CHAPTER 3

2020 INDIVIDUAL ECONOMY ASSESSMENTS

Methodology and Process

The individual economy assessments use a wide range of methods to form an integrated and multilaterally consistent view of 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.[1] 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.[2] The policy discussion in the individual economy assessments highlights policies and reforms that contribute to supporting convergence toward (or maintenance of) external balance, in the context of a summary of the overall policy advice.

The EBA models provide numerical inputs for the identification of external imbalances but, in some cases, may not sufficiently capture all relevant economic characteristics and potential policy distortions. In such cases, the individual economy assessments may need to be complemented by analytically grounded judgment and economy-specific insights in the form of adjustors. IMF staff members estimate an economy's current account gap by combining the EBA model's current account gap estimate with adjustors. For the 2020 assessments, additional adjustors to account for the effects of the COVID-19 crisis on external positions were introduced (see Online Annex 1.1 in Chapter 1). The IMF staff estimates the real effective exchange rate (REER) gap consistent with the staff current account gap by applying a country-specific elasticity, although in some cases additional information is used, such as the EBA REER regression models, unit-labor-cost-based measures, and metrics, to arrive at the staff REER gap estimate. 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 external position from fundamentals and desired policies. As reported in Annex Table 1.1.2 (Chapter 1), the ranges of uncertainty for IMF staff–assessed current account gaps are generally about ±1 percent of GDP. For the 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 1.4). 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 with 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 ±1 percent of GDP as well as REER gaps in the range that reflects the country-specific exchange rate semi-elasticity (for example, ±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.

[1]See Cubeddu and others (2019) for a complete description of the EBA methodology and for a description of the most recent refinements.

[2]The individual economy assessments for 2020 are based on data and IMF staff projections as of June 30, 2021.

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 policies.
[–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	The Netherlands	Spain	United States

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

A two-country example: To clarify how to analyze policy distortions in a multilateral setting and how to distinguish between domestic policy distortions, which may require a country 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. More generally, policy actions that contribute to addressing external imbalances relate to the determinants of current account balances, namely the private and public saving-investment balances. Structural or policy distortions can contribute to excessive or inadequate saving and investment, and the policy advice in the individual economy assessments highlights reforms and policy changes that can contribute to addressing these gaps. Policy advice also seeks to address vulnerabilities associated with external stock positions, including reserves, as well as foreign exchange intervention policies.

Abbreviations and Acronyms

Adj.	adjusted
ARA	assessing reserve adequacy
BOP	balance of payments
CA	current account
CFM	capital flow management
COVID-19	coronavirus disease 2019
CPI	consumer price index
Cycl.	cyclically
EBA	External Balance Assessment
ECB	European Central Bank
ESR	*External Sector Report*
EU	European Union
FDI	foreign direct investment
FX	foreign exchange
GDP	gross domestic product
IIP	international investment position
Liab.	liabilities
NEER	nominal effective exchange rate
NIIP	net international investment position
PIF	Public Investment Fund
QFII	qualified institutional investors
REER	real effective exchange rate
Res.	residual
RQFII	Renminbi qualified institutional investors
SDR	special drawing right
TARGET2	Trans-European Automated Real-time Gross Settlement Express Transfer System
ULC	unit labor cost

Table 3.1. Argentina: Economy Assessment

Overall Assessment: *The external position in 2020 was weaker than the level implied by medium-term fundamentals and desirable policies.* The recent successful sovereign FX debt restructuring agreements with private creditors have provided important short-term cash flow relief, yet a credible and strong macroeconomic and structural plan that can be supported by the international community is needed to improve Argentina's external position over the medium term.

Potential Policy Responses: Policies should carefully balance the need to support the recovery and strengthen domestic and external stability. Growth-friendly fiscal consolidation, combined with prudent monetary policies, is essential to maintain a strong trade surplus, rebuild international reserves, regain market access, and ensure debt sustainability, although this path will depend on the evolution of the global pandemic. In addition, structural reforms to boost Argentina's export capacity and encourage FDI are required. As stability is established, and the pandemic wanes, a gradual conditions-based unwinding of CFM measures and export taxes will need to be considered.

Foreign Asset and Liability Position and Trajectory

Background. Argentina's external gross liabilities rose to 72.6 percent of GDP in 2020, continuing the upward trend from 34 percent of GDP at the end of 2015, when Argentina regained access to international markets. Still, the NIIP increased to 32 percent of GDP (up 5.8 and 23.1 percentage points since the end of 2019 and the end of 2015, respectively), driven by continued private capital outflows and deleveraging by firms, despite strong capital controls.

Assessment. In 2020 Argentina successfully restructured about 99 percent of eligible domestic and foreign law sovereign FX debt held by the private sector (US$82 billion, or 21.4 percent of GDP) with cash flow relief of US$34 billion during 2020–30, yet limited up-front principal reduction. Meanwhile, several provinces and private firms have also reached restructuring agreements, while negotiations are ongoing in others. CFM measures introduced in 2019 remain necessary in the near term to mitigate capital outflow risks. Prospects of market access over the medium term will depend on implementation of a strong macroeconomic and structural reform plan.

2020 (% GDP)	NIIP: 32.0	Gross Assets: 104.6	Res. Assets: 10.3	Gross Liab.: 72.6	Debt Liab.: 57.4

Current Account

Background. The CA reached a surplus of 0.8 percent of GDP in 2020, compared with –0.9 percent of GDP in 2019. The improvement reflects a higher trade surplus (0.3 percent of GDP)—as the COVID-19–related import contraction outweighed the fall in exports—as well as an improvement in the income balance (1.3 percent of GDP), largely on account of lower interest payments related to the debt restructuring operations. The trade surplus narrowed during the latter part of 2020 as FX pressures (reflected in the gap between the official and parallel rates) encouraged imports and discouraged exports. Record-high export prices could support a further improvement in the trade and CA balance in 2021, partially offset by a strong recovery in imports.

Assessment. The EBA CA cyclically adjusted balance reached a deficit of 0.5 percent of GDP, compared with an EBA CA norm equivalent to a deficit of 1.3 percent of GDP. Factoring in the transitory impacts of the COVID-19 crisis in relation to the oil and travel services (including tourism) sectors (–0.2 and –0.3 percent of GDP, respectively) implies a –0.5 percent of GDP adjustment to the deficit. Furthermore, consistent with the need to bring down external debt service to more manageable levels and pave the way for market access, the IMF staff judges the near- to medium-term CA norm to be closer to 1.0 percent of GDP, implying an adjustment of 2.4 percent of GDP. As such, the IMF staff assesses the CA gap to be –2.1 ±1 percent of GDP, the bulk of which reflects a more expansionary fiscal policy stance than warranted as well as FX sales.

2020 (% GDP)	CA: 0.8	Cycl. Adj. CA: –0.5	EBA Norm: –1.3	EBA Gap: 0.8	COVID-19 Adj.: –0.5	Other Adj.: –2.4	Staff Gap: –2.1

Real Exchange Rate

Background. The official REER appreciated by 2.3 percent, on average, in 2020 relative to 2019 and depreciated 1 percent in end-of-period terms. This mostly reflects regained FX market stability, following the 2018–19 crisis (during which the REER depreciated by a combined 35 percent), supported in part by strict CFM measures and central bank interventions targeting a broadly unchanged REER. As of the end of May 2021, reflecting a slowdown in the rate of crawl, the REER had appreciated by 0.9 percent compared to the 2020 average and by about 5.9 percent since the end of 2020.

Assessment. The IMF staff CA gap implies a REER overvaluation of 15.3 percent in 2020 (applying an estimated elasticity of 0.14). However, the REER index model suggests an undervaluation of 2.9 percent. Overall, given realized and expected trade balance improvements and continued compression of wages in 2020, the IMF staff assesses the 2020 REER gap to be in the range of –2.5 to 12.5 percent, with a midpoint of 5 percent, also reflecting significant uncertainty about the equilibrium REER.

Capital and Financial Accounts: Flows and Policy Measures

Background. The CFM measures adopted in August 2019, when Argentina lost access to international markets, were further strengthened in late 2020 in response to FX pressures arising from the monetary financing of the budget and uncertainties over the direction of policies. Current CFM measures include (1) a surrender requirement for FX export proceeds, (2) central bank authorization for payment of dividends and profits, (3) limits on FX purchases by firms and individuals (when purchasing FX, individuals pay a 30 percent tax and a 35 percent fee that can be credited toward income tax payments), and (4) limits on external amortization payments (firms may service up to 40 percent of amortizations falling due between October 2020 and December 2021). There are no restrictions on FX deposit withdrawals for either individuals or firms.

Assessment. The CFM measures significantly reduced the size of the official FX market and slowed the rate of capital outflows. While the tightening of CFM measures may have helped reduce FX pressures (the gap fell from a peak of over 100 percent in October 2020 to about 75 percent in May), they are not a substitute for macroeconomic policies to address underlying imbalances. While CFM measures are needed in the near term, a conditions-based unwinding will be necessary, especially to encourage FDI.

FX Intervention and Reserves Level

Background. Gross international reserves fell to US$39.4 billion (about 10 percent of GDP) by the end of 2020 down US$5.5 billion and US$26 billion relative to the end of 2019 and 2018, respectively. The decline in reserves in 2020 reflects a combination of factors, including debt service payments (public and private) and FX sales (US$4.9 billion). As of the end of May 2021 gross international reserves stood at about US$42 billion, although, after excluding swap lines with other central banks and reserve requirements on domestic US dollar deposits, reserves (and related deposit insurance) reached close to US$8.5 billion.

Assessment. Gross international reserves represented about 60 percent of the IMF's composite metric as of end-2020 after smoothing of temporary effects, and 72 percent without the adjustment.[1] In the context of the projected trade surpluses and reduced debt service payments following external debt restructuring agreements, rebuilding of reserve coverage is necessary to pave the way for market access and the easing of CFM measures over the medium term. Given reserves scarcity, FX intervention (in the official or parallel market) should be limited to addressing disorderly conditions.

Table 3.2. Australia: Economy Assessment

<table>
<tr><td colspan="8">Overall Assessment: The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The increase in the CA surplus recorded in 2020 reflects in large part temporary factors associated with the COVID-19 shock. While considerable uncertainty remains, the CA is expected to return to a deficit in the medium term as domestic demand picks up and temporary factors unwind.

Potential Policy Responses: Policies that promote domestic demand can contribute to maintaining the CA balance close to its norm. The substantial monetary policy easing and fiscal stimulus implemented in response to the COVID-19 shock were appropriate to support the economy and protect vulnerable households and firms. The policy priority in the period ahead should be to maintain adequate policy support, including by scaling up public investment, until the recovery is firmly entrenched. The continued accommodative fiscal and monetary policy stance will support domestic demand and contribute to the narrowing of the CA surplus while keeping the external position in line with fundamentals.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. Australia's NIIP declined to –52.6 percent of GDP in 2020 from –46.2 percent of GDP in 2019 as valuation changes from the Australian dollar's appreciation offset the effect of the CA surplus. The NIIP-to-GDP ratio is expected to stabilize at about –36 percent of GDP over the medium term. Although nearly one-half of Australia's gross liabilities are debt obligations, more than one-half of the liabilities are denominated in domestic currency, while 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 investments and derivatives.

Assessment. The NIIP level and trajectory are sustainable. 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 the Term Funding Facility implemented after the COVID-19 shock has reduced banks' dependence on foreign funding. Despite the recent increase in debt, the government's balance sheet remains strong and can provide credible support in a tail risk event in which domestic banks suffer a major loss.</td></tr>
<tr><td>2020 (% GDP)</td><td>NIIP: –52.6</td><td colspan="2">Gross Assets: 171.3</td><td>Debt Assets: 47.5</td><td colspan="2">Gross Liab.: 223.9</td><td>Debt Liab.: 104.4</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. While Australia has historically run CA deficits, averaging about 3 percent of GDP between 2014 and 2018, the CA balance switched to a surplus of 0.7 percent of GDP in 2019 and rose further to 2.5 percent of GDP in 2020. The increase in surplus in 2020 largely reflects temporary factors related to the COVID-19 shock, including a sharp increase in the primary income balance (an improvement of 1.6 percent of GDP relative to 2019 and the highest-recorded balance as a percent of GDP since the mid-1970s); a collapse in travel services imports, including tourism, while (especially education-related) travel services exports declined by less; relatively strong demand for Australian commodities; and an increase in commodity prices of Australia's main exports late in the year. While there is considerable uncertainty, the CA is expected to gradually return to a deficit over the medium term, albeit at a level lower than the historical average.

Assessment. The EBA model estimates a cyclically adjusted CA surplus of 2.4 percent of GDP compared with a CA norm of –0.1 percent of GDP, suggesting a model-based CA gap of 2.6 percent of GDP. However, in the IMF staff's view, two adjustments are warranted to the cyclically adjusted CA balance: (1) an adjustment of –0.5 percent of GDP to reflect temporary factors related to the COVID-19 shock, mostly due to an increase in the travel services balance; and (2) an adjustment of –1.2 percent of GDP to reflect temporarily lower dividend payments on FDI and portfolio liabilities. Taking these adjustments into consideration, the IMF staff–adjusted CA gap is in the range of –0.1 to 1.9 percent of GDP, with a midpoint of 0.9 percent of GDP.</td></tr>
<tr><td>2020 (% GDP)</td><td>CA: 2.5</td><td>Cycl. Adj. CA: 2.4</td><td>EBA Norm: –0.1</td><td>EBA Gap: 2.6</td><td>COVID-19 Adj.: –1.7</td><td>Other Adj.: 0.0</td><td>Staff Gap: 0.9</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. Australia's REER depreciated by 0.8 percent in 2020 compared with the 2019 average and is about 5 percent lower than its 2015 level. However, the average depreciation in 2020 masks substantial volatility over the course of the year. The REER depreciated in the first half of the year amid the rise in global risk aversion. The second half of the year saw a significant appreciation, with the fourth quarter of 2020 average REER close to 4 percent higher than that of the fourth quarter of 2019 due to a rise in commodity prices of Australia's main exports and a relatively quicker recovery in economic activity in Australia compared with the rest of the world. As of May 2021 the REER had appreciated by about 8.2 percent relative to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –4.5 percent (applying an estimated elasticity of 0.2). The EBA REER level model points to an overvaluation of 9.8 percent, while the REER index model points to a slight undervaluation of 2.1 percent. Overall, the IMF staff assesses the REER gap to be in the range of –8 to 2 percent, with a midpoint of –3 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. The financial account recorded net outflows in 2020, reflecting the sizable CA surplus. While net FDI inflows continued (though at lower levels on account on lower inflows amid the COVID-19 shock), these were offset by net portfolio outflows, other net outflows (mainly reflecting outflows from the financial sector as banks were able to replace foreign borrowing with funding from the central bank using the Term Funding Facility), and derivatives outflows (where both inflows and outflows increased significantly, with net outflows of about 1.1 percent of GDP).

Assessment. Vulnerabilities related to the financial account remain contained, supported by a credible commitment to a floating exchange rate.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="7">Background. The currency has been free floating since 1983. The central bank has not intervened in the FX market since the global financial crisis.

Assessment. The authorities are strongly committed to a floating regime, which reduces the need for reserve holdings. Although domestic banks' external liabilities remain sizable, they are either in local currency or hedged, so reserve needs for prudential reasons are also limited.</td></tr>
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Table 3.3. Belgium: Economy Assessment

Overall Assessment: *The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.*

Potential Policy Responses: In the near term, the overarching policy priority remains mitigation of the health and economic impact of the COVID-19 pandemic, avoiding a premature unwinding of policy support. However, narrowing policy space will require measures to be increasingly targeted as the recovery firms up, balancing protection of vulnerable households and viable firms with facilitating resource reallocation to mitigate scarring. In light of imbalances that existed before the COVID-19 outbreak, in the medium term, policies should refocus on strengthening competitiveness by addressing structural challenges—including labor and product market reforms and other reforms to foster green, digital, and inclusive growth that will support competitiveness through investment in infrastructure, education, and training—as well as on rebuilding fiscal space. These steps could contribute to bringing the external position more in line with medium-term fundamentals and desirable policy settings.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP declined from 51 percent of GDP at the end of 2019 to 45 percent at the end of 2020, driven by valuation changes, to just below its five-year average of 48 percent. Belgium's large creditor position is underpinned by sizable net household financial wealth. While household savings increased thanks to income support measures and precautionary savings during the pandemic, the impact on the NIIP was offset by external borrowing by the government. Gross foreign assets reached 467 percent of GDP in 2020 (up 22 percentage points from 2019 despite a modest decline in nominal terms), inflated by intragroup corporate treasury activities. Gross foreign assets of the banking sector stood at 81 percent of GDP at the end of 2020, well below the pre-global-financial-crisis peak of more than 200 percent, following a decade of consolidation and deleveraging. External public debt increased to 75 percent of GDP in 2020, up from 64 percent in 2019, reflecting a sharp increase in financing needs and demand from international investors, and is predominantly denominated in euros. Though declining as support measures are unwound, public sector financing needs are projected to remain high over the medium term as deficits remain well above precrisis levels and large redemptions come due. TARGET2 balances averaged –€49.6 billion (–11 percent of GDP) in 2020, up from –€27.4 billion in 2019.

Assessment. 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. Looking ahead, based on the projected CA and growth paths, the NIIP-to-GDP ratio is expected to decline. The large and positive NIIP and its trajectory do not raise sustainability concerns.

2020 (% GDP)	NIIP: 45.1	Gross Assets: 466.7	Debt Assets: 172.8	Gross Liab.: 421.6	Debt Liab.: 195.0

Current Account

Background. The CA averaged 0.4 percent of GDP over 2015–19 and has been on a downward but volatile path since its post-global-financial-crisis peak of 1.4 percent in 2015. Volatility in the trade and primary income balances is driven by sizable operations of multinationals and large revisions.[1] In 2020 the CA turned into a deficit of 0.2 percent of GDP from a surplus of 0.3 percent of GDP in 2019, driven by a deterioration in net current transfers (0.3 percent of GDP) linked to a higher EU contribution and a modest decline in the trade balance (0.2 percent of GDP). The latter reflects a decline in net exports of goods in volume terms that was only partially offset by improvements in the terms of trade (energy prices) and in the services balance driven by travel and transportation (especially tourism, where Belgium is a net importer and spending abroad declined more than receipts). For 2021 the CA deficit is projected to widen further, as import growth is expected to outpace export growth, due to the recovery in domestic and external demand—given the large foreign content of exports—and gradual reversal of temporary factors that supported the CA in 2020. The income balance is expected to remain broadly unchanged.

Assessment. EBA model estimates yield a CA gap of –1.5 percent of GDP for 2020, based on a cyclically adjusted CA balance of –0.1 percent of GDP. Adjustment for transitory COVID-19 effects on the CA of –0.3 percent of GDP (driven by –0.4 percent of GDP for travel services, including tourism) and 0.1 and –0.1 percent of GDP for the shift in household consumption from services to consumer goods and the impact on medical goods trade, respectively, brings the gap to –1.8 percent of GDP (relative to an estimated norm of 1.4 percent of GDP). This is within a range estimated by the IMF staff for the CA gap of between –2.8 and –0.8 percent of GDP, applying a standard range for the CA gap of ±1 percent of GDP.

2020 (% GDP)	CA: –0.2	Cycl. Adj. CA: –0.1	EBA Norm: 1.4	EBA Gap: –1.5	COVID-19 Adj.: –0.3	Other Adj.: —	Staff Gap: –1.8

Real Exchange Rate

Background. After depreciating in 2019 by about 2 percent, in excess of euro depreciation (NEER depreciated by 1.1 percent), the ULC- and CPI-based REER appreciated by 3 and 1.4 percent, respectively, relative to the 2019 average. This brings the cumulative appreciation of the ULC- and CPI-based REER, respectively, to 6 and 7 percent over the past five years, thus reversing the sharp depreciation in 2014–15 brought about by wage moderation. The ULC- and CPI-based REER further appreciated by 4.7 and 0.3 percent, respectively, by the end of May 2021 relative to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of 4.3 percent in 2020 (applying an estimated elasticity of 0.42). EBA model estimates point to a REER overvaluation of between 9.6 and 18.2 percent, based on the CPI-based REER index and level models. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be overvalued in the range of 1.8 to 6.8 percent, with a midpoint of 4.3 percent.[2]

Capital and Financial Accounts: Flows and Policy Measures

Background. Gross financial outflows and inflows were on an upward trend prior to the global financial crisis as banks expanded their cross-border operations. These flows have shrunk considerably and have become more volatile as banks have deleveraged. Short-term external debt accounted for 25 percent of gross external debt in 2020. The capital account is open.

Assessment. 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.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.

Table 3.4. Brazil: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* In the wake of the COVID-19 shock, the CA deficit contracted due to the large currency depreciation and improvements in the service and income balances. The trend is expected to persist in 2021.

Potential Policy Responses: Policies that would help keep the CA in line with its norm include desirable fiscal consolidation, accompanied by measures to support public and private investment, including structural reforms to improve efficiency and reduce the cost of doing business. FX intervention, including using derivatives, may be appropriate to alleviate disorderly market conditions in the FX market.

Foreign Asset and Liability Position and Trajectory

Background. Brazil's NIIP was –38 percent of GDP at the end of 2020, moderately stronger than at the end of 2019 (–42 percent of GDP) mainly due to valuation effects associated with the currency depreciation (assets are predominantly denominated in FX while liabilities are more concentrated in local currency). At the end of 2020 external debt declined by about 5 percent in nominal terms compared with 2019, accounting for about 44 percent of GDP and 303 percent of exports, against a value of 36 percent of GDP and 299 percent of exports in 2019, with the large increase in the external-debt-to-GDP ratio in 2020 driven by the significant output contraction when measured in US dollars.

Assessment. Brazil's NIIP has been negative since 2001. Short-term gross external financing needs are significant, at about 11 percent of projected 2021 GDP, with capital flows and the exchange rate particularly sensitive to global financing conditions.

2020 (% GDP)	NIIP: –38.3	Gross Assets: 63.5	Res. Assets: 24.8	Gross Liab.: 102.0	Debt Liab.: 44.3

Current Account

Background. The CA deficit contracted from –3.5 percent of GDP in 2019 to –1.7 in 2020 due to improvements in the trade, service, and income balances, supported, respectively, by the currency depreciation, the contraction in tourism and transportation service imports, and lower distribution of profits and dividends. In 2021 the trade balance is expected to continue to improve on the back of a recovery in economic activity in trading partners that would boost exports, more than offsetting the rebound in imports. Overall, the IMF staff projects a CA balance of about –0.4 percent of GDP for 2021.

Assessment. In 2020 the cyclically adjusted CA balance was –1.6 percent of GDP. EBA estimates suggest a CA norm in 2020 of –2.4 percent of GDP. The IMF staff assesses a CA norm between –1.9 percent of GDP and –2.9 percent of GDP. Thus, after adjusting for the transitory impacts of the COVID-19 crisis on the oil; travel services, including tourism; and medical goods sectors (resulting in an impact on the CA balance of 0.3 percent, –0.3 percent, and 0.1 percent of GDP, respectively), the IMF staff CA gap is assessed at 0.9 percent of GDP. The medium-term outlook for the CA is still difficult to assess, given the unfolding COVID-19 crisis and related policy response.

2020 (% GDP)	CA: –1.7	Cycl. Adj. CA: –1.6	EBA Norm: –2.4	EBA Gap: 0.8	COVID-19 Adj.: 0.1	Other Adj.: 0.0	Staff Gap: 0.9

Real Exchange Rate

Background. After remaining broadly stable in 2019 (–1.9 percent), the REER depreciated sharply in 2020 (–20.6 percent), driven by large capital outflows in the first half of the year. Depreciation pressures have subsided since mid-May 2020. As of end-May 2021, the REER had depreciated by 3.5 percent compared with the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –7.1 percent in 2020 (applying an estimated elasticity of 0.13). The REER index (–36.6 percent) and level (–21.3 percent) methodologies point to some possible overshooting of the nominal exchange rate. Overall, the IMF staff assesses the REER gap at the end of 2020 to be closer to the REER gap implied by the IMF staff CA gap. Therefore, considering the CA norm standard error of 0.8 percent, the IMF staff assesses the REER gap to be in the range of –14.6 to 0.4 percent, with a midpoint of –7.1 percent (undervaluation).

Capital and Financial Accounts: Flows and Policy Measures

Background. Net FDI has fully financed CA deficits since 2015 (averaging 3.2 percent of GDP during 2015–20, while CA deficits averaged –2.2 percent), despite net portfolio outflows (0.6 percent of GDP, on average, during 2015–20). In 2020 net FDI stood at 3.5 percent of GDP against a CA deficit of 1.7 percent. Net portfolio outflows accelerated sharply in the first half of the year before easing in the third quarter and then partly recovering in the fourth quarter, recording a balance of –0.9 percent of GDP over the year (–1 percent of GDP in 2019). Net FDI was stronger than in 2019 due to divestment abroad that more than compensated for lower FDI inflows.

Assessment. The composition of capital flows is expected to remain favorable over the medium term, with positive net FDI inflows outweighing negative portfolio outflows that started in 2016 following the sovereign's downgrade to below investment grade. Nevertheless, the high degree of uncertainty about the scarring effects of COVID-19 on the global economy make it challenging to assess the medium-term prospects for capital flows. A renewed spike in international risk aversion, linked to a potential second wave of COVID-19, or a sudden tightening of global financing conditions could trigger a new bout of capital market volatility.

FX Intervention and Reserves Level

Background. Brazil has a floating exchange rate. In 2020 the central bank sold FX in the spot, repo, and FX swap markets in the amount of US$44.5 billion to dampen excess exchange rate volatility associated with the COVID-19 shock. Nevertheless, reserves remained high at US$356 billion at the end of 2020.

Assessment. The flexible exchange rate has been an important shock absorber. Reserves are adequate relative to various criteria, including the IMF's reserve adequacy metric (161 percent as of the end of 2020) and serve as insurance against external shocks. The authorities should retain strong external buffers, with intervention limited to addressing disorderly market conditions.

Table 3.5. Canada: Economy Assessment

Overall Assessment: *The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.* 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 narrowed in 2020 due to the contraction of demand-induced imports but will moderately widen in the medium term as domestic demand rebounds.

Potential Policy Responses: If imbalances persist, policies should aim to boost Canada's nonenergy exports. These policies include measures geared toward improving labor productivity, investing in research and development 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 underscores the importance of developing a credible medium-term fiscal consolidation plan to support external rebalancing.

Foreign Asset and Liability Position and Trajectory	**Background.** Despite running a CA deficit, Canada's NIIP has improved since 2010, reaching 61.3 percent of GDP in 2020, up from 22.5 percent in 2015 and –18.1 percent in 2010. This largely reflects valuation gains on external assets. At the same time, gross external debt increased to 142.8 percent of GDP at the end of 2020, of which about one-third is short term. **Assessment.** 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.
2020 (% GDP)	NIIP: 61.3 | Gross Assets: 299.4 | Debt. Assets: 88.0 | Gross Liab.: 238.1 | Debt Liab.: 142.8
Current Account	**Background.** The CA deficit stood at 1.8 percent of GDP in 2020, down from 2.1 percent of GDP in 2019, reflecting improvements in primary income balance and in services. The CA deficit has been financed by non-FDI net financial inflows, which have more than offset net outflows of FDI. **Assessment.** The EBA estimates a CA norm of 2.5 percent of GDP and a cyclically adjusted CA of –1.3 percent of GDP for 2020. The IMF staff assesses the CA gap to be narrower after considering (1) CA measurement issues;[1] (2) the authorities' demographic projections and current immigration targets;[2] and (3) the temporary impact of the COVID-19 crisis on oil (0.6 percent of GDP); travel services, including tourism (–0.3 percent of GDP); and the global shift in household consumption from services to consumer goods and the impact on medical goods trade (0.3 percent of GDP each). Taking these factors into consideration, the IMF staff CA gap is in the range of –2.6 to 0.4 percent of GDP.
2020 (% GDP)	CA: –1.8 | Cycl. Adj. CA: –1.3 | EBA Norm: 2.5 | EBA Gap: –3.8 | COVID-19 Adj.: 0.8 | Other Adj.: 1.9 | Staff Gap: –1.1
Real Exchange Rate	**Background.** Relative to the 2019 average, the REER depreciated by 1.1 percent through December 2020. As of end-May, the REER had appreciated by 7.5 percent compared to the 2020 average. **Assessment.** The IMF staff CA gap implies a REER gap of 3.9 percent in 2020 (applying an estimated elasticity of 0.28). The EBA REER index model points to an overvaluation of 2.6 percent in 2020, while the REER level model points to an undervaluation of about 6.5 percent. In the IMF staff's view, the REER level model could overstate the extent of undervaluation. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be overvalued in the range of –1.6 to 9.4 percent, with a midpoint of 3.9 percent.[3]
Capital and Financial Accounts: Flows and Policy Measures	**Background.** The CA deficit in 2020 was financed by non-FDI net financial flows: portfolio (3.7 percent of GDP) and other investment (–0.7 percent of GDP). FDI recorded net outflows of 1.4 percent of GDP (lower than the net outflows in 2019). In 2020 estimated errors and omissions recorded an outflow of 0.1 percent of GDP. **Assessment.** Canada has an open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate.
FX Intervention and Reserves Level	**Background.** Canada has a free-floating exchange rate regime and has not intervened in the FX market since September 1998 (with the exception of participating in internationally concerted interventions). Canada has limited reserves, but its central bank has standing swap arrangements with the Federal Reserve and four other major central banks (it has not drawn on these swap lines). **Assessment.** 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

Overall Assessment: *The external position in 2020 was in line with the level implied by medium-term fundamentals and desirable policies.* The CA surplus widened in 2020, driven by transitory factors linked to the global pandemic crisis, including falling commodity prices; the halt to outbound travel, including tourism; and a surge in pandemic-related exports. When these temporary factors dissipate, the CA surplus is expected to return to its medium-term downward trend as China's economy rebalances toward higher-quality, more-consumption-driven growth.

Potential Policy Responses: Policies that will ensure that the external position remains broadly in line with fundamentals include (1) accelerating structural reforms—further opening domestic markets, reforming state-owned enterprises, and ensuring competitive neutrality with private firms while promoting green investment and strengthening social safety nets—to boost potential growth; (2) shifting policy support toward strengthening social safety nets to reduce high household saving; and (3) further increasing exchange rate flexibility to help the economy adjust to the changing external environment. China has room to provide more fiscal support if needed, preferably through household support and green investment, with monetary policy broadly supportive of economic activity.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP, which declined from a peak of 30.4 percent of GDP in 2008 to 14.5 percent in 2019, further decreased to 14.5 percent in 2020. The drop reflects higher inward direct investment and securities investment received amid relatively robust GDP growth after the first quarter, despite a higher CA surplus and an increase in loans extended abroad.

Assessment. 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$3.4 trillion, 22.6 percent of GDP)—and liabilities are mostly FDI related.

2020 (% GDP)	NIIP: 14.5	Gross Assets: 58.5	Res. Assets: 22.6	Gross Liab.: 44.1	Debt Liab.: 15.9

Current Account

Background. The widening of the CA surplus to 1.8 percent of GDP in 2020 from 0.7 percent in 2019, underpinned by a higher savings-investment balance in the wake of the COVID-19 outbreak, mostly reflects the impact of the global pandemic, including (1) the sudden collapse in outbound travel spending, including tourism; (2) lower commodity prices amid weak global demand; and (3) a surge in exports related to the pandemic enabled by China's relatively early recovery from the initial lockdown. This export surge affected predominantly pandemic-related goods (such as medical equipment and health care products) and durable goods, driven by the global shift in household consumption composition from services to goods, amplified by a significant increase in export prices. The income balance turned more negative in 2020, driven by a higher investment income deficit. The impact of the pandemic is expected to be temporary, with the CA surplus projected to converge to about 0.5 percent of GDP over the medium term, in line with continued rebalancing toward higher-quality and more-consumption-driven growth.

Assessment. The EBA CA methodology estimates the CA gap in 2020 to be 1.9 percent of GDP. Considering that the pandemic-related temporary factors raised the CA surplus by 1.2 percent of GDP (with contributions of 0.1 percent of GDP from the oil balance, 0.5 from the travel services balance, and 0.2 and 0.4 from the shift in household consumption from services to consumer goods and the impact on medical goods trade, respectively), the IMF staff assesses the CA gap to range from –0.7 to 2.1 percent of GDP, with a midpoint of 0.7 percent. The range around the midpoint reflects a number of uncertainties, including about how temporary the impact of the pandemic will be. EBA-identified policy gaps are close to nil on balance as the impact of China's still-high credit growth offsets that of a relatively closed capital account (in a de jure sense), while the fiscal policy gap widened, reflecting more expansionary fiscal policy. The overall gap is largely accounted for by the residual, which reflects factors not directly captured by the underlying model, including distortions that encourage excessive saving.

2020 (% GDP)	CA: 1.8	Cycl. Adj. CA: 1.7	EBA Norm: –0.3	EBA Gap: 1.9	COVID-19 Adj.: –1.2	Other Adj.: 0.0	Staff Gap: 0.7

Real Exchange Rate

Background. After a depreciation of 11.7 percent during 2015–19, the REER appreciated by 2.1 percent in 2020 from the 2019 average, largely driven by the appreciation in the NEER (0.9 percent). In the context of declining depreciation pressure, the use of a countercyclical adjustment factor was phased out in October. As of end-May 2021, the REER had appreciated by 3.0 percent compared ot the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –3.1 percent in 2020 (applying an estimated elasticity of 0.23). The EBA REER index regression estimates the REER gap in 2020 to be –0.3 percent, and the EBA REER level regression estimates the REER gap to be 13.0 percent. Overall, the IMF staff assesses the REER gap to be in the range of –10.5 to 9.5 percent, with a midpoint of –0.5 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Capital outflows (including net errors and omissions) increased to US$246 billion (or 1.7 percent of GDP) in 2020, up from US$122 billion (or 0.8 percent of GDP) in 2019 but still below the average annual outflows of US$636 billion during 2015–16. In part, the increase reflects continued opening up. The reserve requirement on FX forwards, a CFM measure, was lowered from 20 percent to zero in October 2020. Two other CFM measures were adjusted: (1) the ceiling on cross-border financing under the macroprudential assessment framework for financial institutions and enterprises was raised by 25 percent in March 2020, but lowered to the original level for financial institutions in December 2020 and for enterprises in January 2021; and (2) restrictions on the investment quota of foreign institutional investors (QFII and RQFII) were removed, while a new quota ($12.7 billion) was introduced for domestic institutional investors.

Assessment. 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 substantial further opening. Efforts should be redoubled to encourage inward FDI, which would support growth, and to improve corporate governance. CFM measures should not be used to actively manage the capital flow cycle or substitute for warranted macroeconomic adjustment and exchange rate flexibility.

FX Intervention and Reserves Level

Background. FX reserves continued to increase (by US$134 billion in 2020) to US$3.4 trillion, mainly reflecting valuation effects and adjustments in net forward positions, with no sign of large FX intervention.

Assessment. The level of reserves—at 75 percent of the IMF's standard composite metric at the end of 2020 (85 percent in 2019) and 120 percent of the metric adjusted for capital controls (135 percent in 2019)—is assessed to be adequate. The decline in the ratios reflects higher exports, broad money, external debt, and other liabilities, all of which raised the metric.

Table 3.7. Euro Area: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The pandemic has led to a collapse of the services and primary income balances, which was largely offset by an improvement in the goods balance, reducing the CA balance slightly to 2.2 percent of GDP in 2020. In the medium term, the CA surplus is projected to increase relative to the 2019 levels, reflecting in part higher private sector savings, although the range of uncertainty around this projection is exceptionally high given the nature of this crisis. Imbalances could remain sizable at the national level.

Potential Policy Responses: Short-term policies should continue focusing 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 COVID crisis initiatives—both at the national and EU levels—have supported these efforts and could potentially help reduce the CA surplus by supporting investment and consumption, thereby increasing imports. Looking ahead, monetary policy should remain accommodative until inflation has durably converged to the ECB's medium-term price stability objective, and fiscal support should remain in place until the recovery is firmly established, before gradually consolidating toward medium-term objectives. If imbalances in policy gaps persist at the national level, 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, reduce structural and youth unemployment, and enhance competitiveness as the acute phase of the pandemic recedes. Euro-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.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP of the euro area had fallen to about –23 percent of GDP by the end of 2009 but rose substantially to about 0.8 percent of GDP by the end of 2020. The rise was driven by stronger CA balances and modest nominal GDP growth. Relative to 2019 the NIIP increased by 1.1 percentage points of GDP, reflecting primarily the net increase in long-term portfolio securities, partially offset by a decline in net "other investment" assets. Gross foreign positions were about 268.3 percent of GDP for assets and 267.5 percent of GDP for liabilities in 2020. 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.

Assessment. Projections of continued CA surpluses over the medium term suggest that the NIIP-to-GDP ratio will rise further, at a moderate pace. The region's overall NIIP financing vulnerabilities appear low. Despite rising CA balances over the medium term, large net external debtor countries still bear a greater risk of a sudden stop of gross inflows.

2020 (% GDP)	NIIP: 0.8	Gross Assets: 268.3	Debt Assets: 103.8	Gross Liab.: 267.5	Debt Liab.: 103.7

Current Account

Background. The CA balance for the euro area declined slightly to 2.2 percent of GDP in 2020. The collapse in the services and primary income balances was offset by an improvement in the goods balance. Both precautionary and forced savings of the private sector increased sharply in 2020, offsetting the decline in public sector savings, which was largely driven by expansionary policies. Bilateral CA surpluses declined the most vis-à-vis the United Kingdom and the United States, and deficits increased vis-à-vis China. Some large creditor countries, such as Germany and The Netherlands, continued to have sizable surpluses, reflecting high corporate and household saving and weak investment. At the end of the projection horizon, the CA balance will be above the 2019 level, mainly driven by higher private sector savings in Italy and some smaller countries, including Ireland.

Assessment. The EBA model estimates a CA norm of 1.0 percent of GDP, against a cyclically adjusted CA of 1.8 percent of GDP. This implies a gap of 0.8 percent of GDP. IMF staff analysis indicates a slightly 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, 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 were made in Ireland and The Netherlands, given measurement issues. Adjustments for the transitory impact of the COVID-19 crisis on the composition of household consumption, as well as on the medical goods, travel services (including tourism), and oil balance sum to 0.2 percent of GDP. Considering these factors and uncertainties in the estimates, including the cyclical adjustment, the IMF staff CA gap is 0.6 percent of GDP for 2020, with a range of –0.2 to 1.4 percent of GDP.

2020 (% GDP)	CA: 2.2	Cycl. Adj. CA: 1.8	EBA Norm: 1.0	EBA Gap: 0.8	COVID-19 Adj.: 0.2	Other Adj.: –0.3	Staff Gap: 0.6

Real Exchange Rate

Background. The CPI-based REER appreciated by 2.1 percent in 2020, reversing the depreciation in 2019. This reflects a nominal appreciation of 4.1 percent in 2020, which was partially offset by weaker euro area inflation relative to its trading partners. The ULC-based REER appreciated by 2.0 percent. Other published REERs, based on extra-euro-area trading partners, appreciated by 0.8 percent, on average. As of end-May 2021, the REER had appreciated by 1.7 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –1.8 percent in 2020, applying an estimated elasticity of 0.35.[1] The EBA REER index model suggests an overvaluation of 5.5 percent, and the EBA REER level model implies an undervaluation of 0.6 percent. Consistent with the IMF staff CA gap, the IMF staff assesses the REER gap to be in the range of –3.8 to 0.2 percent, with a midpoint of –1.8 percent. 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 9.2 percent in Germany to overvaluations of 0 to 10 percent in several small to large euro area member states. The substantial 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.

Capital and Financial Accounts: Flows and Policy Measures

Background. Mirroring the CA surplus in 2020, the euro area experienced net capital outflows, largely driven by portfolio investment, which more than offset the net inflow of direct and other investment into the euro area.

Assessment. Gross external indebtedness of euro area residents increased by 8 percentage points of GDP due to increases in both short-term debt securities and government and Eurosystem liabilities.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.

Table 3.8. France: Economy Assessment

Overall Assessment: *The external position in 2020 was weaker than the level implied by medium-term fundamentals and desirable policies.*

Potential Policy Responses: 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 imbalances persist, policies would need to continue focusing on further improving competitiveness by reinvigorating structural reforms and on rebuilding fiscal space once the recovery is secured. These policies would bring the external position more in line with medium-term fundamentals and desirable policies.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP stood at –26 percent of GDP in the fourth quarter of 2020, below the range observed during 2014–19 (between –16 and –23 percent of GDP). The NIIP fell by about 3½ percent of GDP since the end of 2019, largely driven by an increase in banks' and public sector gross debt (about 17 and 9 percent of GDP, respectively). While the net position is moderately negative, gross positions are large. Gross assets stood at 352 percent of GDP in the fourth quarter of 2020, of which banks' non-FDI-related assets accounted for about 42 percent, reflecting their global activities. Gross liabilities reached 378.4 percent of GDP in the fourth quarter of 2020, of which external debt was about 242 percent of GDP (53 percent accounted for by banks and 27 percent by the public sector). About three-quarters of France's external debt liabilities are denominated in domestic currency. The average TARGET2 balance in 2020 was about –€2.2 billion.

Assessment. 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 (65 percent of GDP in the fourth quarter of 2020) and banks' gross financing needs—the stock of banks' short-term debt securities was €76 billion in the fourth quarter of 2020 (3.3 percent of GDP), and financial derivatives stood at about 46 percent of GDP.

2020 (% GDP)	NIIP: –26.4	Gross Assets: 352.0	Debt Assets: 199.7	Gross Liab.: 378.4	Debt Liab.: 242.0

Current Account

Background. The CA deficit widened to 2.3 percent of GDP (from 0.7 percent in 2019), driven by a contraction in non-oil goods and services exports. While the deterioration in the CA balance is partly explained by one-off factors (for example, imports of health-care-sector equipment) and temporary factors that are expected to gradually normalize (for example, services balance, including business and tourism travel), it also reflects factors likely to weigh more lastingly on the external position (for example, aeronautics net exports, which contracted by about ½ percent of GDP). Lower investment income also reduced the contribution of the income account (by about 0.2 percent of GDP). Over the medium term, the IMF staff projects the CA deficit will narrow to about 0.7 percent of GDP by 2026 as temporary factors dissipate and selected reforms to improve France's competitiveness start to pay off.

Assessment. The 2020 cyclically adjusted CA deficit is estimated at –2.3 percent of GDP compared with an EBA-estimated norm of a 0.2 percent surplus. The model residual accounts for the bulk of the estimated gap (–2.5 percent of GDP) and its increase since 2019. The IMF staff estimates CA net adjustments related to COVID-19 at 0.4 percent of GDP, driven by travel-services-related transitory factors (0.2 percent of GDP) and exports of medical goods (0.3 percent), which were partially offset by fluctuations in the oil balance (–0.1 percent of GDP). On this basis, the IMF staff assesses that the CA gap in 2020 was between –2.7 and –1.7 percent of GDP (compared with –1.6 to –0.6 percent of GDP in 2019), with a midpoint of –2.2. The CA gap is expected to narrow over the medium term as the effect of the crisis fades.

2020 (% GDP)	CA: –1.9	Cycl. Adj. CA: –2.3	EBA Norm: 0.2	EBA CA Gap: –2.5	COVID-19 Adj.: 0.4	Other Adj.: 0.0	Staff CA Gap: –2.2

Real Exchange Rate

Background. Following a depreciation of the ULC-based REER and the CPI-based REER of 2.6 and 1.7 percent, respectively, in 2019, largely exceeding the depreciation of the euro (the NEER depreciated by only about 1 percent in 2019), both REER measures appreciated strongly in 2020. The ULC-based REER appreciated by 6.1 percent with respect to the 2019 average, while the CPI-based REER appreciated by 1.0 percent. From a longer-term perspective, although both REER measures depreciated by about 10 percent between 2008 and 2019, 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). As of end-May 2021, the REER had appreciated by 1.3 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of 8.0 percent in 2020 (applying an estimated elasticity of 0.27).[1] The EBA REER index model points to a REER gap of –1.9 percent, while the EBA REER level model points to a REER gap of 2.9 percent. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be overvalued in the range of 6.0 to 10.0 percent, with a midpoint of 8.0 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. The CA deficit in 2020 was financed mostly by net portfolio debt inflows (0.4 percent of GDP), other investment flows (2 percent of GDP), and financial derivative flows (1 percent of GDP). Both outward and inward direct investment flows decreased significantly between 2019 and 2020, by 1.2 and 1.8 percent of GDP, respectively. The capital account is open.

Assessment. France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sectors.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. 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

Overall Assessment: *The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies.* The assessment accounts for certain transitory factors owing to the COVID-19 crisis impact on global trade flows. The CA surplus is projected to return to pre-pandemic levels as the current shock recedes—with the recovery in the goods trade surplus more than offsetting the lower services balance—and to resume its modest gradual narrowing over the medium term, supported by a gradual 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.

Potential Policy Responses: Policies aimed at promoting investment and diminishing excess saving would support external rebalancing and a further reduction of the CA balance toward its norm. In particular, the sizable fiscal stimulus in response to the COVID-19 crisis is a welcome use of Germany's substantial 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 persist, growth-oriented fiscal policy, with greater public sector investment in such areas as digitalization, infrastructure, and climate change 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 excess saving and ameliorate external imbalances.

Foreign Asset and Liability Position and Trajectory

Background. Germany's positive NIIP reached 76 percent of GDP by end-2020, more than doubling its level over the last five years. The net rise in foreign assets over this period has, however, still fallen 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 increased during the pandemic and associated quantitative easing (QE) operations of the ECB, exceeding €1.1 trillion at the end of 2020 (32 percent of GDP).

Assessment. With continued implementation of QE measures by the ECB, Germany's exposure to the Eurosystem remains large.

2020 (% GDP)	NIIP: 76.3	Gross Assets: 308.3	Debt Assets: 183.4	Gross Liab.: 232.0	Debt Liab.: 165.2

Current Account

Background. The CA surplus has widened significantly since 2001, peaking at 8.6 percent of GDP in 2015 and falling gradually since then. At 7.0 percent of GDP in 2020, the CA surplus narrowed slightly from 2019, despite an improved balance on oil and gas as well as services (driven in turn by a sharp fall in global oil prices and outbound tourism). The bulk of the CA surplus reflects the large saving-investment surplus of households. The saving-investment balance of the government is expected to turn strongly negative due to the unprecedented fiscal stimulus, and the nonfinancial corporate balance is also projected to be negative due to lower profits.

Assessment. The cyclically adjusted CA balance is estimated by the EBA model to reach 6.9 percent of GDP. The IMF staff assesses the CA norm at 2 to 4 percent of GDP, with a midpoint 0.35 percent of GDP above the 2.6 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 savings. Staff also assesses the cyclically adjusted CA balance to be 0.6 percent of GDP lower than estimated by the model to account for the temporary sharp drop in outbound travel (–0.7 percent of GDP) and in the volume of oil trade associated with the pandemic (–0.1 percent of GDP), partially offset by larger net imports of medical goods (0.2 percent of GDP). Taking these factors into account, staff assesses the 2020 CA gap to be in the range of 2.4 to 4.4 percent of GDP, with a midpoint of 3.4 percent of GDP.[1]

2020 (% GDP)	Actual CA: 7.0	Cycl. Adj. CA: 6.9	EBA Norm: 2.6	EBA Gap: 4.3	COVID-19 Adj.: –0.6	Other Adj.: –0.35	Staff CA Gap: 3.4

Real Exchange Rate

Background. The yearly average CPI-based REER appreciated by 1.3 percent in 2020 relative to 2019, reflecting primarily the appreciation of the euro against the currencies of key trading partners—notably the US dollar. As of end-May 2021, the REER had appreciated by 1.8 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –9.2 percent in 2020 (applying an estimated elasticity of about 0.4). The EBA REER level and index models suggest an undervaluation of 15.4 percent and an overvaluation of 5.6 percent, respectively.[2] Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of 4.2 to 14.2 percent, with a midpoint of 9.2 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2020 net derivatives and other investment outflows comprised the bulk of the capital and financial accounts balance. Reversing a long-standing trend, net portfolio investment outflows shrank due to increased foreign purchases of domestic debt. Net FDI outflows remained positive but declined due to higher inflows.

Assessment. Safe haven status and the strength of Germany's current external position limit risks.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by euro area countries are typically low relative to standard metrics. The currency floats freely.

Table 3.10. Hong Kong SAR: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The CA surplus (in percent of GDP) widened in 2020 mostly due to the sharp decline in economic activity amid the COVID-19 pandemic and stronger income balance. From a longer-term perspective, the CA surplus remained below 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, short-term movements in the REER largely reflect US dollar developments. The credibility of the currency board arrangement has been ensured by a transparent set of rules governing the arrangement, large fiscal and FX reserves, strong financial regulation and supervision, the flexible economy, and a prudent fiscal framework.

Potential Policy Responses: In the near term, accommodative policies, particularly fiscal policy, are still needed to support the economic recovery from the COVID-19 pandemic. In the medium to long term, measures should be taken to ensure fiscal sustainability, given the rapidly aging population. Maintaining policies that support wage and price flexibility is crucial to preserving competitiveness under the currency board arrangement. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the Linked Exchange Rate System have worked well, and continuation of these policies will help keep the external position broadly in line with fundamentals.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP increased significantly to 621 percent of GDP in 2020, from 432 percent in 2019. This was mainly due to a large increase in gross assets by 269 percentage points of GDP, in particular equity investments. Both gross assets and liabilities are high, reflecting Hong Kong SAR's status as a global financial center. Valuation changes have been sizable, as the increase in NIIP during 2016–20 (297 percent of GDP) far exceeded the cumulative financial account balances (31 percent of GDP).

Assessment. Vulnerabilities are low, given the positive and sizable NIIP and its favorable composition. FX reserves are large and stable (142 percent of GDP), and direct investments account for a large share of gross assets and liabilities (33 and 49 percent, respectively); only 13 percent of gross liabilities are portfolio investments.

2020 (% GDP)	NIIP: 621	Gross Assets: 1,814	Debt Assets: 609	Gross Liab.: 1,193	Debt Liab.: 437

Current Account

Background. The CA surplus widened to 6.5 percent of GDP in 2020 amid the pandemic, from 5.8 percent in 2019, driven by a further weakening of domestic demand and a stronger income balance. The trade surplus widened as a large decline in the service surplus—particularly in transportation-related services due to the sharp fall in tourist arrivals (–94 percent year over year)—was more than offset by the narrower goods deficit arising from weaker domestic demand. The income balance improved further, mostly driven by a smaller direct investment deficit in equity and fund shares. 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 is projected to gradually decline to about 4.0 percent of GDP over the medium term.

Assessment. After adjusting for cyclical factors and for the transitory impact of the COVID-19 crisis on the oil, travel services (including tourism), and medical sectors (adjustments of –0.4, 1, and 0.1 percent of GDP, respectively), the CA surplus is estimated to be 5.8 percent of GDP in 2020, within the IMF staff–assessed CA norm range of 3.8 to 6.8 percent of GDP. The IMF staff–assessed CA gap range is hence about –1 to 2 percent of GDP, with a midpoint of 0.5 percent. Given that Hong Kong SAR is not in the EBA sample, the CA norm is estimated by applying EBA-estimated coefficients to Hong Kong SAR and adjusted for measurement issues related to the large valuation effects in the NIIP and the discrepancies between stocks and flows.[1]

2020 (% GDP)	CA: 6.5	Cycl. Adj. CA: 5.2	EBA Norm: —	EBA Gap: —	COVID-19 Adj.: 0.6	Other Adj.: —	Staff Gap: 0.5

Real Exchange Rate

Background. 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 20 percent between 2012–19, the average REER depreciated by about 0.6 percent in 2020. As of end-May 2021, the REER had depreciated by 5.0 percent compared to the 2020 average.

Assessment. The IMF staff assesses the REER gap, based on the IMF staff CA gap range, to be in the range of –5.3 to 2.7 percent, with a midpoint of –1.3 percent (based on the average CA-REER elasticity of about 0.4).[2]

Capital and Financial Accounts: Flows and Policy Measures

Background. As a global financial center, Hong Kong SAR has an open capital account. Nonreserve financial flows turned into net inflows of US$3.0 billion in 2020, from net outflows of US$31.3 billion in 2019, largely driven by other investment flows. The financial account is typically very volatile, reflecting financial conditions in Hong Kong SAR and mainland China (transmitted through growing cross-border financial linkages),[3] shifting expectations of US monetary policy and related arbitrage in the FX and rate markets.

Assessment. 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 financial sector through real sector linkages, particularly in trade and tourism; credit exposures of the banking sector; and fundraising by mainland firms in local financial markets. Financial stress could emerge amid elevated tensions between the United States and China, including potential sanctions on financial institutions in Hong Kong SAR. However, Hong Kong SAR's banking system is assessed to be broadly resilient to macro-financial shocks, given its high capital buffers and profitability.

FX Intervention and Reserves Level

Background. The Hong Kong dollar has appreciated and remained close to the strong side of the convertibility undertaking since April 2020. The strong side of the convertibility undertaking was triggered several times from April to October 2020, mainly driven by increased carry trade activities and equity-related demand for the Hong Kong dollar. This prompted the Hong Kong Monetary Authority to sell HK$383.5 billion in 2020 as part of the currency board arrangement. Total reserve assets increased to about 142 percent of GDP at the end of 2020 (or 1.8 times the monetary base), up from 121 percent in 2019.

Assessment. 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. Despite a large fiscal deficit in 2020, Hong Kong SAR still holds significant fiscal reserves (about 33 percent of GDP at the end of 2020) built up through a track record of strong fiscal discipline in previous years.

Table 3.11. India: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* 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 and portfolio flow liberalization, but trade barriers remain significant.

Potential Policy Responses: Policy responses to the ongoing pandemic have appropriately prioritized support to vulnerable households and firms, through fiscal, monetary, and financial sector policies and structural reforms. Fiscal policy should remain accommodative in the near term, but a concrete medium-term fiscal consolidation is critical to ensure credibility and continued market confidence. Fiscal policy should be accompanied by efforts to further strengthen the financial sector. 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. Exchange rate flexibility should act as the main shock absorber, with intervention limited to addressing disorderly market conditions.

Foreign Asset and Liability Position and Trajectory

Background. As of the end of 2020 India's NIIP improved to –13.1 percent of GDP from –15.0 percent of GDP at the end of 2019 on the back of a temporarily positive CA balance and reserve asset accumulation. Gross foreign assets and liabilities were 32.7 and 45.7 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 21.6 percent of GDP, of which about 51.9 percent was denominated in US dollars and another 33.1 percent in Indian rupees. Short-term external debt on a residual maturity basis stood at 44.8 percent of total external debt and 43.1 percent of FX reserves.

Assessment. With CA deficits projected to widen in the medium term, the NIIP-to-GDP ratio is expected to weaken marginally. India's external debt is moderate compared with that of other emerging market economies, and rollover risks are limited in the short term. The moderate level of foreign liabilities reflects India's gradual approach to capital account liberalization, which has focused primarily on attracting FDI.

2020 (% GDP)	NIIP: –13.1	Gross Assets: 32.7	Res. Assets: 22.5	Gross Liab.: 45.7	Debt Liab.: 21.6

Current Account

Background. The CA balance is estimated to have improved to 1.0 percent of GDP surplus in fiscal year 2020/21 from a 0.9 percent deficit in the previous year. The improvement in the CA balance was largely driven by a sharp decline in imports caused by the negative domestic demand shock amid the COVID-19 pandemic and lower oil prices in the first half of fiscal year. Exports of both goods and services decelerated less than imports owing to a relatively smaller decline in key trading partners' demand. From a saving-investment perspective, the change in the CA reflects a sharp increase in private savings and a decline in private investment, which outweighed the drop in the public sector saving-investment balance. The CA balance is projected to return toward a deficit over the 2021/22 fiscal year due to recovery in domestic demand and higher oil prices, in the context of unusually high uncertainty over the cyclical position of the economy and the outlook for the pandemic.

Assessment. The EBA cyclically adjusted CA balance stood at –0.8 percent of GDP in fiscal year 2020/21. The EBA CA regression estimates a norm of –2.4 percent of GDP, with a standard error of 1.3 percent, thus implying a CA gap of 1.7 percent. In the IMF staff's judgment, a CA deficit of 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. Additional cyclical considerations factor in the transitory impacts of the COVID-19 crisis on oil (–0.6 percent of GDP) and travel services, including tourism (0.2 percent of GDP) balances, and on trade in medical products (–0.1 percent of GDP). Thus, with the IMF staff–assessed CA norm and additional cyclical considerations, the IMF staff–assessed CA gap is assessed to be 1.0 percent of GDP, with a range of 0 to 2 percent of GDP. Positive policy contributions to the CA gap stem mostly from an increase in FX reserves, the credit gap, and capital controls and are partly offset by a larger-than-desirable domestic fiscal deficit (although it is narrower than the world average).

2020 (% GDP)	CA: 1.0	Cycl. Adj. CA: –0.8	EBA Norm: –2.4	EBA Gap: 1.7	COVID-19 Adj.: –0.6	Other Adj.: 0.0	Staff Gap: 1.0

Real Exchange Rate

Background. The average REER in 2020 appreciated by about 0.4 percent from its 2019 average. As of end-May 2021, the REER had depreciated by 1.8 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –6.3 percent (applying an estimated elasticity of 0.17). The EBA REER index and REER level models suggest an overvaluation of 10.9 and 6.6 percent, respectively. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be in the range of –12.8 to 0.2 percent, with a midpoint of –6.3 percent for fiscal year 2020/21.

Capital and Financial Accounts: Flows and Policy Measures

Background. The sum of FDI, portfolio, and financial derivative flows, on a net basis, is estimated at 2.7 percent of GDP in 2020, remaining at a similar level as in 2019. Capital inflows have been supported by investor-friendly reforms in recent years. After a sharp decline in the first half of 2020, net FDI inflows recovered significantly from the third quarter onward and are estimated at 2.0 percent of GDP in 2020 as a whole. Similarly, India faced significant portfolio outflows (0.5 percent of GDP) in the first quarter of 2020 amid the COVID-19 shock. However, portfolio inflows returned after the second quarter, aided by loose global financial conditions and policy measures to ease debt inflows.

Assessment. 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 in the medium term. 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.

FX Intervention and Reserves Level

Background. With the CA surplus and renewed FDI and portfolio flows, in the context of mostly one-sided interventions, foreign reserves reached a record high (US$585.8 billion) in 2020, which has improved the external position. The precautionary accumulation of reserves is aimed at building buffers to mitigate risks due to external vulnerabilities and an associated adverse feedback loop with corporate and financial sectors. Net spot FX purchases were US$88 billion (3.3 percent of GDP), and net forwards purchases were US$43 billion (1.6 percent of GDP) in 2020. Reserve coverage currently is about 22.5 percent of GDP and about 12 months of prospective imports of goods and services.

Assessment. Reserve levels are adequate for precautionary purposes, relative to various criteria, and represent about 236 percent of short-term debt on residual maturity and 197 percent of the IMF's composite metric as of the end of 2020. In this context, further accumulation of reserves is less warranted, and FX intervention should be limited to addressing disorderly market conditions.

Table 3.12. Indonesia: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* Exchange rate flexibility and structural policies should help contain the CA deficit over the medium term. External financing needs appear sustainable. However, they are sizable, and with a large share of foreign portfolio investment, they expose the economy to fluctuations in global financial conditions.

Potential Policy Responses: The projected effect of fiscal consolidation on the CA would be more than offset by the projected pickup in economic activity as the negative effects of the pandemic unwind. Therefore, maintaining external balance will require structural reforms to boost competitiveness and facilitate post–COVID-19 sectoral adjustment. 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.

Foreign Asset and Liability Position and Trajectory

Background. At the end of 2020 Indonesia's NIIP was –26.5 percent of GDP, improving from –30 percent of GDP at the end of 2019. The improvement in the NIIP is mainly explained by an increase of 4.8 percentage points of GDP in assets (that is, reserves, FDI, and deposits). In 2020 gross external assets reached 38 percent of GDP (of which 34 percent were reserve assets), and gross external liabilities stood at 65 percent of GDP. Indonesia's gross external debt was moderate at 39 percent of GDP at the end of 2020 and 89 percent maturing after one year.

Assessment. 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. The share of nonresident holdings of rupiah-denominated government bonds declined from 39 percent of the total stock at the end of 2019 to 25 percent (or 6.3 percent of GDP) at the end of 2020 but remains sizable, making Indonesia vulnerable to global financial volatility, higher US interest rates, and a stronger US dollar. The NIIP, as a percent of GDP, will continue to strengthen over the medium term, reflecting small CA deficits and relatively strong nominal GDP growth.

2020 (% GDP)	NIIP: –26.5	Gross Assets: 38.2	Res. Assets: 12.8	Gross Liab.: 64.7	Debt Liab.: 39.4

Current Account

Background. 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. In 2020 the CA deficit narrowed to –0.4 percent of GDP as the softening in domestic demand led to import contraction that more than compensated for the decline in exports that was associated with low commodity prices and weak external demand. The negative impact on national savings of the fiscal expansion in response to the crisis was more than offset by an increase in private savings, in a context of subdued private consumption. Structural policies are expected to help limit the CA deficit in the medium term.

Assessment. The IMF staff estimates a CA gap of 0.7 percent for 2020, consistent with an estimated cyclically adjusted CA deficit of –0.8 percent of GDP, an IMF staff–assessed norm of –0.5 percent of GDP, and an IMF staff adjustor of 0.9 for demographics. The estimated effects of the COVID-19 crisis are 0 percent.[1] Considering uncertainties in the estimation of the norm, the CA gap for 2020 is in the range of –0.8 to 2.2 percent of GDP.[2] Maintaining external balance will require structural reforms, including strengthening revenue mobilization, and increasing public expenditure on health care, education, and infrastructure.

2020 (% GDP)	CA: –0.4	Cycl. Adj. CA: –0.8	EBA Norm: –0.5	EBA Gap: –0.3	COVID-19 Adj.: 0.0	Other Adj.: 0.9	Staff Gap: 0.7

Real Exchange Rate

Background. 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. With the COVID-19 shock, the REER depreciated by about 10 percent between February and April before recovering toward the middle of the year. In 2020 the REER depreciated by 1.3 percent compared with the 2019 average. As of end-May 2021, the REER had depreciated by 2.1 percent compared to the 2020 average.

Assessment. The IMF staff CA gap estimate of 0.7 percent of GDP implies a REER gap of –3.9 percent with standard elasticities.[3] The REER index and level REER models point to 2020 REER gaps of about 2.1 percent to –11.6 percent, respectively, with an upward shift in the range of the estimated gaps compared with 2019. In the IMF staff's assessment, the EBA index and CA models are most relevant for Indonesia. Considering all inputs, as well as the moderate REER depreciation in 2020, the IMF staff assesses the REER gap in the –6 to 4 percent range, with a midpoint of –1 percent.[4]

Capital and Financial Accounts: Flows and Policy Measures

Background. 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. Starting in March 2020 Indonesia faced large capital outflows from sales 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.

Assessment. 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 safeguarding the fiscal position, keeping inflation in check, advancing financial deepening, and easing supply bottlenecks, would help sustain capital inflows in the medium term.

FX Intervention and Reserves Level

Background. Since mid-2013 Indonesia has had a more flexible exchange rate policy framework. At the end of 2019 reserves were US$129.2 billion compared with US$120.7 billion at the end of 2018. The reserve accumulation reflects mainly the net capital inflows and FX receipts from the 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 spot and forward FX markets in March and April 2020 and introduced daily FX swap auctions to ensure adequate market liquidity. International reserves recovered from April 2020 onward and reached US$136 billion in December 2020.

Assessment. The current level of reserves (equal to 12.8 percent of GDP, about 121 percent of the IMF's reserve adequacy metric and about eight months of prospective imports of goods and services) should provide a sufficient buffer against a wide range of possible external shocks, with predetermined drains also manageable. Exchange rate flexibility should continue to play its role as a shock absorber. If external pressures result in disorderly market conditions in the exchange rate market, the use of FX intervention may be appropriate to mitigate the negative impact on balance sheet exposures.

Table 3.13. Italy: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* Nonetheless, chronic weak productivity and uncertainty about medium-term growth prospects continue to dampen investment and consumption. During 2020 there was large public support for income losses caused by the pandemic, while the household saving rate increased sharply, offsetting government dissaving and keeping the CA broadly unchanged.

Potential Policy Responses: Raising productivity and improving the business climate through structural reforms, and increasing investment under the National Recovery and Resilience Plan, would allow the CA balance to remain near its norm, even as household saving declines and the underlying primary fiscal surplus returns to its pre–COVID-19 level over the medium term, with the external position remaining broadly in line with medium-term fundamentals and desirable policies. In particular, upskilling the workforce and increasing the quality of infrastructure and the effectiveness of the judiciary and public administration would boost productivity, reduce high unemployment, and raise output and domestic absorption. Improving budget efficiency by curtailing wasteful spending and removing extensive tax loopholes would reduce vulnerabilities associated with the rollover of external debt.

Foreign Asset and Liability Position and Trajectory

Background. Italy's NIIP was close to balance (1.8 percent of GDP) at the end of 2020, having trended gradually upward from a strongly negative position since 2013 owing to sustained CA surpluses. Gross assets and liabilities, however, jumped sharply during 2020 to 187 and 185 percent of GDP, respectively. This includes an increase in TARGET2 liabilities (to a record high of 31 percent of GDP) following a moderate decrease in 2019, which offset reduced foreign holdings of Italian sovereign bonds. About one-half of the gross external liabilities is attributable to the general government and the Bank of Italy.

Assessment. Further strengthening public balance sheets and undertaking reforms would lessen vulnerabilities associated with the high public debt and reduce the potential for negative feedback loops between the debt stock and debt servicing costs, as well as between sovereign debt and the financial system.

2020 (% GDP)	NIIP: 1.8	Gross Assets: 186.9	Res. Assets: 10.4	Gross Liab.: 185.1	Debt Liab.: 118.0

Current Account

Background. Italy's CA averaged –1¼ percent of GDP during the decade following euro adoption. In 2013 it moved to balance and in 2019 it registered a multiyear high of 3.0 percent of GDP, which was surpassed marginally in 2020 as weak domestic demand weighed on imports. The COVID-19 shock negatively affected exports, imports, and travel services (including tourism), but the estimated net impact on the trade balance is small. The rising CA in the past decade mirrors the increase in private sector net savings. More than one-half of the increase since 2013 is due to the trade surplus, with the rest reflecting a higher income balance as the nonfinancial private sector's net holdings of foreign assets increased and interest payments on external liabilities declined owing to the ECB's accommodative monetary stance in the context of subdued growth and inflation. The positive primary income balance also reflects the larger share of equity in foreign assets than in liabilities. In terms of saving and investment, the increase in the CA since 2010 is due to higher gross national savings and lower gross domestic investment, particularly private investment.

Assessment. The cyclically adjusted CA is estimated at 2.5 percent of GDP in 2020, 0.3 percentage point below the EBA-estimated CA norm of 2.8 percent of GDP. Given that the pandemic-specific impact on the travel services (including tourism) and oil sectors, as well as the household consumption shift from services to consumer goods and the impact on medical goods trade, is not captured by the usual cyclical adjustment, an adjustor of 0.4 percent of GDP (mostly reflecting the impact on travel services) has been applied, indicating that the CA gap is about 0.1 percent of GDP. Taking into account estimation error, the IMF staff assesses the CA gap to be in the range of –0.9 to 1.1 percent of GDP.

2020 (% GDP)	CA: 3.5	Cycl. Adj. CA: 2.5	EBA Norm: 2.8	EBA Gap: –0.3	COVID-19 Adj.: 0.4	Other Adj.:0.0	Staff Gap: 0.1

Real Exchange Rate

Background. During 2010–19 the CPI-based and ULC-based REER depreciated by 10 and 20 percent, respectively, and both indicators lie below their 1999 levels. Because of a stronger euro, the CPI-based REER appreciated in 2020 (by 0.5 percent relative to the 2019 average), although official statistics may not fully capture actual price and wage dynamics during the pandemic period. As of end-May 2021, the REER had appreciated by 0.6 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –0.3 percent in 2020 (applying an estimated elasticity of 0.25). The level and index CPI-based REER models suggest an overvaluation in 2020 of 2.5 percent and 7.7 percent, respectively, with an average of about 5 percent. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be in the range of –4.3 to 3.7 percent, with a midpoint of –0.3 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account posted net outflows of 3.0 percent of GDP in 2020, reflecting residents' net purchases of foreign assets. However, portfolio investment shifted from inflows to outflows as foreign investors reduced their holdings of Italian sovereign debt securities at the beginning of the COVID-19 pandemic.

Assessment. The current low-global-interest-rate environment is conducive to the smooth functioning of the sovereign debt market. However, large refinancing needs of the sovereign and the banking sector, as well as COVID-19–related balance sheet weakness in some banks, suggest that Italy remains vulnerable to market volatility.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.

Table 3.14. Japan: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* Japan's CA surplus is mainly driven by its income surplus arising from a large positive NIIP and high net returns, which are expected to continue over the medium term.

Potential Policy Responses: The policy response to the ongoing COVID-19 shock has appropriately prioritized support to affected households, workers, and firms while maintaining the smooth functioning of financial markets. A coordinated policy package will be needed to ensure that the external position remains in line with fundamentals. As the recovery strengthens, extraordinary policy support should gradually be withdrawn. In particular, post-pandemic policies should shift toward structural reforms and fiscal sustainability, and fiscal consolidation should proceed in a gradual manner. A well-specified medium-term fiscal framework, accommodative monetary policy, and structural reforms are needed to mobilize investment, reduce debt, and support reflation and growth. Priority should be given to reforms to increase labor supply, boost productivity and wages, reduce barriers to entry in some industries, and accelerate agricultural and professional services sector deregulation.

Foreign Asset and Liability Position and Trajectory	**Background.** The NIIP has grown since 2016, largely driven by an increase in foreign assets related to outward FDI and portfolio outflows. Due to a decline in foreign liabilities and the GDP contraction, the NIIP-to-GDP ratio at the end of 2020 rose to 66.3 percent from 63.8 percent at the end of 2019. On the back of CA surpluses, the NIIP is projected to rise to about 70 percent of GDP in the medium term. Japan holds the world's largest stock of net foreign assets, valued at US$3.3 trillion at the end of 2020. **Assessment.** Japan's foreign asset holdings are well diversified, both by geography and risk classes. Portfolio investment accounts for nearly one-half of gross foreign assets. By currency, 21 percent of portfolio investment is yen-denominated and about one-half is denominated in US dollars. In the event of yen appreciation against the US dollar, the risk of negative valuation effects could materialize. Liabilities' vulnerabilities are limited, with equity and direct investment accounting for 33 percent of gross foreign liabilities. The NIIP generated net annual investment income of 3.6 percent of GDP in 2020. The large positive NIIP, in part, is driven by asset accumulation for old-age consumption, which is expected to be gradually unwound over the long term.
2020 (% GDP)	NIIP: 66.3 · Gross Assets: 212.8 · Debt. Assets: 84.4 · Gross Liab.: 146.5 · Debt Liab.: 90.5
Current Account	**Background.** Japan's CA surplus reflects a high private sector saving-investment balance that more than compensates for the low government saving-investment balance. It also reflects a sizable income balance, owing to its large net foreign asset position. The CA surplus narrowed to 3.3 percent of GDP in 2020 compared with an average of 3.8 percent of GDP during 2016–19. The narrowing in the 2020 CA surplus was largely driven by a decline in the services trade balance amid international travel restrictions. In contrast, the goods trade balance remained in surplus, as a decline in imports caused by the negative domestic demand shock and lower energy prices outweighed a fall in exports. From the saving-investment perspective, the narrowing in the CA reflects a larger fall in saving, particularly for the public sector, relative to the investment-to-GDP ratio. The income balance continued to contribute the most to the CA surplus, at 3.6 percent of GDP in 2020. After the COVID-19 shock dissipates, the CA balance is projected to stabilize at a level slightly above 3 percent of GDP. **Assessment.** The 2020 CA assessment uses the EBA model, in which the estimated cyclically adjusted CA is 3.2 percent of GDP and the cyclically adjusted CA norm is estimated at 3.6 percent of GDP, with a standard error of 1.2 percent of GDP. The IMF staff estimates a 2020 CA norm range between 2.4 and 4.8 percent of GDP. After factoring in the transitory impacts of the COVID-19 crisis on the CA in relation to the oil, travel services (including tourism), and medical goods sectors (–0.1, 0.3, and 0.1 percent of GDP, respectively), the 2020 CA gap midpoint is assessed at –0.1 percent of GDP, with the CA gap range between –1.3 and 1.1 percent of GDP. The EBA-identified policy gaps reflect relatively greater medium-term fiscal consolidation needs, as well as a positive credit gap, in relation to medium-term desired policy. The overall gap is accounted for by the residual, potentially reflecting structural impediments and country-specific factors not included in the model, such as investment bottlenecks, including entrepreneurship entry barriers and corporate savings distortions.
2020 (% GDP)	CA: 3.3 · Cycl. Adj. CA: 3.2 · EBA Norm: 3.6 · EBA Gap: –0.4 · COVID-19 Adj.: 0.3 · Other Adj.: 0.0 · Staff Gap: –0.1
Real Exchange Rate	**Background.** The REER appreciated by 0.9 percent in 2020, relative to the 2019 average. This reflects changes in global risk aversion and the monetary policy stances of key central banks in response to the pandemic. As of end-May 2021, the REER had depreciated by 8.7 percent compared to the 2020 average. **Assessment.** The IMF staff CA gap implies a REER gap of 0.7 percent in 2020 (applying an estimated elasticity of 0.13). The EBA REER level and index models deliver REER gaps of –12 and –20 percent, respectively, for the 2020 average REER. However, the EBA REER level and index models are not used for the assessment because they do not capture Japan-specific factors well. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be in the range of –8.3 to 9.7 percent, with a midpoint of 0.7 percent.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Amid increased global financial volatility, portfolio and FDI outflows decreased sharply in 2020: portfolio outflows to Central and South America and outward FDI flows to Europe and Asia recorded the largest declines. Net FDI and portfolio flows comprise the bulk of the 2020 financial account (2.1 and 0.7 percent of GDP, respectively). Other investments (net) recorded outflows of 0.1 percent of GDP in 2020 compared with inflows of 2 percent of GDP in 2019. At the onset of the pandemic, net short yen positions increased. Nevertheless, this reversed beginning in mid-March, helped by a coordinated policy response by major central banks to enhance the provision of US dollar liquidity. **Assessment.** Vulnerabilities are limited. Inward investment tends to be equity-based, and the home bias of Japanese investors remains strong. So far, outward spillovers from Japan's policies to financial conditions in other economies (interest rates, credit growth) are contained.
FX Intervention and Reserves Level	**Background.** Reserves are about 28 percent of GDP, reflecting legacy accumulation. There has been no FX intervention in recent years. **Assessment.** The exchange rate is free floating. Interventions are isolated (last occurring in 2011), intended to reduce short-term volatility and disorderly exchange rate movements.

Table 3.15. Korea: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The CA surplus widened from the 2019 level on account of a recovery in exports, lower oil prices, and narrowing of the service sector deficit and is projected to narrow slightly over the medium term as domestic demand recovers and transitory factors related to the COVID-19 shock recede.

Potential Policy Responses: To support activity following the COVID-19 outbreak, the authorities have deployed fiscal and monetary stimulus, of which a substantial part 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. Reforms in some of these areas are contained in the authorities' Korean New Deal, to be implemented over the next five years. The exchange rate should remain market determined, with intervention limited to preventing disorderly market conditions.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP has been positive since 2014. Data for 2020 imply that, in 2020, Korea's NIIP was 28.4 percent of GDP, with gross liabilities at 91.4 percent of GDP, of which about one-third was gross external debt. The NIIP declined by about 3 percent of GDP from the 2019 level, largely reflecting valuation effects resulting from a sharp rally in domestic equity prices in the second half of 2020. The NIIP is projected to rise to about 50 percent of GDP in the medium term on the back of CA surpluses and search-for-yield activity by financial institutions driven by asset accumulation for old-age consumption.

Assessment. The positive NIIP is a source of external sustainability. Foreign asset holdings are diversified, with about 36 percent held in equity or debt securities. About 60 percent of foreign assets are denominated in US dollars, implying that depreciation of the won could have positive valuation effects. The structure of liabilities limits vulnerabilities, with equity and direct investment accounting for about 60 percent of total liabilities.

2020 (% GDP)	NIIP: 28.4	Gross Assets: 119.8	Debt Assets: 31.0	Gross Liab.: 91.4	Debt Liab.: 30.8

Current Account

Background. The CA surplus in 2020 widened to 4.6 percent of GDP from 3.6 percent in 2019, driven by a rebound in exports since the third quarter of 2020 and a narrowing of the services deficit due to COVID-19 travel restrictions. The CA surplus has been trending down from the peak of 7.2 percent of GDP in 2015, reflecting a fall in savings, particularly for the household sector, and an increase in the investment-to-GDP ratio. Over the medium term, the CA surplus is projected to narrow slightly to 4.3 percent of GDP as export demand and the service sector balance normalize.

Assessment. The EBA model estimates the cyclically adjusted CA at 4.3 percent of GDP. The CA norm is estimated at 3.5 percent of GDP, with a standard error of 0.9 percent of GDP. After accounting for transitory factors arising from the COVID-19 shock (mainly in the travel services—including tourism—and oil sectors), the IMF staff estimates the 2020 CA gap midpoint at –0.1 percent of GDP. The relative policy gap contribution is estimated at 1.5 percent of GDP; however, this is driven mainly by large exceptional fiscal stimulus in the rest of the world relative to Korea and is not expected to persist over the medium term.

2020 (% GDP)	CA: 4.6	Cycl. Adj. CA: 4.3	EBA Norm: 3.5	EBA Gap: 0.8	COVID-19 Adj.: –0.9	Other Adj.: 0.0	Staff Gap: –0.1

Real Exchange Rate

Background. Following sustained appreciation during 2015–18, the REER depreciated in 2019 by about 4.5 percent, returning to its 2015 level. The REER depreciated further in the first half of 2020 before recovering somewhat more recently. Overall, the average REER for 2020 depreciated by about 2 percent relative to the 2019 average. As of end-May 2021, the REER had appreciated by 0.8 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of 0.2 percent (applying an estimated elasticity of 0.36). The EBA REER index model estimates a REER undervaluation of 3.7 percent, while the REER level model estimates a 12 percent undervaluation. The IMF staff uses the estimated CA gap for its assessment, given the better fit of the EBA CA model. Consistent with the IMF staff CA gap, the IMF staff assesses the REER gap to be in the range of –2.3 to 2.7 percent, with a midpoint of 0.2 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net FDI and portfolio outflows have declined since 2017, when outflows peaked at 4.6 percent of GDP. Portfolio outflows were 3.6 percent of GDP in 2020, reflecting further portfolio diversification and institutional investors' continued search for yield. Net FDI and portfolio outflows comprised the bulk of the 2020 financial account (1.4 and 2.5 percent of GDP, respectively), whereas other investments (net) recorded inflows (0.6 percent of GDP). Despite nonresident equity outflows in the first half of the year, overall capital flows have remained relatively stable in 2020, supported by portfolio debt inflows and a slowdown in outward FDI.

Assessment. The present configuration of net and gross capital flows appears sustainable over the medium term. In recent years, including in the context of the COVID-19 shock, Korea has demonstrated ample capacity to absorb short-term capital flow volatility.

FX Intervention and Reserves Level

Background. Korea has a floating exchange rate. As of the end of 2020, reserves stood at 27 percent of GDP, largely reflecting legacy accumulation. FX intervention data released by the Bank of Korea show net purchases of US$5.3 billion (0.3 percent of GDP) in 2020, with net sales of US$5.9 billion in the first quarter to dampen excess FX volatility amid the COVID-19 shock and net purchases of US$11.5 billion in the fourth quarter, when the won appreciated sharply in nominal effective terms. With valuation gains from non–US dollar-denominated assets, gross reserves rose by US$34.3 billion (2.1 percent of GDP) in 2020. During March–May 2020 the Bank of Korea temporarily drew US$20 billion from the US$60 billion swap line established with the Federal Reserve.

Assessment. Intervention has continued to be two-sided and appears to have been limited to preventing disorderly market conditions. As of the end of 2020, FX reserves were about 99 percent of the IMF's composite reserve adequacy metric, which, together with access to the Federal Reserve swap facility, provides an adequate buffer against a wide range of possible external shocks.

Table 3.16. Malaysia: Economy Assessment

Overall Assessment: *Malaysia's external position in 2020 was substantially stronger than the level implied by medium-term fundamentals and desirable policies due to the large pandemic-related fiscal expansions worldwide compared with Malaysia.*

Potential Policy Responses: Near-term policies should continue to support the recovery through targeted lifelines to households and businesses in the context of accommodative monetary and financial policies. Over the medium term, policies that could support external rebalancing and bring the CA balance closer to its norm include strengthening the social safety net in Malaysia and continuing to encourage private investment and productivity growth, as well as the unwinding of pandemic-related policy support worldwide.

Foreign Asset and Liability Position and Trajectory

Background. Since 2010 Malaysia's NIIP has averaged about 1 percent of GDP. The NIIP was 4.8 percent of GDP in 2020 (compared with –3 percent of GDP at the end of 2019), reflecting higher reserve assets, an increase in net other investment, and a decline in net portfolio investment. Direct investment and portfolio investment abroad contribute the most to assets, whereas direct investment and portfolio liabilities contribute the most to liabilities. Total external debt, measured in US dollars, was about 69 percent of GDP in 2020 (compared with 63.4 percent at the end of 2019), of which about two-thirds was in foreign currency and 38 percent in short-term debt, by original maturity.

Assessment. Malaysia's NIIP is projected to rise over the medium term, reflecting projected CA surpluses. Malaysia's balance sheet strength, exchange rate flexibility, and increased domestic investor participation should continue to help withstand shocks (as they have in the context of the COVID-19 crisis).

2020 (% GDP)	NIIP: 4.8	Gross Assets: 134.6	Res. Assets: 30.6	Gross Liab.: 129.8	Debt Liab.: 28.1

Current Account

Background. Between 2010 and 2019 Malaysia's CA surplus contracted by 7 percentage points, underpinned by lower national savings and robust domestic demand. In 2020 the CA surplus increased to 4.2 percent of GDP against a backdrop of transitory factors, including (1) the decline in travel income, given international travel restrictions; (2) the decline in the oil balance following the slump in fuel prices in 2020; (3) an increase in demand for pandemic-related exports, including rubber glove products and electronic and electrical equipment; (4) the decline in outward remittances as a result of the crisis; and (5) a one-off transaction in the third quarter of 2020, creating a surplus in the secondary income balance.

Assessment. The EBA CA model estimates a cyclically adjusted CA of 4.6 percent of GDP and a CA norm at –0.6 percent of GDP for 2020. After factoring in the transitory effect on the CA of the net exports of pandemic-related medical goods, including rubber glove products (1 percent of GDP); the global household consumption composition shift (0.6 percent of GDP); a one-off transaction in the third quarter of 2020 (0.8 percent of GDP); lower net remittances (0.1 percent of GDP); the decline in receipts from travel services, including tourism (–1.2 percent); and the decline in the oil balance (–0.3 percent of GDP), the IMF staff estimate of the CA gap is about 4.1 percent of GDP (±1 percent of GDP). Relative policy gaps explain 2.0 percentage points of the CA gap. Low public health care expenditures compared with the rest of the world contribute 0.7 percentage point to the CA gap, while the looser fiscal policies adopted in 2020 in the rest of the world relative to Malaysia contribute 1.2 percentage points to the excess surplus. Unidentified residuals are large and likely reflect structural impediments and country-specific factors not included in the model.

2020 (% GDP)	CA: 4.2	Cycl. Adj. CA: 4.6	EBA Norm: –0.6	EBA Gap: 5.2	COVID-19 Adj.: –0.2	Other Adj.: –0.8	Staff Gap: 4.1

Real Exchange Rate

Background. In 2020 the REER depreciated by 3.6 percent relative to the 2019 average and was about 6 percent lower than in 2015. The depreciation in 2020 can be mainly explained by the impact of capital outflows and lower commodity prices on the NEER. As of end-May 2021, the REER had depreciated by 1.0 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER undervaluation of –9.0 percent in 2020, applying an estimated elasticity of 0.46. The EBA REER index and level models estimate Malaysia's REER to be undervalued by –32 percent and –42 percent, respectively. At the same time, considering the lack of underlying macroeconomic stresses, such as inflation or wage pressures, and the broad stability of FX reserves, the IMF staff assesses the REER to be undervalued in the range of –7.0 to –11.0 percent, with a midpoint of –9.0 percent, consistent with the IMF staff CA gap.

Capital and Financial Accounts: Flows and Policy Measures

Background. 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. In 2020 Malaysia saw capital outflows during the March 2020 global risk-off episode, but capital flows stabilized afterward. Since late 2016 the Financial Markets Committee has implemented measures to develop the onshore FX market and increase hedging opportunities.[1]

Assessment. Continued exchange rate flexibility and macroeconomic policy adjustments are necessary to manage capital flow volatility. CFM measures should be gradually phased out, with due regard for market conditions.

FX Intervention and Reserves Level

Background. The risk-off episode caused by the COVID-19 pandemic reduced reserves by about US$1.9 billion by March 2020, to US$101.7 billion. Reserve levels rose thereafter and stood at US$107.6 billion as of December 2020 (compared with $103.6 billion at the end of December 2019).

Assessment. Under the IMF's composite ARA metric, reserves remain broadly adequate. Gross official reserves were about 118 percent of the ARA metric at the end of December 2020. FX interventions should continue to be limited to preventing disorderly market conditions. In case of an inflow surge, some reserve accumulation would be appropriate to increase the reserve coverage ratio, while still allowing the exchange rate to adjust as a first line of defense.

Table 3.17. Mexico: Economy Assessment

Overall Assessment: *The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies.* Mexico's external position strengthened in 2020 owing to the impact of the large fiscal expansions in other major economies (whose actual fiscal balances are relatively further below their desirable medium-term levels) compared with Mexico's muted fiscal response to the pandemic and continued weakening of the domestic investment climate. The assessment remains subject to considerable uncertainty around how temporary the nature of COVID-19 is and its implications for imports and fiscal policies.

Potential Policy Responses: Further domestic fiscal support is needed in the near term to ease the strains of the pandemic, reduce scarring, and facilitate the recovery. Steadfast implementation of structural reforms to deliver stronger investment would help bring down the saving-investment balance and, hence, the external position closer to the level implied by medium-term fundamentals and desirable policies. Such policies should be part of a comprehensive package focused on pursuing strong, durable, and inclusive growth, which should also include credible medium-term tax reform when the recovery is well underway. The floating exchange rate should continue to serve as the main shock absorber, with FX interventions used only to prevent disorderly market conditions. The IMF's Flexible Credit Line continues to provide an added buffer against global tail risks.

Foreign Asset and Liability Position and Trajectory

Background. Mexico's NIIP is projected to improve from about –55 percent of GDP in 2020 to –40 percent of GDP over the medium term, driven mainly by the decline in foreign liabilities. Foreign assets are mostly direct investment (21 percent of GDP) and reserves (18 percent of GDP). Foreign liabilities are mostly FDI (60 percent of GDP) and portfolio investment (49 percent of GDP). Gross public external debt was 29 percent of GDP, of which about one-third was holdings of local currency government bonds.

Assessment. Whereas the NIIP is sustainable, and the local currency denomination of a large share of foreign public liabilities reduces FX risks, the large gross foreign portfolio liabilities could be a source of vulnerability in case of global financial volatility. Exchange rate vulnerabilities are moderate as most Mexican firms with FX debt have natural hedges and actively manage their FX exposures.

2020 (% GDP)	NIIP: –54.9	Gross Assets: 62.6	Res. Assets: 18.5	Gross Liab.: 117.5	Debt Liab.: 45.6

Current Account

Background. In 2020 the CA balance improved sharply to 2.5 percent of GDP from –0.3 percent in 2019, driven by a dramatic contraction in imports amid lower capital inflows (17 percent), a smaller export contraction owing to the relatively larger fiscal expansion in other major economies, the global household consumption composition shift, trade diversion related to the US–China trade dispute (12 percent), and soaring worker remittances (11 percent in US dollar terms). In terms of saving and investment, the increase in saving contributed one-third and the decline in investment contributed two-thirds of the improvement in the CA-to-GDP balance; the private sector saving-investment balance rose by 5.0 percentage points of GDP, more than offsetting the dissaving by the public sector of 2.2 percentage points. The 2021 CA surplus is projected at 1.8 percent of GDP and is subject to considerable uncertainty. Over the medium term, the CA balance is projected to deteriorate toward –1 percent of GDP as the temporary COVID-19 impact on US household consumption composition, remittances, and trade diversion effects dissipate.

Assessment. The EBA model estimates a cyclically adjusted CA norm of –1.9 percent of GDP in 2020. This implies a CA gap of 3.6 percent of GDP, with a range of 2.6 to 4.6 percent of GDP. The relative policy gap contribution is estimated at 2.6 percent of GDP, mainly led by COVID-19–driven accommodation of fiscal policy in the rest of the world. The IMF staff adjustments were made to account for the transitory impact of the COVID-19 pandemic on the travel services sector, including tourism; the global household consumption shift; and remittances (adjustments of 0.4 percent of GDP, –0.6 percent of GDP, and –0.3 percent of GDP, respectively) as well as trade diversion effects related to the US-China trade dispute (adjustment of about –0.3 percent of GDP). Including these adjustments, the IMF staff assesses the CA gap at 2.8 percent of GDP, with a range of 1.8 to 3.8 percent of GDP.

2020 (% GDP)	CA: 2.4	Cycl. Adj. CA: 1.7	EBA Norm: –1.9	EBA Gap: 3.6	COVID-19 Adj.: –0.5	Other Adj.: –0.3	Staff Gap: 2.8

Real Exchange Rate

Background. In 2020 the peso fluctuated considerably in a range of 18–25 percent vis-à-vis the US dollar. The average REER in 2020 was about 7.6 percent lower than the 2019 average, mostly driven by a nominal depreciation. As of end-May 2021, the REER had appreciated by 7.0 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –21.8 percent of GDP (applying an elasticity of 0.13). The EBA REER level and index models estimate an undervaluation of 10.0 and 20.9 percent, respectively, in 2020. The IMF staff's overall assessment, based on the CA gap, is a REER gap in the range of –29.8 to –13.8 percent, with a midpoint of –21.8 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2020 net portfolio and other investment flows were negative, driven by residents' increased acquisition of overseas assets and nonresidents' lower acquisition of Mexican assets. Meanwhile, net FDI inflows remained relatively strong despite the COVID-19 pandemic.

Assessment. While the long maturity of sovereign debt and the high share of local-currency-denominated debt reduce the exposure of government finances to depreciation risks, high foreign ownership of sovereign bonds could contribute to vulnerabilities. The banking sector is broadly resilient. Nonfinancial corporate debt is low, and FX 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.

FX Intervention and Reserves Level

Background. The central bank remains committed to a free-floating exchange rate, whereas discretionary intervention is used solely to prevent disorderly market conditions. At the end of 2020 gross international reserves amounted to US$199 billion (18.5 percent of GDP), up from US$183 billion at the end of 2019, mostly owing to the federal government's debt management operations and valuation changes. In 2020 two nondeliverable forward auctions were conducted, alongside further US dollar liquidity provision measures, in response to large external shocks.

Assessment. At 128 percent of the ARA metric and 281 percent of short-term debt (at remaining maturity), the end-of-2020 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. The Flexible Credit Line arrangement continues to provide an additional buffer.

Table 3.18. The Netherlands: Economy Assessment

Overall Assessment: *The external position in 2020 was 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 challenging.

Potential Policy Responses: The use of available fiscal buffers by the authorities to provide ongoing support to the health care sector and to households and businesses affected by the COVID-19 pandemic remains appropriate, also against the backdrop of the additional space provided by the sustained activation of the escape clause from the EU Stability and Growth Pact. Even after the pandemic subsides, it appears that the government will command room to pursue a growth-oriented fiscal policy. Therefore, policies should avoid a rush to consolidate, thereby promoting and safeguarding the recovery while also supporting public and private investment in physical and human capital to foster potential robust growth, which would also contribute to external rebalancing.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP of The Netherlands reached 113.9 percent of GDP at the end of 2020, reflecting gross assets and liabilities of 1,165.5 and 1,051.6 percent of GDP, respectively, rising from a nearly balanced NIIP at the end of 2009. The largest component of the NIIP comes from the net FDI stock—about €1,111 billion (138.9 percent of GDP) at the end of 2020. According to the latest Coordinated Direct Investment Survey, the inward and outward FDI positions of The Netherlands were second only to those of the United States at the end of 2019, with the largest gross bilateral stocks accounted for by the United States (US$1.85 trillion), the United Kingdom (US$1.06 trillion), and Luxembourg (US$0.87 trillion). The central bank's net TARGET2 claims on the ECB amounted to €38 billion at the end of 2020. Reflecting a persistent CA surplus, the NIIP is expected to increase as a ratio to GDP in 2021, likely keeping it considerably above the 100 percent mark in the absence of large revaluation effects, despite a rising denominator on the back of a rebound in GDP.

Assessment. The Netherlands' safe haven status and its sizable foreign assets limit risks from its large foreign liabilities.

2020 (% GDP)	NIIP: 113.9	Gross Assets: 1,165.5	Debt Assets: 260.6	Gross Liab: 1,051.6	Debt Liab: 308.2

Current Account

Background. In 2020 the CA surplus, in place since 1981, declined to 7.0 percent of GDP (7.5 percent cyclically adjusted). The historically positive goods and services balance, primarily the result of surpluses vis-à-vis EU trading partners, improved at the margin. By contrast, the primary income balance turned into a 1.7 percent of GDP deficit in 2020, despite the positive NIIP, as lower net investment income on FDI was only partly compensated for by a reduction in payouts on net portfolio investment. Likewise, the secondary income balance deteriorated to –1.7 percent of GDP, mainly on the back of other current transfers by the nongovernment sector abroad. Substantial FDI outflows have been the key driver of the financial account since 2000, constituting the counterpart to high nonfinancial corporate net saving (gross saving minus domestic business investment), whereas household net saving (gross saving minus residential investment) has played a comparatively smaller role due to the offsetting impact of substantial mandatory contributions to 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 a structurally strong external position. In 2021 the CA surplus is projected to rebound to 9.0 percent of GDP.

Assessment. The EBA CA model estimates a CA norm of 3.4 percent of GDP and a CA gap of 4.0 percent of GDP in 2020, with an unexplained residual of 1.1 percent of GDP that primarily reflects the high gross saving of multinationals based in The Netherlands. In addition, measurement errors or biases in official statistics may also contribute to an overstatement of the net accumulation of wealth that is attributed to Dutch residents, an issue of particular relevance for The Netherlands as the foreign ownership of publicly listed Dutch corporations has been consistently above 85 percent over the past 10 years. An IMF staff adjustment of –1.4 percent of GDP to offset this bias is approximated with the help of historical data about the foreign ownership structure of Dutch firms provided by the central bank. Moreover, another –0.2 percent of GDP adjustment is applied to account for the (temporary) effects of the COVID-19 pandemic, reflecting lower spending on travel services, including tourism, by Dutch residents abroad (–0.3 percent of GDP) and higher-than-usual trade in medical goods (0.1 percent of GDP). Taking these factors into consideration, and against a norm in a range of 1.4 to 5.4 percent of GDP, the IMF staff assesses a CA gap of 0.4 to 4.4 percent of GDP.[1]

2020 (% GDP)	CA: 7.0	Cycl. Adj. CA: 7.5	EBA Norm: 3.4	EBA Gap: 4.0	COVID-19 Adj.: –0.2	Other Adj.: –1.4	Staff Gap: 2.4

Real Exchange Rate

Background. The annual average CPI-based REER appreciated by 2.0 percent in 2020, with part of the rise in the euro NEER offset by inflation in The Netherlands staying below that of its trading partners, while the average ULC-based REER appreciated by 3.8 percent. However, drawing conclusions from both indicators about shifts in competitiveness in 2020 is hampered by the distortions the COVID-19 pandemic implied for the measurement of consumer prices and ULCs across different countries. As of May 2021 the CPI-based REER was 0.6 percent above its 2020 average.

Assessment. Assuming a semi-elasticity of 0.7, the IMF staff CA gap of 2.4 percent of GDP implies a REER undervaluation of about 3.5 percent. The EBA REER models indicate an overvaluation between 4.2 percent (level model) and 17.8 percent (index model) in 2020, predominantly reflecting unexplained residuals. Taking into account all estimates and the uncertainty surrounding the EBA REER results, the IMF staff views the REER as undervalued by about 0.5 to 6.5 percent, with a midpoint of 3.5 percent, based on its assessment of the CA gap and its range.

Capital and Financial Accounts: Flows and Policy Measures

Background. 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 40 percent of gross FDI assets and liabilities are attributable to subsidiaries of multinationals.

Assessment. 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.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.

Table 3.19. Poland: Economy Assessment

Overall Assessment: *The external position in 2020 was substantially stronger than the level implied by medium-term fundamentals and desirable policies.* The CA balance increased to 3.5 percent of GDP in 2020 from 0.5 percent in 2019, reflecting a large trade surplus in addition to a reduction in the primary income deficit arising from lower earnings of foreign companies in Poland during the pandemic. This comes after a decade-long transition from a large deficit to a small surplus in 2019. A CA surplus is deemed excessive, given that income convergence is incomplete. In 2021 the CA surplus is projected to decrease as the recovery in domestic demand supports import growth and foreign companies' profitability recovers. Uncertainty is high over the medium term due to the COVID-19 pandemic; however, as the economy recovers, the CA surplus is expected to gradually vanish as private net saving returns to a lower level, offsetting an anticipated improvement in government net saving. Next Generation EU grants are expected to boost investment, contributing to the moderation of the CA balance in the projection horizon. Reserves are adequate to insulate against external shocks and disorderly market conditions.

Potential Policy Responses: In the short term, fiscal policy should bolster the health care system, provide businesses with liquidity, and support incomes of vulnerable households, including through employment preservation. Monetary and financial policies should prevent a tightening of financial conditions and enable the financial sector to support firms' liquidity. The tapering of expansionary policies should be gradual once the recovery is in full swing. In the medium term, to help move the CA toward the norm, policies should aim to boost investment by (1) deploying the Next Generation EU funds to raise public investment, support the recovery, and help tackle infrastructure gaps, digitalization, and climate change; and (2) using public policies to foster corporate investment and productivity, while active labor market policies should facilitate sectoral transitions, with structural reforms focused on raising potential growth. Room should be made for priority fiscal spending by better targeting social benefits according to need.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP is estimated to have improved to –46 percent of GDP in 2020 from –50 percent in 2019. Gross assets and liabilities reached 58 and 103 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 in 2020 was a sizable 62.4 percent of GDP, 28 percent of the debt is liabilities to direct investors via intercompany lending, and 74 percent of the debt is of long-term maturity. Short-term debt (excluding intercompany short-term debt), amounting to 16 percent of total debt (10 percent of GDP), is mainly owed by banks (currency and deposits) and the nonfinancial private sector (trade credit). Automatic debt dynamics, helped by Next Generation EU grants, are projected to continue to reduce the negative NIIP in the medium term.

Assessment. While sizable external debt is a vulnerability, rollover risk is mitigated by the large share of long-term debt, as well as by intercompany lending that tends to be automatically rolled over. Adequate reserves reduce residual rollover risk from short-term debt (gross reserves stood at 161 percent of short-term debt in 2020).

2020 (% GDP)	NIIP: –45.9	Gross Assets: 57.6	Res. Assets: 25.9	Gross Liab: 103.4	Debt Liab.: 62.4

Current Account

Background. The CA has moved from large deficits toward surplus since the 2008 crisis. 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 surplus increased from 0.5 percent of GDP in 2019 to 3.5 percent of GDP in 2020, driven by a larger trade surplus, reflecting resilience in exports, as well as import compression, and by a lower primary income deficit, reflecting foreign companies' lower earnings. In the medium term as the economy recovers from the pandemic, the CA surplus is expected to vanish as private net saving returns to a lower level, offsetting an increase in government net saving.

Assessment. For 2020 the EBA CA model estimates a norm of –2.1 percent of GDP (with the standard error of the norm estimate 0.6 percent of GDP) against a cyclically adjusted CA of 3.9 percent of GDP. The resulting EBA gap of 6.0 percent of GDP includes identified policy gaps (2.2 percent of GDP) and an unexplained residual of 3.9 percent of GDP. However, in view of the pandemic-related decline in the primary income account, judged to be transitory, an adjustment of –0.7 percent of GDP to the cyclically adjusted CA balance has been made. Furthermore, an additional adjustment of –0.4 percentage point of GDP has been made, which consists of 0.3 percentage point of GDP to reflect the contraction in travel services (including tourism) net exports, 0.2 point of GDP to reflect increased global demand for medical goods, –0.1 percentage point of GDP to reflect changes in the oil balance, and –0.7 percentage point of GDP to reflect shifts in household consumption composition. In summary, the total adjustment of –1.1 results in a CA gap of 4.9 (±0.6) percent of GDP.

2020 (% GDP)	CA: 3.5	Cycl. Adj. CA: 3.9	EBA Norm: –2.1	EBA Gap: 6.0	COVID-19 Adj.: –1.1	Other Adj.: 0.0	Staff Gap: 4.9

Real Exchange Rate

Background. The annual average REER appreciated by 0.7 percent in 2020 compared with the 2019 average. During the pandemic, unlike during the global financial crisis, movements in the NEER and REER have been muted. In nominal terms, the zloty depreciated by 4.3 percent against the dollar but appreciated by 4.8 percent against the euro since the end of 2019. Over the same period, inflation in Poland has been only slightly higher than in its trading partners. The REER depreciated by 3.9 percent between January and April but appreciated by 4.3 percent between April and December. As of end-May 2021, the REER had appreciated by 1.0 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –11.1 percent in 2020 (applying an estimated elasticity of 0.44). EBA REER index and level model estimates point to an undervaluation of 2.9 and 19.3 percent, respectively. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of –12.6 to –9.6 percent, with a midpoint of –11.1 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. The capital account, dominated by inflows of EU funds for financing investment projects, has averaged about 2 percent of GDP over the past 10 years. The capital account surplus increased to 2.4 percent of GDP in 2020 and is expected to increase further, supported by Next Generation EU grants. Financial market volatility at the onset of the pandemic triggered sizable but short-lived outflows in bond and equity markets, which stabilized beginning in May. Financial account outflows in 2020 amounted to 1.3 percent of GDP.

Assessment. Foreign holdings of domestic government securities have declined significantly since 2016 and, by the end of 2020, represented 17.1 percent of the total. Nevertheless, the overall stock remains sizable at 5.8 percent of GDP and could pose risks, although the diversified foreign investor base is a mitigating factor.

FX Intervention and Reserves Level

Background. Gross international reserves increased by 20 percent to US$154 billion by the end of 2020. Net reserves, which exclude the central bank's repo operations (part of its reserve management strategy) and government FX deposits, are estimated at US$131 billion at the end of 2020, reflecting in part the central bank's conversion to zloty of a portion of EU funds received by the government. This is consistent with the central bank's strategy of building an adequate precautionary reserve buffer. The zloty is free floating. The central bank intervened in the FX market in December 2020 by purchasing FX, the first intervention since 2013.

Assessment. At about 141 percent of the IMF's reserve adequacy metric at the end of 2020, the level of gross reserves is adequate to guard against external shocks and disorderly market conditions.

Table 3.20. Russia: Economy Assessment

Overall Assessment: *The external position in 2020 is moderately stronger than the level implied by medium-term fundamentals and desirable policies.*

Potential Policy Responses: In view of large uncertainties surrounding near-term recovery prospects, the authorities should stand ready to extend targeted support to viable sectors and firms still under stress. Over the medium term, structural reforms to improve the business climate and address inefficiencies in the state-owned enterprise sector, together with investment in infrastructure, health, and education, could lift potential growth and diversify the economy away from oil and gas exports, helping to bring the external sector into balance.

Foreign Asset and Liability Position and Trajectory	**Background.** The NIIP increased to US$504.53 billion in 2020, which, at 34 percent of GDP, is well above the near balance position in 2010. Since 2018 gross assets rose from 81 percent of GDP to 105.2 percent of GDP as of the end of 2020, though liabilities also increased from 58 to 71 percent of GDP. External debt is about one-half of total gross liabilities, and about one-quarter of external debt is in domestic currency. There are no obvious maturity mismatches between the gross asset and liability positions, and the share of nonresidents' holdings of domestic government debt declined from 32.2 percent in December 2019 to 23.3 percent in December 2020. **Assessment.** The projected CA surpluses suggest that Russia will be able to maintain its positive NIIP, lowering risks to external stability. Moreover, the accumulated official external assets, which have increased rapidly since the introduction of the new fiscal rule, provide an important buffer against the COVID-19 shock to oil production and prices.

2020 (% GDP)	NIIP: 34.2	Gross Assets: 105.2	Res. Assets: 40.3	Gross Liab.: 71.0	Debt Liab.: 31.6

Current Account	**Background.** In spite of the sharp fall in oil prices and oil demand, the CA balance registered a surplus of US$33.9 billion (2.3 percent of GDP) in 2020. This was in part because of less travel abroad due to the pandemic, with service imports declining by about US$34.4 billion relative to 2019. **Assessment.** The EBA CA model estimates a norm of 3.2 percent of GDP for 2020 and a cyclically and terms-of-trade adjusted CA surplus of 4.0 percent of GDP. After an adjustment to the underlying CA of 1.1 percent of GDP, to reflect the exceptionally sharp shock to oil prices and oil demand (2.1 percent of GDP), as well as a temporary adjustment for travel service imports, including tourism (–0.9 percent of GDP), the staff CA gap was 1.9 percent of GDP in 2020, with a range of 0.4 to 3.4 percent of GDP. Identified policies contributed 1.5 percent of GDP to the gap. About one-fifth of the total policy gap is due to fiscal policy, reflecting larger consolidation needs in the rest of the world compared with Russia.

2020 (% GDP)	CA: 2.3	Cycl. Adj. CA: 4.0	EBA Norm: 3.2	EBA Gap: 0.8	COVID-19 Adj.: 1.1	Other Adj.: 0.0	Staff Gap: 1.9

Real Exchange Rate	**Background.** The average REER depreciated by 7.4 percent in 2020 and by 14.4 percent over 2017–20. As of end-May 2021, the REER had depreciated by 3.8 percent compared to the 2020 average. **Assessment.** The IMF staff CA gap implies a REER undervaluation of 7.6 percent in 2020 (applying an estimated elasticity of 0.25). The EBA REER index and level model estimates point to a REER undervaluation of 12.3 and 20.8 percent, respectively. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of 1.6 to 13.6 percent, with a midpoint of 7.6 percent.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Following the decline in net private capital outflows in 2019, Russia experienced a period of high volatility accompanied by moderate outflows by both the banking and nonbanking private sectors in early 2020. This volatility abated somewhat, though external private sector deleveraging continued through December. Pressures on financial flows could stem from volatility in oil prices and demand as well as from geopolitical uncertainty. **Assessment.** While Russia is exposed to risks of further outflows, the large FX reserves and the floating exchange rate regime provide substantial buffers to help absorb shocks. The substantial external deleveraging in recent years has also helped reduce susceptibility to external shocks.
FX Intervention and Reserves Level	**Background.** Since the floating of the ruble in November 2014, FX interventions have been limited, and reserve accumulation has been mostly driven by the fiscal rule and oil prices being above the fiscal reference level. In 2020, faced with declining oil prices and capital outflows, the central bank engaged in some reserve sales and halted previously ongoing scheduled FX purchases. Despite FX sales of US$13.7 billion, international reserves rose to US$595.8 billion at the end of 2020 from US$555.2 billion in 2019, thanks to valuation changes related to higher gold prices. **Assessment.** International reserves in 2020 were equivalent to 360.7 percent of the IMF's reserve adequacy metric. Taking into account Russia's vulnerability to oil price shocks, an additional commodity buffer of US$75 billion is appropriate, translating to a ratio of reserves to the buffer-augmented ARA metric of 242.5 percent. While considerably above the adequacy range of 100 to 150 percent, the level of reserves remains appropriate, taking into account Russia's exposure to other external shocks as well as geopolitical tensions.

Table 3.21. Saudi Arabia: Economy Assessment

Overall Assessment: *The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.* The external balance sheet remains strong. Reserves remain adequate when judged against standard IMF metrics, although external savings are not sufficient from an intergenerational equity perspective. 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.

Potential Policy Responses: In the near term, withdrawal of remaining policy support should be carefully managed to ensure that the ongoing recovery continues. Over the medium term, fiscal consolidation could bring the CA balance closer to its norm. The increase in the value-added tax rate, the termination of the cost-of-living allowances, and the reduction in capital spending in 2020 have significantly strengthened the medium-term fiscal position. Other policies announced by the government—energy price reforms and restraint of current spending—if fully implemented, should deliver the additional needed fiscal adjustment at the central government level. Structural reforms that help diversify the economy and boost the non-oil tradables sector would enhance the resilience of the economy to external shocks and could also help bring the CA closer to its norm.

Foreign Asset and Liability Position and Trajectory	**Background.** Net external assets are estimated at 89 percent of GDP at the end of 2020, up from 85 percent of GDP in 2019 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 50, 39, and 11 percent of total external assets, respectively. **Assessment.** The external balance sheet remains very strong. Substantial accumulated assets represent both protection against vulnerabilities from oil price volatility and saving of exhaustible resource revenues for future generations.						
2020 (% GDP)	NIIP: 88.8	Gross Assets: 164.5	Res. Assets: 64.8	Gross Liab.: 75.6	Debt Liab.: 34.1		
Current Account	**Background.** The CA balance is estimated to have registered a deficit of 2.8 percent of GDP in 2020 compared with a surplus of 4.8 percent in 2019. The trade balance is estimated to have decreased by 8.5 percent of GDP as the price and volume of oil exports declined. The terms of trade are estimated to have deteriorated by 34.2 percent. The CA is expected to be in surplus in 2021 as oil revenues recover (the terms of trade are projected to improve by 40.7 percent).[1] **Assessment.** Saudi Arabia's reliance on oil complicates the application of standard external assessment methodologies, given the wide swings of oil prices in 2020. The EBA-Lite methodology generally estimates a negative CA gap, although the size of the estimated gap varies by approach. The estimated CA gap in 2020 is –2.2 percent of GDP using the CA-regression approach. An upward adjustment of 5.6 percent of GDP is applied to the CA to account for the temporary impact of the COVID-19 crisis regarding oil trade (5.3 percent of GDP); travel services trade, including tourism (0.1 percent of GDP); and the shift of household consumption composition from services to consumer goods (0.2 percent of GDP). The Consumption Allocation Rules suggest a CA gap of 0.2 and –3.1 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 –0.8 percent of GDP. The IMF staff assesses a CA gap of –1.5 percent of GDP, with a range of –2.7 to –0.3 percent of GDP in 2020.[2]						
2020 (% GDP)	CA: –2.8	Cycl. Adj. CA: –1.3	EBA Norm: —	EBA Gap: —	COVID-19 Adj.: 5.6	Other Adj.: —	Staff Gap: –1.5
Real Exchange Rate	**Background.** The riyal has been pegged to the US dollar at a rate of 3.75 since 1986. On average, the REER appreciated by 2.5 percent in 2020 and was 7.5 percent above its 10-year average. However, the REER appreciation was mainly driven by the impact of the value-added tax increase on inflation (the NEER only appreciated by 0.6 percent, on average, in 2020 and depreciated by 6 percent from its peak in April). As exports are not subject to value-added taxes, the impact of the REER appreciation on competitiveness is limited unless there is a strong pass-through to costs of labor and intermediate inputs. As of end-May 2021, the REER had depreciated by 2.3 percent compared to the 2020 average. **Assessment.** 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. Consistent with the IMF staff CA gap and based on an elasticity of 0.2, the IMF staff assesses the REER to be overvalued by about 7 percent, with a range of 1 to 13 percent.						
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Net financial outflows continued in 2020 as the PIF invested abroad, although net outflows were smaller than in 2019. The equity market saw large outflows in March 2020 as oil prices declined and COVID-19 struck global financial markets, but has rebounded since April. FX reserves decreased by US$45.9 billion mainly due to a Saudi Arabia Monetary Authority transfer of US$40 billion to the PIF. Reserves are expected to stabilize in 2021 as investments overseas by public sector institutions start to slow. **Assessment.** 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.						
FX Intervention and Reserves Level	**Background.** The investments of the PIF are increasing, although most of the government's foreign assets are still held at the central bank within international reserves. Net FX reserves declined to US$449 billion (64 percent of GDP, 25.1 months of imports, and 333 percent of the IMF's reserve adequacy metric) at the end of 2020 from US$494 billion at the end of 2019 ($724 billion in 2014). This was mainly driven by transfers of foreign assets from the Saudi Arabia Monetary Authority to the PIF. **Assessment.** Reserves play a dual role—savings for both precautionary motives and for future generations. Reserves are adequate for precautionary purposes (measured by the IMF's metrics). Nevertheless, fiscal adjustment is needed over the medium term to strengthen the CA and increase savings for future generations.						

Table 3.22. Singapore: Economy Assessment

Overall Assessment: *The external position in 2020 was substantially stronger than is consistent with fundamentals and desirable policies.* The assessment is subject to a wide range of uncertainty, reflecting Singapore's very open economy and status as a global trading and financial center.

Potential Policy Responses: A sizable fiscal policy response to the COVID-19 pandemic helped reduce external imbalances in 2020, and expected execution of major infrastructure projects should contribute to further reduction of external imbalances in the near term. Over the medium term, Singapore's economy will be undergoing structural transformation, in light of a rapidly aging population and its transition to a new digital economy, while facing challenges linked to climate change. Higher public investment addressing these issues, including spending on health care and investments in physical infrastructure and human capital, would help keep CA imbalances moderate over the medium term by lowering net public saving. Structural reforms are also necessary to improve productivity.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP stood at 308 percent of GDP in 2020, up from 208 percent of GDP in 2019 and the average level of 212 percent of GDP in 2015–19. Gross assets and liabilities are high, reflecting Singapore's status as a financial center. About half of foreign liabilities is in FDI, and about a quarter is in the form of currency and deposits. The CA surplus has been a main driver since the global financial crisis, 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.

Assessment. Large gross non-FDI liabilities (508 percent of GDP in 2020)—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 profiles. Singapore has large official reserves and other official liquid assets.

2020 (% GDP)	NIIP: 307.8	Gross Assets: 1,361.2	Debt Assets: 617.0	Gross Liab.: 1,053.4	Debt Liab.: 417.6

Current Account

Background. The CA surplus was 17.6 percent of GDP in 2020, up from 14.3 percent in 2019. This rise was led by a large decline in service imports, a narrower oil trade deficit, and a decrease in net payments of primary income related to the COVID-19 shock. The CA balance is slightly higher than the average of 16.6 percent since 2015 and significantly lower than the post-global-financial-crisis peak of 22.9 percent in 2010. 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 account balance.[1] Structural factors and policies that boost savings, such as Singapore's status as a financial center, consecutive fiscal surpluses in most years, and the rapid pace of aging—combined with a mandatory defined-contribution pension program (whose assets were about 98.5 percent of GDP in 2020), as well as relatively high productivity—are the main drivers of Singapore's strong external position. The CA surplus is projected to narrow over the medium term on the back of increased infrastructure and social spending. In 2020 public saving decreased with a sizable fiscal expansion in response to the pandemic, while private saving increased.

Assessment. Guided by the EBA framework, the IMF staff assesses the 2020 CA gap to be in the range of 1.2 to 7.2 percent of GDP.[2] The identified policy gaps narrowed significantly to close to zero in 2020, reflecting the sizable fiscal package and an increase in health care expenditure.

2020 (% GDP)	CA: 17.6	Cycl. Adj. CA: 16.9	EBA Norm: —	EBA Gap: —	COVID-19 Adj.: –1.9	Other Adj.: —	Staff Gap: 4.2

Real Exchange Rate

Background. The REER depreciated by 2.6 percent in 2020, reflecting the depreciation of the NEER by 1.2 percent. This followed a depreciation of the REER by 0.3 percent and an appreciation of the NEER by 2.4 percent, both cumulative, between 2017 and 2019. As of May 2021, the REER had depreciated by 0.3 percent relative to the 2020 average.

Assessment. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of 2.5 to 14.5 percent, with a midpoint of 8.5 percent in 2020 (applying an estimated elasticity of 0.5).

Capital and Financial Accounts: Flows and Policy Measures

Background. Singapore has an open capital account. Because it is 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 balance 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 2020 the capital and financial account switched to inflows of 4.2 percent of GDP from outflows of 16.5 percent in 2019 (outflows ranged from 10 to 18 percent in 2015–19). This reflects lower net outflows of portfolio investment led by resident banks switching from a net outflow position in 2019 to a net inflow position in 2020, as well as "other investment" turning from net outflows to net inflows among domestic nonbanks.

Assessment. The unusual capital inflows in 2020 are likely to be transitory, reflecting regional safe haven flows, and are likely to turn to outflows as the effect of the pandemic subsides in subsequent years.

FX Intervention and Reserves Level

Background. With the NEER as the intermediate monetary policy target, intervention is undertaken to achieve inflation and output objectives. Because Singapore is a financial center, prudential motives call for a larger NIIP buffer. Official reserves held by the Monetary Authority of Singapore (MAS) reached US$362 billion (106.6 percent of GDP) in 2020. Aggregate data on FX intervention operations have been published since April 2020.

Assessment. In addition to FX reserves held by the MAS, Singapore also has access to other official foreign assets managed by Temasek and GIC.[3] 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

Overall Assessment: *The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.* The CA turned into a surplus for the first time in nearly two decades on the back of depressed imports following weak domestic demand, a favorable income balance, and strong metal exports. As such, the CA surplus is deemed temporary. The pandemic led to nonresident capital outflows, partly offset by the IMF emergency financing, some asset repatriation and parent support.

Potential Policy Responses: Tackling external imbalances will require a combination of bold implementation of structural reforms to ameliorate competitiveness and gradual but substantial fiscal consolidation, once the pandemic is over, while providing space for infrastructure and social spending (to help reduce poverty and inequality). Reform efforts should focus on improving governance, the efficiency of key product markets (by encouraging private sector participation), and the functioning of labor markets. These reforms are expected to help attract less volatile and longer-term capital inflows, such as FDI. Seizing opportunities to accumulate international reserves, should they arise, would strengthen the country's ability to deal with shocks.

Foreign Asset and Liability Position and Trajectory

Background. With large gross external assets and liabilities (respectively, 164.5 and 132.1 percent of GDP at end-2020), South Africa is highly integrated into international capital markets. The NIIP improved markedly from 8.6 percent of GDP in 2019 to 32.4 percent in 2020 mainly due to nonresident capital outflows and valuation adjustments from rand depreciation. The NIIP is expected to moderate over the medium term as the CA balance is projected to return to a deficit. Gross external debt rose from 52.7 percent of GDP in 2019 to an estimated 55.9 percent of GDP in 2020 due mainly to accounting effects (a sharp GDP contraction during the pandemic). Short-term external debt (on a residual maturity basis) is estimated at about 15.2 percent of GDP in 2020.

Assessment. Risks from large gross external liabilities are mitigated by a sufficiently large external asset position, the liability structure (the bulk is in equities), and the currency composition of external debt (mostly in rand).

2020 (% GDP)	NIIP: 32.4	Gross Assets: 164.5	Debt Assets: 21.9	Gross Liabilities: 132.1	Debt Liabilities: 51.0

Current Account

Background. The CA deficit narrowed from 5.8 percent of GDP in 2013 to 2.5 percent in 2017 but widened to 3 percent in 2019 as the terms of trade deteriorated and the trade balance weakened. The CA turned into a surplus for the first time in nearly two decades in 2020, reaching 2.2 percent of GDP, due to sharp and mainly pandemic-related changes in the trade balance amid unusually depressed imports, strong commodity prices, some rand depreciation, and a favorable income balance. While highly uncertain, the CA surplus is projected to narrow to 1 percent of GDP in 2021, mainly due to higher imports as domestic demand recovers and a weakening income balance, despite the terms of trade remaining robust. Over the medium term, a CA deficit is projected to gradually widen to 2.5–3 percent of GDP as trade balance is expected to deteriorate.

Assessment. The IMF staff estimates a CA gap in the range of –2.1 to –0.1 percent of GDP in 2020. The staff cyclically adjusted CA is estimated at –0.1 percent of GDP, accounting for COVID-19–related adjustors of –1.8 percent of GDP to take account of the unique impact of the pandemic on gold exports, oil imports, travel services including tourism, medical spending imports, and lower dividend payments,[1] as well as the statistical treatment of transfers and income accounts.[2] The adjusted CA norm (0.6 percent of GDP) is obtained by subtracting 1 percentage point from the EBA CA norm (1.6 percent of GDP) to reflect lower life expectancy relative to other countries in the regression sample.[3]

2020 (% GDP)	CA: 2.2	Cycl. Adj. CA: –0.1	EBA Norm: 1.6	EBA gap: –1.7	COVID-19 Adj.: –1.8	Other Adj.: 2.4	Staff Gap: –1.1

Real Exchange Rate

Background. The CPI-REER depreciated during 2011–16, recouped some of the losses in 2017–18, and depreciated again during 2019–20. In particular, the REER in 2020 depreciated by about 9.2 percent in 2020 relative to 2019, mainly due to nominal depreciation during the pandemic. As of end-May 2021, the REER had appreciated by 6 percent compared to end-2020 and by 13.2 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies an overvalued REER with a midpoint of 4.0 percent (applying an estimated elasticity of 0.28). The two REER-based regressions point to undervaluation in a range of 10.5 percent (level approach) and 20.9 percent (index approach). Based on the CA approach, the IMF staff assesses the REER to be overvalued by 4.0 percent, with a range between 0.0 and 8.0 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net FDI slightly increased in 2020 (from 0.6 percent of GDP in 2019 to 1.7 percent). Net portfolio investment turned negative in 2020 (–2.3 percent of GDP) on account of nonresident capital outflows during the pandemic. Gross external financing needs stood at 13 percent of GDP in 2020.

Assessment. In 2021, COVID-19–related financial market volatility in emerging markets may persist, as yields in the US are increasing and despite overall favorable market sentiment and a search for yield. Following large capital outflows and asset sell-offs during the pandemic in spring 2020 and the corresponding significant rand depreciation, demand for South African assets has stabilized so far. As the CA is expected to return to a deficit in 2022, risks from large reliance on non-FDI inflows for external financing and sizable nonresident holdings of local financial assets are mitigated by a flexible exchange rate, relatively small currency mismatches, and a large domestic institutional investor base. The latter tends to reduce asset price volatility during periods of market stress. The South African authorities obtained financing under the IMF's Rapid Financing Instrument for $4.3 billion (100 percent of quota) in July 2020.

FX Intervention and Reserves Level

Background. 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 18.2 percent of GDP, 140.2 percent of gross external financing needs, and 7.3 months of imports at the end of 2020. Reserves stand below the IMF's composite adequacy metric (74 percent of the metric without considering existing CFM measures and 82 percent of the metric after considering them).

Assessment. If conditions allow, reserve accumulation would be desirable over the medium term to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.

Table 3.24. Spain: Economy Assessment

Overall Assessment: *The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* In 2020 the CA remained in surplus for the ninth consecutive year. Further strengthening the NIIP will require sustaining a relatively high CA surplus over the coming years.

Potential Policy Responses: To keep the CA balance in line with its norm, policies need to support investment and foster competitiveness to facilitate the recovery, while carefully managing the public debt load. Using financing from Next Generation EU funds to boost medium-term investments will be important to raise potential growth and support decarbonization and digitalization. Boosting competitiveness through productivity gains 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.

Foreign Asset and Liability Position and Trajectory	**Background.** The NIIP dropped significantly during 2000–09, driven mostly by high CA deficits but also by valuation effects. Following a 15 percentage point increase in 2015–19 due to sustained CA surpluses, the NIIP declined again, reaching –84 percent of GDP in 2020, mainly due to the contraction in GDP. Gross liabilities stood at 290 percent of GDP in 2020, with slightly over 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 markedly, particularly in the context of the COVID-19 crisis, raising its share to 93 percent in 2020 (including TARGET2 liabilities, which reached 44 percent of GDP by the end of 2020).[1] **Assessment.** 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 quantitative easing, which lower the cost of debt.

2020 (% GDP)	NIIP: –84.5	Gross Assets: 205.9	Debt Assets: 94.8	Gross Liab.: 290.4	Debt Liab.: 179.7

Current Account	**Background.** After a peak CA deficit in 2007, corrected initially by a sharp contraction in imports, increased competitiveness from wage moderation and greater internationalization efforts contributed to strong export growth, leading to CA surpluses in 2012–20. As a result of historical data revisions, the average annual CA surplus during 2013–18 was revised from 1.5 to 2.3 percent of GDP. The COVID-19 crisis was associated with a stronger decline in exports than imports, largely due to the sharp decline in receipts from travel services, including tourism. As a result, the CA surplus declined significantly, from 2.1 percent in 2019 to an estimated 0.7 percent of GDP in 2020. With high uncertainty, in 2021 the CA surplus is projected to increase slightly as the pandemic recedes, supported by a gradual recovery in exports, notably tourism. 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. **Assessment.** The cyclically adjusted CA balance is –1.3 percent of GDP, yielding a CA gap of –1.6 percent of GDP. However, the weakening of the CA mainly reflects the pandemic's transitory impact due to shocks not captured by the EBA model, which amount to 2.6 percent for travel services, including tourism; –0.3 percent for oil; 0.3 percent for medical goods; and –0.3 percent for the global shift of household consumption from services to consumer goods. Adjusting for these effects, the 2020 cyclically adjusted CA balance is 1.1 percent of GDP. The EBA CA model suggests a norm of 0.3 percent of GDP for 2020. However, given external risks from a large and negative NIIP, the IMF staff views the appropriate CA norm to be 1.8 percent of GDP, with a range of 0.8 to 2.8 percent of GDP. This yields a CA gap of –1.7 to 0.3 percent of GDP. The IMF staff assessment puts more weight on external sustainability and is guided by the objective of raising the NIIP to below –50 percent over the medium to long term. With a sustained CA surplus of about 1.8 percent of GDP, the NIIP is projected to reach –50 percent of GDP over the medium term under current policies, though with high uncertainty, as zero valuation effects are assumed.[2]

2020 (% GDP)	CA: 0.7	Cycl. Adj. CA: –1.3	EBA Norm: 0.3	EBA Gap: –1.6	COVID-19 Adj.: 2.4	Other Adj.: –1.5	Staff Gap: –0.7

Real Exchange Rate	**Background.** In 2020 the CPI-based REER appreciated by 0.5 and the ULC-based REER depreciated by 4.6 percent from their average 2019 levels. 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 almost fully 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 24 percent. As of May 2021, the CPI-based REER had appreciated by 1.4 percent, and the ULC-based REER had depreciated by 0.2 percent relative to their 2020 averages. **Assessment.** The IMF staff CA gap implies an overvaluation of 2.6 percent, using an elasticity of 0.28, while the EBA REER models estimate a small overvaluation of 4.0 (level) to 6.2 (index) percent for 2020. Therefore, based on the IMF staff CA gap, the IMF staff assesses the REER gap to be in the range of –1.4 to 6.6 percent, with a midpoint of 2.6 percent.[3]
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Financing conditions have eased following some increase in sovereign bond yields in the early stages of the COVID-19 crisis. And by the third quarter of 2020 the private sector was continuing its deleveraging against the rest of the world. In 2020 the financial account balance was largely driven by the substantial increase in liquidity creation by the Eurosystem through the expansion of asset purchase programs and the refinancing of Spanish banks, as well as by net outflows of loans and other bank-related instruments from sectors other than the central bank. Consequently, the accumulation of TARGET2 liabilities, reflecting liquidity creation within the framework of the Eurosystem, was the highest since 2012 (13 percent of GDP in 2020), after having been negative in 2019 for the first time since 2015. **Assessment.** As a result of the pandemic crisis, investor sentiment deteriorated in 2020, notably toward banks. Furthermore, 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.
FX Intervention and Reserves Level	**Background.** The euro has the status of a global reserve currency. **Assessment.** Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.

Table 3.25. Sweden: Economy Assessment

Overall Assessment: *The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies. The CA is expected to decline to its long-term average over the medium term as domestic and global fiscal policies normalize and structural reforms are undertaken.*

Potential Policy Responses: Given large fiscal buffers, Sweden is in a good position to provide further support to companies and households if the crisis is protracted. Over the medium term, policies that could support external rebalancing and bring the CA balance closer to its norm would require structural reforms. Also, there is scope for greener and growth-enhancing private and public investments to facilitate structural transformation and support domestic demand. The central bank has ensured ample liquidity, but further ability to increase aggregate demand may be limited. As the recovery resumes, past imbalances and policy distortions will need to be addressed through implementation of reforms that raise productive investment. Policies that raise potential output, decrease unemployment, and reduce household debt also remain important even as their aggregate impact on the CA is more ambiguous.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP was 18 percent of GDP in 2020, with a small increase of 0.3 percentage points in 2020. It is expected to rise further in the medium term, reflecting the outlook for continued CA surpluses. However, these projections are subject to uncertainty as IIP data include significant errors and omissions, which have averaged –2.1 percent of GDP in the past five years.

Assessment. Gross liabilities are projected to increase to 275 percent of GDP in 2020, with about one-half being gross external debt (137 percent of GDP). Other financial institutions (87 percent of GDP) hold the bulk of net foreign assets, followed by social security funds (26 percent of GDP), households (20 percent of GDP), and the central bank (12 percent of GDP); nonfinancial corporations (60 percent of GDP), monetary financial institutions (51 percent of GDP), and the central government (11 percent of GDP) are net external debtors. Although rollovers of external debt (which includes banks' covered bonds) pose some vulnerability, risks are moderated by the banks' ample liquidity and large capital buffers.

2020 (% GDP)	NIIP: 18.0	Gross Assets: 292.7	Debt Assets: 88.0	Gross Liab.: 274.7	Debt Liab.: 129.4

Current Account

Background. Despite the global COVID-19 crisis, the CA increased to 5.2 percent of GDP in 2020, compared with 2019 (4.6 percent of GDP), supported by exports of goods (machinery and chemicals) in the first quarter and doubling of primary income from investments in the second quarter. Sweden is a net oil importer, with a negative oil balance. Lower domestic demand for external goods and travel services, including tourism, due to decreased economic activity and mobility has reduced imports in 2020 substantially compared with 2019. In addition, low oil prices have decreased the value of oil imports. The impact from the lower-than-usual imports of oil and tourism services is estimated to have improved the CA surplus by about 1.1 percentage points (see COVID-19 adjustor). The cyclically adjusted fiscal stance, which was not as expansionary as in the rest of the world, may have contributed to the mild increase in the CA as well. Over the medium term, the CA is projected to return to its long-term average of 3 percent of GDP.

Assessment. The cyclically adjusted CA is estimated at 6.4 percent of GDP in 2020, 5.1 percentage points above the cyclically adjusted EBA norm of 1.3 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 programs and an older labor force, may also be driving Sweden's saving-investment balances. Overall, taking into account adjustments for oil (–0.4 percent of GDP), travel services including tourism (–0.5 percent of GDP), and medical (–0.2 percent of GDP) imports, which were affected by the COVID-19 crisis, the IMF staff assesses the CA gap at 3.8 percent of GDP in 2020, within a range of ±1.5 percent of GDP, reflecting uncertainty around the EBA estimated norm.

2020 (% GDP)	CA: 5.7	Cycl. Adj. CA: 6.4	EBA Norm: 1.3	EBA Gap: 5.1	COVID-19 Adj.: –1.2	Other Adj.: 0.0	Staff Gap: 3.8

Real Exchange Rate

Background. The krona appreciated by 5.3 percent in ULC-based real effective terms and by 2.4 percent in CPI-based REER terms in 2020 relative to its average level in 2019, partly reflecting the change in the repo rate from negative to zero since the beginning of 2020, financial inflows, and a milder recession than in peers. As of end-May 2021, the CPI-based REER had appreciated by 3.4 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of –10.9 percent in 2020 (applying an estimated elasticity of 0.35). The REER index and level models suggest a gap of –18.4 percent and –16.8 percent, respectively, for 2020. The ULC-based REER index was 5.5 percent below its 28-year average (since the krona was floated in 1993) in 2020. Because this indicator has fluctuated around a broadly stable level since the currency was floated, it provides a useful indication of valuation, which the IMF staff prefers. Overall, the IMF staff assesses the krona to be undervalued by 3 to 13 percent, with a midpoint of 8 percent, as guided by the ULC-based REER index. This REER gap may continue to decline once the situation, including monetary policy, normalizes.

Capital and Financial Accounts: Flows and Policy Measures

Background. Other investments (such as the provision of loans, insurance, pensions, trade credits, etc.) of about 2.5 percent of GDP constituted one-half of the financial account in 2020, with portfolio investment outflows (2.0 percent), direct investments (1.4 percent), and derivatives (–1 percent) being the remainder.

Assessment. Given their size, interconnectedness, and funding model, Sweden's large banks are vulnerable to liquidity risks stemming from global wholesale markets. However, banks have improved their structural liquidity positions in recent years. Also, the authorities have strengthened regulation by introducing liquidity coverage ratio requirements in foreign and domestic currency in addition to the overall liquidity coverage ratio. This created substantial buffers before the COVID-19 crisis and, together with the swift and strong policy response, eased liquidity and funding pressures for banks in 2020.

FX Intervention and Reserves Level

Background. The exchange rate is free floating. Foreign currency reserves increased by US$3 billion to stand at US$59 billion in December 2020, which is equivalent to 22 percent of the short-term external debt of monetary and financial institutions (primarily banks), about 11 percent of GDP, and 3.3 months of imports. There were no FX interventions in 2020.

Assessment. 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; although it was not used, it provided an important backstop function.

Table 3.26. Switzerland: Economy Assessment

Overall Assessment: *Switzerland's external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* However, this change from the previous assessment, in which the external position was judged to be moderately stronger, is subject to higher-than-usual uncertainty related to recent large downward statistical revisions to historical CA balances.[1] The 2019 CA balance is now nearly 5 percentage points of GDP lower than estimated at the time of the 2020 ESR. The revisions suggest a weakening in the external position and add to uncertainty. Data and time will be needed to assess the durability of this downward shift in the external accounts, distinguishing transitory and COVID-19–related effects from structural impacts. A number of pandemic-influenced developments, especially concerning the trade and income accounts, are expected to unwind in the coming years. More broadly, the continued strength of Switzerland's external balance sheet and macroeconomic policy mix would be at odds with an assessment of the overall external position as weaker. Net foreign assets increased in 2020, with reserves now exceeding 130 percent of GDP, reflecting FX operations conducted for monetary policy reasons in the context of FX inflow surges rather than reserve accumulation or exchange rate management purposes. Policy buffers also remain strong—in particular, fiscal buffers—despite the comprehensive response to the pandemic. Overall, these circumstances suggest caution in assessing the external position.

Potential Policy Responses: Fiscal policy should continue to play a key role in responding to the pandemic and ensuring a strong and sustained recovery. Monetary policy should remain accommodative and directed at price stability; macroprudential policies should focus on reducing financial sector risks. FX intervention may be used to partially mitigate strong appreciation pressures that would otherwise push the economy further into deflation. The Swiss National Bank (SNB) should continually review its framework and tools, especially in light of the experience during COVID-19, to consider whether adjusting or extending targets, instruments, and communications would enable it to continue to respond effectively to new challenges. Medium-term policies should be geared toward ensuring balanced domestic and external contributions to growth while improving the public-private mix in financial outflows and thereby easing pressures on the franc. In the post-pandemic environment, fiscal policy should remain supportive, continuing—and enhancing or accelerating, where possible—efforts to foster green, digital transformation and productivity gains and to address important challenges (for example, competitiveness, aging).

Foreign Asset and Liability Position and Trajectory

Background. Switzerland is a major financial center with a positive NIIP of 94.2 percent of GDP and gross foreign asset and liability positions of 758 and 664 percent of GDP, respectively, at the end of 2020. The NIIP reflects both a history of large CA surpluses and valuation changes.[2] Valuation changes reflect fluctuations of exchange rates and prices of securities and precious metals that interact with differences among assets and liabilities in terms of currencies and instruments.[3] Statistical revisions in 2020, to better account for foreign liabilities on FDI and portfolio equity investment, have involved large downward adjustments in NIIP estimates for 2008–19. On the basis of the revised series, the NIIP rose in 2020 by 11 percentage points of GDP, mainly driven by an increase in reserve assets. Projections of the NIIP in 2021 and beyond are complicated by heightened uncertainty; because of the large gross positions and compositional differences among assets and liabilities, even modest changes in exchange rates, asset prices, and returns may have a material effect on the NIIP.

Assessment. Switzerland's large gross liability position and the 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.

2020 (% GDP)	NIIP: 94.2	Gross Assets: 758.0	Res. Assets: 135.9	Gross Liab.: 663.8	Debt Liab.: 205.2

Current Account

Background. Switzerland's CA surpluses averaged over 9 percent of GDP during 2010–19, although statistical revisions reflecting conclusion of the reporting calendar and improved coverage of domiciliary-company foreign liabilities led to downward revisions of surpluses for 2018–19. In 2020, the CA surplus decreased from 6.7 percent of GDP in 2019 to 3.8 percent. The decline likely reflected temporary shocks, especially related to COVID-19, such as weaker trade balances for gold and luxury watches and a larger drop in investment income receipts than expenses due to the relatively better performance of the Swiss economy during the pandemic. Other factors may persist. On balance, the CA position is likely to return toward 2018–19 levels in 2021 as the global economy recovers and the drag from temporary COVID-19–related shocks eases.

Assessment. The EBA CA norm of 5.6 percent of GDP is slightly lower than last year's norm. Based on a cyclically adjusted CA surplus of 3.9 percent and the norm, the overall EBA-estimated CA gap equaled –1.7 percent of GDP in 2020. Domestic policy gaps account for –1.1 percentage points of the gap and include excessive private sector credit (–0.7 percent of GDP) and fiscal overspending (–0.3 percent of GDP), while policy gaps in the rest of the world contribute 2.2 percentage points. Adjustments for (1) specific factors relevant for Switzerland that are not treated appropriately in the income account—namely, valuation losses on fixed-income securities arising from inflation (–2.8 percent of GDP) and retained earnings on portfolio equity investment (–0.6 percent of GDP); and (2) transitory impacts of the COVID-19 pandemic (1.9 percent of GDP) widened the gap to –3.2 percent of GDP (±2 percentage points).[4,5]

2020 (% GDP)	CA: 3.8	Cycl. Adj. CA: 3.9	EBA Norm: 5.6	EBA Gap: –1.7	COVID-19 Adj.: 1.9	Other Adj.: –3.4	Staff Gap: –3.2

Real Exchange Rate

Background. A narrower domestic-foreign interest rate differential and heightened risk aversion, especially at the outbreak of the pandemic, contributed to strong appreciation pressure in the first half of 2020; this pressure subsequently eased. Relative to 2019, the average NEER and CPI-based REER appreciated by 6.1 and 3.8 percent, respectively, notwithstanding sizable FX interventions. From a long-term perspective, the NEER has appreciated by 27 percent since the end of 2010, while the CPI-based REER has appreciated by 2.8 percent (reflecting lower domestic inflation).

Assessment. The IMF staff CA gap implies a REER overvaluation of 6.2 percent in 2020 (applying an estimated elasticity of 0.52). The EBA REER index and level models suggest that the average REER in 2020 was overvalued by 15.4 and 26.4 percent, respectively, with policy gaps accounting for a small amount of the total gap. This finding largely reflects a "reversion to trend" property of the empirical model in the context of prior rapid appreciation episodes. However, due to measurement issues, the results may not fully capture a secular improvement in productivity, especially in knowledge-based sectors. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be overvalued in the range of 2.2 to 10.2 percent, with a midpoint of 6.2 percent.[6]

Capital and Financial Accounts: Flows and Policy Measures

Background. Net financial outflows totaled 1.8 percent of GDP in 2020, with private inflows (14.8 percent of GDP) more than offset by SNB reserve increases (16.6 percent of GDP). This contrasts with 2019, when more moderate SNB reserve gains (2.2 percent of GDP) and private outflows (3.0 percent of GDP) jointly led to net financial outflows of 5.2 percent of GDP. During 2009–20, net private inflows averaged 3.6 percent of GDP, while the average annual increase in SNB reserves was 10.5 percent of GDP.

Assessment. Financial flows are large and volatile, reflecting Switzerland's status as a financial center and safe haven. From a long-term perspective, sizable net private financial outflows prior to the global financial crisis have declined and, on average, turned into net capital inflows, adding to appreciation pressures.

FX Intervention and Reserves Level

Background. Official reserve assets (including gold) amounted to US$1,083 billion (136 percent of GDP) at the end of 2020, up US$228 billion from the end of 2019 (including valuation changes). While FX interventions had been occasional and moderate since exiting the exchange rate floor in 2015, the SNB purchased CHF 110 billion in FX (net) in 2020, the highest amount since 2012.

Assessment. 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 FX inflow surges and given the limited scope for significant easing via other monetary pool tools. In particular, the supply of domestic assets for purchase is limited, and the marginal interest rate on bank deposits at the SNB of –0.75 percent is already the lowest in the world. The SNB's initiation of quarterly publication of (net) FX intervention information in 2020 was an important step to enhance transparency.

Table 3.27. Thailand: Economy Assessment

Overall Assessment: *The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies.* The CA surplus narrowed relative to 2019 due to the COVID-19 shock, reflecting a dramatic fall in the tourism-driven services balance partially offset by a strengthening trade balance as weak domestic demand drove a sharper contraction in imports than in exports.

Potential Policy Responses: In order to bring the CA more in line with medium-term fundamentals and desirable policies, the IMF staff recommends an accelerated, mutually reinforcing macro policy stimulus, led by a fiscal expansion, given available fiscal space, to revitalize domestic demand. This should be deployed toward targeted social transfers to mitigate the effects of the pandemic on the most vulnerable, as well as infrastructure investment to support the recovery and reorientation of affected sectors. In addition, the exchange rate should move flexibly as the key shock absorber, with intervention limited to disorderly market conditions. Further efforts to reform social safety nets should continue, and steps to address widespread informality should reduce precautionary saving and support consumption.

Foreign Asset and Liability Position and Trajectory	**Background.** Thailand's NIIP strengthened in 2020 to 11 percent of GDP from 0.3 percent in 2019. Gross assets rose to about 120 percent of GDP (driven by the increase in reserve assets to 51 percent of GDP), while gross liabilities increased slightly to 109 percent of GDP, comprising direct (about one-half) and portfolio (one-third) investment. Falling inward investment kept net FDI low; outward direct and portfolio investment recovered strongly by the end of the year, offsetting midyear outflows. **Assessment.** The NIIP is projected to remain in a small creditor position over the medium term given CA surpluses. External debt rose to a still-contained 38 percent of GDP, of which short-term debt (on a remaining maturity basis) amounts to 15 percent of GDP; risks to external debt sustainability and liquidity are limited.
2020 (% GDP)	NIIP: 11 · Gross Assets: 120 · Res. Assets: 51 · Gross Liab.: 109 · Debt Liab.: 38
Current Account	**Background.** Thailand's CA surplus declined from 7.0 percent of GDP in 2019 to 3.3 percent of GDP in 2020, reflecting the impact of the pandemic. Containment measures weighed on domestic demand, which led to a larger contraction in imports than exports, which softened due to weak global demand and supply chain disruptions, notwithstanding a surge in net gold exports (gold is widely used as a store of wealth in Thailand, and many households without access to social safety nets had to rely on gold sales in 2020 to meet extraordinary liquidity needs). This led to a strengthening of the trade balance. However, the services account collapsed as international tourism arrivals fell to zero between April and October 2020. The CA in 2021 is expected to narrow to 0.5 percent of GDP as the recovery in domestic and external demand narrows the trade balance and tourism receipts are still slow to recover. **Assessment.** The EBA CA model estimates a cyclically adjusted CA of 1.0 percent of GDP and a CA norm of 1.2 percent of GDP for 2020. The CA gap of –0.2 percent of GDP consists of an identified policy gap of 1.3 percent of GDP (mainly due to fiscal policy and FX intervention) and an unexplained residual of –1.5 percent of GDP, which partly reflects the unique nature of the COVID-19 shock as well as structural factors not fully captured by the EBA model. In this regard, adjustors to account for the large shocks to the travel services (including tourism) and oil sectors of 3.7 and –0.5 percent of GDP, respectively, are applied, as they are not accounted for by the standard EBA cyclical adjustment. Further adjustments regarding the global shift in household consumption composition from services toward consumer goods (–0.3 percent of GDP), net exports of medical supplies triggered by the health emergency (–0.2 percent of GDP), and the aforementioned surge in gold exports (–0.3 percent of GDP) are also applied. Overall, the IMF staff assesses the CA gap to be in the range of 0.7–3.7 percent of GDP, with a midpoint of 2.2 percent of GDP. This gap is expected to narrow over the medium term as policy stimulus is deployed, domestic demand recovers, and the social safety net is enhanced.
2020 (% GDP)	CA: 3.3 · Cycl. Adj. CA: 1.0 · EBA Norm: 1.2 · EBA Gap: –0.2 · COVID-19 Adj.: 2.4 · Other Adj.: 0.0 · Staff Gap: 2.2
Real Exchange Rate	**Background.** The baht has been on a gradual real appreciation trend since the mid-2000s, despite occasional bouts of volatility. In 2020 the REER depreciated 6.9 percent by April, relative to the end of December 2019, as emerging markets faced increased capital outflows due to the outbreak of the pandemic. The REER has since broadly resumed its appreciation, as the virus was controlled in Thailand through the year, and buttressed by positive sentiment about the vaccine, ending the year about 2.6 percent lower relative to its 2019 average. As of end-May 2021, the REER had depreciated by 3.7 percent compared to the 2020 average. **Assessment.** Using an elasticity of 0.56 and based on the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the 1.5–6.5 percent range, with a midpoint of 4.0 percent. The EBA index REER gap in 2020 is estimated at 10.8 percent; the EBA level REER gap is estimated at –5.2 percent.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** In 2020 the capital and financial account balance strengthened to –0.7 percent of GDP from –2.9 percent in 2019, driven by other investment flows. Nonresident holdings of Thai bonds and equities declined in March/April, but recovered by the end of the year, reflecting Thailand's strong external position relative to other emerging markets. Through the year, the authorities accelerated plans to liberalize FX outflows, including easing restrictions on resident holdings of foreign currency securities and deposits. **Assessment.** Since 2013 Thailand has experienced episodes of volatility, reflecting external financial and political conditions. Nevertheless, Thailand has been able to weather such episodes well, given strong external buffers and fundamentals. The IMF staff encourages the prudent liberalization of the financial account and recommends a phaseout of the 2019 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.
FX Intervention and Reserves Level	**Background.** The exchange rate regime is classified as (de jure and de facto) floating. International reserves (including net forward position) increased to 57.3 percent of GDP in 2020, 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 in outflow episodes. **Assessment.** Gross international reserves (including net forward position) increased by more than US$28.7 billion in 2020. While official intervention data are not published, estimates suggest two-sided intervention for the year. Reserves are higher than the range of the IMF's adequacy metrics, and there is still 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.

Table 3.28. Turkey: Economy Assessment

Overall Assessment: *The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.* Expansionary monetary policy and rapid provision of credit by state-owned banks put pressure on the lira last year through dollarization, import, and financial account channels, which led in turn to sales of foreign exchange reserves to support the lira. Despite the marked real exchange rate depreciation, the CA deficit resurfaced because of lower exports (including tourism) and robust imports (including gold). The monetary tightening beginning in late 2020 saw a return of capital inflows and modest reserves buildup, but outflows and reserves losses resumed in March 2021, amid rising policy uncertainty and lira depreciation. Policy uncertainty, large gross external financing needs, and relatively low reserves increase Turkey's vulnerability to shocks. Only over time will the REER undervaluation, with its usual lags, help move the current account back toward its norm, aided by less expansionary policies.

Potential Policy Responses: Policies that could support Turkey's external rebalancing and bring the current account balance closer to its norm include (1) keeping credit growth at sustainable rates; (2) maintaining a firm monetary policy stance, with additional measured tightening if inflation expectations increase further, to, at a minimum, keep the ex ante real policy rate unchanged, which would also help ensure sustainable credit growth; (3) enhancing the fiscal anchor with a credible commitment to future consolidation to bring debt down over time—which would also create greater space for meeting pandemic-related needs in 2021 and minimize scarring; and (4) taking additional steps to build policy credibility, which would encourage capital inflows and support de-dollarization and a buildup of reserves.

Foreign Asset and Liability Position and Trajectory

Background. In 2020, Turkey's NIIP declined from –46 to –56.4 percent of GDP, driven entirely by foreign liabilities, which rose from 79 to 90 percent of GDP.[1] External debt increased from 57 to 63 percent of GDP, driven by lower US dollar GDP. Over 70 percent of external debt is held by the private sector, and about one-third is short term (on a remaining maturity basis). Debt is expected to remain sustainable over the medium term, but debt servicing remains vulnerable to global and domestic financial conditions.

Assessment. Turkey's NIIP has become more negative since the 2000s, with 2020 affected by one-off factors related to the pandemic. The size and composition of external liabilities, coupled with low reserves, increases Turkey's vulnerability to liquidity shocks, sudden shifts in investor sentiment, and a global upswing in interest rates. The FX exposure of nonfinancial companies, including short-term loans, is high, with the potential to affect bank asset quality. NIIP is projected to improve to about –45 percent of GDP in 2025, driven by a decline in liabilities, mainly loans.

2020 (% GDP)	NIIP: –56.4	Gross Assets: 33.6	Res. Assets: 13	Gross Liab.: 90.1	Debt Liab.: 62.8

Current Account

Background. After posting a surplus for the first time in nearly two decades in 2019, the CA registered a deficit of 5.1 percent of GDP in 2020, driven by weaker goods and services exports—including tourism—and robust imports. Credit-driven consumption and investment fueled imports, more than offsetting the lower oil import bill. Gold imports increased from 1½ percent 2019 to 3½ percent of GDP in 2020, driven by policy uncertainty, a weakening currency, and elevated inflation.

Assessment. The EBA CA model estimated norm is –1.5 percent of GDP (with a standard error of ±1.8 percent of GDP). The CA deficit of 5.1 percent of GDP narrows to 4.7 percent of GDP after cyclical adjustment. Adjusting for temporary pandemic-related shocks (1.6, –0.3, and –0.2 percent of GDP for travel services, including tourism, the global shift from services to tradable goods, and oil prices, respectively) and the surge in gold imports (1 percent of GDP) yields an IMF staff CA gap of –1.2 percent of GDP relative to the CA norm. One-off shocks and the range surrounding the norm increase the uncertainty around this assessment.

2020 (% GDP)	CA: –5.1	Cycl. Adj. CA: –4.7	EBA Norm: –1.5	EBA Gap: –3.3	COVID-19 Adj.: 1.1	Other Adj.: 1.0	Staff Gap: –1.2

Real Exchange Rate

Background. The average REER depreciated for a third consecutive year, with a depreciation of more than 10 percent in 2020. The nominal depreciation against the dollar in 2020 was 23.6 percent. As of end-May 2021, the REER had depreciated by 9.0 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of 4.9 percent in 2020 (applying an estimated elasticity of 0.24). The EBA REER level and index approaches suggest that the REER was undervalued in 2020 by about 31 to 35 percent. Considering the recent sharp depreciation of the REER, which is expected to support a rise in Turkey's CA balance toward its norm over the coming years, the IMF staff gives more weight to the EBA REER approaches as the CA continues to adjust. The IMF staff assesses the REER to have been undervalued by about 15–25 percent, with a midpoint of 20 percent and large uncertainties surrounding these estimates.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net capital inflows increased only modestly in 2020, from US$5.5 to US$8.2 billion. Errors and omissions remained negative, likely reflecting unrecorded capital outflows. The modest increase in net inflows was driven by other investment (notably the increased bilateral currency swap agreement with Qatar), which more than offset larger net portfolio outflows and lower net FDI. Turkey introduced limits on bank swaps and other derivative transactions with foreign counterparties as well as export surrender/repatriation requirements (both CFMs) in August 2018. These were being unwound when new bouts of volatility resurfaced in late 2019. Limits on bank swaps and other derivative transactions with foreign counterparties were thus reintroduced and tightened in December 2019 and February–April 2020. These were relaxed in November 2020.

Assessment. The quality of financing continued to worsen in 2020, with increased reliance on short-term financing and reserve drawdown. With annual gross external financing needs projected at about 24 percent of GDP on average in 2021–26 (29.4 percent of GDP in 2020), Turkey remains vulnerable to adverse shifts in global investor sentiment. Remaining CFMs should be phased out as conditions improve to increase market liquidity and support dedollarization.

FX Intervention and Reserves Level

Background. The de jure exchange rate is classified as free floating. The central bank undertook significant FX sales in 2020 to contain pressure on the lira. Gross reserves declined from US$105.7 billion at the end of 2019 to US$93.3 billion by the end of December. Net international reserves dropped by US$26.2 billion to US$14.5 billion by the end of 2020.[2] The composition of reserves has also changed, with an increasing share of gold and non-SDR-basket currencies.

Assessment. Gross reserves decreased from 84 to 74 percent of the IMF's ARA metric during 2020, falling further below the floor of the recommended 100–150 percent ARA adequacy range and covering only 54 percent of short-term external debt (at remaining maturity). Steady reserve accumulation over the medium term is needed given Turkey's large external liabilities, dependence on short-term and portfolio funding, and large domestic FX deposits.

Table 3.29. United Kingdom: Economy Assessment

Overall Assessment: *The external position in 2020 was weaker than the level implied by medium-term fundamentals and desirable policies.* The CA deficit remained high in 2020, reflecting unprecedented high public borrowing to combat economic fallout from the COVID-19 crisis, only partially offset by private saving. The uncertainty around this assessment is significant, reflecting pandemic-related factors, measurement issues, the evolving impact on growth and trade and capital flows of the new EU-UK Trade and Cooperation Agreement, and continuing EU-UK discussions on financial services.

Potential Policy Responses: Following efforts aimed at sustaining the recovery in the near term, policies that could support the external rebalancing and bring the current account balance closer to its norm include structural reforms to boost the United Kingdom's productivity and international competitiveness. This would entail supporting reallocation to fast-growing sectors by upgrading the skill base and ensuring appropriate access to financing for firms, as well as encouraging firm digitalization and innovation. These efforts are particularly important as access to the EU market becomes more restricted.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP declined to –30.3 percent of GDP in 2020 from –28.7 percent of GDP in 2019. Over the past five years, the NIIP has declined by 5 percentage points, reflecting a negative CA contribution (–19.5 percentage points), largely offset by the valuation effect.[1] The composition of assets roughly matches that of liabilities (about 87 percent of GDP in FDI, 137 percent of GDP in derivatives, and about 219 percent of GDP in other investment), although portfolio investment liabilities (177 percent of GDP) exceed assets in portfolio investments (139 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.[2] The IMF staff projects the NIIP to decline over the medium term, although the large and volatile valuation effects make these estimates particularly uncertain.

Assessment. 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).

2020 (% GDP)	NIIP: –30.3	Gross Assets: 587.6	Res. Assets: 6.6	Gross Liab.: 617.8	Debt Liab.: 345

Current Account

Background. The CA deficit widened to –3.5 percent of GDP in 2020 from –3.1 percent in 2019 and remained larger than its historical average. The wider CA deficits since the global financial crisis reflect mostly a weaker income balance, due in part to lower earnings on the United Kingdom's FDI abroad (especially in the euro area). A rise in the trade balance in 2020 reflects a larger decline in domestic demand than in trading partners. This was offset by a fall in the income balance. The worsening in the CA deficit in 2020 was due to a sharp fall in gross saving combined with a slightly smaller decline in investment (relative to GDP).

Assessment. The EBA CA model estimates a norm of –0.4 percent of GDP and a CA gap of –3.3 percent of GDP. However, the underlying CA is assessed to be understated due to measurement biases, including the impact of expected inflation differentials on the CA, estimated to be about 0.5 percent of GDP.[3] In addition, the decline in net imports of travel services including tourism during the pandemic (–0.3 percent of GDP), an increase in imports due to shifts in the composition of household consumption (0.3 percent of GDP), imports of medical goods (0.3 percent of GDP), and stockpiling before Brexit (0.1 percent of GDP) likely affected the CA temporarily but may not be adequately captured in the cyclical components of the CA.[4] Overall, the IMF staff assesses the CA gap in the range of –0.4 to –4.4 percent of GDP, with a midpoint of –2.4 percent of GDP. This range takes into account the uncertainty in the assessment related to the post-Brexit development in UK-EU trade flows and financial services and possible measurement issues.

2020 (% GDP)	CA: –3.5	Cycl. Adj. CA: –3.7	EBA Norm: –0.4	EBA Gap: –3.3	COVID-19 Adj.: 0.3	Other Adj.: 0.6	Staff Gap: –2.4

Real Exchange Rate

Background. The pound appreciated slightly in real effective terms in 2020 by about 0.2 percent relative to its average level in 2019 but has depreciated since mid-2016 by about 7 percent. This depreciation reflects an unwinding of past overvaluation as well as market expectations of more restricted access to the EU market under a post-Brexit trade arrangement. As of end-May 2021, the REER had appreciated by 4.1 percent compared to the 2020 average.

Assessment. The IMF staff CA gap implies a REER gap of 10.0 percent in 2020 (applying an estimated elasticity of 0.24). EBA REER level and index approaches suggest a gap of –3.8 and –12.2 percent, respectively, for 2020. Considering all estimates, the uncertainties around them, and broadly stable REER development in 2020, on average, the IMF staff assesses the REER to be overvalued between 0 and 15 percent, with a midpoint of 7.5 percent, similar to its value in last year's ESR.

Capital and Financial Accounts: Flows and Policy Measures

Background. 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 2020 by net other investments of 4.4 percent of GDP and net FDI inflows of 2 percent of GDP, while net financial derivatives and portfolio investments declined by 1.4 and 0.5 percent of GDP, respectively. 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.

Assessment. Large fluctuations in capital flows are inherent to 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 the change in the trade relationship with the European Union and shift of some financial services to the European Union.

FX Intervention and Reserves Level

Background. The pound has the status of a global reserve currency. The share of global reserves in sterling has not changed since 2015, at about 4.5 percent.

Assessment. Reserves held by the United Kingdom are typically low relative to standard metrics, and the currency is free floating.

Table 3.30. United States: Economy Assessment

Overall Assessment: *The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.* Larger private sector saving has largely offset the 2020 fiscal packages, resulting in a transitory modest deterioration of the CA balance. The deep economic contraction, and ongoing changes in fiscal, trade, and labor-market (including, for example, immigration) policies, add uncertainty to the assessment.

Potential Policy Responses: In the near term, given the unprecedented social and economic fallout from the pandemic, front-loaded fiscal support is needed to ease the burden on households and firms, and to support the economic recovery. Over the medium term, fiscal consolidation will be critical to place debt on a sustainable footing, support external rebalancing, and bring the current account balance closer to its norm. Consolidation should target a medium-term general government primary surplus of about 1 percent of GDP to put the debt-to-GDP ratio on a downward path. Structural policies to increase productivity, including of tradables sectors, such as upgrading infrastructure and enhancing schooling, training, and the mobility of workers, can further contribute to external rebalancing. Tariff barriers should be rolled back, and trade and investment disputes should be resolved in a manner that supports an open, stable, and transparent global trading system.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP, which averaged about –42.6 percent during 2015–18, decreased further from –51.6 percent of GDP in 2019 to –67.3 percent of GDP in 2020. Under the IMF staff baseline scenario, the NIIP is projected to remain broadly unchanged through the medium term as the CA balance reverts to its pre-COVID average.

Assessment. Financial stability risks could surface in the form of an unexpected decline in foreign demand for US fixed-income securities, which are a main component of the country's external liabilities. This risk, which could materialize, for example, due to a failure to reestablish fiscal sustainability, remains moderate given the dominant status of the US dollar as a reserve currency. About 60 percent of US assets are in the form of FDI and portfolio equity claims.

2020 (% GDP)	NIIP: –67.3	Gross Assets: 153.6	Res. Assets: 3.0	Gross Liab.: 220.9	Debt Liab.: 102.6

Current Account

Background. The US CA deficit increased from 2.2 percent of GDP in 2019 to 2.9 percent in 2020 (from 2.0 to 2.7 in cyclically adjusted terms) compared with a deficit of 2.2 percent of GDP in 2015. The evolution since 2015 is explained mostly by deterioration in the non-oil and income balances. In 2020 the trade balance declined slightly from 2019 (from –2.7 to –3.2 percent of GDP) mostly due to changes in the non-oil balance, while the income account declined slightly due to a weaker primary account balance. The large increase in the fiscal deficit (relative to other countries), mostly due to COVID-19, led to only a small increase in the CA deficit in 2020 due to the large increase in private savings. The CA deficit is expected to remain above 2 percent of GDP over the medium term.

Assessment. The EBA model estimates a cyclically adjusted CA balance of –2.7 percent of GDP and a cyclically adjusted CA norm of –0.5 percent of GDP. The norm increased from –0.7 percent GDP in 2019 due to an increase of 1.3 percent of GDP in the medium-term desirable cyclically adjusted general government fiscal balance. The EBA model CA gap is –2.2 percent of GDP for 2020, reflecting policy gaps (–1.2 percent of GDP, all of which corresponds to fiscal policy) and an unidentified residual (about –1.0 percent of GDP) that may reflect structural factors not included in the model. On balance, the IMF staff assesses the 2020 cyclically adjusted CA to be 1.6 percent of GDP lower than the level implied by medium-term fundamentals and desirable policies. This assessment includes an IMF staff adjustor of 0.5 percent of GDP to account for the effects of the COVID-19 crisis on the oil and travel services (including tourism) balances (0.1 percent of GDP each) as well as the shift in household consumption from services to consumer goods and medical goods (0.2 percent of GDP each).

2020 (% GDP)	CA: –2.9	Cycl. Adj. CA: –2.7	EBA Norm: –0.5	EBA Gap: –2.2	COVID-19 Adj.: 0.5	Other Adj.: 0.0	Staff Gap: –1.6

Real Exchange Rate

Background. After appreciating by 2.8 percent in 2019, the REER appreciated by 1.4 percent in 2020. Through the second quarter of 2020, the REER appreciated 4.3 percent in relation to the end of 2019. Despite depreciating in the second half of 2020 by 5.4 percent, as of the end of 2020 the REER was still about 14 percent higher than the average for 2015. As of end-May 2021, the REER had depreciated by 3.9 percent compared to the 2020 average.

Assessment. Indirect estimates of the REER (based on the IMF staff CA assessment) imply that the exchange rate was overvalued by 8.2 percent in 2020 (applying the estimated elasticity of –0.2). The EBA REER index model suggests an overvaluation of 8.3 percent, and the EBA REER level model suggests an overvaluation of 12.4 percent. Considering all the estimates and their uncertainties, the IMF staff assesses the 2020 average REER to be somewhat overvalued, in the 5.2–11.2 percent range, with a midpoint of 8.2 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account balance was about –3.7 percent of GDP in 2020 compared with –1.8 percent of GDP in 2019. An increase in net direct investment (0.5 percent GDP) was offset by decreases in net portfolio investments (0.8 percent GDP) and other net investments.

Assessment. 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.

FX Intervention and Reserves Level

Assessment. 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

Argentina

[1]To smooth the temporary effect of the sharp reductions in short-term debt and exports, and a collapse in the valuation of debt portfolio investments in the wake of the sovereign debt restructuring, the adjusted measure uses a four-year average.

Belgium

[1]Methodological and source data changes led to major revisions of the 2015–19 CA, distorting comparison with previous assessments.
[2]The error bands are based on the range for the CA gap (–2.8 to –0.8 percent), with a midpoint of –1.8 percent and an estimated semi-elasticity of the CA balance to the REER of 0.42.

Canada

[1]The statistical treatment of retained earnings on portfolio equity and inflation is estimated to generate a downward bias in the income balance of the CA on the order of 1.5 percent of GDP.
[2]EBA uses UN demographic projections. The COVID-19 decline in net immigration is considered transitory; immigration will continue to be one of the main sources of population growth in Canada. An EBA CA norm is lowered by 0.4 percentage point to account for this.
[3]The semi-elasticity of the CA with respect to the REER is set to 0.28.

Euro Area

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

France

[1]The range of the REER gap (±4 percent) is based on the range of the CA gap (±0.5 percent of GDP) and an estimated semi-elasticity of the CA balance to the REER of 0.27.

Germany

[1]For Germany, the bulk of the EBA-estimated gap for 2020 reflects the regression's residual, rather than gaps in the policy variables included in the EBA model.
[2]The EBA REER index model has an unusually poor fit for Germany.

Hong Kong SAR

[1]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 the use of EBA-estimated coefficients and their application to Hong Kong SAR. Following this approach, the CA norm in 2020 is estimated at about 14.8 percent of GDP, implying a CA gap of –9.0 percent, which is almost entirely explained by the model residuals. 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 3–5 percentage points, with a midpoint of 4 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, given that 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 4–4½ percentage points, with a midpoint of 4¼ 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 (1½ percentage points, with a midpoint of 1¼ percentage points), 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 the 2017 Hong Kong SAR Article IV Selected Issues Paper for more details.
[2]The range is calculated by applying the average semi-elasticities of Hong Kong SAR and similar economies.
[3]The financial linkages with mainland China have deepened in recent years with the increase in cross-border bank lending, capital market financing, and the internationalization of the renminbi. As of the end of 2020, banking system claims on mainland nonbank entities amounted to HK$6.4 trillion, or about 237 percent of GDP, up by about 22 percentage points from the end of 2019.

Indonesia

[1]The 2020 assessment includes an adjustment for travel services (including tourism) and oil sectors, as well as the global shift in the composition of household consumption from services toward consumer goods. For Indonesia, these adjustors are 0.3, –0.2, and –0.1 percentage point of GDP, respectively, leading to an estimated effect of 0 percentage point of GDP. 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 workforce exit age (this results in an adjustor of 0.9 percentage point).

[2]A range of ±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 1.4 percent).

[3]The semi-elasticity of the CA-to-GDP ratio with respect to the REER is estimated to be –0.17 for Indonesia.

[4]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 0.7 percent of GDP (that is, –3.9 percent). To obtain the width of the range for the REER gap, the standard ±5 percent interval was applied to the midpoint of –1 percent, leading to a range of –6 to 4 percent.

Malaysia

[1]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 CFM measures 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 measure. Over the course of 2017–19, additional measures were announced to help deepen the onshore financial market and facilitate currency risk management.

The Netherlands

[1]A sizable portion of the CA surplus reflects corporate saving of multinationals based in The Netherlands. Due to the volatility of such savings, the assessment of the EBA-estimated current account gap is particularly uncertain, justifying a wider-than-usual CA range.

Saudi Arabia

[1]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$67.4 a barrel in 2021 (US$43.5 a barrel in 2020). Oil export volumes are expected to decrease by 1.9 percent in 2021.

[2]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 6.5 percent of GDP (slightly higher than the CA norm of 6.3 percent of GDP in 2019). The Consumption Allocation Rules assume that the sustainability of the CA trajectory requires that the net present value of all future oil and financial/investment income (wealth) be equal to the net present value of imports of goods and services net of non-oil exports. Estimated CA norms from the Consumption Allocation Rules were –3.0 percent of GDP and 0.2 percent of GDP for the constant real annuity and constant real per capita annuity allocation rules, respectively. The Investment Needs Model takes into account the potential desirability of allocating part of the resource wealth to finance investment, which was not explicitly considered by the consumption-based model and produced a CA gap of –0.8 percent over the medium term. The CA gap in 2020 (–1.5 percent of GDP) represents the IMF staff's overall assessment, taking into account estimates from the three approaches.

Singapore

[1]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.

[2]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. One possibility, though with drawbacks, is to use EBA-estimated coefficients and apply them to Singapore. Following that approach the CA norm is estimated to be about 14.8 percent of GDP in 2020 (including the multilateral consistency adjustment). However, the EBA gap is understated for two reasons, and adjustments are needed. First, a downward adjustment of 1.4 percentage points is made to the EBA's implied contribution of public health care expenditures to the norm to account for the fact that Singapore's health care expenditure is appropriate, given its high efficiency—even though its desirable, as well as current, public health care expenditure is significantly lower than that of other EBA countries. Second, a downward adjustment of 2.5 percentage points to the norm is made to better account for the effect of different net foreign asset components on the CA. Adjusting for these factors, the IMF staff–estimated CA gap is about 4.2 percent of GDP, to which the fiscal policy gap contributes about 0.5 percent of GDP and public health care spending and the credit gap both contribute about –0.2 percent of GDP.

[3]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

[1]The South Africa–specific COVID-19 adjustors of –1.8 percent of GDP in total comprise the adjustments for travel services (including tourism) exports (0.6 percent of GDP), medical spending imports (0.2), the shift in household consumption composition from services toward consumer goods (–0.4), oil imports (–0.4), gold exports (–0.9), and an improved income balance (–0.9).

[2]Net current transfers related to the Southern African Customs Union, 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 by 0.7 percent of GDP. In addition, measurement issues pertaining to the income balance are likely to contribute to an underestimation of the CA by 0.7 percent of GDP.

[3]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 workforce exit age. This results in an adjustor of –1 percent of GDP to the model-based CA norm.

Spain

[1]Based on data available through the fourth quarter of 2020.

[2]The EBA model suggests a CA norm of 0.3 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 60 percent of gross liabilities in the form of debt. Given external stability considerations, including potentially adverse NIIP valuation effects, a CA norm in the range of 0.8 to 2.8 percent of GDP is necessary to raise the NIIP by at least roughly 3 percent of GDP annually over the next 10 years. Over 2004–19, valuation effects were, on average, 1½ percent of GDP a year. 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 0.8 to 2.8 percent of GDP would be feasible under current policies.

[3]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 0.28. The range of the REER gap is ±4 percent, which is obtained from Spain's estimated standard error of the CA norm (1 percent of GDP) and the aforementioned CA-to-REER semi-elasticity.

Switzerland

[1]In December 2020, the SNB published major revisions to the BOP/IIP data. There were two reasons for the revisions: (1) closing a data gap with regard to domiciliary companies; and (2) reflecting data newly available from reporting institutions. Changes under (2) included both information from a newly completed 2019 annual survey and corrections for previous reporting periods concerning companies with especially complex structures. The revisions due to (1) affected only the IIP data from 2008 to 2019; those due to (2) affected the entire BOP (current account, capital account, financial account) and the IIP for the period from 2014 to 2019. As a result, the net IIP showed an average decrease between 2008 and 2019 of CHF 128 billion (about 17 percent), and the current account surpluses for 2018 and 2019 decreased significantly, mostly due to adjustments in primary income expenses, while the 2014–17 balances changed less and in both directions.

[2]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.

[3]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.

[4]The underlying CA is adjusted for Switzerland-specific factors in the income account: (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) 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. In addition, the CA balance is also adjusted for transitory impacts of the COVID-19 pandemic on trade in goods and services, including adjustors for (1) tourism and travel services (an estimated 0.5 percentage point, including the impact on the decline in sales of luxury watches, reflecting the decline in international travel); (2) oil (–0.3 percentage point); (3) household consumption composition shift (–0.4 percentage point); (4) medical products (0.7 percentage point); and (5) precious metals (1.4 percentage points). Adjusting for these COVID-19–related effects, the underlying CA would need to be increased by about 1.9 percent of GDP (that is, resulting in a smaller negative gap).

[5]The CA gap range reflects the uncertainty inherent in the assessment.

[6]The country-specific CA-REER elasticity of 0.52 is relatively large due to the high openness of the Swiss economy.

Turkey

[1]A higher share of external assets relative to external liabilities is denominated in FX. Despite persistent CA deficits, the NIIP fluctuated with no clear trend during 2009–19, due to a mix of positive valuation effects and large net balance of payments errors and omissions.

[2]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

[1]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.
[2]Estimates in Bénétrix 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.
[3]Historically, unrecorded retained earnings on portfolio equity assets also contributed to the underestimation of the CA, but this was estimated at close to zero in 2020.
[4]The IMF staff assesses that part of such changes may be permanent and adjust the CA only partially. In addition, there is likely some overlap of various COVID-19–related adjustments.

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