

**EXECUTIVE  
BOARD  
MEETING**

SM/21/122  
Correction 6

July 29, 2021

To: Members of the Executive Board  
From: The Secretary  
Subject: **2021 External Sector Report—Chapter 3**

Board Action: The attached corrections to SM/21/122 (7/1/21) have been provided by the staff:

**Evident Ambiguity** **Page 26**

**Typographical Errors** **Pages 25 and 35**

Questions: Mr. Leigh, RES (ext. 34747)  
Mr. Rabanal, RES (ext. 36784)



**Table 3.19. Poland: Economy Assessment**

<p><b>Overall Assessment:</b> <i>The external position in 2020 was substantially stronger than the level implied by medium-term fundamentals and desirable policies.</i> The CA balance increased to 3.5 percent of GDP in 2020 from 0.5 percent in 2019, reflecting a large trade surplus in addition to a reduction in the primary income deficit arising from lower earnings of foreign companies in Poland during the pandemic. This comes after a decade-long transition from a large deficit to a small surplus in 2019. A CA surplus is deemed excessive, given that income convergence is incomplete. In 2021 the CA surplus is projected to decrease as the recovery in domestic demand supports import growth and foreign companies' profitability recovers. Uncertainty is high over the medium term due to the COVID-19 pandemic; however, as the economy recovers, the CA surplus is expected to gradually vanish as private net saving returns to a lower level, offsetting an anticipated improvement in government net saving. Next Generation EU grants are expected to boost investment, contributing to the moderation of the CA balance in the projection horizon. Reserves are adequate to insulate against external shocks and disorderly market conditions.</p> <p><b>Potential Policy Responses:</b> In the short term, fiscal policy should bolster the health care system, provide businesses with liquidity, and support incomes of vulnerable households, including through employment preservation. Monetary and financial policies should prevent a tightening of financial conditions and enable the financial sector to support firms' liquidity. The tapering of expansionary policies should be gradual once the recovery is in full swing. In the medium term, to help move the CA towards the norm, policies should aim to boost investment by (i) deploying the Next Generation EU funds to raise public investment, support the recovery, and help tackle infrastructure gaps, digitalization, and climate change, and (ii) using public policies to foster corporate investment and productivity, while active labor market policies should facilitate sectoral transitions, with structural reforms focused on raising potential growth. Room should be made for priority fiscal spending by better targeting social benefits according to need.</p>							
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP is estimated to have improved to -46 percent of GDP in 2020 from -50 percent in 2019. Gross assets and liabilities reached 58 and 103 percent of GDP, respectively. The stock of net FDI (equity and debt), accounting for 36 percent of gross external liabilities, remains diversified across sectors and source countries. While gross external debt in 2020 was a sizable 62.4 percent of GDP, 28 percent of the debt is liabilities to direct investors via intercompany lending, and 74 percent of the debt is of long-term maturity. Short-term debt (excluding intercompany short-term debt), amounting to 16 percent of total debt (10 percent of GDP), is mainly owed by banks (currency and deposits) and the nonfinancial private sector (trade credit). Automatic debt dynamics, helped by Next Generation EU grants, are projected to continue to reduce the negative NIIP in the medium term.</p> <p><b>Assessment.</b> While sizable external debt is a vulnerability, rollover risk is mitigated by the large share of long-term debt, as well as by intercompany lending that tends to be automatically rolled over. Adequate reserves reduce residual rollover risk from short-term debt (gross reserves stood at 161 percent of short-term debt in 2020).</p>						
2020 (% GDP)	NIIP: -45.9	Gross Assets: 57.6	Res. Assets: 25.9	Gross Liab: 103.4	Debt Liab.: 62.4		
<b>Current Account</b>	<p><b>Background.</b> The CA has moved from large deficits toward surplus since the 2008 crisis. This reflects a larger trade surplus (mainly services), despite sustained high primary income deficits from reinvested earnings and dividend payments to direct investors and net earnings of foreign workers in Poland. Low investment and high saving by the corporate sector have been partially offset by net borrowing by households and the government. Poland's CA surplus increased from 0.5 percent of GDP in 2019 to 3.5 percent of GDP in 2020, driven by a larger trade surplus, reflecting resilience in exports, as well as import compression, and by a lower primary income deficit, reflecting foreign companies' lower earnings. In the medium term as the economy recovers from the pandemic, the CA surplus is expected to vanish as private net saving returns to a lower level, offsetting an increase in government net saving.</p> <p><b>Assessment.</b> For 2020 the EBA CA model estimates a norm of -2.1 percent of GDP (with the standard error of the norm estimate 0.6 percent of GDP) against a cyclically adjusted CA of 3.9 percent of GDP. The resulting EBA gap of 6.0 percent of GDP includes identified policy gaps (2.2 percent of GDP) and an unexplained residual of 3.9 percent of GDP. However, in view of the pandemic-related decline in the primary income account, judged to be transitory, an adjustment of -0.7 percent of GDP to the cyclically adjusted CA balance has been made. Furthermore, an additional adjustment of -0.4 percentage point of GDP has been made, which consists of 0.3 percentage point of GDP to reflect the contraction in travel services (including tourism) net exports, 0.2 point of GDP to reflect increased global demand for medical goods, -0.1 percentage point of GDP to reflect changes in the oil balance, and -0.7 percentage point of GDP to reflect shifts in household consumption composition. In summary, the total adjustment of -1.1 results in a CA gap of 4.9 (±0.6) percent of GDP.</p>						
2020 (% GDP)	CA: 3.5	Cycl. Adj. CA: 3.9	EBA Norm: -2.1	EBA Gap: 6.0	COVID-19 Adj.: -1.1	Other Adj.: 0.0	Staff Gap: 4.9
<b>Real Exchange Rate</b>	<p><b>Background.</b> The annual average REER appreciated by 0.7 percent in 2020 compared with the 2019 average. During the pandemic, unlike during the global financial crisis, movements in the NEER and REER have been muted. In nominal terms, the zloty depreciated by 4.3 percent against the dollar but appreciated by 4.8 percent against the euro since the end of 2019. Over the same period, inflation in Poland has been only slightly higher than in its trading partners. The REER depreciated by 3.9 percent between January and April but appreciated by 4.3 percent between April and December. As of end-May 2021, the REER had appreciated by 1.0 percent compared to the 2020 average.</p> <p><b>Assessment.</b> The IMF staff CA gap implies a REER gap of -11.1 percent in 2020 (applying an estimated elasticity of 0.44). EBA REER index and level model estimates point to an undervaluation of 2.9 and 19.3 percent, respectively. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of -12.6 to -9.6 percent, with a midpoint of -11.1 percent.</p>						
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> The capital account, dominated by inflows of EU funds for financing investment projects, has averaged about 2 percent of GDP over the past 10 years. The capital account surplus increased to 2.4 percent of GDP in 2020 and is expected to increase further, supported by Next Generation EU grants. Financial market volatility at the onset of the pandemic triggered sizable but short-lived outflows in bond and equity markets, which stabilized beginning in May. Financial account outflows in 2020 amounted to 1.3 percent of GDP.</p> <p><b>Assessment.</b> Foreign holdings of domestic government securities have declined significantly since 2016 and, by the end of 2020, represented 17.1 percent of the total. Nevertheless, the overall stock remains sizable at 5.8 percent of GDP and could pose risks, although the diversified foreign investor base is a mitigating factor.</p>						
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Gross international reserves increased by 20 percent to US\$154 billion by the end of 2020. Net reserves, which exclude the central bank's repo operations (part of its reserve management strategy) and government FX deposits, are estimated at US\$131 billion at the end of 2020, reflecting in part the central bank's conversion to zloty of a portion of EU funds received by the government. This is consistent with the central bank's strategy of building an adequate precautionary reserve buffer. The zloty is free floating. The central bank intervened in the FX market in December 2020 by purchasing FX, the first intervention since 2013.</p> <p><b>Assessment.</b> At about 141 percent of the IMF's reserve adequacy metric at the end of 2020, the level of gross reserves is adequate to guard against external shocks and disorderly market conditions.</p>						

Table 3.20. Russia: Economy Assessment

<b>Overall Assessment:</b> <i>The external position in 2020 is moderately stronger than the level implied by medium-term fundamentals and desirable policies.</i>							
<b>Potential Policy Responses:</b> In view of large uncertainties surrounding near-term recovery prospects, the authorities should stand ready to extend targeted support to viable sectors and firms still under stress. Over the medium term, structural reforms to improve the business climate and address inefficiencies in the state-owned enterprise sector, together with investment in infrastructure, health, and education, could lift potential growth and diversify the economy away from oil and gas exports, helping to bring the external sector into balance.							
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP increased to US\$504.53 billion in 2020, which, at 34 percent of GDP, is well above the near balance position in 2010. Since 2018 gross assets rose from 81 percent of GDP to 105.2 percent of GDP as of the end of 2020, though liabilities also increased from 58 to 71 percent of GDP. External debt is about one-half of total gross liabilities, and about one-quarter of external debt is in domestic currency. There are no obvious maturity mismatches between the gross asset and liability positions, and the share of nonresidents' holdings of domestic government debt declined from 32.2 percent in December 2019 to 23.3 percent in December 2020.</p> <p><b>Assessment.</b> The projected CA surpluses suggest that Russia will be able to maintain its positive NIIP, lowering risks to external stability. Moreover, the accumulated official external assets, which have increased rapidly since the introduction of the new fiscal rule, provide an important buffer against the COVID-19 shock to oil production and prices.</p>						
2020 (% GDP)	NIIP: 34.2	Gross Assets: 105.2	Res. Assets: 40.3	Gross Liab.: 71.0	Debt Liab.: 31.6		
<b>Current Account</b>	<p><b>Background.</b> In spite of the sharp fall in oil prices and oil demand, the CA balance registered a surplus of US\$33.9 billion (2.3 percent of GDP) in 2020. This was in part because of less travel abroad due to the pandemic, with service imports declining by about US\$34.4 billion relative to 2019.</p> <p><b>Assessment.</b> The EBA CA model estimates a norm of 3.2 percent of GDP for 2020 and a cyclically and terms-of-trade adjusted CA surplus of 4.0 percent of GDP. After an adjustment to the underlying CA of 1.1 percent of GDP, to reflect the exceptionally sharp shock to oil prices and oil demand (2.1 percent of GDP), as well as a temporary adjustment for travel service imports, including tourism (-0.9 percent of GDP), the staff CA gap was 1.9 percent of GDP in 2020, with a range of 0.4 to 3.4 percent of GDP. Identified policies contributed 1.5 percent of GDP to the gap. About one-fifth of the total policy gap is due to fiscal policy, reflecting larger consolidation needs in the rest of the world compared with Russia.</p>						
2020 (% GDP)	CA: 2.3	Cycl. Adj. CA: 4.0	EBA Norm: 3.2	EBA Gap: 0.8	COVID-19 Adj.: 1.1	Other Adj.: 0.0	Staff Gap: 1.9
<b>Real Exchange Rate</b>	<p><b>Background.</b> The average REER depreciated by 7.4 percent in 2020 and by 14.4 percent over 2017–20. As of end-May 2021, the REER had depreciated by 3.8 percent compared to the 2020 average.</p> <p><b>Assessment.</b> The IMF staff CA gap implies a REER undervaluation of 7.6 percent in 2020 (applying an estimated elasticity of 0.25). The EBA REER index and level model estimates point to a REER undervaluation of 12.3 and 20.8 percent, respectively. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of 1.6 to 13.6 percent, with a midpoint of 7.6 percent.</p>						
<b>Capital and Financial Accounts: Flows and Policy Measures</b>	<p><b>Background.</b> Following the decline in net private capital outflows in 2019, Russia experienced a period of high volatility accompanied by moderate outflows by both the banking and nonbanking private sectors in early 2020. This volatility abated somewhat, though external private sector deleveraging continued through December. Pressures on financial flows could stem from volatility in oil prices and demand as well as from geopolitical uncertainty.</p> <p><b>Assessment.</b> While Russia is exposed to risks of further outflows, the large FX reserves and the floating exchange rate regime provide substantial buffers to help absorb shocks. The substantial external deleveraging in recent years has also helped reduce susceptibility to external shocks.</p>						
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Since the floating of the ruble in November 2014, FX interventions have been limited, and reserve accumulation has been mostly driven by the fiscal rule and oil prices being above the fiscal reference level. In 2020, faced with declining oil prices and capital outflows, the central bank engaged in some reserve sales and halted previously ongoing scheduled FX purchases. Despite FX sales of US\$13.7 billion, international reserves rose to US\$595.8 billion at the end of 2020 from US\$555.2 billion in 2019, thanks to valuation changes related to higher gold prices.</p> <p><b>Assessment.</b> International reserves in 2020 were equivalent to 360.7 percent of the IMF's reserve adequacy metric. Taking into account Russia's vulnerability to oil price shocks, an additional commodity buffer of US\$75 billion is appropriate, translating to a ratio of reserves to the buffer-augmented ARA metric of 242.5 percent. While considerably above the adequacy range of 100 to 150 percent, the level of reserves remains appropriate, taking into account Russia's exposure to other external shocks as well as geopolitical tensions.</p>						

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

<p><b>Overall Assessment:</b> <i>The external position in 2020 was weaker than the level implied by medium-term fundamentals and desirable policies.</i> The CA deficit remained high in 2020, reflecting unprecedented high public borrowing to combat economic fallout from the COVID-19 crisis, only partially offset by private saving. The uncertainty around this assessment is significant, reflecting pandemic-related factors, measurement issues, the evolving impact on growth and trade and capital flows of the new EU-UK Trade and Cooperation Agreement, and continuing EU-UK discussions on financial services.</p> <p><b>Potential Policy Responses:</b> Following efforts aimed at sustaining the recovery in the near term, policies that could support the external rebalancing and bring the current account balance closer to its norm include structural reforms to boost the United Kingdom's productivity and international competitiveness. This would entail supporting reallocation to fast-growing sectors by upgrading the skill base and ensuring appropriate access to financing for firms, as well as encouraging firm digitalization and innovation. These efforts are particularly important as access to the EU market becomes more restricted.</p>							
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> The NIIP declined to -30.3 percent of GDP in 2020 from -28.7 percent of GDP in 2019. Over the past five years, the NIIP has declined by 5 percentage points, reflecting a negative CA contribution (-19.5 percentage points), largely offset by the valuation effect.<sup>1</sup> The composition of assets roughly matches that of liabilities (about 87 percent of GDP in FDI, 137 percent of GDP in derivatives, and about 219 percent of GDP in other investment), although portfolio investment liabilities (177 percent of GDP) exceed assets in portfolio investments (139 percent of GDP). The United States, other European countries, and Japan account for about 75 percent of total UK external assets and liabilities, and external liabilities have a larger share denominated in pounds than assets.<sup>2</sup> The IMF staff projects the NIIP to decline over the medium term, although the large and volatile valuation effects make these estimates particularly uncertain.</p> <p><b>Assessment.</b> Despite some decline, the sustainability of the NIIP is not an immediate concern. Since 2000, valuation gains have offset about 40 percent of the effect of CA flows on the IIP, partially reflecting CA measurement issues and depreciation of the pound. However, fluctuations in the large gross stock positions are a potential source of vulnerability (including derivatives, gross assets and gross liabilities both exceed 500 percent of GDP).</p>						
	2020 (% GDP)	NIIP: -30.3	Gross Assets: 587.6	Res. Assets: 6.6	Gross Liab.: 617.8	Debt Liab.: 345	
<b>Current Account</b>	<p><b>Background.</b> The CA deficit widened to -3.5 percent of GDP in 2020 from -3.1 percent in 2019 and remained larger than its historical average. The wider CA deficits since the global financial crisis reflect mostly a weaker income balance, due in part to lower earnings on the United Kingdom's FDI abroad (especially in the euro area). A rise in the trade balance in 2020 reflects a larger decline in domestic demand than in trading partners. This was offset by a fall in the income balance. The worsening in the CA deficit in 2020 was due to a sharp fall in gross saving combined with a slightly smaller decline in investment (relative to GDP).</p> <p><b>Assessment.</b> The EBA CA model estimates a norm of -0.4 percent of GDP and a CA gap of -3.3 percent of GDP. However, the underlying CA is assessed to be understated due to measurement biases, including the impact of expected inflation differentials on the CA, estimated to be about 0.5 percent of GDP.<sup>3</sup> In addition, the decline in net imports of travel services including tourism during the pandemic (-0.3 percent of GDP), an increase in imports due to shifts in the composition of household consumption (0.3 percent of GDP), imports of medical goods (0.3 percent of GDP), and stockpiling before Brexit (0.1 percent of GDP) likely affected the CA temporarily but may not be adequately captured in the cyclical components of the CA.<sup>4</sup> Overall, the IMF staff assesses the CA gap in the range of -0.4 to -4.4 percent of GDP, with a midpoint of -2.4 percent of GDP. This range takes into account the uncertainty in the assessment related to the post-Brexit development in UK-EU trade flows and financial services and possible measurement issues.</p>						
	2020 (% GDP)	CA: -3.5	Cycl. Adj. CA: -3.7	EBA Norm: -0.4	EBA Gap: -3.3	COVID-19 Adj.: 0.3	Other Adj.: 0.6
<b>Real Exchange Rate</b>	<p><b>Background.</b> The pound appreciated slightly in real effective terms in 2020 by about 0.2 percent relative to its average level in 2019 but has depreciated since mid-2016 by about 7 percent. This depreciation reflects an unwinding of past overvaluation as well as market expectations of more restricted access to the EU market under a post-Brexit trade arrangement. As of end-May 2021, the REER had appreciated by 4.1 percent compared to the 2020 average.</p> <p><b>Assessment.</b> The IMF staff CA gap implies a REER gap of 10.0 percent in 2020 (applying an estimated elasticity of 0.24). EBA REER level and index approaches suggest a gap of -3.8 and -12.2 percent, respectively, for 2020. Considering all estimates, the uncertainties around them, and broadly stable REER development in 2020, on average, the IMF staff assesses the REER to be overvalued between 0 and 15 percent, with a midpoint of 7.5 percent, similar to its value in last year's ESR.</p>						
	<p><b>Capital and Financial Accounts: Flows and Policy Measures</b></p> <p><b>Background.</b> Given the United Kingdom's role as an international financial center, portfolio investment and other investment are the key components of the financial account. In net terms, the CA was financed in 2020 by net other investments of 4.4 percent of GDP and net FDI inflows of 2 percent of GDP, while net financial derivatives and portfolio investments declined by 1.4 and 0.5 percent of GDP, respectively. Despite some turbulence in March, access to finance has remained favorable during the COVID-19 crisis, aided by the Bank of England's liquidity support and expanded quantitative easing.</p> <p><b>Assessment.</b> Large fluctuations in capital flows are inherent to countries with a large financial sector. This volatility is a potential source of vulnerability, although it is mitigated by sound financial regulation and supervision and a strong financial sector. An additional risk is that FDI and portfolio investment inflows may decelerate, driven by the change in the trade relationship with the European Union and shift of some financial services to the European Union.</p>						
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> The pound has the status of a global reserve currency. The share of global reserves in sterling has not changed since 2015, at about 4.5 percent.</p> <p><b>Assessment.</b> Reserves held by the United Kingdom are typically low relative to standard metrics, and the currency is free floating.</p>						