INTERNATIONAL MONETARY FUND

July 27, 2015

2015 EXTERNAL SECTOR REPORT— INDIVIDUAL ECONOMY ASSESSMENTS

IMF staff regularly produces papers covering multilateral issues and cross-country analysis. The following document has been released and is included in this package:

- The **2015 External Sector Report—Individual Economy Assessments** prepared by IMF staff and completed on June 26, 2015.

Informal Session to Engage:

The report prepared by IMF staff has benefited from comments and suggestions by Executive Directors following the informal session on July 13, 2015. Such informal sessions are used to engage Executive Directors on multilateral issues and cross-country analyses, and to receive feedback from them. No decisions are taken at these informal sessions. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

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2015 EXTERNAL SECTOR REPORT—INDIVIDUAL ECONOMY ASSESSMENTS

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INDIVIDUAL ECONOMY ASSESSMENTS

A. The External Sector Assessments

The external sector assessments use a wide range of methods, including the External Balance Assessment (EBA) developed by the IMF's Research Department to estimate desired current account balances and real exchange rates (see Annex I of the 2015 External Sector Report, also IMF Working Paper WP/13/272 for a complete description of the EBA methodology). In all cases, the overall assessment is based on the judgment of IMF staff drawing on the inputs provided by these model estimates and other analysis and the estimates are subject to uncertainty.

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

B. Selection of Economies Included in the Report

The 29 systemic economies analyzed in detail in this Report and included in the individual economy assessments are listed below. They were chosen on the basis of an equal weighting of each economy's global ranking in terms of purchasing power GDP, as used in the Fund's *World Economic Outlook*, and in terms of the level of nominal gross trade.

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

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

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

Take a stylized example of a two country world.

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

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

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

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

Individual economy write-ups. While the estimates of the *overall external sector position*, needed *current account adjustment*, and associated *real exchange rate over/undervaluation* would be equal and opposite given there are only two economies in the world, the *individual economy assessments* would clearly identify the quite different issues and risks facing the two economies. In the case of Country A, the *capital flows and foreign asset and liability position* sections would note the vulnerabilities arising from international liabilities and the *potential policy* response section of the *overall assessment* would focus on the need to rein in the *fiscal deficit* and *limit asset price excesses*. For Country B, however, if there were no domestic policy distortions the write up would find no fault with policies and would note that adjustment among other economies would help to reduce the imbalance.

Implications. At the current time, fiscal policy is the area where it is most important to distinguish between domestic and foreign policy gaps (as the contribution of foreign policy is most marked). As discussed later an elimination of the fiscal policy gap in deficit advanced economies could help reduce surplus imbalances in other economies by around 3/4 percent of GDP.

D. Individual Economy Assessments—by Economy

	Australia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Australia has a negative net international investment position (NIIP) of -54 percent of GDP. The ratio has varied in a range between -45 and -60 percent of GDP since 1992. Liabilities are largely denominated in Australian dollars but assets are in foreign currency. Liabilities are split with around a quarter FDI, one half portfolio investment (principally banks' borrowing abroad, and foreign holdings of government bonds) and one quarter other investment and derivatives. The current account deficit is expected to remain at 3-4 percent of GDP over the medium term, resulting in a gently rising NIIP to GDP ratio reaching around 60 percent of GDP in 2020. **Assessment**. The structure of Australia's balance sheet reduces the vulnerability associated with a large negative NIIP. Since Australia's NIIP liabilities are mainly in Australian dollars and there is a net foreign currency asset position, a nominal depreciation would strengthen the external balance sheet. The banking sector has a net foreign currency liability position but it is fully hedged. The NIIP level and trajectory are sustainable. The maturity of banks' external funding has improved since the global financial crisis, and even in a tail risk event where domestic banks suffer a major loss, the government's strong balance sheet position allows it to offer credible support.	**Overall Assessment**: *In 2014 the external position was assessed to be moderately weaker than the level consistent with medium term fundamentals and desirable policies. Since then a sharp decline in the terms of trade has been partly offset by a depreciation of the Australian dollar against the US dollar. If these trends are sustained through 2015 our assessment would be that the external position remains moderately weak, however there is uncertainty surrounding this assessment.* The gap appears to be partly driven by the strength of the exchange rate related to ample global liquidity and the relative attractiveness of highly-rated Australian assets. The depreciation of the Australian dollar over the past six months has been driven by overseas developments such as US dollar appreciation (partly offset by movements in the euro and Yen), and the sharp fall in the terms of trade, as well as some domestic monetary policy easing. **Potential policy responses**: If growth remains on the weak side, further monetary accommodation could be warranted. A faster than expected exit from unconventional monetary policies by major advanced economies, could result in a further exchange rate depreciation which would help support the transition of the economy towards more balanced growth. The government's planned gradual fiscal consolidation over the longer term should help improve the current account by boosting national savings.
Current account	**Background**. Australia has run current account (CA) deficits for most of its history, with deficits averaging around 4 percent of GDP in the last three decades. The deficit narrowed to 2.8 percent of GDP in 2014 but is expected to widen in 2015 following a sharp fall in the terms of trade (iron ore prices have fallen by over 50 percent in the past year). To an extent, the effect on the current account is cushioned by the depreciation of the Australian dollar. Also, resource export volumes are increasing sharply as mining capacity comes on stream, mining related imports are falling back, and lower oil prices will improve the oil balance—overall the current account widens by 0.6 percent of GDP in 2015. Over the medium term, the deficit is expected to be below 4 percent of GDP with a smaller trade deficit partly offset by a larger income deficit as global interest rates normalize and mining income accruing to foreign investors rises. With over half of Australia's exports going to emerging Asia, a key risk is a sharper than expected slowdown in China which could result in a further sharp decline in commodities prices. **Assessment**. Australia's persistent CA deficits reflect a structural saving-investment imbalance with very high private investment relative to a saving rate which is already high by advanced country standards. After accounting for Australia-specific factors driving investment, the staff assessment is that the cyclically-adjusted current account is about 0-1½ percent of GDP below the level implied by medium-term fundamentals and desirable policy settings but this assessment is subject to uncertainty, given that it depends on how non-oil commodity prices evolve. 1/	
Real exchange rate	**Background**. As of May 2015, the real effective exchange rate (REER) has depreciated by 8 and 4 percent compared to its 2013 and 2014 averages respectively and is 9 percent down from a recent peak. But it is 15 percent above its average over the last 30 years and looks relatively high when set against the fall in the terms of trade. A number of factors appear to contribute to an elevated Australian dollar, including, continued substantial capital inflows (possibly related to extraordinary monetary easing in major advanced countries), and domestic/foreign interest rate differentials. **Assessment**. Taking into account factors, including the attractiveness of highly-rated Australian assets, staff assesses the REER to be 0 to15 percent above the level implied by medium-term fundamentals and desirable policy settings. 2/	
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 given its sound fiscal position relative to other advanced economies, owing to relatively high interest rate differentials. **Assessment**. Credible commitment to a floating exchange rate and strong fiscal position limit the vulnerabilities.	
FX intervention and reserves level	**Background**. A free-floater since 1983. The central bank did 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 U.S. The authorities are strongly committed to a floating regime, which reduces the need for reserve holding. **Assessment**. Although domestic banks' external liabilities are sizable, they are either in local currency or hedged with little or no counterparty risks, so reserve needs for prudential reasons are also limited.	

	Australia (continued)
Technical Background Notes	1/ The EBA CA regression approach for 2014 estimates a CA gap of -1.5 percent of GDP but widens to around 2.6 percent of GDP when based on 2015 projections this partly reflects changes in the estimated current account norm (from -1.3 to -0.8 percent of GDP) and a widening of the projected deficit in 2015. Using estimated elasticities these would be consistent with an exchange rate overvaluation of around 6-12 percent in 2014 and around 9-15 percent currently, however these estimates may not capture Australia-specific factors (such as mining related investment) which enables Australia to run a higher current account deficit than estimated by the EBA model. Our assessment is that the current account gap is in the range of 0-1½ percent of GDP. 2/ The EBA REER regression approach, the EBA level REER regression and ES approaches provide estimates of a gap encompassing a wide range from 7 to 18 percent in 2014. Taking into account that the current REER is now around 5 percent lower than the average for 2014, but part of this reflects a decline in the terms of trade, staff assess the extent of overvaluation to be in a range from 0 to 15 percent.

	Belgium	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) remains strong at 55 percent of GDP at end-2014, reflecting very healthy private balance sheets. Despite Belgium's decline as a financial center, gross foreign assets are large (486 percent of GDP at end-2014). Gross foreign assets of the financial sector stood at 103 percent of GDP, down considerably from the pre-crisis peak. The external debt of the public sector was 66 percent of GDP in 2014. **Assessment**. Belgium's large gross external positions reflect its position as a center for corporate treasury units. Risk exposures on the asset side are mostly related to financial sector foreign claims. Risk exposures on the liability side are related to the external public debt. Based on the projected current account and growth paths, the NIIP to GDP ratio is expected to increase gradually going forward. The strongly positive NIIP and its trajectory do not raise sustainability concerns.	**Overall Assessment**: *The external position in 2014 was broadly consistent with medium-term fundamentals and desirable policy settings. Subsequent developments as of May 2015 could point to some strengthening of the external position in 2015, if the recent depreciation of the euro is sustained and if policies to improve competitiveness are not reversed* The strong net international investment position mitigates vulnerabilities associated with the high external public debt. **Potential policy responses**: Planned steady fiscal consolidation, reductions in labor taxes and continued wage moderation will help maintain the consistency of the external position. To protect against a reversal of the recent improvements, productivity enhancing structural reforms (in the labor and product markets) would be useful.
Current account	**Background**. After declining since the early 2000s, the CA has rebounded and reached a surplus of 1.4 percent of GDP in 2014. 1/ This was driven by falling investment, while gross national saving remained broadly stable. The effect of falling energy prices was partly offset by the simultaneous depreciation of the euro and the importance of energy re-exporting, both as raw material and as input in other exports. The cyclically-adjusted CA balance has also improved to an estimated 1.5 percent of GDP for 2014. The 2015 CA balance is projected to improve further to 2.4 percent of GDP. **Assessment**. The EBA model estimates a CA gap of -0.6 percent of GDP for 2014. The staff assessment is similar, estimating a CA gap in the range of -1.5 to +0.5 percent of GDP. 2/ The projected CA evolution is consistent with a fiscal consolidation and a recovery in the household saving rate, which are offset by an increase in both private and public investment.	
Real exchange rate	**Background**. Unit labor costs point to a gradual loss of competitiveness since 2005. Most of this loss has come from lower productivity growth, with a smaller contribution from wage growth exceeding that of trading partners. Real and nominal wage moderation since 2013 had only limited effect on the REER, which for 2014 was only ½ percent lower than the 2013 average. However, as of May 2015 the REER has depreciated by 6 percent from its 2014 average, mainly on account of the euro's depreciation at the beginning of 2015. **Assessment**. Point estimates of the EBA model for 2014 would point to a REER overvaluation of 7 (index model) to 11 percent (level model). The staff assessment, consistent with the CA assessment, is a 2014 REER gap in the range of -2.5 to +7.5 percent. 3/	
Capital and financial accounts: flows and policy measures	**Background**. Gross financial outflows and inflows were on an upward trend during the pre-crisis period along the expansion of banks' cross-border operations. Since 2007 along the bank deleveraging they have shrunk and have been more volatile. Short-term debt accounts for about 47 percent of the external liabilities and financing need. 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 net international investment position reduces the vulnerabilities associated with the high public debt.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	Belgium (continued)
Technical Background Notes	1/ The Belgian CA numbers have undergone major upward revisions in the fall of 2014 and the spring of 2015, complicating the comparison with the previous ESR assessment. 2/ Belgium's status as a center of corporate treasury activities and its resulting large gross foreign asset and liability positions complicate the measurement of the current account, and thus are a source of uncertainty about the CA assessment. 3/ The REER gap assessment is consistent with the staff's CA gap assessment, considering the relatively high ratios of exports and imports to GDP, which tend to make the CA more responsive to the REER.

	Brazil	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Brazil's NIIP stood at -33 percent of GDP at end-2014, broadly in line with 2013, and is projected to deteriorate modestly by 2020. 1/ FDI liabilities account for about half of all liabilities (which total 66 percent of GDP). **Assessment**. The projected deterioration of the NIIP can be moderated if receipts from *pre-salt* oil development contribute to strengthen saving.	**Overall Assessment**: *In 2014, Brazil's external position was weaker than the level consistent with medium-term fundamentals and desirable policy settings. The depreciation of the real compared to the 2014 average—driven in part by worsening ToT and idiosyncratic domestic factors-— would appear to correct part of the currency's previous overvaluation. The current account-to-GDP ratio will likely only improve moderately in 2015 should the prices of Brazil's major export commodities evolve as currently projected. As such, Brazil's external position is projected to strengthen somewhat in 2015. The projected continued worsening in the terms of trade over the medium term and the significant medium term investment needs will tend to slow down the adjustment in the current account going forward. Inward FDI is expected to remain a factor of strength.* **Potential policy responses**: Ongoing fiscal consolidation should continue. Further efforts to increase national saving are needed, including by advancing with pension reform and shifting the structure of public spending away from consumption. Foreign exchange intervention, including through the use of derivatives, can be appropriate to address bouts of excess volatility in the foreign exchange rate market.
Current account	**Background**. Despite subdued domestic demand and real currency depreciation, Brazil's current account (CA) deficit increased to 4.5 percent of GDP (4.1 percent cyclically adjusted) in 2014 amid adverse CA shocks, including from sharply worsening terms of trade, drought-related imports, and the crisis in Argentina. 2/ The projected deterioration in prices for Brazil's major commodity exports is expected to reduce exports value (other things constant) by over 1 percent of GDP in 2015. The CA is nevertheless projected to improve as the large depreciation plays out and domestic demand weakens further in 2015 (reflecting in part the tightening of macroeconomic policies) and recovers only gradually thereafter. Brazil's CA remains vulnerable to further declines in commodity prices. A larger-than-expected investment recovery could widen the deficit unless domestic savings strengthen. 3/ Rising oil production will boost exports in the medium term, although lower oil prices and potential funding constraints could dampen investment in exploration and exports. 4/ **Assessment**. Staff estimates that the CA norm consistent with fundamentals and desirable policy settings ranges from -0.5 to -2 percent of GDP. The 2014 CA gap thus ranged from -2 to -3.5 percent of GDP. 5/	
Real exchange rate	**Background**. Following years of strong appreciation, the CPI-based real effective exchange rate (REER) depreciated by 24 percent between end-2010 and May 2015; it depreciated by 13 percent since July 2014 alone, in part due to worsening ToT and idiosyncratic domestic factors. The REER on average depreciated by 2 percent between 2013 and 2014 and has depreciated a further 10 percent as of May 2015. Alternative measures of relative prices based on unit labor costs and the ratio of non-tradables over tradables prices suggest at best modest improvements in price competitiveness between end-2010 and March 2015. **Assessment**. Staff's assessment is that the real was on average some 15-25 percent above the level consistent with fundamentals and desirable policy settings in 2014. 5/	
Capital and financial accounts: flows and policy measures	**Background**. Brazil continues to attract sizable capital inflows, including inward DI flows of some 4 percent of GDP a year. Net DI (DI inflows minus DI outflows) financed around 70 percent of the current account deficit in 2014. Intercompany loans accounted for about 50 percent of net DI. With Petrobras likely to issue less debt in global markets this year, intercompany loans related to bond issuance will decline, but may be partially offset by Petrobras asset sales. Portfolio inflows have remained buoyant during most of 2014, when the monetary policy stance tightened further. Interest differentials will continue to attract net inflows, but in the short-term low economic growth and confidence may weaken investor interest. External debt remains relatively low at 30.4 percent of GDP as of end-2014. 2/ **Assessment**. The composition of flows has a favorable risk profile, but managing flows is likely to remain a challenge.	
FX intervention and reserves level	**Background**. Brazil has a floating exchange rate. Central bank intervention has been geared at reducing volatility and managing capital inflows, which resulted in a large increase of international reserves during 2006 to mid-2011. Since mid-2011, reserves have remained broadly stable. Intervention in 2014 relied on the use of FX swaps and FX repos. 6/ The intervention program reduced excess FX volatility and stabilized capital flows in the aftermath of the Fed tapering speech of May 2013, but its continued extension may have slowed convergence to a more competitive exchange rate and encouraged risk taking by the private sector. The preannounced intervention program ended in March 2015. **Assessment**. The flexible exchange rate has been an important shock absorber. Reserves are above adequate levels relative to various criteria including the IMF's composite reserve adequacy metric. Intervention can be appropriate if aimed at avoiding excessive FX volatility. Staff welcomes that the preannounced intervention program was not continued beyond March 2015.	

	Brazil (continued)
Technical Background Notes	1 / The projection takes valuation effects into account. 2/ The authorities are in the process of revising external sector statistics in line with the sixth edition of the Balance of Payments and International Investment Position manual (BPM6). This movement is consistent with the adoption of the new methodology of the System of National Accounts (SNA 2008) in Brazil, published in March 2015. Revised BOP data for 2014 were published in April 2015, with revised external debt data published in June. As part of this conversion, at least two important revisions are being made: foreign holdings of domestic debt securities are included in external debt statistics, and its income is recorded in the income account. External debt has been revised upward on account of these changes. 3/ Brazil's domestic savings are low compared to other emerging economies. 4/ Brazil currently features a small oil balance deficit; in the short run, falling oil prices thus strengthen the current account ceteris paribus while they may depress the outlook for oil production in the medium term. 5/ Estimates suggest a current account norm between -3.3 percent (EBA current account approach) and -1.2 percent (NIIP-stabilizing approach). The EBA REER index approach suggests that the real was undervalued by 3 percent on average in 2014 while the REER level approach suggests overvaluation of 15 percent. Staff's assessment of a current account norm range of -0.5 to -2 percent reflects significant commodity price downside risks, the objective to avoid a significant deterioration in the NIIP over the medium term and would facilitate expenditure switching away from consumption and towards investment. 6/ In the Brazilian FX repo, the Central Bank sells dollars with the commitment to repurchase them at a pre-determined future date. That is, the Central Bank retains a long dollar position following execution of the repo. In the Brazilian FX swap, the Central Bank enters into a contract whereby it agrees to pay the onshore dollar rate on a given notional value plus the variation in the exchange rate, and to receive the SELIC rate on the BRL equivalent (at the moment of initiation) of the given notional value. The net value of these payments is redeemed in local currency. Under this mechanism, the Central bank pays the holder if the BRL depreciates by more than the difference between the SELIC rate and the onshore dollar rate, and receives payment from the holder in the opposite case. This instrument provides hedging to agents with prospective hard currency needs.

	Canada	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. After a decade of *negative* net international investment positions (NIIP) of some 15 percent of GDP, Canada's NIIP turned *positive* beginning the last quarter of 2013 (1½ percent of GDP) and rose sharply to 7 percent of GDP at the end of 2014. The shift in the NIIP was driven by a surge in foreign equity markets. Canada has a positive net equity position because of sizable FDI and portfolio investment overseas, and a negative net debt position mostly due to government borrowing. Gross external debt is 86 percent of GDP. **Assessment**. The NIIP is sustainable with limited near term risk, as external debt is low relative to other advanced economies and the positive net equity position provides a hedge against currency depreciation.	**Overall Assessment**: *The external position in 2014 was broadly consistent with medium-term fundamentals and desirable policy settings.* *Looking forward to 2015, persistently low oil prices could worsen the current account balance, but this effect is likely to be mitigated by softer domestic demand and an expected rebound in non-energy exports from a weaker Canadian dollar and a more buoyant U.S. economy. This should keep the assessment of the external position in 2015 largely unchanged.* Over the longer-term strengthening the external position would require addressing the productivity gap with trading partners, rebuilding capacity in the manufacturing sector, and addressing infrastructure bottlenecks in the energy sector (e.g. limited pipeline and refinery capacity). **Potential policy responses**: Improving labor productivity through targeted programs, removing barriers to international trade and FDI, promoting greater competition by facilitating inter-provincial trade and labor mobility, and raising the national savings rate by further fiscal consolidation, particularly at the provincial level, would bring Canada closer to its desirable external position. Provincial governments have identified measures to cut expenditures (health care spending, freezing public service hiring, reducing tax subsidies), supplemented with additional measures on the revenue side if necessary, to deliver a balanced budget.
Current account	**Background**. Canada posted a current account (CA) deficit of 2.2 percent of GDP in 2014, an improvement of 0.7 percent over 2013. The CA has been in deficit since 2009, as the non-energy trade balance deteriorated from low labor productivity, weak external demand, and significant real currency appreciation. Canada's energy exports continue to increase, rising from 13 percent of total domestic exports in 2004 to 20 percent in 2014. The oil trade balance rose to 3.5 percent of GDP in 2014, up from 2.9 percent in 2013. Looking forward to 2015, persistently low oil prices could worsen the current account balance but a rebound in non-energy exports on the back of a weaker currency and strong US demand could mitigate this effect. We project the oil trade balance to fall to 2.5 percent of GDP in 2015. In terms of the savings-investment (S-I) balance, the current account deterioration was consistent with the worsening of the general government (S-I) balance, although since 2010, government savings has been growing and the gap has shrunk. **Assessment.** The EBA estimates a CA gap of −2 percent of GDP for 2014 (from −3.4 percent of GDP for 2013), but this estimate likely overstates the desirable external adjustment. The EBA underestimates the strength of Canada's cyclical position and overestimates its oil trade balance and terms of trade. 1/ Accounting for these factors puts the staff-assessed current account gap at a range of 0 to −1.5 percent of GDP.	
Real exchange rate	**Background.** The real effective exchange rate (REER) appreciated by 31 percent between 2000 and 2011 as energy prices soared, but from 2013 to 2014, the REER depreciated by 6 percent as the interest rate differential with the US narrowed and capital inflows tapered. Following a sharp drop in energy prices in 2014Q4, 2/ the REER depreciated a further 4 percent through May 2015. **Assessment.** The EBA REER index model estimates a REER gap of −0.5 percent for 2014 (against 10 percent for 2013). 3/ This compares with the staff assessment of 0 to 5 percent overvaluation (down from 5 to 10 percent overvaluation reported in the July 2014 Pilot External Sector Report) given the smaller staff-assessed CA gap.	
Capital and financial accounts: flows and policy measures	**Background.** The CA deficit has been financed primarily by net portfolio inflows, attracted by Canada's strong growth prospects, heavy investment in oil and gas extraction, and relatively high interest rates which made Canada a safe-haven and carry trade destination. Until recently, portfolio inflows had added upward pressure on the exchange rate. **Assessment**. Canada has a fully open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate and a strong and credible fiscal position.	
FX intervention and reserves level	**Background.** Canada has a free floating exchange rate regime, and the central bank has not intervened in the foreign exchange market since September 1998 (with the exception of participating in internationally concerted interventions for other purposes). The Bank of Canada has limited reserves but has standing swap arrangements with the Federal Reserve and four other major central banks (it has not drawn on these swap lines in the past). **Assessment**. Policies in this area are appropriate to the circumstances of Canada.	

	Canada (continued)
Technical Background Notes	1/ There are two reasons why the EBA may have overestimated the CA norm, the CA value consistent with fundamentals and desirable policies. First, the model adjusts for the business cycle using Canada's output gap relative to the world (GDP-weighted average) output gap, while a more relevant measure for Canada is the output gap relative to the United States. Using the U.S as the benchmark would reduce the CA "norm" for Canada because the output gap for the United States is currently larger (more negative) than the world output gap. Canada's cyclical strength is therefore underestimated by the EBA model. Second, the EBA overestimates Canada's trade balance by using the WEO global oil prices rather than the lower market price for Canadian oil, particularly, heavy crude oil from western Canada's oil sands (the lower price reflects lower quality and infrastructure bottlenecks). 2/ The REER depreciated by about 2 percent (q-o-q) in 2014Q4. 3/ The EBA REER level model, on the other hand, estimates the gap to be -10.6 percent, most of which is due to the residual (-10.1 percent).

	China	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Gross foreign assets, at 62 percent of GDP at end-2014 are dominated by foreign reserves, while gross liabilities, at 42 percent of GDP, mainly represent FDI liabilities. Net IIP has further declined to around 20 percent of GDP at end-2014; the ratio has been declining since the global financial crisis in light of the much reduced current account surpluses, valuation changes, and still fast growth of GDP. **Assessment**. The NIIP to GDP ratio is expected to be slightly above 20 percent of GDP over the medium term, with a modest rise of the current account in 2015. Vulnerabilities are low with large foreign exchange reserves and FDI-dominated liabilities.	**Overall Assessment**: *The external position in 2014 was moderately stronger compared with the level consistent with medium-term fundamentals and desirable policy settings, and the renminbi was moderately undervalued. Since then, there has been substantial appreciation which has brought the exchange rate to a level no longer undervalued. Also, foreign exchange intervention has dropped sharply. Nevertheless, the trade surplus has risen and domestic policy gaps remain, which suggests that the external position probably remains moderately stronger than warranted. Sustained external rebalancing will require addressing the remaining domestic policy gaps.* **Potential policy responses**: External imbalances have been reduced considerably since the global financial crisis. Finishing the job—meaning achieving a lasting balance in the external position—will require continued progress in closing the remaining domestic policy gaps. Success will move the economy to a more sustainable growth path, with higher consumption and lower overall saving, that secures both domestic and external balance. This can be achieved through successful implementation of the authorities' reform agenda. Priorities include creating a more market-based financial system; opening markets to more competition and SOE reform; improving the social safety net; and achieving a flexible, market-based exchange rate. The latter is critical for facilitating the likely further REER appreciation over the medium-term as well as allowing for two-way movements in line with evolving conditions.
Current account	**Background**. The current account (CA) surplus has fallen from its peak of over 10 percent of GDP in 2007 to 2.1 percent of GDP in 2014 (2.5 percent of GDP cyclically adjusted). The decline reflects strong investment growth, REER appreciation, weakness in major advanced economies, and, more recently, a trend widening of the services deficit (mainly due to strong outbound tourism and education spending). Gross national saving has remained around 50 percent of GDP. In 2015, the Terms-of-trade (ToT) gains from lower commodity prices—estimated at about 1 percent of GDP—are expected increase the CA surplus to 3.0 percent of GDP. **Assessment**. The CA in 2014 is 1-3 percent of GDP stronger than implied by fundamentals and desirable policies. This assessment is unchanged from the last ESR, as the actual CA, cyclically adjusted CA, and identified policy gaps are somewhat smaller than last year. 1/ Uncertainty about the cyclical adjustment justifies a range of 2 percent for the gap. The CA gap is mainly attributed to low social spending, reserve accumulation, and capital controls. Reforms, if successfully implemented, will lower private saving, and reduce the CA gap.	
Real exchange rate	**Background**. The REER has been on an appreciating trend since the 2005 exchange rate reform, gaining an average of 5 percent a year during 2006–14 (3 percent in 2014). By May 2015, the REER appreciated by 11 percent against the 2014 average, against the background of ToT gains and link of the exchange rate band to the appreciating USD (the RMB appreciated against the euro (16 percent) and yen (13 percent); and appreciated 0.5 percent against the USD). China continues to manage closely its exchange rate and conducts intervention on an intermittent basis. **Assessment**. The REER appreciation through 2014 has been broadly consistent with changing fundamentals (especially faster productivity growth than in trading partners). The EBA models and staff judgment, consistent with the CA gap, suggest that the 2014 average REER was 3-12 percent below the level consistent with medium-term fundamentals and desirable policies. 2/ The subsequent sizable REER appreciation appears to be more than would be suggested by changes in fundamentals (productivity growth and improved ToT), which suggests the exchange rate is no longer undervalued.	
Capital and financial accounts: flows and policy measures	**Background**. China continues liberalizing its capital account, but restrictions remain broad-based. For example, external borrowing is regulated and portfolio flows are primarily channeled through programs that are subject to quotas and approvals. Nonetheless, actual gross flows of FDI and other investments have been sizable **Assessment**. Over the medium term, a well-sequenced loosening of capital controls that supports domestic financial liberalization would be appropriate. The opening of the capital account is likely to lead to sizable gross capital outflows reflecting domestic savers' desire for portfolio diversification over the medium term. The adjustment path, however, is hard to predict and could vary depending on prevailing market and economic conditions.	
FX intervention and reserves level	**Background**. Intervention declined in 2014, with BOP data suggesting an accumulation of USD 119 billion, USD 314 billion less than 2013. Moreover, data suggest that there was minimal intervention in 2014: Q3 and, since then, sales of reserves of USD 29 billion in 2014: Q4 and USD 80 billion in 2015: Q1. **Assessment.** Reserves were at about 149 percent of the IMF's composite metric unadjusted for capital controls at end-2014 (down from 160 percent in 2013); relative to the metric adjusted for capital controls, reserves were at 238 percent, down from 254 percent in 2013. Given China's progress and plans with capital account liberalization, the appropriate metric is shifting toward the unadjusted one; under either metric, further accumulation is unnecessary from a reserve adequacy perspective.	

	China (continued)
Technical Background Notes	1/ The total CA gap from EBA is 2.5 percent of GDP for 2014, up from 1.5 percent of GDP in 2013 due to a change in the residual. The change in the residual in large part reflects a revised EBA model to better capture demographics. The staff assessment puts more weight on the identified policy gaps, which capture the link between domestic reforms and securing balance in the external position. The contribution of identified policy gaps is 1.8 percent of GDP (versus 2.2 percent of GDP in 2013), actual CA is 2.1 percent of GDP (versus 1.6 percent of GDP in 2013); and cyclically adjusted CA is 2.5 percent of GDP. 2/ A range of 3–12 percent for the REER is consistent with the range of 1–3 percent of GDP for the CA using inverse elasticities of 3-4 (that is, 3-4 percent REER appreciation is equivalent to a 1 percent of GDP decline in the current account surplus). The EBA Index REER model for 2014 data shows a total REER gap of minus 6.5 percent and the contribution of identified policy gaps of minus 7.5 percent, both in the range of 3–12 percent assessed by staff. The EBA Level model estimates a total REER gap 6.8 percent (that is, REER is stronger than the level consistent with medium-term fundamentals and desirable policy settings) identified policy gaps of minus 3.5 percent. However, that estimate is discarded from consideration, as the Level model estimates appear implausible, particularly for earlier years, suggesting little reliability in China's case.

	Euro Area	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) of the euro area deteriorated through the crisis, to -17 percent of GDP in 2008, but has since rebounded to around -11.6 percent in 2014:Q4, as a result of improved current accounts, modest nominal GDP growth, and valuation effects. A more stable outlook and projections of continued current account surplus suggest that the NIIP to GDP ratio will continue to improve at a moderate pace, rising to about zero percent over the medium term. **Assessment**. The NIIP positions of individual member countries still vary greatly. Despite recent improvements, external vulnerabilities persist due to market perceptions of the capability of some euro area countries with sizable net foreign liabilities to service their debts.	**Overall Assessment**: *The external position of the euro area in 2014 was broadly consistent with the level implied by medium-term fundamentals and desirable policies. In 2015, the current account is projected to rise, reflecting continued weak demand, an improvement in the net oil balance, and the weaker euro, pointing to a strengthening external position. The REER depreciation so far in 2015 has been beneficial given the current stage of the economic cycle and the need to address low inflation and reduce deflation risks. At the same time, the REER is moderately weaker than the level that would be consistent with medium-term fundamentals. Along with countercyclical monetary policy, a broader policy agenda that includes more growth-friendly fiscal policy, a strengthening of bank balance sheets, and productivity-enhancing structural reforms, would contribute to a gradual real appreciation of the euro over the medium term.* *In addition, imbalances in the external position remain at the national level, stemming from weak demand, low inflation, persistently high unemployment, and financial fragmentation. Further adjustment is needed for both surplus and deficit member states to rebalance their external positions.* **Potential policy responses**: Continued monetary accommodation is appropriate to lift inflation closer to the ECB's medium-term price stability objective, which should mitigate the real depreciation caused by the weaker euro, help increase demand and facilitate relative price adjustments at the national level. Monetary easing should be complemented with policies to strengthen banks' balance sheets, structural reforms to enhance productivity and improve competitiveness, and more growth-friendly fiscal policy to promote investment and structural reforms. This should also help achieve external rebalancing within the union.
Current account	**Background**. The current account (CA) balance for the euro area strengthened slightly in 2014 to 2.3 percent of GDP, up from 2.2 percent of GDP in 2013. The cyclically-adjusted current account in 2014 is estimated to be a surplus of about 1.9 percent of GDP. The cyclical position and adjustment of the CAs, however, varies significantly across member countries. **Assessment**. Staff assesses that the euro area 2014 current account is broadly in line with the level suggested by medium-term fundamentals and desired policies (as in the EBA estimated norm), with a CA gap ranging from -1 to 1 percent of GDP. The CA norm of [2.0] percent of GDP reflects primarily the adverse demographics and weak medium-term growth prospects in the euro area. The CA is expected to strengthen further in 2015 by nearly 1 percent of GDP, reflecting an improvement in the net oil balance by about 0.7 percent of GDP, some competitiveness gains, and continued weak domestic demand. External imbalances at the national level remain and are expected to persist. Improvements in the current accounts of debtor countries have been driven mainly by import compression, reflecting sluggish domestic demand, while surpluses in large creditor countries continue to increase. 1/ 2/	
Real exchange rate	**Background**. The CPI-based real effective exchange rate was essentially unchanged from 2013 to 2014, but fell by 10 percent as of May 2015, compared with its average level in 2014, reflecting both a nominal depreciation and slowing inflation in the euro area relative to its trading partners. The nominal depreciation in 2015 is expected to persist, not least due to the divergent economic and monetary policy outlook among the major advanced economies. **Assessment**. Staff assesses the euro area real exchange rate in 2014 (year average) to be consistent with medium-term fundamentals, with a REER gap of between -5 to 5 percent. The REER depreciation in 2015 is also consistent with the near-term cyclical outlook and the need for continued monetary accommodation. Important differences, however, remain at the national level and are expected to persist.	
Capital and financial accounts: flows and policy measures	**Background**. The slight rise of the CA surplus in 2014 was mirrored by financial outflows on a net basis. In particular, the financial account deficit was predominantly driven by bank-related and portfolio debt outflows, which were partially offset by increases in portfolio equity inflows. **Assessment**. The trend of financial flows has closely followed developments in the current account and was supported by easing financial conditions in the euro area. Looking ahead, the return of capital flows would depend crucially on growth prospects of the region, external conditions, and institutional reform efforts including the long-term vision to complete the architecture of the EMU.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.	

	Euro Area (continued)
Technical Background Notes	1/ The IMF EBA analysis for the euro area covers 11 euro area members, which are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, and Spain. The assessments of CA and REER gaps for the euro area are derived from GDP-weighted averages of the assessments of the individual countries listed above, as well as from estimates for the euro area as a whole. 2/ When applying GDP-weighted aggregation for the euro area, the CA is corrected for reporting discrepancies in intra-area transactions, as the CA of the entire euro area is about ½ percent of GDP less than the sum of the individual 11 countries' CA balances (for which no such correction is available).

	France	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. After averaging near balance in the four years before the global crisis, the net international investment position (NIIP) deteriorated, to around -15 percent of GDP in 2013, reflecting current account deficits and valuation losses. Gross asset and liability positions grew steadily in the pre-crisis period, in parallel with the expansion of French banks' balance sheets. Since the crisis, the gross asset position has declined moderately and stood at 271 percent of GDP in 2013, with large exposures to Italy and Spain. Public external debt accounts for about 20 percent of the gross liability position, which came to about 286 percent of GDP in 2013. Stability of the French public debt market is an important element of euro-zone financial stability. Current projections assume a small surplus current account surplus and a stabilization of the NIIP to GDP ratio over the medium term. **Assessment**. The net external position is negative but its size and trajectory do not raise sustainability concerns. However, there are vulnerabilities due to large exposures to Italy and Spain on the asset side, and to the external public debt on the liability side.	**Overall Assessment**: *The external position in 2014 was weaker than the level consistent with medium-term fundamentals and desirable policy settings*. Developments as of May 2015, including the depreciation of the euro and lower oil prices, suggest some strengthening of the external position. However, it is still moderately weaker than implied by fundamentals, given high unit labor costs and fiscal deficits. To improve cost competitiveness durably, the labor tax wedge cuts undertaken since 2013 (equivalent to 3 percent of total labor costs, spanning 2014-17) should be backed by wage moderation. Measures taken in 2013 to improve non-cost competitiveness (labor market reforms, regulatory simplification, and support to SMEs) reinforced by a comprehensive reform package ("Macron Law") this year. **Potential policy responses**: Wage moderation (especially of the minimum wage), continued reform of the labor market, and productivity-enhancing reforms (increasing competition in product markets and further regulatory simplification) would help restore competitiveness. Along with the planned gradual elimination of the fiscal deficit over the medium term, these measures should help correct the external imbalance (as well as promote growth).
Current account	**Background**. Over the past decade, the current account has deteriorated from a surplus of 2.3 percent of GDP in 2002 to a deficit of 1 percent in 2014, mostly due to structural factors (the cyclically-adjusted deficit is estimated at -1.5 percent of GDP). The deterioration originates from a worsening net saving position of the private sector and higher government deficits in equal proportions. The current account is set to improve significantly in 2015, to -0.4 percent of GDP, up from 1 percent in 2014, reflecting in part lower oil prices (the energy trade deficit amounted to 3 percent in 2014; savings from lower energy prices this year are estimated at 0.9 percent of GDP) and the depreciation of the euro. **Assessment**. The staff assesses the 2014 current account to be 1 to 3 percent of GDP below its cyclically-adjusted norm. This is consistent with the EBA model estimate that the cyclically-adjusted current account is 2 percent weaker than the value consistent with medium-term fundamentals and desirable policy settings. Recent developments, including the depreciation of the euro and lower oil prices, suggest some strengthening of the external position. Over the medium term, the current account deficit is projected to stabilize at about 0.6 percent of GDP as imports pick up in line with domestic demand. The gradual elimination of the fiscal deficit will help narrow the EBA-estimated gap.	
Real exchange rate	**Background**. The trend deterioration in unit labor costs (11.3 percent cumulative appreciation of the ULC-based real effective exchange over the last 10 years) points to a loss of competitiveness consistent with the assessment of an imbalance in the current account. However, such loss of competitiveness is less evident based on relative price indicators, such as CPI-based real effective exchange rate (REER), as firms appear to have squeezed profit margins to retain price competitiveness. The EBA REER regression model estimates a 10 percent overvaluation (as informed by the REER regression in levels), close to the overvaluation underlying the EBA CA regression estimate of about 7 percent. 1/ The recent euro/dollar exchange rate realignment implies a 5 percent depreciation in the CPI-based REER relative to the 2014 average (in turn ½ percent below the 2013 average). **Assessment**. Staff assesses the real exchange rate to be 5 to 10 percent overvalued, as the recent depreciation of the euro is modest in ULC-based REER terms and will not fully correct past competitiveness losses.	
Capital and financial accounts: flows and policy measures	**Background**. The current account deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Flows in financial derivatives have grown sizably on both the asset and liability side since 2008. The capital account is open. **Assessment**. France remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities.	
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.	

	France (continued)
Technical Background Notes	1/ The EBA Level REER model estimates a gap of some +10 percent, while the gap estimated by the EBA Index REER model is about -1 percent. Considering in addition the ULC based REER, which provides an additional perspective on the loss of competitiveness, the staff's assessment is that the real exchange rate is above the level consistent with fundamentals and desirable policy settings by 5-10 percent.

	Germany	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Germany's positive net international investment position (NIIP) was reduced to close to balance in the years following reunification. Since the beginning of the millennium, the NIIP recovered and reached 33 percent of GDP at end-2014. 1/ The pace of NIIP build-up has fallen short of the cumulated current account surpluses but returns (excluding revaluations) earned on assets have been higher than those paid on liabilities since 2004. The NIIP is expected to continue to grow as the CA surplus remains sizable in the medium term. German financial corporations have a large positive net portfolio investment position (38 percent of GDP), while the general government—in part reflecting Germany's safe haven status—has a large negative position (40 percent of GDP). During the crisis, the Bundesbank accumulated large net claims on the Eurosystem (Target2), which stood at 16 percent of GDP at end-2014. **Assessment**. Safe haven status and the strength of its current external position limit risks.	**Overall Assessment**: *Germany's external position in 2014 was substantially stronger than implied by medium-term fundamentals and desirable policy settings. Subsequent developments as of May 2015, notably the energy import price declines and the depreciation of Germany's REER, point toward a further strengthening of the external position.* Recent energy price declines and the depreciation of the euro, assuming these trends are not reversed, are expected to put an upward pressure on the current account in 2015. Staff projects some rebalancing in the medium run due to stronger wage growth relative to euro area trading partners and higher domestic demand. **Potential policy responses**: Policies should generate positive demand spillovers to the rest of the euro area and focus on boosting growth potential and reducing the German current account surplus. Policy priorities include higher public investment, service sector and energy policy reform.
Current account	**Background**. The current account has averaged 6.2 percent of GDP over the last decade and reached 7.6 percent of GDP in 2014, a 0.8 pp. increase relative to 2013. Most of the increase is accounted for by an improvement in the gas and oil balance, with about equal contributions from declines in volumes and prices. This improvement is expected to strengthen further in 2015, as energy prices should remain lower than in 2014. REER depreciation since mid-2014 is expected to put further upward pressure on the CA, though it will partly offset the decline in the oil price. On a geographical basis, the surplus vis-à-vis stressed countries in the euro area remained stable in 2014, after declining substantially in recent years. The saving-investment balance of the non-financial corporations and the government each contributed about ½ percent of GDP to the improvement in the current account in 2014 relative to 2013. **Assessment**. The cyclically-adjusted current account balance stood at 8.1 percent of GDP in 2014, which is 3-5 percentage points of GDP stronger than the value implied by fundamentals and desirable policies. Staff assesses the norm at 3-5 percent of GDP. The norm implied by the EBA model is 3.9 percent. 2/	
Real exchange rate	**Background**. As of May 2015, the CPI based real exchange rate has depreciated in effective terms by about 6 percent from its 2014 average primarily because of nominal bilateral depreciations vis-à-vis the USD and the RMB. These exchange rate movements are related to the expected monetary tightening in the U.S. and the implementation of quantitative easing in the euro area. Despite the recent depreciation trend, various measures of REER were 0-3.5 percent more appreciated in 2014 than in 2013 on an annual average basis. **Assessment**. Staff's assessment for 2014 is of a REER undervaluation of 5–15 percent. The EBA REER Level model yields an undervaluation of about 16 percent. The undervaluation implied by the CA regression model using standard trade elasticities is 7-12 percent. 3/	
Capital and financial accounts: flows and policy measures	**Background**. Before the crisis Germany exported capital primarily in the form of bank outflows. During the crisis, capital flow reversals particularly affected portfolio investment. In 2014, net portfolio and direct investment flows constituted about ½ and 1/3 of the capital and financial account balance, respectively. The stock of Germany's net (Target2) claims on the Eurosystem went down from a peak of €750 billion in August 2012 to €532 billion in April 2015. **Assessment**. Lower exposure to the Eurosystem and a resumption of private capital outflows are associated with reduced euro area financial stress and a partial reversal of euro area financial fragmentation.	
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.	

	Germany (continued)
Technical Background Notes	1/ Germany's balance of payments statistics, including the NIIP, are not comparable to those reported in last year's country page due to the transition to BPM6. 2/ The rapidly-aging population contributes 3.3 percentage points to the estimated EBA CA norm of 3.9 percent of GDP. Most of the EBA-estimated gap for 2014 reflects the regression's residual rather than gaps in the policies included in the EBA model. 3/ The EBA REER Index model has an unusually poor fit for Germany, predicting a depreciating trend that has not occurred. The result for 2014 is an estimate of *over*valuation (of 7.3 percent) that has been discarded from the assessment as implausible, including in light of the assessment that the CA is too strong.

	Hong Kong SAR	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** Hong Kong SAR has significant net foreign assets of around 280 percent of GDP as of Q4-2014. Both external financial assets (1434 percent of GDP) and liabilities (1150 percent of GDP) are high reflecting Hong Kong SAR's status as a major international financial center with considerable cross-territory investment. The GDP share of net foreign assets is projected to follow a trend that gradually converges to levels broadly in line with the average prior to the global financial crisis driven by expected returns and valuation changes. The trend decline mainly reflects the interest-growth differential—as nominal GDP is expected to grow faster than the effective returns on NFA (net investment income as a share of NFA). Given the large gross assets and liabilities, annual fluctuations in NFA due to valuation changes have been sizable. **Assessment.** The external position is sustainable and expected to follow a path that converges to NFA to levels broadly in line with the average before the global financial crisis around 200 percent of GDP.	**Overall Assessment**: *The external position in 2014 was broadly consistent with medium-term fundamentals and desirable policy settings. As of May 2015, the REER has appreciated by 6 percent relative to the 2014 average. This is unlikely to change the overall assessment, as it is partly explained by the improvement in the terms of trade and, importantly, expected to be offset by Hong Kong SAR's strong self-equilibrating tendencies resulting from flexible goods, factor, and asset markets.* **Potential policy responses**: Macroeconomic policies are broadly appropriate. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the Linked Exchange Rate System have worked well to keep the external position broadly in balance. Continuation of these policies, therefore, will help keep the external position broadly in line with medium-term fundamentals.
Current account	**Background.** Hong Kong's current account surplus declined considerably since the global financial crisis, with average of about 1⅔ percent of GDP during 2012–14 and 1.9 percent in 2014. The surplus is projected to increase to around 3 percent of GDP in the medium-term as global growth and interest rates recover. The recent favorable terms of trade shock (largely from the decline in oil price) is projected to improve the trade balance, raising the current account by about ½ percent of GDP. As a small and highly open economy that is both a trading hub and financial center, the current account balance projections are subject to uncertainty. **Assessment.** The current account is consistent with medium-term fundamentals and desirable policies. Staff quantitative assessment suggests that the difference between the cyclically-adjusted current account in 2014 and that consistent with fundamentals and desirable policies is between -3 to 3 percent of GDP (EBA-type results indicate a larger deviation, but are in this case subject to uncertainty and potential biases). 1/	
Real exchange rate	**Background.** The REER appreciated by about 4 percent in 2014 relative to the average REER in 2013. By May 2015 REER appreciated by about 6 percent compared to the average REER in 2014. The Hong Kong SAR system possesses strong self-equilibrating tendencies, thanks to flexible goods, factor, and asset markets. Real median monthly earnings have declined by about 3 percent in the second half of 2014 compared to the second half of 2013. **Assessment.** The real exchange rate is broadly consistent with medium-term fundamentals and desirable policies. Based on empirical EBA-type estimates and factoring in the uncertainties and variability of an offshore trading and financial center, the exchange rate is assessed by staff to be from -10 to 10 percent different from the level consistent with medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background.** Gross inflows and outflows are about 80 percent of GDP, largely comprising portfolio flows and cross-border lending and deposits. In 2014, Hong Kong SAR has experienced net private inflows. Hong Kong SAR has a fully open capital account and no capital controls. **Assessment**. Large financial resources and proactive financial supervision and regulation limit the risks from potential volatile capital flows.	
FX intervention and reserves level	**Background.** Hong Kong SAR has a currency board arrangement. International reserves have been built up in a nondiscretionary way as a result of a long-standing commitment to the Linked Exchange Rate System. The stock of reserves is equivalent to around US$328.5 billion (about 113 percent of GDP) at end-2014. **Assessment.** Currently reserves are adequate for precautionary purposes and should continue to evolve in line with the automatic adjustment inherent in the currency board system. Hong Kong SAR also holds significant fiscal reserves built up through a track record of strong fiscal discipline.	

	Hong Kong SAR (continued)
Technical Background Notes	1/ Hong Kong SAR is not in the EBA sample as it is an outlier along many dimensions of EBA analysis. Taking into consideration variability of the current account in an international trading and financial center, application of EBA methodology to Hong Kong SAR's current account provides a poor fit. The difference between the current account consistent with fundamentals and desirable policies, and the cyclically-adjusted current account is estimated to be about 10½ percent of GDP, with EBA regression residual of a similar magnitude and a neutral impact of combined contributions of policy gaps. The large residual is nearly fully explained by the contribution of three variables: aging-related interaction term, NFA position (both sample outliers, which could bias the results given potential model nonlinearities at extreme values), and financial center dummy (subject to uncertainty given the small number of financial centers in the sample). Moreover, EBA estimates do not account for the cyclical impact of low interest rates on investment income, which is sizable given the large share of interest-bearing foreign assets.

	India
Foreign asset and liability position and trajectory	**Background**. India's net international investment position (NIIP) deteriorated to -17 percent of GDP in 2013/14 from -12 percent in 2010/11, driven by current account deficits financed in good part by rising corporate external borrowing. Gross foreign assets and liabilities are relatively modest, at 25 and 42 percent of GDP, respectively. The bulk of assets are in the form of FDI and official reserves. Liabilities include FDI, portfolio equity, and increasingly debt. Reserves (at US$352 billion), having dipped during the period of exchange market turmoil in mid-2013, are well above May 2013 levels. 1/ **Assessment**. With current account deficits of under 2½ percent of GDP projected for the medium term and higher GDP growth, the NIIP-to-GDP ratio is expected to remain broadly stable. India's external debt, at about 23 percent of GDP, is moderate compared to some other emerging market economies, and its maturity profile is favorable as the share of long-term external debt in total debt is about 80 percent and the ratio of short-term external debt to FX reserves is low.
Current account	**Background**. The current account (CA) deficit narrowed from 1.7 percent of GDP in 2013/14 to 1.3 percent of GDP in 2014/15 helped by lower oil import prices (oil trade balance was about -5 percent of GDP in 2013/14) and notwithstanding the removal of restrictions on gold imports. In terms of the savings-investment balance, the improvement in the current account deficit reflects sluggish private investment. The CA deficit is expected to widen to about 2½ percent of GDP over the medium term on the back of strengthening domestic demand and the real rupee appreciation to date. **Assessment**. The EBA CA regression estimates a norm of -4.2 percent of GDP. 2/ However, in staff's judgment, global financial markets cannot be counted on to reliably finance a deficit of that size in light of India's current (but reduced) vulnerabilities. Given the risks from global financial market volatility, staff judges that a smaller deficit of about 2½ percent is a more appropriate norm. This level is larger than the estimated underlying CA deficit of 1¾ percent of GDP in 2014/15. 3/ Staff assess the CA gap to be in a range of –¼ to +1¾ percent of GDP. 4/
Real exchange rate	**Background**. The average REER appreciated by about 1½ percent between 2013 and 2014, despite a large depreciation during the period of exchange market turmoil in mid-2013. As of May 2015, the REER was about 8 percent higher than the average REER in 2014. The appreciation pressures are due to the terms of trade gain and substantial capital inflows to India. **Assessment**. The EBA Level REER and Index REER regression approaches estimate a gap of about +5 and +1 percent for the 2014 average REER, respectively. The staff assesses the REER gap to be in a range of -2 to +8 percent. 5/
Capital and financial accounts: flows and policy measures	**Background**. India's financial account is dominated by portfolio equity and FDI flows. Debt flows, particularly in the form of non-resident Indian (NRI) deposits and external commercial borrowings (ECB) by Indian corporates, have increased in recent years. As well, net portfolio debt flows have been particularly large in 2014/15 given India's reduced vulnerabilities and easy global financial conditions. **Assessment**. Given that portfolio debt flows have been volatile and the exchange rate has been sensitive to these flows and changes in global risk aversion, attracting more stable sources of financing would reduce vulnerabilities. In the past year, the authorities have taken several steps toward this goal, including by liberalizing caps on FDI inflows in railways infrastructure, construction, defense and insurance sectors. In addition, all future investment by foreign portfolio investors in the debt market in India is to be made in securities with a minimum residual maturity of three years. On the outflow side, as a capital flow management measure, the authorities have raised the limit of foreign exchange remittance for individuals from $125,000 to $250,000.
FX intervention and reserves level	**Background**. The evolution of the rupee is consistent with a floating arrangement. Foreign exchange intervention is guided by the need to limit volatility and build buffers for precautionary purposes. International reserves have increased by $48 billion since April 2014 to reach $352 billion as at end-May 2015. Reserve coverage currently stands at about 7½ months of prospective goods and services imports up from 6½ months a year earlier, partly reversing the erosion in coverage during 2007-13. **Assessment**. Reserve levels are adequate for precautionary purposes. International reserves stand at about 7½ months of import cover, representing 170 percent of short-term debt and 155 percent of the IMF's composite metric. 6/

Overall Assessment

Overall Assessment:

The external sector position in 2014/15 is broadly consistent with medium-term fundamentals and desirable policy settings. As of May 2015, subsequent developments do not point to a significant change in the external position.

India's low per capita income, favorable growth prospects, and development needs justify running CA deficits, but too great reliance on debt financing and portfolio inflows would create significant external financing vulnerabilities. Furthermore, despite a reduction in external vulnerabilities, there is need for vigilance given commodity price volatility and the recent REER appreciation.

Potential policy responses:

To reduce external vulnerabilities and reach the authorities' fiscal deficit goal of 3 percent of GDP by 2017/18, continued fiscal consolidation is needed, including by passage of a goods and services tax, and further subsidy reforms. Easing domestic supply bottlenecks would also boost exports and improve investment prospects.

Current reserve levels are adequate. The flexible exchange rate policy followed by the Reserve Bank of India is sound, and the current policy of at times smoothing exchange rate volatility is appropriate.

The CA financing mix would be improved by enhancing the environment for FDI. Given the potential risks to corporate balance sheets, including from significant unhedged FX exposures, further relaxation of limits on ECB (especially for sectors without natural hedges) should be implemented cautiously.

	India (continued)
Technical Background Notes	1/ India's NFA (at -26 percent of GDP in 2013) is lower than NIIP, mainly due to differing valuation of portfolio equities. 2/ The EBA ES (external sustainability) approach would give a CA norm of -2.1 percent of GDP for India, as the CA consistent with holding the NFA-to-GDP ratio at its current level. Such a norm is of little interest, however, as India's net external position is only moderately negative and is not on a deteriorating trend. 3/ The estimated underlying CA here incorporates the EBA-estimated cyclical adjustment and also takes account of the temporary impact of the restrictions on gold imports (about ½ of one percent of GDP) which were only withdrawn in 2014/15. 4/ See IMF (2014), *India: Staff Report for 2014 Article IV Consultation*, IMF Country Report No. 14/57, for additional model-based estimates of the CA deficit norm in India. 5/ The mid-points of the REER gap and the CA gap have the same sign, partly reflecting India's exchange rate-inelastic oil and gold imports, and binding supply-side constraints (including energy shortages) which may dampen relative-price responsiveness in the short-term. 6/ Reserves stand at 193 percent of the metric adjusted for capital controls, the construction of which is explained in the IMF policy paper, Assessing Reserve Adequacy—Specific Proposals. The Indian authorities have previously argued that de jure measures of capital controls (as used in constructing the new IMF metric) provide a very misleading picture of the significance of capital account restrictions in India.

	Indonesia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. At end 2014, Indonesia's net international investment position (NIIP) position stood at -47 percent of GDP, compared to -41 percent of GDP at end 2013. The components as a percent of GDP were reserves (+13), net FDI (-26), net equities (-11), net portfolio debt (-11), and other investment (-12). A majority of the change was due to strong net portfolio inflows (mainly government debt) in 2014. At end 2014, gross external liabilities stood at -71 percent of GDP (up from 62 percent of GDP at end 2013). Indonesia's gross external debt is moderate at 33 percent of GDP, with about 5 percent of GDP denominated in rupiah as of end 2014. **Assessment**. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable, but non-resident holdings of rupiah debt could be affected by global volatility.	**Overall Assessment:** *Indonesia's external position in 2014 was moderately weaker than implied by medium-term fundamentals and desirable policies. As of May 2015, subsequent developments do not point to a clear or significant change in the external position.* Policy actions since mid 2013 (monetary policy tightening, exchange rate and bond yield flexibility, and fuel subsidy reforms) should help improve the external position in the medium term. However, lower non-oil commodity prices and weak trading partner demand for commodity exports in 2014 and so far in 2015 have offset the benefit of lower oil prices and exchange rate depreciation, affecting the pace of current account adjustment. External financing appears sustainable, but could be affected by domestic or external shocks. **Potential Policy Responses:** Monetary policy should continue to focus on containing inflation within Bank Indonesia's target band and facilitating external adjustment. Fiscal policy can support monetary policy in bringing external adjustment and help contain vulnerability to funding pressures by aiming for a small primary deficit over the medium term, led by reforms aimed at increasing the tax take, while providing space of increased infrastructure spending to help ease supply bottlenecks. Continued flexibility of the exchange rate and use of market-determined interest rates would also help facilitate adjustment and absorb shocks. Easing trade and investment restrictions, deepening financial markets, and improving labor markets would also help promote growth and strengthen competitiveness over the medium term.
Current account	**Background**. Indonesia's CA deficit is projected at about 3 percent of GDP in 2015, similar to 2014. In the near term, lower non-oil commodity prices and weak trading partner demand for commodity exports are expected to continue offsetting partially the benefits of lower oil prices and exchange rate depreciation, factoring in observations made through the first quarter of 2015. Over the medium term, a moderate reduction in the CA deficit is expected from a further rise in manufacturing exports, aided by the lagged effects of the rupiah's depreciation, stronger demand from advanced economies, and gains from trade integration. Relatively low projected world oil prices should also help compensate for an expected sluggishness in commodity exports and rise in capital imports tied to new infrastructure investment. Adjustment would be supported over time by continued exchange rate flexibility and a prudent monetary and fiscal stance, in keeping with increasing domestic saving. In 2014, the oil and gas trade balance was about -1 percent of GDP and the non oil and gas trade balance was about 2 percent of GDP. **Assessment**. The EBA CA results suggest a gap of -1.8 percent of GDP for 2014 (based on a cyclically-adjusted CA balance of -2.6 percent of GDP and a norm of -0.7 percent of GDP). However, this estimate may not fully capture the effect of further declines in commodity prices on the CA norm. Taking uncertainties and Indonesia's investment needs into account, staff believes a norm of -0.5 to -2.5 percent of GDP is appropriate. This suggests a CA gap range of about 0 to -2 percent of GDP for 2014, which reflects domestic policy gaps in social spending as well as external policy gaps (particularly fiscal deficits) in partner countries.	
Real exchange rate	**Background**. On average, the REER depreciated by about 6 percent in 2014 relative to the 2013 average. However, it appreciated in late 2014, reflecting a temporary increase in inflation related to the reduction in domestic fuel price subsidies, but steadied in the first quarter of 2015 resulting in a 4 percent appreciation in May 2015 relative to the 2014 average. **Assessment**. EBA level and index REER results suggest an undervaluation of about 8 and 10 percent, respectively, However, using the CA gap assessment above and standard elasticities, staff assesses the REER to be overvalued by 0 to 10 percent in 2014, consistent with the erosion in Indonesia's terms of trade and projected falls in oil and gas production over the long run. 1/	
Capital and financial accounts: flows and policy measures	**Background**. Indonesia's gross external financing requirement is expected to be about 10 percent of GDP in 2015, with amortization at about 7 percent of GDP. Net direct investment FDI and new borrowing are projected at 2.1 percent and 8.8 percent of GDP, respectively. **Assessment**. Net and gross financial flows appear sustainable, but could dissipate or reverse in the event of large domestic or external shocks. 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. As of end-May 2015, reserves stood at US$110.8 billion (equal to 143 percent of IMF's reserve adequacy metric—assuming a floating exchange rate—and about 6.6 months of prospective imports of goods and services). In addition, the authorities have in place contingencies and swap lines equivalent to around US$76 billion. **Assessment**. Volatile capital flows could cause reserves to decline significantly. While the composite metric may not adequately account for commodity price volatility, the current level of reserves should be sufficient to absorb most shocks, with predetermined drains also manageable. Intervention should aim primarily at smoothing volatility, while allowing the exchange rate to adjust to external shocks.	

	Indonesia (continued)
Technical Background Notes	1/ The EBA index REER results, approach may not capture well sustained distortions, while the EBA level approach may suffer from measurement error in constructing price levels. Both results are also driven by large, unexplained residuals.

	Italy	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Italy's net international investment position (NIIP) has deteriorated significantly since joining the Euro area, with net liabilities of 28 percent of GDP as compared with 7 percent at end 2000, reflecting mainly current account deficits and valuation adjustments. Gross assets and liabilities grew steadily during this period, reaching 136 and 164 percent of GDP respectively, 39 and 60 percent higher than in 2000. External debt represents about ¾ of gross external liabilities. While the level of external debt is in line with the Euro area as a whole, its composition—half is owed by the public sector—underscores the vulnerabilities related to the high level of public sector debt. Looking forward, modest current account surpluses forecast over the medium-term will gradually shrink Italy's net liability position as a share of GDP. **Assessment**. In light of the current account's shift into a surplus, overall external sustainability is not a major concern. Still, some further strengthening of balance sheets is desirable, as Italy is vulnerable to financial contagion given its large stock of government debt and the sizable holdings of public and private debt by non-residents.	**Overall Assessment**: *The external position in 2014 was broadly consistent but likely still weaker than suggested by medium-term fundamentals and desirable policy settings. Developments as of May 2015 point toward some strengthening of the external position due to the depreciation of Italy's REER.* The assessment of 2014 is supported by Italy's weak productivity and competitiveness indicators. In particular, stronger growth, consistent with reducing high unemployment and public debt, while strengthening the external balance sheet, would require a modest weakening of the real effective exchange rate from average 2014 levels. **Potential policy responses**: Implementation of structural reforms will be critical to improving competitiveness and boosting potential growth. Continued progress in medium-term fiscal consolidation will also help close the competitiveness gap and maintain investor confidence. Combined, these measures will support growth and employment over the medium-term.
Current account	**Background**. Italy's current account (CA) averaged a deficit of 1½ percent of GDP in the decade following the adoption of the euro. Starting in 2012, it moved into balance and by 2014, it registered a surplus of 1.9 percent of GDP (up from 1 percent of GDP in 2013). The improvement in the current account is accounted for by the growing trade surplus, which reached more than 3 percent of GDP in 2014, owing both to higher exports and subdued imports. In 2015, the current account surplus is projected to rise further to 2.3 percent of GDP, reflecting the lower oil bill and euro depreciation. In terms of saving and investment, declining investment accounted for about 60 percent of the improvement in the current account since 2010, while higher public and private saving contributed the rest. **Assessment**. Despite the recent improvement in the current account, the EBA model suggests that the cyclically-adjusted level, which stood at 0.7 percent of GDP in 2014, was about 1.3 percent of GDP below the norm implied by medium-term fundamentals and desirable policy settings. 1/ Given these estimates and the need for stronger growth to reduce public debt and unemployment over the medium term, while improving the external balance sheet, staff assesses a gap of -1.5 to 0 percent of GDP for 2014.	
Real exchange rate	**Background**. Stagnant productivity and rising labor costs have resulted in a gradual appreciation of the real effective exchange rate (REER) since joining the Euro area, both in absolute terms and relative to the Euro area average. A comparison of price-based indices suggests that the appreciation over the 2000-2014 period has exceeded the Euro area average by about 0 to 10 percent, with indicators based on unit labor cost generally showing a wider gap than other price-based measures. 2/ The recent strengthening of the U.S. dollar vis-à-vis the euro contributed to a depreciation of the REER relative to the 2014 average of about 5 percent as of May 2015. **Assessment**. The EBA methodologies provide a relatively tight range of REER gap estimates in 2014. The REER regression methods suggest an overvaluation of 3 percent (EBA Index REER model) and 6½ percent (EBA Level REER model) in 2014. The CA regression method yields an overvaluation of about 5 percent. On balance, and consistent with the staff assessment of the CA in 2014, staff assessed that a real effective depreciation of 0-10 percent would support further adjustment and address economic imbalances over the medium-term.	
Capital and financial accounts: flows and policy measures	**Background**. Portfolio and other-investment inflows typically have financed the current account deficit, and a modest net FDI outflow, without much difficulty. This was also the case in 2014, which saw a strong return of foreign investment in portfolio securities in the first half of the year, led by investment in government securities. TARGET2 liabilities, accumulated by banks over 2011-12, have declined. 3/ **Assessment**. While supported by the QE, Italy remains vulnerable to a loss in market confidence, owing to the large refinancing needs of the sovereign and banking sectors, and tight credit conditions from financial fragmentation.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	Italy (continued)
Technical Background Notes	1/ The weakening of the CA balance relative to the norm in 2014 is largely the result of a revision in the EBA methodology, which raised the CA norm for countries having both a relatively rapidly aging population and high dependency ratio, such as Italy. 2/ Depending on the measure used, Italy's REER appreciated by -0.4 to 1 percent between 2013 and 2014 (year average on year average). 3/ The sharp rise in Target 2 balances in the second half of 2014 reflected the policy adopted by Treasury to reduce issuance of new debt securities, and a temporary spike due to interbank transactions. Target 2 balances have since declined.

	Japan
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) position has nearly doubled in the last ten years to close to 70 percent of GDP in 2013 (assets: 166 percent; liabilities: 98 percent) . In the medium term it is projected to rise toward 75 percent with higher current account (CA) surpluses, before stabilizing as valuation effects are offset by dis-saving as the population ages. **Assessment**. Vulnerabilities are limited (equity and direct investment comprise a rising share of liabilities, now at 35 percent of total). Assets are diversified geographically and by risk classes. The NIIP generates annual investment income at 3-3 ½ percent of GDP, keeping the current account balance positive despite the rising trade deficit.
Current account	**Background**. The 2014 CA surplus fell to 0.5 percent of GDP. Export volumes grew 0.6 percent y/y (4 ¾ percent in value) in the face of continued headwinds - rising share of offshoring, loss of market share, limited pass-through of the depreciation to lower export prices, and low global investment. Nonetheless, exports picked up in Q4 2014 supported by gradual economic recovery overseas and delayed J-curve effects. Despite weak domestic demand and the REER depreciation, import volumes grew 0.7 percent (5 ¾ percent in value), with rising import penetration in electronics and smartphones. **Assessment.** - EBA estimates the 2014 cyclically-adjusted CA at 0.6 percent of GDP. Staff adjust the estimate for temporary factors (delayed effects of depreciation, elevated energy imports with the nuclear power plant shutdown, regional tensions), to get an underlying, cyclically-adjusted CA of 2-2 ¼ percent of GDP. - EBA estimates the 2014 CA norm at 3.1 percent of GDP. Staff adjust the estimate to account for factors not captured by EBA - structurally lower export competitiveness and permanently higher domestic demand and imports under complete Abenomics - to get a norm of 1 ¼ to 2 percent of GDP. - The underlying CA in 2014 is therefore assessed to be 0-1 percent of GDP larger than the norm, broadly consistent with desirable policies and medium-term fundamentals. (*See notes, below.)* The 2015 surplus is expected to rise to 2 percent of GDP under the current policy mix on lower oil prices (the oil balance deficit improves from – 3.6 percent of GDP in 2014 to -2.5 percent projected in 2015) and a pick-up in export growth.
Real exchange rate	**Background**. The real effective exchange rate (REER) depreciated 5 ¾ percent between 2013 and 2014 (a further 7 percent through May 2015 (relative to the 2014 average), mainly on account of the nominal depreciation fueled by further widening of interest rate differentials relative to the U.S. (10y JGB yields stayed suppressed below 60 bps for most of 2014 in anticipation of further BoJ easing, and eventually dipped as low as 30 bps after the BoJ accelerated its QQE program in October). **Assessment**. The EBA REER Level model estimates the 2014 average REER to be 21 percent weaker (EBA Index REER model: 26 percent weaker) than the level consistent with fundamentals and desirable policies, mainly from a large unexplained residual. The model does not include fiscal policy and so the estimated policy gap is close to zero. Other Japan-specific factors that affect the REER – JGB-UST spread, portfolio rebalancing, speculative short positions against the yen, and the shock requiring higher energy imports - are also not included. Because of these missing factors, the EBA REER model is not used in Japan's assessment. Instead, using the staff-assessed CA gap range as reference, staff assess a 2014 REER gap midpoint of -5 percent with an indicative range of 0 to - 10 percent.
Capital and financial accounts: flows and policy measures	**Background**. There has been a pick-up in portfolio outflows as institutional investors have begun to diversify overseas. Net short yen positions have eased from their extreme highs of last year, but continue to be an important driver of exchange rate movements. **Assessment**. Vulnerabilities are limited (inward investment tends to be equity-based and home bias of Japanese investors remains strong). So far there have been no large spillovers from QQE to domestic financial conditions in other economies in the region and elsewhere (interest rates, credit growth). If outflows from Japan accelerate, they could provide an offset to any tightening in domestic financial conditions regional economies face with normalization of policy rates in other advanced economies.
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 in 2011) to reduce short-term volatility and disorderly exchange rate movements.

Overall Assessment

Overall Assessment:
The 2014 external position was broadly consistent with medium-term fundamentals and desirable policies.

As of May 2015, the key developments relative to 2014 are the reduction in the oil import bill, the REER depreciation, and some pickup in exports. The REER depreciation compared to the average of 2014 has been beneficial, given the current stage of the economic cycle and the need to address low inflation and reduce deflation risks. At the same time the REER has moved toward a moderately weaker level than would be consistent with its fundamentals suggested in the 2014 assessment.
Together with these developments, sustained easing by the BoJ while others tighten, combined with the lack of bolder structural reform and the absence of a credible and specific medium-term fiscal consolidation plan could strengthen the external position.

Potential policy responses:
Forceful structural reforms are needed to raise growth as well as lift prices. These include measures to boost labor supply, reduce labor market duality, enhance risk capital provision, and accelerate agricultural and services sector deregulation. Fiscal consolidation should proceed anchored by a concrete plan to achieve the medium-term target, and its conduct attuned to economic conditions and prospects. These 'desirable' policies are expected to support growth, boost domestic demand, imports and prices, without overreliance on depreciation of the yen, and help prevent the external position from moving out of line with fundamentals over the medium term.

	Japan (continued)
Technical Background Notes	1/ Export elasticities are structurally lower because offshoring of production and a higher share of intermediate goods exports which makes Japanese exports less sensitive to yen fluctuations than in the past. 2/ The norm is positive because of high corporate saving in excess of domestic investment opportunities, low residential investment, and a sizable income account owing to the large NFA position and favorable return differential on assets relative to liabilities. 3/ The uncertainty in the CA gap results from (i) varying estimates of the impact of temporary factors weighing on the CA; (ii) hard-to-quantify implications of Abenomics policies for the norm; and (iii) uncertain effects of structural changes – higher offshoring, reduced competitiveness of some tradable sectors – on the trade balance.

	Korea	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** Korea's net international investment position (NIIP) increased from -2.9 percent of GDP in 2013 to 5.8 percent in 2014. This position is expected to strengthen further as the current account is in strong surplus. The net external debt position was -16.7 percent of GDP in 2014. Banks' short term external debt remains below the pre-crisis levels, and the risks of currency mismatch are limited as the bulk of the short term external debt is matched with forward hedging activities mainly by exporters. **Assessment**. The NIIP position and dynamics present little risk to external sustainability.	**Overall Assessment**: *The external position in 2014 was substantially stronger than that implied by medium-term fundamentals and desirable policies.* Developments as of May of 2015 point to a broadly similar external position in 2015. Such assessment is subject to uncertainty related to the persistence of the large fall in oil prices, Korea being one of the largest oil importers in the ESR and the sharp movements of relevant cross rates. **Potential policy responses**: Building growth momentum in the near term could have some impact on reducing imbalances, and the recent monetary, fiscal, and other policy steps to boost domestic demand are steps in the right direction. A more durable reduction will require a steady shift away from Korea's heavy reliance on manufacturing exports for growth—increasing productivity in the non-traded sector, aided by structural reforms, would help. The authorities' more expansionary fiscal policy stance, both this year and over the medium term, could narrow imbalances, all the more so if coupled with an expanded social safety net that reduces the need for precautionary savings, as would fiscal rebalancing in advanced economies. Real exchange rate appreciation over time should also play a role, and the rate should remain market determined with intervention limited to smoothing excessive volatility.
Current account	**Background**. The current account (CA) in 2014 was around 6¼ percent, broadly unchanged from 2013 but significantly above the average over the last 5 years. In 2015, the CA will likely increase due to a combination of short run factors most notably the sharp fall in global oil prices, given Korea's oil trade deficit at 7% in 2013. The CA is expected to decline moderately in the medium term, reflecting stronger projected domestic demand related to economic recovery and some impact of structural reforms, as well as demographic changes that could reduce savings. **Assessment**. The EBA regression model has the 2014 current account at about 6¼ percentage points of GDP above the estimated cyclically-adjusted norm of 0.9 percent. A small part of this estimated gap could be accounted for by relatively low public social spending in Korea and the fiscal policy gaps of other countries, but there are also important factors not fully captured by the model's variables and cyclical adjustments, including Korean firms and consumers cautious approach in the short-run to the large windfall from lower oil prices and the lagged export response to past won appreciation. In addition, demographic factors could be adding to the current level of savings. Accounting for these considerations, staff assesses the 2014 current account gap at 2½ to 5 percent of GDP. 1/	
Real exchange rate	**Background**. The won has been on a gradual appreciating trend on a trade-weighted basis since 2012, having appreciated by 6% in 2014 relative to 2013 average, although this masks important movements in cross rates—in particular, the won continues to climb against the yen, Japan being Korea's main export competitor, but has weakened against the U.S. dollar since last July. The REER as of May 2015 has appreciated by 3% from its 2014 average. **Assessment**. Despite some real appreciation, the REER for 2014 is assessed to be 5 to 13 percent weaker than the level consistent with fundamentals and desired policies. 2/	
Capital and financial accounts: flows and policy measures	**Background**. With an increase in net portfolio outflows and a decrease in net banking outflows (about 1¾ percent of GDP for both) offsetting each other, the overall net capital flow deficit remained at 5 percent of GDP. A proposed technical change to an existing bank levy, predicted to take effect later in 2015, does not substantially alter the macroprudential policy setting. **Assessment**. Korea's net and gross flows appear sustainable.	
FX intervention and reserves level	**Background**. Korea has a floating exchange rate. The quantity of reserves has increased steadily since the sharp decline in 2008 but has been broadly stable (at around 130 percent) as a share of the IMF's composite reserve adequacy metric during most of this period. In dollar terms reserves increased by $35 billion in the first half of 2014 but have declined since then reflecting valuation losses. **Assessment**. Intervention should be limited to smoothing excessive volatility. The stock of reserves should be sufficient to buffer against a range of possible external shocks.	

	Korea (continued)
Technical Background Notes	1/ **Current Account.** The increase in the current EBA-estimated CA gap compared to last year's estimate (around 5 percent of GDP) is largely driven by recent methodological changes regarding the treatment of demographic factors. In the case of Korea, such modifications result in a larger unexplained residual and reduce the CA norm by 1¾ percent due to its somewhat unique combination of rapid population aging and a substantial increase in life expectancy. The staff's assessed CA gap range accounts for this, as well as applying other adjustments to the EBA estimated CA norm similar to last year's (mainly related to the model's treatment of the impact of changes in the terms of trade). 2/ **REER.** Staff's assessment of the REER gap is subject to a high degree of uncertainty related to both the difficulty in predicting when and by how much Korea's exports will respond to exchange rate movements, as well as the diversity of estimates produced by the EBA's exchange rate regression models. Staff analysis suggests that Korean export volumes have become highly inelastic to exchange rate movements in the short run, and where the longer term implications of the won's recent real appreciation are particularly difficult to forecast. A smaller estimated elasticity may be related to a range of structural factors including branding, product cycles, global supply chains and offshoring of production. Recent cross-rate movements if permanent, notably the yen, could eventually lead to more off-shoring, lower investment in domestic capacity and R&D, and reduced export proceeds. At the same time, the stronger dollar could provide some buffer. The long-run impacts on export volume would also be clouded by structural developments in Korea's key industries. On the other hand, EBA's REER regressions suggest a wide range of estimated gaps. The index model points to the won being roughly consistent with fundamentals and desired policies 0.1 percent, whereas the level model points to a substantially weaker won 13.8 percent. Our assessed range uses as inputs EBA implied calculations as well as staff's estimated elasticities.

	Malaysia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) was –4.6 percent of GDP at end 2013. Assets were about 133 percent of GDP in 2013 of which about one-third are direct investment assets. Gross liabilities (including both ringgit- and foreign currency-denominated liabilities) were about 138 percent of GDP at end 2013. Total external debt was 68 percent of GDP at the end of 2014, of which 49 percent is short-term debt. Foreign-currency debt is 41 percent of GDP. 1/ **Assessment**. The NIIP is not a major source of risk; it is projected to rise in the medium term reflecting the projected current account surpluses. The country has large institutional investors that have behaved countercyclically in past episodes of outflows.	**Overall Assessment**: *The external position in 2014 was stronger than that consistent with medium-term fundamentals and desirable policy settings. Developments as of May 2015, most notably the decline in energy prices amid limited depreciation of the REER, suggest a softening of the external position. The bilateral depreciation against the US$ has mitigated the loss of export income from the lower price of oil and gas In 2015 the external position will remain stronger than warranted by fundamentals and desirable policy settings, albeit weaker than in 2014.* **Potential policy responses**: The external rebalancing of Malaysia's economy is substantial. Looking ahead, over the medium-term, increased public sector saving will be offset by sustained private consumption and investment activity and is expected to result in a current account surplus of 0-2 percent of GDP over the medium-term, gradually closing the gap with the norm. Staff views any remaining current account and real exchange rate gaps as reflecting inadequate social protection (beyond that captured by public health expenditure), the need to improve the risk sharing characteristics of the pension system, investment bottlenecks, infrastructure gaps, labor force skill mismatches, and rigidities in the labor market. Consistent with the authorities' intentions, stronger social safety nets and efforts to remove bottlenecks to investment would help to further moderate the current account surplus.
Current account	**Background**. Malaysia's current account (CA) surplus has declined by 5 percentage points since 2011 to 4.6 percent of GDP in 2014. From a saving-investment perspective, about two thirds of the CA adjustment was due to a strong surge in private investment and ETP-related investment projects, which bodes well for medium term growth. Terms of trade are expected to fall by 4 percent in 2015. Malaysia's exports are diversified which mitigates the negative impact of lower oil prices. LNG exports represent 9 percent of total exports. The likely income loss of lower oil prices at constant volumes is estimated at 2 percent of GDP. The exchange rate depreciation mitigates the effect. The current account surplus for 2015 is projected at 2.1 percent of GDP. **Assessment**. The EBA CA regression approach estimates that the cyclically-adjusted CA is stronger (by about 5.5 percent of GDP) than consistent with medium-term fundamentals and desirable policies. The estimated policy gap is about zero, so nearly the entire gap is a residual requiring interpretation. However, Malaysia's CA surplus partly reflects factors that are not well captured in the EBA: in particular, insufficient social safety nets (not fully captured by public health spending), which drive up saving rates; bottlenecks to investment, resulting in relatively low private investment. It is difficult to separate the above factors into slow-moving structural ones (that are given in the short run and add to the gap) and controllable policy variables that explain the gap. Taking these factors and the uncertainty surrounding model estimates into account, staff assesses the norm to be 1.5 percent of GDP and the CA gap to be 3.9 percent of GDP (plus or minus 1 percent of GDP) in 2014. In 2015, a lower price of gas exports may reduce the surplus by 2 percent of GDP. The gap under the external sustainability approach is 1.2 percent of GDP.	
Real exchange rate	**Background**. The average REER in 2014 was similar to 2013. By May 2015, while the REER depreciation with respect to the 2014 average was 3 percent, the ringgit had depreciated by 9 percent against the USD. 3/ **Assessment**. The EBA REER index regression estimates Malaysia's REER to be 21 percent below levels warranted by fundamentals and desirable policies, though most of the gap is an unexplained residual. The analysis of the level REER provides an estimate of 15 percent undervaluation. Staff's assessment is that the REER undervaluation for 2014 is 13 percent (plus or minus 5 percent), based on staff's view of the CA gap and the semi-elasticity of the current account with respect to the REER.	
Capital and financial accounts: flows and policy measures	**Background**. Malaysia has typically recorded net capital outflows. Although net FDI flows are generally small, gross FDI flows are large, reflecting the growing importance of Malaysia as a direct investor abroad. In 2014, net FDI abroad increased to 4.8 percent of GDP and net FDI outflows were 1.7 percent of GDP. Net total outflows were about 7.3 percent of GDP, with portfolio outflows accounting for about half of it. Half of the portfolio outflows were recorded in the last quarter, when oil prices fell dramatically. **Assessment**. The authorities have continued to liberalize FX administration, including via greater flexibility for resident companies to undertake FDI abroad and obtain loans from related resident and nonresident companies.	
FX intervention and reserves level	**Background**. While Malaysia maintains a flexible exchange rate regime, BNM intervention seeks to limit excess volatility and generally has been two-sided. From end-September 2014 through mid-April 2015 reserves have declined by US$ 21.7 billion. 5/ **Assessment**. At the end of December of 2014, official reserves stood at about 83 percent of the IMF's composite reserve adequacy metric, and covered 81 percent and 27 percent of short-term external debt and broad money, respectively. However, reserves in excess of the current level proved useful in 2014 and the authorities may increase reserves in favorable occasions.	

	Malaysia (continued)
Technical Background Notes	1/ Ringgit-denominated debt held by nonresidents, including Malaysian government securities and Bank Negara Bills and Notes, increased rapidly since the global financial crisis; during the second half of 2014 foreign investors largely reduced their exposures to Bank Negara Bills and Notes. Short-term foreign-currency denominated external debt has risen in the last few years, largely due to banking sector activity, it is matched by an increase in short-term external assets and is covered by foreign reserves. 2/ The non-oil current account deficit fell from -2.1 percent in 2013 to -1.4 percent in 2014. 3/ Since 2000, movements in the REER have been driven almost entirely by the nominal exchange rate rather than inflation differentials. 4/ The semi-elasticity is estimated at 0.29 and takes into account Malaysia's trade openness and commodity exports. 5/ During the global financial crisis foreign reserves fell by about 28 percent between August 2008 and March 2009, but then registered a strong increase in early 2011; a decline was again recorded in August–September 2011. Gradual increases continued until mid 2013, when reserves declined. In the last quarter of 2014 reserves fell by 15 percent.

	Mexico	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** Mexico's NIIP is -33 percent of GDP (gross foreign assets and liabilities are 42 percent and 76 percent of GDP, respectively). Portfolio liabilities are 37 percent of GDP, of which around one third are holdings of local-currency government bonds. With projected current account deficits averaging less than 2.5 percent of GDP, the NIIP to GDP ratio is projected to remain steady over the medium term. **Assessment.** While the NIIP is sustainable, gross foreign portfolio liabilities could be a channel of vulnerability to global financial volatility, especially through the sovereign bond market.	**Overall Assessment**: *In 2014, Mexico's external sector position was broadly consistent with medium-term fundamentals and desirable policy settings.* *The weakening of the REER during the first quarter of 2015 is not large enough to change this assessment.* The FCL provides an added buffer against global tail risks. **Potential policy responses**: As the external sector position is broadly consistent with medium-term fundamentals, there is no reason to alter the planned policy settings. The authorities have committed to reducing the public sector borrowing requirement from 4.6 percent of GDP in 2014 to 2.5 percent of GDP in 2018. The consolidation relies on a gradual increase in tax revenues related to the 2014 tax reform and expenditure rationalization. At the same time private investment is expected to rise counteracting the impact of rising public saving on the current account. The central bank will set monetary policy to ensure that the inflation remains close to the 3 percent target within the horizon at which monetary policy operates, while maintaining a flexible exchange rate policy and using intervention to prevent disorderly market conditions.
Current account	**Background**. The current account (CA) deficit fell to 2.0 percent of GDP in 2014 (2 percent in cyclically–adjusted terms as well) due to lower net factor payments (in particular lower profit repatriation). In 2015, the current account deficit is projected to remain at a similar level, with stronger manufacturing exports offsetting the weakening of the hydrocarbon trade balance. Over the medium term, private investment related to the structural reforms is expected to rise, matched by greater public sector savings and a gradual increase in private savings as a result of higher oil production. **Assessment**. Mexico's CA appears to be broadly in line with the level consistent with medium term fundamentals and desirable policy settings. The EBA model estimates a cyclically-adjusted current account norm of -2.9 percent, implying a positive CA gap of 0.8 percent of GDP (including the upward influence on the CA norm of fiscal policies of other countries). The staff assessment is similar with a gap of between 0 and 1 percent of GDP for 2014.	
Real exchange rate	**Background**. The average REER was broadly unchanged from 2013 to 2014. As of May 2015, the REER depreciated by 7 percent relative to the average 2014 value. The depreciation can be explained by the fall in the oil price and the general strengthening of the U.S. dollar vis-à-vis most currencies. The floating exchange rate has been a key shock absorber in an unsettled global environment.[1/] **Assessment**. The EBA REER regression estimates a small undervaluation of 1-10 percent in 2014, based on the level and index approaches, consistent with the EBA estimate of a small positive current account gap. The staff assesses Mexico's real effective exchange rate to be broadly consistent with fundamentals and desirable policy settings (with a gap ranging from 0 to -10 percent). The recent depreciation, if sustained, could increase slightly the estimated undervaluation.	
Capital and financial accounts: flows and policy measures	**Background**. Since 2010, a large share of capital inflows has gone into purchases of locally-issued government paper and other portfolio investments. Going forward, the structural reforms are expected to lead to higher FDI, while portfolio inflows into government paper are likely to slow down. **Assessment**. While the rising local currency share and long duration of sovereign debt reduce the exposure of government finances to depreciation risks, the strong presence of foreign investors leaves Mexico exposed to a reversal of capital flows and an increase in risk premia. The authorities have refrained from capital flow management measures, in line with their view that an open capital account reduces policy uncertainty and supports long-term growth. Capital flow risks should also be mitigated by the prudent macroeconomic policies.	
FX intervention and reserves level	**Background**. The central bank remains committed to a floating exchange rate, using limited intervention 2/ only to address possible disorderly market conditions. The central bank builds up reserves through purchases of the net foreign currency proceeds of the state oil company. In 2015 the accumulation is slowed down by temporary dollar auctions. 3/ **Assessment**. The current level of foreign reserves is adequate for normal times according to a range of reserve coverage indicators, and falls in the lower end of the 100-150 percent range of the IMF's composite reserve adequacy metric. The current policy of reserve accumulation is broadly consistent with the expected gradual rise in foreign-held portfolio liabilities. The Fund FCL arrangement has been an effective complement to international reserves against global tail risks.	

	Mexico (continued)
Technical Background Notes	1/ Following the tapering announcement by then Federal Reserve Chairman Bernanke in May 21, 2013, Mexico's currency experienced one of the sharpest depreciations across emerging markets, falling by nearly 8.4 percent by end-June 2013, and followed by a rapid recovery. 2/ Since December 8,2014, the Bank of Mexico operates again a rule-based intervention mechanism, in which up to U.S. dollar 200 million are auctioned whenever the peso loses more than 1.5 percent of its value compared to the previous session's official exchange rate. A similar program had been in place before April 2013. 3/ Since March 11, 2015, the Bank of Mexico auctions USD 52 million daily thereby reducing reserve accumulation somewhat. This program expires on September 29, subject to review.

	The Netherlands	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Since 2000, the NIIP has continuously strengthened and reached 72.3 percent of GDP at end-2014 up from 41.3 percent in 2013. The increase chiefly reflects large net FDI outflows and a strong other investment position as well as valuation effects on overseas holdings due to higher equity prices and the euro's depreciation. In 2014, total assets reach 537 percent of GDP and liabilities 465 percent of GDP. Over the medium term, the NIIP is expected to continue growing, given the projected sizeable current account surpluses **Assessment.** The Netherland's safe haven status and its sizeable foreign assets limit risks from its large foreign liabilities.	**Overall Assessment:** *The external position in 2014 was stronger than the level consistent with medium-term fundamentals and desirable policy settings. The REER depreciation since 2014 is likely to further strengthen the external position.* The Netherlands' status as a trade and financial center and natural gas exporter make an external assessment more uncertain than usual. **Potential policy responses** Structural reforms to raise the productivity of smaller, domestic firms and progress in repairing household balance sheets and strengthening the banking system will support domestic demand and contribute to reducing external imbalances. A shift towards more productive investment will also help in the rebalancing.
Current account	**Background**. The current account has been in surplus since 1981, reaching 10.6 percent of GDP in 2014, after 10.9 percent of GDP in 2013. The high current account surpluses reflect mainly the savings of the corporate sector and institutional pensions held by households, only in part compensated by higher health expenditure than OECD average, and Netherlands' status as a trade and financial center and natural gas exporter. The large corporate savings have been used to finance substantial FDI outflows by global firms in the Netherlands. Household savings have also increased as a result of deleveraging following the sharp declines in housing prices starting in mid-2008. The CA surplus in 2014 is slightly below its level in 2013 (10.9 percent of GDP), given a lower service balance despite improved terms of trade. Declining oil and commodity prices had only minor effects in 2014, reducing the CA surplus by 0.2 percent of GDP, mainly explained by lower gas exports (-0.6 percent of GDP). Strong export growth amid euro depreciation and contained exporter margins are projected to deliver a higher CA surplus than in 2014. **Assessment**. Staff assesses that the current account gap is smaller than that estimated in the EBA model due to the following country-specific factors: (i) unlike many other advanced economies, the Netherlands has a fully funded pension system which has increased household saving rates; (ii) following the real estate collapse, household deleveraging has also kept saving rates high, and (iii) statistical issues related to the income measurement of large FDI flows. Taking account these factors, staff assessment of the current account gap is in the range of 0-3 percent of GDP. 1/ In the medium term the CA surplus is likely to decline, supported by a recovery in domestic demand, progress in household deleveraging, and demographic trends.	
Real exchange rate	**Background.** Both the ULC and CPI based REERs depreciated by 2.1 and 1.7 percent respectively in 2014, mainly due to the 1.6 percent nominal effective depreciation, primarily reflecting the euro depreciation. As of April May 2015, the REER depreciated by 5½ percent from its 2014 average. **Assessment**. The EBA REER gaps estimates for 2014 are -1.4 percent and -10.1 percent respectively for the EBA index and level models. Taking into account the EBA REER results and also the current account gap implication of around 4½ percent REER gap, staff assesses that the REER remained undervalued by around 5 percent within a range of 0-10 percent. The further depreciation of the euro in 2015 is likely to have increased the undervaluation of the exchange rate.	
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. On average, gross FDI outflows largely match corporate profits. **Assessment.** The strong external position limits vulnerabilities from capital flows. The financial account is likely to remain in deficit as long as the corporate sector continues to invest substantially abroad.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment.** Reserves held by the Euro area are typically low relative to standard metrics, but the currency is free floating.	

	The Netherlands (continued)
Technical Background Notes	1/ In comparison with last year, the EBA-estimated CA gap in 2014 (unexplained residual plus the contribution of identified policy gaps) narrowed by 1.1 percentage point to 3.6 percent of GDP. The smaller gap reflects a lower cyclically adjusted CA surplus (down from 9.7 to 9.2 percent of GDP) and a higher estimated CA norm of 5.7 percent of GDP (after 5.0 percent in 2013). 2/The larger external balance sheet, presence of large international corporations, and issues related to the measurement of the current account add uncertainty to this assessment. According to the DNB, half of the positions in assets and liabilities are attributable to subsidiaries of foreign multinationals, which are identified as Special Financial Institutions (SFIs).

	Poland	Overall Assessment
Foreign asset and liability position and trajectory	**Background.** A large negative net international investment position (NIIP) has stabilized at 60 percent of GDP in 2014 (assets at 42 percent and liabilities at 103 percent of GDP). Amid a moderate widening of the current account (CA) deficit, financed largely by non-debt creating EU flows, the NIIP is projected to improve to 58 percent of GDP by 2020. **Assessment.** Vulnerabilities exist, but sustainability concerns surrounding the large negative NIIP are mitigated by diversified FDI liabilities and associated intra-company lending (over 40 percent of foreign liabilities are FDI) and the projected improvement of the NIIP under the baseline. Broadly adequate reserves and the FCL arrangement also help mitigate liquidity risks (ST debt is 20 percent of total) that may arise from the large negative NIIP.	**Overall Assessment**: *The external position in 2014 was broadly consistent with medium-term fundamentals and desirable policies. As of May 2015, it appears that the impact of lower oil prices is being more than offset by strong domestic demand growth, this does not change the overall assessment going forward.* Desirable policies include continued modest fiscal consolidation. Reserves are broadly adequate. The FCL arrangement provides an added buffer. **Potential policy responses**: Modest fiscal consolidation in Poland, and in the rest of the world in aggregate, should continue. Vigilance with respect to bank funding (including foreign exchange swaps) is warranted including by standing ready to extend FX liquidity in the event of external shocks. Modest additional reserve accumulation would be appropriate to further bolster buffers. The exchange rate should be allowed to play its appropriate cushioning role.
Current account	**Background.** The CA deficit declined from around 5 percent of GDP in 2010-11 to 1.4 percent of GDP in 2014. Underlying the improvement is increased savings and a reduction in investment from the highs due to front loaded absorption of EU funds. The moderate CA deficit in 2014 largely reflects income repatriation by multinational companies' domestic affiliates and a trade surplus of 1.8 percent of GDP. In 2015, the CA is projected to improve only marginally, despite the improvement in the oil trade deficit (3.4 percent of GDP in 2013) which is more than offset by higher non-oil imports due to strong domestic demand**.** **Assessment.** The CA is broadly consistent with the level consistent with fundamentals and desirable policies. The CA approach estimates a gap of around 0.6 percent of GDP, reflecting the sum of offsetting domestic and partners' policy gaps (a reduction in Poland's structural fiscal deficit will be needed to reduce its domestic policy gap) and a residual. The cyclically-adjusted CA is estimated at -1 percent of GDP, and the CA norm is -1.6 percent of GDP. The staff assessment is similar, with a CA gap range for 2014 centered on +0.5 (plus or minus 1) percent of GDP.	
Real exchange rate	**Background**. The real effective exchange rate (REER) appreciated 0.8 percent in 2014 relative to 2013. It depreciated 2 percent as of May 2015 largely reflecting nominal depreciation vis-à-vis the US dollar and the Swiss Franc. Capital inflows following ECB QE action could result in appreciation of the zloty , though the 50 bp cut in March could mitigate the impact. **Assessment.** The EBA models suggest undervaluation of between 2 and 11 percent. The ES estimate of the REER gap is 5 percent; 2 percent using the REER index and 11 percent using level REER. Based on these inputs, and the assessment of the CA, staff assesses Poland's real exchange rate in 2014 to be close to a level consistent with fundamentals and desirable policy settings, with a REER gap centered on -2.5 with a range of -7.5 to +2.5.	
Capital and financial accounts: flows and policy measures	**Background.** The capital account is dominated by EU structural fund inflows. In recent years, inflows in the financial account were centered on portfolio flows (government bonds), as FDI slowed. Capital inflows remained weak in 2014, in tandem with narrowing of the CA deficit. **Assessment.** High foreign holdings, 40 percent of total government bonds, suggest potential vulnerability. Pension modifications, which mechanically increased the share of foreign investors in the domestic government bond market, may exacerbate the vulnerabilities. The diversified investor base is a mitigating factor.	
FX intervention and reserves level	**Background.** Reserves have increased from USD 93 bln in 2010 to 100 bln in 2014. The zloty has floated freely. **Assessment.** Reserves are broadly adequate, standing at about 114 percent of the IMF's composite reserve adequacy metric. Nonetheless, additional reserve accumulation would be appropriate to further bolster buffers. The FCL also provides insurance against external risks.	

	Poland (continued)
Technical Background Notes	1/ Poland has a total current account gap (including residual) of 0.6 percent. The contribution of identified policy gaps are -0.5 percent. The domestic fiscal policy gap is -1 percent but is offset by fiscal gaps in trading partners that result in a total contribution of -0.1 of fiscal policies to the current account gap. In addition, Poland's other gaps (health spending and capital controls) are small but of opposite sign to the fiscal gap. 2/ The various EBA model approaches suggests a modest undervaluation of between 2 and 11 percent (the ES estimate of the REER gap is 5 percent; and the estimated undervaluation using the REER index regression approach is 2 percent and 11 percent using the REER in level). With a qualitatively unchanged policy gaps across the two approaches, but a higher regression residual of 11 percent in the REER levels approach we give more weight to the EBA index REER approach. Staff's assessment of the CA gap range, suggest that the REER is centered on -2.5 with a range of -7.5 to +2.5.

	Russia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) was positive at end-December 2014 at about 18 percent GDP (up from 6 percent in 2013); with gross assets of 70 percent of GDP and liabilities of 52 percent of GDP. Total external debt was 36 percent of GDP. Historically, the NIIP position has not kept pace with the CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows. 1/ **Assessment**. The projected current account surpluses mean that Russia will continue to maintain a positive international investment position, which minimizes risks to external stability. Recent deleveraging reduces risks further.	**Overall Assessment**: *The external position in 2014 was moderately weaker than the level consistent with medium-term fundamentals and desirable policy settings.* *Relative to the 2014 assessment period, the REER has depreciated. This in part reflects the adjustment to a new norm with substantially lower oil prices and sanctions that are affecting medium term growth. The structural implications of the sanctions create exceptional uncertainty when assessing the external position. Nevertheless, staff's initial view is that the depreciation has moved the REER toward a level closer to medium-term fundamentals that have changed materially since the last ESR.* **Potential policy responses**: The nonoil fiscal deficit remains significantly higher than its long-term desirable level and needs to adjust to facilitate a rebalancing from public to private activity, and a re-allocation of government expenditure from current to capital spending. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase public saving that would be matched by both higher private and public sector investment over the medium-term.
Current account	**Background**. From 2000 to 2013, the current account (CA) surplus fell from 18 to 2 percent of GDP despite increasing oil prices, as consumption increased rapidly. A correction, however, is underway with the CA improving to 3.1 percent in 2014 and 4.5 percent in 2015. This improvement took place despite the negative terms of trade shock, as reduced oil export revenue (approximately 5 percent of GDP) was offset by falling absorption due to the real depreciation of the ruble, and tightening of financial conditions. **Assessment**. There are particular uncertainties with the external assessment when oil plays such a dominant role in the economy, compounded now by the uncertain long-term impact of sanctions in saving-investment decisions and therefore the normative external position. 2/Staff believes higher uncertainty warrants higher savings, hence a stronger current account norm than implied by the model. Against this background, staff assesses that the 2014 CA gap was between -3 to 0 percent of GDP. In the medium term, fiscal policy should be tightened to rebuild buffers, save more of the oil wealth for future generations, and counter Dutch disease.	
Real exchange rate	**Background**. The sustained oil price boom and related expansion of domestic demand led to a strong real effective exchange rate (REER) appreciation between 2000 and 2013. The REER has since depreciated 8 percent between 2013 and 2014, and through May 2015, by a further 2 percent on average relative to the average for 2014, despite significant inflation differentials with trading partners. This reflects lower oil prices, sanctions, and the move to a floating exchange rate regime in November 2014. **Assessment**. EBA estimates that the average REER in 2014 was 7 percent overvalued based on the CA regression approach and 10 percent undervalued based on the REER level regression approach (and 13 percent based on the index approach). The latter approach, however, is less reliable in commodity-exporting countries over a period in which commodity prices have been exceptionally high and is discarded from the staff assessment. Based on the current account gap, and taking into account the uncertainties discussed in the current account assessment, staff assesses that the REER was overvalued by 0-10 percent on average during 2014. Staff assess that the recent depreciation has moved the REER toward a level closer to medium-term fundamentals.	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows have picked-up, as the non-bank sector has increasingly found it difficult to rollover existing debt and confidence has deteriorated. Geopolitical tensions and lower oil prices will continue to weigh on the outlook. Over the medium term, structural outflows are expected to decline if Russia improves its investment climate. **Assessment**. While Russia is exposed to risks of accelerated capital outflows and sudden stop of external funding because of the exceptional current geopolitical tensions, large international reserves provide substantial buffers and the new floating exchange rate regime help absorb these shocks.	
FX intervention and reserves level	**Background**. The CBR intervened according to its FX intervention rule in large volumes in 2014 dampening the pace of depreciation before abandoning its managed float policy. The CBR has since moved to a floating exchange rate regime and limited intervention, and in May 2015, started rebuilding reserves as uncertainty remains elevated. **Assessment**. The current level of foreign reserves is adequate according to a range of reserve coverage indicators and is above 150 percent of the IMF's composite reserve adequacy metric. Accumulation of fiscal savings in the oil funds should continue and the current policy of small regular reserve purchases to replenish reserves could be justified by the heightened level of uncertainty related to sanctions and as a buffer given Russia's vulnerability to oil shocks. Large FX interventions should be limited to episodes of market distress.	

	Russia (continued)
Technical Background Notes	1/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The Central Bank of Russia 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. 2/ EBA-estimated 2014 CA norm was 5 percent of GDP; and the cyclically adjusted CA was 2.9 percent. The lower model-based gap relative to 2013 reflects both an improvement in the 2014 CA (from 1.6 percent in 2013) and a small reduction in the estimated current account norm (from 5.2 percent in 2013). This change in the norm broadly reflects two offsetting factors, with lower oil prices reducing the norm by 1 percent and lower medium-term growth increasing the norm by 0.5 percent. The EBA estimated CA norm of 4.8 percent of GDP, rests mostly on the need to save out of income from non-renewable oil exports. Staff's assessment shares this basic logic in also calling for a CA surplus for Russia, but acknowledges that such saving (i.e., refraining from consumption) would not necessarily have to take a financial form, and could in part take the form of productive investment spending, which could justify a somewhat lower CA surplus than the EBA-estimated norm. Sanctions and geopolitical tensions have introduced an additional level of complexity in the external assessment, as they introduce exceptional uncertainty in model based estimates.

	Saudi Arabia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. External assets are substantial at an estimated 140 percent of GDP in mid-2014, while total external liabilities were 36 percent of GDP (portfolio and other investments were 8.3 percent of GDP). All external debt is private. The net international investment position (NIIP) stood between 85 and 105 percent of GDP during 2007-mid-2014. The average return on assets was relatively low at about 2½ percent compared to 5 percent on liabilities during the period. External assets are dominated by international reserves, but details on the composition of external assets are not available. Projections suggest that the NIIP/GDP ratio will remain broadly stable over the medium term. **Assessment**. The external balance sheet is very strong. Substantial accumulated assets represent both savings of the exhaustible resource revenues for future generations and protection against vulnerabilities from oil price volatility.	**Overall Assessment**: *The external position in 2014 was broadly consistent with fundamentals. This assessment takes account of the dominant role of fiscal policy in determining the external position. Projections for 2015 suggest the current account may be weaker than estimated norms. Fiscal policy adjustment will be needed to close the current account gap.* The decline in the oil price reduced the current account surplus in 2014 and is expected to result in a small deficit in 2015. With the forecast trend improvement in oil prices, the current account is projected to improve over the medium term. While a current account gap is projected in 2015, the very strong external balance sheet including high foreign exchange reserves and no significant concerns about capital flows are strong mitigating factors. The current account deficit projected for this year is very small in relation to available buffers. Given the structure of the Saudi economy, with exports dominated by oil and oil-related products, external adjustment will need to be driven by fiscal adjustment rather than exchange rate adjustment. **Potential policy responses**: While sizeable fiscal buffers mean there is no need for a sharp cut in government spending in the face of lower, but uncertain, oil prices, fiscal consolidation is needed. The non-oil fiscal deficit remains significantly above the level implied by intergenerational equity models and at current spending levels fiscal buffers will be significantly depleted. Fiscal adjustment is the key to increasing the current account over the medium-term in line with intergenerational equity needs. Government investment on infrastructure and education is appropriate, but it is important to ensure that this spending is efficiently meeting development needs. Efforts are needed to reduce current spending and increase non-tax revenues.
Current account	**Background**. The current account (CA) surplus in 2014 narrowed to 10.9 percent of GDP from 18.2 percent in 2013. This reflected lower oil revenues and weaker petrochemical prices. [1] The oil price decline is projected to result in a small current account deficit in 2015 as oil export revenues decline by 14 percent of GDP. As oil prices are anticipated to partially recover over the medium term, CA surpluses are also expected to recover (to 5 percent of GDP in 2020). Over the long term, the CA will be determined by: (i) the fiscal strategy chosen—the balance between saving to create an income stream for future generations versus spending on consumption and investment, the latter of which will boost future growth if carried out efficiently; and (ii) the pace of oil extraction and future oil prices. **Assessment**. Saudi Arabia is one of the world's largest oil exporters, with oil exports over 65 percent of non-oil GDP and 80 percent of exports of goods and services. As with other large exporters of nonrenewable resources, it is faced with concerns of intergenerational equity and is affected by oil market volatility. These factors subject its CA to wide swings and the assessment of its external position to considerable uncertainty. Staff's assessment is that there was a negative current account gap in 2014, although the estimated size of this gap varies with the methodology used (from -8.5 to -0.5 percent of GDP, with an average gap of -3 percent of GDP). [2/] However, this gap is driven by current fiscal policy settings. Projections suggest the current account gap may widen in 2015.	
Real exchange rate	**Background**. The Riyal has been pegged to the U.S. dollar at a rate of 3.75 since 1986. The real effective exchange rate (REER) has appreciated by 16 percent over the past year and is currently about 20 percent above its average over the past decade. The REER is mainly influenced by the U.S. nominal exchange rate vis-à-vis trade partners and oil price dynamics (which affect domestic prices through government (and therefore consumer) spending). **Assessment**. Most exports are oil or oil-related products, and exchange rate movements have a limited impact on competitiveness. Rather, external adjustment will come via the impact of fiscal policy on domestic demand and imported goods and services.	
Capital and financial accounts: flows and policy measures	**Background**. Inflows are dominated by FDI, while outflows are largely trade credits and portfolio investment. Capital account restrictions and underdeveloped domestic capital markets continue to limit portfolio and investment inflows, Steps to allow increased foreign investment in the equity market are ongoing. **Assessment**. There are no immediate risks or vulnerabilities associated with capital flows.	
FX intervention and reserves level	**Background**. Saudi Arabia does not have a Sovereign Wealth Fund. The government's foreign assets are held at the central bank within international reserves. International reserves were about 97 percent of GDP (36 months of imports) at end-2014, although they did decline modestly in the final months of 2014. Reserves play a dual role—for both precautionary motives and as savings for future generations. **Assessment**. Reserve assets are more than adequate for precautionary purposes (measured by the Fund's metrics). Nevertheless, a larger current account surplus and resulting NIIP accumulation would be needed to ensure an equitable intergenerational transfer of oil revenues in real per capita terms.	

	Saudi Arabia (continued)
Technical Background Notes	1/ Errors and omissions are estimated at -2 percent of GDP in 2014. 2/ EBA methodology assessments are not available for Saudi Arabia. Staff considered a number of methodologies, including those that incorporate the special intertemporal considerations that are dominant in economies in which exports of non-renewable resources are a very high share of output and exports. Estimates suggest current account norms for 2014 range from 19.4 percent of GDP (external sustainability or ES approach) to 11.6 percent of GDP (MB approach from IMF Country Report No. 13/229) to 11.4 percent of GDP (EBA-lite approach). The corresponding current account gaps are estimated at, respectively, -8.5 percent, -0.7 percent, and -0.5 percent. The estimated fiscal gap in 2014 is 17.7 percent of GDP (derived as the difference between the actual fiscal balance and that consistent with intergenerational equity). If this fiscal gap is closed, the current account gap is eliminated under the ES approach. Consequently, the estimated current account gap under the ES methodology is entirely driven by current fiscal policy settings. The estimated CA gap under EBA-lite reflects a fiscal policy gap (of about -7.5 percent) and a large unexplained residual (of about +7 percent) owing to the fact that Saudi Arabia is a significant outlier in the EBA-lite sample (e.g. due to historically very large and volatile external surpluses).

	Singapore	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) stood at 182 percent of GDP at end-2014, relatively flat since 2011 and significantly lower than the pre-GFC peak of 254 percent of GDP in 2006. Current account and growth projections imply that the NIIP to GDP ratio is likely to rise substantially over the medium term. 1/ **Assessment**. The external balance sheet is not a major source of risk. Potential vulnerabilities posed by the large and mainly short-term gross non-FDI liabilities (487 percent of GDP in 2014)—predominantly cross-border deposit taking by foreign bank branches—are mitigated by banks' large short-term external assets and the authorities' close monitoring of banks' liquidity risk profiles. Singapore also has large official reserves and other official liquid assets. 2/	**Overall Assessment**: *The external position in 2014 was substantially stronger than what is consistent with medium-term fundamentals and desirable policies*. Developments in late-2014 and early-2015; including the decline in the energy bill, is expected to have a small impact on the external position. The assessment for 2014 and the size of the imbalance are subject to a wide range of uncertainty reflecting Singapore's very open economy and position as a global trading and financial center. **Potential policy responses**: From a multilateral perspective, and consistent with the authorities' current policies, increased public spending, a stronger social safety net, a more-even distribution of consumption across generations, helped by an expected slower absorption of foreign workers would contribute to moderate the current account over the medium term.
Current account	**Background**. The large current account (CA) surplus (19.1 percent of GDP in 2014, an increase of 1.2 percent of GDP relative to 2013) reflects a strong goods balance that is somewhat offset by remittance outflows and a negative income balance. 3/ The recent oil price decline led to a significant increase in the oil trade balance (OTB) at the end of 2014 and the first quarter of 2015, and is expected to contribute to an increase in the CA in 2015 (by about 1.5 percent of GDP) assuming that the price decline is sustained. 4/ A weaker outlook for external demand and more accommodative fiscal policies are expected to partially offset this increase. The recent easing of monetary policy through a slightly lower trend appreciation of the nominal effective exchange rate (NEER) band is not expected to materially affect external balance.5/ Overall, the CA is expected to increase by about 1-1.5 percent of GDP in 2015. Structural factors and policies that boost the saving rate such as financial center status, limited social safety nets, high income inequality and the rapid pace of aging combined with a defined-contribution pension scheme are the main drivers of Singapore's strong external position. **Assessment**. Singapore is a small, very open economy that has a large positive NIIP, very high per capita income and is aging at a very high speed. Such non-standard factors make a quantitative assessment of its CA subject to a wide range of uncertainty. Considering a range of estimates (based on EBA-like, EBA-lite and CGER models) staff assesses the 2014 CA as stronger than the level consistent with medium-term fundamentals and desirable policies, by 2 to 8 percent of GDP. 6/	
Real exchange rate	**Background**. The 26 percent appreciation of the real effective exchange rate (REER) since 2005 has raised the REER above its previous peak in the late 1990s. The REER depreciated by 0.2 percent in 2014 and is 0.5 percent lower as of May 2015 relative to the 2014 average. This mainly reflects decelerating inflation but is also contributed by a lower NEER appreciation driven by a strong U.S. dollar and the easing of monetary policy. The recent halt in REER appreciation is expected to reverse over time as the temporary impact of the oil price shock on inflation is reversed in 2016 and domestic demand picks up in response to the large terms of trade shock. **Assessment**. While non-standard factors make a quantitative assessment difficult, staff assesses that the real exchange rate is around 4-16 percent weaker than warranted by medium-term fundamentals and desirable policies. This estimate is drawn from the CA assessment and relies on a semi-elasticity of the CA with respect to the REER of about 0.5, consistent with Singapore's high level of openness. This assessment is subject to a wide range of uncertainty reflecting the uncertainty in the underlying CA assessment and the semi-elasticity of the CA with respect to the REER.	
Capital and financial accounts: flows and policy measures	**Background**. Singapore has a fully open capital account. The financial account deficit tends to co-move with the global financial cycle (i.e. outflows are larger when global financial activity is strong). This reflects in part reinvestment abroad of income from the foreign assets of the official sector (the largest contributor by sector to net financial flows). Financial flows also encompass sizable net inward FDI and smaller but more volatile net bank-related flows.7/ **Assessment**. The financial account is likely to remain in deficit as long as income from NFA is reinvested abroad.	
FX intervention and reserves level	**Background**. With the NEER as the intermediate monetary policy target, intervention is undertaken to achieve inflation and output targets. Singapore's official reserves declined by 10 percent (28.5 billion USD) since mid-2014, reflecting valuation changes. 8/ As a financial center, prudential motives call for a large NIIP buffer, also in the form of reserves. **Assessment**. At end-Q42014, official reserves covered about 25 percent of short-term external debt. However, reserves are far in excess of thresholds for other adequacy metrics. 9/ While non-standard factors warrant generous reserve buffers, current levels appear adequate and there is no case for further accumulation for precautionary purposes.	

	Singapore (continued)
Technical Background Notes	1/ Valuation changes have been an important driver of changes in the NIIP, given the large gross assets and liabilities. 2/ Singapore's official reserves amounted to about 87 percent of GDP in 2014. 3/ Singapore has a negative income balance despite its large and positive NIIP position. This reflects the lower rate of return earned on its foreign assets relative to the return paid on its foreign liabilities. The lower return on foreign assets may reflect the fact that the composition of Singapore's assets is tilted towards portfolio whereas the composition of its liabilities is tilted towards foreign direct investment. 4/ Singapore is a net oil importer, with a net oil trade balance of -5.6 percent of GDP in 2013. The net oil balance would be smaller if one takes into account the high imported petroleum product content in Singapore's exports of petrochemicals and other oil intensive products and services like water transportation. In addition Singapore has some sectors that are closely linked to investment in the oil sectors such as production of oil rigs. The decline in investment in the oil sector is expected to reduce Singapore's exports of these products, in particular if the oil price decline is sustained. 5/ The recent monetary policy easing in January involved a slight decline in the trend appreciation of the NEER band from an estimated 2 percent to 1 percent per annum, and was motivated by the slowdown in inflation amid a closing output gap and weak external demand. 6/ Non-standard factors make quantitative assessment of Singapore's external position difficult and subject to significant uncertainty. Singapore is not in the sample used to estimate the EBA models because it is an outlier along several dimensions (e.g. the NFA position, per capita income, fiscal balance and the aging speed) and nonlinearities in their impacts on the CA would not be captured in the EBA framework. That said, the EBA CA framework, appropriately adjusted for the special characteristics of Singapore, can still be informative. Applying the EBA coefficients to Singapore suggests that the CA surplus is mainly explained by the high level of productivity, the large fiscal surplus and high rate of aging, plus a dummy regressor for status as a financial center, and its large NFA position. The EBA-estimated CA gap is about 6 percent of GDP (relative to a cyclically-adjusted level of the CA of about 19.5 percent of GDP in 2014). Of that, about 1 percentage point of GDP is identified as policy gaps (driven by the fiscal balance and public spending on health care) and the remaining 5 percentage points of GDP is the residual. However, that estimated CA surplus norm could be overstated, in particular if the high NFA level is interpreted as a byproduct of past excessive surpluses. 7/ The latter is the result of considerably larger gross inflows and outflows. 8/ There was also a large decline in the central bank's FX swap positions by 23.5 billion USD. Based on a statement issued by the central bank, most of the receipts from maturing swaps were transferred to the sovereign wealth fund for longer term investment. 9/ 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 located in reserve-currency countries or currency unions.

	South Africa
Foreign asset and liability position and trajectory	**Background**. Gross external debt increased to 41 percent of GDP in 2014 from 26 percent in 2008, of which 10 percent of GDP was short-term. About 55 percent of external debt is denominated in rand. Total gross external liabilities amounted to 130 percent of GDP at end-2014, of which about 34 percent were direct investments, 35 percent were portfolio equity liabilities, 15 percent were portfolio debt liabilities, and the remainder were other investments. **Assessment**. Large gross external liabilities pose risks. However, these risks are mitigated by a large external asset position resulting in a small negative net IIP position (-11.5 percent of GDP).
Current account	**Background.** The CA deficit narrowed to 5.4 percent of GDP in 2014, from 5.8 percent in 2013, on the back of weak non-oil imports. As a net oil importer (by more than 4 percent of GDP in 2014), South Africa will benefit from lower oil prices, though this effect will be partly offset by the fall in export prices and the increase in the volume of fuel imports. The CA deficit is projected to narrow to 4.8 percent of GDP in 2015. **Assessment.** The EBA estimates a CA norm of -1.9 percent of GDP and a gap of -3.5 percent of GDP for 2014, largely explained by the regression residual as South Africa's main policy challenges are structural and not captured by the EBA framework. Staff assesses the CA to be 1½ to 3½ percentage points weaker than implied by medium-term fundamentals and desirable policy settings in 2014.[1] The projected decline in the CA deficit would narrow the CA gap in 2015. However, the CA deficit is projected to remain above the desired level, keeping the external position weaker than fundamentals.
Real exchange rate	**Background.** The CPI-based REER depreciated by 21 percent since end-2010 (6 percent on average in 2014 compared to the 2013 average), having almost reversed the appreciation of 2009-10. The ULC-based REER has registered a similar depreciation since end-2010, but remains 25 percent more appreciated than at end-2008. The EBA REER regressions (which use the CPI-based REER) point to undervaluation for 2014.[2] However, other indicators, including the EBA CA regression approach and South Africa's declining share in world's exports, suggest overvaluation. As of May 2015 the REER was little changed from its 2014 average. **Assessment**. Consistent with the assessment of the CA gap, staff assesses a REER overvaluation of 5-20 percent for 2014.[3] If the CA gap narrows as expected in 2015, the assessed overvaluation would decline. But the extent of overvaluation is difficult to pinpoint and adjustment will mainly have to come from reforms that tackle the economy's structural impediments.
Capital and financial accounts: flows and policy measures	**Background.** Net FDI declined to -0.4 percent of GDP in 2014. Portfolio, other investment flows, and unrecorded transactions accounted for most of the financing of the CA deficit. Gross external financing needs amounted to 16.5 percent of GDP in 2014. **Assessment.** The risks posed by the reliance on non-FDI flows and nonresident holdings of local financial assets are significant, but mitigated by the floating exchange rate, the fact that the portfolio inflows go into long-term local currency bonds and equities, the large share of index-tracking investors, and the large domestic institutional investor base. Nevertheless, a sharp slowdown or sudden reversal of capital inflows would complicate the financing of the CA deficit.
FX intervention and reserves level	**Background**. South Africa has a floating exchange rate regime. Foreign exchange intervention is rare. Reserves cover about 94 percent of gross external financing needs and over five months of imports, but are below the IMF's composite adequacy metric (at 80 percent of the metric without considering capital flow management measures, and 88 percent of it considering them). Gold reserves account for about 11 percent of reserves. **Assessment**. As financing conditions allow, reserve accumulation is desirable (with or without considering capital flow management measures), subject to maintaining the primacy of the inflation objective.

Overall Assessment

Overall Assessment:
The external position in 2014 was weaker than implied by desirable policy settings and medium-term fundamentals Subsequent developments as of May 2015 would tend to strengthen the external position, but not enough to change the overall assessment.

The decline in oil prices is anticipated to lower the CA deficit in 2015, but this will remain elevated and mainly financed by non-FDI flows. Despite the REER depreciation of recent years, structural constraints are slowing the CA adjustment. Gross external financing requirements are relatively high, posing vulnerabilities. A reduction in capital inflows would complicate the financing of the CA deficit and, if severe, could induce a significant growth slowdown.

Potential policy responses:
Improving energy availability is key to boost exports and lower the current account deficit. Implementation of the authorities' National Development Plan would help improve competitiveness over the medium term, but additional labor and product market reforms are also essential.

Fiscal consolidation would help alleviate external vulnerabilities. A build-up of reserves would strengthen the country's ability to deal with FX liquidity shocks.

	South Africa (continued)
Technical Background Notes	1/ The CA gap presented here results from the CA regression approach and the External Sustainability (ES) approach. The ES approach compares the CA balance expected to prevail in the medium term with the one that would stabilize South Africa's stock of net foreign assets at its EM peers' benchmark (-35 percent of GDP). According to this approach, to stabilize South Africa's net IIP at the peers' level, South Africa's CA deficit would need to be less than 2 percent of GDP, compared to staff's projection of a CA deficit of about 4- 4½ percent of GDP over the medium term. The CA regression approach yields a gap for 2014 of -3.5 percent of GDP. Hence, the staff's gap range for 2014 is centered on -2½ percent of GDP. 2/ The EBA REER Index regression approach gives an undervaluation of 23 percent for 2014. The newly introduced REER Level regression approach estimates an undervaluation of 7 percent for 2014, even with a significant decline of the fitted real effective exchange rate since 2005. However, gauging the appropriate exchange rate for South Africa is challenging due to its structural changes since 1994 and high REER volatility. The history of South Africa's REER divides roughly into two periods and levels: before 2000 the average level was much higher than the post-2000 average. Moreover the REER has fallen steeply over the last several years. In this context, REER regression-based models such as EBA that use CPI-based REERs are very likely to point to undervaluation, unless they can link the full downward trend of the REER to deteriorating fundamentals. Also, the sensitivity of trade flows to the exchange rate movements appears lower than implied by long-run elasticities as structural impediments, including electricity shortages, prolonged strikes, and concentrated product markets, hamper adjustment. It appears that the level of the REER that is consistent with a given level of the current account has declined over time, but empirical models are unable to fully explain this shift. 3/ Using the CA gap range and applying a long-run elasticity estimate would suggest a REER overvaluation of about 5-12 percent. However, considering the uncertainty regarding the elasticity and the possibility that it may be lower, the overvaluation range is assessed to be 5-20 percent.

	Spain	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) liabilities dropped from -34 percent of GDP in 2000 to –91 percent of GDP in 2009, driven mainly by substantial current account (CA) deficits but also reflecting valuation effects. The current account improved subsequently, but the NIIP remains elevated at –93 percent at end-2014. High gross external debt has stabilized around 160 percent of GDP. **Assessment**. The large negative NIIP comes with external vulnerabilities, including from valuation changes and the large gross financing needs from external debt. Mitigating factors are a favorable maturity structure of Spain's outstanding sovereign debt with an average of 6 ½ years and current ECB measures such as QE.	**Overall Assessment**: *The external position in 2014 was substantially weaker than that consistent with medium-term fundamentals and desirable policy settings.* *As of May 2015, the impact of lower oil import prices and REER depreciation is broadly offset by strong domestic demand growth. However, these recent developments do not change the overall assessment.* In particular, despite the strong improvement in the current account since the pre-crisis peak deficit in 2007, achieving both a sufficiently declining IIP and much lower unemployment would require a substantially weaker real effective exchange rate. **Potential policy responses**: The authorities' recent reforms and policy plans to deliver gradual fiscal consolidation, further improve active labor market policies, foster corporate and household debt restructuring, and to advance product market reforms, are in line with reducing imbalances. A more ambitious fiscal adjustment would lead to a faster improvement of the current account. In the medium term, further structural reforms of the labor market and accelerated implementation of product market reforms would be required to speed the adjustment. Continued monetary easing at the euro area level—motivated by the need to raise the prospects of achieving the ECB's price stability objective and to support demand, given the weak and fragile growth, large output gaps and very low inflation for the euro area as a whole—would also support Spain's adjustment efforts.
Current account	**Background**. With imports accelerating along with the recovery, the CA declined to a 0.8 percent of GDP surplus in 2014 (or -0.5 percent of GDP cyclically adjusted) after a 1.4 percent surplus in 2013 and a peak deficit in 2007 of 10 percent of GDP. Since 2014, the sharply lower oil price helped reduce overall import costs, partly offsetting higher import growth following the surge in domestic demand. The depreciation of the euro positively contributed to Spain's exports outside the Euro zone, while ECB measures have helped to drive down interest rates on external debt. **Assessment**. Although the EBA model-based estimates of current account norms would suggest a balanced CA for 2014 (0 percent of GDP), the staff assessment considers the overriding need to sharply improve the NIIP and gauges the 2014 cyclically-adjusted CA to have been 0.5-2.5 percent of GDP weaker than desirable. Surpluses of this magnitude will need to be maintained until the NIIP is at safer and sustainable levels. Under staff's current forecast, a gradually improving current account will improve the IIP by about 3-4 percent of GDP annually in the medium term. To the extent the output gap is larger, for example, reflecting a structural level of unemployment closer to international peers, the cyclically-adjusted current account would be lower and thus the gap with respect to the desirable level larger.	
Real exchange rate	**Background**. By 2014, the CPI-based real effective exchange rate (REER) had declined by 1 percent from its 2013 level, and by 3 percent from its 2008 peak, only a limited reversal of the almost 12 percent appreciation since euro entry. The ULC-based REER, however, shows the appreciation has been substantially reversed since that time, largely reflecting substantial labor shedding. Export market shares have been resilient. Recently, as of May 2015, the REER has depreciated by 5 percent from its 2014 average. **Assessment**. The two EBA REER regression model approaches, the "index" and "level" REER tools, estimate an overvaluation of 13.3 and 10.3 percent for 2014, respectively (with reference to the CPI-based REER); a historical REER (CPI and ULC based) and other model-based analysis, including taking into consideration IIP sustainability, suggest the overvaluation may be smaller. On balance, staff assesses a 2014 gap of around 5 to 10 percent above the level consistent with medium-term fundamentals and desirable policies. However, as for the current account analysis, achieving significantly lower unemployment rates closer to international peers in the medium term would likely imply a larger gap.	
Capital and financial accounts: flows and policy measures	**Background**. Since mid-2012, financing conditions have greatly eased, with sovereign bond yields near historical lows, non-resident portfolio inflows have resumed, and ECB borrowing has fallen significantly. **Assessment**. The ECB's actions as well as domestic reform progress have greatly helped improve investor sentiment. However, large external financing needs both in the public and private sector leave Spain vulnerable to sudden changes in market sentiment and spillovers from Europe.	
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.	

	Spain (continued)
Technical Background Notes	1/ The EBA CA regression-based approach estimate would suggest that a balanced CA (0 percent of GDP) would be appropriate for Spain. However, the empirically-based EBA norm is not an appropriate basis for a normative CA assessment for an economy with an extremely negative NIIP. The staff assessment is thus based on higher norm level that is consistent with the overriding need to substantially strengthen the external balance sheet.

	Sweden	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The Swedish net IIP has improved by 14 percentage points in 2014 to -4 percent of GDP. It is estimated to improve further in the medium term, reflecting projected current account surpluses. However, there has been a large discrepancy between the recorded net IIP and the notional balance implied by cumulative current account balances. This is explained in part by negative valuation effects and the large net errors and omissions. **Assessment**. Gross assets are at about 290 percent of GDP and gross liabilities at about 294 percent of GDP in 2014. More than one-third of the latter are external debt liabilities (about 110 percent of GDP), including liquid liabilities from Sweden's large banking sector. While Sweden's safe haven status moderates risks, sizable gross liabilities create vulnerabilities.	**Overall Assessment**: *Sweden's external position in 2014 was moderately stronger than the level consistent with medium-term fundamentals and desirable policies. As of May 2015, subsequent developments do not point to a clear change in the external position.* This comes despite an absence of obvious policy distortions affecting the current account or the exchange rate. As currently specified, EBA models suggest a lower current account norm. However, these estimates do not capture difficult-to-model structural factors, including Sweden's very large financial sector, demographic pressures, merchanting trade center, fully funded pension schemes, and recent structural policy reforms. **Potential policy responses**: Current account and exchange rate trends likely reflect a variety of structural factors, while clear and substantial policy distortions are absent. Hence, current policies in place are broadly appropriate.
Current account	**Background**. The current accounts balance was 6.3 percent of GDP in 2014, about 1 percentage point lower than 2013. This mostly reflects stronger domestic demand and weak export demand, whereas lower oil prices and the weaker *krona* worked in the opposite direction. The *krona* continued to depreciate in effective terms in early 2015 as the stronger dollar compensated for the appreciation against the euro in March. Over the medium-term, the current account is expected to decline moderately, from 6.3 percent in 2015 to 5.6 percent in 2020, mostly reflecting stronger domestic demand contributions to growth. **Assessment**. The cyclically-adjusted current account was 6.3 percent of GDP in 2014, which is 7.4 percentage points above the cyclically adjusted EBA norm estimate (of -1.1 percent of GDP). However, there are no clear and substantial policy distortions that can be pointed to and a high saving rate, including high pension contributions driven by a phased shift to a defined contributions pension scheme, is not unusual for an aging society. In addition, other structural factors, such as Sweden's large financial sector and its export structure, may not be fully captured by the EBA model. This suggests that substantial surpluses are likely to persist into the medium term. Staff assesses Sweden's adjusted current account norm to be around 2½ to 6½ percent of GDP, implying a current account gap in the range of -½ to 3½ percent of GDP in 2014. 1/	
Real exchange rate	**Background**. After a period of strong appreciation driven by safe-haven flows in the aftermath of the crisis, Sweden's strong fiscal position, and robust growth performance, the Swedish *krona* depreciated in real effective terms by about 5 percent in 2014 (year average, relative to 2013 average). Since early 2015, the *krona* has fluctuated but most recently strengthened against the euro, largely reflecting the effects of the monetary policy decisions by the ECB and Riksbank. As of May 2015, the REER had depreciated by 7.4 percent relative to its 2014 average. **Assessment**. EBA estimates using the REER level and index approaches suggest an undervaluation of 6.8 and 10.3 percent, respectively, for 2014. However, consistent with staff's estimates of a smaller current account gap using the macroeconomic balance approach, the real exchange rate gap is assessed to be in the range of -10 to +2 percent.	
Capital and financial accounts: flows and policy measures	**Background**. The surplus in the current account is balanced by the financial account (mainly portfolio investments). Given their size and funding model, Sweden's large banks remain vulnerable to liquidity risk stemming from global wholesale markets even though banks have improved their structural liquidity measures in recent years. **Assessment**. A further rebalancing of flows, with a drop in short-term flows in favor of longer maturities, is desirable. Macroprudential policies, including stricter capital requirements on domestic banks, raising funding stability standards, and accelerating mortgage amortization on the household side, can play an important role in this rebalancing process.	
FX intervention and reserves level	**Background**. The exchange rate is freely floating. Foreign currency reserves remained constant at USD 53.3 bn in December 2014, which is equivalent to about 42 percent of the Swedish banks' short term foreign current liabilities, after the Riksbank boosted borrowed currency reserves by about one-third in early 2013. **Assessment**. Given the large gross external liabilities of banks, maintaining FX liquidity buffers—in the form of reserves and swap lines—is a helpful policy; the current level of foreign currency reserve holdings appears broadly appropriate.	

	Sweden (continued)
Technical Background Notes	1/ The EBA CA regression model leaves Sweden with an unexplained positive residual that is both unusually large and very persistent. Alternative specifications that provide a closer fit for Sweden, including accounting for cross-country heterogeneity, household pension contributions, and fixed effects suggest that the CA norm would be on average about 5½ percentage points higher than EBA estimates. Several factors play a role in this regard. First, Sweden's dependency ratio has persistently ranked among the highest in the EBA sample, and there is evidence that the current EBA model substantially understates the implications of this for Sweden's CA norm. For example, the residuals from the standard EBA model display a strong positive correlation with Swedish household contributions to funded pension schemes, which suggests that the schemes' fund allocation to foreign assets is playing a role. Moreover, while Sweden currently is not classified as a financial center in the EBA model, its banking sector is very large (with assets of over 400 percent of GDP) and serves as a financial center for the Nordic-Baltic region. Taking this into account also raises the implied CA norm (the relatively large degree of uncertainty around the CA norm is typical for large financial centers). Finally, Sweden ranks among the countries with the largest share of merchanting trade—a business model that has been shown to lead to larger CA balances—so accounting for this would further raise the estimated CA norm.

	Switzerland	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Switzerland is a financial center with a positive net international investment position (NIIP) of about 120 percent of GDP and large gross foreign asset and liability positions of 624 and 504 percent of GDP, respectively. The NIIP to GDP ratio has been volatile with no significant trend over the last 10 years, despite large current account surpluses. The ratio is projected to rise moderately in the medium term as recent exchange rate appreciation contributes to a wider output gap and significant inflation undershooting, both of which will temporarily depress nominal GDP growth. Over the longer run, the ratio is expected to stabilize and then decline modestly. **Assessment**. Switzerland's large gross liabilities and the volatility of its capital flows present risks, but these are mitigated by Switzerland's large net asset position and foreign reserves.	**Overall Assessment**: *In 2014, the underlying external position was broadly consistent with medium-term fundamentals and desirable policy settings.* This assessment takes into account measurement anomalies in the Swiss balance of payments. *After the significant REER appreciation in early 2015, the external position will likely weaken.* **Potential policy responses**: Monetary easing, perhaps via a schedule of FX purchases (given limited options for other methods of monetary easing), would help limit the near-term growth slowdown, reduce risks of inflation expectations becoming anchored at low levels, and lessen franc overvaluation.
Current account	**Background**. Switzerland has a moderate to large CA surplus, dominated by net investment income and goods balance. Preliminary estimates from the authorities indicate a surplus of 7 percent of GDP in 2014, down from 11 percent in 2013, reflecting mainly a decline in primary income. Correcting for net foreign ownership of FDI retained earnings and other factors (e.g., merchanting exports) that have a tangential relation to the real Swiss economy would further reduce the "true" CA surplus. 1/ **Assessment**. The EBA CA regression approach estimates a CA gap of around 0.7 percent of GDP, reflecting a cyclically-adjusted current account surplus of 7.5 percent of GDP and an EBA CA regression-estimated norm of 6.8 percent of GDP. However, Switzerland's current account surplus is misleadingly high because it is driven by non-traditional flows—such as merchanting activities, commodity trading, financial and insurance services, and net FDI earnings—that are highly affected by the operations of large multinationals, financial firms, and wealthy foreigners, whose savings may not be fundamentally Swiss. The CA assessment is subject to unusually high uncertainty, given these anomalies, the high volatility of income flows, and the potential for large revisions to the preliminary 2014 CA estimate. Taking these considerations into account, staff assesses a CA gap for 2014 ranging from -3.5 to 2.5 percent of GDP. The CA gap is expected to become more negative in the near term due to REER appreciation so in far in 2015, which will adversely affect competiveness.	
Real exchange rate	**Background**. The REER (CPI basis) appreciated by 26 percent from 2007 to 2011. In September 2011, the SNB established a floor of 1.20 for the CHF/EUR exchange rate, and the REER depreciated by 4 percent during 2011–14. The SNB exited from the floor on January 15, 2015. As of May 2015, the REER has appreciated by 10 percent from its average 2014 level. **Assessment**. The EBA REER index and level regression-based estimates suggest that the average REER in 2014 was overvalued by 11 and 13 percent, respectively, relative to its fundamentals and desirable policy settings. Taking into consideration these estimates, the somewhat smaller estimates implied by staff's CA assessment, and staff's broader analysis, staff assesses that the franc was broadly in line with fundamentals in 2014 (overvalued by 0–10 percent). Overvaluation likely increased in 2015 due to the appreciation so far this year.	
Capital and financial accounts: flows and policy measures	**Background**. Significant net outward FDI (mostly reinvested earnings) has been a consistent feature of the financial account in recent years, although bank lending flows have become critical since the crisis. The SNB absorbed very large safe-haven inflows (intermediated by the banking system) during 2009–12 through reserve accumulation. **Assessment**. Safe-haven capital inflows may return in the event of a re-emergence of euro area stress, an intensification of EM turmoil (including due to a disorderly UMP exit by major central banks), or political risks.	
FX intervention and reserves level	**Background**. The SNB accumulated foreign exchange reserves of about 70 percent of GDP during 2009–14 in various rounds of intervention, including to defend the CHF/EUR floor. At end-2014 the SNB's balance sheet was approaching 90 percent of GDP. The SNB exited from the floor on January 15, 2015. The franc has since floated between 1.00–1.10 CHF/EUR, with the SNB intervening occasionally (mainly in the immediate aftermath of the exit from the floor). **Assessment**. Reserves are large relative to GDP but more moderate relative to external liabilities. Substantial reserves are explained in part by the volatility of capital flows. In recent years, interventions have been monetary policy operations aimed at avoiding persistent inflation undershooting and given the limited supply of domestic assets available for purchase. Interventions have also helped limit exchange rate overvaluation.	

	Switzerland (continued)
Technical Background Notes	1/ Swiss multinational firms are often partly owned by foreigners through portfolio shares. Thus, a part of the retained earnings of these companies, which form a large component of Swiss current account receipts, should be attributed to foreign shareholders, rather than counted as domestic income. See T. Mancini-Griffoli and N. Stoffels, "Adjusting the Current Account to Better Capture Wealth Accumulation," mimeo, Swiss National Bank, August 2012. See also Annex 1 to the 2015 Article IV staff report.

	Thailand	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) had been improving steadily from a large deficit in 2000 (-48 percent of GDP), until 2009, when the NIIP came close to balance (-2 percent of GDP). Subsequently, large increases in direct and portfolio investment valuations raised foreign liabilities and lowered the NIIP to -23 percent of GDP in 2014. Net foreign liabilities are expected to remain broadly stable going forward. **Assessment**. The deterioration of the NIIP during 2010–2014 appears to be due largely to valuation changes as, on average, the current account was in surplus. There are limited risks to external debt sustainability because Thailand's external debt is projected to remain low and net foreign liabilities (as a percent of GDP) are expected to stabilize. That said, the relatively high share of short-term external debt in total external debt (almost 40 percent) needs close monitoring. 1/	**Overall Assessment**: *The external position in 2014 was broadly consistent with medium-term fundamentals and desirable policy setting.* Developments in late-2014 and early-2015, including the significant decline in commodity prices, the REER appreciation in early 2015, and the easing of monetary policy stance, are not likely to change the overall assessment for 2015. However, this assessment and the size of the imbalance are subject to a wide range of uncertainty reflecting Thailand's open economy, changing terms of trade (TOT) and REER, and political uncertainties. **Potential policy responses**: A medium-term infrastructure investment policy is key to unlocking growth by boosting private investment, which would justify a temporary increase in the current account deficit. The authorities should continue to allow the exchange rate to move flexibly Reserves are more than adequate and intervention should be limited to smooth excessive volatility. Despite the low-interest-rate environment, there are no signs of growing financial imbalance and hence no reason to tighten macroprudential policies.
Current account	**Background**. Thailand's current account (CA) has been volatile over the last decade, ranging from a 4¼ percent of GDP deficit in 2005 to a 8¼ percent of GDP surplus in 2009, against the backdrop of a relatively stable trend real appreciation and volatile economic fundamentals. The current account surplus came down sharply from its peak in 2009 at 8¼ percent of GDP to -0.6 percent in 2013 and rose to 3.2 percent in 2014, and is expected to narrow and remain close to balance over the medium term. 2/ **Assessment**. The high CA surplus in 2014 was mainly due to commodity price declines (the net oil trade balance in 2014 was -5 percent of GDP) and import compression. The latter is expected to be temporary and is associated with the large and adverse impact of political events on aggregate demand in 2014, as well as delays in executing planned public investment (about 3 percent of GDP). The EBA CA model estimate of a gap of 3.5 percent of GDP is adjusted to be 1.2 percent of GDP (3.5 minus 2.3 percent of GDP due to oil price declines and import compression) in 2014. Similarly, in cyclically adjusted terms, the EBA estimated CA norm and CA outcome are -0.6 and 0.7 percent of GDP, respectively. After accounting for Thailand-specific factors, staff assesses Thailand's 2014 CA to be close to the level consistent with medium-term fundamentals and appropriate policies with a CA gap between -1 and 1 percent of GDP. Overall, the CA in 2015, which is projected at 4.2 percent of GDP, is not likely to change the overall assessment of the external position as consumers and businesses are expected to gradually increase spending. 3/	
Real exchange rate	**Background**. Barring the global financial crisis, the Thai baht generally has been appreciating in real effective terms since 2005. After appreciating strongly during late 2012 and the first four months of 2013, the real effective exchange rate (REER) weakened until the first half of 2014 and then strengthened in the second half of 2014.The REER (annual average) in 2014 was about 3.2 percent weaker than its 2013 average level. Compared with 2014 average, the latest REER (May 2015) appreciated by 3 percent. 4/ **Assessment**. Staff assesses the 2014 REER to be broadly consistent with medium-term fundamentals and appropriate policies, within a range of -5 percent below to +5 percent above such a level. Looking forward, the REER appreciation in early 2015 might be more than offset by depreciation in later part of 2015 as the impact of the oil price shock on inflation persists and U.S. monetary policy tightens.	
Capital and financial accounts: flows and policy measures	**Background**. The capital and financial account balance turned negative in 2014, from a balance in 2013. Net equity and bond inflows declined and became negative in 2013 and 2014 due to Fed's tapering talk and political uncertainties. **Assessment**. While capital flows to banks reflect mostly hedging activities of the trade sector and therefore follow the trade balance, portfolio flows benefited from the relatively better fundamentals of the economy compared with advanced economies, but faced headwinds from the asynchronous monetary policies of AEs,, emerging market sell-offs and political uncertainties. The authorities have allowed exchange rate flexibility to smooth capital flow volatility. Capital inflows are expected to continue, partially offset by outward investment as the authorities push forward with their financial account liberalization plans.	
FX intervention and reserves level	**Background**. The exchange rate is largely floating with no evidence of significant intervention. In 2014, international reserves declined primarily on valuation changes. Gross official reserves were about 45 percent of GDP in 2014, over three times short-term debt, and above the IMF's composite adequacy metrics (187 percent of the IMF's metric unadjusted for capital controls and 222 percent of the metric adjusted for capital controls). The Bank of Thailand's net forward FX position has declined to six percent of GDP in 2014. **Assessment**. Thailand's gross reserves are more than adequate and there is no need to build up reserves for precautionary purposes. The exchange rate should continue to move flexibly in response to domestic and external shocks, including volatile capital flows. 5/	

	Thailand (continued)
Technical Background Notes	1/ The valuation effect results from the difference in returns between portfolio inflows and outflows. On the one hand, large capital inflows in most years in the period 2005-2012 contributed to growth of asset prices and baht appreciation. As a result, investment returns accruing to foreign investors increased. On the other hand, a large proportion of Thailand international investment assets consists of foreign exchange reserves, which were mainly invested in foreign government bonds with lower return. 2/ Since total imports and net imports of oil products account for 11 percent and 5 percent of GDP, respectively, the recent oil price decline led to a significant improvement in the oil trade balance (OTB) in 2014, and is expected to contribute to an additional increase in the CA surplus in 2015, assuming that the price decline is sustained. The gains from oil price declines are shared by consumers (reduction in gasoline retail price), government (reinstating excise tax on diesel), and the oil fund (established by the government to alleviate the impact of volatile global oil prices). 3/ Thailand's volatile CA reflects a changing saving-investment balance with fluctuating investment arising from various shocks. In addition, Thailand is a net importer of oil and net exporter of rice and rubber, and the gain for OTB is larger than the export losses from price declines in rice and rubber. Though volatile in recent years, public investment declined in 2014 due to political instability. The delay in public investment also contributed to a decline in private investment. Therefore, falling fixed investment led to import compression and a larger CA surplus in 2014. In 2015, continued weak growth in Europe, the slowdown in China, and an increase in non-oil imports associated with higher public investment are expected to partially offset the increase in the OTB. 4/ The REER depreciation in 2014 reflects decelerating inflation and a decline in the NEER in the first half of 2014 driven by a strong U.S. dollar and an accommodative domestic monetary policy. 5/ The authorities of Thailand have argued that *de jure* measures of capital controls (as used in constructing the capital control-adjusted metric) overstate the de facto capital account restrictions in Thailand.

	Turkey	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Turkey's net international investment position (NIIP) is somewhat weaker than those of peers. The NIIP deteriorated to about -55 percent of GDP at end-2014 from -48 percent in 2013, Moreover, the composition of foreign liabilities has worsened in recent years, with short-term debt liabilities accounting for 16 percent of GDP. **Assessment**. The composition of foreign liabilities exposes Turkey to liquidity shocks. Moreover, if the current account deficit does not narrow substantially in the years ahead, Turkey's NIIP would continue to deteriorate by some 10-15 percent in the medium term, magnifying the challenge.	**Overall Assessment**: *In 2014, Turkey's external position was weaker than the level consistent with medium-term fundamentals and desirable policy settings.* *Developments so far in 2015 suggest some strengthening of the external position, mainly due to a terms of trade gain from lower oil import prices.* However, net international reserves are still low, and the NIIP will continue to deteriorate until the CA deficit is narrowed. Moreover, given large financing needs and short-term nature of capital inflows, Turkey remains vulnerable to capital flow reversal. **Potential policy responses**: Reducing further the CA deficit is necessary to diminish vulnerabilities. Monetary policy should keep real interest rates solidly in positive territory. The CBRT should increase net international reserves, limiting foreign exchange intervention to smoothing periods of excessive volatility. Structural reforms aimed at increasing private sector saving, including pension reform, are needed to enhance private saving and allow high growth with a sustainable current account deficit. These reforms should be supported by fiscal policy tightening over the medium term to increase public saving.
Current account	**Background**. The current account (CA) deficit narrowed to 5.8 percent of GDP in 2014, due to less gold imports, weaker economic activity, and lower oil import prices. The EBA model estimates that the underlying CA in 2014 was some 4 percent of GDP weaker than the level implied by medium-term fundamentals and desirable policies. The CA deficit is expected to decrease further in 2015 as the effects of lower energy import costs are fully reflected. 1/ **Assessment**. Staff assesses that the CA gap in 2014 was in the range of – 2 to – 4 percent of GDP, consistent with EBA estimates. While lower oil prices and the restrictive impact of tightening of financing conditions are expected to reduce the CA deficit and gap for 2015, tighter monetary and fiscal policies are still necessary to reduce the CA remaining gap.	
Real exchange rate	**Background**. The real effective exchange rate (REER) has fluctuated considerably in recent years; for 2014 it depreciated by 5 percent from 2013 on a year average basis. The EBA REER index approach estimates 6.4 percent overvaluation in 2014; the REER Level regression suggests 17 percent overvaluation. The external sustainability approach estimates that about 10 percent REER adjustment is required to stabilize net foreign assets. As of May 2015 the REER fell close to its 2014 average level as lira depreciated vis-a-vis the US dollar. **Assessment**. Consistent with the assessment of the CA gap, staff assessment is that REER was overvalued by about 5-10 percent in 2014. As of early 2015, the improved terms of trade, combined with a broadly unchanged REER, would suggest some reduction in the REER gap.	
Capital and financial accounts: flows and policy measures	**Background**. Turkey has received substantial capital inflows in recent years. In 2014 net inflows (including US$2.2 bn in net errors and omissions) weakened and amounted to some 5.4 percent of GDP. Short-term debt remains the predominant financing instrument. Turkey has in the past experienced frequent episodes of strong capital flow reversals. Turkey has not made use of capital controls on inflows or outflows. **Assessment**. Short-term debt exposes Turkey to significant rollover risks. Gross external financing needs are estimated at over 25 percent of GDP in 2015, making Turkey vulnerable to changes in global market conditions.	
FX intervention and reserves level	**Background**. The exchange rate is floating, along with occasional intervention. Since June 2013, the central bank sells foreign exchange to commercial banks through regular auctions. The cumulative total amount of these sales reached US$ 17.6 billion in 2013 and fell to about US$ 10 billion in 2014. Turkey's gross reserves equaled 95 percent of the IMF composite adequacy metric at end-2014 (same as at end-2013). Adjusting the level of reserves for ROM-related reserve holdings reduced it to 72 percent of the composite adequacy metric in the end of 2014. Reserve cover of short-term debt on a remaining maturity basis declined marginally to 76 percent at end-2014. 2/ Taking into account the CA deficit that needs to be financed, reserve cover drops to 65 percent. Thus, reserves available for intervention are significantly lower than gross reserves. **Assessment**. Given Turkey's low net international reserves, reserve accumulation is warranted.	

	Turkey (continued)
Technical Background Notes	1/ The windfall of lower energy prices is estimated at about 2.5 percent of GDP in 2015. Oil trade balance was -5.8 percent of GDP on average in 2010-2014. 2/ ROM (Reserve Option Mechanism) allows commercial banks to meet their reserve requirements on lira-denominated liabilities by using foreign exchange and gold.

<table>
<tr><th></th><th>United Kingdom</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The net international investment position (NIIP) stood at -20 percent of GDP in 2014. The revised series shows a declining external position from 2011. Staff projections for the current account and GDP suggest that the official NIIP to GDP ratio would stabilize at around -45 percent by 2020. 1/
Gross assets and liabilities are more than 500 percent of GDP, reflecting the international activities of large financial institutions.
Assessment. The NIIP and sustainability issues are not yet a concern. But fluctuations in the underlying gross positions are a source of external vulnerability to the extent that they could lead to large changes in the net position.</td><td rowspan="5">Overall Assessment:
The external position in 2014 was weaker than implied by medium-term fundamentals and desirable policy settings. The real exchange rate appreciation seen so far in 2015 may further weigh on the external position.
External deficits reflect insufficient public and private saving rates. The external position is influenced by the lack of competitiveness and limited export diversification.
Potential policy responses:
Sustaining a strong and durable recovery in the UK requires rebalancing away from public support toward private-sector led demand, along with greater reliance on external demand. The current fiscal consolidation plan implemented within a medium-term framework and an accommodative monetary policy stance contribute to the goal of external rebalancing. Further structural reforms focused on broadening the skill base and investing in public infrastructure will boost productivity, improving the competitiveness of the economy.</td></tr>
<tr><td>Current account</td><td>Background. During the recovery from the crisis, the CA balance has deteriorated from -3 to -5½ percent of GDP. The decline in the CA balance is accounted for primarily by a lower income balance, reflecting a fall in earnings on the UK's foreign direct investment abroad, notably earnings on investment exposed to the euro area. The trade balance has been stable around -2 percent of GDP, despite a 9½ percent real exchange rate depreciation between 2007 and 2014. In 2015, the recent oil price drop is expected to contribute to a lower trade deficit.
Household and non-financial sector saving-investment balances have declined, more than offsetting the slight improvement in the general government balance.
Assessment. The EBA CA regression approach estimates a CA gap of around -4.5 percent of GDP for 2014. However, the recent deterioration in the income balance is not expected to be all permanent, suggesting a smaller underlying CA deficit and smaller CA gap than implied by the EBA model. Taking this and other factors (such as the CA gaps implied by the REER regressions discussed below) into account, staff assesses the 2014 cyclically-adjusted CA balance to be 1½ -3½ percent weaker than the current account norm.</td></tr>
<tr><td>Real exchange rate</td><td>Background. Sterling appreciated in real effective terms in the first half of 2014 before stabilizing; for 2014 as a whole, the average REER was 8 percent more appreciated than for 2013. As of May 2015, the REER has strengthened by 6.5 percent from its average level in 2014. This appreciation may reflect the UK's relatively strong domestic demand and differences in interest rates (both current and prospective) between the UK and many advanced economies.
Assessment. For 2014, the EBA exchange rate assessment implied by the EBA CA regression model indicates an overvaluation of 18 percent. The EBA REER regressions estimate an overvaluation of 2.3 percent (REER Level model) and 5.6 percent (REER Index model). Staff assesses the 2014 REER as 5–15 percent above the level consistent with fundamentals and desirable policy settings; this assessment is informed by and consistent with the staff's CA assessment.</td></tr>
<tr><td>Capital and financial accounts:
flows and policy measures</td><td>Background. Given the UK's role as an international financial center, portfolio investment and financial derivatives are the key components of the financial account.
Assessment. Large fluctuations in capital flows are inherent to financial transactions in countries with a large financial services sector. This volatility is a potential source of vulnerability.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. The pound has the status of a global reserve currency.
Assessment. Reserves held by the UK are typically low relative to standard metrics, and the currency is free floating.</td></tr>
</table>

	United Kingdom (continued)
Technical Background Notes	1/ The official NIIP data might understate the true position—attempts to value FDI at market values suggest an NIIP of around 20 percent of GDP. Market value estimates of FDI assets assume that values move in line with equity market indices in the UK and abroad. These estimates are uncertain as actual FDI market values could evolve differently from equity markets.

	United States	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) declined from -18.7 per cent of GDP in 2010 to -34.5 percent of GDP in 2014, reflecting sustained current account deficits, stronger performance of the U.S. stock market relative to trading partners, and valuation changes of foreign currency denominated assets. 1/ Under staff's baseline scenario, U.S. NIIP would deteriorate by about 10 percentage points of GDP over the next five years predominantly due to projected current account deficits. **Assessment**. A decline in foreign demand for U.S. debt securities (for example, by a protracted failure to restore long-run fiscal sustainability) would raise financial stability risks, but at the same time weaken the exchange rate and strengthen the trade balance. Given the dollar's reserve currency status, such financial stability concerns are limited. Most U.S. foreign assets are denominated in foreign currency and over 50 percent are in the form of FDI and portfolio equity claims, whose value tend to decline when global growth and stock markets are weak, as well as when the U.S. dollar appreciates.	**Overall Assessment**: *The U.S. external position was broadly consistent with medium-term fundamentals and desirable policies in 2014. As of May 2015, sizable recent REER appreciation has weakened the U.S. external position. This is partially offset by lower oil prices. The U.S. REER is currently moderately above the level consistent with medium-term fundamentals.* The U.S. external position has improved considerably in recent years, as have assessed imbalances and fiscal policy gaps. As of May, the REER was about 9 percent above its average value of 2014. This was due to solid U.S. economic performance and divergence of U.S. growth and monetary policy prospects from key trading partners. The negative effects of the REER on the external position in 2015 are partially offset by the positive effects of lower oil prices. **Recommended policies**: Over the medium term, fiscal consolidation should aim for a general government primary surplus of about ¾ percent of GDP (a federal government primary surplus of about 1 percent of GDP). Structural policies should be implemented to raise productivity and labor force growth, including taking steps to fully exploit the benefits of the boom in unconventional energy production. This would be consistent with maintaining external stability and achieving full employment.
Current account	**Background**. The U.S. current account (CA) deficit has narrowed from its pre-crisis height of 6 percent of GDP to 2.4 percent of GDP in 2014, reflecting a sharp reduction in the fiscal deficit, higher private saving, lower investment in the aftermath of the financial crisis, and a stronger energy trade balance (due to the rapid increase of unconventional energy production). 2/ The CA deficit is expected to decline moderately but steadily from 2015 through the medium-term as the effects of a stronger U.S. economy and a more appreciated U.S. dollar are only partly offset by lower oil prices. **Assessment**. The EBA model estimates a cyclically-adjusted CA gap of -1.2 percent of GDP for 2014. The calculation, however, does not fully account for the increase of unconventional energy production and the effects of the 2014 price decline on domestic energy production and the oil balance. The staff view is, on balance, that the 2014 cyclically-adjusted CA is between 0 and 1 ¼ percent weaker than the level implied by medium-term fundamentals and desirable policies. 3/	
Real exchange rate	**Background**. The real effective exchange rate (REER) appreciated in 2014 by about 2 percent compared to 2013. Notwithstanding this moderate overall annual figure, the REER appreciated by more than 6 percent in the second half of 2014, due to solid U.S. economic performance and divergence of U.S. growth and monetary policy prospects from key trading partners. As of May 2015, the REER was about 9 percent stronger than its average value over 2014. **Assessment.** Indirect estimates of the REER (relying on the preferred current account assessment) suggest the exchange was overvalued by about 5 percent in 2014. Direct REER analyses suggest an overvaluation of between 2 and 8 percent. 4/ Considering all estimates and the uncertainties around them, staff assess the 2014 average REER as overvalued, within a range of 0 to 10 percent, compared to the level implied by medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. Net financial outflows were about 0.8 percent of GDP in 2014. 5/ Portfolio inflows increased by about 40 percent, year over year, in 2014 but were offset by weaker direct investment and other inflows. On the outflow side, there were further increases in U.S. portfolio investment overseas, but much less so than the previous year. The stronger outlook for the U.S. economy compared to its key trading partners, the dollar reserve currency status and safe haven motives continue to boost foreign demand for U.S. Treasury securities. **Assessment**. The U.S. has a fully open capital account. Vulnerabilities are limited by the dollar's status as a reserve currency and the U.S. role as a safe haven.	
FX intervention & reserves level	**Assessment**. The dollar has the status of a global reserve currency. Reserves held by the U.S. are typically low relative to standard metrics, but the currency is free floating.	

	United States (continued)
Technical Background Notes	1/ The U.S. has a positive net equity position, with sizable portfolio equity and direct investment abroad, and a negative debt position vis-à-vis the rest of the world, owing to sizeable foreign holdings of U.S. Treasuries and corporate bonds. Gross assets and liabilities are about 140 and 180 per cent of GDP, respectively. 2/ The oil portion of the CA had a deficit of 1.1 percent of GDP in 2014, 0.3 percentage points lower than in 2013, reflecting less net imports and lower oil prices. 3/ Developments in the oil sector are not fully captured in the EBA. In particular, the price elasticity of U.S. oil production has dramatically increased following the shale revolution. While acknowledging that the use of price elasticity of oil is implicit in the EBA, it is important to note that the terms of trade adjustment used in the EBA CA assessment is derived from longer historical relationships, which fail to fully capture the changing level and nature of U.S. oil production. 4/ The two direct EBA models are the REER Index model and the REER Level model. 5/ This is substantially below pre-crisis levels of about 5.0 percent of GDP.