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2018 EXTERNAL SECTOR REPORT—INDIVIDUAL ECONOMY ASSESSMENTS

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INDIVIDUAL ECONOMY ASSESSMENTS

A. The External Sector Assessments

The external sector assessments use a wide range of methods, including the External Balance Assessment (EBA) developed by the IMF's Research Department to estimate desired current account balances and real exchange rates (see IMF Working Paper WP/13/272 for a complete description of the EBA methodology and Annex I of the 2015 External Sector Report for a discussion of more recent refinements). This year, as is done periodically, the EBA models were refined to reflect insights gained since the last round of changes. Refinements aimed at better capturing the role that certain fundamentals (demographics, institutions and potential current account measurement biases), macroeconomic policies (foreign exchange intervention and credit excesses) and other structural features could play in driving current account dynamics. A full description of the refinements can be found in the 2018 ESR Technical Supplement.

In all cases, the overall assessment is based on the judgment of IMF staff drawing on the inputs provided by these model estimates and other analysis. Since estimates are subject to uncertainty, overall assessments are presented in ranges. The external sector assessments are based on data and IMF staff projections as of June 22, 2018.

The external assessments discuss a broad range of external indicators: the current account, the real effective exchange rate, capital and financial accounts flows and measures, foreign exchange (FX) and reserves, and the foreign asset or liability position.[1] The individual economy assessments are discussed with the respective authorities as a part of bilateral surveillance.

B. Selection of Economies Included in the Report

The 30 systemic economies analyzed in detail in this Report and included in the individual economy assessments are listed below. They were chosen on the basis of an equal weighting of each economy's global ranking in terms of purchasing power GDP, as used in the IMF's *World Economic Outlook*, and in terms of the level of nominal gross trade.

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

[1] 2018 real effective exchange rates (REERs) are estimated based on data available as of June 22, 2018.

C. Domestic and Foreign Policies and Imbalance Calculations: An Example

The thought experiment: A simplified example could help to clarify how policy distortions are analyzed in a multilateral setting and how the analysis can distinguish between domestic policy distortions where a country might need to take action to reduce its external imbalance and those that are generated abroad and where no action by the home country is needed (but where action by others would help reduce the external imbalance).

Take a stylized example of a two-country world.

Country A has a large current account deficit, a large fiscal deficit and high public debt.

Country B has a current account surplus (matching the deficit in Country A), but has no policy distortions.

External imbalances: 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 there is a domestic policy distortion in Country A that needs adjustment. However, the analysis for Country B would show that there were no domestic policy gaps—instead adjustment by Country A would automatically eliminate the imbalance in Country B.

Individual economy write-ups: While the estimates of the *overall external sector position*—, needed *current account adjustment* and associated *real exchange rate change*—would be equal and opposite given there are only two economies in the world, the *individual economy assessments* would clearly 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 of the *overall assessment* would focus on the need to rein in the *fiscal deficit* and *limit asset price excesses*. For Country B, however, if 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 to reduce the imbalance.

Implications: At the current juncture and going forward, it remains critical to distinguish between domestic and foreign fiscal policy gaps. The elimination of the fiscal policy gap in a systemic deficit country would help reduce surplus imbalances in other systemic economies.

Table 1. Summary of EBA and Staff-Assessed CA Gaps, 2017
(in percent of GDP)

Country	Overall Assessment	Actual CA [A]	Cycl Adj. CA [B]	EBA Norm [C]	EBA Gap 1/ [D=B-C]	Staff CA Gap 2/ [E]	Staff Adjustments [F=D-E] 3/ Total	Norm	Other	Staff CA Gap Range	Staff REER Gap	Staff REER Gap Range
Argentina	Weaker	-4.8	-5.0	-1.7	-3.3	-3.3	0.0	...	...	+/-1	25.0	+/-7.5
Australia	Broadly Consistent	-2.5	-2.4	-0.6	-1.9	-1.0	-0.9	-0.9	...	+/-0.5	8.5	+/-8.5
Belgium	Weaker	-0.2	-0.3	2.2	-2.5	-2.5	0.0	...	...	+/-1	6.0	+/-2.5
Brazil	Broadly Consistent	-0.5	-1.8	-2.4	0.7	0.2	0.5	0.5	...	+/-0.5	-2.0	+/-5
Canada	Moderately Weaker	-2.9	-2.4	2.2	-4.6	-1.9	-2.7	-0.4	-2.3	+/-1.5	7.0	+/-6
China	Moderately Stronger	1.4	1.4	-0.3	1.7	1.7	0.0	...	...	+/-1.5	-3.0	+/-10
Euro Area 4/	Moderately Stronger	3.5	3.4	1.5	1.9	1.3	0.6	0.4	0.2	+/-0.7	-4.0	+/-4
France	Moderately Weaker	-0.6	-0.6	0.9	-1.6	-1.6	0.0	...	...	+/-0.5	4.0	+/-4
Germany	Substantially Stronger	8.0	8.3	2.8	5.5	5.0	0.5	0.5	...	+/-1.25	-15.0	+/-5
India	Broadly Consistent	-1.9	-2.1	-3.0	0.9	0.4	0.5	0.5	...	+/-1	-1.0	+/-6
Indonesia	Broadly Consistent	-1.7	-1.6	-0.8	-0.8	0.1	-0.9	-0.9	...	+/-1.5	-1.1	+/-8.3
Italy	Broadly Consistent	2.8	2.1	2.5	-0.3	-0.3	0.0	...	...	+/-1	5.0	+/-5
Japan	Broadly Consistent	4.0	3.6	3.2	0.4	0.5	-0.1	...	-0.1	+/-1.3	-3.5	+/-9.5
Korea	Moderately Stronger	5.1	4.5	3.0	1.6	1.6	0.0	...	...	+/-1	-4.5	+/-2.75
Malaysia	Stronger	3.0	3.7	0.6	3.1	3.1	0.0	...	...	+/-1	-6.8	+/-2
Mexico	Broadly Consistent	-1.7	-1.4	-2.5	1.1	0.5	0.6	...	0.6	+/-1	-4.0	+/-8
Netherlands	Substantially Stronger	10.2	10.3	3.5	6.8	6.8	0.0	...	...	+/-2	-10.0	+/-3
Poland	Broadly Consistent	0.3	0.8	-1.7	2.4	1.0	1.4	...	1.4	+/-1	-2.5	+/-2.5
Russia	Moderately Weaker	2.3	3.2	3.8	-0.5	-1.3	0.7	0.7	...	+/-1.25	5.0	+/-5
South Africa	Moderately Weaker	-2.5	-2.5	0.7	-3.2	-1.3	-1.9	-1.1	-0.8	+/-1	5.0	+/-5
Spain	Moderately Weaker	1.9	1.5	1.4	0.1	-1.5	1.6	1.6	...	+/-1	6.5	+/-3.5
Sweden	Moderately Stronger	3.3	3.6	1.8	1.8	1.6	0.2	...	...	+/-1.5	-5.0	+/-5
Switzerland	Broadly Consistent	9.8	9.6	6.2	3.4	0.8	2.6	...	2.6	+/-2	-1.5	+/-3.8
Thailand	Substantially Stronger	10.6	10.1	0.5	9.6	6.0	3.6	...	3.6	+/-2	-10.5	+/-3.5
Turkey	Weaker	-5.6	-4.8	-0.9	-4.0	-2.2	-1.8	-1.0	-0.7	+/-1	0.0	+/-10
United Kingdom	Weaker	-4.1	-4.0	1.0	-5.0	-3.0	-2.0	...	-2.0	+/-2	7.5	+/-7.5
United States	Moderately Weaker	-2.4	-2.3	-0.7	-1.6	-1.5	-0.1	...	...	+/-0.5	12.0	+/-4
Hong Kong SAR	Broadly Consistent	4.3	3.3	...	...	0.0	...	...	...	+/-1.5	0.0	+/-5
Singapore	Substantially Stronger	18.8	18.9	...	...	5.5	...	...	...	+/-3	-10.0	+/-6
Saudi Arabia	Weaker	2.2	...	...	...	-2.0	...	...	...	+/-1	15.0	+/-5
Discrepancy 5/	...	...	...	...	...	**0.03**	...	...	...	...	...	...

Source: Fund staff estimates.
1/ Figures may not add up due to rounding effects.
2/ Refers to the mid-point of the CA Gap.
3/ Breakdown between norm and other factors (namely temporary or measurement errors) is approximate, and includes rounding in some cases.
4/ The EBA euro area current account norm is calculated as the GDP-weighted average of norms for the 11 largest Euro area economies, adjusted for reporting discrepancies in intra-area transactions (which were equivalent to 0.6 percent of GDP in 2017). The staff-assessed CA gap is calculated as the GDP-weighted average of staff-assessed gaps for the 11 largest Euro area economies.
5/ Weighted average sum of staff-assesed CA gaps.

D. Individual Economy Assessments—by Economy

<table>
<tr><th></th><th>Argentina</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Argentina has historically been a net debtor country. Following the government's debt default in the early 2000s, its net international investment position (NIIP) became that of a net creditor, reaching a peak in 2013. After the current and capital account restrictions began to be lifted in early 2016 and Argentina regained access to international capital markets, the net creditor NIIP fell as significant amounts of new external debt were issued. At end-2017, the NIIP stood at 3.5 percent of GDP, although there has been a re-composition of Argentina's external liabilities toward a greater reliance on portfolio liabilities and other investments, and less on foreign direct investment. Total external liabilities reached US$312 billion, of which US$231 billion (or about 75 percent) corresponded to portfolio and other investments. Also, about half of these total liabilities (US$163 billion) were of the general government and central bank.

Assessment. Projections of continued current account deficits imply Argentina's NIIP is likely to evolve to a net debtor position over the next few years. The IMF staff estimates a medium-term NIIP of -15 percent of GDP. The vulnerability in the composition of liabilities to capital flow reversals, with portfolio liabilities and other investments increasing their share in total liabilities from around 51 percent in 2012 to 75 percent in 2017, materialized in early 2018. External liabilities are expected to continue to grow because of a continued large public sector financing requirement (alongside limited domestic capital markets), access to international capital markets, and a recovery in FDI. This rise in external liabilities is expected to outpace the accumulation of external assets.</td><td rowspan="6">Overall Assessment:
The external position is weaker than implied by medium-term fundamentals and desirable policies.

The CA deficit widened in 2017, largely financed by portfolio inflows to finance the fiscal deficit. The growing CA imbalance and reliance on short-term domestic and external financing have laid the conditions for a currency and liquidity crisis in May 2018. This subsequently led to Argentina approaching the IMF for financial support.

Potential policy responses:
The stronger fiscal consolidation announced by the authorities for 2018-20 will help reduce the CA deficit. Together with a stronger framework for inflation targeting (which will lower nominal interest rates over the medium term) and a faster pace in the reduction of official imbalances should reduce upward pressures on the peso. Continued progress in implementing supply-side reforms would increase productivity and competitiveness, attract FDI, and reduce the real exchange rate overvaluation over time.</td></tr>
<tr><td>Current account</td><td>Background. Argentina's CA deficit has widened significantly in the past two years, largely because of the sharp widening in the trade deficit, including for both goods and services, and rising interest payments. The CA deficit reached 4.8 percent of GDP at end-2017, a level not registered since the early 2000s. The CA deficit is projected to start contracting to around 2 percent of GDP in the medium term (mainly from a fall in the fiscal deficit).

Assessment. Based on the CA model, Argentina's CA gap in 2017 was estimated at -3.3 percent, owing to a cyclically adjusted CA balance of -5.0 percent and a cyclically adjusted norm of -1.7 percent. Most of the policy gap is attributable to a looser-than-desired fiscal policy, which is partially offset by the positive contribution from FX intervention in 2017 to rebuild reserves. The large negative residual may reflect the remaining distortions in product and labor markets that hinder Argentina's international competitiveness. Staff estimates the cyclically adjusted CA deficit to be 2.3 to 4.3 percent of GDP larger than the level implied by medium-term fundamentals and desirable policies.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA | -4.8 | Cycl. Adj. CA | -5.0 | EBA CA Norm | -1.7 | EBA CA Gap | -3.3 | Staff Adj. | 0.0 | Staff CA Gap | -3.3</td></tr>
<tr><td>Real exchange rate</td><td>Background. The average REER remained broadly stable in 2017. Estimates through May 2018 show that the REER has depreciated by 22 percent relative to the 2017 average. The recent nominal depreciation partially offsets the cumulative real appreciation since mid-2016.

Assessment. Based on the estimates of the CA gap, staff assesses the average REER gap in 2017 to be between 17.5 and 32.5 percent above the level implied by medium-term fundamentals and desirable policies.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. The acceleration of the CA deficit over the last two years has been largely financed by portfolio inflows, mainly through an increase in government liabilities. Following the easing of balance of payments restrictions in 2016, capital account openness is now above its 2001 level (before most restrictions began to be imposed), implying greater room for capital mobility.

Assessment. The increasing reliance on short-term, volatile portfolio flows were creating growing risks to the external balance which materialized in early 2018. The expectation is, with consistent policy implementation, the CA deficit will fall, confidence will return, and these risks will lessen.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. Argentina moved to a free-floating exchange rate regime in 2016, as a component of its inflation targeting framework. However, the central bank (BCRA) has intervened in the FX spot market in modest amounts to smooth excess volatility. However, in April 2018 the BCRA began intervening significantly in 2018 (selling around USD 10.2 billion in the spot market between March 3 and May 15 and an accumulated USD 2.3 billion in the forward market (as of June 4). Reserves as of June 8 stood at USD 49.6 billion.

Assessment. Reserve coverage at end-May 2018 was around 76 percent of the ARA metric. Disbursements under the IMF program as well as more limited FX intervention are expected to lead to a steady rise in reserve coverage through time.</td></tr>
</table>

	Argentina (concluded)
Technical Background Notes	

	Australia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Australia has a large negative net international investment position (NIIP), reaching -55 percent of GDP at the end of 2017. Liabilities are largely denominated in Australian dollars, while assets are in foreign currency. Foreign liabilities are composed of around one quarter of FDI, one half of portfolio investment (principally banks borrowing abroad and foreign holdings of government bonds), and one quarter of other investment and derivatives. The NIIP improved in 2017 (by 3 percent of GDP relative to 2016), partly driven by a narrowing of the current account deficit and partly by strong nominal economic growth. The NIIP to GDP ratio is expected to remain around -55 percent of GDP over the medium term. **Assessment**. The NIIP level and trajectory are sustainable. The External Stability (ES) approach suggests that the NIIP would be stabilized at around current levels with a CA deficit between 2½-3 percent, which is larger than the cyclically adjusted CA deficit in 2017. The structure of Australia's external balance sheet reduces the vulnerability associated with its high negative NIIP. Since Australia's external liabilities are mainly in Australian dollars and there is a net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector has a net foreign currency liability position but it is fully hedged. The maturity of banks' external funding has improved since the global financial crisis, and even in a tail risk event where domestic banks suffer a major loss, the government's strong balance sheet position allows it to offer credible support.	**Overall Assessment**: *The external position of Australia in 2017 was assessed to be broadly consistent with medium term fundamentals and desirable policies, although the Australian dollar remains somewhat overvalued. The* CA deficit in 2017 narrowed to 2.3 percent of GDP, primarily reflecting stronger terms of trade, mainly because of higher coal and iron ore prices. The depreciation of the Australian dollar in real effective terms in 2013-15 has been partly reversed since September 2015, though it remains well below the peaks observed in 2011-13. The depreciation in 2014-15 had reduced much of the prior substantial overvaluation of the Australian dollar. **Potential policy responses**: The Australian dollar remains moderately overvalued, and if growth was on the weak side, or commodity prices fell again, further monetary accommodation would be warranted. The government's planned gradual, medium-term fiscal consolidation should help narrow the current account deficit by boosting national savings.
Current account	**Background**. Australia has run CA deficits for most of its history, reflecting a structural saving-investment imbalance with very high private investment relative to a private saving rate that is already high by advanced country standards. Since the early 1980s, deficits have averaged around 4 percent of GDP. The CA deficit in 2017 narrowed to 2.5 percent of GDP primarily reflecting stronger terms of trade, because of higher coal and iron ore prices in response to measures restricting domestic supply in China, and a ramp-up in new resource exports. Over the medium term, the CA deficit is expected at around 2.5 percent of GDP. This is lower than the historical average of around 4 percent, given the end of the prolonged import-intensive mining investment boom and a lower interest differential on Australian bonds relative to foreign bonds compared with longer-term averages. With over half of Australia's exports going to emerging Asia, a key risk is a sharper than expected slowdown in China resulting in a further sharp decline in commodities prices. **Assessment**. The EBA CA regression approach for 2017 estimates a CA norm of -0.6 percent of GDP, with a standard deviation of 0.5. Taking the relative output gaps and the cyclical component of the commodity terms of trade into account, the cyclically adjusted CA for 2017 is estimated to be -2.4 percent of GDP, indicating a CA gap of -1.9 percent of GDP. However, in staff's view, the CA norm of Australia is closer to -1.5 percent of GDP, reflecting traditionally large investment needs due to its size, low population density, and initial conditions. Therefore, the adjusted CA gap for Australia is assessed to be in the range of -0.5 to -1.5 percent of GDP.	
CA Assessment 2017	Actual CA: -2.5 | Cycl. Adj. CA: -2.4 | EBA CA Norm: -0.6 | EBA CA Gap: -1.9 | Staff Adj.: -0.9 | Staff CA Gap: -1.0	
Real exchange rate	**Background**. In 2017, Australia's REER appreciated by 2.7 percent relative to the 2016 average. As of December 2017, the REER was some 15 percent above its thirty-year average, consistent with the strengthening of the terms of trade in that period. Estimates through May 2018 show that the REER has depreciated by 4 percent relative to the 2017 average. **Assessment**. Considering estimates of the staff-assessed CA gap, the estimated REER gaps, and the gaps implied by the ES approach, staff assesses the REER to be 0 to 17 percent above the level implied by medium-term fundamentals and desirable policy settings. 1/ The recent appreciation of the exchange rate, accompanying an increase in the terms of trade, also suggests that the REER remains somewhat overvalued.	
Capital and financial accounts: flows and policy measures	**Background**. The mining investment boom has been funded predominantly offshore. Net FDI inflows into this sector have partially offset the reduced need for the banking sector to borrow abroad. As investment in new mining projects winds down, related demand for imports will decrease, buffering the impact on the overall balance of payments. Australia also received large inflows in recent years into bond markets. The weighted average maturity of government bonds is 6.6 years, and has lengthened over time, with 90 percent of the issue maturing by 2027. **Assessment**. Credible commitment to a floating exchange rate and a strong fiscal position limit the vulnerabilities.	
FX intervention and reserves level	**Background**. A free-floater since 1983. The central bank undertook brief but large intervention in 2007–08 when the market for Australian dollars became illiquid (bid-ask spreads widened) following banking sector disruptions in the United States. The authorities are strongly committed to a floating regime, which reduces the need for reserve holding. **Assessment**. Although domestic banks' external liabilities are sizable, they are either in local currency or hedged with little or no counterparty risks, so reserve needs for prudential reasons are also limited.	

	Australia (concluded)
Technical Background Notes	1/ The REER index and level models imply an overvaluation of 6 and 17 percent respectively, while the CA gap is consistent with an overvaluation of 5 percent (applying an estimated elasticity of 0.2), and the ES approach suggests the REER is broadly in line.

	Belgium	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) remains strong at 50 percent of GDP as of 2017Q3 compared with 49 percent a year earlier, reflecting the continued positive net financial wealth of households. Gross foreign assets were large at 488 percent of GDP, inflated by intra-group corporate treasury activities. Gross foreign assets of the banking sector stood at 88 percent of GDP, down considerably from the pre-crisis peak. External public debt was 65 percent of GDP as of 2017Q3, predominantly denominated in euros. **Assessment**. Belgium's large gross international asset and liability positions are inflated by the presence of corporate treasury units, without creating macro-relevant mismatches. The remaining risk exposures on the asset side mostly relate to financial sector claims. Risk exposures on the liability side are related to external public debt. Based on the projected current account and growth paths, the NIIP-to-GDP ratio is expected to decline gradually over the medium term. The strongly positive NIIP and its trajectory do not raise sustainability concerns.	**Overall Assessment**: *The external position in 2017 was weaker than medium-term fundamentals and desirable policy settings would imply*. Further reductions in the labor tax wedge, together with an expected improvement of the investment income balance, point toward a modest strengthening of the external position over the medium term. The strong net international investment position mitigates vulnerabilities associated with the high external public debt. **Potential policy responses**: Steady fiscal consolidation, reductions in labor taxes, and continued wage moderation would help make the external position fully consistent with fundamentals and policy settings. Productivity enhancing structural reforms (especially reforms to address the severe labor market fragmentation) would also be helpful.
Current account	**Background**. Since the global financial crisis, the current account has hovered around balance, averaging -0.3 percent of GDP over the period 2008–17. In 2017, the current account recorded a deficit of -0.2 percent of GDP. The stability in the current account balance masks significant movements in the trade and primary income balances. The goods balance moved into a surplus in 2015 for the first time since the crisis, whereas the primary income balance turned negative in 2015, driven by a decline in the investment income balance. The CA is projected to register a small surplus over the medium term, supported by an improving investment income balance as monetary conditions normalize. **Assessment**. The EBA model yields a CA gap of -2.5 percent of GDP for 2017, based on a cyclically adjusted CA balance of -0.3 percent (relative to an estimated norm of 2.2 percent). This is within the range estimated by staff for the CA gap of between -3½ to -1½ percent of GDP, which applies a standard range for the CA gap of +/- 1 percent of GDP.	
2017 CA Assessment	Actual CA: -0.2 | Cycl. Adj. CA: -0.3 | EBA CA Norm: 2.2 | EBA CA Gap: -2.5 | Staff Adj.: 0.0 | Staff CA Gap: -2.5	
Real exchange rate	**Background**. The REER (both ULC- and CPI-based) appreciated nearly 20 percent between 2000-08. Over the past decade the REER has been more volatile, with wage moderation contributing to an 8 percent depreciation of both the ULC- and CPI-based REER in 2014–15. The ULC-based REER was little changed in 2017 compared with 2016, while the CPI-based REER appreciated by 1.7 percent. Through May 2018, the CPI-based REER has appreciated by a further 1.2 percent relative to the 2017 average, whereas the ULC-based REER has depreciated by 1.9 percent. **Assessment**. The EBA model points to an REER overvaluation of between 6 and 14 percent, based on the CPI-based REER index and level models; the REER overvaluation resulting from the EBA CA gap model is somewhat lower. Staff's assessment is an REER overvaluation in the range of 3½ to 8½ percent, using an elasticity of 0.42.	
Capital and financial accounts: flows and policy measures	**Background**. Gross financial outflows and inflows were on an upward trend during the pre-crisis period as banks expanded their cross-border operations. Since the crisis, these flows have shrunk and become more volatile as banks have deleveraged. In 2017, net financial flows amounted to -0.1 percent of GDP. Short-term external debt accounted for 29 percent of gross external debt as of 2017Q3. 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 strong NIIP reduces the vulnerabilities associated with the high 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.	

	Belgium (concluded)
Technical Background Notes	

<table>
<tr><th></th><th colspan="12">Brazil</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="12">Background. Brazil's NIIP was -34 percent of GDP at end-2017, slightly weaker than the 2011-16 average (around -30 percent of GDP), mainly due to valuation effects. Over the medium term, the NIIP is projected to strengthen gradually to around -30 percent of GDP, as GDP growth and valuation effects are expected to offset current account deficits (around 1-2 percent). While FDI accounts for about half of all liabilities, the rise in external debt since the global financial crisis (to about 33 percent of GDP and 265 percent of exports) is a source of risk.
Assessment. Brazil's NIIP is comparable to that of its peers. Short-term gross external financing needs are moderate at 7-8 percent of GDP annually. The CA deficit required to stabilize the NIIP at -32 percent is 1.2 percent of GDP.</td><td rowspan="7">Overall Assessment:
Brazil's external position in 2017 was broadly consistent with medium-term fundamentals and desirable policies. The REER appreciated further in 2017 and returned to the level close to 2014 (before large external adjustment). The current account deficit will likely deteriorate in 2018 reflecting an improving cyclical position, including investment.

Potential policy responses:
Efforts to raise national savings are needed to provide room for a sustainable expansion in investment. Fiscal consolidation, including from the new federal spending cap and social security reform, should contribute to boosting net public savings. Structural efforts remain necessary to improve overall competitiveness.</td></tr>
<tr><td>Current account</td><td colspan="12">Background. The CA deficit narrowed to 0.5 percent of GDP in 2017, owing to the weak domestic demand, especially investment, and strong exports. The CA deficit is expected to widen in 2018 and rise gradually to about 2 percent of GDP in the medium term as private demand recovers, partially offset by the envisaged fiscal consolidation. However, a decline in the terms of trade and a sharp slowdown in trading partner growth remain a downside risk. 1/
Assessment. In 2017, the cyclically adjusted CA was -1.8 percent of GDP, reflecting a still large and negative output gap. EBA estimates suggest a CA norm in 2017 of -2.4 percent of GDP. However, taking into consideration the vulnerabilities associated with negative NIIP position and estimates from the EBA ES approach, staff assess a CA norm between -1.5 and -2.5 percent of GDP. Thus, the CA is assessed to have been broadly consistent with fundamentals and desirable policies.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>-0.5</td><td>Cycl. Adj. CA</td><td>-1.8</td><td>EBA CA Norm</td><td>-2.4</td><td>EBA CA Gap</td><td>0.7</td><td>Staff Adj.</td><td>0.5</td><td>Staff CA Gap</td><td>0.2</td></tr>
<tr><td>Real exchange rate</td><td colspan="12">Background. After the sharp depreciation in 2015-16, the REER (INS) appreciated by about 10 percent during 2017, reflecting improvements in terms of trade and a positive market response to the new government's reform agenda. Estimates through May 2018 show that the REER has depreciated by 11.4 percent relative to the 2017 average.
Assessment. EBA REER index and level methodologies indicate a 9 to 23 percent overvaluation for 2017. Consistent with the CA gap, staff assess the REER to be broadly in line with fundamentals and desirable policies. The estimated REER gap is between -7 and 3 percent.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="12">Background. Brazil continues to attract sizable capital flows. Net FDI continued to fully finance the CA deficit since 2015 (averaging 3.4 percent of GDP during 2015-17, while CA deficits averaged 1.7 percent.) Despite political uncertainty, net outflows of portfolio debt liabilities declined in 2017, after recording substantial outflows in 2016 (from 1.7 percent of GDP to 0.3 percent of GDP). Interest differentials, still large despite recent monetary easing, the big domestic market, and large external buffers should help to attract inflows. Still, rigidities in budget, banking sector, and labor and product markets, if not properly addressed, may weaken investors' interest.
Assessment. Flows have a favorable risk profile, but tighter global financial conditions, weak implementation of reforms, and political uncertainty remain downside risks to capital flows.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="12">Background. Brazil has a floating exchange rate. Its gross reserves remained broadly constant in 2017, at $374 billion at end-2017, equivalent to 18.2 percent of GDP and around 160 percent of the IMF's composite reserve adequacy metric.
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. The authorities should retain strong buffers, with intervention limited to addressing disorderly market conditions.</td></tr>
</table>

	Brazil (concluded)
Technical Background Notes	1/ Brazil currently features a near zero oil balance; in the short run, oil prices are neutral with respect to the CA. Also, the development of Brazil's offshore oil potential has been drastically cut back and is no longer projected to contribute significantly to export growth.

<table>
<tr><th></th><th colspan="12">Canada</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="12">Background. Canada's net international investment position (NIIP) rose from 10.3 percent of GDP in 2016 to 18.7 percent of GDP in 2017, reflecting significant valuation gains on external assets. At the same time, gross external debt remained broadly stable at 115 percent of GDP, of which about a third is short-term. The NIIP is projected to decline in the medium term, in line with sustained, albeit narrowing, current account (CA) deficits.
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.</td><td rowspan="6">Overall Assessment:
The external position in 2017 remained moderately weaker than 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. Recent developments do not suggest a change in the assessment of the external position for 2017.

In the medium term, the external position is expected to strengthen as non-energy exports gradually benefit from improved price competitiveness and investment in services and manufacturing capacity.

Potential policy responses:
Policies to boost Canada's non-energy exports include measures geared at improving labor productivity; investing in R&D and physical capital; promoting FDI; developing services exports; and diversifying Canada's export markets. The planned increase in public infrastructure investment should boost competitiveness and improve the external position over time. A credible medium-term consolidation plan for fiscal policy will also be necessary to support the external rebalancing. Maintaining tight macroprudential policies to ensure financial stability should also support private sector saving.</td></tr>
<tr><td>Current account</td><td colspan="12">Background. The CA deficit narrowed to 2.9 percent of GDP in 2017 (from 3.2 percent of GDP in 2016), driven by an improvement in the energy trade balance. The CA deficit has been largely financed by portfolio inflows, which have more than offset significant direct investment outflows. The overall change in the CA was underpinned by improvements in both public and private savings-investment balances, with both increasing by around 0.1 percent of GDP in 2017.
Assessment. The EBA estimates a CA norm of 2.2 percent of GDP, and a cyclically adjusted CA gap of -4.6 percent of GDP for 2017. This gap has widened significantly compared with last year, partly reflecting EBA methodological changes. The gap also partly reflects CA measurement issues. 1/ Staff also adjusted the CA gap to better reflect the authorities' demographic projections and current immigration targets, 2/ and a steeper-than-usual discount between Canadian oil prices and international prices. 3/ As such, staff estimates the CA norm to be about 1.8 percent of GDP, with the CA gap between -3.4 and -0.4 percent of GDP.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>-2.9</td><td>Cycl. Adj. CA</td><td>-2.4</td><td>EBA CA Norm</td><td>2.2</td><td>EBA CA Gap</td><td>-4.6</td><td>Staff Adj.</td><td>-2.7</td><td>Staff CA Gap</td><td>-1.9</td></tr>
<tr><td>Real exchange rate</td><td colspan="12">Background. The real effective exchange rate (REER) appreciated by around 1.5 percent on an annual average basis between 2016 and 2017. Estimates through May 2018 show that the REER has been unchanged relative to the 2017 average.
Assessment. The EBA REER index model points to an overvaluation of 2.2 percent in 2017, while the REER level model points to an undervaluation of around 6 percent. In staff's view, the REER level model could overstate the extent of undervaluation. 4/ Consistent with the assessed CA gap, staff estimates that the real effective exchange rate is overvalued by about 1 to 13 percent relative to medium-term fundamentals and desirable policies. 5/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="12">Background. The CA deficit in 2017 has been financed by net portfolio inflows (4.9 percent of GDP). Non-resident investors mostly purchased corporate debt securities (59 percent of portfolio net inflows). Foreign acquisition of Canadian equities and government debt securities stood at 10 and 31 percent, respectively. In 2017 foreign direct investment recorded a higher net outflow of 3.3 percent of GDP (2.4 percent of GDP in 2016).
Assessment. Canada has an open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate and, while the government is running fiscal deficits slightly less than 1 percent of GDP in the near term, there is strong and credible commitment to fiscal consolidation over the medium term.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="12">Background. Canada has a free-floating exchange rate regime, and has not intervened in the foreign exchange market since September 1998 (except for participating in internationally concerted interventions). Canada has limited reserves but its central bank has standing swap arrangements with the US Federal Reserve and four other major central banks (it has not drawn on these swap lines).
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 holding.</td></tr>
</table>

	Canada (concluded)
Technical Background Notes	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 current account of the order of 1.7 percent of GDP. 2/ EBA uses UN demographic projections. These differ from the authorities' projections due to methodological differences. The authorities' projections suggest slightly higher population growth and a slightly lower CA norm. The authorities' demographic projections also do not incorporate recent increases in immigration targets, which are assumed to be permanent. Together, these effects are assumed to reduce the EBA estimate of the CA norm by around 0.4 percent. 3/ The price discount between Canadian crude (WCS) and the West Texas benchmark has been $10 per barrel more than its historical average. This amounts to a temporary reduction in oil export prices by around 20 percent and suggests a higher underlying CA position (by around 0.6 percent of GDP). 4/ The approach includes commodity terms of trade rather than oil prices as an explanatory variable, while Canada's REER has mirrored movements in oil prices much more closely than its commodity terms of trade. 5/ The semi-elasticity of the CA with respect to the REER is estimated at 0.27.

	China	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) remains positive, but has declined to 15 percent of GDP by end-2017 after peaking at 33 percent of GDP in 2007. This deterioration is driven by a reduction in the current account (CA) surplus, valuation changes, and sustained high GDP growth. Gross foreign assets (58 percent of GDP by end-2017) are dominated by foreign reserves, while gross liabilities (43 percent of GDP) mainly reflect inward FDI. Reserve assets reached US$3.2 trillion by end-2017 (about 27 percent of 2017 GDP), which is about US$138 billion higher than in 2016. **Assessment**. The NIIP-to-GDP ratio is expected to remain strong, with a modest decline over the medium term, in line with projected CA surpluses. The NIIP is not a major source of risk at this point, as assets remain high—reflecting large foreign reserves—and liabilities are mostly FDI-related. Capital outflow pressures have subsided, partially supported by capital flow management measures (CFMs), and there are currently no substantial net outflow pressures. Nonetheless, these pressures may resurface and trigger a fall in reserves as the private sector seeks to accumulate foreign assets faster than non-residents accumulate Chinese assets.	**Overall Assessment**: *The external position in 2017 was moderately stronger compared with the level consistent with medium-term fundamentals and desirable policies.* This reflects the remaining distortions and policy gaps that affect the saving-investment balance, such as inadequate social spending. While the external position was moderately stronger, the renminbi in 2017 was broadly in line with fundamentals and desirable policies. The difference in assessment is due to the distortions affecting the savings-investment balance, which render the CA less sensitive to REER fluctuations. That said, it is important that China address those distortions and the resulting current account gap decisively—doing so would benefit both China and the global economy. **Potential Policy Responses**: External imbalances have declined considerably since the global financial crisis. Achieving a lasting balance in the external position will require continued progress in closing the remaining domestic policy gaps and addressing distortions. Success will move the economy to a more sustainable growth path, with higher consumption and lower overall saving. This can be achieved through successful implementation of the authorities' reform agenda as well as consistent macroeconomic policies. Priorities include improving the social safety net; SOE reform and opening markets to more competition; creating a more market-based and robust financial system; taking steps to attract more inward FDI, including by ensuring that foreign investors receive the same treatment as domestic investors; and achieving a flexible, market-based exchange rate with a better communication strategy. Continuing the move toward a more market-based and transparent monetary policy framework is a key element in ensuring an orderly transition to an effective float, which may also require use of foreign exchange reserves to smooth excessive volatility. China should seek a negotiated settlement to trade disputes that supports and strengthens the international trading system and the global economy.
Current account	**Background**. The CA surplus continued to decline, reaching 1.4 percent of GDP in 2017 (1.4 percent of GDP cyclically adjusted), about 0.4 percentage points lower than in 2016. This mainly reflects a shrinking trade balance (driven by high import volume growth), notwithstanding REER depreciation. Viewed from a longer perspective, the CA surplus declined substantially relative to the peak of about 10 percent of GDP in 2007, reflecting strong investment growth, REER appreciation, weak demand in major advanced economies, and, more recently, a widening of the services deficit. **Assessment**. The EBA estimate of the current account norm for 2017 was -0.3 percent of GDP and the EBA-estimated CA gap about 1.7 percent of GDP.1/ The remaining total gap is mostly accounted for by the residual, which reflects factors other than policy gaps identified in the EBA model, including distortions that encourage excessive savings. The contribution of identified policy gaps is, on net, largely mutually offsetting: loose fiscal policy and excessive credit growth contribute to narrowing the CA gap, but this is largely offset by inadequate health spending, capital flow management measures (CFMs), and reserves (which widen the CA gap). Overall, staff assesses the CA to be 0.2 to 3.2 percent of GDP stronger than implied by medium-term fundamentals and desirable policies.	
CA Assessment 2017	Actual CA 1.4 | Cycl. Adj. CA 1.4 | EBA CA Norm -0.3 | EBA CA Gap 1.7 | Staff Adj. 0.0 | Staff CA Gap 1.7	
Real exchange rate	**Background**. In 2017, the average REER depreciated by about 2.5 percent relative to 2016, driven by the depreciation in the NEER (2.2 percent). Estimates through May 2018 show that the REER has appreciated by 3.4 percent relative to the 2017 average. **Assessment**. The 2017 EBA REER index regression estimates China's REER to be 5.3 percent lower than levels warranted by fundamentals and desirable policies— compared with 2.7 percent higher in 2016.2/ However, this assessment is subject to large uncertainties related to the outlook and shifts in portfolio allocation preferences.3/ Overall, staff assesses the REER to be broadly consistent with fundamentals and desirable policies, with the gap being in the range of -13 to +7 percent. The exchange rate is assessed as being in line with fundamentals, amid a moderately stronger CA, due to the low elasticity of China's CA to changes in the REER (0.23). This largely reflects distortions that encourage excessive savings. These savings, along with potential future capital account liberalization and residents' search for diversification, may lead to the resumption of capital outflow pressures and a weaker exchange rate over the medium term.	
Capital and financial accounts: flows and policy measures	**Background**. Net capital outflows declined to US$82 billion in 2017, down from the record highs of US$647 billion in 2015 and US$646 billion in 2016. Net direct investment inflows turned positive in 2017, as FDI inflows remained stable while Overseas Direct Investment declined over 50 percent, reflecting a tightening of CFMs. Net portfolio and other investments also turned positive, but errors and omissions remained negative and persistently high (-1.8 percent of GDP) suggesting that unrecorded capital flows may have evaded the tightening of CFMs. China's capital account remains relatively closed in a *de jure* sense and the authorities have materially increased the enforcement of existing measures to help reduce outflow pressure. More recently, the authorities have loosened some CFMs (such as the reserve requirement on bank's offshore RMB deposits or on bank's FX derivatives positions, both set to zero) and tightened others (such as the limit on overseas RMB withdrawal by payment cards, which now applies on an individual basis and not per card) and have put in place a framework to regulate cross-border financing by financial and non-financial corporations to alter the volume and composition of capital flows. **Assessment**. Over the medium term, the sequence of capital control loosening that is consistent with exchange rate flexibility should carefully consider domestic financial stability. Specifically, the further opening of the capital account is likely to create substantially larger *two-way* gross flows. Hence, the associated balance sheet adjustments and the shifts in market sentiment call for prioritizing the shift to an effective float (while using FX intervention to smooth excessive FX volatility) and strengthening domestic financial stability prior to a substantial further liberalization of the capital account. Efforts should be stepped up to encourage inward FDI, which would generate positive growth spillovers and improve corporate governance standards.	
FX intervention and reserves level	**Background**. FX reserves rose by US$129 billion in 2017 after declining in 2015 and 2016 by US$513 billion and US$320 billion, respectively. Staff estimates suggest that this change mainly reflected valuation changes, return on reserves, and minor net FX purchases accompanying the unwinding of forward positions built in 2016; these estimates are subject to a margin of error which could include no intervention. **Assessment**. Reserves stood at 97 percent of the IMF's composite metric unadjusted for capital controls at end-2017 (down from 106 in 2016); relative to the metric adjusted for capital controls, reserves stood at 157 percent (down from 172 in 2016). The decline of the ratio is driven by higher broad money (M2) growth, external debt, and other liabilities which are driving up the metric. Given that the progress made in capital account liberalization over time was partly reversed by the recent capital account tightening measures, the capital account is considered partially open. Consequently, reserves would be considered adequate in the range indicated by the adjusted and unadjusted metrics. Overall, staff assesses the current level of reserves to be adequate. As the transition to greater flexibility advances, intervention should be limited to smooth excessive volatility.	

	China (concluded)
Technical Background Notes	1/ The current account norm for 2017 (-0.3 percent) is lower than in 2016 (0.2 percent) reflecting methodological changes to the EBA framework, including those to better capture institutional quality and demographic effects. For China, the refined institutional quality measure indicates a lower perception of institutional risk—which could discourage excess savings and encourage investment—as captured by the lower contribution of the corresponding coefficient to the fitted current account (0.8 percent in 2017 vs 2.7 percent in 2016). With changes in the contribution of other variables mostly operating in the opposite direction (including demographics), taken together the refinements in methodology result in an overall reduction of China's CA norm by 0.5 percent of GDP relative to 2016. 2/ The EBA REER Level model estimates a total REER gap of 8.0 percent, with identified policy gaps of -6.9 percent. However, the model fit of the EBA REER Level model is very poor for China. 3/ Shifting expectations about monetary and exchange rate policy, re-assessments of the government's reform agenda, or a desire by residents to diversify into foreign assets can trigger large changes in capital flows and exchange rate pressures, even in the absence of significant changes in fundamentals as captured by the EBA.

	Euro Area	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) of the euro area fell to about -18 percent of GDP by the end of 2008, but has since recovered, reaching around -1 percent by the end of 2017. The rise has been driven by stronger current account balances and modest nominal GDP growth. Growth in both gross foreign asset and liability positions remains low, but relatively steady after sharply slowing in 2008, coincident with the broader global slowdown in international financial flows. Gross foreign positions are now about 221 percent of GDP for assets and 222 percent of GDP for liabilities in 2017. However, net external liabilities remain high in some countries, including Spain and Portugal. **Assessment**. Projections of continued current account surpluses suggest that the NIIP-to-GDP ratio will improve further, at a moderate pace, with the euro area expected to soon become a net external creditor, absent large differences in valuation changes on gross external assets versus liabilities. The region's overall NIIP financing vulnerabilities appear low. Despite improved current accounts, large net external debtor countries still bear a greater risk of a sudden stop of gross inflows.	**Overall Assessment**: *The external position of the euro area in 2017 was moderately stronger than the level implied by medium-term fundamentals and desirable policies. In 2018, the current account surplus is projected to shrink modestly as the region's economic recovery continues.* Imbalances at the national level remain sizeable and progress in reducing them slowed (see individual euro area member country pages). Further adjustment is needed by net external creditors to strengthen domestic demand (reducing surpluses) and net external debtors to raise productivity and competitiveness (raising surpluses or lowering deficits). The euro area's external position may be affected by the UK's eventual exit from the EU and rising trade tensions. These will be assessed in the context of future ESR reports. **Potential policy responses**: Monetary policy should remain accommodative until inflation has durably converged to the ECB's medium-term price stability objective, facilitating relative price adjustments at the national level by enabling greater inflation differentials across monetary union members. Area-wide initiatives to make the currency union more resilient (e.g., banking union, capital markets union, fiscal capacity for macro stabilization) could also reinvigorate investment and reduce savings-investment imbalances at this juncture. At the country-level, efforts are needed to address imbalances, including policies to strengthen private sector balance sheets, structural reforms to enhance productivity and improve competitiveness, and a more growth-friendly composition of national fiscal policies. Countries with stronger-than-warranted external positions should expand investment and promote structural reforms to raise their potential and reduce their current accounts, while those with weaker external positions should continue consolidating to reduce their debt and increase their buffers, while undertaking competitiveness-enhancing reforms. In general, a more balanced policy mix with the implementation of priority institutional and structural reforms at the country level would help to reduce external imbalances, including within the euro area.
Current account	**Background**. The current account (CA) balance for the euro area in 2017 was at 3.5 percent of GDP (cyclically adjusted 3.4 percent), having increased steadily since 2011, when it was close to zero. Most euro area countries are now running current account surpluses (apart from Cyprus, France, Greece, Latvia and Slovakia). Import compression in the aftermath of the crisis and external competitiveness gains from price and wage adjustments have strengthened the current accounts of net external debtors, like Spain and Portugal. Some large creditor countries, such as Germany and the Netherlands, continued to accumulate sizable surpluses, reflecting strong corporate and household saving and weak investment. **Assessment**. The EBA model estimates a CA norm of 1.5 percent of GDP, against a cyclically adjusted CA of 3.4 percent of GDP. This implies a gap of 1.9 percent of GDP. Staff's analysis indicates a higher CA norm, consistent with the assessed external positions of euro area member countries. The higher norm considers the large net external liabilities positions in some countries (e.g. Spain) and reflects uncertainty over the demographic outlook and the impact of the recent large-scale immigration on national savings (e.g. Germany). Considering the uncertainties in the estimates, staff assess the CA gap to be 1.3 percent, with a range of 0.6 to 2 percent of GDP for 2017. This leaves the underlying CA moderately stronger than the level implied by medium-term fundamentals and desirable policies. 1/ 2/	
CA Assessment 2017	Actual CA 3.5 | Cycl. Adj. CA 3.4 | EBA CA Norm 1.5 | EBA CA Gap 1.9 | Staff Adj. 0.6 | Staff CA Gap 1.3	
Real exchange rate	**Background**. The CPI-based real effective exchange rate appreciated by about 1.6 percent from 2016 to 2017, mostly reflecting the gradual strengthening of the euro area's recovery. Weaker inflation in the euro area relative to its trading partners accounts for a real appreciation lower than the nominal appreciation of about 2.1 percent. Estimates through May 2018 show that the REER has appreciated by 2.2 percent relative to the 2017 average. **Assessment**. The EBA index REER model points to an overvaluation of about 2.2 percent in 2017, while the level REER model suggests an undervaluation of about 2.9 percent. On balance, staff assesses the euro area 2017 average real exchange rate gap of -8 to 0 percent, consistent with assessed exchange rates of euro area member countries. As with the CA, the aggregate masks a large degree of heterogeneity in REER gaps across euro area member states, ranging from an undervaluation of 10-20 percent in Germany to overvaluations of 0–10 percent in several small to mid-sized euro area member states. The large differences in REER gaps within the euro area highlight the continuing need for net debtor countries to improve their external competitiveness and for net creditor countries to boost domestic demand.	
Capital and financial accounts: flows and policy measures	**Background**. Mirroring the 2017 CA surplus, the euro area experienced net capital outflows, largely driven by portfolio debt and FDI outflows. These were somewhat tempered by inflows into portfolio equity and loans and other bank-related instruments. The geography of gross capital inflows shifted with the global financial and sovereign debt crises, with inflows from the core euro area economies into the rest of the euro area diminishing. **Assessment**. Capital outflows in portfolio debt and inflows into portfolio equity over the past couple years likely arose in large part from the ECB's monetary accommodation through its asset purchase program, which has lowered yields on debt and spurred interest in equity.	
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.	

	Euro Area (concluded)
Technical Background Notes	1/ The IMF EBA analysis for the euro area covers 11 euro area members, which are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, and Spain. The assessments of CA and REER gaps for the euro area are derived from GDP-weighted averages of the assessments of the individual countries listed above. 2/ When applying GDP-weighted aggregation for the euro area, the actual CA and the CA norm are corrected for reporting discrepancies in intra-area transactions, as the CA of the entire euro area is about 0.56 percent of GDP in 2017 less than the sum of the individual 11 countries' CA balances.

<table>
<tr><th></th><th colspan="12">France</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="12">Background. After averaging near balance in 2000-05, the net international investment position (NIIP) deteriorated during the global financial crisis, and has remained below -13 percent of GDP since 2013, reaching a low of -20 percent of GDP in 2017, largely driven by increases in public sector external debt and by banks' net external liabilities. The moderately negative net position masks large gross positions, particularly for financial (bank and non-bank) institutions, reflecting their global activities. Specifically, the gross asset position has been rising and stood at 289 percent of GDP in 2017, of which banks' non-FDI related assets account for about a third, and other non-bank financial institutions close to another third. More than three-quarters of French bank's foreign assets are in advanced economies (40 percent in other eurozone economies) and 7 percent in large emerging markets. Gross liabilities have also increased, and stood at 309 percent of GDP in 2017, of which external debt is estimated at 194 percent of GDP (of this, the public-sector accounts for 55 percent of GDP, and banks for 87 percent of GDP). Target 2 balances were at -€9.4 billion (-0.4 percent of GDP) at end-2017.

Assessment. The NIIP is negative but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities due to external public debt and banks' financing on the liability side, given significant bank debt maturing in 2018 (€60 billion, or 2.6 percent of GDP) and sizable financial derivatives (about 30 percent of GDP).</td><td rowspan="6">Overall Assessment:
The external position in 2017 was moderately weaker than that implied by medium-term fundamentals and desirable policy settings. Recent measures to improve competitiveness, including labor tax wedge cuts, CIT tax cuts, and labor and product market reforms are expected to strengthen the external position over the medium term.

Potential policy responses:
Steady fiscal consolidation and steadfast implementation of planned structural reforms (e.g., apprenticeship and vocational training reforms, as well as other product and service market reforms) would help improve competitiveness, reduce external imbalances, and support long-run growth.</td></tr>
<tr><td>Current account</td><td colspan="12">Background. The current account (CA) fell from around balance before the global financial crisis to a deficit of 0.6 percent of GDP in 2017. The CA deficit reflects a persistent trade deficit (of around 1 percent of GDP, on average, since 2012), which has outweighed a positive (but declining) income balance. Over the last year, the CA balance improved by 0.2 percent of GDP on the account of a strong service export growth.

Assessment. The 2017 cyclically adjusted CA deficit is estimated at 0.6 percent of GDP, compared with an EBA-estimated norm of a surplus of 0.9 percent. On this basis, staff assesses that the CA gap in 2017 was between -2 to -1 percent of GDP. The CA gap is projected to narrow further over the medium run, as recent and planned structural and fiscal reforms are expected to help reduce the trade and fiscal deficits.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>-0.6</td><td>Cycl. Adj. CA</td><td>-0.6</td><td>EBA CA Norm</td><td>0.9</td><td>EBA CA Gap</td><td>-1.6</td><td>Staff Adj.</td><td>0.0</td><td>Staff CA Gap</td><td>-1.6</td></tr>
<tr><td>Real exchange rate</td><td colspan="12">Background. The ULC-based REER for the whole economy (based on a broad set of trading partners) appreciated by around 3-11 percent since the late 1990s. As a result, France has lost about a third of its export market share in the 2000s, and has not been able to regain it since. These developments suggest that France has lost competitiveness, notwithstanding relatively stable CPI-based REER indices over this period. Both the ULC-based REER and CPI-based REER indicators appreciated by around 0.3-0.9 percent during 2017, and an additional 1.3-2.9 percent through May 2018 (relative to the 2017 average).

Assessment. The CPI-based index and level REER EBA models do not point to REER overvaluation (the REER gap ranges between -2.2 to 4.1 percent), while The EBA CA gap model points to an overvaluation of around 4-8 percent (given an elasticity of 0.25 percent). Staff's assessment, which is based on estimates of the EBA CA model but also other approaches, is an REER overvaluation in the range of 0 to 8 percent.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="12">Background. The CA deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Financial derivative flows have grown sizably both on the asset and the liability side since 2008. The capital account is open.

Assessment. France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sector.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="12">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.</td></tr>
</table>

	France (concluded)
Technical Background Notes	

<table>
<tr><th></th><th colspan="10">Germany</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="10">Background. Germany's positive net international investment position (NIIP) reached 60 percent of GDP at end-2017; about twice the 2012 level. The net rise in foreign assets over this period has however fallen short of the accumulation of current account (CA) surpluses. The NIIP of financial corporations other than MFIs is large and positive (57 percent of GDP), while that of the general government is large and negative (25 percent of GDP), partly reflecting Germany's safe haven status. The NIIP is expected to reach near 85 percent of German GDP and 4 percent of world GDP by 2022, as the projected CA surplus remains sizable 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 been on an upward trend since 2015 and surpassed €956 billion in May 2018 (28 percent of GDP), after declining between 2012 and 2014.
Assessment. With the implementation of quantitative easing measures by the ECB, Germany's exposure to the Eurosystem has continued to widen.</td><td rowspan="6">Overall Assessment:
Germany's external position in 2017 remained substantially stronger than implied by medium-term fundamentals and desirable policy settings. Staff projects a modest narrowing in the medium run, supported by a gradual realignment of price competitiveness, and continued strong 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 realign price competitiveness within the monetary union. The projected adjustment is, however, partial, and additional policy actions will be necessary to make further progress on external rebalancing.

Potential policy responses:
A more growth-oriented fiscal policy, making use of fiscal space to stimulate potential growth, structural reforms to foster entrepreneurship, as well as pension reforms prolonging working lives would reduce savings, stimulate investment, and reduce external imbalances.</td></tr>
<tr><td>Current account</td><td colspan="10">Background. The CA surplus has been widening since 2001. It averaged 7.9 percent of GDP over the last five years, peaking at 8.9 percent of GDP in 2015. In 2017 it was 8 percent of GDP. Net exports fell for the first time in 6 years, reflecting a deterioration in the terms of trade. However, the CA balance with the rest of euro area continued to rise. The bulk of the CA surplus reflects large saving-investment surpluses of non-financial corporations (NFCs) and households, with rising savings of NFCs and fiscal consolidation accounting for the upward trend.
Assessment. The cyclically adjusted CA balance reached 8.3 percent of GDP in 2017, slightly below the 2016 level and 3¾ -6¼ percentage points stronger than the value implied by fundamentals and desirable policies. Staff assesses the CA norm at 2- 4½ percent of GDP, with a midpoint ½ percent of GDP above the CA norm implied by the new EBA model of 2¾ percent. Such upward adjustment reflects uncertainty over the demographic outlook and the impact of the recent large-scale immigration on national savings. 1/ 2/</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>8.0</td><td>Cycl. Adj. CA</td><td>8.3</td><td>EBA CA Norm</td><td>2.8</td><td>EBA CA Gap</td><td>5.5</td><td>Staff Adj.</td><td>0.5</td></tr>
<tr><td></td><td colspan="10">Staff CA Gap 5.0</td></tr>
<tr><td>Real exchange rate</td><td colspan="10">Background. The yearly average CPI-based and ULC-based real effective exchange rates (REER) appreciated 1½ and ½ percent in 2017, respectively, reflecting the nominal appreciation of the euro against the currencies of key trading partners – most notably the British pound and the yen, but also the US dollar, yuan, and Swiss franc – and the relative pick-up in inflation and labor costs. Estimates through May 2018 show that the REER has appreciated by 1.3 percent relative to the 2017 average.
Assessment. Staff's assessment for 2017 is of a REER undervaluation of 10–20 percent. The refined EBA REER Level model yields an undervaluation of 19 percent. The undervaluation implied by the CA gap assessment using standard trade elasticities is 15–30 percent. 3/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="10">Background. In 2017, net portfolio flows constituted almost ¾ of the capital and financial accounts balance, with direct investment being the second largest item (1/6 of total). On a regional basis, over ⅔ of the net outflows were toward European countries and 10 percent toward the Americas (mostly the US). 80 percent of net inflows in 2017 originated from the EU, while net investment by emerging countries has picked up considerably, representing about 40 percent of total. Net direct foreign investment inflows and outflows recovered to historical highs, after a drop in 2016, coming/going mostly from/to euro area countries.
Assessment. Safe haven status and the strength of Germany's current external position limit risks.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="10">Background. The euro has the status of global reserve currency.
Assessment. Reserves held by euro area countries are typically low relative to standard metrics. The currency is freely floating.</td><td></td></tr>
</table>

	Germany (concluded)
Technical Background Notes	1/ Demographic factors have a lower contribution to the EBA CA norm than previously estimated (¾ percentage points of GDP, instead of the previously estimated 3 percentage points of GDP), due to demographic projection updates and model refinements. Moreover, for Germany, nearly all of the EBA-estimated gap for 2017 reflects the regression’s residual rather than gaps in the policies variables included in the EBA model. 2/ The estimated norm reflects changes in the credit gap estimates to better reflect the German financial cycle. Staff assesses the credit-to-GDP to be currently lower than its long-term equilibrium, and that gradually closing of such gap will help support investment over the medium term. 3/ The EBA REER Index model implies that the REER is close to equilibrium. However, the EBA REER Index model has an unusually poor fit for Germany.

	Hong Kong SAR	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) reached around 409 percent of GDP as of end-2017, up from 275 percent in 2012. Gross assets (about 1,605 percent of GDP) and liabilities (about 1,196 percent of GDP) are high, reflecting Hong Kong SAR's status as a major international financial center. Valuation changes have been sizable and positive, as the change in NIIP in the past 5 years was over 200 percent of 2017 GDP compared with cumulated financial account balances of only 20 percent of 2017 GDP in the same period. On the other hand, income accrued to the large NIIP has been modest, due to relatively low yields on assets and, even more importantly, substantially higher payments on liabilities. **Assessment**. Vulnerabilities are low given the size of NIIP and its favorable composition, with large and stable stock of reserve assets as a share of total assets, and direct investment accounting for a large and rising share of total assets and liabilities (37.6 and 52.6, respectively in 2016).	**Overall Assessment**: *The external position in 2017 was broadly consistent with medium-term fundamentals and desirable policy settings.* Developments through March 2018 do not suggest a change in this assessment. The current account surplus has declined relative to its pre-2010 level on account of structural factors, including opening of the mainland capital account and changes in offshore merchandise trade activities. As a result of Hong Kong SAR's Linked Exchange Rate System (LERS), short-term movements in the REER largely reflect US dollar developments. Hong Kong SAR's flexible goods, factor, and asset markets continue to support the LERS. 3/ **Potential policy responses**: Macroeconomic policies are broadly appropriate. Maintaining policies that support wage and price flexibility is crucial particularly as the tightening cycle of US monetary policy continues. 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 medium-term fundamentals.
Current account	**Background**. The current account (CA) surplus increased marginally to 4.3 percent of GDP in 2017 from 4.0 percent in 2016, although it continues to be substantially lower than the pre-global financial crisis average (around 10 percent in 2000-08). From a sectoral perspective, the gradual decline of private saving (from the peak of 34.4 percent of GDP in 2006 to 24.6 percent of GDP in 2017), driven by robust consumption growth, tight labor market, and wealth effects related to strength in the housing market, accounted for most of the drop in the CA surplus. The CA surplus is projected to be 3.1 percent of GDP in 2018. **Assessment**. The CA is broadly consistent with medium-term fundamentals and desirable policies. Staff's quantitative assessment finds that the cyclically adjusted CA at 3.3 percent is roughly in the mid-point of the CA norm range of 1.8 to 4.8 percent of GDP. The CA gap range is hence -1½ to 1½ percent of GDP. Given the large valuation effects in the NIIP and the resulting discrepancies between stocks and flows, the CA needs to be adjusted for measurement issues.1/	
CA Assessment 2017	Actual CA: 4.3 | Cycl. Adj. CA: 3.3 | EBA CA Norm: -- | EBA CA Gap: -- | Staff Adj.: -- | Staff CA Gap: 0.0	
Real exchange rate	**Background**. The REER was essentially unchanged in 2017 (0.3 percent below the average REER in 2016). REER dynamics are largely determined by the HKD/USD peg and the subdued inflation in Hong Kong SAR. The HKD has depreciated by 4.0 percent in real effective terms through May 2018 compared with the 2017 average and the weak side of the convertibility undertaking was triggered in April and May prompting the HKMA to sell USD in the market. **Assessment**. The real exchange rate is broadly consistent with medium-term fundamentals and desirable policies. Based on elasticity estimates for similar economies and factoring in the uncertainties and variability of an offshore trading and financial center, the REER gap is assessed by staff to be between -5 to +5.	
Capital and financial accounts: flows and policy measures	**Background**. As a financial center, Hong Kong SAR has an open capital account. Non-reserve financial flows moved from sizable net outflows in 2016 back to inflows in 2017. The financial account is typically very volatile both in terms of portfolio and direct investment. These large movements are likely associated with both financial volatility in the mainland, transmitted through growing cross-border financial linkages 2/ as well as shifting expectations of a US policy rate hike and related arbitraging in the FX and rates markets. **Assessment**. Large financial resources and proactive financial supervision and regulation limit the risks from potentially volatile capital flows, as do deep and liquid markets. The greater financial exposure to mainland China could pose risks to the banking sector if mainland growth slows sharply and financial stress emerges in some key sectors, such as export-oriented manufacturing or real estate. However, given the high origination and underwriting standards that Hong Kong SAR banks have maintained, the credit risk appears manageable.	
FX intervention and reserves level	**Background**. Hong Kong SAR has a currency board arrangement. International reserves have been built up as the HKD was often pushed to the strong side of its trading range, particularly following the global financial crisis. The stock of reserves in end-2017 was equivalent to around 120 percent of GDP, unchanged from end-2016 and in line with its level in end-2012, and has since grown 2.1 percent (by March 2018). In April and May of 2018, the HKD hit the lower range of the convertibility undertaking of 7.85 a few times, prompting the HKMA to sell USD in the market under the normal functioning of the LERS. As liquidity is drained from the system, short-term HKD money market interest rates will continue to rise gradually closing the gap with the LIBOR and reducing HKD depreciation pressures. **Assessment**. Currently, reserves are adequate for precautionary purposes and should continue to evolve in line with the automatic adjustment inherent in the currency board system. Hong Kong SAR also holds significant fiscal reserves built up through a track record of strong fiscal discipline.	

	Hong Kong SAR (concluded)
Technical Background Notes	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 to use EBA estimated coefficients and applying them to Hong Kong SAR. Following that approach, the CA norm is estimated to be about 13.8 percent of GDP. The implied CA gap of -10.6 is almost entirely due to EBA regression residuals, with the policy gap accounting for only -0.2 percentage points. The large residual reflects a combination of factors chiefly related to measurement issues that are relevant for Hong Kong SAR but not captured by EBA. First, an adjustment of 4-6 percentage points is made to EBA's implied contribution of the NIIP position. The NIIP variable in EBA captures average income effects across countries. In fact, Hong Kong SAR's NIIP has been driven by valuation effects (see box on foreign assets and liabilities), and thus it has had a systematically lower income balance relative to its NIIP compared with other economies. Second, the opening of the Precious Metals Depository has resulted in a decline of 4-4½ 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, the decline in logistics and trading activities in Hong Kong SAR in response to mainland China's increased onshoring accounts for a decline of 1-1½ percentage points in the CA. While leading to lower income, the loss of activity 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 HKSAR's own economy rebalances in response to changes in mainland demand. Adjusting for these factors, staff estimates that the CA gap is close to zero. See SIP in the 2016 Article IV staff report for more details. 2/ The financial linkages with the mainland have deepened in recent years with the increase in cross-border bank lending, securities issuance in Hong Kong SAR by mainland entities and the internationalization of the RMB. As of 2017Q4, banking system claims, including those of foreign banks, on mainland nonbank entities amounted to HK$5.5 trillion, or about 207 percent of GDP, up by 15 percentage points from a year earlier. 3/ See SIP in the 2016 Article IV staff report and IMF WP17/09.

<table>
<tr><th></th><th>India</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. India's net international investment position (NIIP) has improved slightly since 2014, going from -18.1 percent of GDP at the end of FY2014/15 to -17.3 percent of GDP as of end-2017. Gross foreign assets and liabilities were 24 and 42 percent of GDP, respectively, at end-2017. The modest level of foreign liabilities reflects India's gradual approach to capital account liberalization, which has focused mostly on FDI. The bulk of assets are in the form of official reserves and FDI, while liabilities include mostly FDI and portfolio equity.
Assessment. With CA deficits of about 2½ percent of GDP projected for the medium term, the NIIP-to-GDP ratio is expected to slightly deteriorate. India's external debt, at about 20 percent of GDP, is moderate, compared with other emerging market economies. 48 percent of the external debt is denominated in US dollars and another 37 percent is dominated in Indian rupees. The debt maturity profile is favorable, as long-term external debt accounts for about 81 percent of the total, and the ratio of short-term external debt to foreign exchange (FX) reserves is low.</td><td rowspan="6">Overall Assessment:
The external sector position in 2017/18 is broadly consistent with fundamentals and desirable policy settings. India's low per capita income, favorable growth prospects, demographic trends, and development needs justify running CA deficits. External vulnerabilities remain, although they have been reduced since 2013. India's economic risks stem from more volatile global financial conditions, oil price volatility, and a retreat from cross-border integration. Progress has been made on FDI liberalization, while portfolio flows remain controlled. India's trade barriers remain significant.
Potential policy responses:
An increase in non-debt creating capital flows through FDI will help improve the CA financing mix and contain external vulnerabilities. Gradual liberalization of the portfolio flows should be considered, while monitoring risks of portfolio flows' reversals. Exchange rate flexibility should remain the main shock absorber, with intervention limited to addressing disorderly market conditions. Continued vigilance is needed, given potential external shocks. Going forward, further structural reform efforts to revamp the business climate, ease domestic supply bottlenecks, and facilitate trade and investment liberalization are essential to improve competitiveness and investment prospects, attract FDI, and boost exports.</td></tr>
<tr><td>Current account</td><td>Background. The current account (CA) deficit is estimated to have increased to about 1.9 percent of GDP in FY2017/18 from 0.7 percent of GDP in the previous year. Reflecting a recovery in commodity (especially oil) prices, imports surged by 19 percent in FY2017/18, following a slight decline in the previous year. Export growth also picked up to 10 percent in FY2017/18, from 5 percent in FY2016/17, in line with the global growth recovery. Over the medium term, the CA deficit is expected to increase to about 2½ percent of GDP, on the back of strengthening domestic demand.
Assessment. The EBA cyclically adjusted CA deficit stood at 2.1 percent of GDP in FY2017/18. The EBA CA regression estimates a norm of -3.0 percent of GDP for India in FY2017/18, with a standard deviation of 0.5 percent, thus implying an EBA gap of 0.9 percent. As discussed in previous External Sector Reports and Article IV IMF staff reports, in Staff's judgment, a CA deficit of about 2.5 percent of GDP is a more appropriate norm and consistent with the ES approach. Based on India's historical cash flows and restrictions on capital inflows, global financial markets cannot be counted on to reliably finance a CA deficit above 3 percent of GDP. While FDI flows have increased in recent years, they are not sufficient to cover CA deficits for this and outer years. Portfolio flows are highly volatile and susceptible to changes in the global risk appetite as demonstrated in the taper tantrum episode. Thus, based on the staff-assessed CA norm, the CA gap is in the range of -0.6 to +1.4 percent of GDP. Positive policy contributions to the CA gap from a negative credit gap, larger-than-desirable intervention in the FX market, and a relatively closed capital account are offset by a negative unexplained residual, which likely captures underlying competitiveness problems.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA | -1.9 | Cycl. Adj. CA | -2.1 | EBA CA Norm | -3.0 | EBA CA Gap | 0.9 | Staff Adj. | 0.5 | Staff CA Gap | 0.4</td></tr>
<tr><td>Real exchange rate</td><td>Background. The average REER in 2017 appreciated by about 4.1 percent over its 2016 average. As of May2018, the REER depreciated 3.6 percent relative to its 2017 average.
Assessment. The EBA Index REER and Level REER regression approaches estimate a gap of 10.9 and 8.8 percent for the 2017 average REER, respectively. However, these approaches have large estimation errors for India. Based on the CA gap, the REER is assessed to be in line with fundamentals with the range of -7 to +5 percent for FY2017/18.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. The sum of FDI, portfolio, and financial derivatives flows on a net basis is estimated at 1.9 percent of GDP in FY2017/18, slowing from 2.3 percent in FY2016/17 despite larger portfolio inflows. Net FDI flows moderated to 1.2 percent of GDP in FY2017/18, from 1.6 percent in FY2016/17. Portfolio inflows into government and corporate securities were strong in 2017, leading to almost fully exhausting ceilings on non-resident investment. That said, in line with global trends, there were some portfolio outflows in 2018.
Assessment. Given that 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. Implementation of structural reforms to improve business climate would help to attract FDI.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. The evolution of the rupee is generally consistent with a floating arrangement. Spot foreign exchange intervention was US$28 billion (1.1 percent of GDP) and net forwards increased by US$28.5 billion in 2017. International reserves reached $424.5 billion at end-March 2018, increasing by about $55 billion since March 2017. Reserves slightly declined to about $412 billion as of end-May 2018. Reserve coverage currently is about 16.3 percent of GDP and about 7.5 months of prospective goods and services imports.
Assessment. Reserve levels are adequate for precautionary purposes relative to various criteria. International reserves represent about 190 percent of short-term debt and more than 160 percent of the IMF's composite metric. 1/</td></tr>
</table>

	India (concluded)
Technical Background Notes	1/ Reserves stand at about 210 percent of the metric adjusted for capital controls, the construction of which is explained in the IMF policy paper, *Assessing Reserve Adequacy—Specific Proposals*. While the adjusted reserve metric uses a composite index to measure capital account openness that is based on de jure capital control indices, staff analysis indicates that India's capital account is not as closed as suggested by traditional measures. See Annex IV in IMF (2016), *India: Staff Report for the 2016 Article IV Consultation*, IMF Country Report No. 16/75 and Chapter 5 in IMF (2016), *India: Selected Issues*, IMF Country Report No. 16/76.

	Indonesia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. At end-2017, Indonesia's net international investment position (NIIP) stood at -33½ percent of GDP, compared with -35¾ percent of GDP at end-2016 (and -40½ percent at end-2012). Gross external assets reached 33¼ percent of GDP (of which, close to 40 percent were reserve assets) and gross external liabilities, 66¾ percent of GDP. Indonesia's gross external debt was moderate at 34¾ percent of GDP at end-2017, of which 19¾ percent was denominated in rupiah and 84½ percent was maturing after one year. About one-third of the government's external debt (18 percent of GDP at end-2017) was denominated in rupiah. **Assessment**. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable and subject to limited roll-over risk, but nonresident holdings of rupiah denominated government bonds, at 38 percent of the total stock (or 6 percent of GDP) at end-April 2018, combined with shallow domestic financial markets, make Indonesia susceptible to global financial volatility, higher US interest rates, and stronger US dollar. Staff projections for the current account suggest that the NIIP position as a percent of GDP will continue to strengthen over the medium term.	**Overall Assessment:** *The external position of Indonesia in 2017 was assessed to be broadly consistent with medium-term fundamentals and desirable policies.* Stable commodity prices and external demand developments should help to contain the current account deficit. External financing appears sustainable, although the large share of foreign portfolio holdings makes the economy vulnerable to a sharp tightening of global financial conditions. **Potential policy responses**: Continued flexibility of the exchange rate and market-determined bond yields would continue to underpin external stability. The fiscal position should be strengthened by accelerating tax reforms, while keeping the fiscal deficit below the legal limit and allowing for more infrastructure and social spending. While expanding the safety-net could lead to a widening in the CA deficit over the medium term, structural policies will be necessary to bolster global value chain participation and external competitiveness. Emphasis should be given to easing FDI and non-tariff trade restrictions, as well as strengthening labor markets, including through streamlining stringent job protection and improving job placement services, vocational training, and overall education.
Current account	**Background**. Indonesia's current account deficit reached 1.7 percent of GDP in 2017, an improvement from the peak of 3.2 percent in 2013, as the economy has adjusted to the low commodity prices. Exports and imports started to pick up in Q4: 2016, as commodity prices bottomed out. Over the medium term, a moderate increase in the current account deficit is expected from a rise in capital goods and raw material imports tied to infrastructure investment and a pickup in domestic demand. A gradual increase in manufacturing exports, stronger demand from trading partners, and more favorable commodity prices should help limit the current account deficit. **Assessment**. Staff estimates a CA gap of 0.1 percent for 2017, consistent with an estimated cyclically adjusted CA balance of -1.6 percent of GDP and a norm of -1.7 percent of GDP. 1/ Taking uncertainties around the estimates into account, staff assesses that a norm of -3.2 percent to -0.2 percent of GDP is appropriate.[2/] This suggests a CA gap in the range of -1.4 percent to 1.6 percent of GDP for 2017. Domestic policy gaps, including in social spending and reserve accumulation, as well as policy gaps in partner countries (particularly fiscal) are largely offset by the unexplained residuals of the model, which could reflect structural distortions in the labor market and barriers to FDI and trade.	
CA Assessment 2017	Actual CA -1.7 · Cycl. Adj. CA -1.6 · EBA CA Norm -0.8 · EBA CA Gap -0.8 · Staff Adj. -0.9 · Staff CA Gap 0.1	
Real exchange rate	**Background**. The REER remained broadly stable between 2013 and 2016. In 2017, the average REER appreciated by 1.2 percent relative to the average of 2016 due to a relatively higher inflation rate than its trading partners, as the average NEER depreciated by 0.7 percent. Estimates through May 2018 show that the REER has depreciated by 4.3 percent relative to the 2017 average. **Assessment**. The EBA index and level REER models point to an REER gap of about 2.1 percent to -5.5 percent for 2017, respectively, in line with staff's REER gap assessment in the range of -9.4 percent to 7.2 percent (based on the CA assessment and estimated elasticities).	
Capital and financial accounts: flows and policy measures	**Background**. In 2017, net capital and financial account inflows (2.9 percent of GDP) were sustained by net FDI inflows (2.0 percent of GDP) and net portfolio inflows (2.0 percent of GDP), partly offset by net other investment inflows of -1.1 percent of GDP. In the first quarter of 2018, net capital and financial account inflows declined to 0.7 percent of GDP, with net portfolio inflows of -0.5 percent of GDP. **Assessment**. Net and gross financial flows have been relatively steady since the global financial crisis despite some short periods of volatility. The contained current account deficit and strengthened policy frameworks, including exchange rate flexibility since mid-2013 have also helped reduce capital flow volatility. Continued strong policies focused on strengthening the fiscal position, keeping inflation in check, 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. Its floating regime has better facilitated adjustments in exchange rates to market conditions. At end-2017, reserves were US$130.2 billion (equal to 13 percent of GDP, about 138 percent of IMF's reserve adequacy metric, and about 8 months of prospective imports of goods and services), compared with US$116.4 billion at end-2016. In addition, contingencies and swap lines amounting to about US$81½ billion are in place. In February–April 2018, international reserves fell by US$7 billion to US$124.9 billion mainly due to FX intervention in response to depreciation pressures on the rupiah. **Assessment**. While the composite metric may not adequately account for commodity price volatility, the current level of reserves (US$124.9 billion at end-April) should be sufficient to absorb most shocks, with predetermined drains also manageable. FX intervention should aim primarily at preventing disorderly market conditions, while allowing the exchange rate to adjust to external shocks.	

	Indonesia (concluded)
Technical Background Notes	1/ As Indonesia is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime-age and exit age from the workforce. This results in an adjustor of -0.9 percentage point being applied to the model-estimated CA norm (-0.8 percent of GDP). 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 1.5 percent).

	Italy	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Italy's net international investment position (NIIP) reached -7 percent of GDP at end-2017, returning broadly to the level at end-2000 (-6 percent of GDP). Gross assets and liabilities, however, reached 157 and 164 percent of GDP respectively, both 58 percentage points higher than in 2000. TARGET2 liabilities rose from about 15 to 26 percent of GDP between end-2015 and end-2017, in part reflecting residents' net purchases of foreign assets and the creation of liquidity by the Bank of Italy's participation in the ECB's asset purchase program. Debt securities represent about ¾ of gross external liabilities, half of which is owed by the public sector. Modest current account (CA) surpluses forecast should continue to improve gradually the NIIP. **Assessment**. Further strengthening of balance sheets would reduce vulnerabilities, related to the high public debt and potential negative feedback loops between the debt stock and debt servicing costs.	**Overall Assessment**: *The external position in 2017 was broadly in line with fundamentals and desirable policy settings. Recent developments suggest that this assessment remains valid.* Nonetheless, improving competitiveness would help strengthen growth, consistent with reducing high unemployment and public debt, and safeguard the external balance sheet. **Potential policy responses**: Strong implementation of structural reforms, including to improve the wage bargaining mechanism to better align wages with productivity at the firm level, as well as efforts to strengthen bank balance sheets will be critical to improving competitiveness, boosting potential growth, and reducing vulnerabilities. Progress in fiscal consolidation will also help reduce external vulnerabilities and maintain investor confidence.
Current account	**Background**. Italy's CA averaged -1¼ percent of GDP in the decade following euro adoption. Starting in 2013, it moved into balance; by 2017, it registered a surplus of 2.9 percent of GDP (up slightly from 2.7 percent of GDP in 2016). About two-thirds of the improvement since 2013 was driven by Italy's growing trade surplus, supported initially by lower commodity prices and subsequently by a rebound in external demand. The rest was due to a higher income balance following the increase in residents' net purchases of foreign assets and a reduction of external liabilities' payments, related not least to the impact of monetary policy. In terms of saving and investment, declining investment accounted for ⅔ of the improvement in the CA since 2010, while higher public saving contributed most of the rest. **Assessment**. The cyclically adjusted CA is estimated at 2.1 percent of GDP in 2017, 0.3 p.p. below the EBA estimated CA norm of 2½ percent of GDP. 1/ Staff assesses a CA gap in the range of -1.3 and +0.7 percent of GDP. Italy's sizable and long-standing structural rigidities, however, hamper its ability to improve competitiveness (also reflected in negative residuals from the EBA CA model). 2/	
CA Assessment 2017	Actual CA: 2.8 | Cycl. Adj. CA: 2.1 | EBA CA Norm: 2.5 | EBA CA Gap: -0.3 | Staff Adj.: 0.0 | Staff CA Gap: -0.3	
Real exchange rate	**Background**. From 2016 to 2017, the CPI-based real effective exchange rate (REER) appreciated by 0.8 percent while the ULC-based REER was unchanged. From a longer perspective, stagnant productivity and rising labor costs have led to a gradual appreciation of the REER since Italy joined the euro area, both in absolute terms and relative to the euro area average (by about 10 percent using ULC-based indices). As of May 2018, the REER appreciated by a further 0.6 percent relative to the 2017 average. **Assessment**. The EBA level and index REER models suggest a modest overvaluation of 5.4 percent and 7.2 percent, respectively. This is generally consistent with, but slightly below, the persistent wage-productivity differentials vis-à-vis key partners, and it corresponds to a CA gap in the lower end of the staff-assessed CA gap range. 3/ Taken together, staff assesses a REER gap of 0–10 percent.	
Capital and financial accounts: flows and policy measures	**Background.** Portfolio and other-investment inflows typically have financed the CA deficits of the past, despite a modest net FDI outflow, without much difficulty. Italy's financial account posted net outflows of about 3 percent of GDP in 2017, largely reflecting residents' net purchases of foreign assets, even as foreign investment in Italian portfolio securities continued. **Assessment.** While supported by monetary accommodation by the ECB, Italy remains vulnerable to market volatility, owing to the large refinancing needs of the sovereign and banking sectors, and the potentially tight credit conditions from the still high stock of NPLs in the banking sector.	
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.	

	Italy (concluded)
Technical Background Notes	1/ The CA norm for 2017 (2.5 percent) is lower than in 2016 (4.4 percent), reflecting methodological refinements to the EBA framework, particularly as it pertains to capturing demographic effects and credit cycles. For Italy, the refined model indicates a positive, but smaller, contribution of demographics (1.7 instead of 3.4 percent), and a small positive contribution of policies (including credit) of 0.3 percent (instead of -0.5 percent as in 2016). 2/ IMF Working Paper No. 18/60, "Italy: Quantifying the Benefits of a Comprehensive Package" provides an overview of the structural distortions and the impact on the REER in Italy. 3/ The elasticity of the REER to the CA gap is estimated to be 0.26.

<table>
<tr><th></th><th>Japan</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The net international investment position (NIIP) has remained at about 60 percent of GDP over 2013-2017, with assets reaching 184 percent and liabilities reaching 124 percent of GDP in 2017. In the medium term the NIIP is projected to rise to about 77 percent with current account (CA) surpluses, before gradually stabilizing due to population aging.
Assessment. Vulnerabilities are limited (equity and direct investment comprise a rising share of liabilities, now at 36 percent of total). Assets are diversified geographically and by risk classes. The NIIP generated net annual investment income of 3.6 percent of GDP in 2017.</td><td rowspan="6">Overall Assessment:
The 2017 external position was broadly consistent with medium-term fundamentals and desirable policies.

Developments since end-2017 do not change the assessment. A continued accommodative stance by the Bank of Japan is consistent with the objective of reflating the economy, and needs to be accompanied by bold structural reforms and a credible and specific medium-term fiscal consolidation plan to maintain an external position consistent with medium-term fundamentals.

Potential policy responses:
A more forceful and coordinated policy package is needed to raise growth and inflation in a sustainable manner. This includes structural measures to boost wages, increase labor supply, reduce labor market duality, enhance risk capital provision, reduce barriers to entry in some industries, and accelerate agricultural and professional services sector deregulation. Fiscal consolidation should proceed in a gradual manner anchored by a credible medium-term fiscal framework. These 'desirable' policies are expected to support growth, imports and prices, and maintain an external position in line with fundamentals over the medium term.</td></tr>
<tr><td>Current account</td><td>Background. In line with growing national savings, the CA surplus has risen since 2013, reaching 4 percent of GDP in 2017, driven mainly by an improvement in the trade balance which was largely underpinned by lower energy prices. In 2017, the CA surplus increased by 0.1 percent of GDP relative to 2016, due to an improvement in the income balance, as the fall in the goods balance was offset by a higher services balance. Japan's CA is positive because of high corporate saving in excess of domestic investment opportunities, and a sizable income account owing to its large NFA position. The income balance continues to account for most of the current account surplus (90 percent in 2017).
Assessment. The CA assessment uses the EBA estimates, but makes an adjustment to the cyclically adjusted CA to reflect a factor not fully captured in the EBA model. In particular, the EBA estimated cyclically adjusted CA of 3.6 percent of GDP is adjusted upward by 0.1 percent to reflect temporary factors (elevated energy imports with the nuclear power plant shutdown).1/ The EBA estimates the 2017 cyclically adjusted CA norm at 3.2 percent of GDP, with a standard error of 1.3 percent of GDP. Staff estimates a CA norm range between 1.9 and 4.5 percent of GDP. The underlying CA gap midpoint in 2017 is therefore assessed to be 0.5 percent of GDP (with a CA gap range between -0.8 and 1.8), broadly consistent with desirable policies and medium-term fundamentals. However, the large unexplained portion of the EBA CA gap suggests that important bottlenecks to investment remain.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA | 4.0 | Cycl. Adj. CA | 3.6 | EBA CA Norm | 3.2 | EBA CA Gap | 0.4 | Staff Adj. | -0.1 | Staff CA Gap | 0.5</td></tr>
<tr><td>Real exchange rate</td><td>Background. After depreciating substantially during 2013-15, the average real effective exchange rate (REER) appreciated substantially during 2016. In 2017, the average REER weakened by about 4.9 percent relative to 2016, reflecting a significant nominal yen depreciation at the end of 2016 related in part to rising global interest rates following the US election. Estimates through May 2018, show that the REER has depreciated by 2.3 percent relative to the 2017 average while it has appreciated by 0.7 percent relative to end-2017.
Assessment. The EBA REER Index and Level models estimate the 2017 average REER to be 17-18 percent lower than the level consistent with fundamentals and desirable policies, mainly from a large unexplained residual. Because of absent Japan-specific factors in the model, less weight is given to the EBA REER models. Using the staff-assessed CA gap range as reference and a staff-estimated semi-elasticity of 0.14 yields an indicative range for the REER gap as -13 to 6 percent with a midpoint of -4 percent. Taking into consideration that this broad REER gap range is due to the low semi-elasticity, the REER is assessed as broadly in line with medium-term fundamentals and desirable policies.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. Portfolio outflows continued during most of 2017—though at a slower pace than in 2016—as institutional investors continued to diversify overseas and FDI outflows continued. Net short yen positions have prevailed since Q2 2017, but after end-March net positions are balanced.
Assessment. Vulnerabilities are limited (inward investment tends to be equity-based and home bias of Japanese investors remains strong). So far there have been no large spillovers from Yield Curve Control to financial conditions in other economies (interest rates, credit growth). If outflows from Japan accelerate, they could provide an offset to tighter domestic financial conditions in the region due to normalization of policy rates in other advanced economies.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. Reserves are about 25 percent of GDP, on legacy accumulation. There has been no FX intervention in recent years.
Assessment. The exchange rate is free floating. Interventions are isolated (last in 2011) to reduce short-term volatility and disorderly exchange rate movements.</td></tr>
</table>

	Japan (concluded)
Technical Background Notes	1/ As in previous years, staff adjusted the EBA estimate of Japan's cyclically adjusted CA to account for the reliance on energy imports after the 2011 earthquake that temporarily reduced the CA. This adjustment takes into account changing energy prices and it also reflects the authorities' latest plans to restore nuclear energy.

<table>
<tr><th></th><th colspan="12">Korea</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="12">Background. The net international investment position (NIIP) has been positive since 2014. At end-2017, it stood at 16 percent of GDP, with gross liabilities totaling 79 percent of GDP, of which 27 percent of GDP was gross external debt.
Assessment. The positive NIIP position strengthens external sustainability and should increase further as the current account remains in surplus. Risks from currency mismatches are lower than before the global financial crisis (GFC), as short-term external liabilities of banks, which rose to relatively high levels before the GFC, declined back to below pre-crisis levels. Also, in the non-financial sector the bulk of short-term external debt is held by exporters who typically hedge their currency risk.</td><td rowspan="6">Overall Assessment:
The external position in 2017 was assessed to be moderately stronger than warranted by medium term fundamentals and desirable policy settings. This reflects excessive saving, including for precautionary purposes, as well as relatively weak private investment.

Potential policy responses:
Significantly more expansionary fiscal policy to boost domestic demand in the short and longer run will help to reduce imbalances, given the substantial fiscal space. This will also contribute to a recalibration of the policy mix, thereby gradually reducing reliance on monetary policy. Structural policies should also play an important role by facilitating rebalancing of the economy toward services and boosting domestic demand growth. These include strengthening the social safety net to lessen incentives for precautionary savings and addressing bottlenecks to investment. The exchange rate should remain market determined, with intervention limited to addressing disorderly market conditions.</td></tr>
<tr><td>Current account</td><td colspan="12">Background. The current account (CA) surplus in 2017 was 5.1 percent of GDP. The surplus declined by 1.9 percentage points in 2017 and now stands below its five-year average. This decline reflected (i) a surge in imports of capital goods, more than compensating for a rise in exports, (ii) a narrowing of the service balance, associated with a decline in shipping services and tourist arrivals from China, (iii) a smaller income balance, and (iv) rising commodity prices. The investment-to-GDP ratio rose, more than offsetting a marginal increase in the savings ratio. The CA surplus is projected to remain large on the back of strong export performance, and in the absence of fiscal easing and well targeted structural measures.
Assessment. The EBA model estimates the 2017 cyclically adjusted CA surplus to be 4.5 percent of GDP, and the CA norm to be in the range 2.0 to 4.0 percent of GDP. This yields a CA gap midpoint of 1.6 percent of GDP with a range of 0.6 to 2.6 percent of GDP. Identified policy gaps from significantly tighter than desired fiscal policy and relatively low social spending are key contributors to the CA gap. The latter acts to increase precautionary savings, and thus the CA, through lack of access to the social safety net.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>5.1</td><td>Cycl. Adj. CA</td><td>4.5</td><td>EBA CA Norm</td><td>3.0</td><td>EBA CA Gap</td><td>1.6</td><td>Staff Adj.</td><td>0.0</td><td>Staff CA Gap</td><td>1.6</td></tr>
<tr><td>Real exchange rate</td><td colspan="12">Background. The REER appreciated by 3.0 percent in 2017, thus continuing a gradual appreciating trend since 2013. As of May 2018, the REER has appreciated 2.0 percent relative to the 2017 average.
Assessment. The REER in 2017 is estimated to have been below the level consistent with fundamentals and desired policies by 7.2 to 1.7 percent. This range is derived by applying to the range for the CA gap above a semi-elasticity of the CA-to-GDP ratio to the REER of 0.36. The REER regression models suggest gaps of -2.1 (EBA Level REER model) and +4.4 (EBA Index REER model).</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="12">Background. Net capital outflows have been relatively stable over the medium term despite significant shifts in composition. In 2017, they decreased to 5.7 percent of GDP from 7.2 percent of GDP in 2016. Non-resident portfolio inflows surged to $17.7 billion as foreigners sharply expanded purchases of debt securities. Equity inflows have also been strong, with the share of foreign ownership in the domestic stock market rising to 33 percent in end-2017.
Assessment. The present configuration of net and gross capital flows appears sustainable over the medium term. Korea has demonstrated the capacity to absorb short term capital-flow volatility in magnitudes occurred over the last few years.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="12">Background. Korea has a floating exchange rate. FX intervention appears to have been two-sided since early 2015, based on staff estimates. Staff estimates that total net intervention in 2017 was limited to around US$10 billion (0.7 percent of GDP); US$5 billion was in forward markets. In 2018, net intervention as of end-April is estimated to have been around US$2 billion. Reserves increased steadily from 2009 through mid-2014, but remained broadly stable through 2016. In 2017, reserves increased by $18 billion including valuation effects. At end-2017, total reserves stood at $389 billion (25.4 percent of GDP).
Assessment. Intervention appears to have been limited to address disorderly market conditions since 2015. Foreign exchange reserves were around 107 percent of the IMF's composite reserve adequacy metric in end-2017, which provides a sufficient buffer against a wide range of possible external shocks.</td></tr>
</table>

	Korea (concluded)
Technical Background Notes	

<table>
<tr><th></th><th colspan="10">Malaysia</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="10">Background. Malaysia's net international investment position (NIIP), as a percent of GDP, averaged around 1.7 percent of GDP since 2010, with changes in recent years reflecting both capital flows and valuation effects. In 2017, it turned into a net liability position of 2 percent of GDP, driven by lower direct investment assets and higher portfolio liabilities (2016: net assets of about 5¼ percent of GDP). 1/ Official reserves contribute most to net assets, while net portfolio liabilities contribute most to net liabilities. Total external debt was at about 69.4 percent of GDP in 2017, about one-third of which was denominated in local currency and more than one-half was of medium-term maturity, helping to reduce FX and rollover risks. Interbank and intercompany loans account for the bulk of private external debt in foreign currency, while the federal government's external debt is mostly in local currency. 2/
Assessment. The NIIP is expected to rise gradually over the medium term, reflecting projected moderate current account (CA) surpluses. Balance sheet strength of banks and domestic institutional investors, maturity and currency composition of external debt, presence of longer-term foreign portfolio investors, exchange rate flexibility, and adequate reserves would provide resilience to Malaysia's potential external vulnerabilities.</td><td rowspan="6">Overall Assessment:
The external position in 2017 was stronger than the level consistent with fundamentals and medium-term desirable policies. The current account surplus in 2017, as a ratio to GDP, was higher than a year ago, following recovery in external demand and improvement in the terms of trade. REER developments since end 2017 support the adjustment of the external position.

Potential policy responses:
Over the past few years Malaysia's growth model has become increasingly driven by domestic demand, and its current account surplus has narrowed significantly. Going forward, macroeconomic policy adjustments, continued exchange rate flexibility, and structural policies should address the existing policy gaps.

The authorities should continue with medium-term fiscal consolidation. Spending needs should accommodate further improvements in social protection and public healthcare. At the same time, addressing structural bottlenecks (for example, labor market frictions in terms of skills mismatch; low female participation; and weak education quality) and further improving physical infrastructure would help support higher private investment and productivity.</td></tr>
<tr><td>Current account</td><td colspan="10">Background. Malaysia's CA surplus has declined by about 7 percentage points of GDP between 2010 and 2017, driven mainly by a decline in national saving, while investment also rose. In 2017, the CA surplus, as a share of GDP, was higher at 3 percent (2016: 2.4 percent) as the goods balance improved on export recovery. The goods balance is in surplus, while the services and income accounts are in deficits.
Assessment. The refined EBA CA model estimates 2017 CA norm at 0.5 percent of GDP after cyclical and multilateral consistency adjustments. 3/ The 2017 cyclically adjusted CA is estimated at about 3.7 percent of GDP. This leads to an estimated 2017 CA gap of 3.2 percent of GDP (±about 1 percent of GDP). Unidentified residuals explain the entire CA gap, potentially reflecting structural distortions and country-specific factors not included in the model. On identified domestic policy gaps, low public healthcare spending explains a part of the excess surplus. The CA balance is expected to remain in surplus, albeit a lower one, over the medium term, driven by smaller private sector net saving.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>3.0</td><td>Cycl. Adj. CA</td><td>3.7</td><td>EBA CA Norm</td><td>0.6</td><td>EBA CA Gap</td><td>3.1</td><td>Staff Adj. | 0.0</td><td>Staff CA Gap | 3.1</td></tr>
<tr><td>Real exchange rate</td><td colspan="10">Background. The annual average real effective exchange rate (REER) depreciated by 1.7 percent in 2017. It was nearly 15 percent lower from its 2013 peak, reflecting impact on the currency from capital outflows and negative terms of trade shocks. Since late 2017, the REER has appreciated. In March 2018, it was up by 5.5 percent from its 2017 average.
Assessment. The EBA REER models estimate Malaysia's REER to be about 33–36 percent below what is warranted by fundamentals and desirable policies. However, the usual macroeconomic stresses associated with such undervaluation are absent, for example, high core inflation, sustained wage pressure, or significant FX reserve build up. Consistent with the assessed CA gap, staff assesses the REER gap in 2017 was close to -6¾ percent (± about 2 percent). 4/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="10">Background. Since the Global Financial Crisis, Malaysia experienced significant capital flow volatilities, largely driven by portfolio flows in and out of the local-currency debt market. 5/ In 2017, the annual financial account balance was in a small surplus for the first time since 2011. Net capital inflows continued in the first four months of 2018. Since late 2016, the Financial Markets Committee has implemented measures to develop the onshore FX market. 6/
Assessment. Exchange rate flexibility and macroeconomic policy adjustments should continue to play the central role in response to capital flow volatility. A more holistic approach toward onshore market development, including phasing out of current capital flow management measures, would have potential benefits.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="10">Background. Gross foreign reserves stood at US$102.4 billion in 2017, witnessing the first annual increase after 2012. Malaysia faced significant reserve losses in 2014 and 2015. As of mid-May 2018, gross reserves were at US$109.4 billion.
Assessment. Under the IMF's composite reserve adequacy metric, which classifies Malaysia's regime as "floating", gross official reserves are currently within the adequacy range (118 percent of the metric as of end-2017). In case of disorderly market conditions reserves could be deployed. In the face of a capital inflow surge, a combination of further reserve accumulation and some exchange rate appreciation would be appropriate.</td></tr>
</table>

	Malaysia (concluded)
Technical Background Notes	1/ The ratios to GDP are based on staff estimates using the bilateral US dollar exchange rate (official statistics are published in national currency). As of end-2017, gross external assets were 132 percent of GDP. 2/ Malaysia's local currency external debt reflects holdings of domestically-issued debt (mainly Malaysian Government Securities-MGS) by nonresident investors (about 12.2 percent of GDP as of end-2017). Short-term FX-denominated debt largely belongs to the banking system and a good portion is matched by short-term foreign currency assets. 3/ The 2017 EBA norm is lower than the 2016 norm, reflecting refinements and data updates to the EBA model. But the changes are within the standard error of estimation. 4/ The REER gap is based on the estimated semi-elasticity of CA to REER at –0.47. The elasticity estimate has been updated from the last assessment. It is based on cross-country estimates of export and import elasticities, obtained from the IMF's Consultative Group on Exchange Rates (CGER), and adjusted for updates to Malaysia's trade openness and share of commodity exports. 5/ Since the Global Financial Crisis, the financial account balance fluctuated between net inflows of 17 percent of GDP in 2011Q2 and net outflows of 11.5 percent of GDP in 2014Q1. 6/ On December 2, 2016, the Financial Markets Committee (FMC) 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 capital flow management measures under the IMF's Institutional View on capital flows. In addition, the authorities' strengthened enforcement of regulations on resident banks' non-involvement in offshore ringgit transactions was considered as enhanced enforcement of an existing capital flow management measure. In April, September, and November 2017, additional measures were announced to help deepen the onshore financial market and facilitate currency risk management.

	Mexico	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Mexico's NIIP was -45.7 percent of GDP in 2017 (gross foreign assets and liabilities were 54.8 percent and 100.6 percent of GDP, respectively). Over the past five years, the NIIP has remained relatively stable at around -47 percent of GDP, with negative balance of payments flows largely compensated for by exchange rate- and other valuation effects. While known portfolio assets are small, portfolio liabilities stood at 43.5 percent of GDP in 2017, of which around one fifth were holdings of local-currency government bonds. A predominant share of FX liabilities was denominated in US dollars (80 percent in the case of outstanding federal government securities). 95 percent of debt securities liabilities were long term, mainly FX-denominated (41 percent) and local currency-denominated government bonds (28 percent), with average maturities of 21 and 8 years, respectively. The NIIP-to-GDP ratio is projected to decline only marginally to about -44 percent by 2023. **Assessment.** While the NIIP is sustainable, the large gross foreign portfolio liabilities holdings could be a source of vulnerability in case of global financial volatility. A significant weakening of the peso could complicate policy making through balance sheet exposures.	**Overall Assessment**: *In 2017, Mexico's external sector position was broadly consistent with medium-term fundamentals and desirable policies.* The depreciation of the peso in 2016 and early 2017 contributed to the strengthening of the CA in 2017. Uncertainty about the future trade relations with the United States also contributed to a decline in private investment, while public investment continued to decline driven by a decline in investment by the state oil company (PEMEX). The undervaluation of the REER was partly reversed during the second half of 2017, reflecting a perceived reduction in the risk of severe protectionist actions. Taking into account the temporary effects on the exchange rate, staff assesses the CA and the REER to remain broadly in line with medium-term fundamentals and desirable policies. **Potential policy responses**: Despite the absence of external imbalances at this point, further structural reforms to improve competitiveness and strengthen exports will be essential for boosting growth while maintaining external sustainability also in the medium- and long term. The authorities have committed to reducing the public sector borrowing requirement from 4.6 percent of GDP in 2014 to 2.5 percent in 2018, and met this target with a margin already in 2017. The central bank sets monetary policy to ensure that inflation remains close to the 3-percent target. Staff recommends that the authorities continue to rely on the floating exchange rate as the main shock absorber, and use foreign exchange intervention solely to prevent disorderly market conditions. The IMF Flexible Credit Line provides an added buffer against global tail risks.
Current account	**Background**. In 2017, the current account (CA) deficit continued to narrow to 1.7 percent of GDP (1.4 percent cyclically adjusted), from 2.1 percent in 2016. This was driven by a decline in both public and private investment, the former in particular related to oil and gas investment by the state-owned oil company, PEMEX, and the latter partly because of uncertainties around external trade relations. Despite higher oil prices, the oil balance fell further, reflecting continued low production, although this was more than offset by an exceptionally strong non-oil goods balance. **Assessment**. The EBA model estimates a cyclically adjusted current account norm of -2.5 percent of GDP in 2017. 1/ This implies a CA gap of 1.1 percent of GDP in 2017. Staff estimates a somewhat smaller gap within the range of -0.5 and 1.5 percent of GDP, as the temporary reduction in investment will unwind going forward, supported partly by the improving sentiment and a strengthening of the peso, although uncertainties remain high. 2/	
CA Assessment 2017	Actual CA | -1.7 | Cycl. Adj. CA | -1.4 | EBA CA Norm | -2.5 | EBA CA Gap | 1.1 | Staff Adj. | 0.6 | Staff CA Gap | 0.5	
Real exchange rate	**Background**. The average REER in 2017 was 2.2 percent stronger than the 2016 average. It appreciated by 15.5 percent relative to its January 2017 low, reflecting a perceived reduced risk of severe protectionist action by key trading partners. The free-floating exchange rate has been a key shock absorber in an unsettled global environment. In 2018, the peso initially strengthened substantially on more optimism about the NAFTA negotiations, but this was fully reversed from mid-April to mid-May as NAFTA uncertainty remained, with the peso reaching its weakest level since early 2017. As of May 2018, the REER had depreciated by 2.4 percent relative to the 2017 average. **Assessment**. The EBA level REER regression estimates an undervaluation of 11.9 percent in 2017. The index approach yields higher undervaluation (23.2 percent). Staff puts less weight on the index approach as it has shown the peso to be persistently undervalued for the last 9 years. The external sustainability approach suggests a 1.5 percent undervaluation and the staff-assessed CA gap implies a REER undervaluation of 3.8 percent (applying an estimated elasticity of 0.13). Considering all estimates and the uncertainties around them, staff assesses Mexico's real effective exchange gap to be in the range of 4 to -12 percent. The peso is thus broadly in line with fundamentals.	
Capital and financial accounts: flows and policy measures	**Background**. During 2010-14, a large share of capital inflows went into purchases of locally-issued government paper and other portfolio investments. In 2015-17 gross portfolio inflows slowed markedly. Net flows from local currency government securities were marginally negative in 2017, due primarily to the elimination of previous arbitrage opportunities favoring holdings of short term peso securities. Going forward, structural reforms are expected to lead to higher FDI, while portfolio inflows are unlikely to return to the previous high growth rates. **Assessment**. The long average maturity of sovereign debt and the high share of local currency financing reduce the exposure of government finances to depreciation risks. The banking sector is well capitalized and liquid and assessed to be resilient to large shocks. Non-financial corporate debt levels are low and foreign exchange risks well covered by natural and financial hedges. Nonetheless, the strong presence of foreign investors leaves Mexico exposed to greater risk of capital flow reversals and risk premium increases. The authorities have refrained from capital flow management measures. Capital flow risks are also mitigated by prudent macroeconomic policies.	
FX intervention and reserves level	**Background**. The central bank remains committed to a free-floating exchange rate, which has been the key shock absorber, while discretionary intervention is used solely to prevent disorderly market conditions. In the past, the central bank built up reserves primarily through purchases of the net foreign currency proceeds of the state oil company, which have declined substantially, and occasionally through auctions. 3/ At end-2017, FX reserves had declined to US$175.5 billion (15.3 percent of GDP) from US$178.0 at end-2016. In February 2017, the Foreign Exchange Commission announced a new FX hedging program, enabling the Bank of Mexico to offer up to US$20 billion of non-deliverable forwards (NDF) settled in pesos with a maturity of up to 12 months. The program adds to the authorities' toolkit to counter disorderly market conditions. Several auctions took place in 2017, with total NDF sales amounting to US$5.5 billion. As of mid-May, no new NDF sales or other discretionary interventions had taken place in 2018. **Assessment**. At 123 percent of the ARA metric and 271 percent of short-term debt (at remaining maturity), the current level of foreign reserves remains adequate. Staff recommends that the authorities continue to maintain reserves at an adequate level over the medium term. The Flexible Credit Line arrangement has been an effective complement to international reserves, providing protection against global tail risks.	

	Mexico (concluded)
Technical Background Notes	1/ The current account norm estimate has a standard error of 1.4 percent. 2/ More specifically, staff-assessed cyclically adjusted CA is somewhat wider than implied by the EBA model (-2.0 instead of -1.4 percent of GDP). 3/ Rules-based intervention mechanisms were in place between December 8, 2014 and February 17, 2016. During this time, pre-announced amounts were automatically offered for auction when the exchange rate depreciated by more than a threshold (1 or 1.5 percent) on a given day. Regular auctions with no minimum price were also used. Since February 17, 2016, the authorities moved to discretionary intervention and used it only once in 2016 and once in 2017 (US$2 billion). Data on intervention amounts are published weekly.

<table>
<tr><th></th><th>The Netherlands</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The Netherlands' net international investment position (NIIP) increased to 74 percent of GDP at the end of 2017 (with gross assets and liabilities totaling 1251 and 1177 percent of GDP, respectively), rising from almost balanced NIIP at end-2009. The largest component of the NIIP comes from the net FDI stock, which reached 956 billion euro (130 percent of GDP) at the end of 2017. TARGET2 assets on the euro system increased to reach 120 billion euro. Over the medium term, the NIIP is expected to continue growing to about 100 percent of GDP, in line with projected sizable current account (CA) surpluses.
Assessment. The Netherlands' safe haven status and its sizable foreign assets limit risks from its large foreign liabilities.</td><td rowspan="6">Overall Assessment:
The external position in 2017 was substantially stronger than the level consistent with medium-term fundamentals and desirable policy settings.
The Netherlands' status as a trade and financial center and natural gas exporter make an external assessment more uncertain than usual.

Potential policy responses:
The expansionary fiscal policy planned by the new government, progress in repairing household balance sheets, and the strengthening of the banking system could support domestic demand and adequately contribute to reducing excess external imbalances. Higher wage growth, consistent with tighter labor market conditions, would however be needed to help rebalancing within the monetary union. In addition, structural reforms aimed at raising the productivity of small domestic firms and encouraging domestic productive investment, as well as pension reforms to reduce precautionary savings, would also reduce the CA surplus.</td></tr>
<tr><td>Current account</td><td>Background. The CA surplus increased to 10.2 percent of GDP in 2017 (10.3 percent cyclically adjusted), driven by continued strong net exports. The CA has been in surplus since 1981—a reflection of a positive goods and services balance—and until 2000 was mainly driven by household savings. Since 2001 however, non-financial corporate net savings have progressively taken over as the main driver of the surpluses, with large and global corporate savings financing substantial FDI outflows. Households savings have nonetheless also risen since mid-2008 as a result of deleveraging following the sharp declines in housing prices and increases in mandatory contributions to the second-pillar pension funds. The Netherlands' status as a trade and financial center and natural gas exporter likely plays a role to account for the strong structural position.
Assessment. The EBA CA model estimates a CA norm of 3.5 percent of GDP and a CA gap of 6.8 percent of GDP in 2017 1/. As the CA surplus essentially reflects the high corporate savings and liquidity of Netherlands-based multinationals, partly due to some favorable tax treatment for corporate income, as well as more recent but possibly long-lasting increases in household saving rates, the assessment of the EBA estimated current account gap is particularly uncertain. Taking these factors into account, staff assesses the norm in a range of 1.5-5.5 percent of GDP, and a corresponding CA gap of 4.8-8.8 percent of GDP. In the short term, a more expansionary fiscal stance will put some downward pressure on the surplus, while over the medium to long term further declines in the surplus will be supported by progress in private sector deleveraging, declining gas exports, and demographic trends, including divestment by pension funds.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA | 10.2 | Cycl. Adj. CA | 10.3 | EBA CA Norm | 3.5 | EBA CA Gap | 6.8 | Staff Adj. | 0.0 | Staff CA Gap | 6.8</td></tr>
<tr><td>Real exchange rate</td><td>Background. The real effective exchange rate (REER) has been on an appreciation path since April 2015. The annual average CPI-based and ULC-based REER appreciated 1 percent and 1.7 percent, respectively, in 2017. The REER appreciated by an additional 0.9 percent through May 2018, relative to the 2017 average.
Assessment. The EBA REER models indicate a range of overvaluation of 10.6 percent (index model) to slight undervaluation of 0.7 percent (level model) in 2017, largely attributable to unexplained residuals. The staff-assessed CA gap implies a REER undervaluation of 9.2 percent (elasticity of 0.74). Taking into account all estimates and the uncertainty surrounding the EBA REER results, staff assesses that the REER remained undervalued by around 10 percent within a range of 7–13 percent.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. Net FDI and portfolio outflows dominate the financial account. FDI outflows are driven by the investment of corporate profits abroad. On average, gross FDI outflows largely match corporate profits. 2/
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.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. The euro is a global reserve currency.
Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</td></tr>
</table>

	The Netherlands (concluded)
Technical Background Notes	1/ In comparison with last year, the EBA-estimated CA gap in 2017 (unexplained residual plus the contribution of identified policy gaps) widened by 3.2 percent of GDP, reflecting increasing unidentified residuals. The larger gap reflects a higher cyclically adjusted CA surplus (from 8.9 to 10.3 percent of GDP) and a much lower CA norm (from 5.3 to 3.5 percent of GDP) due to the exclusion of the financial center dummy. 2/The larger external balance sheet, presence of large international corporations, and issues related to the measurement of the current account add uncertainty to this assessment. According to the DNB, half of the positions in a ssets and liabilities are attributable to subsidiaries of foreign multinationals.

	Poland	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** The net international investment position (NIIP) stood at negative 65 percent of GDP in 2017, broadly in line with the average level of recent years. Gross liabilities increased to 118 percent of GDP, while gross assets remained at the level of 2016 (52 percent of GDP). FDI (equity and debt) accounted for 45 percent of gross external liabilities in 2017, and is diversified across sectors and source countries. While gross external debt is sizable (72 percent of GDP at end-2017), a quarter of it is liabilities to direct investors. The share of short-term debt (at remaining maturity) is relatively high (28 percent of total gross debt). Currency mismatch stems from the different shares of euro-, USD- and zloty-denominated instruments in gross assets and liabilities, and therefore, movements in bilateral exchange rates of these three currencies affect the NIIP. **Assessment.** While sizable external debt, including short-term debt, presents a vulnerability, rollover risk is mitigated by the large share of debt FDI, which tends to be stable. Sizable reserves also help to mitigate liquidity risk that may arise from rolling over the large amount of short-term debt.	**Overall Assessment**: *The external position in 2017 was broadly in line with medium-term fundamentals and desirable policies.* The cyclically adjusted CA balance in 2017 is expected to decline going forward on accelerated absorption and utilization of EU funds. Reserves are sufficient to guard against external shocks and disorderly market conditions. Developments since end-2017 do not change the overall assessment. **Potential policy responses**: Policies should manage the cyclical upswing to preserve external balance. This will require timely monetary policy responses to prevent nascent overheating pressures from becoming more widespread and migrating to consumer prices. A gradual structural fiscal consolidation is also needed from a cyclical perspective and to lower the structural deficit in order to create space to absorb future costs of adverse demographics and the eventual decline in EU funds.
Current account	**Background.** Sizable CA deficits during 2004-14 have been replaced more recently by close-to-balance/small surplus positions, notwithstanding a significant primary income deficit. The improvement in the CA followed a large depreciation during 2014-16 and lower public investment due to the transition to the 2014-20 EU funds cycle, with favorable terms of trade contributing as well. Poland's CA turned positive in 2017 at 0.3 percent of GDP, as the increase in the services surplus more than offset the decline in the goods surplus. From a saving-investment perspective, the increase in the CA in 2017 was supported by low public investment due to delayed EU funds absorption. **Assessment.** For 2017, the cyclically adjusted current account stood at a surplus of 0.8 percent of GDP, and the EBA CA norm was a deficit of 1.7 percent of GDP. The resulting EBA gap of 2.4 percent of GDP reflects the sum of domestic and external policy gaps of 0.4 percentage points, and an estimation residual of 2.1 percentage points. Delayed absorption and utilization of EU funds account for about 1.4 percentage points of the EBA gap. 1/ Staff assesses that the CA was broadly in line with fundamentals and medium-term policies in 2017, with a CA gap range centered on 1 (± 1) percent of GDP. 2/ 3/	
CA Assessment 2017	Actual CA: 0.3 · Cycl. Adj. CA: 0.8 · EBA CA Norm: -1.7 · EBA CA Gap: 2.4 · Staff Adj.: 1.4 · Staff CA Gap: 1.0	
Real exchange rate	**Background.** The annual-average real effective exchange rate (REER) depreciated by a cumulative 7¾ percent during 2014-16, largely on nominal depreciation vis-à-vis the US dollar and the Swiss franc, as the zloty tends to move in line with the euro. The depreciation is consistent with NBP policy rate cuts in response to deflationary pressures and domestic policy uncertainties in the run-up to and following the 2015 election. However, the REER appreciated by 3.2 percent on average in 2017 (6.7 percent from end-2016 to end-2017), mainly on account of nominal appreciation. Against the backdrop of general volatility in emerging market economies, between end-2017 and end-May 2018, the zloty weakened by about 6.9 percent against the US dollar, and by 5.9 percent against the euro, with no intervention from the NBP. Estimates through May 2018 show that the REER has appreciated by 6.4 percent relative to the 2017 average. **Assessment.** The EBA REER and CA models suggest an undervaluation of between 0 and 5 percent for 2017. The REER gap implied by the EBA CA model is -5 percent and the REER index model suggests a gap of -2.5 percent. 4/ Overall, staff assesses Poland's REER in 2017 to have been close to the level consistent with fundamentals and desirable policy settings, with a gap in range of -5 to 0 percent.	
Capital and financial accounts: flows and policy measures	**Background.** The capital account is dominated by EU funds inflows for financing investment projects, despite a temporary slowdown in EU funds absorption in 2016-17 due to the transition to the 2014-20 EU funds cycle. In recent years, net financial inflows have decreased and were volatile. **Assessment.** The foreign holdings (around 41.7 percent) of government debt securities indicate potential vulnerabilities, but the ratio continued to decline in 2017 as domestic banks increased their holdings in response to the introduction of the bank asset tax, which exempts government bonds. The diversified foreign investor base is another mitigating factor.	
FX intervention and reserves level	**Background.** Gross international reserves were stable at US$113 billion at end-2017. Net reserves, which exclude the NBP's repo operations (part of its reserve management strategy) from gross reserves, have increased from US$96.1 billion at end-2016 to about US$104.9 billion at end-2017 as the NBP has continued to build an adequate precautionary reserve position. The zloty has floated freely. **Assessment**. Net reserves are now about adequate, standing at 95 percent of the IMF's composite reserve adequacy (ARA) metric in 2017 (gross reserves are about 110 percent of the ARA metric).	

	Poland (concluded)
Technical Background Notes	1/ The cyclically adjusted CA balance is therefore assessed to be -0.7 (instead of model-implied 0.8) percent of GDP. 2/ The 0.4 percentage points contribution of identified policy gaps reflects a combination of a domestic fiscal policy gap of -0.4 percentage points that is more than offset by fiscal gaps in trading partners, resulting in a positive 0.2 percentage points contribution of fiscal policies to the current account gap. The credit gap and health spending together contribute an additional 0.3 percentage points to the total policy gap. Capital controls and reserves contribute negative 0.1 percent of GDP to the total gap. 3/ The EBA estimation standard error for the 2017 CA norm is 0.6 percent of GDP. 4/ The REER level model for Poland suggests an undervaluation of 16.9 percent. However, the model has residuals of 14.6 percent, and may not adequately capture changes in the equilibrium REER that occurred during the sample period.

	Russia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) at end-2017 was at 18 percent GDP (marginally higher than in 2016 and up from 10 percent in 2013, the last pre-crisis year). Gross assets were at 88 percent of GDP and liabilities—split evenly between equity and debt—constituted 70 percent of GDP, both lower than in 2016 on account of higher dollar GDP and private sector deleveraging. Total external debt was at 34 percent of GDP at end-2017, a 6 percentage point reduction from the year before. 1/ There are no obvious maturity mismatches between the gross asset and liability position. Historically, the NIIP position has not kept pace with the CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows. 2/ **Assessment**. The projected current account surpluses suggest that Russia will continue to maintain a positive IIP, which lowers risks to external stability. Moreover, official external assets have been increasing rapidly since the introduction of the new fiscal rule. The recent external deleveraging by the private sector reduces risks further.	**Overall Assessment**: *The external position in 2017 was moderately weaker than suggested by fundamentals and desirable policy settings. Since then, worsening geopolitical tensions have weakened the exchange rate, but have not altered the overall assessment. While this has not altered the overall assessment, the correction likely brought the REER closer to fundamentals.* Since 2016, the REER has recovered as oil prices rebounded, economic uncertainty declined, and appetite for Russian government assets recovered. However, the evolving nature of economic sanctions against Russia and their structural implications create exceptional uncertainty when assessing the external position. **Potential policy responses**: Russia's moderately weaker external position and lingering uncertainty suggest the need for greater diversification and prudence. Fiscal policy should operate within the parameters of the new fiscal rule to reduce the impact of oil price volatility on the non-oil sector, while government expenditure should be rebalanced to capital spending, while leaving space for higher health spending. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase savings on a net basis, and yet create some room for somewhat higher private and public-sector investment over the medium term.
Current account	**Background**. Following a decade of continuously shrinking surpluses, the Current Account (CA) balance temporarily surged on the back of an oil price shock to 5 percent of GDP in 2015, as reduced oil export revenues (approximately 7 percent of GDP) were more than offset by falling absorption. However, demand recovery has reduced the surplus to 1.9 percent of GDP in 2016, before recovering energy prices marginally raised it to 2.3 percent of GDP in 2017 (despite a further deterioration of 0.2 percent of GDP in the non-energy CAB). In the medium-term, the authorities' fiscal consolidation plans should support a gradual increase in the CAB (mostly on account of a rising non-oil balance). **Assessment**. The EBA CA model yields a norm for 2017 of 3.8 percent of GDP, compared with a cyclically adjusted CA surplus of 3.2 of GDP, resulting in a CA gap of –½ percent of GDP. 3/ There are substantial uncertainties about the external assessment when volatile oil prices play a dominant role in the economy. The impact and duration of sanctions are also difficult to quantify but, on balance, staff assesses that they create long-lasting uncertainty, raising the CA norm both through higher precautionary savings and lower investment. Staff assesses the 2017 CA gap at –1¼ percent, with a confidence interval between –2½ and 0 percent. The fiscal gap accounts for most of the CA gap. Thus, in the medium term, fiscal policy should be tightened—while raising infrastructure and health spending—to rebuild buffers and save more of the oil wealth for future generations. The new fiscal rule provides a reasonable mechanism for achieving this goal.	
CA Assessment 2017	Actual CA: 2.3 | Cycl. Adj. CA: 3.2 | EBA CA Norm: 3.8 | EBA CA Gap: -0.5 | Staff Adj.: 0.7 | Staff CA Gap: -1.3	
Real exchange rate	**Background**. Following the dual shocks of oil prices and sanctions, and the floating of the ruble in November 2014, the REER depreciated by over 35 percent between mid-2014 and February 2016. Part of this depreciation represented an overshooting that was corrected in 2017, when the REER appreciated by 16 percent. The REER remained broadly stable since mid-2017 at a level some 15 percent below the pre-crisis level. By May 2018, the REER has depreciated by 5.8 percent relative to the 2017 average, in part due to the imposition of new US sanctions in April. **Assessment**. Both the EBA Level and Index REER models indicate a small undervaluation of around 5 percent. Staff assesses that the 2017 REER was between 0 and 10 percent above its equilibrium level, in line with the staff-assessed CA gap (applying an estimated elasticity of 0.26).	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows continued in 2017, though at a significantly slower pace than in 2014-15, as confidence has returned. Private sector external deleveraging has continued in the face of limited access to international capital markets. Nonetheless, volatile oil prices will continue to weigh on the outlook. Over the medium term, structural outflows are expected to decline but only provided that Russia improves its investment climate. **Assessment**. While Russia is exposed to risks of accelerated capital outflows because of geopolitical uncertainties, the floating exchange rate regime and large international reserves provide substantial buffers to help absorb such shocks.	
FX intervention and reserves level	**Background**. Since the floating of the ruble in November 2014, FX interventions have been limited. International reserves rose to US$457 billion at end-March 2018, up from U$378 billion at end-2016, due to valuation effects and MoF's FX purchases in line with the provisions of the new fiscal rule, which attempts to shield the non-oil economy from oil price volatility. In response to geopolitical volatility in early April, FX purchases were temporarily backloaded. **Assessment**. International reserves at end-2017 were equivalent to 264 percent of the IMF's reserve adequacy metric, considerably above the adequacy range of 100-150 percent. Considering Russia's vulnerability to oil price shocks, an additional commodity buffer of $58 million is appropriate, translating into a ratio of reserves to the buffer-augmented metric to 195 percent, a level still considerably above the adequacy level, but justifiable given the high degree of uncertainty related to sanctions. 4/ Large FX interventions should be limited to episodes of market distress.	

	Russia (concluded)
Technical Background Notes	1/ Russia's foreign assets are mostly in foreign currency (over 93 percent as of end-2017), while liabilities are predominantly in rubles (64 percent). However, about three-quarters of external debt is denominated in foreign currency. The 19 percent increase in the dollar GDP in 2017 (on account of rebounding oil prices and ruble appreciation) explains most of the reduction in assets- and liabilities-to-GDP ratios. 2/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The CBR includes estimates of "disguised" capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level, and this treatment of "disguised" outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position. 3/ The 2017 CA norm for Russia is 2½ percentage points of GDP lower than under the previous methodology. 4/ The commodity buffer is computed in line with Annex III of the Guidance Note on Reserve Adequacy.

	Saudi Arabia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Net external assets were 81 percent of GDP at end-2017. 1/ External assets declined by 10 percent of GDP during 2017 and 17 percent of GDP since their 2015 peak largely due to a decline in central bank FX reserves. External liabilities rose by 1.1 percent of GDP in 2017 mainly because of new government borrowing. Projections suggest the NIIP-to-GDP ratio will increase over the medium-term to around 92.6 percent of GDP in 2023 as the current account (CA) remains in surplus. No details are available on the composition of external assets. **Assessment**. The external balance sheet remains very strong. Substantial accumulated assets represent both savings of the exhaustible resource revenues for future generations and protection against vulnerabilities from oil price volatility.	**Overall Assessment**: *The external position in 2017 was weaker than the level consistent with desirable medium-term fiscal policy settings. Planned fiscal adjustment needs to be successfully implemented to further strengthen the CA and increase saving for future generations.* The pegged exchange rate provides Saudi Arabia with a credible policy anchor. In 2017, the REER depreciated, but this trend has reversed in recent months with the strengthening of the US dollar. Given the close link between the fiscal and external balance and the structure of the economy, with exports dominated by oil and oil-related products and limited substitutability between imports and domestically produced goods, external adjustment will be driven primarily by fiscal policy. The external balance sheet remains very strong. Despite the substantial drawdown since 2015, reserves remain very comfortable when judged against standard IMF metrics, although external savings are not sufficient from an intergenerational equity perspective. Under the government's planned fiscal adjustment, reserves will increase over the medium term. **Potential policy responses**: Continued fiscal consolidation is necessary over the short- and medium-term to strengthen the CA and increase saving for future generations. The authorities planned fiscal adjustment is based on further energy price reforms, non-oil revenue measures, and expenditure restraint. The non-exported oil primary fiscal deficit is expected to narrow substantially over the medium-term and reduce the external gap. Fiscal adjustment should be supported by reforms to strengthen the fiscal framework. Structural reforms that help diversify the economy and boost the non-oil tradables sector over the medium-term will also support a stronger external position over time.
Current account	**Background**. The CA deficit moved back into a surplus of 2.7 percent of GDP in 2017 from a deficit of 3.9 percent of GDP in 2016. Imports of goods fell by 7 percent as the economy contracted while exports increased by 20 percent largely due to higher oil prices (import volumes fell by 9 percent while export volumes decreased by 1.5 percent). The terms of trade improved by 22.5 percent in 2017 and is projected to improve by a further 28.8 percent in 2018. The trade balance rose to over 15 percent of GDP. The CA surplus is expected to increase to 9.3 percent of GDP in 2018 as oil revenues increase further and then to narrow over the medium-term as the oil price declines. 2/ **Assessment**. The reliance on oil subjects the CA to wide swings and complicates the application of standard external assessment methodologies. The estimated CA gap varies with the methodology. The estimated CA gap in 2017 varies depending on the methodology: -2.4 percent of GDP using the EBA-lite macro-balance approach, -1.9 percent of GDP using the external sustainability approach, and -1.6 percent using an alternative specification for oil-exporters. 3/ Staff assesses a CA gap in a range of -1 to -3 percent of GDP in 2017. Planned fiscal adjustment needs to be successfully implemented to further strengthen the CA over the medium-term.	
CA Assessment 2017	Actual CA: 2.7 | Cycl. Adj. CA: -- | EBA CA Norm: -- | EBA CA Gap: -- | Staff Adj.: -- | Staff CA Gap: -2.0	
Real exchange rate	**Background**. The Riyal has been pegged to the US dollar at a rate of 3.75 since 1986. The REER in 2017 was on average 15 percent above its 10-year average, but this gap declined to 10 percent by year-end. Estimates through May 2018 show that the REER has depreciated by 2.0 percent relative to the 2017 average. **Assessment**. The REER depreciated with the US dollar in 2017, but this trend has reversed in recent months. Exchange rate movements have a limited impact on competitiveness in the short-run 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. Staff estimates an average REER gap in 2017 in the range of 10-20 percent, but at the lower end of this range by end-2017. As fiscal consolidation proceeds, it would be expected that the REER gap would narrow as domestic costs and prices are restrained.	
Capital and financial accounts: flows and policy measures	**Background**. Recorded net financial outflows increased in 2017. Errors and omissions declined to 0.6 percent of GDP in 2017 compared with 10.3 percent of GDP in 2016. FX reserves continued to fall, but at a slower pace. **Assessment**. Analysis of the financial account is complicated by the large errors and omissions in the balance of payments in some years. The strong reserves position limits immediate risks and vulnerabilities.	
FX intervention and reserves level	**Background.** The government is developing a sovereign wealth fund by broadening the mandate of the Public Investment Fund (PIF). Nevertheless, most of the government's foreign assets are still held at the central bank within international reserves. Reserves fell to $489 billion (71 percent of GDP, 28 months of imports, and 470 percent of the IMF's reserve metric) at end-2017, down from $727 billion in 2014. **Assessment**. Reserves play a dual role—savings for both precautionary motives and for future generations. Reserves are more than adequate for precautionary purposes (measured by the IMF's metrics). Nevertheless, continued fiscal adjustment is needed to strengthen the CA and increase savings for future generations.	

	Saudi Arabia (concluded)
Technical Background Notes	1/ The NIIP may be underestimated given the large errors and omissions in the balance of payments over many years and inconsistencies between the BoP and IIP data. 2/At current oil production, a $1 change in the oil price results in a 0.4 percent of GDP first-round change in the CA balance. The oil price is assumed to be $70.7 in 2018, declining to $59.2 in 2023 ($53.2 in 2017). 3/ *EBA models do not include Saudi Arabia*. Staff considered three methodologies, including one that incorporates the special intertemporal considerations that are dominant in economies in which exports of non-renewable resources are a very high share of output and exports. Estimated CA norms for the external sustainability (ES) approach were 5.5 percent of GDP and 2.7 percent of GDP for the constant real per capita annuity and constant real annuity allocation rules, respectively. Using the macro-balance approach, the CA norm is estimated at 4.6 percent of GDP under the EBA-lite approach. An alternative specification estimated on a sample of oil-exporting countries and a narrower set of control variables (see Behar and Fouejieu, 2017) suggests a CA norm of 3.8 percent of GDP.

	Singapore	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** The net international investment position (NIIP) increased to 248 percent of GDP in 2017, reaching the highest level since 2009 (though still lower than pre-GFC peak of 265 percent of GDP in 2006). The current account (CA) surplus has been a main driver since the GFC, although in 2017 valuation effects also contributed significantly to the increase in the NIIP. CA and growth projections imply that the NIIP will rise over the medium term. **Assessment.** The external balance sheet is not a major source of risk. Potential vulnerabilities posed by the large gross non-FDI liabilities (472 percent of GDP in 2017)—predominantly cross-border deposit taking by foreign bank branches—are mitigated by banks' large short-term external assets and authorities' close monitoring of banks' liquidity risk profiles. However, given Singapore's status as a financial center, global financial conditions should be carefully monitored. Singapore has large official reserves and other official liquid assets. 2/	**Overall Assessment**: The external position in 2017 was *substantially stronger than what is consistent with fundamentals and desirable policies.* The current account balance was similar to the previous year. The assessment for 2017 and the size of the imbalance are subject to a wide range of uncertainty, reflecting Singapore's very open economy and position as a global trading and financial center. **Potential policy responses**: Singapore's economy is undergoing structural transformation in light of a rapidly aging population and challenges posed by transition to a new digital economy. Higher public investment addressing these issues, investments in physical infrastructure, human capital, and public health-care related expenditures would help moderate the current account imbalances over the medium term by lowering net public saving. Structural reforms also aim at improving labor productivity, which supports a trend appreciation of the currency. The gradual normalization of monetary policy recently initiated by MAS will help rebalancing by allowing gradual appreciation of the NEER over time.
Current account	**Background.** The CA surplus of 19 percent of GDP in 2017, similar to in 2016, reflects a strong goods balance that is partly offset by deficits in the services and income account balances. 3/ The oil trade deficit widened in 2017. 4/ Structural factors and policies that boost savings, such as Singapore's status as a financial center, a limited social safety net, high income inequality, and the rapid pace of aging combined with a mandatory defined-contribution pension scheme (whose assets were about 70 percent of GDP in 2015) are the main drivers of Singapore's high saving rate and strong external position. Fiscal policy has been associated with increased social and infrastructure spending in recent years. If this trend continues, it will contribute to a lower CA surplus over the medium term. **Assessment.** Singapore is a small, very open economy with a large positive NIIP and high income per capita, but it is aging rapidly. Such non-standard factors make a quantitative assessment of its CA subject to a wide range of uncertainty. Guided by the EBA framework, staff assesses the 2017 CA as substantially higher than the level consistent with fundamentals and desirable policies, by 2.5–8.5 percent of GDP. 5/ The fiscal balance contributed about 2 percent of GDP to the identified policy gap.	
CA Assessment 2017	Actual CA: 18.8 | Cycl. Adj. CA: 18.9 | EBA CA Norm: -- | EBA CA Gap: -- | Staff Adj.: -- | Staff CA Gap: 5.5	
Real exchange rate	**Background.** The real effective exchange rate (REER) depreciated by 1 percent year over year in 2017 due to low inflation in Singapore, while the nominal effective exchange rate (NEER) appreciated by 0.2 percent year over year. This followed depreciation of REER by 3 percent and appreciation of NEER by 0.6 percent, both in cumulative terms, between 2014 and 2016. Estimates through May 2018 show that the REER has depreciated by 1.4 percent relative to the 2017 average. **Assessment.** Notwithstanding the nonstandard factors that make a quantitative assessment difficult, staff assesses that the REER is 4-16 percent weaker than warranted by fundamentals and desirable policies. This assessment is subject to a wide range of uncertainty about both the underlying CA assessment and the semi-elasticity of the CA with respect to the REER.	
Capital and financial accounts: flows and policy measures	**Background.** Singapore has an open capital account. The financial account deficit tends to rise during periods of lower uncertainty in global financial markets. It reflects in part reinvestment abroad of income from the foreign assets of the official sector. Financial flows also encompass sizable net inward FDI and smaller but more volatile net bank-related flows. 6/ In 2017, the deficit on the capital and financial account narrowed substantially to 10 percent of GDP, compared with the large deficits of 15-20 percent in 2014-16. This reflects the decrease in outflows in other investments (driven by inflows to banks) and resumed inflows in financial derivatives. As a trade and financial center in Asia, changes in market sentiment in emerging market and low-income countries in the region can affect Singapore significantly. **Assessment.** The financial account is likely to remain in deficit as long as the trade surplus remains large.	
FX intervention and reserves level	**Background.** With the NEER as the intermediate monetary policy target, intervention is undertaken to achieve inflation and output objectives. Official reserves held by the Monetary Authority of Singapore (MAS) reached US$ 280 billion (86 percent of GDP) in 2017. As a financial center prudential motives call for a large NIIP buffer also in the form of reserves. **Assessment.** In addition to FX reserve held by the MAS, Singapore also has access to other official foreign assets managed by Temasek and the GIC. 7/ The current level of official external assets appear adequate, even after considering prudential motives, and there is no clear case for further accumulation for precautionary purposes.	

	Singapore (concluded)
Technical Background Notes	1/ Staff estimates in US dollar terms. Valuation changes have been an important driver of changes in the NIIP, given the large gross assets and liabilities. 2/ Singapore's official reserves held by the Monetary Authority of Singapore (MAS) amounted to about 86 percent of GDP in 2017. 3/ Singapore has a negative income balance despite its large positive NIIP position. This reflects the lower rate of return on its foreign assets relative to the return paid on its foreign liabilities. The lower return on foreign assets may reflect the fact that the composition of Singapore's assets is tilted toward safer assets which yield lower returns. 4/ Singapore is a net oil importer, with a net oil trade deficit of about 2 percent of GDP in 2017. The oil trade deficit would be smaller if one considers the high imported petroleum product content in Singapore's exports of petrochemicals and other oil intensive products and services like water transportation. In addition, Singapore has some sectors that are closely linked to investment in the oil sectors, such as production of oil rigs. The decline in investment in the oil sector is expected to reduce Singapore's exports of these products. 5/ Nonstandard factors make quantitative assessment of Singapore's external position difficult and subject to significant uncertainty. Singapore is not included in the sample used to estimate the EBA models because it is an outlier along several dimensions (e.g., large external asset and lability positions, highly positive NFA position). Estimates based on the EBA CA framework suggest that Singapore's CA surplus is mainly explained by the high level of productivity, fiscal surplus, and its large NFA position. The estimated CA gap is about 5.5 percent of GDP (relative to the cyclically adjusted level of the CA of about 18.9 percent of GDP in 2017 and norm of about 13.4 percent of GDP). Identified policy gaps under the regression models are driven largely by the need for more fiscal spending to strengthen the social safety net. 6/ The latter is the result of considerably large gross inflows and outflows. 7/ 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	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** South Africa's economy is highly integrated into international financial markets, with large external assets and liabilities. After valuation effects led to a marked improvement of the net international investment position (NIIP) in 2015 (from –8 percent of GDP at end-2014 to 16 percent of GDP one year later), the NIIP has remained strong, standing at 12 percent of GDP as of end-2017. However, the NIIP is expected to weaken somewhat over the medium term on account of CA deficits. Gross external debt rose to 49.6 percent of GDP at end-2017 from 26 percent of GDP at end-2008 on the back of an increase in long-term debt. Short-term external debt (residual maturity) amounted to 14.2 percent of GDP at end-2017. **Assessment.** Large gross external liabilities pose risks. Mitigating factors include the comfortable external asset position and the sizable rand-denominated share of external debt (about half of total external debt).	**Overall Assessment**: *The external position of South Africa in 2017 was moderately weaker than implied by fundamentals and desirable policy settings.* In 2017, the current account gap remained broadly unchanged, and South Africa remains highly reliant on non-FDI flows to finance its relatively high current account deficit. Despite several years of REER depreciation until recently, structural rigidities result in a relatively slow pace of CA adjustment. Developments since end-2017 do not change the assessment. **Potential policy responses**: Several measures would help to reduce the external position gap, including improving competitiveness and increasing employment and savings. These measures include fostering entry into key product markets (such as power generation, transportation, and telecommunications); upgrades in infrastructure and education/skills within the fiscal envelope; and greater financial inclusion. Preserving government debt sustainability and accelerating labor and product market reforms are also essential to continue to attract foreign inflows, especially durable inflows such as FDI. Seizing opportunities—such as large FDI inflow transactions—to accumulate reserves would strengthen the country's ability to deal with FX liquidity shocks.
Current account	**Background.** The CA deficit narrowed to 2.5 percent of GDP in 2017 from 2.8 percent in 2016, owing to a further improvement in the trade balance as terms-of-trade gains more than outweighed a pick-up in domestic demand. The CA deficit is projected to widen to around 3 percent of GDP in 2018 as the surplus on the trade balance moderates. **Assessment.** The CA regression model estimates a CA norm surplus of 0.7 percent of GDP. However, an adjustment to the norm of 1.1 percent of GDP is needed given special demographic factors relative to other countries in the regression sample. 1/ Therefore, staff considers a CA norm of -0.4 percent of GDP. Over time, as policy uncertainty may unwind following the new administration's initial announcements, the CA norm may be further reduced. The cyclically adjusted CA stood at -2.5 percent of GDP in 2017. However, given statistical treatments related to the transfers and income accounts, an additional adjustment of 0.8 percent of GDP is needed. Hence, staff considers a revised cyclically adjusted CA of -1.7 percent of GDP, implying a CA gap of -1.3 percent of GDP. The CA gap is largely explained by structural factors not captured by the model. 1/	
CA Assessment 2017	Actual CA: -2.5 | Cycl. Adj. CA: -2.5 | EBA CA Norm: 0.7 | EBA CA Gap: -3.2 | Staff Adj.: -1.9 | Staff CA Gap: -1.3	
Real exchange rate	**Background.** After several years of REER depreciation, the CPI-REER appreciated by 12.4 percent on average in 2017 relative to 2016. Despite renewed depreciation in the second half of 2017, a marked appreciation at the turn of the year more than reversed this weakening. As of May 2018, the REER had appreciated an additional 5.6 percent relative to the 2017 average. **Assessment.** The REER is assessed through two REER-based regressions and by computing the implied REER gap from the CA gaps. The CA approaches, on which staff puts greater weight, point to overvaluation of 2–9 percent. The REER approaches point to undervaluation of between 7.4 percent (level approach) and 13.4 percent (index approach), but these results are considered less reliable. 3/ Staff assesses a REER overvaluation of 0–10 percent for 2017, broadly consistent with the CA gap. 4/	
Capital and financial accounts: flows and policy measures	**Background.** Net FDI flows at -1.7 percent of GDP in 2017 marked the fourth consecutive year with net FDI outflows. Portfolio investment remained strong at 4.7 percent of GDP, becoming the main source of financing of the CA deficit. Gross external financing needs stood at 14 percent of GDP in 2017. **Assessment.** High reliance on non-FDI flows and high nonresident holdings of local financial assets pose risks. These are mitigated by a floating exchange rate, the fact that nonresident portfolio holdings are mainly denominated in local currency, and a large domestic institutional investor base.	
FX intervention and reserves level	**Background.** South Africa has a floating exchange rate regime. Foreign exchange intervention is rare. At end-2017, international reserves were equivalent to 14.5 percent of GDP, down from 16 percent the year before. They cover 5½ months of projected imports, but are below the IMF's composite adequacy metric (64 percent of the metric without considering existing capital flow management measures, and 70 percent of the metric after considering them). **Assessment.** As conditions allow, reserve accumulation is desirable to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.	

	South Africa (concluded)
Technical Background Notes	1/ The staff-assessed CA gap uses results from the EBA CA regression, the External Sustainability (ES) approaches, and staff's judgment. • As South Africa is among the few outlier countries regarding adult mortality rates, the demographic indicators are adjusted to account for the younger average prime-age and exit age from the workforce. This results in an adjustor of -1.1 percent of GDP to the model-estimated CA norm. • Net current transfers related to the Southern African Customs Union (SACU), which are assessed to have a net negative impact on the CA, are not accounted for in the regression model and therefore warrant an adjustment of the cyclically adjusted CA. In addition, large and positive IIP valuation changes relative to other countries in the sample point to the need for adjusting the cyclically adjusted CA gap. The combined adjustment is 0.8 percent of GDP. • The ES approach compares the CA balance expected to prevail in the medium term with the one that would stabilize South Africa's stock of net foreign assets at its emerging market peers' benchmark (-35 percent of GDP). According to the ES approach, stabilizing South Africa's NIIP at the level of emerging market peers would require a CA deficit of 1.4 percent of GDP. Compared with staff's adjusted medium-term projection of a CA deficit of 3.6 percent of GDP, the latter implies a CA gap of -2.3 percent of GDP. 2/ Gauging the appropriate REER for South Africa is challenging as the pre-2000 average REER was at a more appreciated level than the post-2000 average. In this context, REER regression-based models are likely to point to undervaluation, unless they can link the full downward trend of the REER to deteriorating fundamentals. 3/ Applying a long-run elasticity estimate of 0.27 would suggest a REER overvaluation of 2–9 percent. However, considering the uncertainty regarding the estimates as well as the REER-regression results, staff assesses REER overvaluation in the order of 0–10 percent.

<table>
<tr><th></th><th colspan="10">Spain</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="10">Background. The net international investment position (NIIP) dropped from -35 percent of GDP in 2000 to -94 percent of GDP in 2009, driven mostly by high current account (CA) deficits but also by valuation effects. The NIIP remained elevated at -81 percent of GDP at end-2017, yet has improved by 14 percentage points since 2013, partly due to sustained CA surpluses during the period. Gross liabilities stood at 242 percent of GDP in 2017, with more than 2/3 in the form of external debt. While the private sector has deleveraged since the crisis, NIIP accounted for by the general government and the central bank increased, raising its share from around ¼ in 2010 to ¾ in 2017. Part of that increase is due to TARGET2 liabilities, which had reached 32 percent of GDP by end-2017. 1/

Assessment. The large negative NIIP comes with external vulnerabilities, including from large gross financing needs from external debt and potentially adverse valuation effects. Mitigating factors are a favorable maturity structure of outstanding sovereign debt (averaging 7 years) and current ECB measures, such as QE, that lower the cost of debt.</td><td rowspan="6">Overall Assessment:
The external position in 2017 was moderately weaker than consistent with medium-term fundamentals and desirable policy settings. Recent developments suggest that the external position continues to gradually strengthen.
Staff assesses Spain's current account (CA) norm to be relatively high, in part due to external sustainability risks from a large negative net international investment position (NIIP). In 2017, the CA remained in surplus, helped by robust external demand, low interest rates, and improved competitiveness from wage moderation. Spain recorded its fifth consecutive annual CA surplus, unprecedented in recent Spanish history. Despite the improvement in the CA since the pre-crisis peak deficit in 2007, achieving both a sufficiently strong NIIP and further reductions in unemployment continues to require a moderately lower real effective exchange rate for a sustained period.

Potential policy responses:
The authorities' structural reforms in response to the global financial crisis, in particular the labor market reform, with the resulting wage moderation, and fiscal deficit reductions supported the reduction in imbalances.
Reducing the still sizable structural fiscal deficit is a key policy requirement to lower the remaining imbalances. Moving forward with additional structural reforms of the labor market and faster implementation of product market reforms are also required to achieve the necessary additional adjustment.
Continued monetary accommodation at the euro area level to lift inflation closer to the ECB's medium-term price stability objective should support external demand and Spain's adjustment efforts.</td></tr>
<tr><td>Current account</td><td colspan="10">Background. After a peak CA deficit in 2007 of 9.6 percent of GDP, corrected initially by a sharp contraction in imports, exports and imports have since grown strongly along with the economic recovery leading to CA surpluses in 2013-17. The CA surplus reached 1.9 percent of GDP in 2017. Regained competitiveness from wage moderation and greater internationalization efforts by Spanish firms contributed to strong export growth, and an increase in Spain's share of world goods exports. CA surpluses are projected to continue in the medium term notwithstanding the recent appreciation of the euro and the projected moderately higher oil prices.

Assessment. The EBA CA model suggests a norm of 1.4 percent of GDP for 2017, which is roughly equal to the cyclically adjusted CA balance (1.5 percent of GDP). However, given external risks from a large and negative NIIP, staff's assessment puts more weight on external sustainability, and is guided by the objective of strengthening the NIIP to above -50 percent over the medium term. This yields a CA norm of about 3 percent of GDP, with a range of 2-4 percent of GDP, and a CA gap of -2.5 to -0.5 percent of GDP. 2/ Another factor supporting a higher CA gap is a high uncertainty about the output gap against the backdrop of past structural reforms and large structural changes of the economy: if the output gap is larger (for example, reflecting a structural level of unemployment closer to international peers), the cyclically adjusted CA would be lower and thus the gap with respect to the desirable level would be larger.</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA</td><td>1.9</td><td>Cycl. Adj. CA</td><td>1.5</td><td>EBA CA Norm</td><td>1.4</td><td>EBA CA Gap</td><td>0.1</td><td>Staff Adj.</td><td>1.6 | Staff CA Gap -1.5</td></tr>
<tr><td>Real exchange rate</td><td colspan="10">Background. In 2017, both the CPI-based and the ULC-based real effective exchange rate (REER) appreciated by 2 percent from their average 2016 levels. The CPI-based REER is still about 8 percent lower than its 2009 peak, partially reversing the 21 percent appreciation from the euro entry in 1999 until 2009. The ULC-based REER shows that the appreciation since euro entry has been substantially reversed, initially because of significant post-crisis labor shedding and, more recently, of wage moderation and enhanced output growth. After reaching its peak in 2008, the ULC-based REER depreciated by 17 percent. As of May 2018, the CPI-based REER and the ULC-based REER appreciated an additional 0.6 to 2.0 percent, relative to their 2017 averages, boosted by euro appreciation.
Assessment. The two EBA REER models estimate an overvaluation in the range of 5.1 to 5.8 percent for 2017; whereas the CA model implies a close-to-zero overvaluation. 3/ Taking into account also the historical CPI- and ULC-based REER, and the risks from NIIP sustainability, on balance, staff assesses a 2017 REER gap in the range of 3 to 10 percent.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="10">Background. Financing conditions have continued to be favorable, with sovereign bond yields near historical lows. At the same time, the private sector has continued its deleveraging against the rest of the world. TARGET2 liabilities increased during 2015-17 at an annual average pace of 5 percent of GDP, reflecting the creation of liquidity within the framework of the Eurosystem's asset purchase program. In this context of plentiful liquidity, resident agents increased their net investment in foreign assets and net liability flows against the rest of the world (excluding the Bank of Spain) declined. Recent net capital outflows are also explained by a net FDI outflow.
Assessment. The ECB's actions as well as domestic reforms and fiscal consolidation have greatly helped improve investor sentiment. However, large external financing needs both in the public and private sector leave Spain vulnerable to sudden changes in market sentiment and spillovers from Europe.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="10">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.</td></tr>
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	Spain (concluded)
Technical Background Notes	1/ Based on data available through 2017: Q4. 2/ The EBA model suggests a CA norm of 1.4 percent of GDP, with a standard deviation of 1.3 percent of GDP. This CA norm is 0.4 percentage points of GDP lower than that reported in last year's ESR report, largely reflecting data updates and refinements to the EBA framework. In the case of Spain, a reduction in the contribution of demographic factors to the CA norm was partly offset by a more positive contribution of policy variables, particularly the refined private credit variable That said, the empirically-based EBA norm doe s not fully account for the very negative NIIP, with around 30 percent of gross liabilities in the form of equity. Given external stability considerations, a CA norm in the range of 2-4 percent of GDP is necessary to strengthen the NIIP by about 5 percent of GDP annually over the next 5-10 years. 3/ The semi-elasticity of the CA to the REER is estimated at 0.28.

	Sweden	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The Swedish net IIP reached 9.6 percent of GDP in 2017, up 4.6 percentage points in the year. It is expected to rise further in the medium term, reflecting the outlook for continued current account (CA) surpluses. It is worth noting that over the last decade, the average annual increase in the net IIP was about 0.7 percent of GDP, well below the average CA surplus of 5.3 percent of GDP. This gap may partly reflect negative valuation effects, but its persistence since 2000 suggests potential measurement issues. This is consistent with the large errors and omissions, which have averaged -2.9 percent of GDP in the past decade. **Assessment**. Gross liabilities were 278 percent of GDP in 2017, with about a third being external debt (91 percent of GDP). Although rollovers of external debt (which include banks' covered bonds) pose some vulnerability, risks are moderated by the banks' liquidity and capital buffers. Sweden's strong FX reserves and low public debt help ensure capacity to manage pressures.	**Overall Assessment**: Sweden's external position in 2017 was *moderately stronger* than the level consistent with medium-term fundamentals and desirable policies. Subsequent developments do not point to a change in the external position. **Potential policy responses**: Under current and prospective policies, a decline in the current account surplus can be expected in the medium-term. Accommodative monetary policy is supporting domestic demand growth, and some appreciation of the krona is expected when inflation returns to target. A mildly expansionary fiscal policy stance—consistent with converging to the lower medium-term surplus target—will also support demand going forward. Overall investment is solid, but it remains important to implement reforms to sustain the higher level of residential investment. Efforts to facilitate migrant integration into the labor market should continue in order to raise potential output and also reduce household uncertainties around the sustainability of Sweden's strong social model.
Current account	**Background**. The CA balance is estimated to have fallen to 3.2 percent of GDP in 2017, from 4.2 percent in 2016 and well below its average in the past decade (5.3 percent). This decline is in part related to an unusually large decline in net services (of 1.1 percent of GDP), with three-fifths of which coming from financial services and other unspecified services. **Assessment**. The cyclically adjusted current account was 3.6 percent of GDP in 2017, 1.8 percentage points above the cyclically adjusted EBA norm of 1.8 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 may also be driving Sweden's savings-investment balances. Overall, staff assesses Sweden's CA gap at 1.6 percent of GDP in 2017, within a range of +/- 1.5 percent of GDP, reflecting uncertainty around both the 2017 CA outturn and the EBA estimated norm.	
CA Assessment 2017	Actual CA 3.3 | Cycl. Adj. CA 3.6 | EBA CA Norm 1.8 | EBA CA Gap 1.8 | Staff Adj. 0.2 | Staff CA Gap 1.6	
Real exchange rate	**Background**. The Swedish krona was mostly unchanged in real effective terms in 2017 relative to its average level in 2016, as monetary policy in Sweden helped keep the yield curve broadly aligned with that of Germany. As of May 2018, the REER has weakened by 5.8 percent relative to the 2017 average. **Assessment**. EBA analysis suggest a gap of -10 percent using the REER index and level approaches, respectively, for 2017. In contrast, in 2017 the ULC based REER index is only 3 percent below its 25-year average, well within its +/- 12.5 percent historical fluctuation range. Applying a 0.25 semi-elasticity of CA to REER to the CA gap of 1.6 percent +/- 1.5 percent of GDP gives a valuation range for the *krona* of 0 to -12 percent. Given uncertainties related to EBA's CA gap estimates for Sweden, staff gives greater weight to estimates from the EBA REER models and the ULC based REER position, and assesses the *krona* to be undervalued by 0 to 10 percent. This REER gap is expected to be temporary, with the krona likely to appreciate in the medium term as monetary policy eventually normalizes.	
Capital and financial accounts: flows and policy measures	**Background**. Given their size and funding model, Sweden's large banks remain vulnerable to liquidity risks stemming from global wholesale markets even though banks have improved their structural liquidity measures in recent years. **Assessment**. A further decline in banks' short-term funding in favor of longer maturities is desirable over time. Macroprudential policies, including planned increases in capital buffers of domestic banks, raising funding stability standards, and mortgage amortization regulations on the household side, can help contain vulnerabilities and hence potential liquidity risks.	
FX intervention and reserves level	**Background**. The exchange rate is freely floating—Riksbank statements regarding their potential to intervene have not as yet been implemented. Foreign currency reserves stood at USD 54 billion in December 2017, which is equivalent to 20 percent of the short-term external debt of monetary and financial institutions (primarily banks) and about 11 percent of GDP. **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, it would not be appropriate to reduce Sweden's existing reserves. A further tightening of FX liquidity requirements on banks should be evaluated.	

	Sweden (concluded)
Technical Background Notes	

<table>
<tr><th></th><th>Switzerland</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Switzerland is a financial center with a positive net international investment position (NIIP) of 127 percent of GDP and gross foreign asset and liability positions of 714 and 587 percent of GDP, respectively, at end-2017. The NIIP-to-GDP ratio is about unchanged from its peak in 2011 at 133 percent, having subsequently declined steadily—despite CA surpluses averaging about 10 percent of GDP—reflecting mainly persistent negative valuation effects, but recovered by around 35 percentage points from 2015 to 2017 partly on account of valuation gains. 1/ Valuation changes reflect fluctuations in exchange rates and prices of securities and precious metals that interact with mismatches between assets and liabilities in terms of currencies and financial instruments. 2/
Assessment. Switzerland's large gross liability position and the volatility of financial flows present some risk, but these are mitigated by its large gross asset position and the fact that most external liabilities are denominated in Swiss francs. Nonetheless, given the large gross positions and compositional mismatch between assets and liabilities, relatively modest changes in exchange rates and asset prices can have a material effect on the NIIP.</td><td rowspan="6">Overall Assessment:
Switzerland's external position was broadly consistent with medium-term fundamentals and desirable policies in 2017, although this assessment is subject to especially-high uncertainty. REER overvaluation following the exit from the floor in 2015 had been unwound by 2017. Were the recent real depreciation to continue, future assessments could be affected.

Potential policy responses:
Macroeconomic policies should be geared toward ensuring balanced contributions to GDP growth from domestic and external demand. This objective requires moving to—and maintaining—a structurally-neutral fiscal stance, which would also ease the burden on monetary policy that faces operational limits during periods of economic weakness or safe-haven appreciation pressures. In addition, monetary policy should continue to accommodate a modest secular trend real appreciation via timely adjustment of the policy interest rate to keep inflation within target. Foreign c urrency intervention should be reserved for addressing large exchange market pressures that would otherwise cause temporary volatility in inflation and output. In addition, reforming the corporate income tax would encourage
investment by SMEs, thereby reducing net saving.</td></tr>
<tr><td>Current account</td><td>Background. Switzerland has run large CA surpluses, averaging about 10 percent of GDP since 2006. The composition of the CA has changed considerably during this period. While in earlier years the largest component was the income balance, in recent years this has been replaced to a large extent by the trade balance. Within the latter, goods (which include merchanting) have been responsible for an increasing share of the surplus, particularly the chemical and pharmaceutical categories. The CA surplus increased to 9.8 percent of GDP in 2017 from 9.4 percent of GDP in 2016.
Assessment. Based on a cyclically adjusted CA surplus of 9.6 percent of GDP and an EBA CA norm of 6.2 percent of GDP (which partly reflects the demand for saving by the large share of prime-age savers), the total gap including the unexplained residual equaled to 3.4 percentage points of GDP in 2017, of which the policy gap contributed -0.5 percentage points (mainly due to excessive private sector credit). Some Switzerland-specific factors not appropriately treated in the measured underlying CA lower the CA gap: (i) inclusion of retained earnings on portfolio equity investment and (ii) compensation for valuation losses on fixed income securities arising for inflation that is recorded as income. 3/ After accounting for these factors, staff estimates a remaining CA gap of about 0.8 percent of GDP (with a range of ±2 percentage points). 4/</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA | 9.8 | Cycl. Adj. CA | 9.6 | EBA CA Norm | 6.2 | EBA CA Gap | 3.4 | Staff Adj. | 2.6 | Staff CA Gap | 0.8</td></tr>
<tr><td>Real exchange rate</td><td>Background. The CPI-based REER appreciated by 25 percent during 2007–17, including two episodes of rapid appreciation in response to safe-haven inflows. The first spike occurred in July 2011, and led the SNB to establish a floor of 1.20 for the CHF/EUR exchange rate in September 2011. After appreciating sharply following the exit from the floor on January 15, 2015, the REER moderated, initially on account of a partial unwinding of the overshooting of the nominal effective exchange rate and, subsequently, on lower inflation in Switzerland than in its trading partners. The average REER for 2017 weakened by 2.2 percent relative to the 2016 average, and as of May 2018, it had weakened a further 5.4 percent (compared with the 2017 average).
Assessment. The EBA REER index and level models suggest the average REER in 2017 was 15-22 percent overvalued, with policy gaps accounting for a modest amount of the total gap. To a large extent, this finding reflects the "reversion to trend" properties of the empirical model in the context of the prior rapid appreciation episodes. However, due to measurement issues, these results may not fully capture the secular improvement in productivity, especially in knowledge-based sectors. Based on the CA gap, staff assesses the REER gap to have been in the range of -5.3 to +2.3 percent in 2017.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. In recent years, Switzerland has experienced large inflows in the form of currency and deposits, in part due to its status as a safe haven. Since 2007, these cumulative net inflows amounted to about 75 percent of GDP. To reduce the attractiveness of these inflows, since January 15, 2015, banks' placements at the SNB (above a certain threshold) have been subject to a negative interest rate of 0.75 percent. These inflows stopped during 2017. There are no restrictions on financial flows.
Assessment. Financial flows are large and volatile, reflecting Switzerland's status as a financial center and a safe haven, with inflows tending to accelerate during periods of heightened global and regional uncertainty.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. Foreign exchange reserves amounted to USD811 billion (120 percent of GDP) at end-2017, up USD 132 billion (including valuation changes) since end-2016, with the bulk of the increase taking place in the first half of 2017. About 75 percent was accumulated during 2009–15, including to defend the previous exchange rate floor. Since exiting the floor, the SNB has intervened periodically, purchasing sizable volumes in response to large appreciation pressures from safe-haven surges, as well as more frequently but in smaller amounts. Purchases ceased in mid-2017.
Assessment. Reserves are large relative to GDP but more moderate when compared with short-term foreign liabilities. The high level of reserves reflects monetary policy operations aimed at avoiding persistent undershooting of inflation (which averaged -0.3 percent during 2012–17) as a result of inflow surges, given the limited scope for significant further easing via other monetary policy tools. In particular, the supply of domestic assets available for purchase is very limited, and the interest rate on banks' deposits at the SNB is -0.75 percent, which is the lowest in the world. Past interventions also helped to avoid potential exchange rate overvaluation.</td></tr>
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	Switzerland (concluded)
Technical Background Notes	1/ 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. 2/ As a result, an appreciation (depreciation) of the Swiss franc has a negative (positive) effect on the NIIP, while a symmetric percentage increase in share prices in Switzerland and abroad would reduce the NIIP. 3/ The underlying CA is adjusted for: (i) retained earnings on portfolio equity investment that are not recorded in the income balance of the CA under BPM6; and (ii) the recording of nominal interest on fixed income securities under the BPM framework, which compensates for expected valuation losses (due to inflation and/or nominal exchange rate movements), even though this stream compensates for the (anticipated) erosion in the real value of debt assets and liabilities. Adjusting for both of these effects, and taking into account the lagged NFA contribution to the norm, the underlying CA would need to be reduced by about 2¾ percent of GDP. 4/ The CA gap range reflects the uncertainty inherent in the assessment.

	Thailand
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) improved steadily from -48 percent of GDP in 2000 to -2 percent of GDP in 2009. Subsequently, the NIIP declined to -24 percent of GDP in 2014, despite CA surpluses averaging 1.6 percent of GDP, largely due to valuation changes and other stock-flow adjustments. 2/ The NIIP further declined to around -7 percent of GDP in 2017 with steady increase in gross assets, accompanied by a rising CA surplus and subdued FDI, amid steadily rising outward investment by residents. **Assessment**. In 2017, gross assets were 100 percent of GDP (44 percent being reserve assets) and gross liabilities were 107 percent of GDP (dominated by non-debt liabilities). External debt declined from nearly 35 percent of GDP in 2014 to 32.7 percent of GDP (one-fifth being public debt). Short term debt stood at 14 percent of GDP. There are limited risks to external debt sustainability as external debt is projected to remain relatively low over the medium term and net foreign liabilities as a share of GDP are expected to stabilize.
Current account	**Background**. Thailand's current account (CA) has been volatile over the last decade, ranging from a deficit of 4 percent of GDP in 2005 to a surplus of 7¼ percent of GDP in 2009. The CA then dropped to a deficit of 1¼ percent of GDP by 2013 and rose back to a record surplus of 11.7 percent of GDP in 2016 (with the 5-year average of 4.4 percent of GDP). The 12.9 percent of GDP turnaround in the CA between 2013-16 can be largely accounted for by a 5.8 percent of GDP decline in net oil imports and a 3 percent of GDP rise in the services balance (mainly tourism). Net oil imports and tourism also account for the bulk (two-thirds) of the increase in the CA in 2016. The CA surplus modestly declined to 10.6 percent of GDP in 2017, reflecting an increase of imports of 1½ percent of GDP. **Assessment**. The EBA CA model estimated a small (0.5 percent of GDP) terms-of-trade (ToT) cyclical adjustment, with a cyclically adjusted 2017 CA of 10.1 percent of GDP and a CA norm of 0.5 percent of GDP. The CA gap of 9.6 percent of GDP consists of an identified policy gap of 1.8 percent of GDP (0.4 percent of GDP from domestic policy gaps), and an unexplained residual of 7.8 percent of GDP. The large unexplained residual partly reflects Thailand-specific features not fully captured by the EBA model. Notwithstanding continued improvement in ToT and the boom in tourism, private domestic demand remained weak, reflecting a cautious response to these positive shocks during the ongoing political transition that weighed on private sector confidence. Considering these factors, staff assesses the CA surplus to be 4 percent to 8 percent of GDP larger than the level consistent with medium-term fundamentals and desirable policies. 3/ The CA gap is expected to narrow over the medium term, as policy stimulus is deployed, political uncertainty dissipates, private confidence recovers, and steps are taken to reform the safety net.
CA Assessment 2017	Actual CA: 10.6 | Cycl. Adj. CA: 10.1 | EBA CA Norm: 0.5 | EBA CA Gap: 9.6 | Staff Adj.: 3.6 | Staff CA Gap: 6.0
Real exchange rate	**Background**. The baht has been on a broadly stable real effective exchange rate (REER) appreciation trend since the mid-2000s. Exceptional periods were the Fed's tapering talk in mid-2013 and the domestic monetary policy easing cycle in 2015: Q1, when the baht depreciate d for several quarters. The REER resumed its gradual real appreciation trend in 2016 and continued this trend in 2017. In 2017, the REER appreciated by 3.4 percent relative to 2016 4/, while, as of May 2018, the REER appreciated by an additional 2.5 percent compared with the average of 2017. **Assessment**. Using an elasticity of 0.6, staff assesses the 2017 REER to be 7 percent to 14 percent below levels consistent with medium-term fundamentals and desirable policies. This gap is expected to narrow over the medium term as policy stimulus and structural reforms are deployed, supporting domestic demand and a growth-driven real exchange rate appreciation process. 5/
Capital and financial accounts: flows and policy measures	**Background**. The capital and financial account balance has been negative since 2013. In 2017, the net negative balance amounted to 4 percent of GDP. Outward FDI hit a record high of 4.6 percent of GDP owing to Thai firms' overseas investment. Outward portfolio investment reached 2.6 percent of GDP (two-thirds is equity securities), higher than portfolio inflows of 2.1 percent of GDP (mostly concentrated in the long-term securities issued by the government and corporate sectors). Net other investment outflows were about 1 percent of GDP. The authorities continued with financial account liberalization, encouraging outward investment by residents. **Assessment**. Up to 2013, Thailand enjoyed overall portfolio inflows benefiting from its strong fundamentals. But from 2013, Thailand has faced headwinds, including the Fed's interest rate lift-off, China's slowdown, and political uncertainty. Capital outflows are manageable considering the resilient external sector and the greater flexibility of the baht, partially offsetting the current account surplus.
FX intervention and reserves level	**Background**. The exchange rate regime is classified as (de jure and de facto) floating. International reserves were 44½ percent of GDP in 2017, standing at over three times short-term debt, 234 percent of the IMF's reserve metric unadjusted for capital controls, and 278 percent of the metric adjusted for capital controls. Staff considers the unadjusted adequacy metric to be more appropriate. (The adjusted metric relies on de jure capital controls, which fail to capture recent liberalization measures and the extent to which controls are binding). **Assessment**. Interventions appear to have been mostly one-sided, as suggested by the sizable and continuous monthly increase in the stock of reserves and FX forward position during 2017 (the only proxies for intervention, as actual intervention data are not published). International reserves (including net forward position) increased by US$41.7 billion (9 percent of GDP) during 2017, and further increased by US$12.1 billion (2½ percent of GDP) in 2018Q1. Reserves are higher than the range of the IMF's adequacy metrics and there is no need to build up reserves for precautionary purposes. The exchange rate should move flexibly, acting as a shock absorber, with intervention limited to avoiding disorderly market conditions.

Overall Assessment

Overall Assessment:
The external position in 2017 was substantially stronger than warranted by medium-term fundamentals and desirable policy settings.
Despite a modest decline, the current account remained large, reflecting a cautious response of domestic demand to large, positive income shocks amid political uncertainty, as well as structural challenges. The REER appreciation trend continued in 2017.

Potential policy responses:
External rebalancing requires a concerted policy effort to support domestic demand and a gradual, sustained appreciation of the REER over the medium term. Mutually reinforcing monetary and fiscal stimulus, coupled with structural reforms, should support domestic demand and help lower the current account gap over time. Such a strategy would facilitate the needed REER appreciation through a growth-driven process, boosting real incomes.
The boost to public infrastructure within available fiscal space should crowd-in private investment. The authorities should continue addressing structural rigidities by reforming social safety nets, notably the fragmented pension schemes compounded by widespread informality, and reducing barriers to investment, especially in the services sector.
The exchange rate should move flexibly as the key shock absorber. Intervention should be limited to avoiding disorderly market conditions. Reserves exceed all adequacy metrics, thus there is no need to build up reserves for precautionary purposes.

	Thailand (concluded)
Technical Background Notes	1/ The assessment is based on the refined EBA model. Preliminary figures from the previous model indicate a similar assessment. 2/ These persistent negative valuation effects during 2010-14 have been driven mainly by capital inflows contributing to the growth of asset prices and baht appreciation. 3/ The EBA model has a very large (and rising since 2013) unexplained residual for Thailand, likely driven by imperfect measurement of the large, positive ToT shock, the boom in tourism, and political uncertainty. Staff adjustments improve the measurement of these Thailand-specific cyclical and transitory factors through (i) updated weights in the EBA terms of trade index, with an adjustment of 1-1.5 percent of GDP; (ii) an estimate of the cyclical component in the recent boom in tourism, with an adjustment of 0.5-1.0 percent of GDP; and (iii) an estimate of the transitory impact of the ongoing political transition not captured by the institutional quality variables included in the EBA model, with an adjustment of 0-3 percent of GDP. Moreover, the public health expenditure variable does not fully reflect the largely underdeveloped social safety nets, including low minimum pensions accruing to the large informal sector, which contribute to the current high levels of precautionary savings. 4/ The REER appreciated more than 6 percent since 2005. 5/ The EBA index REER gap in 2017 is estimated at 6.4 percent; the EBA level REER gap is estimated at -2.1 percent.

	Turkey	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Turkey's net international investment position (NIIP) deteriorated significantly from -42 percent of GDP in 2016 to -53 percent of GDP at end-2017, a weak position relative to peers, reflecting a wider CA deficit and increased valuation of equity liabilities driven by rising equity prices more than offsetting the impact of Lira depreciation. 1/ Total foreign liabilities amount to 80 percent of GDP, dominated by debt, which, at 53 percent of GDP, remains sustainable over the medium term. Improvements seen in debt maturities over 2015-16 have been slightly reversed due to the lower subsequent quality of inflows and risks remain significant, given that short-term debt and non-resident holding of domestic portfolio debt amount to around 25 percent of GDP. Debt service of the private sector is vulnerable to hikes in global rates with 40 percent of long-term debt being on adjustable interest rate terms. In addition, a large portion (37 percent) of private domestic debt is denominated in FX. Non-debt external liabilities are low relative to peers at 27 percent of GDP, with FDI equity capital liabilities comprising 20 percent of GDP and the remainder being mostly in equity securities. **Assessment**. The large negative NIIP and the composition of foreign liabilities expose Turkey to liquidity shocks, sudden shifts in investor sentiment, and increases in global interest rates. Turkey's NIIP is projected to deteriorate further by about 5 percentage points of GDP by 2023 due to sustained CA deficits. The FX component of domestic debt also comprises a balance sheet risk for corporates with the potential to worsen bank asset quality with negative feedback on growth and financial stability.	**Overall Assessment**: *In 2017, Turkey's external position was weaker than the level consistent with medium-term fundamentals and desirable policies, although the sharp REER depreciation since 2016 is expected to support the CA adjustment toward its norm over the medium term.* *Large financing needs and a high share of short-term and portfolio inflows make Turkey vulnerable to capital flow reversals.* **Potential policy responses**: Tighter macroeconomic policies are necessary to reduce the large current account deficit, while also allowing reserves to be rebuilt, raising the NIIP, and shifting the composition of liabilities away from short-term debt. Specifically, tighter fiscal, and quasi-fiscal, and monetary policies will help rein in domestic demand and imports, while macroprudential policies could help to slow credit growth, improve the quality of external financing, and lower risks from FX exposure in the economy. Monetary policy should aim at re-anchoring inflation expectations and building the credibility of the inflation target. The CBRT should increase reserve coverage, while limiting FX sales to periods of excessive lira volatility. The combination of these macro policies and reforms to strengthen competitiveness and encourage private saving would help to sustain external rebalancing.
Current account	**Background**. The CA deficit narrowed sharply between 2011 and 2016 (from 8.9 to 3.8 percent of GDP), principally driven by the decline in oil prices. It widened again in 2017 to 5.6 percent, however, due to expansionary policies as well as greater gold imports, offsetting the impact of growth in exports and recovery in tourism receipts. 2/ The stimulus-backed recovery in domestic demand has led to the output gap turning positive in 2017 with clear signs of overheating emerging. **Assessment.** EBA model estimates suggest that the cyclically adjusted CA balance in 2017 was 4.0 percent of GDP lower than the level implied by medium-term fundamentals and desirable policies. After adjusting the CA balance for the temporary surge in gold imports (0.7 percent of GDP), and the EBA estimated CA norm downward for NIIP-related considerations, staff assesses the CA gap to be in the -1.2 to -3.2 percent of GDP range. 3/	
CA Assessment 2017	Actual CA: -5.6 | Cycl. Adj. CA: -4.8 | EBA CA Norm: -0.9 | EBA CA Gap: -4.0 | Staff Adj.: -1.8 | Staff CA Gap: -2.2	
Real exchange rate	**Background**. The Turkish REER has been on a depreciating trend since 2013. In 2017, the average REER depreciated by 10 percent from the year before, standing 25 percent below its peak. By May 2018, the lira had fallen an additional 13 percent in real terms relative to the 2017 average. **Assessment**. The EBA REER Index and level approaches suggest the REER was undervalued in 2017 in the range of 5-6 percent. The EBA CA approach points to a REER overvaluation of around 14.5 percent, while the ES approach suggests an REER broadly in line with fundamentals. Staff assesses the 2017 REER to have moved to the broadly in line range (+/-10 percent), which will support a narrowing of the CA deficit going forward. This assessment is also supported by other measures of competitiveness, including rising export shares and declining unit labor cost measures of the REER.	
Capital and financial accounts: flows and policy measures	**Background**. The quality of financing weakened in 2017 with a decline in net FDI (to below 1 percent of GDP) and higher portfolio inflows into government and bank debt securities stimulated by carry trades. Turkish spreads have narrowed, but remain elevated relative to other large emerging market economies. Rollover rates on non-financial corporate external loans declined earlier in the year as firms made more use of domestic credit supported by state guarantees, but have recovered since then. Turkey has not made use of capital controls on either inflows or outflows. **Assessment**. Following earlier improvements in the financing structure of the current account over 2015-16 with the start of credit deleveraging, the quality of financing has again deteriorated in 2017 as credit growth resumed, with increased reliance on volatile capital flows for external financing. Gross external financing needs are over 25 percent of GDP making Turkey vulnerable to adverse shifts in global investor sentiment.	
FX intervention and reserves level	**Background**. The de facto and de jure exchange rate is floating. The CBRT stopped selling foreign exchange to commercial banks in 2016 though it continues to provide direct sales of FX to energy-importing SOEs. Reserves have been impacted by several measures to support FX liquidity, including 1-week FX deposit auctions, changes to the Reserve Option Mechanism aimed at releasing FX liquidity used for lira reserve requirements, and accepting below-market rate lira payments for US dollar–denominated export rediscount credit repayments. These measures have contributed to limiting the net inflow of FX into gross reserves, which have remained low at around $108 billion USD at end-2017 (82 percent of the ARA metric) while net international reserves declined to $31 billion USD. 4/ **Assessment**. Given the low reserve coverage of external financing requirements (less than half) and low net international reserves, further reserve accumulation is needed.	

	Turkey (concluded)
Technical Background Notes	1/ Despite persistent CA deficits, the NIIP has fluctuated with no clear upward trend over 2009–16, due to a mix of positive valuation effects and large net BOP errors and omissions. 2/ Staff estimates the additional cyclical contribution to the CA deficit due to gold imports in 2017 at 0.7 percent of GDP (the demeaned gold trade deficit over 1998-2017 was 0.4 percent of GDP, compared with 1.1 percent of GDP in 2017). 3/ Staff assesses Turkey's CA norm about 1 percent of GDP lower than the estimated EBA CA norm. The staff-assessed norm of -1.9 percent of GDP is consistent with a gradual improvement in the NIIP to levels comparable to peers and a reduction in vulnerabilities. 4/ Net international reserves net out from gross international reserves the CBRT's FX liabilities to banks. The latter includes the Reserve Option Mechanism (ROM), which allows banks to meet reserve requirements on lira liabilities with foreign exchange and gold. The ROM balances are held at blocked accounts at CBRT for 14 days, and may be fully substituted with lira liquidity after this maintenance period. Domestic banks may also use FX deposits at the CBRT as collateral for lira liquidity facilities, including swaps with maturities of up to 1 month.

<table>
<tr><th></th><th>United Kingdom</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The net international investment position (NIIP) declined from -4.4 percent of GDP in 2016 to -12.8 percent of GDP in 2017. Over the past five years, the NIIP has strengthened by 16 percentage points, reflecting a negative CA contribution (-24pp) more than offset by valuation and growth effects (35 percentage points and 5 percentage points, respectively). 1/ Staff projects the NIIP to weaken over the medium term, although the importance of and uncertainty around valuation effects cast significant doubt around these estimates.
Assessment. The sustainability of the NIIP is not a concern. UK's external assets have a higher foreign-currency component than its external liabilities, so the NIIP improves with sterling depreciation. However, fluctuations in the underlying gross positions are a potential source of vulnerability (both gross assets and liabilities amount to over 500 percent of GDP).</td><td rowspan="6">Overall Assessment:
The external position in 2017 was weaker than implied by medium-term fundamentals and desirable policy settings.

Although improving, the current account deficit remained high in 2017, reflecting low public and private savings. Over the medium term, the deficit is set to narrow helped by the past sterling depreciation and ongoing fiscal consolidation.
The uncertainty around this assessment is significant, reflecting both possible measurement issues in external sector statistics as well as uncertainty about the future trade arrangement with the EU and its possible effect on growth and trade flows.

Potential policy responses:
The current fiscal consolidation plan implemented within a medium-term framework will appropriately continue to support the external rebalancing.
Further structural reforms focused on broadening the skill base and investing in public infrastructure should boost productivity, improving the competitiveness of the economy.
Maintaining financial stability through macroprudential policies should also support private-sector saving. These efforts are particularly important in light of expectations that access to the EU market will become more restrictive.</td></tr>
<tr><td>Current account</td><td>Background. The CA balance improved to -4.1 percent of GDP in 2017 (from -5.8 percent in 2016), remaining significantly below its average historical values. The wider CA deficits since the global financial crisis reflect mostly weaker income balance, due in part to lower earnings on the UK's foreign direct investment abroad (especially in the euro area). By contrast, the trade balance has been stable at around -2 percent of GDP through 2016, and increased to -1.4 percent in 2017, supported by strong growth in trading partners and a weaker sterling. The CA improvement in 2017 was also driven by an improvement in net income flows (0.9 percent of GDP), helped by the positive valuation effect from sterling depreciation which increase the sterling value of income inflows denominated in foreign currency.
From a savings-investment perspective, the CA dynamics during 2017 reflect an improvement in gross national savings, but the CA deficit reflects a still elevated general government deficit (2.2 percent of GDP in 2017) and low private sector savings.
Assessment. The EBA CA model estimates a CA gap of -5 percent of GDP for 2017 (a cyclically adjusted CA balance of -4 percent of GDP compared with a CA norm of 1 percent of GDP). However, the cyclically adjusted CA could be understated due to measurement biases, as suggested by the observed persistent, positive, and large valuation effects that have kept the NIIP broadly stable since the 1980s. 2/ Looking ahead, the recovery of global growth relative to UK growth should translate into higher net income inflows over time. Uncertainty around the CA gap estimation is high, as evident from the results under different methodologies, possibly reflecting such large measurement issues. Overall, staff assesses the 2017 cyclically adjusted CA balance to be 1 to 5 percent of GDP weaker than the CA norm, with a mid-point of 3 percent of GDP. This range takes into account the uncertainty in the assessment due to the Brexit negotiation process, possible measurement issues, the REER assessment below, and the External Sustainability (ES) approach. 3/ 4/</td></tr>
<tr><td>CA Assessment 2017</td><td>Actual CA | -4.1 | Cycl. Adj. CA | -4.0 | EBA CA Norm | 1.0 | EBA CA Gap | -5.0 | Staff Adj. | -2.0 | Staff CA Gap | -3.0</td></tr>
<tr><td>Real exchange rate</td><td>Background. Sterling depreciated by 10 percent in 2016 in real effective terms relative to its average level in 2015 and by an additional five percent from 2016 to 2017. The depreciation may reflect in part an unwinding of past overvaluation, and in part market expectations of more restrictive access to the EU market in the future. As of May 2018 the REER had appreciated by 1.9 percent relative to its 2017 average.
Assessment. EBA REER level and index approaches suggest a gap of -9.3 and -10.0 percent, respectively, for 2017. In comparison to previous years, the REER assessment is subject to a greater margin of uncertainty due to uncertainty about the UK's new trading relationship with the EU and its effects on the equilibrium level of the REER. Overall, staff assesses the REER to be between 0 and 15 percent above the level consistent with fundamental and desirable policy settings. This range is broadly anchored on the CA assessment. The weaker sterling and strong trading partner growth are expected to support further CA deficit narrowing in the near term.</td></tr>
<tr><td>Capital and financial accounts:
flows and policy measures</td><td>Background. Given the UK's role as an international financial center, portfolio investment and other investment are the key components of the financial account.
Assessment. Large fluctuations in capital flows are inherent to financial transactions in countries with a large financial sector. This volatility is a potential source of vulnerability, although it is mitigated by sound financial regulation and supervision and a strong financial sector. An additional risk is that FDI and portfolio investment inflows may decelerate driven by concerns about the UK's future trade relations with the EU.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. The pound has the status of a global reserve currency.
Assessment. Reserves held by the UK are typically low relative to standard metrics, and the currency is free floating.</td></tr>
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	United Kingdom (concluded)
Technical Background Notes	Note: The Office for National Statistics introduced in 2017 methodological changes, revising the historical series of the CA and the NIIP. Revisions to the CA are negative in most years and relate mainly to the primary income balance. 1/ The official NIIP data might understate the true position—estimates of FDI stocks at market values imply a much higher NIIP. Bank of England estimates suggest that the NIIP based on market values could be close to 80 percent of GDP in 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 UK and abroad. These estimates are uncertain, as actual FDI market values could evolve differently from equity markets. 2/ Staff's estimates of valuation effects have been persistently positive even during periods without significant exchange rate depreciation (i.e. 2000 to 2007, and 2009 to 2015), pointing to potential measurement issues. 3/ The ES approach provides a complementary perspective when the regression approaches yield unsatisfactory empirical fits, as in the case of the UK. This approach suggests a CA gap of about -3 percent of GDP relative to the CA level that would stabilize NFA to GDP at its 2016 level. 4/ Should Brexit lead to a significant increase in trade barriers, the equilibrium exchange rate could be weaker than suggested here.

	United States	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) increased from -44.7 percent of GDP in 2016 to -40.5 percent of GDP in 2017 (but still somewhat below the average of -37.3 percent of GDP for the period 2012-16), mostly due to valuation changes linked to the depreciation of the US dollar by end-2017. Under staff's baseline scenario, the NIIP is projected to decline by about 8 percent of GDP over the next five years, due to a path of increasing current account deficits. **Assessment**. Financial stability risks could surface in the form of an unexpected decline in foreign demand for US fixed income securities, which are the major component of the country's external liabilities. This risk has risen with the deterioration in the US medium-term fiscal outlook, but remains moderate given the dominant status of the US dollar as a reserve currency. Most US foreign assets are denominated in foreign currency and around 65 percent are in the form of FDI and portfolio equity claims, the value of which tends to decline when global growth and stock markets are weak, and when the US dollar appreciates.	**Overall Assessment**: *The US external position was moderately weaker than implied by medium-term fundamentals and desirable policies in 2017.* The strengthening of the economy and the fiscal stimulus are expected to increase the CA deficit in the coming years, moving it further from the level justified by medium term fundamentals and desirable policies. Actual and prospective changes in trade, taxation, and immigration policies add substantial uncertainty to the assessment. **Potential policy responses**: Fiscal consolidation, to achieve a general government primary surplus of about 1¼ percent of GDP (a federal government primary surplus of about 1½ percent of GDP) will be necessary to put the debt-GDP ratio on a downward path and address the CA gap. Structural policies to strengthen export competitiveness and further reduce the CA gap include, within the tighter budgetary envelope, upgrading investment in transportation infrastructure, enhancing schooling and training of workers, supporting the working poor, and policies to increase growth in the labor force (including skill-based immigration reform). Trade and investment disagreements should be resolved without resorting to the imposition of tariff and non-tariff barriers.
Current account	**Background**. The US CA deficit was unchanged between 2016 and 2017 at 2.4 percent of GDP, compared with a deficit of 2.1 percent of GDP in 2013. The deterioration was led by the non-oil balance, which reached a deficit of 2.0 percent of GDP in 2017 compared with a deficit of 0.6 percent of GDP in 2013. For 2017, two opposing forces have been at play in 2017: a depreciating dollar and stronger private investment growth. The CA deficit is expected to increase over the medium-term due to a stronger US economy and the planned fiscal expansion, including the 2017 tax cuts. **Assessment**. The EBA model estimates a cyclically adjusted CA of -2.3 percent of GDP, and a cyclically adjusted CA norm of -0.7 percent of GDP. The cyclically adjusted CA gap is -1.5 percent of GDP for 2017, reflecting policy gaps (-0.6 percent of GDP) and an unidentified residual (about -1.0 percent of GDP). The External Sustainability Approach estimates a CA gap of -2.2 percent of GDP. On balance, staff assesses the 2017 cyclically adjusted CA to be 1.0 to 2.0 percent of GDP lower than the level implied by medium-term fundamentals and desirable policies.	
CA Assessment 2017	Actual CA: -2.4 | Cycl. Adj. CA: -2.3 | EBA CA Norm: -0.7 | EBA CA Gap: -1.6 | Staff Adj.: -0.1 | Staff CA Gap: -1.5	
Real exchange rate	**Background**. The real effective exchange rate (REER) appreciated by about 18 percent between 2012 and 2016 but it depreciated by about 0.6 percent in 2017. As of May 2018, the REER had depreciated by a further 2.0 percent relative to the 2017 average. **Assessment**. Indirect estimates of the REER (based on the EBA current account assessment) imply that the exchange rate was overvalued by 12 percent in 2017 (applying an estimated elasticity of 0.12). The EBA REER index model suggests an overvaluation of 8.1 percent, the EBA REER level model suggests an overvaluation of 14.4 percent, and the External Sustainability Approach estimates a REER overvaluation of 12.5 percent. Considering all the estimates and their uncertainties, staff assesses the 2017 average REER to be moderately overvalued, in the 8-16 percent range, compared with the level implied by medium-term fundamentals and desirable policies. The recent currency depreciation has reduced this gap.	
Capital and financial accounts: flows and policy measures	**Background**. Net financial inflows were about 1.8 percent of GDP in 2017, compared with 2.0 percent of GDP in 2016. Net portfolio investments and other investments increased by 0.2 and 0.8 percent of GDP, respectively, year over year, in 2017 but were partially offset by weaker net direct 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 stronger outlook for the US economy compared with key trading partners, 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.	

	United States (concluded)
Technical Background Notes	