CHAPTER 3

2018 INDIVIDUAL ECONOMY ASSESSMENTS

Methodology and Process

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

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

External assessments are presented in ranges, in recognition of inherent uncertainties, and in different categories generally reflecting deviations of the overall external position from fundamentals and desired policies. Overall external positions are labeled as either: "broadly in line," "moderately weaker (stronger)," "weaker (stronger)," and "substantially weaker (stronger)" (see Table 3.A and Box 1.1). The criteria for applying the labels on the overall external positions are multidimensional. Regarding the wording to describe the current account and real effective exchange rate (REER) gaps: (1) when comparing the cyclically-adjusted current account to the current account norm, the wording "higher" or "lower" is used, corresponding to positive or negative current account gaps, respectively; (2) a quantitative estimate of the staff's view of the REER gap is generally reported as [–] percent "over" or "under" valued. Current account gaps in the range of +/– 1 percent of GDP as well as REER gaps in the range of +/– 5 percent are generally consistent with external positions that are labeled in line with fundamentals, although REER ranges vary depending on exchange rate semi-elasticities which differ significantly across countries.

Selection of Economies

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

[1]See *The External Balance Assessment Methodology: 2018 Update* for a complete description of the EBA methodology and for a description of the most recent refinements.

[2]The individual country assessments are based on data and IMF staff projections as of June 20, 2019.

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

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

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

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

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

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

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

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

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

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

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

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

Abbreviations and Acronyms

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

Table 3.1. Argentina: Economy Assessment

Overall Assessment: *The external position in 2018 was weaker than implied by medium-term fundamentals and desirable policies.* The CA deficit at the end of 2018 was broadly unchanged relative to the previous year, with official inflows (mainly associated with the IMF program) replacing private portfolio inflows as the main source of funding to cover still large gross fiscal financing needs. That said, a significant CA adjustment is currently underway.

Potential Policy Responses: The fiscal consolidation envisaged under the IMF-supported program, together with a stronger monetary and exchange policy framework, should help reabsorb the large CA deficit and lower the risks of large peso volatility. Supply-side reforms such as eliminating trade restrictions and introducing tax and product market reforms, would increase productivity and competitiveness and attract FDI, reducing the risk of overvaluation.

Foreign Asset and Liability Position and Trajectory

Background. After Argentina regained access to international capital markets in early 2016, significant new external debt was issued and the NIIP fell from its 2013 peak of 10 percent of GDP to 3 percent of GDP by the end of 2017. The financial crisis that ensued in May 2018, with the sudden stop of capital inflows as well as the rapid depreciation of the peso (by about 70 percent in the peso/US$ rate on average over the year), led to a sharp improvement in the NIIP, which reached about 12.1 percent of GDP by end 2018, mainly driven by lower liabilities due to valuation effects and price changes.

Assessment. Argentina is likely to maintain a net creditor position although declining gradually over the medium term. While external liabilities are expected to grow, due to continued large public sector financing requirements, they are not expected to outpace the accumulation of external assets, resulting in a projected NIIP of about 8 percent of GDP by 2024. Greater portfolio liabilities and other investments (projected to rise from 51 percent of overall liabilities in 2012 to 76 percent in 2018) point to continued vulnerability to capital flow reversals.

2018 (% GDP)	NIIP: 12.1	Gross Assets: 70.3	Res. Assets: 12.3	Gross Liab.: 58.2	Debt Liab.: 46.7

Current Account

Background. The CA deficit widened to 5.2 percent of GDP at end-2018, a level not registered since the early 2000s. However, the economic recession and sharp depreciation of the peso following the mid-2018 financial crisis caused a broad-based import contraction which, together with a normalization of agriculture exports, is expected to lead to a CA deficit of about 2 percent of GDP in 2019, and about 2.5 percent of GDP in the medium term. The official sector's reliance on external borrowing means Argentina will continue to have a structural income account deficit.

Assessment. The EBA CA model estimates a –6.8 percent of GDP cyclically adjusted CA deficit in 2018, against a CA norm of –2.5 percent of GDP. Taking into account the impact of the drought on agricultural exports (about 1.3 percent of GDP), staff considers Argentina's CA deficit to be 2.0 to 4.0 percent of GDP higher than the level implied by fundamentals and desirable policies. The CA gap is largely the result of looser-than-desired fiscal policy and modest credit growth during 2018, only partially offset by reserve buildup. The large negative residual likely reflects distortions in product and labor markets that hinder Argentina's competitiveness.

2018 (% GDP)	Actual CA: –5.2	Cycl. Adj. CA: –6.8	EBA CA Norm: –2.5	EBA CA Gap: –4.3	Staff Adj.: 1.3	Staff CA Gap: –3.0

Real Exchange Rate

Background. The REER depreciated by about 18 percent on average in 2018 relative to 2017, driven by a sharp nominal depreciation of the peso (36 percent on average) only partially offset by an increase in relative prices. The average, however, masks the significant peak-to-trough real depreciation in 2018. Estimates as of May 2019 suggest the REER was 5.3 percent weaker than the 2018 average.

Assessment. The CA model shows the REER to be overvalued by about 30 percent on average in 2018 (assuming an elasticity of 0.14). This, however, mainly reflects the fact that the CA adjustment started with a lag and is expected to take full effect in 2019. Staff believes that the large REER depreciation in 2018 more than corrected the estimated overvaluation and projects that, after overshooting by about 10 to 15 percent, the REER will experience a gradual appreciation during 2019 and the next few years. This is also consistent with estimates of the EBA REER Index model, which shows an REER gap of –5.9 percent in 2018. Staff assesses the 2018 REER to be undervalued in the range of 10 to 15 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. The rise in the CA deficit until mid-2018 has been largely financed by portfolio inflows, notably government liabilities. In 2018:Q2 and 2018:Q3, as the government lost access to international markets, positions in Argentine assets were unwound. The sudden stop and capital flight were offset by official inflows from the IMF, World Bank, and an increase in the PBoC swap line. As a result, gross official reserves rose by US$10.8 billion compared with 2017. Following capital account pressures in May 2018 and intensifying carry-trade flows, the central bank tightened limits on banks' net long FX positions and introduced caps on government debt holdings by domestic banks.

Assessment. Greater reliance on short-term, volatile portfolio flows exposed Argentina's external balance to risks that materialized in 2018. The elimination of LEBACs and consistent implementation of the stabilization policies underlying the program with the IMF should restore market confidence and help reduce external vulnerabilities going forward.

FX Intervention and Reserves Level

Background. Faced with increasing currency pressures, the central bank, following a free-floating, inflation-targeting framework since 2016, intervened significantly in 2018 (selling about US$16 billion in the spot market, and accumulating US$3.6 billion in the forward market, a position that was later unwound). In line with the recently adopted FX intervention rule, the central bank has purchased about US$1 billion so far in 2019 and reserves stood at US$65 billion end-May.

Assessment. Reserve coverage at end-2018 was about 95.2 percent of the ARA metric. Fiscal consolidation combined with disbursements under the IMF program, the drawing of the swap line with the PBoC, and other multilateral assistance are expected to lead to a further rise in reserve coverage through time.

Table 3.2. Australia: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The CA deficit in 2018 narrowed to about 2 percent of GDP mainly due to stronger terms of trade and a ramp-up in new resource exports.

Potential Policy Responses: With output below potential, macroeconomic policy should in the near term remain supportive of Australia's economic rebalancing after the mining investment boom. The current monetary policy stance is appropriately accommodative, although going forward it should remain data-dependent guided by the inflation and growth outlook. The recent infrastructure investment boost has provided welcome support, although budget surpluses should be targeted in the medium term, consistent with the authorities' medium-term fiscal plans. Structural reforms should aim at boosting productivity, especially of the nonmining sector.

Foreign Asset and Liability Position and Trajectory

Background. Australia has a large and relatively stable negative NIIP, amounting to about –50.5 percent of GDP at the end of 2018. Liabilities are largely denominated in Australian dollars, whereas assets are in foreign currency. Foreign liabilities are composed of about 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 2018 (by 3 percent of GDP relative to 2017), partly driven by nominal economic growth. The NIIP-to-GDP ratio is expected to remain around –50 percent of GDP over the medium term.

Assessment. The NIIP level and trajectory are sustainable. The External Stability approach suggests that the NIIP would be stabilized at around current levels over the medium term with a CA deficit between 2 and 2½ percent. The structure of Australia's external balance sheet reduces the vulnerability associated with its high negative NIIP. With external liabilities mainly denominated in Australian dollars and a net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector's net foreign currency liability position is mostly hedged. The maturity of banks' external funding has lengthened since the global financial crisis, and in a tail risk event where domestic banks suffer a major loss, the government's strong balance sheet position allows it to offer credible support.

2018 (% GDP)	NIIP: –50.5	Gross Assets: 131.3	Debt Assets: 42.3	Gross Liab.: 181.8	Debt Liab.: 89.3

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 economy standards. Since the early 1980s, deficits have averaged around 4 percent of GDP. The CA deficit in 2018 narrowed to 2.0 percent of GDP, primarily reflecting mostly stronger terms of trade and a ramp-up in new resource exports, including liquified natural gas, offsetting the negative impact of drought on rural exports. Over the medium term, the CA deficit is expected at a level lower than the historical average of about 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 commodity prices.

Assessment. Considering the relative output gaps and the cyclical component of the commodity terms of trade, the EBA model estimates a cyclically adjusted CA deficit of 2.4 percent of GDP for 2018, which when compared with the EBA CA norm of –0.4 percent of GDP suggests a CA gap of –2.0 percent. However, in staff's view, the CA norm of Australia is closer to –1.3 percent of GDP, reflecting Australia's traditionally large investment needs due to its size, low population density, and initial conditions, whereas the temporary negative impact of adverse weather conditions on exports would increase the cyclical adjustment by an additional 0.1 percent of GDP. Taking these adjustments into consideration, the staff-assessed CA for 2018 is assessed to be broadly in line and in the range of –0.4 to –1.4 percent of GDP.

2018 (% GDP)	Actual CA: –2.0	Cycl. Adj. CA: –2.4	EBA CA Norm: –0.4	EBA CA Gap: –2.0	Staff Adj.: 1.1	Staff CA Gap: –0.9

Real Exchange Rate

Background. In 2018, Australia's REER depreciated by 4.0 percent relative to the 2017 average. As of May 2019, the REER was some 4.5 percent below the 2018 average, but still some 2 percent above its 30-year average.

Assessment. Considering estimates of the EBA REER models, and REER gap derived from the staff-assessed CA gap, staff assesses the 2018 REER to be overvalued in the range of 0 to 12 percent.[1]

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 6.2 years, with the majority of existing bonds maturing after 2026. Net capital inflows remained modest in 2018, with the composition of foreign investment further shifting from the mining sector to nonmining sector.

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, so reserve needs for prudential reasons are also limited.

Table 3.3. Belgium: Economy Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external position in 2018 was weaker than medium-term fundamentals and desirable policies would imply. Recent measures to improve competitiveness, together with an improving investment income balance, should support the external position over the medium term. The strong NIIP mitigates vulnerabilities associated with the high external public debt.

Potential Policy Responses: Steady fiscal consolidation, structural reforms to support labor force participation, linking wages to productivity, improving the business environment, simplifying regulations, and strengthening competition in services and regulated professions can help bring the external position more in line with fundamentals.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. The NIIP remains strong at 42 percent of GDP at end-2018—compared with 53 percent a year earlier—reflecting the continued positive net financial wealth of households. Gross foreign assets were large at 419 percent of GDP, inflated by intragroup corporate treasury activities. Gross foreign assets of the banking sector stood at 79 percent of GDP, down considerably from the precrisis peak. External public debt was 60 percent of GDP, predominantly denominated in euros. Target 2 balances averaged –€9.9 billion (–2.2 percent of GDP) in 2018.

Assessment. Belgium’s large gross international asset and liability positions are inflated by the presence of corporate treasury units, which do not appear to create macrorelevant mismatches. Based on the projected current account and growth paths, the NIIP-to-GDP ratio is expected to decline gradually going forward. The strongly positive NIIP and its trajectory do not raise sustainability concerns.</td></tr>
<tr><td>2018 (% GDP)</td><td>NIIP: 42.4</td><td>Gross Assets: 419.5</td><td>Debt Assets: 165.6</td><td colspan="2">Gross Liab.: 377.0</td><td>Debt Liab.: 171.5</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. Since the global financial crisis, the CA has hovered around balance, averaging –0.3 percent of GDP over the 2009–17 period.[1] The stability in the CA balance masks significant movements in the trade and primary income balances, reflecting large operations of multinationals. After registering a surplus of 0.7 percent of GDP in 2017, preliminary data indicate a CA deficit of 1.3 percent of GDP in 2018. The movement largely reflects lower primary income outflows related to the operations of multinational enterprises and unusually large R&D imports by one firm. Data are subject to revision and possibly measurement biases.

Assessment. Preliminary EBA model estimates yield a CA gap of –3.7 percent of GDP for 2018, based on a cyclically adjusted CA balance of –1.3 percent (relative to an estimated norm of 2.4 percent). This is within the range estimated by staff for the CA gap of between –4.7 to –2.7 percent of GDP, which applies a standard range for the CA gap of ±1 percent of GDP.</td></tr>
<tr><td>2018 (% GDP)</td><td>Actual CA: –1.3</td><td>Cycl. Adj. CA: –1.3</td><td>EBA CA Norm: 2.4</td><td>EBA CA Gap: –3.7</td><td>Staff Adj.: 0.0</td><td>Staff CA Gap: –3.7</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. The REER (both ULC- and CPI-based) appreciated by nearly 20 percent during 2000–09. Over the past decade the REER has been more volatile, with wage moderation contributing to an 8 percent depreciation of both the ULC- and CPI-based REER in 2014–15, which has since been reversed. In 2018, the ULC-based REER appreciated by 1.2 percent and the CPI-based REER appreciated by 2.4 percent relative to the 2017 average. Through May 2019, the CPI-based REER has depreciated by 1.2 percent.

Assessment. Preliminary EBA model estimates point to an REER overvaluation of between 13 and 22 percent, based on the CPI-based REER index and level models; the REER overvaluation resulting from the EBA CA gap model is 8.8 percent, using an elasticity of 0.42. Staff assesses the REER to be overvalued in the range of 6 to 11 percent, using standard error bands.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. Gross financial outflows and inflows were on an upward trend during the precrisis period as banks expanded their cross-border operations. Since the crisis, these flows have shrunk and become more volatile as banks have deleveraged. Short-term external debt accounted for 29 percent of gross external debt at end-2018. 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 high public debt.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">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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Table 3.4. Brazil: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The current account is projected to weaken as the cyclical recovery, especially investment, strengthens.

Potential Policy Responses: Efforts to raise national savings are needed to provide room for a sustainable expansion in investment. Fiscal consolidation, including from the federal spending cap and social security reform, should contribute to boosting net public savings. Structural reforms to reduce the cost of doing business would also help strengthen competitiveness. Foreign exchange intervention, including through the use of derivatives, can be appropriate to alleviate disorderly market conditions in the foreign exchange market.

Foreign Asset and Liability Position and Trajectory

Background. Brazil's NIIP was –32.1 percent of GDP at end-2018, slightly weaker than the 2011–17 average (about –29 percent of GDP). Over the medium term, the NIIP is projected to strengthen gradually to about –30 percent of GDP, as GDP growth and valuation effects deriving from Brazil's long dollar position are expected to offset current account deficits (of about 2 percent of GDP). Whereas 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 has remained negative and is currently at the same level as in 2011. Short-term gross external financing needs are moderate, at about 6 percent of GDP, but capital flows and the exchange rate are particularly sensitive to global financing conditions. The CA deficit required to stabilize the NIIP at –35 percent is 1.5 percent of GDP.

2018 (% GDP)	NIIP: –32.1	Gross Assets: 47.9	Res. Assets: 20.1	Gross Liab.: 80.0	Debt Liab.: 22.9

Current Account

Background. The CA deficit widened from 0.5 percent of GDP in 2017 to 0.8 percent in 2018 due in part to a modest pickup in domestic demand and is expected to gradually widen to about 2 percent of GDP in the medium term as the recovery continues. However, risks stemming from terms-of-trade fluctuations, unwinding of cross-border integration, and trading partner growth remain tilted to the downside.

Assessment. In 2018, the cyclically adjusted CA was –2.1 percent of GDP, reflecting a still large negative output gap. EBA estimates suggest a CA norm in 2018 of –2.9 percent of GDP. However, taking into consideration the vulnerabilities associated with a sizable negative IIP, financial risks associated with a large and increasing public debt, and the sensitivity to global financial conditions, staff assesses a CA norm between –1.9 and –2.9 percent of GDP. Thus, the CA is assessed to be broadly in line with the level implied by fundamentals and desirable policies.

2018 (% GDP)	Actual CA: –0.8	Cycl. Adj. CA: –2.1	EBA CA Norm: –2.9	EBA CA Gap: 0.8	Staff Adj.: –0.5	Staff CA Gap: 0.3

Real Exchange Rate

Background. After appreciating in 2016–17, the REER depreciated by about 10 percent in 2018, partly reflecting political uncertainty ahead of the presidential elections. As of May 2019, the REER had depreciated by 1.4 percent relative to the 2018 average.

Assessment. EBA REER index and level methodologies indicate a 9.4 percent undervaluation and 2.1 percent overvaluation, respectively, for 2018. Consistent with the CA gap, staff assesses the REER gap to be in the range of –3 to 6 percent.*

Capital and Financial Accounts: Flows and Policy Measures

Background. Brazil continues to attract sizable capital flows. Net FDI has fully financed the CA deficits since 2015 (averaging 3.3 percent of GDP during 2015–18, whereas CA deficits averaged 1.5 percent), although partially offset by net portfolio outflows (0.8 percent of GDP on average during 2016–18). While interest differentials, broadly adequate external buffers, and envisaged reforms to increase trade openness should support portfolio inflows going forward, rigidities in the budget, the financial sector, and labor and product markets, if not properly addressed, may weaken investors' interest.

Assessment. Weaker than expected global growth, tightening of global financial conditions, and weak implementation of envisaged reforms remain downside risks to capital flows.

FX Intervention and Reserves Level

Background. Brazil has a floating exchange rate. Its gross reserves remained broadly constant in 2018, at $375 billion at end-2018, some 20 percent of GDP and about 163 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.

**The staff assessed REER gap of –1.5 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.5. Canada: Economy Assessment

Overall Assessment: *The external position in 2018 was 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 material change in the assessment of the external position for 2018.

The current account is expected to weaken in 2019 and then strengthen over the medium term as nonenergy exports gradually benefit from improved price competitiveness and investment in services and manufacturing capacity.

Potential Policy Responses: Policies to boost Canada's nonenergy exports include measures geared at improving labor productivity, investing in research and development and physical capital, promoting foreign direct investment, developing services exports, and diversifying export markets. The planned increase in public infrastructure investment should boost competitiveness and improve the external position in the medium term. A credible medium-term consolidation plan for fiscal policy will also be necessary to support the external rebalancing.

Foreign Asset and Liability Position and Trajectory

Background. Despite running a CA deficit, Canada's NIIP has improved since 2010, reaching 23.1 percent of GDP in 2018, up from 20.6 percent in 2017 and –18 percent in 2010. This largely reflects valuation gains on external assets. At the same time, gross external debt increased to 121 percent of GDP, of which about one-third is short term.

Assessment. Canada's foreign assets have a higher foreign currency component than its liabilities, which provides a hedge against currency depreciation. The NIIP level and trajectory are sustainable.

2018 (% GDP)	NIIP: 23.1	Gross Assets: 235.1	Debt Assets: 59.9	Gross Liab.: 212.0	Debt Liab.: 105.3

Current Account

Background. The CA deficit narrowed further to 2.6 percent of GDP in 2018 (from 2.8 percent of GDP in 2017), driven by an improvement in energy exports, which were partly offset by import growth. The CA deficit has been partially financed by equity portfolio inflow and deposits, which have more than offset direct investment outflows.

Assessment. The EBA estimates a CA norm of 2.0 percent of GDP and a cyclically adjusted CA gap of –5.0 percent of GDP for 2018. The EBA gap widened relative to 2017, as the improvement in the CA was less than expected given output gap movements. Staff assesses the CA gap to be lower after taking into account (1) CA measurement issues,[1] (2) the authorities' demographic projections and current immigration targets,[2] and (3) the steeper-than-usual discount between Canadian oil prices and international prices.[3] Taking these factors into consideration, staff assesses the CA lower than warranted by fundamentals and desired policies, with a gap in the range between –0.6 and –3.6 percent of GDP.

2018 (% GDP)	Actual CA: –2.6	Cycl. Adj. CA: –3.0	EBA CA Norm: 2.0	EBA CA Gap: –5.0	Staff Adj.: 2.9	Staff CA Gap: –2.1

Real Exchange Rate

Background. The REER depreciated by about 0.5 percent on an annual average basis between 2017 and 2018. As of May 2019, the REER had depreciated by about 2.3 percent relative to the 2018 average.

Assessment. The EBA REER index model points to an overvaluation of 2.1 percent in 2018, whereas the REER level model points to an undervaluation of about 6.9 percent. In staff's view, the REER level model could overstate the extent of undervaluation.[4] Consistent with the staff-assessed CA gap, staff assesses the REER to be overvalued in the range of 2 to 13 percent.[5]

Capital and Financial Accounts: Flows and Policy Measures

Background. The CA deficit in 2018 was partially financed by net portfolio inflows and deposits. Nonresident investors mostly purchased corporate debt securities. In 2018, FDI recorded a lower net outflow of 0.6 percent of GDP (3.3 percent of GDP in 2017).

Assessment. Canada has an open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate.

FX Intervention and Reserves Level

Background. Canada has a free-floating exchange rate regime and has not intervened in the foreign exchange market since September 1998 (with the exception of participating in internationally concerted interventions). Canada has limited reserves, but its central bank has standing swap arrangements with the 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.

Table 3.6. China: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level consistent with medium-term fundamentals and desirable policies.* This represents a change from earlier assessments when the external position was judged to be moderately stronger. While the trend decline in CA surplus since the 2007 peak is largely structural, reflecting progress in rebalancing, the sharp decline in 2018 was partly supported by higher commodity and semiconductor prices. It remains important to ensure that rebalancing in China continues in order to avoid a return of excessive CA surpluses.

Potential Policy Responses: Achieving a lasting balance in the external position will require the gradual closing of domestic policy gaps in fiscal and credit areas to be accompanied by reforms that address distortions to ensure that the economy remains on a more sustainable growth path, with higher consumption and lower overall saving. This can be achieved through successful implementation of the authorities' reform agenda. 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 equal treatment of foreign and domestic investors; and moving more to a flexible, market-based exchange rate. This will require a more market-based and transparent monetary policy framework and communications.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP remains positive but declined to 15.9 percent of GDP by end-2018 after peaking at 33 percent of GDP in 2007. This deterioration is driven by a reduction in the CA surplus, valuation changes, and sustained high GDP growth. Gross foreign assets (55 percent of GDP by end-2018) are dominated by foreign reserves, whereas gross liabilities (40 percent of GDP) mainly reflect inward FDI. Reserve assets were stable and stood at US$3.1 trillion by end 2018 (about 24 percent of GDP).

Assessment. The NIIP-to-GDP ratio is expected to remain strong, with a modest decline over the medium term, in line with the projected CA. 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 remained subdued, despite pressures on the US dollar–renminbi bilateral exchange rate during the second half of 2018. There are currently no substantial net outflow pressures, although such pressures may resurface as the private sector seeks to accumulate foreign assets faster than nonresidents accumulate Chinese assets.

2018 (% GDP)	NIIP: 15.9	Gross Assets: 54.6	Res. Assets: 23.6	Gross Liab.: 38.7	Debt Liab.: 13.0

Current Account

Background. The CA surplus declined further in 2018, reaching 0.4 percent of GDP in 2018, about 1 percentage point lower than in 2017. This mainly reflects a shrinking trade balance (driven by high import volume growth) and a continued increase in the services deficit (mostly driven by tourism), as well as higher commodity and semiconductor prices. Viewed from a longer perspective, the CA surplus has 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, technological upgrades in manufacturing, and a widening of the services deficit. In line with continued rebalancing, the CA surplus is expected to gradually decline further over the next few years.

Assessment. Consistent with the EBA CA methodology, which estimates that the cyclically adjusted CA exceeds the norm by 0.8 percent of GDP, staff assesses the CA to be broadly in line with fundamentals and desired policies with a CA gap range of –0.7 to +2.3 percent.[1] The EBA-identified policy gaps are small on net (–0.3 percent), reflecting largely mutually offsetting forces: loose fiscal policy and excessive credit growth on the one hand and inadequate health spending on the other hand. The overall gap is mostly accounted for by the residual, which reflects other factors, including distortions that encourage excessive savings.

2018 (% GDP)	Actual CA: 0.4	Cycl. Adj. CA: 0.3	EBA CA Norm: –0.4	EBA CA Gap: 0.8	Staff Adj.: 0.0	Staff CA Gap: 0.8

Real Exchange Rate

Background. In 2018, the average REER appreciated by about 1.4 percent relative to 2017, driven by the appreciation in the NEER (1.5 percent). Estimates through May 2019 show that the REER has depreciated by about 0.2 percent relative to the 2018 average.

Assessment. The 2018 EBA REER index regression estimates China's REER to be at the same level as warranted by fundamentals and desirable policies—compared with 5.3 percent lower in 2017.[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 gap to be in the range of –11.5 to 8.5 percent.*

Capital and Financial Accounts: Flows and Policy Measures

Background. After witnessing capital inflows in the first half, there were some modest outflows in the latter part of 2018. Overall, China registered a small net capital inflow of US$30 billion in 2018, compared with net capital outflows of US$103 billion in 2017, and down significantly from the record outflows of US$647 billion in 2015 and US$646 billion in 2016. China's capital account remains relatively closed in a de jure sense. More recently, a 20 percent reserve requirement on FX forwards, a CFM, was reintroduced, and the authorities reimposed administrative measures to control the exchange rate in August 2018.

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 counter disorderly market conditions) 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 declined modestly by US$67 billion in 2018, after rising by US$129 billion in 2017. Staff estimates suggest that, after adjusting for estimated valuation changes and return on reserves, this change reflected minor net FX sales during episodes of market pressures; these estimates are subject to a margin of error, which could include no intervention.

Assessment. Reserves stood at 90 percent of the IMF's composite metric unadjusted for capital controls at end-2018 (down from 106 percent and 97 percent in 2016 and 2017, respectively); relative to the metric adjusted for capital controls, reserves stood at 143 percent (down from 156 percent in 2017). The decline of the ratio is driven by higher broad money (M2) growth, external debt, and other liabilities that are driving up the metric. Given that the capital account is considered only partially open, 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.

**The staff assessed REER gap of –1.5 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.7. Euro Area: Economy Assessment

Overall Assessment: *The external position in 2018 was moderately stronger than the level implied by medium-term fundamentals and desirable policies.* Going forward the CA surplus is projected to narrow modestly as surpluses decline in large net external creditor countries, supported by a gradual realignment of price competitiveness and solid domestic demand.

Nevertheless, imbalances at the national level are expected to remain sizable. Countries with excess CA surpluses should continue to strengthen investment and potential growth, whereas those with weak external positions should work to further raise productivity and competitiveness.

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 (for example, banking and capital markets union, fiscal capacity for macrostabilization) could also reinvigorate investment and reduce savings-investment imbalances. At the country level, efforts are needed to address imbalances. Countries with stronger-than-warranted external positions should use available fiscal space to expand investment and promote structural reforms to foster entrepreneurship and raise their potential growth. Meanwhile, countries with weaker-than-warranted 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.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP of the euro area fell to about –17 percent of GDP by the end of 2009, but has since recovered, reaching about –4 percent by the end of 2018.[1] The rise has been driven by stronger CA balances and modest nominal GDP growth. Gross foreign positions were about 228 percent of GDP for assets and 232 percent of GDP for liabilities in 2018. However, net external assets reached elevated levels in large net external creditors (for example, Germany and the Netherlands), whereas net external liabilities remained high in some countries, including Spain and Portugal.

Assessment. Projections of continued CA surpluses suggest that the NIIP-to-GDP ratio will improve further, at a moderate pace, and the euro area is expected to soon become a net external creditor. The region's overall NIIP financing vulnerabilities appear low. Despite improved CAs, large net external debtor countries still bear a greater risk of a sudden stop of gross inflows.

2018 (% GDP)	NIIP: –3.8	Gross Assets: 228.0	Debt Assets: 89.7	Gross Liab.: 231.8	Debt Liab.: 94.6

Current Account

Background. The CA balance for the euro area increased steadily from 2011, when it was close to zero, reaching a peak of 3.2 percent in 2016–17. In 2018, the CA balance narrowed to 2.9 percent of GDP, reflecting higher oil prices and weaker external demand from key trading partners (China, Turkey, United Kingdom) in the context of rising trade tensions and Brexit-related uncertainties. Some large creditor countries, such as Germany and the Netherlands, continued to have sizable surpluses, reflecting strong corporate and household saving and weak investment.

Assessment. The EBA model estimates a CA norm of 1.1 percent of GDP, against a cyclically adjusted CA of 2.9 percent of GDP. This implies a gap of 1.8 percent of GDP. Staff's analysis indicates a higher CA norm than estimated by the EBA model, consistent with the assessed external positions of euro area member countries. The higher CA norm takes into account the large net external liabilities positions in some countries (for example, Spain) and uncertainty about the demographic outlook and the impact of the recent large-scale immigration (for example, Germany). In addition, adjustments to the underlying CA for measurement issues are considered in a few cases (for example, Ireland and the Netherlands). Considering these factors and uncertainties in the estimates, staff assesses the CA gap to be 1.3 percent for 2018, with a range of 0.5 to 2.1 percent of GDP.[2,3]

2018 (% GDP)	Actual CA: 2.9	Cycl. Adj. CA: 2.9	EBA CA Norm: 1.1	EBA CA Gap: 1.8	Staff Adj.: –0.6	Staff CA Gap: 1.3

Real Exchange Rate

Background. The CPI-based REER appreciated by about 3.0 percent from 2017 to 2018, reflecting that the nominal appreciation of about 5.2 percent was partly offset by weaker inflation in the euro area relative to its trading partners. Estimates through May 2019 show that the REER has depreciated by 3.1 percent relative to the 2018 average, partly reflecting the euro area's relatively weaker growth and inflation outlook.

Assessment. Consistent with the assessed REERs of euro area member countries, staff assesses the average euro real exchange rate gap in the range of –5 to –1 percent,[4] with a midpoint of –3 percent.* 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 8 to 18 percent in Germany to overvaluations of 0 to 10 percent in several small to mid-sized euro area member states. The large differences in REER gaps within the euro area highlight the continued need for net external debtor countries to improve their external competitiveness and for net external creditor countries to boost domestic demand.

Capital and Financial Accounts: Flows and Policy Measures

Background. Mirroring the 2018 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.

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.

**The staff assessed REER gap of –3 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.8. France: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by medium-term fundamentals and desirable policies.*

Potential Policy Responses: Although the external position is in line with fundamentals, a coordinated policy response that addresses domestic policy distortions with offsetting effects is needed. Steadfast implementation of recently enacted structural reforms (for example, labor market reforms), together with further efforts to reduce corporate administrative burdens, promote innovation, and strengthen competition in service sectors, would help improve competitiveness and investment and support long-term growth. Steady medium-term fiscal consolidation would also help keep the external position in line with medium-term fundamentals.

Foreign Asset and Liability Position and Trajectory	**Background.** Since 2015, the NIIP has averaged about –16 percent of GDP, largely driven by public sector and banking sector net external debt, as the net FDI position is positive and over 20 percent of GDP. The NIIP improved slightly from –20 percent of GDP in 2017 to –11 percent of GDP in 2018, due to lower nonfinancial firms' portfolio equity liabilities partly reflecting valuation effects. Whereas the net position is moderately negative, gross positions are large, particularly for financial (bank and nonbank) institutions, reflecting their global activities. Specifically, the gross asset position stood at 290 percent of GDP in 2018, of which banks' non-FDI-related assets account for about one-third, and other nonbank financial institutions close to another one-third. On the other hand, gross liabilities reached 301 percent of GDP in 2018, of which external debt is estimated at 200 percent of GDP (of this, the public sector accounts for 54 percent of GDP, and banks for 104 percent of GDP). Target 2 balances averaged at about –€36 billion (–1.5 percent of GDP) in 2018. **Assessment.** The NIIP is negative, but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities coming from large public external debt and banks' gross financing needs—bank debt maturing in 2019 is estimated at €75 billion (3.2 percent of GDP), and financial derivatives stand at 30 percent of GDP.
2018 (% GDP)	NIIP: –11.4 / Gross Assets: 289.9 / Debt Assets: 153.1 / Gross Liab.: 301.2 / Debt Liab.: 193.1
Current Account	**Background.** The CA deficit has hovered around 0.7 percent of GDP since 2010, although it narrowed to 0.3 percent in 2018 (from 0.6 percent in 2017). The lower CA deficit in 2018 took place despite a deterioration in the oil balance and largely reflected lower import growth amid weak investment. **Assessment.** The 2018 cyclically adjusted CA deficit is estimated at 0.3 percent of GDP, compared with an EBA-estimated norm of a surplus of 0.5 percent. On this basis, staff assesses that the CA gap in 2018 was between –1.2 and –0.2 percent of GDP.
2018 (% GDP)	Actual CA: –0.3 / Cycl. Adj. CA: –0.3 / EBA CA Norm: 0.5 / EBA CA Gap: –0.7 / Staff Adj.: 0.0 / Staff CA Gap: –0.7
Real Exchange Rate	**Background.** After depreciating by about 4 to 9 percent since 2010, mainly due to the euro depreciation, both the ULC-based and the CPI-based REER appreciated moderately by 0.6 to 2.2 percent in 2018 relative to their 2017 average. Through May 2019, the CPI-based REER has depreciated by 1.6 percent. From a longer perspective, the ULC-based REER appreciated by about 3 to 9 percent since the late 1990s, notwithstanding relatively stable CPI-based REER indices. As a result, France has lost about one-third of its export market share in the 2000s and has not regained it since. **Assessment.** The EBA REER Index model points to a REER gap of –0.4 percent, whereas the EBA REER Level model points to a REER gap of 7.1 percent. Meanwhile, given an elasticity of 0.27, the EBA CA gap points to an overvaluation of 1 to 4 percent. In line with estimates derived from the CA assessment, staff assesses the REER gap to be in the 1 to 4 percent range.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** The CA deficit has been financed mostly by debt inflows (portfolio and other investment), whereas 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.
FX Intervention and Reserves Level	**Background.** The euro has the status of a global reserve currency. **Assessment.** Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.

Table 3.9. Germany: Economy Assessment

Overall Assessment: *The external position in 2018 was substantially stronger than implied by medium-term fundamentals and desirable policies.* Staff projects a modest narrowing in the medium term, supported by a gradual realignment of price competitiveness and continued solid domestic demand. As Germany is part of the euro area, the nominal exchange rate does not flexibly adjust to the country's external position, but stronger wage growth relative to euro area trading partners is expected to contribute to realigning price competitiveness within the monetary union. 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 that promotes potential growth, structural reforms to foster entrepreneurship (for example, expanding access to venture capital, stronger tax incentives for research and development, and more investment in digital infrastructure), as well as additional tax relief for lower-income households, boosting their purchasing power, and pension reforms prolonging working lives would help reduce excess saving, stimulate investment, and reduce external imbalances.

Foreign Asset and Liability Position and Trajectory

Background. Germany's positive NIIP reached 61 percent of GDP in 2018, more than twice the 2012 level. The net rise in foreign assets over this period has, however, fallen short of the accumulation of CA surpluses. The NIIP of financial corporations other than monetary financial institutions is large and positive (57 percent of GDP), whereas 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 exceed 80 percent of German GDP by 2023, 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, but has stabilized and started declining, standing at €934 billion in May 2019 (27 percent of GDP), down from over €976 billion in mid-2018.

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

2018 (% GDP)	NIIP: 60.6	Gross Assets: 252.9	Debt Assets: 89.8	Gross Liab.: 192.3	Debt Liab.: 143.2

Current Account

Background. The CA surplus has widened significantly since 2001, peaking at 8.5 percent of GDP in 2015 and falling gradually since then. In 2018, the CA surplus declined to 7.3 percent of GDP (from 8.0 percent of GDP in 2017), driven by a decline in net exports (partly due to higher energy prices) and reflecting a narrowing of the CA balance vis-à-vis most major trading partners (though concentrated among oil exporters). The bulk of the CA surplus reflects large saving-investment surpluses of NFCs and households, with rising savings of NFCs and continued fiscal consolidation accounting for the upward trend.

Assessment. The cyclically adjusted CA balance reached 7.6 percent of GDP in 2018, 0.7 percentage points below the 2017 level. Staff assesses the CA norm at 2 to 4 percent of GDP, with a midpoint ½ percent of GDP above the CA norm implied by the EBA model of 2.5 percent. Such upward adjustment reflects uncertainty over the demographic outlook and the impact of the recent large-scale immigration on national savings. Taking these factors into account, staff assesses the 2018 CA gap to be in the range of 3.6 to 5.6 percent of GDP.[1,2]

2018 (% GDP)	Actual CA: 7.3	Cycl. Adj. CA: 7.6	EBA CA Norm: 2.5	EBA CA Gap: 5.1	Staff Adj.: – 0.45	Staff CA Gap: 4.6

Real Exchange Rate

Background. The yearly average CPI-based and ULC-based REERs appreciated 2.4 and 3.5 percent in 2018, respectively, reflecting the nominal appreciation of the euro against the currencies of key trading partners—most notably the US dollar, the yen, and the Swiss franc—and the relative pickup in labor costs. Estimates through May 2019 show that the REER has depreciated by 1.2 percent relative to the 2018 average.

Assessment. The EBA REER Level model yields an undervaluation of 16 percent, whereas the undervaluation implied by the assessed CA gap using standard trade elasticities is in the range of 12 to 27 percent.[3] Taking these estimates into consideration and the 2018 real appreciation, staff assesses the 2018 REER to have been undervalued in the range of 8 to 18 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2018, net portfolio outflows constituted over three-quarters of the capital and financial accounts balance, with direct investment being the second largest item (one-fifth of total). From a destination basis, 80 percent of the outflows went to European countries, with about 6 percent going to the Americas (mostly the United States). Meanwhile, the source of gross inflows is different, with only 14 percent of inflows originating from the European Union, due to falling investment by noneuro EU countries (Denmark, United Kingdom), whereas investment by emerging markets (especially Turkey) and North America picked up considerably. FDI inflows and outflows continued to recover, 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.

FX Intervention and Reserves Level

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.

Table 3.10. Hong Kong SAR: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by medium term fundamentals and desirable policies.* The CA 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 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.

Potential Policy Responses: Macroeconomic policies are broadly appropriate. Maintaining policies that support wage and price flexibility is crucial to preserving competitiveness. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the LERS have worked well, and continuation of these policies will help keep the external position broadly in line with medium-term fundamentals.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP reached about 357 percent of GDP as of end-2018, up from 275 percent in 2012. Gross assets (about 1,510 percent of GDP) and liabilities (about 1,154 percent of GDP) are high, reflecting Hong Kong SAR's status as a major international financial center. Valuation changes have been sizable and positive, partly reflecting measurement biases, as the change in NIIP during 2014–18 (150 percent of 2018 GDP) far exceeded the cumulative financial account balances (20 percent of 2018 GDP). On the other hand, income accrued to the large NIIP has been modest despite some increase in the last two years, due to relatively low yields on assets and, even more important, substantially higher payments on liabilities.

Assessment. Vulnerabilities are low given the positive NIIP and its favorable composition. Reserve assets are large and stable (117 percent of GDP at end-2018), direct investments account for a large share of total assets and liabilities (38 and 53 percent, respectively, in 2018), and portfolio liabilities accounted for only 13 percent of total liabilities at end-2018.

2018 (% GDP)	NIIP: 356.7	Gross Assets: 1,510.3	Debt Assets: 515.2	Gross Liab.: 1,153.6	Debt Liab.: 394.2

Current Account

Background. The CA surplus, after peaking at about 15 percent of GDP in 2008, is estimated to have reached 4.3 percent of GDP in 2018, down from 4.5 percent in 2017. Last year's decline was driven by a larger trade deficit in goods on the back of higher oil prices and robust domestic demand, which was partially offset by higher services and income balances. From a sectoral perspective, the gradual decline in private saving (from the peak of 34.4 percent of GDP in 2006 to 22.9 percent of GDP in 2018), driven by robust consumption growth, a 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 about 3.5 percent of GDP over the medium term.

Assessment. Staff's quantitative assessment finds that the projected cyclically adjusted CA, at 4.5 percent, is in the midpoint of the CA norm range of 3.0 to 6.0 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]

2018 (% GDP)	Actual CA: 4.3	Cycl. Adj. CA: 4.5	EBA CA Norm: —	EBA CA Gap: —	Staff Adj.: —	Staff CA Gap: 0.0

Real Exchange Rate

Background. REER dynamics are largely determined by the HK dollar/US dollar peg and subdued inflation in Hong Kong SAR. In line with the US dollar, after appreciating in real effective terms by about 20 percent between 2012–17, the HK dollar depreciated by 1.9 percent in 2018 compared with the 2017 average. The weak side of the convertibility undertaking has been triggered several times since April 2018, prompting the HKMA to sell US dollars in the market.

Assessment. 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 and 5 percent.*

Capital and Financial Accounts: Flows and Policy Measures

Background. As a financial center, Hong Kong SAR has an open capital account. Nonreserve financial flows moved from sizable net inflows in 2017 to outflows of similar magnitude in 2018. The financial account is typically very volatile, reflecting financial conditions on the mainland, transmitted through growing cross-border financial linkages, as well as shifting expectations of US monetary policy and related arbitraging in the FX and rates markets.[2]

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 HK dollar was often pushed to the strong side of its trading range, particularly following the global financial crisis. The stock of reserves at end-2018 was equivalent to about 117 percent of GDP, lower than at end-2017 but still above its level at end-2015. Since April 2018, the HK dollar hit the lower range of the convertibility undertaking of 7.85 a few times, prompting the HKMA to sell US dollars in the market under the normal functioning of the LERS. As liquidity is drained from the system, short-term HK dollar money market interest rates will continue to rise gradually closing the gap with the LIBOR and reducing HK dollar depreciation pressure.

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.

**The midpoint of the staff assessed REER gap is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.11. India: Economy Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external sector position in 2018 was broadly in line with the level implied by fundamentals and desirable policies. India's low per capita income, favorable growth prospects, demographic trends, and development needs justify running CA deficits. External vulnerabilities remain, as highlighted by bouts of turbulence in 2018. India's economic risks stem from volatility in global financial conditions and an oil price surge, as well as a retreat from cross-border integration. Progress has been made on FDI liberalization, whereas portfolio flows remain controlled. India's trade barriers remain significant.

Potential Policy Responses: Whereas the external position is broadly in line with fundamentals, measures to rein in fiscal deficits should be accompanied by efforts to enhance credit provision through faster cleanup of bank and corporate balance sheets and strengthening the governance of public banks. Improving the business climate, easing domestic supply bottlenecks, and liberalizing trade and investment will be important to help attract FDI, improve the CA financing mix, and contain external vulnerabilities. Gradual liberalization of portfolio flows should be considered, while monitoring risks of portfolio flows' reversals. Exchange rate flexibility should remain the main shock absorber, with intervention limited to addressing disorderly market conditions.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. As of end-2018, India's NIIP improved to –15.9 percent of GDP, from –17.3 percent of GDP at end-2017. Gross foreign assets and liabilities were 22.2 and 38.1 percent of GDP, respectively. The bulk of assets are in the form of official reserves and FDI, whereas liabilities include mostly other investments (39 percent), FDI (37 percent), portfolio equity (13 percent), and debt (10 percent). External debt amounted to some 20 percent of GDP, of which about half was denominated in US dollars and another 36 percent in Indian rupees. Long-term external debt accounted for about 80 percent of the total. Short-term external debt on a residual maturity basis stood at 43 percent of total external debt and 55.8 percent of FX reserves.

Assessment. With CA deficits projected to continue in the medium term, the NIIP-to-GDP ratio is expected to weaken marginally. The moderate level of foreign liabilities reflects India's gradual approach to capital account liberalization, which has focused mostly on attracting FDI. India's external debt is moderate compared with other emerging market economies, but rollover risks remain elevated in the short term.</td></tr>
<tr><td>2018 (% GDP)</td><td>NIIP: –15.9</td><td>Gross Assets: 22.2</td><td>Res. Assets: 14.5</td><td>Gross Liab.: 38.1</td><td colspan="2">Debt Liab.: 18.3</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. The CA deficit is estimated to have increased to 2.5 percent of GDP in fiscal year 2018/19 from 1.9 percent of GDP in the previous year, due to higher commodity prices and strong domestic demand in the first half of the fiscal year. Robust export growth continued, supported by partners' strengthening demand and rupee depreciation. Over the medium term, the CA deficit is expected to remain about 2½ percent of GDP.

Assessment. The EBA cyclically adjusted CA deficit stood at 2.5 percent of GDP in fiscal year 2018/19. The EBA CA regression estimates a norm of –3.4 percent of GDP for India in fiscal year 2018/19, with a standard error of 1.4 percent, thus implying an EBA gap of 0.9 percent. In staff's judgment, a CA deficit of about 2½ percent of GDP is financeable over time. Based on India's historical cash flow and capital inflow restrictions, global financial markets cannot be counted on to reliably finance a CA deficit above 3 percent of GDP. FDI flows are not yet sufficient to cover protracted and large CA deficits; portfolio flows are volatile and susceptible to changes in global risk appetite, as demonstrated in the taper tantrum episode and again in fall 2018. Based on the staff-assessed CA norm, the CA is in line with fundamentals and desired policies, with a CA gap range from –1.0 to 1.0 percent of GDP. Positive policy contributions to the CA gap stem from a negative credit gap and a relatively closed capital account, partly offset by a larger-than-desirable domestic fiscal deficit and a large decline in FX reserves.</td></tr>
<tr><td>2018 (% GDP)</td><td>Actual CA: –2.5</td><td>Cycl. Adj. CA: –2.5</td><td>EBA CA Norm: –3.4</td><td>EBA CA Gap: 0.9</td><td>Staff Adj.: –0.9</td><td>Staff CA Gap: 0.0</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. The average REER in 2018 depreciated by about 3.8 percent from its 2017 average. As of May 2019, the rupee had appreciated by about 7.7 percent in real terms compared with the average REER in 2018.

Assessment. The EBA REER Index and REER level models estimate a REER gap of 5.4 and 2.5 percent, respectively, for 2018. Meanwhile, the external stability approach estimates a REER gap of about –2.0 percent. Based on the staff-assessed CA gap, the REER gap is assessed to be in the range of –6 to 6 percent for fiscal year 2018/19.*</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. The sum of FDI, portfolio, and financial derivative flows on a net basis is estimated at 0.8 percent of GDP in fiscal year 2018/19, down from 2 percent in fiscal year 2017/18. Net FDI inflows remained unchanged at 1.3 percent of GDP in fiscal year 2018/19, despite investor-friendly reform efforts that could have attracted more investment. Bouts of both equity and debt outflows, especially in the spring and fall of 2018, brought net portfolio flows into negative territory (by 0.5 percent of GDP) in fiscal year 2018/19.

Assessment. Yearly capital inflows are relatively small, but, given the modest scale of FDI, flows of portfolio and other investments are critical to finance the CA. As evidenced by the episodes of external pressures, 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.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">Background. The authorities responded to market pressure in fall 2018 with a combination of exchange rate flexibility and FX intervention. Spot foreign exchange sales were US$26 billion (1 percent of GDP) and net forwards decreased by US$31.5 billion in 2018. International reserves stood at $411.9 billion at end-March 2019, down by about $12.5 billion from March 2018. Reserve coverage currently is about 15.2 percent of GDP and about 6.7 months of prospective imports of goods and services.

Assessment. Reserve levels are adequate for precautionary purposes relative to various criteria. International reserves represent about 155 percent of short-term debt and 149 percent of the IMF's composite metric.[1]</td></tr>
</table>

**The midpoint of the staff assessed REER gap is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.12. Indonesia: Economy Assessment

Overall Assessment: *The external position in 2018 was assessed to be moderately weaker than implied by medium-term fundamentals and desirable policies.* Exchange rate flexibility and trade-related policy actions (import compression and export promotion) together with broadly stable (projected) commodity prices are expected to modestly reduce the current account deficit over the medium term. 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: Improving Indonesia's external position requires boosting competitiveness through higher infrastructure and social spending while maintaining fiscal sustainability through the mobilization of revenues. In addition, structural policies are necessary to bolster global value chain participation, ease FDI and nontariff trade restrictions, and strengthen labor markets and worker skills (for example, streamlining stringent job protection and improving job placement services, vocational training, and overall education). Flexibility of the exchange rate and market-determined bond yields should continue to support external stability.

Foreign Asset and Liability Position and Trajectory

Background. At end-2018, Indonesia's NIIP stood at –30 percent of GDP, compared with –33 percent of GDP at end-2017 (and –39½ percent at end-2012). Gross external assets reached 33.3 percent of GDP (of which, close to 35 percent were reserve assets) and gross external liabilities, 63.8 percent of GDP. Indonesia's gross external debt was moderate at 36.2 percent of GDP at end-2018, of which 19 percent was denominated in rupiah and 87 percent was maturing after one year. About one-third of the government's external debt 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 rollover risk, but nonresident holdings of rupiah-denominated government bonds, at 34 percent of the total stock (or 6.4 percent of GDP) at end-2018, combined with shallow domestic financial markets, make Indonesia susceptible to global financial volatility, higher US interest rates, and a stronger US dollar. Staff projections for the current account suggest that the NIIP position as a percent of GDP will be stable over the medium term.

2018 (% GDP)	NIIP: –30.5	Gross Assets: 33.3	Res. Assets: 11.6	Gross Liab.: 63.8	Debt Liab.: 36.2

Current Account

Background. After narrowing since 2013, Indonesia's CA deficit increased to 3 percent of GDP in 2018, from a 1.6 percent deficit in 2017, driven by mainly by growing domestic demand and higher oil prices. The CA deficit is projected to narrow slightly to 2.9 percent in 2019 on the back of weaker import growth, in part due to the lagged effects of the sharp exchange rate depreciation since mid-2018 and lower oil prices. A gradual increase in manufacturing exports, underpinned by improved competitiveness and stronger demand from trading partners, should help limit the CA deficit over the medium term.

Assessment. Staff estimates a CA gap of –1.5 percent for 2018, consistent with an estimated cyclically adjusted CA balance of –3.3 percent of GDP and a staff-assessed norm of –1.8 percent of GDP.[1] Taking into account uncertainties in the estimation of the norm, the CA gap for 2018 is in the range of –3 percent to 0 percent of GDP.[2] The offsetting impact of domestic policy gaps suggests that addressing excess imbalances will require reforms to improve labor markets and competitiveness. The lagged effects of the weaker rupiah should help improve the CA deficit in the near term.

2018 (% GDP)	Actual CA: –3.0	Cycl. Adj. CA: –3.3	EBA CA Norm: –0.9	EBA CA Gap: –2.4	Staff Adj.: 0.9	Staff CA Gap: –1.5

Real Exchange Rate

Background. The REER remained broadly stable between 2013 and 2017. In 2018, the average REER depreciated by 6.0 percent relative to the average of 2017 due to a depreciation of the nominal exchange rate by 7.1 percent from tighter global financial conditions that led to capital flow pressures. Estimates through May 2019 show that the REER has appreciated by 5.0 percent relative to the 2018 average.

Assessment. The EBA index and level REER models point to an REER gap of about –3.2 percent to –15.5 percent for 2018, with the change driven by the depreciation of the REER. Meanwhile, the CA gap estimate of –1.5 percent of GDP with standard elasticities and uncertainty ranges (± 5 percent), would indicate that the REER is overvalued in the range of 3 to 13 percent. Taking into account the depreciation in 2018, staff assesses the REER gap to be in the –9 to 1 percent range.*

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2018, net capital and financial account inflows (2.5 percent of GDP) were sustained by net FDI inflows (1.4 percent of GDP), net portfolio inflows (0.9 percent of GDP), and net other investment inflows of 0.2 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 CA 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-2018, reserves were US$120.6 billion (equal to 12 percent of GDP, about 118 percent of the IMF's reserve adequacy metric and about 6.4 months of prospective imports of goods and services), compared with US$130.2 billion at end-2017. The loss in international reserves reflects mainly FX intervention in response to the disorderly market conditions triggered by the tightening of global financial conditions last year. In addition, contingencies and swap lines amounting to about US$92.5 billion are in place.

Assessment. Whereas the composite metric may not adequately account for commodity price volatility, the current level of reserves (US$124.3 billion at end-April) should provide a sufficient buffer against a wide range of possible external shocks, with predetermined drains also manageable. FX intervention, while broadly appropriate last year, should continue to aim primarily at preventing disorderly market conditions, while allowing the exchange rate to adjust to external shocks.

**The staff assessed REER gap of –4 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.13. Italy: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by fundamentals and desirable policies.* Nonetheless, policies to improve competitiveness are necessary to support growth, reduce high unemployment and public debt, and safeguard the external balance sheet.

Potential Policy Responses: Although the external position is in line with fundamentals, credible, growth-friendly, and inclusive fiscal consolidation is necessary to reduce external vulnerabilities and maintain investor confidence. Structural reforms, including to improve the wage bargaining mechanisms to better align wages with productivity at the firm level, as well as efforts to strengthen bank balance sheets, are also critical to improving competitiveness, boosting potential growth, and reducing vulnerabilities. The elements of this package of policies will likely have offsetting effects on the CA while being supportive of overall growth.

Foreign Asset and Liability Position and Trajectory

Background. Italy's NIIP reached –4.1 percent of GDP at end-2018, returning broadly to the level at end-2000 (–6 percent of GDP). Gross assets and liabilities, however, reached 153 and 157 percent of GDP, respectively, both about 55 percentage points higher than in 2000. TARGET2 liabilities rose from about 15 to 28 percent of GDP between end-2015 and end-2018, 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 three-quarters of gross external liabilities, half of which are owed by the public sector. Modest expected CA surpluses should continue to gradually improve 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, as well as between sovereign debt and the financial system.

2018 (% GDP)	NIIP: –4.1	Gross Assets: 152.5	Debt Assets: 59.3	Gross Liab.: 156.6	Debt Liab.: 108.6

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 multiyear-high surplus of 2.8 percent of GDP before declining slightly in 2018 as higher energy costs and weaker external demand reduced the trade surplus. 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 liability payments, related not least to the impact of monetary policy. In terms of saving and investment, declining overall investment (partly due to weak credit growth) accounted for two-thirds of the improvement in the CA since 2010, with higher public saving contributing the rest.

Assessment. The cyclically adjusted CA is estimated at 2.2 percent of GDP in 2018, 0.1 percentage point below the EBA-estimated CA norm of 2.3 percent of GDP. Staff assesses a CA gap in the range of –1.1 to 0.9 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).

2018 (% GDP)	Actual CA: 2.6	Cycl. Adj. CA: 2.2	EBA CA Norm: 2.3	EBA CA Gap: –0.1	Staff Adj.: 0.0	Staff CA Gap: –0.1

Real Exchange Rate

Background. From 2017 to 2018, both the CPI-based and ULC-based REER appreciated by 1.6 percent. As of May 2019, the REER had depreciated by 1.9 percent relative to the 2018 average. Stagnant productivity and rising labor costs led to a gradual appreciation of the REER since Italy joined the euro area, both in absolute terms and relative to the euro area average (by about 10 percent using ULC-based indices).

Assessment. The EBA level and index REER models suggest a modest overvaluation of 6.9 percent and 9.7 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 below the lower end of the staff-assessed CA gap range.[1] Taken together, staff assesses a REER gap of 0 to 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 2.5 percent of GDP in 2018, reflecting residents' net purchases of foreign assets.

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.

Table 3.14. Japan: Economy Assessment

Overall Assessment: *The 2018 external position was broadly in line with the level implied by medium-term fundamentals and desirable policies.* 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: Ensuring that the external position remains in line with fundamentals requires a coordinated policy package that addresses domestic policy distortions with offsetting effects. Whereas fiscal consolidation should proceed in a gradual manner, it will need to be accompanied by a credible medium-term fiscal framework and structural reforms that support domestic demand. These include measures to boost wages, increase labor supply, reduce labor market duality, reduce barriers to entry in some industries, and accelerate agricultural and professional services sector deregulation.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP remained at about 60 percent of GDP over 2014–18, with assets reaching 182 percent and liabilities reaching 121 percent in 2018. In the medium term, the NIIP is projected to rise to about 68 percent with CA surpluses, before gradually stabilizing due to population aging. Japan holds the world's largest stock of net foreign assets, which at end-2018 was valued at US$3.03 trillion.

Assessment. Foreign asset holdings are diversified geographically and by risk classes. Portfolio investment accounts for 45 percent of total foreign assets, with 20 percent yen-denominated. However, with about half of portfolio investment denominated in US dollars, negative valuation effects could materialize in the event of yen appreciation against the US dollar. Liabilities' vulnerabilities are limited, with equity and direct investment accounting for 31 percent of total liabilities. The NIIP generated net annual investment income of 3.8 percent of GDP in 2018. The large positive NIIP in part reflects the accumulation of assets for old-age consumption, which is expected to be gradually unwound over the long term.

2018 (% GDP)	NIIP: 61.0	Gross Assets: 181.9	Debt Assets: 87.7	Gross Liab.: 120.9	Debt Liab.: 79.6

Current Account

Background. Japan's CA surplus reflects high corporate gross saving exceeding domestic investment and a sizable income balance owing to its large NFA position. In line with growing national savings, the CA surplus has risen since 2014, reaching 4.2 percent of GDP in 2017 and 3.5 percent in 2018. The income balance continues to contribute most to the CA surplus, at 3.8 percent in 2018. While lower energy prices largely underpinned the 2014–17 CA balance increase, higher energy prices were an important driver of the decrease in the CA surplus in 2018—with the goods trade balance falling to 0.2 percent of GDP in 2018. The increase in exports in 2018 was more than offset by the increase in imports (largely due to higher energy prices). Over the medium term, the CA balance is projected to remain stable at about 3.6 percent of GDP.

Assessment. The 2018 CA assessment uses the EBA model, in which the estimated cyclically adjusted CA is 3.3 percent of GDP and the cyclically adjusted CA norm is estimated at 3.1 percent of GDP, with a standard error of 1.2 percent of GDP. Staff estimates a CA norm range between 1.9 and 4.3 percent of GDP. The 2018 CA gap midpoint is assessed to be 0.2 percent of GDP (with the CA gap range between –1.0 and 1.4), suggesting that the underlying CA is in line with the level consistent with fundamentals and desirable policies. The large unexplained portion of the EBA CA gap suggests that important bottlenecks to investment remain.

2018 (% GDP)	Actual CA: 3.5	Cycl. Adj. CA: 3.3	EBA CA Norm: 3.1	EBA CA Gap: 0.2	Staff Adj.: 0.0	Staff CA Gap: 0.2

Real Exchange Rate

Background. The 2018 average REER stands at its 2014 level, when it was assessed to be broadly in line with the level consistent with fundamentals and desirable policies. After appreciating during 2014–16, the average REER depreciated during 2016–18. In 2018, the average REER weakened by 0.8 percent relative to 2017 as a confluence of factors led to an overall stable REER, with earlier expectations of a more rapid pace of US monetary normalization on the one hand and speculation of earlier-than-expected normalization in Japan on the other (with 10-year Japanese government bond rates reaching a three-year high in October). Estimates through May 2019 show that the REER has appreciated by 2.9 percent relative to the 2018 average, although markets remain volatile, reflecting changes in global risk aversion and the monetary policy stances of key central banks.

Assessment. The EBA REER Index and Level models estimate the 2018 average REER to be 17 to 22 percent lower than the level consistent with fundamentals and desirable policies. However, the EBA REER gaps are unexplained by the models, partly because the REER models do not include Japan-specific factors that affect the REER, including the Japanese government bond–US Treasury spread, portfolio rebalancing, and temporary speculative positions vis-à-vis the yen. As a result, less weight is given to the EBA REER models. Using the staff-assessed 2018 EBA CA gap range as a reference and applying a staff-estimated semielasticity of 0.13 yields an indicative range for the 2018 REER gap of between –11 and 8 percent with a midpoint of –1.5 percent.*

Capital and Financial Accounts: Flows and Policy Measures

Background. Portfolio outflows continued during most of 2018—registering a faster pace than in 2017—as institutional investors continued to diversify overseas (mostly to Europe) and FDI outflows continued. Net FDI and portfolio flows comprise the bulk of the 2018 financial account (2.7 and 1.8 percent of GDP, respectively), whereas other investments (net) recorded inflows (1.3 percent of GDP). Net short yen positions have prevailed since June 2018.

Assessment. Vulnerabilities are limited. (Inward investment tends to be equity-based, and the home bias of Japanese investors remains strong.) So far there have been no large spillovers from the Bank of Japan's yield curve control to financial conditions in other economies (interest rates, credit growth). If capital outflows from Japan accelerate, they could provide an offset to the effects of tighter domestic financial conditions in the region.

FX Intervention and Reserves Level

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 occurring in 2011), intended to reduce short-term volatility and disorderly exchange rate movements.

**The staff assessed REER gap of –1.5 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.15. Korea: Economy Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external position in 2018 was assessed to be moderately stronger than warranted by medium-term fundamentals and desirable policies. 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 term 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>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. The NIIP has been positive since 2014 and rising gradually since 2010. In December 2018, it reached 24 percent of GDP, with gross liabilities totaling 64 percent of GDP, of which 26 percent of GDP was gross external debt.

Assessment. The positive NIIP strengthens external sustainability and should increase further as the CA is projected to remain in surplus. Risks from currency mismatches are lower than before the global financial crisis, as short-term external liabilities of banks, which rose to relatively high levels before the global financial crisis, declined back to below precrisis levels.</td></tr>
<tr><td>2018 (% GDP)</td><td>NIIP: 24.0</td><td>Gross Assets: 88.3</td><td>Debt Assets: 26.0</td><td>Gross Liab.: 64.3</td><td colspan="2">Debt Liab.: 23.9</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. The CA surplus narrowed further in 2018, from the peak of 7.6 percent of GDP in 2015. This decline from 4.9 percent of GDP in 2017 to 4.4 percent in 2018 mainly reflected (1) a decline in the goods trade balance, as the terms of trade worsened substantially; and (2) a decline in the income balance, reflecting in part increased dividend payouts from firms. The service balance increased owing to a less negative transportation balance and a rebound in tourist arrivals. From an investment-saving perspective, the narrowing of the CA is explained by larger fall in the savings rate than in the investment-to-GDP ratio.

Assessment. The EBA model estimates the 2018 cyclically adjusted CA surplus to be 4.2 percent of GDP, and the CA norm to be in the range 1.7 to 3.7 percent of GDP. In line with the EBA estimates, staff assesses the CA gap midpoint of 1.4 percent of GDP with a range of 0.4 to 2.4 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 social safety net.</td></tr>
<tr><td>2018 (% GDP)</td><td>Actual CA: 4.4</td><td>Cycl. Adj. CA: 4.2</td><td>EBA CA Norm: 2.7</td><td>EBA CA Gap: 1.4</td><td>Staff Adj.: 0.0</td><td>Staff CA Gap: 1.4</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. The REER appreciated by 1.0 percent in 2018, thus continuing a gradual appreciating trend since 2013 (up about 10 percent since 2013). As of May 2019, the REER weakened by about 5.1 percent relative to the 2018 average.

Assessment. The EBA REER regression models suggest gaps ranging from –5.4 (for the REER Level model) and 3.8 (for the REER Index model). Staff assesses the REER gap in 2018 to be in the range of –7 to –1 percent, which is derived by applying the estimated semielasticity of 0.36 to the staff-assessed CA gap.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. Net capital outflows have been relatively stable over the medium term despite significant shifts in composition. In the 2018, they decreased to 4.1 percent of GDP from 5.2 percent of GDP in 2017. Nonresident portfolio inflows surged to US$21.1 billion as foreigners continued to sharply expand purchases of debt securities. On the other hand, nonresidents sold US$6 billion worth of equities (on a net basis), contributing to a correction in equity prices of about 20 percent in 2018.

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 that occurred over the last few years.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">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 2018 was limited, with spot interventions roughly offsetting the change in the forward position. Reserves increased steadily from 2009 through mid-2014, remained broadly stable through 2016, and have increased slightly since. In 2018, reserves increased by US$14.4 billion, including valuation effects. At end-2018, total reserves stood at US$403 billion (23.4 percent of GDP).

Assessment. Intervention appears to have been limited to addressing disorderly market conditions since 2015. Foreign exchange reserves were about 106 percent of the IMF’s composite reserve adequacy metric at end-2018, which provides a sufficient buffer against a wide range of possible external shocks. According to staff estimates net intervention since 2016 has been slightly negative.</td></tr>
</table>

Table 3.16. Malaysia: Economy Assessment

Overall Assessment: *The external position in 2018 was stronger than implied by fundamentals and medium-term desirable policies.* Over the past few years Malaysia's growth model has become increasingly driven by private domestic demand, and its CA surplus has narrowed significantly. A further decline in the surplus is projected over the medium term on the back of policies supporting continued robust domestic private demand.

Potential Policy Responses: The planned medium-term fiscal consolidation should be accompanied by policies to strengthen the social safety net and continue to encourage private investment. Fiscal spending should be reoriented to accommodate further improvements in social protection and public health care. At the same time, continued efforts are needed to improve the quality of public infrastructure (supported by enhanced public finance management) and to address structural impediments holding back private investment. Specifically, efforts to improve the quality of education, reduce skills mismatch, and encourage female labor participation would help to support private investment and productivity.

Continued exchange rate flexibility is necessary to facilitate external adjustment, with intervention limited to addressing disorderly market conditions.

Foreign Asset and Liability Position and Trajectory

Background. Malaysia's NIIP has averaged about 1 percent of GDP since 2010, with changes in recent years reflecting both capital flows and valuation effects. As of end-2018, the NIIP fell to about –5.2 percent of GDP (compared with –2 percent of GDP at end-2017), with higher net direct investment and other investment liabilities more than offsetting the reduction in net portfolio capital liabilities.[1] Official reserves contribute most to net assets, whereas net portfolio liabilities contribute most to net liabilities. Total external debt, measured in US dollars, was about 62.4 percent of GDP at end-2018 (compared to 70 percent of GDP at end-2017), of which about two-thirds was in foreign currency and 44 percent in short-term debt, by original maturity.

Assessment. The NIIP should rise gradually over the medium term reflecting projected moderate CA surpluses. Malaysia's balance sheet strength, along with exchange rate flexibility and increased domestic investor participation, would help support resilience to a variety of shocks, including outflows associated with external liabilities.[2]

2018 (% GDP)	NIIP: –5.2	Gross Assets: 113.6	Res. Assets: 28.3	Gross Liab.: 118.9	Debt Liab.: 51.0

Current Account

Background. Malaysia's CA surplus declined by about 7 percentage points of GDP between 2010 and 2017, driven mainly by lower national savings and a modest rise in investment. In 2018, the CA surplus further declined to 2.1 percent of GDP (from 3 percent in 2017), despite a higher oil balance. The goods balance was in surplus, whereas the services and income accounts registered larger deficits.

Assessment. The EBA CA regression estimates the 2018 CA norm at –0.2 percent of GDP after cyclical and multilateral consistency adjustments. The 2018 cyclically adjusted CA is estimated at about 2.3 percent of GDP. This leads to an estimated 2018 CA gap of 2.4 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. Identified domestic policy gaps have an offsetting effect. Whereas low public health care spending contributes to the excess surplus, FX intervention that helped to prevent further currency depreciation reduces the surplus. The CA balance is expected to remain in surplus, albeit a lower one, over the medium term, driven by lower private sector net saving.[3]

2018 (% GDP)	Actual CA: 2.1	Cycl. Adj. CA: 2.3	EBA CA Norm: –0.2	EBA CA Gap: 2.4	Staff Adj.: 0.0	Staff CA Gap: 2.4

Real Exchange Rate

Background. In 2018, the average REER appreciated by 4.2 percent. However, it had depreciated nearly 2.4 percent since April 2018. The REER is about 10 percent lower than its 2013 level, reflecting the impact on the NEER from capital outflows and terms-of-trade shocks, with the latter contributing to a decline in the CA surplus. Through May 2019, the REER has depreciated by 2.0 percent relative to the 2018 average.

Assessment. The EBA REER Index and Level models estimate Malaysia's REER to be undervalued by about 25 and 37 percent, respectively. However, the usual macroeconomic stresses associated with such undervaluation are absent (for example, high core inflation, sustained wage pressure, or significant FX reserve buildup). Consistent with the assessed CA gap, staff assesses the REER gap in 2018 to be –5 percent (± about 2 percent).

Capital and Financial Accounts: Flows and Policy Measures

Background. Since the global financial crisis, Malaysia has experienced periods of significant capital flow volatility, largely driven by portfolio flows in and out of the local-currency debt market. Following the tightening of global financial conditions and general elections in spring 2018, portfolio outflows again intensified, although they have recovered somewhat since late 2018. Since late 2016, the Financial Markets Committee has implemented measures to develop the onshore FX market.[4]

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

FX Intervention and Reserves Level

Background. Malaysia faced significant reserve losses between 2014 and 2016 and witnessed an increase of nearly US$8 billion in 2017. Reserves were generally unchanged in 2018, although it masked intrayear volatility. After increasing by US$7.1 billion through end-April 2018, reserves fell by US$8.1 billion during the remainder of the year, reaching US$101.4 billion as of end-2018.

Assessment. Under the IMF's composite reserve adequacy metric (ARA),[5] reserves remain broadly adequate. Gross official reserves are about 108 percent of the ARA metric as of end-2018, but reserves adjusted for net forward positions are below 100 percent of the ARA metric. Given limited reserves and the increased hedging opportunities since 2017, FX interventions should be limited to preventing disorderly market conditions. In case of an inflow surge, some reserve accumulation would be appropriate to increase the reserve coverage ratio.

Table 3.17. Mexico: Economy Assessment

Overall Assessment: *In 2018, the external sector position was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The CA deficit widened slightly, amid uncertainty about future trade relations with the United States and the Mexican elections, as well as significant exchange rate volatility.

Potential Policy Responses: Despite the current absence of external imbalances, further structural reforms to improve competitiveness and the investment climate will be essential for boosting growth and exports while also maintaining external sustainability in the medium and long term. To this effect, the commitment to maintain the public sector borrowing requirement at or below 2.5 percent of GDP will help to safeguard fiscal and external sustainability, although efforts to boost non-oil tax revenue are necessary to provide space for much-needed public investment.
The floating exchange rate should continue to serve as the main shock absorber, with FX interventions used to prevent disorderly market conditions. The IMF Flexible Credit Line provides an added buffer against global tail risks.

Foreign Asset and Liability Position and Trajectory

Background. Mexico's NIIP was –46 percent of GDP in 2018 (gross foreign assets and liabilities were 46.7 percent and 93.0 percent of GDP, respectively). Over the past five years, the NIIP has remained relatively stable in the range of –46 to –51 percent of GDP—with negative balance of payments flows largely compensated for by exchange rate and other valuation effects—and is projected to remain broadly stable through 2024. In 2018, foreign assets mainly consisted of direct investment (17 percent of GDP) and reserves (14 percent of GDP), whereas foreign liabilities were mostly FDI (45 percent of GDP) and portfolio investment (40 percent of GDP). Gross public sector external debt stood at 25 percent of GDP, of which about one-third was holdings of local currency government bonds and the remainder was mostly denominated in US dollars.

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

2018 (% GDP)	NIIP: –46.4	Gross Assets: 46.7	Res. Assets: 14.4	Gross Liab.: 93.0	Debt Liab.: 37.4

Current Account

Background. In 2018, the CA deficit widened slightly to 1.8 percent of GDP (1.6 percent cyclically adjusted), from 1.7 percent in 2017, after having gradually narrowed from 2.6 percent of GDP in 2015 driven by an improved non-oil trade balance. Over the medium term, a broadly stable CA deficit at current levels is projected, as a stronger oil balance broadly offsets widening primary income deficits.

Assessment. The EBA model estimates a cyclically adjusted CA norm of –2.6 percent of GDP in 2018.[1] This implies a CA gap of 1.0 percent of GDP in 2018, with an estimated policy gap of 0.7 percent of GDP. Staff estimates a similar CA gap within the range of 0.0 and 2.0 percent of GDP.

2018 (% GDP)	Actual CA: –1.8	Cycl. Adj. CA: –1.6	EBA CA Norm: –2.6	EBA CA Gap: 1.0	Staff Adj.: 0.0	Staff CA Gap: 1.0

Real Exchange Rate

Background. The free-floating exchange rate continued to fulfill its role as a key shock absorber in 2018. It fluctuated notably during the year, reflecting periods of heightened uncertainty related to an unsettled global environment, NAFTA-related uncertainty, and the Mexican elections. The average REER in 2018 was broadly unchanged relative to the 2017 average. While subject to significant volatility, by May 2019 the REER was about 4.3 percent stronger than its 2018 average.

Assessment. The EBA REER Level model estimates an undervaluation of 9.5 percent in 2018, whereas the REER Index model yields a higher undervaluation (21.0 percent). Staff put less weight on the REER index approach as it has implied a large and persistent undervaluation of the peso for most of the sample period. The external sustainability approach suggests a 3.3 percent undervaluation. Considering all estimates and the uncertainties around them, staff's assessment is based on the EBA CA model gap (applying a semielasticity of 0.16) and estimates Mexico's REER gap to be in the range of –14 to 2 percent.

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 2015–18, gross portfolio inflows slowed markedly. In 2018, net inflows into the private sector turned negative, including due to high uncertainty from domestic and global developments. EPFR bond and equity flows turned negative in the second half of 2018, though they remained positive for the year overall. Going forward, the oil auctions completed since the start of the energy reforms are expected to support higher FDI, whereas 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. Nonfinancial corporate debt levels are low and foreign exchange risks generally 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, whereas 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.[2] In 2018, no new NDF sales or other discretionary interventions took place.[3] At end-2018, FX reserves increased to US$176.4 billion (14.5 percent of GDP) from US$175.4 at end-2017.

Assessment. At 117 percent of the Assessing Reserve Adequacy metric at end-2018 and 234 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.

Table 3.18. Netherlands: Economy Assessment

Overall Assessment: *The external position in 2018 was substantially stronger than the level consistent with medium-term fundamentals and desirable policies.* The Netherlands' status as a trade and financial center and natural gas exporter makes an external assessment more uncertain than usual.

Potential Policy Responses: Implementation of the envisaged expansionary fiscal policy and use of the additional fiscal space under the Medium-Term Objective over the medium term will help support domestic demand and contribute to reducing excess external imbalances. In addition, reforms aimed at supporting household and small and medium-sized enterprise rebalancing are necessary to encourage investment and should be complemented by an expansion of direct support to research and development, and public investment in digitalization and lifelong learning.

Foreign Asset and Liability Position and Trajectory

Background. The Netherlands' NIIP reached 66.7 percent of GDP at the end of 2018 (with gross assets and liabilities totaling 1,062 and 995 percent of GDP, respectively), rising from an almost balanced NIIP at end-2009. The largest component of the NIIP comes from the net FDI stock, about €943 billion (122 percent of GDP) at the end of 2018. The Netherlands reported the largest inward and outward FDI positions in the world at end-2017, according to the latest Coordinated Direct Investment Survey. The United States, Luxembourg, and the United Kingdom are the top three partner countries, with gross bilateral stock positions close to €2.2, €1.4, and €1.4 trillion, respectively. TARGET2 assets of the Eurosystem are estimated at about €100 billion. Over the medium term, the NIIP is expected to continue growing to above 100 percent of GDP, in line with projected sizable CA surpluses.

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

2018 (% GDP)	NIIP: 66.7	Gross Assets: 1,061.9	Debt Assets: 205.7	Gross Liab.: 995.2	Debt Liab.: 275.8

Current Account

Background. The CA has been in surplus since 1981—a reflection of a positive goods and services balance, largely vis-à-vis EU trading partners. In 2018, the CA surplus increased to 10.8 percent of GDP (11 percent cyclically adjusted), driven by continued strong net exports, whereas the primary income balance is low despite the large NIIP, reflecting a dominant role of multinationals. Nonfinancial corporate net saving (that is, gross saving minus domestic business investment) has been the main driver of the surpluses since 2000, with large corporate savings financing substantial FDI outflows. Household net saving (that is, gross saving minus residential investment) only contributes a small part of the CA surpluses, reflecting offsetting high mandatory contributions to the second-pillar pension funds and high real estate investment. The Netherlands' status as a trade and financial center and natural gas exporter likely contributes to the strong structural position.

Assessment. The EBA CA model estimates a CA norm of 3.3 percent of GDP and a CA gap of 7.7 percent of GDP in 2018, with an unexplained residual of 6.2 percent of GDP.[1] The large unexplained residual primarily reflects the high gross saving of Netherlands-based multinationals, a fraction of which may reflect measurement errors or biases as official statistics may overstate the net accumulation of wealth by Dutch residents. However, at this stage, data constraints related to the complexity of corporate and ownership structures prevent proper quantification. Taking these factors into account, staff assesses the norm in a range of 1.3 to 5.3 percent of GDP, and a corresponding CA gap of 4.2 to 8.2 percent of GDP. The CA gap is expected to narrow moderately over the medium term, supported by continued strong domestic demand and expedited phasing-out of gas production.

2018 (% GDP)	Actual CA: 10.8	Cycl. Adj. CA: 11.0	EBA CA Norm: 3.3	EBA CA Gap: 7.7	Staff Adj.: –1.5	Staff CA Gap: 6.2

Real Exchange Rate

Background. The annual average CPI-based REER appreciated about 2.0 percent, whereas the average ULC-based REER depreciated by about 0.5 percent in 2018. The REER appreciation was largely driven by the euro appreciation (about 1.8 percent), whereas the Dutch CPI and ULC grew more slowly than its trading partners'. As of May 2019, the REER was unchanged relative to the 2018 average.

Assessment. The EBA REER models indicate an overvaluation between 2.2 percent (level model) and 14.5 percent (index model) in 2018, largely attributable to unexplained residuals. The staff-assessed CA gap implies a REER undervaluation of about 8.6 percent (assuming a semielasticity of 0.72). Taking into account all estimates and the uncertainty surrounding the EBA REER results, staff assesses that the REER remained undervalued by about 5.8 to 11.4 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net FDI and portfolio outflows dominate the financial account. FDI outflows are driven by the investment of corporate profits abroad, largely by multinationals. 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.

FX Intervention and Reserves Level

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.

Table 3.19. Poland: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with that suggested by medium-term fundamentals and desirable policies.* Increased absorption of EU funds, continued buoyant private consumption, and weaker external demand returned the CA to a small deficit in 2018. Over the medium term, the CA deficit is expected to widen gradually, reflecting further declines in government and household net saving rather than a more desirable increase in private investment, which has been persistently low.

Potential Policy Responses: Policies should aim at boosting private investment and productivity while restraining fiscal current spending. Therefore, focus should be given to structural reforms aimed at removing existing barriers to private investment, facilitating access to skilled labor, enhancing the predictability of policies affecting firms, and providing a level playing field for all investors, including by protecting the rights of minority shareholders and ensuring competition. Front-loaded fiscal consolidation can support these medium-term objectives, although room will need to be made for priority spending, especially for health care and public investment, as EU funds are gradually reduced.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP is estimated to have reached –59 percent of GDP in 2018, broadly in line with the average level of recent years. Both gross assets and liabilities declined (to 48 percent of GDP and 107 percent of GDP, respectively). Inward FDI (both equity and debt), which accounts for about 46 percent of gross external liabilities, is diversified across sectors and source countries. Whereas gross external debt is sizable (62 percent of GDP at end-2018), more than a quarter corresponds to liabilities to direct investors. The share of short-term debt (at remaining maturity) is relatively high (29 percent of total gross debt), but non-FDI short-term debt is much lower at 17 percent of total gross external debt (11 percent of GDP). Over the medium term, the negative NIIP position is expected to narrow, consistent with Poland's ongoing income convergence.

Assessment. Whereas 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 rolled over automatically. Sizable reserves also mitigate any residual liquidity risk related to short-term debt (gross reserves at end-2018 were about 187 percent of non-FDI short-term debt at remaining maturity).

2018 (% GDP)	NIIP: –58.8	Gross Assets: 48.1	Res. Assets: 20.1	Gross Liab.: 106.9	Debt Liab.: 45.1

Current Account

Background. The CA has improved significantly since the global financial crisis, reaching close to balance during 2015–17 on higher goods and services balances, notwithstanding large and rising primary income deficits. Low investment and rising saving by the corporate sector (which reached 5 percent of GDP in recent years) have been partly offset by (declining) net borrowing by households and the government. In 2018, Poland's CA returned to a small deficit of 0.7 percent of GDP on slower external demand, increased absorption of EU funds, and buoyant private consumption. Higher oil prices and larger remittance outflows by foreign workers also reduced the CA. Under the baseline, the CA deficit relative to GDP is expected to widen further on declining government and household saving.

Assessment. For 2018, the EBA model estimates a cyclically adjusted CA deficit of 0.6 percent of GDP and a CA norm of –2.3 percent of GDP. The resulting EBA gap of 1.7 percent of GDP includes identified policy gaps (1.0 percent of GDP). However, given Poland's need to reduce its large negative NIIP position to safer levels over the next five years (that is, to 45 percent of GDP, which is the level consistent with that of other EU member countries after controlling for per capita income) a CA deficit of 1.7 percent of GDP would be more appropriate. As such, after applying a 0.8 percentage point adjustment to the norm, staff assesses the CA to have been broadly in line with fundamentals and medium-term policies in 2018, with a CA gap of 0.9 (±1) percent of GDP.[1,2]

2018 (% GDP)	Actual CA: –0.7	Cycl. Adj. CA: –0.6	EBA CA Norm: –2.3	EBA CA Gap: 1.7	Staff Adj.: –0.8	Staff CA Gap: 0.9

Real Exchange Rate

Background. The REER appreciated in 2017 (by 3.4 percent) and again marginally (1.7 percent) in 2018. In nominal terms, the zloty appreciated by about 4½ percent against the dollar (annual average) and was stable against the euro in 2018. Between end-2018 and May 2019, the zloty depreciated by 0.1 percent against the dollar and by 1 percent against the euro.

Assessment. The REER index model suggests a gap of –2.7 percent.[3] Overall, staff assesses, based on the REER model and the CA gap, that Poland's REER gap in 2018 was in the range of –5 to 0 percent.*

Capital and Financial Accounts: Flows and Policy Measures

Background. The capital account is dominated by inflows of EU funds for the financing of investment projects. In the financial account, net FDI inflows increased significantly in 2018, on account of smaller foreign placement of FDI assets. Net issuance of government debt declined considerably in recent years as the fiscal position improved.

Assessment. The sizable foreign holdings of (both zloty- and FX-denominated) government debt securities (about 49 percent of total; 25 percent of GDP) suggests a potential vulnerability. This share has been declining since 2016 as domestic banks have increased their holdings in response to 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 in 2018 and reached US$117 billion at year-end. Net reserves, which exclude the National Bank of Poland's (NBP's) repo operations (part of its reserve management strategy) from gross reserves, increased marginally to about US$98 billion at end-2018, reflecting net inflows of EU funds. This is consistent with the NBP's strategy of building an adequate precautionary reserve buffer. The zloty is a free-floating currency, and the NBP does not intervene.

Assessment. Standing at 97 percent of the IMF's composite reserve adequacy (ARA) metric in 2018, net reserves remain adequate to insulate against external shocks and disorderly market conditions. Gross reserves were about 115 percent of the ARA metric.

**The staff assessed REER gap of –2.5 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.20. Russia: Economy Assessment

Overall Assessment: *The external position in 2018 was moderately stronger than that suggested by fundamentals and desirable policies.* Favorable commodity prices have boosted exports, whereas worsening geopolitical tensions weakened the exchange rate and contained imports. As a result, the CA surplus reached a historical high. In the meantime, uncertainty about sanctions has weighed on capital flows and complicates the external sector assessment.

Potential Policy Responses: Fiscal policy should continue operating within the parameters of the new fiscal rule to reduce the impact of oil price volatility on the non-oil sector while rebalancing government expenditure toward health, education, and infrastructure in the medium term. Greater focus should be given to structural reforms aimed at improving the business climate and boosting private sector investment, especially in the non-oil sector. Both the reorientation of fiscal expenditure to key areas and an increase in private sector investment will raise Russia's growth potential while bringing the external position into balance.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP rose to US$370.9 billion at end-2018, which at 22 percent of GDP is marginally higher than in 2017 and well above the near balance net stock position in 2010. Gross assets stood at 81 percent of GDP, while liabilities (53 percent equity and 47 percent debt) declined from 68 percent of GDP in 2017 to 59 percent of GDP on private sector deleveraging. Debt liabilities to nonresidents, three-quarters of which are in foreign currencies, declined from 32 percent of GDP in 2017 to 28 percent of GDP by end-2018. Nonresidents have also cut their holdings of ruble-denominated government debt to about 25 percent of the total stock from a peak of 34.5 percent in 2018:Q1 due to heightened geopolitical tensions.[1] There are no obvious maturity mismatches between the gross asset and liability positions. Historically, the NIIP position has not kept pace with CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows.[2]

Assessment. The projected CA surpluses suggest that Russia will see a gradual rise of its positive NIIP, lowering risks to external stability. Moreover, official external assets have been increasing rapidly since the introduction of the new fiscal rule, despite the temporary suspension of the associated FX purchases between August 2018 and January 2019. The recent external deleveraging by the private sector further reduced risks.

2018 (% GDP)	NIIP: 22.4	Gross Assets: 80.9	Res. Assets: 28.3	Gross Liab.: 58.5	Debt Liab.: 18.9

Current Account

Background. On the back of strong energy exports and moderate import growth, the CA balance reached 6.9 percent of GDP in 2018, the highest level in more than a decade. However, the nonenergy CA remains in deficit (8.6 percent of GDP in 2018), reflecting relatively weak competitiveness in the nonenergy sector. In the medium term, the CA surplus is expected to taper off to about 3 percent of GDP on moderating oil prices and a pickup in imports.

Assessment. The EBA CA model yields a norm for 2018 of 3.1 percent of GDP, compared with a cyclically adjusted CA surplus of 6.6 percent of GDP. This implies an EBA CA gap of 3.5 percent of GDP, for which identified policies contributed 2.8 percent of GDP, mainly reflecting the lower-than-desirable health spending and the large fiscal surplus in 2018. However, given that the EBA model may be underestimating the cyclical effects related to the oil price increase in 2018, staff assesses the CA gap to be lower and about 1.6 percent of GDP in 2018, with a confidence interval between 0.6 and 2.6 percent of GDP. The large uncertainty also reflects difficulties in estimating the impact and duration of sanctions (protracted sanctions could lead to higher precautionary savings, lower investment, and a higher CA norm).

2018 (% GDP)	Actual CA: 6.9	Cycl. Adj. CA: 6.6	EBA CA Norm: 3.1	EBA CA Gap: 3.5	Staff Adj.: –1.9	Staff CA Gap: 1.6

Real Exchange Rate

Background. The REER depreciated by 7.6 percent in 2018, despite higher oil prices, mainly reflecting sanctions, both those imposed in 2018 and the threat of new measures. As of May 2019, the ruble has appreciated by 3.4 percent in real terms relative to the 2018 average.

Assessment. EBA Level and Index REER models indicate an undervaluation of 20 percent and 15 percent, respectively. However, both approaches generate large residuals (about –10 percent). Among the model determinants, the most important contributor to undervaluation is health expenditure. Using an elasticity parameter of 0.27, staff assesses that the 2018 REER was undervalued by between 2 and 10 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net private capital outflows continued in 2018 (lower net liabilities generated an outflow of US$38 billion, and the net acquisition of financial assets resulted in an outflow of US$39 billion). In the banking sector, outflows mainly took the form of a reduction in foreign liabilities, whereas the nonbanking private sector built up foreign assets during this period. Sanctions and the projected moderation of oil prices are expected to weigh on flows over the medium term.

Assessment. Whereas Russia is exposed to risks of continued outflows due to geopolitical uncertainties, the large FX reserves and the floating exchange rate regime provide substantial buffers to help absorb external 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$469 billion (more than 16 months of imports) by end-2018.

Assessment. International reserves at end-2018 were equivalent to 275 percent of the IMF's reserve adequacy metric, considerably above the adequacy range of 100 to 150 percent. Taking into account Russia's vulnerability to oil price shocks and sanctions, an additional commodity buffer of $65 billion is appropriate, translating into a ratio of reserves to the buffer-augmented metric to 204 percent. The ratio remains above the adequacy level but is justifiable given the high degree of geopolitical uncertainty. Large FX interventions should be limited to episodes of market distress.

Table 3.21. Saudi Arabia: Economy Assessment

Overall Assessment: *The external position in 2018 was moderately weaker than the level consistent with desirable medium-term fiscal policies.* The pegged exchange rate provides Saudi Arabia with a credible policy anchor. Given the close link between the fiscal and external balance and the structure of the economy, 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. Reserves remain very comfortable when judged against standard IMF metrics, although external savings are not sufficient from an intergenerational equity perspective. Reserves are expected to decline over the medium term as the CA moves to broad balance and investments overseas by public sector institutions continue.

Potential Policy Responses: Fiscal consolidation is needed to strengthen the CA and increase saving for future generations. Fiscal adjustment should be based on further energy price reforms, non-oil revenue measures, expenditure restraint, and increased efficiency of spending, 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 can also support a stronger external position over the long term.

Foreign Asset and Liability Position and Trajectory	**Background.** Net external assets are estimated at 86 percent of GDP at end-2018, down from 91 percent of GDP in 2017 and 105 percent in 2015.[1] Projections suggest the NIIP-to-GDP ratio will increase slightly over the medium term (to about 91 percent of GDP by 2024) as the CA remains in surplus in the near term and moves to broad balance by 2024. 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 exhaustible resource revenues for future generations and protection against vulnerabilities from oil price volatility.
2018 (% GDP)	NIIP: 85.5 | Gross Assets: — | Res. Assets: 63.2 | Gross Liab.: — | Debt Liab.: 28.3
Current Account	**Background.** The CA balance increased further, reaching a surplus of 9.2 percent of GDP in 2018, up from a surplus of 1.5 percent in 2017 and a deficit of close to 9 percent in 2015. The trade balance improved by 7.5 percent of GDP, as the 36 percent increase in oil export revenues more than offset the 13 percent increase in imports of services. The terms of trade improved by 23.5 percent in 2018 as oil prices rose. The CA surplus is expected to decline to 6.9 percent of GDP in 2019 as oil revenues decline (the terms of trade are projected to decline by 4.4 percent) and import growth continues. Over the medium term, a gradual decline in oil exports and import growth should push the CA into broad balance.[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 2018 is –0.6 percent of GDP using the EBA-lite approach. The consumption-based allocation model suggests a CA gap of –0.2 percent of GDP and –3.4 percent of GDP for the constant real annuity and constant real per capita annuity allocation rules, respectively. The investment-needs model suggests a CA gap of 0.3 percent of GDP.[3] Staff assesses a CA gap of –1.7 percent of GDP with a range from 0 to –3.4 percent of GDP in 2018. Fiscal adjustment needs to be implemented to strengthen the CA over the medium-term.
2018 (% GDP)	Actual CA: 9.2 | Cycl. Adj. CA: 8.9 | EBA CA Norm: — | EBA CA Gap: — | Staff Adj.: — | Staff CA Gap: –1.7
Real Exchange Rate	**Background.** The riyal has been pegged to the US dollar at a rate of 3.75 since 1986. The REER depreciated by 1 percent in 2018 (year over year) and was on average 7 percent above its 10-year average. As of May 2019, the REER had depreciated by about 0.7 percent relative to the 2018 average. **Assessment.** Exchange rate movements have a limited impact on competitiveness in the short term as most exports are oil or oil-related products and there is limited substitutability between imports and domestically produced products, which in turn have significant imported labor and intermediate input content. Staff estimates an average REER gap in 2018 in the range of 5 to 10 percent. Fiscal consolidation will help narrow the REER gap as domestic absorption is restrained.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Recorded net financial outflows increased in 2018 as public sector institutions continued to accumulate external assets. E&O were small at about 0.6 percent of GDP in 2018 compared with 10.3 percent of GDP in 2016. FX reserves increased marginally. Reserves are expected to decline over the medium term as the CA moves to broad balance and investments overseas by public sector institutions continue as part of the diversification strategy under the government's Vision 2030 plan. **Assessment.** Analysis of the financial account is complicated by the lack of detailed information on the nature of the financial flows and the large E&O in the balance of payments in some years. The strong reserves position limits risks and vulnerabilities.
FX Intervention and Reserves Level	**Background.** The assets of the Public Investment Fund are increasing, although most of the government's foreign assets are held at the central bank within international reserves. Reserves increased slightly to $490 billion (63 percent of GDP, 26.7 months of imports, and 414 percent of the IMF's reserve adequacy metric) at end-2018 but are down from $724 billion in 2014. The reserve coverage is expected to decline to 247 percent of the IMF's ARA metric by 2024, above the IMF's recommended range of reserves of 100 to 150 percent. **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.

Table 3.22. Singapore: Economy Assessment

Overall Assessment: *The external position in 2018 was substantially stronger than what is consistent with fundamentals and desirable policies.* Singapore's very open economy and position as a global trading and financial center make the assessment more uncertain than usual.

Potential Policy Responses: Singapore's economy is undergoing structural transformation in light of a rapidly aging population and challenges posed by its transition to a new digital economy. Higher public investment addressing these issues, including spending on health care and investments in physical infrastructure and human capital, would help moderate the CA imbalances over the medium term by lowering net public saving. Structural reforms are also necessary to improve productivity, which would support a trend real exchange rate appreciation.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP stood at 223 percent of GDP in 2018, after a gradual rise from 197 percent in 2013. Gross assets and liabilities are high, reflecting Singapore's status as a financial center (about 1,053 and 830 percent of GDP, respectively). The CA surplus has been a main driver since the global financial crisis, but valuation effects were material in some years. CA and growth projections imply that the NIIP will rise over the medium term. The large positive NIIP in part reflects the accumulation of assets for old-age consumption, which is expected to be gradually unwound over the long term.

Assessment. Large gross non-FDI liabilities (427 percent of GDP in 2018)—predominantly cross-border deposit taking by foreign bank branches—present some risks, but these are mitigated by large gross asset positions, banks' large short-term external assets, and the authorities' close monitoring of banks' liquidity risk profiles. Singapore has large official reserves and other official liquid assets.

2018 (% GDP)	NIIP: 223.0	Gross Assets: 1,053.4	Debt Assets: 504.0	Gross Liab.: 830.4	Debt Liab.: 354.2

Current Account

Background. The CA surplus was 17.9 percent of GDP in 2018, up from 16.4 percent in 2017, largely driven by a narrowing of the deficit in the services balance. The CA balance is slightly higher than its average since 2013 but lower than the post-global-financial-crisis peak of 22.9 percent in 2010. Singapore's large CA balance reflects a strong goods balance that is partly offset by deficits in the services and income account balances.[1] The oil trade deficit widened in 2018. Structural factors and policies that boost savings, such as Singapore's status as a financial center, consecutive fiscal surpluses, and the rapid pace of aging—combined with a mandatory defined-contribution pension program (whose assets were about 80 percent of GDP in 2018), as well as relatively high productivity—are the main drivers of Singapore's strong external position. The CA surplus is projected to narrow on the back of increased infrastructure and social spending.

Assessment. Guided by the EBA framework, staff assesses the 2018 CA as higher than the level consistent with fundamentals and desirable policies, by 1.1–7.1 percent of GDP.[2] This gap in part reflects tighter-than-desired fiscal balance.

2018 (% GDP)	Actual CA: 17.9	Cycl. Adj. CA: 18.4	EBA CA Norm: —	EBA CA Gap: —	Staff Adj.: —	Staff CA Gap: 4.1

Real Exchange Rate

Background. The REER depreciated by 0.5 percent year over year in 2018 due to relatively low inflation in Singapore, whereas the NEER appreciated by 1 percent year over year. This followed a depreciation of the REER by 1.4 percent and an appreciation of the NEER by 1.9 percent, both cumulative, between 2015 and 2017. As of May 2019, the REER had appreciated by 0.6 percent relative to 2018 average.

Assessment. Notwithstanding the nonstandard factors that make a quantitative assessment difficult, staff assesses that the REER is undervalued by 2.2 to 14.2 percent. This assessment is subject to a wide range of uncertainty about both the underlying CA assessment and the semielasticity of the CA with respect to the REER.

Capital and Financial Accounts: Flows and Policy Measures

Background. Singapore has an open capital account. As a trade and financial center in Asia, changes in market sentiment can affect Singapore significantly. Increased risk aversion in the region, for instance, may lead to inflows to Singapore given its status as a regional safe haven, whereas global stress may lead to outflows. The financial account deficit reflects in part reinvestment abroad of income from official foreign assets, as well as sizable net inward FDI and smaller but more volatile net bank-related flows.[3] In 2018, the deficit on the capital and financial account widened to 14 percent of GDP from 8 percent in 2017 (deficits ranged from 8 to 18 percent in 2015–17). This reflected resumed outflows in other investments (driven by the increase in bank asset flows).

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. As a financial center, prudential motives call for a larger NIIP buffer. Official reserves held by the MAS reached US$288 billion (79 percent of GDP) in 2018, of which S$45billion was transferred to the government in May for management by sovereign wealth fund GIC. Aggregated data on net FX purchases will be published beginning in 2020.

Assessment. In addition to FX reserves held by the MAS, Singapore also has access to other official foreign assets managed by Temasek and GIC.[4] The current level of official external assets appears adequate, even after considering prudential motives, and there is no clear case for further accumulation for precautionary purposes.

Table 3.23. South Africa: Economy Assessment

Overall Assessment: *The external position in 2018 was moderately weaker than implied by fundamentals and desirable policies.* In 2018, the current account gap remained broadly unchanged. Non-FDI flows continued to finance most of the relatively high current account deficit. REER depreciation in earlier years appears to have contributed little to CA adjustment due to unaddressed structural rigidities.

Potential Policy Responses: Reducing external gaps will require bold implementation of structural reforms to improve competitiveness and gradual fiscal consolidation while providing space for infrastructure and social spending (to improve education levels and skills). Efforts are also needed to improve the efficiency of key product markets (by encouraging private participation in power generation, transportation, and telecommunications) and the functioning of labor markets. These reforms will help attract durable foreign inflows such as FDI. Seizing opportunities to accumulate international reserves would strengthen the country's ability to deal with FX liquidity shocks.

Foreign Asset and Liability Position and Trajectory

Background. With large gross external assets and liabilities (respectively, 133 and 122 percent of GDP), South Africa is highly integrated into international capital markets. The NIIP improved markedly from –8 percent of GDP in 2014 to 16 percent of GDP in 2015, mainly on valuation changes, and declined to 10 percent of GDP in 2018. It is expected to continue moderating over the medium term as CA deficits are projected to remain relatively high. Gross external debt rose from 26 percent of GDP in 2008 to 47 percent of GDP in 2018 due mainly to public sector long-term debt. Short-term external debt (on a residual maturity basis) was slightly below 15 percent of GDP in 2018.

Assessment. Risks from large gross external liabilities are mitigated by several factors, including South Africa's comfortable external asset position, as well as the fact that the bulk of the liabilities are in the form of equities and that about half of all external debt is rand-denominated.

2018 (% GDP)	NIIP: 10.4	Gross Assets: 132.5	Debt Assets: 14.0	Gross Liab.: 122.1	Debt Liab.: 40.0

Current Account

Background. The CA deficit narrowed from 5.8 percent of GDP in 2013 to 2.4 percent in 2017, but widened to 3.5 percent in 2018 as the terms of trade declined and the trade balance weakened. The CA deficit is projected at 3.7 percent of GDP in the medium term owing to an elevated deficit in the income account—projected to remain at about 3 percent of GDP.

Assessment. Staff estimates a CA gap in the range of –0.8 to –2.8 percent of GDP in 2018, derived from a revised cyclically adjusted CA and an adjusted model-based norm. The revised cyclically adjusted CA (–2.4 percent of GDP) is obtained by subtracting 1.5 percentage points from the cyclically adjusted CA (–3.9 percent of GDP) for the statistical treatment of transfers and income accounts. The adjusted CA norm (–0.6 percent of GDP) is obtained by subtracting 1.1 percentage points from a surplus CA norm from the regression model (0.5 percent of GDP) to reflect the lower life expectancy at prime age relative to other countries in the regression sample.[1] The estimated CA gap is largely explained by structural factors outside the model.

2018 (% GDP)	Actual CA: –3.5	Cycl. Adj. CA: –3.9	EBA CA Norm: 0.5	EBA CA Gap: –4.4	Staff Adj.: 2.6	Staff CA Gap: 1.8

Real Exchange Rate

Background. The CPI-REER depreciated during 2011–15 and recouped some of the losses through early 2018. In 2018, the REER strengthened about 2 percent after an earlier rally related to the appointment of the new president was unwound.

Assessment. The two REER-based regressions (the REER approaches) point to undervaluation in a range of 1.8 percent (level approach) and 14 percent (index approach), but staff deems these results less reliable.[2] Staff assesses the REER to be overvalued by 2 to 12 percent, relying on the CA approach where the implied REER gap is estimated from the CA gaps.[3]

Capital and Financial Accounts: Flows and Policy Measures

Background. Net FDI flows turned positive in 2018 (0.8 percent of GDP). Portfolio investment, at 2.5 percent of GDP, remained the main source of financing the CA deficit. Gross external financing needs stood at 18 percent of GDP in 2018.

Assessment. Risks from large reliance on non-FDI inflows and nonresident holdings of local financial assets are mitigated by a flexible exchange rate, a large share of local currency component in nonresident portfolio holdings, and a large domestic institutional investor base, which tends to reduce asset price volatility during periods of stress.

FX Intervention and Reserves Level

Background. South Africa's exchange rate regime is classified as floating. Central bank intervention in the foreign exchange market is rare. International reserves were about 14 percent of GDP, 77 percent of gross external financing needs, and 5½ months of imports in 2018. Reserves stand below the IMF's composite adequacy metric (63 percent of the metric without considering existing capital flow management measures and 68 percent of the metric after considering them).

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

Table 3.24. Spain: Economy Assessment

Overall Assessment: *The external position in 2018 was moderately weaker than consistent with medium-term fundamentals and desirable policies.* In 2018, the CA remained in surplus for the sixth consecutive year, unprecedented in recent Spanish history. Despite the sharp improvement in the CA since the deficit peak in 2007, achieving both a sufficiently strong NIIP and further reductions in unemployment will continue to require a relatively high CA surplus and a moderately weaker REER for a sustained period.

Potential Policy Responses: Structural reforms in response to the global financial crisis—in particular labor market reform, with the resulting wage moderation and fiscal adjustment—supported the reduction in imbalances.
Sustaining this progress and further lowering external vulnerability will require restarting structural fiscal consolidation as well as additional reforms to address labor market duality. Boosting productivity and competitiveness will require faster implementation of product and service market reforms, and actions to enhance education outcomes, training of workers, and firms' innovation capacity.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP dropped from –35 percent of GDP in 2000 to –94 percent of GDP in 2009, driven mostly by high CA deficits but also by valuation effects. The NIIP remained elevated at –74 percent of GDP in 2018:Q4, yet has improved by 21 percentage points since 2014, partly due to sustained CA surpluses during the period and despite some negative valuation effects. Gross liabilities stood at 231 percent of GDP in 2018:Q4, with more than two-thirds in the form of external debt. Whereas the private sector has deleveraged since the crisis, NIIP accounted for by the general government and the central bank increased, raising its share from about one-quarter in 2010 to over three-quarters in 2018:Q4. Part of that increase is due to TARGET2 liabilities, which had reached 33 percent of GDP by end-2018.[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 seven years) and current ECB measures, such as QE, that lower the cost of debt.

2018 (% GDP)	NIIP: –74.3	Gross Assets: 156.4	Res. Assets: 70.8	Gross Liab.: 230.7	Debt Liab.: 143.6

Current Account

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 2013–18. 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. The CA surplus was estimated at 0.9 percent of GDP in 2018. The trade surplus declined relative to 2017, mostly reflecting movements in exchange rates, external demand, and oil prices. Moderate CA surpluses are projected to continue in the medium term.

Assessment. The EBA CA model suggests a norm of 1.1 percent of GDP for 2018, which is roughly equal to the cyclically adjusted CA balance (0.9 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 to long term. This yields a CA norm of about 2 percent of GDP, with a range of 1 to 3 percent of GDP, and a CA gap of –2.1 to –0.1 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 were still negative (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.

2018 (% GDP)	Actual CA: 0.9	Cycl. Adj. CA: 0.9	EBA CA Norm: 1.1	EBA CA Gap: –0.2	Staff Adj.: –0.9	Staff CA Gap: –1.1

Real Exchange Rate

Background. In 2018, the CPI-based REER appreciated by 2.1 percent from its average 2017 level, whereas the ULC-based REER was unchanged. The CPI-based REER is still moderately lower than its 2009 peak, partially reversing the significant appreciation from euro entry in 1999 until 2009. The ULC-based REER shows that the appreciation since euro entry has been substantially reversed, initially because of postcrisis labor shedding and, more recently, of wage moderation and enhanced output growth. After reaching its peak in 2008, the ULC-based REER depreciated by 18 percent. As of May 2019, the CPI-based REER and the ULC-based REER had depreciated by 1.3 and 0.7 percent relative to their 2018 averages, respectively.

Assessment. The EBA REER models estimate an overvaluation of 6.0 to 6.8 percent for 2018, whereas the CA model implies a close-to-zero overvaluation.[3] Taking into account also the need for sustaining postcrisis competitiveness gains, and the risks from NIIP sustainability, on balance, staff assesses a 2018 REER gap in the range of 1 to 9 percent.

Capital and Financial Accounts: Flows and Policy Measures

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. In 2018, the financial account balance was largely driven by net outflows of loans and other bank-related instruments (from sectors other than the central bank) and portfolio equity. The accumulation of TARGET2 liabilities, reflecting liquidity creation within the framework of the Eurosystem's asset purchase program, has moderated from close to 6 percent of GDP in 2015 and 2016 to less than 2 percent of GDP in 2018.

Assessment. The ECB's monetary accommodation, domestic reforms, and fiscal consolidation adopted in response to the crisis, and the strong economic recovery, have helped improve investor sentiment. However, large external financing needs both in the public and private sector leave Spain vulnerable to sudden changes in market volatility.

FX Intervention and Reserves Level

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

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

Table 3.25. Sweden: Economy Assessment

Overall Assessment: *The external position in 2018 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: A mildly expansionary fiscal policy stance—consistent with converging to the lower medium term surplus target—should support demand going forward. While overall investment is high, it remains important to implement reforms to help restore residential investment following the recent slump. Reforms to facilitate migrant integration into the labor market should be implemented to raise potential output and reduce household uncertainties around the sustainability of Sweden's strong social model. Over time, some appreciation of the krona is expected when inflation returns to target.

Foreign Asset and Liability Position and Trajectory

Background. The Swedish NIIP reached 6.7 percent of GDP in 2018, up 2.5 percentage points in the year. It is expected to rise further in the medium term, reflecting the outlook for continued CA surpluses. It is worth noting that over the last decade, the average annual increase in the NIIP was about 1.5 percent of GDP, well below the average CA surplus of 4.6 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 E&O, which have averaged –1.8 percent of GDP in the past decade.

Assessment. Gross liabilities reached 243 percent of GDP in 2018, with about two-thirds being external debt (168 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.

2018 (% GDP)	NIIP: 6.7	Gross Assets: 249.6	Debt Assets: 88.8	Gross Liab.: 243.0	Debt Liab.: 134.8

Current Account

Background. The CA balance is estimated to have fallen to 2 percent of GDP in 2018, from 2.8 percent in 2017 and well below its average in the past decade (4.6 percent). This CA balance decline is led by the trade balance, including a decline in the oil balance of 0.4 percent of GDP.

Assessment. The cyclically adjusted CA is estimated at 2.3 percent of GDP in 2018, 1.3 percentage points above the cyclically adjusted EBA norm of 1 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 1.3 percent of GDP in 2018, within a range of ± 1.5 percent of GDP, reflecting uncertainty around the EBA estimated norm.

2018 (% GDP)	Actual CA: 2.0	Cycl. Adj. CA: 2.3	EBA CA Norm: 1.0	EBA CA Gap: 1.3	Staff Adj.: 0.0	Staff CA Gap: 1.3

Real Exchange Rate

Background. The Swedish krona depreciated by 4.1 percent in real effective terms in 2018 relative to its average level in 2017, as underlying inflation remained low and political uncertainties developed around the September elections and extended government formation process. Through May 2019, the CPI-based REER depreciated by 5.2 percent.

Assessment. EBA analysis suggest a gap of –16.7 and –17.7 percent using the REER Index and Level approaches, respectively, for 2018. In contrast, in 2018 the ULC-based REER index is only 6 percent below its 25-year average, well within its ± 12.5 percent historical fluctuation range. Applying a 0.35 semielasticity of CA to REER to the CA gap of 1.3 percent ± 1.5 percent of GDP gives a valuation range for the krona of 1 to –8 percent. Given uncertainties related to the 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 5 to 15 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. Macroprudential policies implemented in recent years (increases in capital buffers of domestic banks and mortgage amortization regulations on the household side) can help contain vulnerabilities and hence potential liquidity risks. Continuing to monitor an extended (three-month) liquidity coverage ratio in US dollars and euros will remain useful in ensuring the adequacy of the FX liquidity buffers of banks.

FX Intervention and Reserves Level

Background. The exchange rate is free floating. Foreign currency reserves stood at US$61 billion in December 2018, which is equivalent to 21 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, Sweden should maintain adequate foreign reserves.

Table 3.26. Switzerland: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* This assessment is subject to especially high uncertainty: REER overvaluation following the exit from the floor in 2015 had been unwound by 2017. Were real depreciation to resume, 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 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. Monetary policy should continue to be directed at maintaining inflation within the definition of price stability, with foreign currency intervention reserved for addressing large exchange market pressures. Macroprudential policies should be used to address excessive private credit (related to mortgage lending) and reduce financial sector risks. Meanwhile, reforming the corporate income tax would encourage small and medium-sized enterprise investment and reduce corporate net saving.

Foreign Asset and Liability Position and Trajectory

Background. Switzerland is a financial center with a positive NIIP of 128 percent of GDP and gross foreign asset and liability positions of 694 and 565 percent of GDP, respectively, as of end 2018. The NIIP reflects both CA surpluses, which average nearly 10 percent of GDP, and large, bidirectional valuation changes, although valuation losses tend to dominate.[1] These 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 the large gross asset position and the fact that about two-thirds of 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.

2018 (% GDP)	NIIP: 128.2	Gross Assets: 693.6	Debt Assets: 217.3	Gross Liab.: 565.4	Debt Liab.: 192.1

Current Account

Background. Switzerland has run large CA surpluses, averaging nearly 10 percent of GDP since 2006. The CA balance is estimated at 10.2 percent of GDP for 2018, an increase from the downwardly revised surplus of 6.7 percent for 2017. Ex post CA revisions are frequent, mainly due to changes in estimated investment income. Surpluses on trade of goods and services (including merchanting) have been driving the overall positive CA balance.

Assessment. Based on a cyclically adjusted CA surplus of 10.4 percent of GDP and an EBA CA norm of 5.9 percent of GDP (which partly reflects demand for saving by the large share of prime-age savers), the overall EBA estimated CA gap equaled 4.5 percent of GDP in 2018. Domestic policy gaps account for –1.0 percentage points of the CA gap and consist of excessive private sector credit (1.3) and fiscal underspending (–0.4), while policy gaps in the rest of the world contribute 0.3 percentage point. Some Switzerland-specific factors not appropriately treated in the income account lower the CA gap: (1) inclusion of estimated retained earnings on portfolio equity investment and (2) compensation for valuation losses on fixed income securities arising from inflation.[3] After accounting for these factors, staff estimates a CA gap of about 0.9 percent of GDP (with a range of ±2 percentage points).[4]

2018 (% GDP)	Actual CA: 10.2	Cycl. Adj. CA: 10.4	EBA CA Norm: 5.9	EBA CA Gap: 4.5	Staff Adj.: –3.5	Staff CA Gap: 0.9

Real Exchange Rate

Background. The CPI-based REER appreciated by 16 percent during 2008–18, including two episodes of rapid appreciation in response to safe-haven inflows. The first spike occurred in July 2011 and led the Swiss National Bank (SNB) to establish a floor of 1.20 for the Swiss franc–euro exchange rate in September 2011. After appreciating sharply following the exit from the floor in 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 2018 weakened by 2.8 percent relative to the 2017 average. As of May 2019, the REER had depreciated by 0.1 percent compared with the 2018 average.

Assessment. The EBA REER Index and Level models suggest that the average REER in 2018 was 11 to 17 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" property of the empirical model in the context of the prior rapid appreciation episodes. However, due to measurement issues, these results may not fully capture the secular improvement in productivity, especially in knowledge-based sectors. Based on the CA gap, staff assesses the REER gap to have been in the range of –6.5 to 1 percent in 2018.*

Capital and Financial Accounts: Flows and Policy Measures

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 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 in mid-2017 and foreigners reduced holdings of currency and deposits in 2018. 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.

FX Intervention and Reserves Level

Background. Foreign exchange reserves amounted to US$788 billion (114 percent of GDP) at end-2018, down US$24 billion (including valuation changes) since end-2017. About 75 percent of reserves were 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 dwindled since mid-2017, amounting to only Sw F 2.3 billion in 2018.

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 –0.15 percent during 2012–18) as a result of inflow surges and 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 marginal 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 potentially large exchange rate overvaluation.

**The staff assessed REER gap of –3.75 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.*

Table 3.27. Thailand: Economy Assessment

Overall Assessment: *The external position in 2018 was substantially stronger than warranted by medium-term fundamentals and desirable policies.* While the CA surplus has narrowed since peaking in 2016, it remains sizable, continuing to reflect the tepid recovery of domestic demand amid political uncertainty.

Potential Policy Responses: Mutually reinforcing macro policy stimulus, led by a fiscal expansion and structural reforms, should support domestic demand and lower the CA surplus over time. Such a strategy would facilitate the needed REER appreciation through a growth-driven process, boosting real incomes. Higher public infrastructure within available fiscal space should crowd in private investment, whereas efforts to reform and expand social safety nets, notably the fragmented pension program, should reduce precautionary saving and widespread informality. Reforms to reduce barriers to investment, especially in the services sector, are also necessary.

The exchange rate should move flexibly as the key shock absorber. Intervention should be limited to avoiding disorderly market conditions. With reserves exceeding all adequacy metrics, there is no need to build up reserves for precautionary purposes.

Foreign Asset and Liability Position and Trajectory

Background. Thailand's NIIP continued to strengthen in 2018 to about –0.5 percent of GDP, compared with –9.1 percent of GDP in 2017 and –24 percent of GDP in 2014. Gross assets declined to about 96 percent of GDP (41 percent being reserve assets), whereas gross liabilities declined 3 percentage points to 97 percent of GDP (dominated by direct about half and portfolio a third investment). Net FDI continued to decline as outward investment (particularly by corporates) increased; portfolio (equities) and other investment also declined (by about 2 percentage points of GDP).

Assessment. External vulnerabilities have been reduced with the strengthening of the NIIP, which is projected to reach a small creditor position over the medium term. With external debt steady at about 32 percent of GDP, of which short-term debt (on a remaining maturity basis) amounts to 16 percent of GDP, external debt sustainability and liquidity risk are limited.

2018 (% GDP)	NIIP: –0.5	Gross Assets: 96.4	Res. Assets: 43.2	Gross Liab.: 96.9	Debt Liab.: 29.5

Current Account

Background. Thailand's CA surplus declined sharply to 7 percent of GDP in 2018, following the continued strengthening of the CA surplus since 2013, with an all-time high of 11.7 percent in 2016 (driven by favorable terms of trade and tourism). The reduction in the surplus in 2018 reflects a consumption-led strengthening of domestic demand and a decline in net exports. Exports slowed due to US-China trade tensions and a moderation in global external demand; imports remained robust, but with the broader regional trade slowdown weighing on imports of intermediate goods toward the end of the year. The services account contracted by about 0.1 percent of GDP relative to 2017, due to a temporary slowdown in tourism receipts.

Assessment. The EBA CA model estimates a cyclically adjusted CA of 7.0 percent of GDP and a CA norm of 0.1 percent of GDP for 2018. The CA gap of 6.9 percent of GDP consists of an identified policy gap of 1.5 percent of GDP and an unexplained residual of 5.4 percent of GDP, which partly reflects Thailand-specific features and structural challenges not fully captured by the EBA model. Political uncertainty continued to weigh on investment in 2018, although its effect has moderated somewhat (0 to 1.5 percent of GDP), including following the confirmation of the elections date.[1] Taking all of this into account, and recognizing uncertainties related to the output gap measure, staff assesses the CA balance to be about 3.8 to 7.0 percent of GDP higher than warranted by fundamentals and desired policies. This 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.

2018 (% GDP)	Actual CA: 7.0	Cycl. Adj. CA: 7.0	EBA CA Norm: 0.1	EBA CA Gap: 6.9	Staff Adj.: –1.5	Staff CA Gap: 5.4

Real Exchange Rate

Background. The baht has been on a gradual real appreciation trend since the mid-2000s, despite occasional bouts of volatility (such as the mid-2013 US Federal Reserve tapering talks and the domestic monetary policy easing cycle in early 2015). In 2018, despite some volatility through the year, with marked depreciations in 2018:Q2 and 2018:Q3, the REER appreciated overall by 3.0 percent relative to 2017. As of May 2019, the baht had appreciated an additional 4 percent relative to the 2018 average.

Assessment. Using an elasticity of 0.64, the 2018 REER would be assessed as undervalued by about 6 to 11 percent.[2]

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2018, the capital and financial account weakened to –4.5 percent of GDP from –2.8 percent in 2017. This has been driven primarily by net portfolio flows, which strengthened to 1.1 percent of GDP. Nonresident holdings of Thai bonds declined in 2018:S1 and reversed in 2018:S2 as nonresident flows rebounded. This reflects increased gross capital inflows relative to other emerging market economies in the region during the broader emerging market selloff, with Thailand benefiting from its strong external position. Outward FDI remained robust at 4 percent of GDP owing to Thai firms' overseas investment. Net other investment outflows were about 1 percent of GDP. The authorities continued with their gradual and prudent financial account liberalization, encouraging outward investment by residents. The capital and financial account balance has been negative since 2013.

Assessment. Since 2013, Thailand has experienced episodes of volatility reflecting changes in external financial conditions continued political uncertainty, and more recently concerns about the impact of US-China trade tensions. Nevertheless, Thailand has been able to weather such episodes well, given its strong external buffers and fundamentals, which have supported the ability of investors to distinguish Thailand from others in the emerging market asset class.

FX Intervention and Reserves Level

Background. The exchange rate regime is classified as (de jure and de facto) floating. International reserves stood at 47.4 percent of GDP in 2018, standing at over three times short-term debt and 12 months of imports, and over 200 percent of the IMF's standard reserve adequacy metric (unadjusted for capital controls).

Assessment. Interventions were two-sided over the course of 2018, as proxied by the increase and then decrease in reserves over the course of the year (official intervention data are not published). Gross international reserves (including net forward position) remained stable during 2018. Reserves are higher than the range of the IMF's adequacy metrics, and there continues to be no need to build up reserves for precautionary purposes. The exchange rate should move flexibly to act as a shock absorber, with FX intervention limited to avoiding disorderly market conditions.

Table 3.28. Turkey: Economy Assessment

Overall Assessment: *The external position in 2018 was broadly in line with the level implied by fundamentals and desirable policies.* This reflects the ongoing and lagged adjustment of external balances following the sharp REER depreciation in 2018, which is projected to gradually unwind. Large external financing needs and relatively low reserves make Turkey vulnerable to financial account reversals.

Potential Policy Responses: Despite a broadly in line external position, a comprehensive policy package is needed to strengthen external resilience and support a sustainable rebalancing of the economy to more balanced and properly financed growth.

To this end, monetary policy should aim to reanchor inflation expectations and strengthen central bank credibility, while rebuilding reserves. Meanwhile, fiscal policy should allow automatic stabilizers to operate and reorient spending toward the most vulnerable.

Focused structural reforms are necessary to enhance productivity and ensure more stable domestic funding sources. Specifically, efforts are needed to reduce labor market rigidities and improve the business climate, including by reforming insolvency and corporate restructuring frameworks.

Foreign Asset and Liability Position and Trajectory

Background. After peaking at –54 percent of GDP at end-2017, Turkey's NIIP narrowed to –48 percent of GDP at end-2018. This mostly reflected valuation effects from the lira's sharp depreciation in 2018, as a higher share of external assets relative to external liabilities are denominated in FX (a portion of the liabilities are in the form of Turkish equities and lira-denominated debt securities).[1] Total foreign liabilities reached 78 percent of GDP in 2018, dominated by debt, which, at 55 percent of GDP, remains sustainable over the medium term. Private external debt service is vulnerable to global financial conditions as much of the debt is in FX, a significant portion is short term (22 percent of GDP), and much of the long-term debt (about 40 percent) is at variable rates.

Assessment. The size and composition of external liabilities, coupled with low reserves, expose Turkey to liquidity shocks, sudden shifts in investor sentiment, and increases in global interest rates. The FX exposure of nonfinancial corporates is high, with the potential to worsen bank asset quality. Turkey's NIIP is projected to gradually fall to about –40 percent of GDP by 2021, driven by a decline in liabilities, mainly loans, as the economy rebalances.

2018 (% GDP)	NIIP: –47.8	Gross Assets: 29.9	Res. Assets: 12.1	Gross Liab.: 77.7	Debt Liab.: 55.1

Current Account

Background. The CA deficit, after averaging 4 percent during 2014–16, widened sharply to 5.6 percent of GDP in 2017 as policy stimulus resulted in overheating. The CA deficit narrowed to 3.5 percent in 2018, supported by a steep lira depreciation and associated import compression in 2018:H2. The CA is expected to swing to a slight surplus of 0.5 percent in 2019, reflecting the continuation of these factors.[2]

Assessment. The EBA CA model estimates a norm of –1.6 percent of GDP, with a large standard error of close to 2 percent. With a cyclically adjusted CA deficit in 2018 of –2.5 percent of GDP, the CA gap is estimated at –0.9 percent of GDP. After taking into account the temporary large imports of gold (0.7 percent of GDP higher than normal), staff assesses the 2018 CA to be broadly in line with fundamentals and desired policies, with a gap in the range of –1.2 to 0.8 percent of GDP.

2018 (% GDP)	Actual CA: –3.5	Cycl. Adj. CA: –2.5	EBA CA Norm: –1.6	EBA CA Gap: –0.9	Staff Adj.: 0.7	Staff CA Gap: –0.2

Real Exchange Rate

Background. In 2018, the average REER depreciated by 14 percent relative to 2017, standing some 37 percent below its 2010 peak. After depreciating sharply in 2018:Q3, the REER appreciated in 2018:Q4, reflecting in part the lagged effects of exchange rate pass-through to inflation. As of May 2019, the REER had depreciated by 10.3 percent relative to the 2018 average.

Assessment. The EBA REER index and level approaches suggest the REER was undervalued in 2018 by 21 to 23 percent, albeit with large uncertainties. The staff-assessed CA gap suggests a REER gap close to zero, reflecting the ongoing and lagged adjustment of external balances to the REER depreciation. Giving more weight to the EBA REER approaches as the CA continues to adjust, staff assesses the REER to be undervalued in the range of 10 to 20 percent, with a midpoint around 15 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net capital flows switched from an inflow of US$38.5 billion (4.5 percent of GDP) in 2017 to an outflow of US$0.5 billion (0.1 percent of GDP) in 2018 (both excluding reserves and E&O). However, positive E&O, likely reflecting repatriation of foreign assets and unrecorded capital inflows, increased from US$0.6 billion in 2017 to US$17.2 billion in 2018, moderating the impact of the change in recorded flows. This slowdown of net inflows was driven by net portfolio outflows and a decline in banks' external loans, with spreads rising significantly and external rollovers of long-term debt by banks falling as low as 42 percent in September. Net FDI flows remained low at about 1 percent of GDP. High E&O, netting US$17.2 billion (2.2 percent of GDP) in 2018, suggest unidentified financing sources were tapped to meet financing needs. To address currency volatility, Turkey introduced a capital flow management measure in the form of limits to bank swaps and other derivative transactions with foreign counterparties in August. This measure was partially unwound as volatility receded.

Assessment. After deteriorating in 2017, the quality of financing worsened further in 2018 following the market turmoil in 2017:Q3, with the maturity structure of external debt shortening, rollover rates of external bank funding dropping, and financing dominated by E&O and reserve drawdown. With annual gross external financing needs of about 22 percent of GDP, Turkey remains vulnerable to adverse shifts in global investor sentiment, as was demonstrated in 2018.

FX Intervention and Reserves Level

Background. The de facto and de jure exchange rate is floating. Reserves were impacted by several measures to support FX liquidity, changes to required reserves and the Reserve Option Mechanism aimed at releasing FX liquidity, and accepting lira payments for US dollar–denominated export rediscount credit repayments. The central bank also provides direct sales of FX to energy-importing SOEs. While likely having a stabilizing impact in the short term, these measures have contributed to a decline in gross reserves to US$93 billion (12 percent of GDP) at end-2018, US$14.7 billion (1.9 percent of GDP) lower than at end-2017. Net international reserves stood at US$30 billion (3.9 percent of GDP) at end-2018, declining by US$0.8 billion (0.1 percent of GDP).[3]

Assessment. Gross reserves amounted to 76 percent of the IMF's ARA metric at end-2018, down from 80 percent at end-2017, whereas reserve coverage of external financing requirements dropped to 45 percent in 2018, from 51 percent the year prior. Accumulation of reserves over the medium term is needed given sizable external liabilities and dependence on short-term and portfolio funding.

Table 3.29. United Kingdom: Economy Assessment

Overall Assessment: *The external position in 2018 was weaker than implied by medium-term fundamentals and desirable policies.* The CA deficit remained high in 2018, reflecting low public and private savings. Over the medium term, the deficit is set to narrow somewhat helped by ongoing fiscal consolidation.

The uncertainty around this assessment is significant, reflecting both measurement issues and uncertainty about the future trade arrangement with the European Union and its possible effect on growth and trade flows.

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 (within the budget envelope) 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 restricted.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP strengthened to –6.7 percent of GDP in 2018 from –8.1 percent of GDP in 2017. Over the past five years, the NIIP has strengthened by 11.3 percentage points, reflecting a negative CA contribution (–20.6 percentage points) more than offset by valuation and growth effects (28.9 percentage points and 3.0 percentage points, respectively).[1] The composition of assets roughly matches that of liabilities (about 80 percent of GDP for FDI; 65 percent of GDP for equity instruments, nearly 100 percent of GDP in derivatives; 200 percent of GDP for other investment), although liabilities in debt securities (95 percent of GDP) exceed assets in debt securities (55 percent of GDP). Investments in Europe, Japan, and the United States account for around 75 percent of total UK assets and liabilities, and external liabilities have a larger share denominated in sterling than assets.[2] 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 an immediate concern. Since 2000, valuation gains have offset about a third of the effect of CA flows on the IIP, partly reflecting CA measurement issues and sterling depreciation (the United Kingdom's external assets have a higher foreign currency component than its external liabilities). However, fluctuations in large gross stock positions are a potential source of vulnerability (including derivatives, gross assets and gross liabilities both exceed 500 percent of GDP).

2018 (% GDP)	NIIP: –6.7	Gross Assets: 521.6	Debt Assets: 256.2	Gross Liab.: 528.4	Debt Liab.: 272.0

Current Account

Background. The CA deficit worsened to –3.9 percent of GDP in 2018 (from –3.3 percent in 2017) and is expected to worsen marginally to –4.2 percent of GDP in 2019, thus 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 United Kingdom's FDI abroad (especially in the euro area).[3] By contrast, the trade balance was broadly stable at about –1.5 percent of GDP in 2018, supported by relatively stronger growth in trading partners and a weaker sterling. Nonetheless, the widening of the CA deficit in 2018 was driven equally by a worsening in the primary income balance (–0.3 percent of GDP) and a deterioration of the trade balance (–0.3 percent of GDP), despite the weak currency. From a savings-investment perspective, the CA dynamics during 2018 reflect a reduction in gross national savings by 1 percent of GDP driven by a reduction in corporate savings (from 9.8 to 8.2 percent of GDP) that more than offsets an improvement in public savings.

Assessment. The EBA CA model estimates a CA gap of –4.4 percent of GDP for 2018 (a cyclically adjusted CA balance of –3.9 percent of GDP compared with a norm of 0.5 percent of GDP). However, the cyclically adjusted CA is assessed to be understated due to measurement biases reflected in the large NIIP valuation effects. Looking ahead, the recovery of global growth relative to UK growth is expected to translate into higher net income inflows. Uncertainty around the CA gap estimation is high, as evident from the results under different methodologies, partly reflecting measurement uncertainties (large and volatile NIIP valuation changes and other unidentified stock-flow adjustments). Overall, staff assesses the 2018 cyclically adjusted CA balance to be 1 to 4.8 percent of GDP lower than the CA norm, with a midpoint of 2.9 percent of GDP. This range takes into account the uncertainty in the assessment due to the Brexit negotiation process and possible measurement issues.[4]

2018 (% GDP)	Actual CA: –3.9	Cycl. Adj. CA: –3.9	EBA CA Norm: 0.5	EBA CA Gap: –4.4	Staff Adj.: 1.5	Staff CA Gap: –2.9

Real Exchange Rate

Background. Sterling appreciated by 1.8 percent in 2018 in real effective terms relative to its average level in 2017 but has depreciated since mid-2016 by about 7 percent. Sterling depreciation since 2016 may reflect an unwinding of past overvaluation, as well as market expectations of more restrictive access to the EU market in the future.

Assessment. EBA REER Level and Index approaches suggest a gap of –8.5 and –13.2 percent, respectively, for 2018. However, given uncertainties related to the United Kingdom's new trading relationship with the European Union, these model estimates might be less appropriate. Overall, staff assesses the REER to be overvalued by between 0 and 15 percent. This range is broadly anchored on the CA assessment.

Capital and Financial Accounts: Flows and Policy Measures

Background. Given the United Kingdom's role as an international financial center, portfolio investment and other investments are the key components of the financial account. In net terms, the CA was financed in 2018 by a recovery in net FDI inflows (driven by a fall in outward FDI flows from 5.2 percent of GDP to 1.4 percent of GDP in 2018) and by repatriation of portfolio assets (worth –4.1 percent of GDP) combined with an increase in portfolio liabilities of 6.8 percent of GDP, whereas other investments saw capital flows worth 7.8 percent of GDP in net terms.

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 United Kingdom's future trade relations with the European Union.

FX Intervention and Reserves Level

Background. The pound has the status of a global reserve currency. Despite uncertainty on the future relationship between the United Kingdom and the European Union, the share of global reserves in sterling has been unchanged since 2015, at about 4.5 percent.

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

Table 3.30. United States: Economy Assessment

Overall Assessment: *The external position was moderately weaker than implied by medium-term fundamentals and desirable policies in 2018.* A strong economy and the fiscal stimulus imply a sustained CA deficit in the coming years, moving it further from the level justified by medium-term fundamentals and desirable policies. The effects of actual and prospective changes in trade, taxation, and labor market (including, for example, immigration) policies continue to add uncertainty to the assessment.

Potential Policy Responses: Fiscal consolidation, aiming at a medium-term general government primary surplus of about 1.2 percent of GDP (a federal government primary surplus of about 1 percent of GDP), would be appropriate to put the debt-to-GDP ratio on a downward path and address external imbalances. Structural policies to increase competitiveness, while maintaining full employment, include upgrading infrastructure; enhancing schooling, training, and mobility of workers; and encouraging labor force participation. The recently imposed tariff barriers should be rolled back, as trade and investment disagreements with other countries should be resolved without resorting to the imposition of tariff and nontariff barriers.

Foreign Asset and Liability Position and Trajectory

Background. The NIIP, which averaged about –33 percent during 2012–14, is estimated to have decreased further from –39.6 percent of GDP in 2017 to –47.4 percent of GDP in 2018 (before accounting for valuation effects, which amounted to 2.9 percent of GDP through 2018:Q3). Under staff's baseline scenario, the negative NIIP is projected to expand by 4 percent of GDP over the next five years, on the back of sustained CA deficits.

Assessment. Financial stability risks from rising negative NIIP could surface in the form of an unexpected decline in foreign demand for US fixed income securities, which are the main component of the country's external liabilities. This risk, which could materialize due to a failure to reestablish fiscal sustainability, remains moderate given the dominant status of the US dollar as a reserve currency. About 64 percent of US assets are in the form of FDI and portfolio equity claims.

2018 (% GDP)	NIIP: –47.4	Gross Assets: 123.9	Debt Assets: 38.3	Gross Liab.: 171.3	Debt Liab.: 85.0

Current Account

Background. The US CA deficit was unchanged between 2017 and 2018 at 2.3 percent of GDP, compared with a deficit of 2.1 percent of GDP in 2014. The deterioration was led by the non-oil balance, which reached a deficit of 2.8 percent of GDP in 2018 compared with a deficit of 1.7 percent of GDP in 2014. The larger output gap did not result in an increase in the CA deficit in 2018 as these effects were offset by an improving oil balance and a stronger income account, and because of weaker-than-anticipated (import-intensive) investment. However, trade-balance outturns have been difficult to interpret as a result of shifts in the timing of exports and imports due to tariffs. Going forward, the US CA deficit is expected to rise to 2.6 percent of GDP by 2020 as US demand rises further above potential output, partly driven by the projected fiscal easing.

Assessment. The EBA model estimates a cyclically adjusted CA of –2.1 percent of GDP and a cyclically adjusted CA norm of –0.9 percent of GDP. The cyclically adjusted CA gap is –1.2 percent of GDP for 2018, reflecting policy gaps (–0.7 percent of GDP, of which –0.6 percent corresponds to fiscal policy) and an unidentified residual (about –0.5 percent of GDP). The External Sustainability Approach estimates a CA gap of –1.2 percent of GDP. On balance, and taking into account recent increases in oil production, staff assesses the 2018 cyclically adjusted CA to be 0.9 to 1.9 percent of GDP lower than the level implied by fundamentals and desirable policies.[1]

2018 (% GDP)	Actual CA: –2.3	Cycl. Adj. CA: –2.1	EBA CA Norm: –0.9	EBA CA Gap: –1.2	Staff Adj.: –0.2	Staff CA Gap: –1.4

Real Exchange Rate

Background. After depreciating by about 7 percent in 2017 (eop), the REER appreciated by about 4 percent in 2018 (eop), yet as of end-2018 was about 18 percent higher than the average for 2014. Through May 2019, the US dollar appreciated 3.4 percent in real terms relative to the 2018 average.

Assessment. Indirect estimates of the REER (based on the EBA CA assessment) imply that the exchange rate was overvalued by 10 percent in 2018 (applying an estimated elasticity of 0.12). The EBA REER index model suggests an overvaluation of 8.0 percent, the EBA REER level model suggests an overvaluation of 11.9 percent, and the External Sustainability Approach estimates a REER overvaluation of 10.3 percent. Considering all the estimates and their uncertainties, staff assesses the 2018 average REER to be somewhat overvalued, in the 6 to 12 percent range.

Capital and Financial Accounts: Flows and Policy Measures

Background. Net financial inflows were about 2.3 percent of GDP in 2018, compared with 1.6 percent of GDP in 2017. Net portfolio investments and other investments decreased by 0.8 and 0.6 percent of GDP, respectively, in 2018 and were offset by stronger 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 status of the dollar as a reserve currency and, possibly, by safe-haven flows.

FX Intervention and Reserves Level

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

Assessment. Reserves held by the United States are typically low relative to standard metrics. The currency is free floating.

Technical Endnotes by Economy

Australia

[1]For 2018, the REER index and level models imply an overvaluation of 2 and 11 percent, respectively, whereas the CA gap is consistent with an overvaluation of 5 percent (applying an estimated elasticity of 0.2). Lingering policy and structural distortions explain the larger REER gap range relative to the CA gap range.

Belgium

[1]The Belgian CA estimates are subject to frequent and large revisions complicating the current assessment and comparison with past assessments.

Canada

[1]The statistical treatment of retained earnings on portfolio equity and inflation is estimated to generate a downward bias in the income balance of the CA of the order of 1.7 percent of GDP.
[2]The EBA uses UN demographic projections. These differ from the authorities' projections due to methodological differences. The authorities' projections suggest slightly higher population growth and a slightly lower CA norm. The authorities' demographic projections also do not incorporate recent increases in immigration targets, which are assumed to be permanent. Together, these effects reduce the EBA estimate of the CA norm by about 0.3 percent.
[3]The price discount between Canadian crude (WCS) and the West Texas benchmark increased in 2018 to an average of US$26 a barrel (from US$13 in 2017). The estimated temporary effect on the CA is about 0.9 percent of GDP.
[4]The approach includes commodity terms of trade rather than oil prices as an explanatory variable, whereas Canada's REER has mirrored movements in oil prices much more closely than its commodity terms of trade.
[5]The semielasticity of the CA with respect to the REER is estimated at 0.27.

China

[1]The CA norm for 2018 (–0.4 percent) is broadly similar to the one in 2017 (–0.3 percent), with a range of ± 1.5 percent of GDP.
[2]The EBA REER level model estimates a total REER gap of 12.6 percent, with identified policy gaps of –2.5 percent. However, the model fit of the EBA REER level model is very poor for China.
[3]Shifting expectations about trade tensions, monetary and exchange rate policy, reassessments of the government's reform agenda, or a desire by residents to diversify into foreign assets could 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

[1]The reported NIIP reflects the euro area's position vis-à-vis the rest of the world.
[2]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 the GDP-weighted and trade-weighted averages, respectively, of the assessments of the individual countries listed above.
[3]When applying GDP-weighted aggregation for the euro area, the CA norm is subtracted by 0.6 percent of GDP, which is the difference between the sum of the individual 11 countries' CA balances and the CA of the entire euro area.
[4]The EBA REER level model indicates an overvaluation of 0.8 percent, whereas the index model points to an overvaluation of 6.0 percent in 2018.

Germany

[1]For Germany, the bulk of the EBA-estimated gap for 2018 reflects the regression's residual rather than gaps in the policy 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 ratio to be currently lower than its long-term equilibrium, and that gradual closing of that 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

[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 apply them to Hong Kong SAR. Following that approach, the CA norm in 2018 is estimated to be about 16 percent of GDP, implying a CA gap of about –11½ percent, which is almost entirely explained by the model residuals. However, the EBA gap is overstated, as it does not properly reflect the measurement issues that are relevant for Hong Kong SAR. As such, three adjustments are made: (1) An adjustment of 5 to 7 percentage points is made to the EBA's implied contribution of the NIIP position. This is because the positive NIIP contribution in the EBA captures average income effects that are less rel-

evant for Hong Kong SAR, as the income balance relative to its NIIP is systematically lower than those of other economies. (2) The opening of the Precious Metals Depository has resulted in a decline of 4 to 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. (3) Mainland China's increased onshoring has led to a decline in logistics and trading activities in Hong Kong SAR (1 to 1½ percent of GDP in CA), which did not result in lower consumption because it is viewed as temporary and to be replaced with increased provision of high-value-added services as Hong Kong SAR's own economy rebalances in response to changes in mainland demand. Adjusting for these factors, staff assesses the CA gap to be close to zero.
[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 renminbi. As of end-2018, banking system claims, including those of foreign banks, on mainland nonbank entities amounted to HK$5.6 trillion, or about 198 percent of GDP, down by about 9 percentage points from a year earlier.

India

[1]Reserves stand at about 187 percent of the ARA metric adjusted for capital controls. Whereas 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.

Indonesia

[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 (–0.9 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 1.4 percent).

Italy

[1]The elasticity of the REER to the CA gap is estimated to be 0.26.

Malaysia

[1]The ratios to GDP are based on staff estimates using US dollar values.
[2]Close to one-third of external debt is denominated in local currency and is largely of medium-term maturity, helping reduce FX and rollover risks. Malaysia's local currency external debt reflects holdings of domestically issued debt (mainly Malaysian government securities) by nonresident investors (about 13 percent of GDP as of 2018:Q3). Short-term FX-denominated debt largely belongs to the banking system, and a good portion is matched by short-term foreign currency assets, which are being closely supervised by Bank Negara Malaysia. Stress test analysis by staff suggests that the Malaysian economy would be resilient to a large capital flow reversal due to the depth of the domestic financial markets and the role of institutional investors.
[3]The estimated 2018 EBA norm is 0.8 percentage point lower than the 2017 norm, largely reflecting a decrease in the net foreign assets and a lower debt-stabilizing fiscal balance. The REER gap is based on the estimated semielasticity of CA to REER at 0.46.
[4]On December 2, 2016, the Financial Markets Committee announced a package of measures aimed at facilitating onshore FX risk management and enhancing the depth and liquidity of onshore financial markets. Two of these measures were classified as CFMs under the IMF's institutional view on capital flows. In addition, the authorities' strengthened enforcement of regulations on resident banks' noninvolvement in offshore ringgit transactions was considered enhanced enforcement of an existing capital flow management measure. Over the course of 2017, additional measures were announced to help deepen the onshore financial market and facilitate currency risk management.
[5]The IMF's composite reserve adequacy metric classifies Malaysia's regime as "floating" since 2016.

Mexico

[1]The CA norm estimate has a standard error of 1.2 percent.
[2]Rules-based spot market intervention mechanisms were in place until February 2016. During this time, preannounced amounts were automatically offered for auction when the exchange rate depreciated by more than a threshold (for example, 1 or 1.5 percent) on a given day. Regular auctions with no minimum price were also used. Since February 2016, the authorities have moved to discretionary spot intervention and used it only once in 2016 and once in 2017 (US$2 billion). Data on intervention amounts are published weekly.
[3]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 in NDF settled in pesos with a maturity of up to 12 months. As of today, the US$5.5 billion in notional value outstanding has been continuously rolled over. The program adds to the authorities' toolkit to counter disorderly market conditions.

Netherlands

[1]In comparison with last year, the EBA-estimated CA gap in 2018 (unexplained residual plus the contribution of identified

policy gaps) is higher, reflecting a higher CA and a slightly lower CA norm.
[2]The larger external balance sheet, presence of large international corporations, and issues related to the measurement of the CA add uncertainty to this assessment. According to the Dutch Central Bank, half of the positions in assets and liabilities are attributable to subsidiaries of foreign multinationals.

Poland

[1]The 1.0 percentage point contribution from identified policy gaps mainly reflects the fiscal policy gap, with a too-loose domestic fiscal policy contributing –0.1 percentage point being more than offset by too-lax fiscal policies in trading partners. Small policy gaps in credit, public health spending, and reserves offset one another.
[2]The standard error for the 2018 CA norm is 0.6 percent of GDP. However, staff uses a larger confidence band to reflect potential measurement errors mainly related to the impact of remittances of foreign workers on the CA.
[3]The REER Level model for Poland suggests an undervaluation of 18.9 percent. However, the model's large residuals (–16.9 percent) suggest that it may not adequately capture changes in the equilibrium REER that occurred during the sample period.

Russia

[1]Nominal GDP denominated in US dollars grew by only 3.3 percent in 2018, largely reflecting moderate growth and a weak ruble.
[2]Unfavorable valuation changes arise because the Russian stock market has performed very well in the past 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as prepayments on import contracts whose goods are not delivered, repeated large transfers abroad that deviate from standard remittance behavior, or securities transactions at inflated prices. The central bank includes estimates of disguised capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level, and this treatment of disguised outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position.

Saudi Arabia

[1]Despite an increase in the nominal value of external assets and liabilities, net external assets declined due to the large increase in nominal GDP driven by the oil price increase. The NIIP may be underestimated given the large E&O in the balance of payments over many years and inconsistencies between the BOP and IIP data.
[2]At current oil production, a US$1 change in the oil price results in a 0.5 percent of GDP first-round change in the CA balance. The oil price is assumed to be US$65.5 in 2019, declining to US$57.4 in 2024 (US$67.9 in 2018).
[3]EBA models do not include Saudi Arabia. Staff considered three methodologies, including two that incorporate the special intertemporal considerations that are dominant in economies in which exports of nonrenewable resources are a very high share of output and exports. The consumption-based model (Bems and de Carvalho Filho 2009) assumes that the sustainability of the CA trajectory requires that the net present value of all future oil and financial/investment income (wealth) be equal to the net present value of imports of goods and services net of non-oil exports. Estimated CA norms for the consumption-based model were 12.6 percent of GDP and 9.4 percent of GDP for the constant real per capita annuity and constant real annuity allocation rules, respectively. Using the EBA-lite approach, the cyclically adjusted CA norm is estimated at 9.4 percent of GDP under the EBA-lite approach. The investment needs model (Araujo et al. 2016) takes into account the possibility that it might be desirable to allocate a part of the resource wealth to finance investment, which was not explicitly considered by the consumption-based model and produced a CA gap of 0.3 percent over the medium term.

Singapore

[1]Singapore has a negative income balance despite its large positive NIIP position, reflecting lower rates of return on its foreign assets relative to returns on its foreign liabilities, possibly due to the fact that the composition of Singapore's assets is tilted toward safer assets with lower returns.
[2]Nonstandard factors make a quantitative assessment of Singapore's external position difficult and subject to significant uncertainty. Singapore is not included in the EBA sample because it is an outlier along several dimensions (for example, large external asset and liability positions, highly positive NIIP position). Estimates are guided by the EBA CA framework, which suggest that Singapore's CA norm is mainly explained by its large NIIP position, the high level of income per working-age population, rapid population aging, and high public health spending efficiency. The staff-estimated CA gap is about 4.1 percent of GDP, although this carries a high degree of uncertainty. The fiscal policy gap contributed about 1 percent of GDP to the overall model-identified policy gaps.
[3]The latter is the result of considerably large gross inflows and outflows.
[4]The reserves-to-GDP ratio is also larger than in most other financial centers, but this may reflect in part that most other financial centers are in reserve-currency countries or currency unions. External assets managed by the government's investment corporation and wealth fund (GIC and Temasek) amount to at least 70 percent of GDP.

South Africa

[1]The final CA gap estimate results from the CA regression 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-based CA norm.
- Net current transfers related to the Southern African Customs Union, assessed to have a net negative impact on the CA, are not accounted for in the regression model and warrant an adjustment to the cyclically adjusted CA. In addition, measurement issues pertaining to the income balance are likely to contribute to an underestimation of the CA.

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

[3]Applying an estimated long-term elasticity of 0.27 would suggest a REER overvaluation of 2 to 12 percent.

Spain

[1]Based on data available through 2018:Q4.

[2]The EBA model suggests a CA norm of 1.1 percent of GDP, with a standard error of 0.7 percent of GDP. But the empirically based EBA norm does not fully account for the very negative NIIP, with about 30 percent of gross liabilities in the form of equity. Given external stability considerations, including potentially adverse NIIP valuation effects, a CA norm in the range of 1 to 3 percent of GDP is necessary to strengthen the NIIP by at least roughly 3 percent of GDP annually over the next 10 years. CA surpluses during 2013–18 of about 1.5 percent of GDP, on average, suggest that maintaining CA balances aligned with the staff-assessed norm of 1 to 3 percent of GDP would be feasible with adequate policies in place.

[3]The semielasticity of the CA to the REER is estimated at 0.22.

Switzerland

[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, whereas a symmetric percentage increase in share prices in Switzerland and abroad would reduce the NIIP.

[3]The underlying CA is adjusted for (1) retained earnings on portfolio equity investment that are not recorded in the income balance of the CA under the sixth edition of the IMF *Balance of Payments and International Investment Position Manual*, and (2) the recording of nominal interest on fixed income securities under the *Balance of Payments Manual* framework, which compensates for expected valuation losses (due to inflation and/or nominal exchange rate movements), even though this stream compensates for the (anticipated) erosion in the real value of debt assets and liabilities. Adjusting for both of these effects and taking into account the lagged NFA contribution to the norm, the underlying CA would need to be reduced by about 3.6 percent of GDP.

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

Thailand

[1]A big data approach (Baker and others 2016; Hlatshwayo 2016; 2018) reveals a significant negative correlation between uncertainty indices and private consumption and investment, albeit to a smaller degree relative to 2017. As in prior years, staff adjusts the cyclically adjusted CA for measurement biases in the EBA terms-of-trade estimates (about 0.5 to 1 percentage point of GDP).

[2]The EBA index REER gap in 2018 is estimated at 7.3 percent; the EBA level REER gap is estimated at –6.1 percent.

Turkey

[1]Despite persistent CA deficits, the NIIP has fluctuated with no clear trend during 2009–18, due to a mix of positive valuation effects and large net BOP E&O.

[2]Gold imports increased in response to elevated uncertainty following the 2016 coup attempt and subsequent economic overheating. Staff estimates the additional cyclical contribution to the CA deficit due to gold imports in 2018 at 0.7 percent of GDP, based on the average annual 1999–2016 gold trade deficit of 0.4 percent of GDP compared with 1.1 percent of GDP in 2018.

[3]Net international reserves equal to gross international reserves minus the central bank's FX liabilities to banks, including the Reserve Option Mechanism.

United Kingdom

[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 for mid-2017 (November 2017 inflation report). Market value estimates of FDI assets assume their valuations move in line with those of equity market indices in the United Kingdom and abroad. These estimates are highly uncertain, as actual FDI market values could evolve differently across different equity markets.

[2]A 2017 survey of firms by the Office for National Statistics found that 90 percent of FDI liabilities were in sterling, whereas about half of FDI assets were in foreign currency. However, the currency composition of cross-border banking positions reported

by the Bank for International Settlements is similar between assets and liabilities.

[3]The marked shift in recent years from FDI assets to portfolio equity assets implies a greater than historical underestimation of the income balance, as retained earnings on portfolio equity assets are not recorded on an accrual basis.

[4]Should Brexit lead to a significant increase in trade barriers, the equilibrium exchange rate could be weaker than suggested here.

United States

[1]Small adjustor reflects correction to the terms-of-trade contribution, which does not include recent increases in oil production.

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