDP using the CA-regression approach. The consumption allocation rules suggest a CA gap of –2.3 percent of GDP and –5.0 percent of GDP for the constant real annuity and constant real per capita annuity allocation rules, respectively. The Investment Needs Model suggests a CA gap of –2.6 percent of GDP. The IMF staff assesses a CA gap of –3.0 percent of GDP with a range from –1.8 to –4.2 percent of GDP in 2019.<sup>2</sup></p>					
	2019 (% GDP)	Actual CA: 5.9	Cycl. Adj. CA: 5.2	EBA CA Norm: —	EBA CA Gap: —	Staff Adj.: —
<b>Real Exchange Rate</b>	<p><b>Background.</b> The riyal has been pegged to the US dollar at a rate of 3.75 since 1986. The Saudi Arabian Monetary Authority recently issued a statement reiterating its commitment to the peg. On average, the REER depreciated by 0.4 percent in 2019 but was 5.4 percent above its 10-year average. As of end-May 2020, the REER had appreciated by about 2.9 percent relative to the 2019 average.</p> <p><b>Assessment.</b> Exchange rate movements have a limited impact on competitiveness in the short term as most exports are oil or oil-related products, and there is limited substitutability between imports and domestically produced products, which in turn have significant imported labor and intermediate input content. The IMF staff assesses the 2019 REER gap to be about 13 percent with a range of 10 to 16 percent.</p>					
	<p><b>Capital and Financial Accounts: Flows and Policy Measures</b></p> <p><b>Background.</b> Net financial outflows continued in 2019 as public sector institutions accumulated external assets. FX reserves increased marginally. Reserves are expected to decline in 2020 as the CA slips into a deficit and investments overseas by public sector institutions continue as part of the diversification strategy under the government's Vision 2030 plan. Equity markets saw large outflows in March 2020 as oil prices declined and COVID-19 struck global financial markets but have seen some rebound more recently.</p> <p><b>Assessment.</b> Analysis of the financial account is complicated by the lack of detailed information on the nature of the financial flows. The strong reserves position limits risks and vulnerabilities to capital flows.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The investments of the Public Investment Fund are increasing, although most of the government's foreign assets are still held at the central bank within international reserves. Net FX reserves had increased slightly to US\$494 billion (62 percent of GDP, 30.6 months of imports, and 375 percent of the IMF's reserve adequacy metric) at end-2019 but are down from US\$724 billion in 2014. Reserves have fallen by US\$50 billion since end-2019, mainly due to transfers of foreign assets to the sovereign wealth fund.</p> <p><b>Assessment.</b> Reserves play a dual role: savings for both precautionary motives and for future generations. Reserves are more than adequate for precautionary purposes (measured by the IMF's metrics). Nevertheless, fiscal adjustment is needed over the medium term to raise the CA and increase savings for future generations.</p>					

**Table 3.22. Singapore: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was substantially stronger than with the level implied by medium-term fundamentals and desirable policies.</i> Singapore's very open economy and its position as a global trading and financial center make the assessment more uncertain than usual.						
<b>Potential Policy Responses:</b> Amid COVID-19, both external and domestic demand significantly weakened. A sizable fiscal stimulus has been introduced drawing down accumulated government financial assets. The authorities should continue monitoring the implementation of stimulus measures and stand ready to provide further stimulus if needed. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, higher public investment, including on health care, physical infrastructure, and human capital, would help moderate the CA imbalance by lowering net public saving. Structural reforms are also necessary to improve productivity, which would support a trend real exchange rate appreciation.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> The NIIP stood at 241 percent of GDP in 2019, up from 206 percent of GDP in 2018 and 187 percent in 2014. Gross assets and liabilities are high, reflecting Singapore's status as a financial center (about 1,135 and 896 percent of GDP, respectively). About half of foreign liabilities is in FDI, and about a third is in the form of currency and deposits. The CA surplus has been a main driver, but valuation effects were material in some years. CA and growth projections imply that the NIIP will rise over the medium term. The large positive NIIP in part reflects the accumulation of assets for old-age consumption, which is expected to be gradually unwound over the long term.					
	<b>Assessment.</b> Large gross non-FDI liabilities (438 percent of GDP in 2019)—predominantly cross-border deposit taking by foreign bank branches—present some risks, but these are mitigated by large gross asset positions, banks' large short-term external assets, and the authorities' close monitoring of banks' liquidity risk. Singapore has large official reserves and other official liquid assets.					
2019 (% GDP)	NIIP: 240.8	Gross Assets: 1,135.2	Debt Assets: 533.0	Gross Liab.: 894.4	Debt Liab.: 357.9	
<b>Current Account</b>	<b>Background.</b> The CA surplus was 17.0 percent of GDP in 2019, similar to 17.2 percent in 2018. The CA balance is slightly lower than its average since 2014 and significantly lower than the post-global-financial-crisis peak of 22.9 percent in 2010. The CA balance is likely to decline in 2020—due to the COVID-19 movement restrictions and weak external demand—to about 13 percent of GDP, but the uncertainty around this projection is high. Singapore's large CA balance reflects a strong goods balance and small surplus in the services balance that is partly offset by a deficit in the income balance. <sup>1</sup> The oil trade deficit narrowed in 2019. Structural factors and policies that boost saving, such as Singapore's status as a financial center, consecutive fiscal surpluses, and the rapid pace of aging—combined with a mandatory defined-contribution pension program (whose assets were about 83.8 percent of GDP in 2019), as well as relatively high productivity—are the main drivers of Singapore's strong external position. The CA surplus over the medium term is projected to narrow on the back of increased infrastructure and social spending.					
	<b>Assessment.</b> Guided by the EBA framework, the IMF staff assesses the 2019 CA gap to be in the range of 1 to 7 percent of GDP. <sup>2</sup> This gap in part reflects a tighter-than-desired fiscal balance and, to a limited extent, relatively low government health spending.					
2019 (% GDP)	Actual CA: 17.0	Cycl. Adj. CA: 16.8	EBA CA Norm: —	EBA CA Gap: —	Staff Adj.: —	Staff CA Gap: 4
<b>Real Exchange Rate</b>	<b>Background.</b> The REER appreciated by 0.1 percent year over year in 2019 reflecting the appreciation of the NEER by 1.4 percent year over year. This followed a depreciation of the REER by 1.8 percent and an appreciation of the NEER by 1.1 percent, both cumulative, between 2016 and 2018. As of May 2020, the REER had depreciated by 2.8 percent relative to 2019 average.					
	<b>Assessment.</b> The IMF staff assesses that the REER is undervalued by 2 to 14 percent, with a midpoint of 8 percent, applying the semi-elasticity of 0.5 to the staff CA gap. This assessment is subject to a wide range of uncertainty about both the underlying CA assessment and the semi-elasticity of the CA with respect to the REER.					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> Singapore has an open capital account. As a trade and financial center in Asia, changes in market sentiment can affect Singapore significantly. Increased risk aversion in the region, for instance, may lead to inflows to Singapore given its status as a regional safe haven, whereas global stress may lead to outflows. The financial account deficit reflects in part reinvestment abroad of income from official foreign assets, as well as sizable net inward FDI and smaller but more volatile net bank-related flows. In 2019, the deficit on the capital and financial account widened to 19 percent of GDP from 13 percent in 2018. This reflected higher net outflows of portfolio investment, more than offsetting the increase in net inflows of direct investment and a decline in the net outflows of other investment.					
	<b>Assessment.</b> The financial account is likely to remain in deficit as long as the trade surplus remains large.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> With the NEER as the intermediate monetary policy target, intervention is undertaken to achieve inflation and output objectives. As a financial center, prudential motives call for a larger NIIP buffer. Official reserves at the Monetary Authority of Singapore (MAS) reached US\$279 billion (75 percent of GDP) in 2019, after US\$33 billion was transferred to the government in May 2019 for management by sovereign wealth fund GIC. It increased to US\$302 billion in April 2020. The MAS started publishing aggregate data on foreign exchange intervention in April 2020. On March 19, the MAS announced the establishment of a US\$60 billion swap facility with the US Federal Reserve.					
	<b>Assessment.</b> In addition to FX reserves held by the MAS, Singapore also has access to other official foreign assets managed by Temasek and GIC. <sup>3</sup> The current level of official external assets appears adequate, even after considering prudential motives, and there is no clear case for further accumulation for precautionary purposes.					



**Table 3.23. South Africa: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately weaker than the level implied by medium-term fundamentals and desirable policies, with the CA gap staying at the same level as in 2018. Portfolio flows continued to finance most of the relatively high CA deficit.</i>						
<b>Potential Policy Responses:</b> In the near term, policies need to cushion the negative impact of the COVID-19 crisis and protect the vulnerable through temporary and targeted fiscal support. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, reducing external gaps will require bold implementation of structural reforms to improve competitiveness and gradual but substantial fiscal consolidation while providing space for infrastructure and social spending (to improve educational attainment and skills and help reduce poverty and inequality). Efforts are also needed to improve the efficiency of key product markets (by encouraging private sector participation in power generation, transportation, and telecommunications) and the functioning of labor markets. These reforms will help attract durable capital inflows such as FDI. Seizing opportunities to accumulate international reserves, should they arise, would strengthen the country's ability to deal with FX liquidity shocks.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> With large gross external assets and liabilities (respectively, 137 and 129 percent of GDP in 2019), South Africa is highly integrated into international capital markets. The NIIP rose markedly from –8 percent of GDP in 2014 to 16 percent of GDP in 2015, mainly on valuation changes, but declined to 8 percent of GDP in 2019. The NIIP is expected to continue moderating over the medium term as CA deficits are projected to remain relatively high. Gross external debt rose from 26 percent of GDP in 2008 to an estimated 50 percent of GDP in 2019 due mainly to public sector long-term debt. Short-term external debt (on a residual maturity basis) is estimated at about 15.7 percent of GDP in 2019.</p> <p><b>Assessment.</b> Risks from large gross external liabilities are mitigated by several factors, including South Africa's comfortable external asset position, as well as the fact that the bulk of the liabilities are in the form of equities and that about half of all external debt is rand-denominated.</p>					
2019 (% GDP)	NIIP: 8	Gross Assets: 137	Debt Assets: 13.9	Gross Liabilities: 129	Debt Liabilities: 43.2	
<b>Current Account</b>	<p><b>Background.</b> The CA deficit narrowed from 5.8 percent of GDP in 2013 to 2.5 percent in 2017 but widened to 3.5 percent in 2018 as the terms of trade deteriorated and the trade balance declined. The CA deficit for 2019 was 3 percent of GDP due to increases in the trade and income balances. With high uncertainty related to the COVID-19 outbreak, in 2020 the CA deficit is projected to decline to 1.8 percent of GDP, mainly due to import compression and lower oil prices. The CA deficit is projected to widen to about 4 percent of GDP in the medium term owing to an elevated deficit in the income account—projected to remain at about 4 percent of GDP.</p> <p><b>Assessment.</b> The IMF staff estimates a CA gap in the range of –0.5 to –2.7 percent of GDP in 2019, derived from a revised cyclically adjusted CA and an adjusted model-based norm. The revised cyclically adjusted CA (–1.7 percent of GDP) is obtained by subtracting 1.5 percentage points from the cyclically adjusted CA (–3.2 percent of GDP) for the statistical treatment of transfers and income accounts. The adjusted CA norm (–0.1 percent of GDP) is obtained by subtracting 1 percentage point from a surplus CA norm from the regression model (0.9 percent of GDP) to reflect the lower life expectancy at prime age relative to other countries in the regression sample.<sup>1</sup> The estimated CA gap is largely explained by structural factors outside the model.</p>					
2019 (% GDP)	CA: –3.0	Cycl. Adj. CA: –3.2	EBA CA Norm: 0.9	EBA CA Gap: –4.0	Staff Adj.: 2.5	Staff CA Gap: –1.5
<b>Real Exchange Rate</b>	<p><b>Background.</b> The CPI-REER depreciated during 2011–16 and recouped some of the losses in 2017–18. In 2019, the REER depreciated by about 3.5 percent relative to 2018. As of end-May 2020, the REER further depreciated by 14.7 percent relative to the 2019 average.</p> <p><b>Assessment.</b> The IMF staff assesses the REER to have been overvalued by 1.7 to 9.7 percent in 2019, with a midpoint of 5.7 percent, relying on the CA approach, in which the implied REER gap is estimated from the staff CA gap.<sup>2</sup> The two REER-based regressions point to undervaluation in a range of 3.3 percent (level approach) and 15.7 percent (index approach), but the staff deems these results less reliable.<sup>3</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Net FDI flows stayed positive in 2019 (0.4 percent of GDP). Net portfolio investment (2.6 percent of GDP) remained as the main source of financing the CA deficit. Gross external financing needs stood at 20 percent of GDP in 2019.</p> <p><b>Assessment.</b> In 2020, COVID-19–related large portfolio outflows from emerging markets may continue. Moody's in end-March downgraded the sovereign's credit rating to sub-investment status, increasing capital outflow pressure. Risks from large reliance on non-FDI inflows and nonresident holdings of local financial assets are mitigated by a flexible exchange rate, a large local currency component in nonresident portfolio holdings, and a large domestic institutional investor base. The latter tends to reduce asset price volatility during periods of market stress. The South African authorities have requested financing under the IMF's Rapid Financing Instrument.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> South Africa's exchange rate regime is classified as floating. Central bank intervention in the foreign exchange market is rare. International reserves are estimated to have been about 16 percent of GDP, 80 percent of gross external financing needs, and nine months of imports at end-2019. Reserves stand below the IMF's composite adequacy metric (76 percent of the metric without considering existing CFMs and 83 percent of the metric after considering them).</p> <p><b>Assessment.</b> If conditions allow, reserve accumulation would be desirable to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.</p>					



**Table 3.24. Spain: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was broadly in line with the level implied by medium-term fundamentals and desirable policies. In 2019, the CA remained in surplus for the eighth consecutive year. Achieving a sufficiently strong NIIP will continue to require a relatively high CA surplus for a sustained period.</i>						
<b>Potential Policy Responses:</b> Structural reforms in response to the global financial crisis—in particular labor market reform, with the resulting wage moderation, and fiscal adjustment—helped reduce imbalances. To mitigate the impact of the COVID-19 crisis, targeted and temporary income and liquidity support is warranted. If sources of external vulnerability that existed prior to the COVID-19 outbreak persist in the medium term, policies should foster competitiveness and carefully manage the public debt load. Boosting competitiveness through productivity gains over the medium term would entail continued wage flexibility, reforms to address labor market duality, implementation of product and service market reforms, and actions to enhance education outcomes and innovation.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP dropped significantly during 2000–09, driven mostly by high CA deficits but also by valuation effects. The NIIP was –74 percent of GDP in 2019, but has risen by 15 percentage points since 2015, partly due to sustained CA surpluses and despite some negative valuation effects. Gross liabilities stood at 250 percent of GDP in 2019, with about two-thirds in the form of external debt. Whereas the private sector has deleveraged since the 2008–12 crisis, the NIIP accounted for by the general government and the central bank increased, raising its share to more than four-fifths in 2019. Part of that increase is due to TARGET2 liabilities, which had reached 30 percent of GDP by end-2019.<sup>1</sup></p> <p><b>Assessment.</b> The large negative NIIP comes with external vulnerabilities, including from large gross financing needs and potentially adverse valuation effects. Mitigating factors are a favorable maturity structure of outstanding sovereign debt (averaging almost eight years) and current ECB measures, such as QE, that lower the cost of debt.</p>					
2019 (% GDP)	NIIP: –73.5	Gross Assets: 176.1	Debt Assets: 80.9	Gross Liab.: 249.6	Debt Liab.: 151.7	
<b>Current Account</b>	<p><b>Background.</b> After a peak CA deficit in 2007, corrected initially by a sharp contraction in imports, regained competitiveness from wage moderation and greater internationalization efforts contributed to strong export growth, leading to CA surpluses in 2012–19. Historical data revisions, including upward changes in tourism receipts, show that recent CA surpluses were higher than reported earlier—the annual average surplus during 2013–18 was revised from 1.5 to 2.3 percent of GDP. The CA surplus was estimated at 2.0 percent of GDP in 2019. With high uncertainty, the 2020 CA is projected at slightly below 2 percent of GDP, with imports declining more strongly than exports partly because of low oil prices. Weaker-than-expected exports—particularly tourism receipts—are a key downside risk around this projection. Moderate CA surpluses are projected to continue in the medium term.</p> <p><b>Assessment.</b> The EBA CA model suggests a norm of 1.1 percent of GDP for 2019, which is below the cyclically adjusted CA balance (2.2 percent of GDP). However, given external risks from a large and negative NIIP, the IMF staff’s assessment puts more weight on external sustainability and is guided by the objective of raising the NIIP to at least –50 percent over the medium to long term. The NIIP is projected to reach –57 percent of GDP over the medium term under current policies, though with high uncertainty as zero valuation effects are assumed. Allowing for a safety margin, the IMF staff therefore considers a CA norm of about 2 percent of GDP, with a range of 1 to 3 percent of GDP. This yields a CA gap of –0.8 to 1.2 percent of GDP.<sup>2</sup></p>					
2019 (% GDP)	Actual CA: 2.0	Cycl. Adj. CA: 2.2	EBA CA Norm: 1.1	EBA CA Gap: 1.1	Staff Adj.: –0.9	Staff CA Gap: 0.2
<b>Real Exchange Rate</b>	<p><b>Background.</b> In 2019, the CPI-based REER and the ULC-based REER depreciated from their average 2018 levels by 1.9 and 1.4 percent, respectively. The CPI-based REER is still moderately lower than its 2009 peak, partially reversing the significant appreciation from euro entry in 1999 until 2009. The ULC-based REER shows that the appreciation between 1999 and 2008 has been substantially reversed, initially because of labor shedding and thereafter due to wage moderation and strong output growth until 2019. After reaching its peak in 2008, the ULC-based REER depreciated by 19 percent. As of May 2020, the CPI-based REER had depreciated by 0.3 percent and the ULC-based REER had depreciated by 1.6 percent relative to their 2019 averages.</p> <p><b>Assessment.</b> The EBA REER models estimate an overvaluation of 4.9 to 5.2 percent for 2019, whereas the IMF staff CA gap implies an undervaluation of 0.9 percent. Taking into account also the need for preserving competitiveness, and the risks from NIIP sustainability, on balance, the IMF staff assesses the 2019 REER gap to be in the range of –4.9 to 3.1 percent, with a midpoint of –0.9 percent.<sup>3</sup></p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Financing conditions have continued to be favorable, despite some increase in sovereign bond yields in the wake of the COVID-19 crisis. And by 2019:Q4 the private sector had continued its deleveraging against the rest of the world. In 2019, the financial account balance was largely driven by net outflows of loans and other bank-related instruments (especially from sectors other than the central bank). The accumulation of TARGET2 liabilities, reflecting liquidity creation within the framework of the Eurosystem’s asset purchase program, was negative for the first time since 2015 (–3 percent of GDP in 2019).</p> <p><b>Assessment.</b> Investor sentiment had continued to improve in 2019. However, amid the pandemic crisis, large external financing needs leave Spain vulnerable to sustained market volatility, although the ECB’s policies to maintain favorable liquidity conditions and monetary accommodation remain a mitigating factor.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The euro has the status of a global reserve currency.</p> <p><b>Assessment.</b> Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>					

**Table 3.25. Sweden: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was stronger than the level implied by medium-term fundamentals and desirable policies.</i> The outlook for 2020 is clouded by high uncertainty caused by the COVID-19 crisis, which will likely push Sweden into a recession in 2020. External global demand is projected to retract, and with it Sweden's CA surplus. Given the unprecedented crisis any assessment going forward is difficult to make and subject to revisions.						
<b>Potential Policy Responses:</b> Given its large fiscal buffers, Sweden was in a good position to provide timely, substantial support to companies and households through various compensation programs, guarantees, and tax deferrals. The Riksbank is providing ample liquidity and has expanded its quantitative easing program. A swap line with the US Federal Reserve was established to address dollar funding pressures. Additional sizable targeted policies, complemented by broader stimulus packages, will be required to secure adequate resources for the health care system and limit the propagation of the health crisis to economic activity. If imbalances and policy distortions that existed prior to the COVID-19 outbreak persist in the medium term, reforms should be implemented to raise potential output and reduce household uncertainties around the sustainability of Sweden's strong social model.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The Swedish NIIP reached 21.0 percent of GDP in 2019, up 12.9 percentage points in the year. It is expected to rise further in the medium term, reflecting the outlook for continued CA surpluses. Although the increase in the NIIP is above the CA surplus in 2019 due to large positive valuation effects, it is worth noting that the data for 2019 are still preliminary and subject to considerable errors and omissions, which have averaged -1.3 percent of GDP in the past decade.</p> <p><b>Assessment.</b> Gross liabilities were 263 percent of GDP in 2019, with about half being gross external debt (138 percent of GDP). Other financial institutions (70 percent of GDP) hold the bulk of net foreign assets as well as social security funds (21 percent of GDP) and the government (16 percent of GDP). Nonfinancial corporations (48 percent of GDP) and monetary financial institutions (38 percent of GDP) are net external debtors. Although rollovers of external debt (which include banks' covered bonds) pose some vulnerability, risks are moderated by the banks' ample liquidity and large capital buffers. In response to the COVID-19 crisis, the authorities lowered the countercyclical capital buffer from 2.5 percent to 0 and eased the requirement for the liquidity coverage ratio for individual and total currencies. These measures, together with Sweden's strong FX reserves, the swap line with the Federal Reserve, and low public debt, appear to have helped manage crisis-related pressures, but the full impact on corporate and bank balance sheets remains uncertain as it is still unfolding.</p>					
2019 (% GDP)	NIIP: 21.0	Gross Assets: 283.5	Debt Assets: 91.4	Gross Liab.: 262.5	Debt Liab.: 132.2	
<b>Current Account</b>	<p><b>Background.</b> After being unexpectedly low at 1.9 percent of GDP in 2018, the CA increased in 2019 to 4.2 percent of GDP, interrupting a trend decline in the surplus in the past decade. Despite rising exports, imports were flat in 2019 owing to weak investment and durables consumption. Sweden is a net oil importer with a negative oil balance of 1.3 percent of GDP. The CA in 2020 is expected to decline to 2.8 percent of GDP due to depressed external demand, but this projection is subject to high uncertainty.</p> <p><b>Assessment.</b> The cyclically adjusted CA is estimated at 4.5 percent of GDP in 2019, 3.2 percentage points above the cyclically adjusted EBA norm of 1.2 percent of GDP. However, the estimated EBA norm for Sweden has been below the actual CA balance for the past two decades, suggesting that factors not captured by the model, such as Sweden's mandatory contributions to fully funded pension plans and an older labor force, may also be driving Sweden's saving-investment balances. Overall, the IMF staff assesses Sweden's CA gap at 3.2 percent of GDP in 2019, within a range of <math>\pm 1.5</math> percent of GDP, reflecting uncertainty around the EBA-estimated norm.</p>					
2019 (% GDP)	Actual CA: 4.2	Cycl. Adj. CA: 4.5	EBA CA Norm: 1.2	EBA CA Gap: 3.2	Staff Adj.: 0.0	Staff CA Gap: 3.2
<b>Real Exchange Rate</b>	<p><b>Background.</b> The Swedish krona depreciated by 4 percent in real effective terms (CPI based) in 2019 relative to its average level in 2018. In May 2020 it was at the same level as its 2019 average. The temporary weakness of the krona in March and April 2020 may partly have reflected financial outflows in response to the crisis, accommodative monetary policy, and demand for foreign currency funding.</p> <p><b>Assessment.</b> EBA analysis suggests a gap of -19.4 percent and -19.0 percent using the REER index and level approaches, respectively, for 2019. The ULC-based REER index is 10.8 percent below its 27-year average (since the krona was floated in 1993) in 2019. Applying a 0.35 semi elasticity of CA to the REER to the CA gap of 3.2 percent <math>\pm 1.5</math> percent of GDP<sup>1</sup> gives a valuation range for the krona of -5.1 to -13.7 percent. Overall, the IMF staff assesses the krona to be undervalued by 5 to 15 percent, with a midpoint of 10 percent. This REER gap may decline once the situation, including monetary policy, normalizes.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Portfolio investment outflows of 2.1 percent provided two-thirds of the financial account balance in 2019, with other investment (1.4 percent) and direct investment (0.4 percent) outflows comprising the remainder.</p> <p><b>Assessment.</b> Given their size and funding model, Sweden's large banks remain vulnerable to liquidity risks stemming from global wholesale markets, even though banks have improved their structural liquidity measures in recent years. The authorities' swift and strong policy response to the COVID-19 crisis appears to have eased liquidity and funding pressures for banks, but the full extent of the impact remains uncertain as it is still unfolding.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The exchange rate is free floating. Foreign currency reserves stood at US\$56 billion in December 2019, which is equivalent to 19 percent of the short-term external debt of monetary and financial institutions (primarily banks) and about 11 percent of GDP.</p> <p><b>Assessment.</b> In view of the high dependence of Swedish banks on wholesale funding in foreign currency, and the disruptions in such funding that have occurred at times of international financial distress, Sweden should maintain adequate foreign reserves. A US\$60 billion swap facility was agreed with the Federal Reserve to address risks to dollar funding related to the COVID-19 crisis.</p>					

**Table 3.26. Switzerland: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately stronger than the level implied by medium-term fundamentals and desirable policies. However, the assessment for 2019 is subject to significant uncertainty given complex measurement issues and data lags.</i>						
<b>Potential Policy Responses:</b> Fiscal policy should continue to play a key role in responding to the coronavirus pandemic. Foreign exchange intervention may be used to partially mitigate appreciation pressures that would otherwise push the economy further into deflation but should not preclude secular real appreciation. Against the backdrop of high uncertainty in global economic conditions, and the medium-term outlook for external positions, medium-term policies should be geared toward ensuring balanced domestic and external contributions to growth. Fiscal policy should remain supportive in the post-pandemic environment, including to help address structural challenges (for example, competitiveness, aging, and climate change). Monetary policy should remain directed at price stability, and macroprudential policies should focus on reducing financial sector risks. More frequent publication of foreign exchange intervention data is encouraged.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> Switzerland is a major international financial center with a positive NIIP of 117 percent of GDP and gross foreign asset and liability positions of 761 and 644 percent of GDP, respectively, at end-2019. The NIIP reflects both a history of large CA surpluses and valuation changes. <sup>1</sup> Valuation changes reflect fluctuations in exchange rates (ERs) and prices of securities and precious metals that interact with differences between assets and liabilities in terms of currencies and instruments. <sup>2</sup> There was a sizable decrease in the NIIP in 2019, from 127 to 117 percent of GDP, mainly reflecting significantly higher investment returns on portfolio liabilities than on portfolio assets. Projections of the NIIP in 2020 and beyond are complicated by heightened uncertainty, and because of the large gross positions and compositional mismatches between assets and liabilities, even modest changes in exchange rates, asset prices, and returns can have a material effect on the NIIP.					
	<b>Assessment.</b> Switzerland's large gross liability position and volatility of financial flows and investment returns present some risk, but this is mitigated by the large gross asset position and the Swiss franc denomination of about two-thirds of external liabilities.					
2019 (% GDP)	NIIP: 117.4	Gross Assets: 761.0	Debt Assets: 242.8	Gross Liab.: 643.7	Debt Liab.: 194.9	
<b>Current Account</b>	<b>Background.</b> Switzerland has run large CA surpluses, averaging about 10 percent of GDP since 2009. The CA balance has been estimated at 11.5 percent of GDP in 2019, an increase from 8.2 percent in 2018, driven by lower income payments on FDI to nonresidents. Large revisions are common, mainly downward and due to changes in investment income. In 2020, sizable fiscal support, an expected drop in merchanting profits (reflecting lower commodity prices and demand), and a weaker investment income balance will likely bring the CA surplus down to about 8½ percent of GDP.					
	<b>Assessment.</b> The EBA CA norm of 6.3 percent of GDP is slightly higher than last year's norm. Based on a cyclically adjusted CA surplus of 11.5 percent of GDP and the norm, the overall EBA estimated CA gap equaled 5.3 percent of GDP in 2019. Domestic policy gaps account for –0.5 percentage point of the CA gap and include excessive private sector credit (–0.9) and fiscal underspending (0.5), while policy gaps in the rest of the world contribute 0.5 percentage point. Switzerland-specific factors not appropriately treated in the income account lower the gap to about 1.8 percent of GDP (with a range of ±2 percentage points): (1) inclusion of estimated retained earnings on portfolio equity investment and (2) compensation for valuation losses on fixed-income securities arising from inflation. <sup>3,4</sup> A further downward revision of 2019 CA surplus may reduce or eliminate the gap. The decline in the NIIP despite a large CA surplus argues against increasing misalignment in 2019.					
2019 (% GDP)	Actual CA: 11.5	Cycl. Adj. CA: 11.5	EBA CA Norm: 6.3	EBA CA Gap: 5.3	Staff Adj.: –3.5	Staff CA Gap: 1.8
<b>Real Exchange Rate</b>	<b>Background.</b> The CPI-based REER depreciated by 5.8 percent in 2015–19. After appreciating sharply following the exit from the ER floor relative to the euro in 2015, the REER moderated, initially with unwinding of the overshooting of the nominal effective ER and, subsequently, on lower inflation in Switzerland than in its trading partners. The average REER for 2019 strengthened by 1.0 percent relative to the 2018 average. As of May 2020, the REER had appreciated by 3.9 percent compared with the 2019 average.					
	<b>Assessment.</b> The EBA REER index and level models suggest that the average REER in 2019 was 13.5 to 19.7 percent overvalued, respectively, with policy gaps accounting for a modest amount of the total gap. To a large extent, this finding reflects the “reversion to trend” property of the empirical model in the context of the prior rapid appreciation episodes. However, due to measurement issues, these results may not fully capture the secular improvement in productivity, especially in knowledge-based sectors. Accordingly, based on the IMF staff CA gap, the staff assesses the 2019 REER gap to be in the range of –7.4 to 0.4 percent, with a midpoint of –3.5 percent. <sup>5</sup> The CA-REER elasticity of 0.52 is relatively large due to the high openness of the economy.					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> During 2019, net financial outflows totaled 5.2 percent of GDP, including moderate accumulation of Swiss National Bank (SNB) reserves. Since 2015, SNB deposits at the bank (above a threshold) have been subject to a negative interest rate of 0.75 percent, which likely contributed to a reduction of nonresident currency holdings and deposits during 2018–19. There are no restrictions on financial flows.					
	<b>Assessment.</b> Financial flows are large and volatile, reflecting Switzerland's status as a financial center and safe haven.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> Official reserve assets (including gold) amounted to US\$855 billion (118 percent of GDP) at end-2019, up US\$68 billion from end-2018 (including valuation changes). Since exiting the ER floor in 2015, the SNB has intervened periodically, purchasing in response to appreciation pressures from safe haven surges, and more frequently but in smaller amounts. Purchases amounted to CHF13 billion in 2019 and have continued in 2020. The SNB has a standing swap line with the Federal Reserve.					
	<b>Assessment.</b> Reserves are large relative to GDP but more moderate in comparison with short-term foreign liabilities. The high level of reserves also reflects monetary operations aimed at avoiding persistent undershooting of inflation as a result of inflow surges and given the limited scope for significant easing via other monetary policy tools. In particular, the supply of domestic assets for purchase is very limited, and the marginal interest rate on bank deposits at the SNB of –0.75 percent is the lowest in the world. More frequent publication of foreign exchange intervention data and information—now annual—is encouraged.					

**Table 3.27. Thailand: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was substantially stronger than the level implied by medium-term fundamentals and desirable policies. Relative to 2018, imports contracted more than exports, and domestic demand was weak, which increased the CA surplus in 2019.</i>						
<b>Potential Policy Responses:</b> In the near term, given the large COVID-19 shock, the IMF staff recommends an accelerated, mutually reinforcing macro policy stimulus, led by a fiscal expansion, given available fiscal space, deployed toward targeted social transfers and relief measures. The exchange rate should move flexibly as the key shock absorber, with intervention limited to disorderly market conditions. Over the medium term, if imbalances that existed prior to the COVID-19 outbreak persist, policies should aim to revitalize domestic demand, which would facilitate the needed REER appreciation. Infrastructure investment should be accelerated to support recovery and reorientation of sectors affected by the pandemic, such as tourism. Efforts to reform and expand social safety nets should continue, and steps to address widespread informality will reduce precautionary saving and support consumption.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Thailand's NIP continued to rise in 2019 to about -1.8 percent of GDP (from -2.2 percent in 2018), reflecting a higher CA surplus. Gross assets rose to about 97.6 percent of GDP (driven by the increase in reserve assets to 41.3 percent of GDP) while gross liabilities increased slightly to 99.4 percent of GDP (comprising direct [about half] and portfolio [a third] investment). Increasing outward investment continues to keep net FDI low; portfolio (debt) outflows increased.</p> <p><b>Assessment.</b> The NIP is projected to reach a small creditor position over the medium term given (albeit narrowing) CA surpluses. External vulnerabilities are limited: external debt is steady at about 31.7 percent of GDP, of which short-term debt (on a remaining maturity basis) amounts to 16 percent of GDP; risks to external debt sustainability and liquidity are limited.</p>					
2019 (% GDP)	NIP: -1.8	Gross Assets: 97.6	Res. Assets: 41.3	Gross Liab.: 99.4	Debt Liab.: 28.1	
<b>Current Account</b>	<p><b>Background.</b> Thailand's CA surplus rose sharply from 5.6 to 7.0 percent of GDP in 2019, reversing the contraction achieved in 2018. US-China trade tensions contributed to weak export growth, particularly of manufacturing goods, together with low intermediate goods imports. However, weak domestic demand further compressed capital and consumer goods imports, leading to a rise in the trade balance. The services account rose relative to 2018, as tourism receipts recovered from a low 2018 base. As of May 2020, tourism arrivals had declined sharply due to the impact of the coronavirus pandemic, while the trade balance rose as imports contracted, while non-gold exports weakened in the face of supply chain disruptions and falling external demand. The CA surplus in 2020 is expected to narrow to 4.9 percent of GDP.</p> <p><b>Assessment.</b> The EBA CA model estimates a cyclically adjusted CA of 6.6 percent of GDP and a CA norm of 0.4 percent of GDP for 2019. The CA gap of 6.1 percent of GDP consists of an identified policy gap of 2.2 percent of GDP (mainly due to fiscal policy and FX intervention) and an unexplained residual of 4 percent of GDP, which partly reflects structural factors not fully captured by the EBA model. Recognizing these factors as well as uncertainties related to the output gap, the IMF staff assesses the CA gap to be about 4.6 to 7.6 percent of GDP.<sup>1</sup> This CA gap is expected to narrow over the medium term as policy stimulus is deployed, domestic demand picks up, and the social safety net is enhanced.</p>					
2019 (% GDP)	Actual CA: 7.0	Cycl. Adj. CA: 6.6	EBA CA Norm: 0.4	EBA CA Gap: 6.1	Staff Adj.: 0.0	Staff CA Gap: 6.1
<b>Real Exchange Rate</b>	<p><b>Background.</b> The baht has been on a gradual real appreciation trend since the mid-2000s, despite occasional bouts of volatility. In 2019, the REER appreciated overall by 5.6 percent relative to 2018, as the baht was one of the best performing currencies in the region. As of May 2020, the REER had depreciated by 4.2 percent relative to its 2019 average as capital outflows accelerated in connection with the coronavirus pandemic.</p> <p><b>Assessment.</b><sup>2</sup> Using an elasticity of 0.62 and based on the IMF staff CA gap, the staff assesses the REER to be undervalued in the 7 to 12 percent range, with a midpoint of 9.5 percent.</p>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> In 2019, the capital and financial account balance rose to -2.4 percent of GDP from -3.1 percent in 2018. The key drivers were net portfolio flows and other investment. Nonresident holdings of Thai bonds and equities surged in the middle of the year and corrected somewhat in the third quarter. Inflows resumed in the fourth quarter, reflecting in part Thailand's strong external position relative to other emerging market and developing economies. Outward FDI fell to 2.6 percent of GDP from 4.2 percent in 2018. In July 2019, the authorities introduced measures to curb speculative inflows, tightening the limit on the outstanding amount of nonresident baht accounts. They also eased FX regulations, in line with the broader strategy to liberalize the financial account in a gradual and prudent manner. In 2020, Thailand experienced large capital outflows in line with the regional trends, in both equities and bonds, amounting to US\$4 billion by May 2020.</p> <p><b>Assessment.</b> Since 2013, Thailand has experienced episodes of volatility reflecting external financial and political conditions, and recently concerns about the impact of US-China trade tensions and the coronavirus pandemic. Nevertheless, Thailand has been able to weather well such episodes, given strong external buffers and fundamentals. The IMF staff recommends phasing out the reduction in the limits on nonresident baht accounts. Instead, a comprehensive package of macroeconomic, financial, and structural policies should be pursued, complemented by continued efforts to liberalize capital outflows.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The exchange rate regime is classified as (de jure and de facto) floating. International reserves (including the net forward position) amounted to 47.6 percent of GDP in 2019, which is more than three times short-term debt and 12 months of imports, and more than 200 percent of the IMF's standard reserve adequacy metric. In response to the COVID-19 shock, the exchange rate has been allowed to adjust, with some FX sales since March.</p> <p><b>Assessment.</b> Gross international reserves (including the net forward position) increased by more than US\$19 billion in 2019. While official intervention data are not published, estimates suggest net purchases for most of the year. Reserves are higher than the range of the IMF's adequacy metrics, and there continues to be no need to build up reserves for precautionary purposes. The exchange rate should move flexibly to act as a shock absorber, with intervention limited to avoiding disorderly market conditions.</p>					



**Table 3.28. Turkey: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was moderately stronger than the level implied by medium-term fundamentals and desirable policies, although uncertainties are high.</i> This assessment reflects the lagged adjustment of external balances following the sharp depreciation of the real exchange rate in 2018, which is projected to unwind over time. Large external financing needs and relatively low reserves leave Turkey vulnerable to shocks.</p> <p><b>Potential Policy Responses:</b> In the near term, policies need to cushion the impact of the COVID-19 crisis and protect the most vulnerable through temporary and targeted fiscal support, preferably within a policy package that would help secure greater external stability. If imbalances that existed prior to the COVID-19 outbreak persist in the medium term, policies should aim to strengthen external resilience and support a sustainable rebalancing of the economy. Monetary policy, supported by efforts to rein in rapid credit growth, would aim to reduce inflation durably and strengthen central bank credibility while rebuilding reserves. Focused structural reforms would be necessary to enhance productivity, increase resilience to shocks, and strengthen the broader public sector balance sheet and improve transparency in general. These could include efforts to bolster the business climate, including by further strengthening Turkey's insolvency and corporate restructuring frameworks.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> After reaching –54 percent of GDP at end-2017, Turkey's NIIP rose to –48 percent at end-2018 and –46 percent at end-2019. The large change in 2018 mostly reflected valuation effects from the lira's sharp depreciation that year, as a higher share of external assets relative to external liabilities are denominated in FX (a portion of the liabilities are in the form of Turkish equities and lira-denominated debt securities).<sup>1</sup> After a large increase in 2017, total foreign liabilities remained broadly stable at about 79 percent of GDP at end-2019. Based on 2020 first quarter data, the NIIP rose to –41 percent of GDP, largely due to a decline in equity liabilities. Foreign liabilities are dominated by debt, which, at 54 percent of GDP, remains sustainable over the medium term. Private external debt service is vulnerable to global and domestic financial conditions because most of the debt is in FX, a significant portion of which is short term (about 20 percent of GDP, on a remaining maturity basis), with about 40 percent of long-term debt at variable rates.</p> <p><b>Assessment.</b> The size and composition of external liabilities, coupled with relatively low reserves, continue exposing Turkey to liquidity shocks, sudden shifts in investor sentiment, and increases in global interest rates. The FX exposure of nonfinancial companies is high, with the potential to undermine bank asset quality. Turkey's NIIP is projected to gradually increase to about –32 percent of GDP by 2025, driven by a decline in liabilities, mainly loans, as the economy rebalances in a post-COVID environment.</p>					
	2019 (% GDP)	NIIP: –45.8	Gross Assets: 33.7	Res. Assets: 14.0	Gross Liab.: 79.5	Debt Liab.: 53.9
<b>Current Account</b>	<p><b>Background.</b> The CA deficit, after averaging 3.5 percent of GDP during 2014–16, widened to 4.8 percent in 2017 as policy stimulus resulted in overheating, before narrowing in 2018 to 2.7 percent as domestic demand contracted and the lira depreciated sharply. The CA registered a surplus of 1.2 percent of GDP in 2019, reflecting continued import compression and strong tourism receipts. In the first quarter of 2020, the CA registered a deficit, which led to a decline in the 12-month CA surplus to 0.2 percent of GDP. Import tariffs of up to 30 percent have been imposed on a large number of items. The IMF staff projects a broadly balanced CA in 2020 with a rise in the goods balance (driven by import compression) offset by a fall in services (due to a fall in travel services).</p> <p><b>Assessment.</b> The EBA CA model estimates a norm of –1.7 percent of GDP, with a particularly large standard error of 1.8 percentage points of GDP. The cyclically adjusted CA surplus in 2019 is estimated at 0.8 percent of GDP. After taking into account the temporarily large receipts from travel services (0.9 percent of GDP higher than normal in 2019), the IMF staff assesses the CA gap to be about 1.6 percent of GDP, subject to considerable uncertainty (with a range between –0.2 and 3.4 percent of GDP).</p>					
	2019 (% GDP)	Actual CA: 1.2	Cycl. Adj. CA: 0.8	EBA CA Norm: –1.7	EBA CA Gap: 2.5	Staff Adj.: 0.9
<b>Real Exchange Rate</b>	<p><b>Background.</b> After depreciating sharply in 2018, the average REER depreciated by 2.2 percent in 2019 and a further 7.8 percent through May 2020 driven by nominal depreciation of the lira.</p> <p><b>Assessment.</b> The EBA REER level and index approaches suggest the REER remained undervalued in 2019 by 21 to 23 percent, albeit with large uncertainties. The IMF staff CA gap suggests the REER was undervalued by 7 percent (based on an elasticity of 0.22). The staff assesses the REER to be undervalued by 7 to 23 percent in 2019 (with a midpoint of 15 percent).</p>					
	<p><b>Capital and Financial Accounts: Flows and Policy Measures</b></p> <p><b>Background.</b> Net capital flows registered modest inflows of US\$0.5 billion in 2018 and US\$5.6 billion in 2019 (0.7 percent of GDP and excluding reserves and E&amp;O). E&amp;O were positive in 2018, likely reflecting repatriation of foreign assets and unrecorded capital inflows before switching to outflows in 2019. In the first quarter of 2020, net capital outflows were US\$6 billion due to portfolio and other investment outflows. To help address currency volatility in August 2018, Turkey introduced limits on bank swaps and other derivatives transactions with foreign counterparties as well as export surrender and repatriation requirements (both CFMs). These measures were partially unwound as volatility receded, but limits on bank swaps and other derivatives transactions with foreign counterparties were reintroduced and tightened in December 2019 and February–April 2020 in response to new bouts of volatility.</p> <p><b>Assessment.</b> The quality of financing remained weak in 2019. Turkey remains vulnerable to adverse shifts in global and domestic investor sentiment, with annual gross external financing needs of about 23 percent of GDP on average during 2020–21. CFMs should be phased out as macroeconomic and financial conditions improve.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The de jure exchange rate is classified as floating. With pressure on the lira in early 2020, including from the COVID shock, gross reserves had declined by US\$22 billion as of mid-May 2020, and net international reserves have dropped by US\$15 billion to US\$26 billion since the beginning of the year.<sup>2</sup></p> <p><b>Assessment.</b> Gross reserves increased to 85 percent of the IMF's ARA metric at end-2019, from 74 percent at end-2018, but dipped to 67 percent in mid-May 2020. Similarly, reserve coverage of external financing requirements rose to 64 percent in 2019, from 46 percent the year prior, and then dropped to 49 percent in mid-May. Significant accumulation of reserves over the medium term is needed given sizable external liabilities and dependence on short-term and portfolio funding.</p>					

**Table 3.29. United Kingdom: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2019 was weaker than the level implied by medium-term fundamentals and desirable policies.</i> The CA deficit remained high in 2019, reflecting low public and private saving. The uncertainty around this assessment is significant, reflecting both measurement issues and uncertainty about the future trade arrangement with the European Union and its possible effect on growth and trade flows. Although the COVID-19 pandemic is a major disruption to trade and capital flows, the net impact on the UK CA is uncertain.</p> <p><b>Potential Policy Responses:</b> Macroeconomic policies in the short term (2020–21) should focus on supporting the economy, addressing the impact of the coronavirus, and facilitating the recovery. Once the pandemic is over, structural reforms, including those focused on broadening the skill base, should boost the United Kingdom's productivity and international competitiveness. These efforts are particularly important in light of expectations that access to the EU market will become more restricted.</p>						
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP declined to –25.2 percent of GDP in 2019 from –12.8 percent of GDP in 2018, to a large extent due to the pound's appreciation. Over the past five years, the NIIP has declined by 2.5 percentage points, reflecting a negative CA contribution (–19.7 percentage points) largely offset by valuation and growth effects (13.7 percentage points and 3.6 percentage points, respectively).<sup>1</sup> The composition of assets roughly matches that of liabilities (about 86 percent of GDP in FDI, 70 percent of GDP in equity instruments, about 98 percent of GDP in derivatives—about ¾ linked to interest rates and ¼ to exchange rates—and about 183 percent of GDP in other investment), although portfolio investment liabilities (167 percent of GDP) exceed assets in portfolio investments (126 percent of GDP). The United States, other European countries, and Japan account for about 75 percent of total UK external assets and liabilities, and external liabilities have a larger share denominated in pounds than assets.<sup>2</sup> The IMF staff projects the NIIP to decline over the medium term, although the large and volatile valuation effects make these estimates particularly uncertain.</p> <p><b>Assessment.</b> Despite some decline, the sustainability of the NIIP is not an immediate concern. Since 2000, valuation gains have offset about 40 percent of the effect of CA flows on the IIP, partially reflecting CA measurement issues and depreciation of the pound. However, fluctuations in the large gross stock positions are a potential source of vulnerability (including derivatives, gross assets and gross liabilities both exceed 500 percent of GDP).</p>					
	2019 (% GDP)	NIIP: –25.2	Gross Assets: 508.6	Debt Assets: 250.7	Gross Liab.: 533.8	Debt Liab.: 288.0
<b>Current Account</b>	<p><b>Background.</b> The CA deficit narrowed marginally to –3.8 percent of GDP in 2019 (from –3.9 percent in 2018) and remains significantly larger than its historical average. The wider CA deficits since the global financial crisis reflect mostly weaker income balance, due in part to lower earnings on the United Kingdom's FDI abroad (especially in the euro area). In 2019, a slightly rise in the trade balance was offset by a slight fall in the income balance. The CA deficit is projected to decline to 3.5 percent of GDP in 2020 due to a narrower trade deficit and slight rise in the primary income balance.</p> <p><b>Assessment.</b> The EBA CA model estimates a norm of 0.4 percent of GDP and a cyclically adjusted EBA CA gap of –4.2 percent of GDP. However, the CA is assessed to be understated due to measurement biases, which are partly reflected in the large NIIP exchange rate valuation effects and in other unidentified stock-flow adjustments. An important source of bias is retained earnings on portfolio equity assets, which are not recorded on an accrual basis—estimated at about 0.8 percent of GDP.<sup>3</sup> A second source is the unrecorded impact of expected inflation differentials on the CA—estimated to be about 0.5 percent of GDP. Overall, the IMF staff assesses the CA gap in the range of –0.9 to –4.9 percent of GDP. This range takes into account the uncertainty in the assessment related to the outcome of the negotiations on the future UK-EU relationship and possible measurement issues.<sup>4</sup></p>					
	2019 (% GDP)	Actual CA: –3.8	Cycl. Adj. CA: –3.8	EBA CA Norm: 0.4	EBA CA Gap: –4.2	Staff Adj.: 1.3
<b>Real Exchange Rate</b>	<p><b>Background.</b> The pound remained unchanged in real effective terms in 2019 relative to its average level in 2018 but has depreciated since mid-2016 by about 6 percent. Sterling depreciation since 2016 may reflect an unwinding of past overvaluation as well as market expectations of more restricted access to the EU market in the future. As of May 2020, the REER had depreciated by 0.4 percent compared with the 2019 average.</p> <p><b>Assessment.</b> EBA REER level and index approaches suggest a gap of –5.6 and –12.6 percent, respectively, for 2019. However, given uncertainties related to the United Kingdom's new trading relationship with the European Union, these model estimates may not be entirely appropriate. The IMF staff CA gap assessment implies an REER gap of 12 percent. Overall, the staff assesses the REER to be overvalued between 0 and 15 percent, with a midpoint of 7.5 percent.</p>					
	<p><b>Capital and Financial Accounts: Flows and Policy Measures</b></p> <p><b>Background.</b> Given the United Kingdom's role as an international financial center, portfolio investment and other investment are the key components of the financial account. In net terms, the CA was financed in 2019 by broadly stable net FDI inflows of 1 percent of GDP, net other investments worth 5.7 percent of GDP (reflecting rising inflows and declining outflows), while net portfolio investments declined by 2 percent of GDP (reflecting accumulation of assets abroad by 4.9 percent of GDP and higher investments in the United Kingdom of 2.8 percent of GDP). Nonresidents' net purchases of UK debt (portfolio and direct investment) represented 2 percent of GDP. Despite some turbulence in March, access to finance has remained favorable during the COVID-19 crisis, aided by the Bank of England's liquidity support and expanded quantitative easing.</p> <p><b>Assessment.</b> Large fluctuations in capital flows are inherent to financial transactions in countries with a large financial sector. This volatility is a potential source of vulnerability, although it is mitigated by sound financial regulation and supervision and a strong financial sector. An additional risk is that FDI and portfolio investment inflows may decelerate, driven by concerns about the United Kingdom's future trade relations with the European Union.</p>					
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The pound has the status of a global reserve currency. Despite uncertainty about the future relationship between the United Kingdom and the European Union, the share of global reserves in sterling has not changed since 2015, at about 4.5 percent.</p> <p><b>Assessment.</b> Reserves held by the United Kingdom are typically low relative to standard metrics, and the currency is free floating.</p>					



**Table 3.30. United States: Economy Assessment**

<b>Overall Assessment:</b> <i>The external position in 2019 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. Larger private sector saving is expected to largely offset the 2020 fiscal packages, resulting in a relatively steady CA deficit in the coming years. The deep economic contraction, and the effects of actual and prospective changes in fiscal, trade, and labor market (including, for example, immigration) policies add uncertainty to the assessment.</i>						
<b>Potential Policy Responses:</b> Given the unprecedented social and economic fallout from the coronavirus outbreak and associated containment measures, the United States should expand fiscal efforts to ease the burden of the shutdown on households and firms. Once the immediate health crisis has subsided, the United States should also use its still-considerable fiscal space to put in place a front-loaded package that would increase investment in infrastructure, facilitate the transition to a lower-carbon economy, and offer consumption subsidies to kick-start demand. Over the medium term, fiscal consolidation, aimed at a medium-term general government primary surplus of about ¾ percent of GDP, should be reinvigorated to put the debt-GDP ratio on a downward path and address the CA gap. Structural policies to increase competitiveness include upgrading infrastructure, enhancing schooling, training and mobility of workers, supporting the working poor, and policies to increase growth in the labor force (including skill-based immigration reform). Tariff barriers should be rolled back, and trade and investment disagreements with other countries should be resolved in a manner that supports an open, stable, and transparent global trading system.						
<b>Foreign Asset and Liability Position and Trajectory</b>	<b>Background.</b> The NIIP, which averaged about –41 percent during 2014–17, decreased further from –46.4 percent of GDP in 2018 to –51.3 percent of GDP in 2019, including as a result of valuation effects of –4.9 percent of GDP. Under the IMF staff’s baseline scenario, the NIIP is projected to decline by about 2 percent of GDP through the medium term, on the back of sustained CA deficits.					
	<b>Assessment.</b> Financial stability risks could surface in the form of an unexpected decline in foreign demand for US fixed income securities, which are the main component of the country’s external liabilities. This risk, which could materialize, for example, as a result of failure to reestablish fiscal sustainability, remains moderate given the dominant status of the US dollar as a reserve currency. About 63 percent of US assets are in the form of FDI and portfolio equity claims.					
2019 (% GDP)	NIIP: –51.3	Gross Assets: 136.8	Debt Assets: 40.4	Gross Liab.: 188.1	Debt Liab.: 87.2	
<b>Current Account</b>	<b>Background.</b> The US CA deficit decreased from 2.4 percent of GDP in 2018 to 2.3 percent in 2019 (from 2.4 to 2.0 in cyclically adjusted terms), compared with a deficit of 2.1 percent of GDP in 2014. The evolution since 2014 is explained by a fall in the non-oil balance. The large fiscal deficit did not lead to an increase in the CA deficit in 2019 due to a move in the oil balance toward surplus and a positive income account. However, trade-balance outturns continued to be difficult to interpret as a result of shifts in the timing of exports and imports due to tariffs. In 2020, the fiscal expansion in the wake of the COVID-19 crisis is expected to be offset by higher private sector saving. Higher net exports due to compressing imports are projected to offset a weaker income account. The CA deficit is expected at about 2 percent of GDP.					
	<b>Assessment.</b> The EBA model estimates a cyclically adjusted CA of –2 percent of GDP, and a cyclically adjusted CA norm of –0.7 percent of GDP. The cyclically adjusted CA gap is –1.3 percent of GDP for 2019, reflecting policy gaps (–0.9 percent of GDP, of which –0.9 percent corresponds to fiscal policy) and an unidentified residual (about –0.4 percent of GDP) that may reflect structural factors not included in the model. On balance, the IMF staff assesses the 2019 cyclically adjusted CA to be –0.8 to –1.8 percent of GDP lower than implied by medium-term fundamentals and desirable policies.					
2019 (% GDP)	Actual CA: –2.3	Cycl. Adj. CA: –2.0	EBA CA Norm: –0.7	EBA CA Gap: –1.3	Staff Adj.: 0.0	Staff CA Gap: –1.3
<b>Real Exchange Rate</b>	<b>Background.</b> After depreciating by 1 percent in 2018 (year over year), the REER appreciated by 2.8 percent in 2019 (year over year). As of end-2019 the REER was thus still about 17 percent higher than the average for 2014. Through May 2020, the US dollar appreciated 4.9 percent in real terms relative to the 2019 average.					
	<b>Assessment.</b> Indirect estimates of the REER (based on the EBA CA assessment) imply that the exchange rate was overvalued by 11.4 percent in 2019 (applying an estimated elasticity of 0.11). The EBA REER index model suggests an overvaluation of 8.1 percent, and the EBA REER level model suggests an overvaluation of 10.9 percent. Considering all the estimates and their uncertainties, the IMF staff assesses the 2019 average REER to be somewhat overvalued, in the 8 to 14 percent range, with a midpoint of 11 percent. <sup>1</sup>					
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<b>Background.</b> Net financial inflows were about 1.8 percent of GDP in 2019, compared with 2.2 percent of GDP in 2018. Stronger net portfolio investment flows were offset by weaker direct and other investment flows.					
	<b>Assessment.</b> The United States has an open capital account. Vulnerabilities are limited by the dollar’s status as a reserve currency, with foreign demand for US Treasury securities supported by the status of the dollar as a reserve currency and, possibly, by safe haven flows.					
<b>FX Intervention and Reserves Level</b>	<b>Background.</b> The dollar has the status of a global reserve currency. Reserves held by the United States are typically low relative to standard metrics. The currency is free floating.					

## Technical Endnotes by Economy

### Australia

<sup>1</sup>The REER gap range (–1.5 to –6.5 percent) is derived from the CA gap range (0.3 to 1.3 percent) with an elasticity of 0.2.

### Belgium

<sup>1</sup>The Belgian CA numbers underwent major revisions in 2015, 2016, 2017, and 2019, complicating the comparison with previous external sector assessments.

<sup>2</sup>The error bands are based on the range for the CA gap (2.5 to 4.5 percent) and an estimated semi-elasticity of the CA balance to the REER of 0.42.

### Brazil

<sup>1</sup>New questions added to the Brazilian Capital Abroad Survey and to the Foreign Capital in Brazil Survey in 2019 improved the data coverage and accuracy of the services, income, and reinvested earnings components of the balance of payments. The improved data were included in the balance of payments in September/November 2019 and resulted in an upward revision of debits in services, interest and reinvested earnings, and the downward revision of credits in reinvested earnings, with consequent increase of the current account deficit for 2018 from US\$15 billion to US\$41.3 billion. The change in the assessment for Brazil between 2018 to 2019 is primarily due to these statistical revisions. The new data coverage will apply going forward. Revisions of the 2019 CA, incorporating data sourced from the two surveys, are scheduled for August and November 2020.

<sup>2</sup>Based on CA gap point estimate of –1.2 percent from the EBA CA methodology and Brazil's CA to REER semi-elasticity of –0.11, the REER gap is estimated at 11 percent (overvalued). The two REER methodologies give –10.7 percent (undervalued) and 2.4 percent (overvalued), respectively, with a midpoint of about –4 percent (undervalued). Based on this, staff assesses the REER gap to be in the range –4 to 11, with a midpoint of 3.5 percent (overvalued).

### Canada

<sup>1</sup>The statistical treatment of retained earnings on portfolio equity and inflation is estimated to generate a downward bias in the income balance of the current account of the order of 1.9 percent of GDP.

<sup>2</sup>EBA uses UN demographic projections. These differ from the authorities' projections due to methodological differences. The authorities' projections suggest slightly higher population growth and a slightly lower CA norm. The authorities' demographic projections also do not incorporate recent increases in immigration

targets, which are assumed to be permanent. Together, these effects reduce the EBA estimate of the CA norm by about 0.3 percent.

<sup>3</sup>The price discount between Canadian crude (WCS) and the West Texas benchmark increased in 2018 to an average of US\$26 a barrel (from US\$13 in 2017), before moderating back to US\$14 in 2019. The price discount in 2019 is estimated to temporarily reduce the CA by about 0.1 percent of GDP.

<sup>4</sup>The approach includes commodity terms of trade rather than oil prices as an explanatory variable, while Canada's REER has mirrored movements in oil prices much more closely than its commodity terms of trade.

<sup>5</sup>The semi-elasticity of the CA with respect to the REER is estimated at 0.27.

### Euro Area

<sup>1</sup>The export and import elasticities are taken as the average of estimates from Consultative Group on Exchange Rate Issues (CGER)-inspired export and import equations using various types of REERs relevant for the euro area (with an ADL (2,2,2) model on quarterly data 2000–19). The trade balance elasticity is calculated using the share of exports and imports for *extra-EA trade* in GDP.

<sup>2</sup>The REER gap range derived from the CA gap range (0.4 to 2.0 percent) is –1.2 to –5.7 percent (with an elasticity of 0.35). The range of –5.7 to 0 is determined by putting more weight on the current account gap method and less on the two REER models.

### France

<sup>1</sup>The range of the REER gap (2.2 to 5.9 percent) is obtained from the range of the CA gap (–1.6 to –0.6 percent of GDP) and an estimated semi-elasticity of the CA balance to the REER of 0.27.

### Germany

<sup>1</sup>For Germany, the bulk of the EBA-estimated gap for 2019 reflects the regression's residual rather than gaps in the policy variables included in the EBA model.

<sup>2</sup>The estimated norm reflects changes in the credit gap estimates to better reflect the German financial cycle. The IMF staff assesses the credit-to-GDP ratio to be currently lower than its long-term equilibrium, and that gradual closing of that gap will help support investment over the long term.

<sup>3</sup>The EBA REER Index model implies that the REER is close to equilibrium. However, the EBA REER Index model has an unusually poor fit for Germany.

<sup>4</sup>The range of the REER gap (–6 to –16 percent) is obtained from the range of the CA gap and an estimated semi-elasticity of the CA balance to the REER in the range of 0.3–0.5.

### Hong Kong SAR

<sup>1</sup>Hong Kong SAR is not in the EBA sample as it is an outlier along many dimensions of EBA analysis, thus one possibility—though with obvious drawbacks—is to use EBA-estimated coefficients and apply them to Hong Kong SAR. Following this approach, the CA norm in 2019 is estimated to be about 14 percent of GDP, implying a CA gap of about  $-8\frac{1}{2}$  percent, which is almost entirely explained by the model residuals. However, the EBA CA gap is overstated, as it does not properly reflect the measurement issues that are relevant for Hong Kong SAR for which three adjustments are made. First, an adjustment of 3 to 5 percentage points is made to the EBA's implied contribution of the NIIP position. This is because the positive NIIP contribution in the EBA captures average income effects that are less relevant for Hong Kong SAR, because the income balance relative to its NIIP is systematically lower than that of peer economies, due to a persistently higher share of debt instruments on the asset side than on the liability side. Second, the opening of the Precious Metals Depository has resulted in a decline of 4 to  $4\frac{1}{2}$  percentage points in the gold trade balance that does not reflect changes in wealth but rather the increased physical settlement of gold futures contracts. Third, mainland China's increased onshoring has led to a decline in logistics and trading activities in Hong Kong SAR (1 to  $1\frac{1}{2}$  percent of GDP in CA), which did not result in lower consumption because it is viewed as temporary and to be replaced with increased provision of high-value-added services as Hong Kong SAR's own economy rebalances in response to mainland demand. See Guo (2017) for more details.

<sup>2</sup>The range is calculated by applying the exchange rate semi-elasticities of Hong Kong SAR and similar economies to the IMF staff CA gap range.

<sup>3</sup>The financial linkages with the mainland have deepened in recent years with the increase in cross-border bank lending, capital market financing, and the internationalization of the RMB. As of December 2019, banking system claims on mainland nonbank entities amounted to HK\$6.1 trillion, or about 213 percent of GDP, up by about 14 percentage points since end-2018.

### India

<sup>1</sup>The REER range is based on  $\pm 1$  percent of uncertainty around the IMF staff-assessed current account gap and semi-elasticity of 0.18.

### Indonesia

<sup>1</sup>As Indonesia is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime age and exit age from the workforce. This results in an adjustor of 0.9 percentage point being applied to the model-estimated CA norm.

<sup>2</sup>A range of  $\pm 1.5$  percent is added to reflect the fact that the EBA regression estimates are subject to normal uncertainty (the standard error of the EBA norm is 1.3 percent).

<sup>3</sup>The semi-elasticity of CA/GDP with respect to REER, based on trade adjustment, is estimated to be  $-0.18$  for Indonesia.

<sup>4</sup>The midpoint of the REER range is calculated by taking the average of the estimated gap from the EBA index model (that is, 2.1 percent) and the REER gap implied by the IMF staff CA gap estimate of  $-1.0$  percent of GDP (that is, 5.6 percent). To obtain the width of the range for the REER gap, the standard  $\pm 5$  percent interval was applied to the midpoint of 3.9 percent, leading to a range of  $-1.2$  to 8.9.

### Italy

<sup>1</sup>Under tiering, deposits at the ECB below a country-level cap of six times the minimum reserve requirement benefit from higher rates. Because Italy was the only country below that threshold, it attracted liquid assets from other euro area banks. This is a one-off effect.

<sup>2</sup>Debt assets and liabilities data are for 2018.

<sup>3</sup>The semi-elasticity of the CA balance (percent of GDP) to REER is estimated to be 0.26.

### Japan

<sup>1</sup>The staff range for the REER gap is computed by applying the staff-estimated semi-elasticity of 0.14 to the staff CA gap range.

### Malaysia

<sup>1</sup>The ratios to GDP are based on IMF staff estimates using US dollar values.

<sup>2</sup>Close to one-third of external debt is denominated in local currency and is largely of medium-term maturity, helping reduce FX and rollover risks. Malaysia's local currency external debt reflects holdings of domestically issued debt (mainly Malaysian government securities) by nonresident investors (about 13 percent of GDP as of end-2019). Short-term FX-denominated debt largely belongs to the banking system, and a good portion is matched by short-term foreign currency assets, which are being closely supervised by Bank Negara Malaysia. Stress test analysis by the IMF staff suggests that the Malaysian economy would be resilient to a large capital flow reversal due to the depth of the domestic financial markets and the role of institutional investors.

<sup>3</sup>The point and range estimates of the REER gap are based on the estimated semi-elasticity of CA to REER at 0.46.

<sup>4</sup>On December 2, 2016, the Financial Markets Committee announced a package of measures aimed at facilitating onshore FX risk management and enhancing the depth and liquidity of onshore financial markets. Two of these measures were classified as CFMs under the IMF's institutional view on capital flows.

In addition, the authorities' strengthened enforcement of regulations on resident banks' noninvolvement in offshore ringgit transactions was considered enhanced enforcement of an existing CFM. Over the course of 2017–19, additional measures were announced to help deepen the onshore financial market and facilitate currency risk management.

<sup>5</sup>The IMF's composite reserve adequacy metric classifies Malaysia's regime as "floating" since 2016.

## Netherlands

<sup>1</sup>The range of the REER gap (–4.1 to –9.9 percent) is obtained from the range of the CA gap and an estimated semi-elasticity of the CA balance to the REER of 0.7.

## Poland

<sup>1</sup>The 1.7 percentage point contribution from identified policy gaps reflects mainly effects of the credit gap (0.7 percentage point) and the fiscal policy gap, in which a too-loose domestic fiscal policy (contributing –0.1 percentage point) is more than offset by too-loose fiscal policies in trading partners (0.9 percentage point). Small domestic policy gaps in public health spending and reserves are partially offset by these gaps in the rest of the world. Given that Poland's negative NIIP has continued to decline and is projected to decline further over the medium term, no adjustor has been applied to the CA norm.

<sup>2</sup>The standard error for the 2019 CA norm is 0.6 percent of GDP. However, the IMF staff uses a larger confidence band to reflect potential measurement error related mainly to the impact of remittances of foreign workers on the CA.

<sup>3</sup>The REER level model for Poland suggests an undervaluation of 18.5 percent. However, the model's large residuals (–16.1 percent) suggest that it may not adequately capture changes in the equilibrium REER that occurred during the sample period.

## Russia

<sup>1</sup>Nominal GDP denominated in US dollars grew by only 1.9 percent in 2019, largely reflecting moderate growth.

<sup>2</sup>Unfavorable valuation changes arise because the Russian stock market has performed very well in the past 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as prepayments on import contracts whose goods are not delivered, repeated large transfers abroad that deviate from standard remittance behavior, or securities transactions at inflated prices. The central bank includes estimates of disguised capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level, and this treatment of disguised outflows

may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position.

<sup>3</sup>Due to lower volatility in oil prices in 2019, the IMF staff does not see a need to make additional adjustment for cyclical effects.

<sup>4</sup>The range of the REER estimate is  $\pm 5$  percent around the midpoint, reflecting uncertainties of various shocks (for example, current and potential implementation of sanctions) and volatility in the oil market.

## Saudi Arabia

<sup>1</sup>At current oil exports, a US\$1 change in the oil price results in a 0.5 percent of GDP first-round change in the CA balance. The average oil export price is assumed to be US\$36.20 in 2020 (\$66.50 in 2019). Oil export volumes are expected to decrease by 6 percent in 2020.

<sup>2</sup>EBA models do not include Saudi Arabia. The IMF staff considered three approaches in the EBA-Lite methodology, including two that incorporate the special intertemporal considerations that are dominant in economies in which exports of nonrenewable resources are a very high share of output and exports. Using the CA regression approach, the cyclically adjusted CA norm is estimated at 7.4 percent of GDP (lower than the CA norm in 2018 because the headline fiscal deficit consistent with the IMF staff's recommended path of the non-oil primary fiscal deficit is now somewhat larger due to lower oil revenues). The Consumption Allocation Rules (Bems and de Carvalho Filho 2009) assume that the sustainability of the CA trajectory requires that the net present value (NPV) of all future oil and financial/investment income (wealth) be equal to the NPV of imports of goods and services net of non-oil exports. Estimated CA norms from the Consumption Allocation Rules were 8.1 percent of GDP and 10.8 percent of GDP for the constant real annuity and constant real per capita annuity allocation rules, respectively. The Investment Needs Model (Araujo and others 2016) takes into account the possible desirability of allocating a portion of the resource wealth to finance investment, which was not explicitly considered by the consumption-based model and produced a CA gap of –2.6 percent over the medium term. The CA gap in 2019 (–3.0 percent of GDP) is the average of the estimates from the three approaches.

## Singapore

<sup>1</sup>Singapore has a negative income balance despite its large positive NIIP position, reflecting lower rates of return on its foreign assets relative to returns on its foreign liabilities, possibly due to the fact that the composition of Singapore's assets is tilted toward safer assets with lower returns.

<sup>2</sup>Nonstandard factors make a quantitative assessment of Singapore's external position difficult and subject to significant uncertainty. Singapore is not included in the EBA sample because it is an outlier along several dimensions (for example,

large external asset and liability positions, highly positive NIIP position). Therefore, IMF staff estimates the CA norm using various approaches. Overall, the staff-estimated CA gap is about 4 percent of GDP, to which the fiscal policy gap contributes about 1.4 percent of GDP and the health spending gap about 0.2 percent of GDP.

<sup>3</sup>The reserves-to-GDP ratio is also larger than in most other financial centers, but this may reflect in part that most other financial centers are in reserve-currency countries or currency unions. External assets managed by the government's investment corporation and wealth fund (GIC and Temasek) amount to at least 70 percent of GDP.

### South Africa

<sup>1</sup>The final CA gap estimate results from the CA regression and IMF staff judgment.

(1) Because South Africa is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime age and exit age from the workforce. This results in an adjustor of –1 percent of GDP to the model-based CA norm.

(2) Net current transfers related to the Southern African Customs Union (SACU), assessed to have a net negative impact on the CA, are not accounted for in the regression model and warrant an adjustment to the cyclically adjusted CA. In addition, measurement issues pertaining the income balance are likely to contribute to an underestimation of the CA.

(3) The 2019 EBA CA norm is higher than in 2018 because of the required lower desirable fiscal deficit to stabilize future debt.

<sup>2</sup>Applying an estimated long-term elasticity of 0.26 would suggest a REER overvaluation of 2 to 10 percent.

<sup>3</sup>Gauging the appropriate REER for South Africa is challenging. The weakening of average REER levels from pre-2000 to post-2000 would likely lead REER regression-based model results to indicate undervaluation, unless the model can sufficiently attribute the observed weakening in average REER to weaker fundamentals.

### Spain

<sup>1</sup>Based on data available through 2019:Q4.

<sup>2</sup>The EBA model suggests a CA norm of 1.1 percent of GDP, with a standard error of 0.8 percent of GDP. But the empirically based EBA norm does not fully account for the very negative NIIP, with about 30 percent of gross liabilities in the form of equity. Given external stability considerations, including potentially adverse NIIP valuation effects, a CA norm in the range of 1 to 3 percent of GDP is necessary to raise the NIIP by at least roughly 3 percent of GDP annually over the next 10 years. Over 2013–19, valuation effects were on average –2.9 percent of GDP per annum. CA surpluses during 2013–19 of about 2.2 percent of GDP, on average, suggest that maintaining CA balances

aligned with the IMF staff–assessed norm of 1 to 3 percent of GDP would be feasible under current policies.

<sup>3</sup>The REER gap midpoint is obtained from the IMF staff-assessed CA gap and an estimated semi-elasticity of the CA to the REER of 0.22. The range of the REER gap is  $\pm 4$  percent, which is obtained from Spain's estimated standard error of the EBA CA norm (0.8 percent of GDP) and the aforementioned CA-to-REER semi-elasticity.

### Sweden

<sup>1</sup>The range is used to reflect uncertainty around the EBA estimated norm.

### Switzerland

<sup>1</sup>Other stock-flow adjustments include changes in statistical sources, such as changes in the number of entities surveyed and items covered, although their quantitative importance is not known.

<sup>2</sup>As a result, an appreciation (depreciation) of the Swiss franc has a negative (positive) effect on the NIIP, whereas a symmetric percentage increase in share prices in Switzerland and abroad would reduce the NIIP.

<sup>3</sup>The underlying CA is adjusted for (1) retained earnings on portfolio equity investment that are not recorded in the income balance of the CA under the sixth edition of the IMF *Balance of Payments and International Investment Position Manual*, and (2) the recording of nominal interest on fixed income securities under the Balance of Payments Manual framework, which compensates for expected valuation losses (due to inflation and/or nominal exchange rate movements), even though this stream compensates for the (anticipated) erosion in the real value of debt assets and liabilities. Adjusting for both of these effects and taking into account the lagged net foreign assets contribution to the norm, the underlying CA would need to be reduced by about 3.5 percent of GDP.

<sup>4</sup>The CA gap range reflects the uncertainty inherent in the assessment.

<sup>5</sup>The IMF staff CA gap for 2019 was 1.8 percent of GDP, with a range of  $\pm 2$  percentage points. With an estimated CA-REER semi-elasticity of 0.52, the IMF staff CA gap implies a REER gap from –7.4 percent to +0.4 percent, with a midpoint of –3.5 percent.

### Thailand

<sup>1</sup>The IMF staff no longer sees a case for including the country-specific adjustors introduced in past external sector assessments to account for temporary factors not in the CA model. Specifically, the adjustor for political uncertainty has been removed given the elections were held in March 2019;



a big data approach confirms that there is no longer any significant correlation between private demand elements and political uncertainty measures for 2019. Further, the adjustment for terms of trade has been removed as there is no notable divergence between the total terms-of-trade series the IMF staff used and the commodities terms-of-trade series used in the EBA.

<sup>2</sup>The REER range is based on the current account range from the CA approach, using an elasticity of 0.62, the country-specific elasticity estimated for Thailand. The current account range is computed as the estimated CA gap (6.1 percent of GDP) with an error band using the standard error of the norm for Thailand (1.6 percent of GDP).

<sup>3</sup>The EBA index REER gap in 2019 is estimated at 13.5 percent; the EBA level REER gap is estimated at -1.6 percent.

## Turkey

<sup>1</sup>Despite persistent CA deficits, the NIIP fluctuated with no clear trend during 2009–18, due to a mix of positive valuation effects and large net balance of payments E&O.

<sup>2</sup>Net international reserves are defined as gross international reserves minus the central bank's FX liabilities to banks, including the Reserve Option Mechanism.

## United Kingdom

<sup>1</sup>The official NIIP data may understate the true position—estimates of FDI stocks at market values imply a much higher NIIP. Estimates from the Bank of England suggested that the NIIP based on market values could have been close to 80 percent of GDP for mid-2017 (November 2017 inflation report). Market value estimates of FDI assets assume their valuations move in line with those of equity market indices in the United Kingdom and abroad. These estimates are highly uncertain, as actual FDI market values could evolve differently across different equity markets.

<sup>2</sup>Estimates in Juvenal and others (2019) suggest that, in 2017, about 90 percent of external assets were denominated in foreign currency, compared with 60 percent for external liabilities.

<sup>3</sup>The marked shift in recent years from FDI assets to portfolio equity assets implies a greater-than-historical underestimation of the income balance.

<sup>4</sup>Should Brexit lead to a significant increase in trade barriers, the equilibrium exchange rate could be weaker than suggested here.

<sup>5</sup>These values reflect the relative weights put on the different approaches, with a higher weight on the CA gap methodology. The wide range reflects the large uncertainty as to the future of the UK-EU relationship.

## United States

<sup>1</sup>The midpoint is obtained from the CA model gap, applying an estimated semi-elasticity of 0.11. The range stems from the largest absolute discrepancy between the CA model and the set of REER models.

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