

**EXECUTIVE
BOARD
MEETING**

SM/21/122

Correction 1

July 13, 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:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Pages 10, 12, 20, 28, 30, 34

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

Table 3.4. Brazil: Economy Assessment

<p>Overall Assessment: <i>The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.</i> In the wake of the COVID-19 shock, the CA deficit contracted due to the large currency depreciation and improvements in the service and income balances. The trend is expected to persist in 2021.</p> <p>Potential Policy Responses: Policies that would help keep the CA in line with its norm include desirable fiscal consolidation, accompanied by measures to support public and private investment, including structural reforms to improve efficiency and reduce the cost of doing business. FX intervention, including using derivatives, may be appropriate to alleviate disorderly market conditions in the FX market.</p>						
Foreign Asset and Liability Position and Trajectory	<p>Background. Brazil's NIIP was -39 percent of GDP at the end of 2020, moderately stronger than at the end of 2019 (-42 percent of GDP) mainly due to valuation effects associated with the currency depreciation (assets are predominantly denominated in FX while liabilities are more concentrated in local currency). At the end of 2020 external debt declined by about 5 percent in nominal terms compared with 2019, accounting for about 45 percent of GDP and 303 percent of exports, against a value of 36 percent of GDP and 299 percent of exports in 2019, with the large increase in the external-debt-to-GDP ratio in 2020 driven by the significant output contraction when measured in US dollars.</p> <p>Assessment. Brazil's NIIP has been negative since 2011. Short-term gross external financing needs are significant, at about 11 percent of projected 2021 GDP, with capital flows and the exchange rate particularly sensitive to global financing conditions.</p>					
2020 (% GDP)	NIIP: -38.5	Gross Assets: 63.5	Res. Assets: 24.8	Gross Liab.: 102.0	Debt Liab.: 44.6	
Current Account	<p>Background. The CA deficit contracted from -3.5 percent of GDP in 2019 to -1.7 in 2020 due to improvements in the trade, service, and income balances, supported, respectively, by the currency depreciation, the contraction in tourism and transportation service imports, and lower distribution of profits and dividends. In 2021 the trade balance is expected to continue to improve on the back of a recovery in economic activity in trading partners that would boost exports, more than offsetting the rebound in imports. Overall, the IMF staff projects a CA balance of about -0.4 percent of GDP for 2021.</p> <p>Assessment. In 2020 the cyclically adjusted CA balance was -1.6 percent of GDP. EBA estimates suggest a CA norm in 2020 of -2.4 percent of GDP. The IMF staff assesses a CA norm between -1.9 percent of GDP and -2.9 percent of GDP. Thus, after adjusting for the transitory impacts of the COVID-19 crisis on the oil; travel services, including tourism; and medical goods sectors (resulting in an impact on the CA balance of 0.3 percent, -0.3 percent, and 0.1 percent of GDP, respectively), the IMF staff CA gap is assessed at 0.9 percent of GDP. The medium-term outlook for the CA is still difficult to assess, given the unfolding COVID-19 crisis and related policy response.</p>					
2020 (% GDP)	CA: -1.7	Cycl. Adj. CA: -1.6	EBA Norm: -2.4	EBA Gap: 0.8	COVID-19 Adj.: 0.1	Other Adj.: 0.0 Staff Gap: 0.9
Real Exchange Rate	<p>Background. After remaining broadly stable in 2019 (-1.9 percent), the REER depreciated sharply in 2020 (-20.6 percent), driven by large capital outflows in the first half of the year. Depreciation pressures have subsided since mid-May 2020. As of end-May 2021, the REER had depreciated by 3.5 percent compared with the 2020 average.</p> <p>Assessment. The IMF staff CA gap implies a REER gap of -7.1 percent in 2020 (applying an estimated elasticity of 0.13). The REER index (-36.6 percent) and level (-21.3 percent) methodologies point to some possible overshooting of the nominal exchange rate. Overall, the IMF staff assesses the REER gap at the end of 2020 to be closer to the REER gap implied by the IMF staff CA gap. Therefore, considering the CA norm standard error of 0.8 percent, the IMF staff assesses the REER gap to be in the range of -14.6 to 0.4 percent, with a midpoint of -7.1 percent (undervaluation).</p>					
Capital and Financial Accounts: Flows	<p>Background. Net FDI has fully financed CA deficits since 2015 (averaging 3.2 percent of GDP during 2015-20, while CA deficits averaged -2.2 percent), despite net portfolio outflows (0.6 percent of GDP, on average, during 2015-20). In 2020 net FDI stood at 3.5 percent of GDP against a CA deficit of 1.7 percent. Net portfolio outflows accelerated sharply in the first half of the year before easing in the third quarter and then partly recovering in the fourth quarter, recording a balance of -0.9 percent of GDP over the year (-1 percent of GDP in 2019). Net FDI was stronger than in 2019 due to divestment abroad that more than compensated for lower FDI inflows.</p> <p>Assessment. The composition of capital flows is expected to remain favorable over the medium term, with positive net FDI inflows outweighing negative portfolio outflows that started in 2016 following the sovereign's downgrade to below investment grade. Nevertheless, the high degree of uncertainty about the scarring effects of COVID-19 on the global economy make it challenging to assess the medium-term prospects for capital flows. A renewed spike in international risk aversion, linked to a potential second wave of COVID-19, or a sudden tightening of global financing conditions could trigger a new bout of capital market volatility.</p>					
FX Intervention and Reserves Level	<p>Background. Brazil has a floating exchange rate. In 2020 the central bank sold FX in the spot, repo, and FX swap markets in the amount of US\$44.5 billion to dampen excess exchange rate volatility associated with the COVID-19 shock. Nevertheless, reserves remained high at US\$356 billion at the end of 2020.</p> <p>Assessment. The flexible exchange rate has been an important shock absorber. Reserves are adequate relative to various criteria, including the IMF's reserve adequacy metric (161 percent as of the end of 2020) and serve as insurance against external shocks. The authorities should retain strong external buffers, with intervention limited to addressing disorderly market conditions.</p>					

Table 3.6. China: Economy Assessment

<p>Overall Assessment: <i>The external position in 2020 was in line with the level implied by medium-term fundamentals and desirable policies.</i> The CA surplus widened in 2020, driven by transitory factors linked to the global pandemic crisis, including falling commodity prices; the halt to outbound travel, including tourism; and a surge in pandemic-related exports. When these temporary factors dissipate, the CA surplus is expected to return to its medium-term downward trend as China's economy rebalances toward higher-quality, more-consumption-driven growth.</p> <p>Potential Policy Responses: Policies that will ensure that the external position remains broadly in line with fundamentals include (1) accelerating structural reforms—further opening domestic markets, reforming state-owned enterprises, and ensuring competitive neutrality with private firms while promoting green investment and strengthening social safety nets—to boost potential growth; (2) shifting policy support toward strengthening social safety nets to reduce high household saving; and (3) further increasing exchange rate flexibility to help the economy adjust to the changing external environment. China has room to provide more fiscal support if needed, preferably through household support and green investment, with monetary policy broadly supportive of economic activity.</p>							
Foreign Asset and Liability Position and Trajectory	<p>Background. The NIIP, which declined from a peak of 30.4 percent of GDP in 2008 to 14.5 percent in 2019, further decreased to 14.5 percent in 2020. The drop reflects higher inward direct investment and securities investment received amid relatively robust GDP growth after the first quarter, despite a higher CA surplus and an increase in loans extended abroad.</p> <p>Assessment. The NIIP-to-GDP ratio is expected to remain positive, with a modest decline over the medium term. The NIIP is not a major source of risk at this point, as assets remain high—reflecting large foreign reserves (US\$3.4 trillion, 22.6 percent of GDP)—and liabilities are mostly FDI related.</p>						
2020 (% GDP)	NIIP: 14.5	Gross Assets: 58.5	Res. Assets: 22.6	Gross Liab.: 44.1	Debt Liab.: 15.9		
Current Account	<p>Background. The widening of the CA surplus to 1.8 1.9 percent of GDP in 2020 from 0.7 percent in 2019, underpinned by a higher savings-investment balance in the wake of the COVID-19 outbreak, mostly reflects the impact of the global pandemic, including (1) the sudden collapse in outbound travel spending, including tourism; (2) lower commodity prices amid weak global demand; and (3) a surge in exports related to the pandemic enabled by China's relatively early recovery from the initial lockdown. This export surge affected predominantly pandemic-related goods (such as medical equipment and health care products) and durable goods, driven by the global shift in household consumption composition from services to goods, amplified by a significant increase in export prices. The income balance turned more negative in 2020, driven by a higher investment income deficit. The impact of the pandemic is expected to be temporary, with the CA surplus projected to converge to about 0.5 percent of GDP over the medium term, in line with continued rebalancing toward higher-quality and more-consumption-driven growth.</p> <p>Assessment. The EBA CA methodology estimates the CA gap in 2020 to be 1.9 percent of GDP. Considering that the pandemic-related temporary factors raised the CA surplus by 1.2 percent of GDP (with contributions of 0.1 percent of GDP from the oil balance, 0.5 from the travel services balance, and 0.2 and 0.4 from the shift in household consumption from services to consumer goods and the impact on medical goods trade, respectively), the IMF staff assesses the CA gap to range from -0.7 to 2.1 percent of GDP, with a midpoint of 0.7 percent. The range around the midpoint reflects a number of uncertainties, including about how temporary the impact of the pandemic will be. EBA-identified policy gaps are close to nil on balance as the impact of China's still-high credit growth offsets that of a relatively closed capital account (in a de jure sense), while the fiscal policy gap widened, reflecting more expansionary fiscal policy. The overall gap is largely accounted for by the residual, which reflects factors not directly captured by the underlying model, including distortions that encourage excessive saving.</p>						
2020 (% GDP)	CA: 1.8	Cycl. Adj. CA: 1.7	EBA Norm: -0.3	EBA Gap: 1.9	COVID-19 Adj.: -1.2	Other Adj.: 0.0	Staff Gap: 0.7
Real Exchange Rate	<p>Background. After a depreciation of 11.7 percent during 2015–19, the REER appreciated by 2.1 percent in 2020 from the 2019 average, largely driven by the appreciation in the NEER (0.9 percent). In the context of declining depreciation pressure, the use of a countercyclical adjustment factor was phased out in October. As of end-May 2021, the REER had appreciated by 3.0 percent compared to the 2020 average.</p> <p>Assessment. The IMF staff CA gap implies a REER gap of -3.1 percent in 2020 (applying an estimated elasticity of 0.23). The EBA REER index regression estimates the REER gap in 2020 to be -0.3 percent, and the EBA REER level regression estimates the REER gap to be 13.0 percent. Overall, the IMF staff assesses the REER gap to be in the range of -10.5 to 9.5 percent, with a midpoint of -0.5 percent.</p>						
Capital and Financial Accounts: Flows and Policy Measures	<p>Background. Capital outflows (including net errors and omissions) increased to US\$246 billion (or 1.7 percent of GDP) in 2020, up from US\$122 billion (or 0.8 percent of GDP) in 2019 but still below the average annual outflows of US\$636 billion during 2015–16. In part, the increase reflects continued opening up. The reserve requirement on FX forwards, a CFM measure, was lowered from 20 percent to zero in October 2020. Two other CFM measures were adjusted: (1) the ceiling on cross-border financing under the macroprudential assessment framework for financial institutions and enterprises was raised by 25 percent in March 2020, but lowered to the original level for financial institutions in December 2020 and for enterprises in January 2021; and (2) restrictions on the investment quota of foreign institutional investors (QFII and RQFII) were removed, while a new quota (\$12.7 billion) was introduced for domestic institutional investors.</p> <p>Assessment. While currently absent, substantial net outflow pressures may resurface as the private sector seeks to accumulate foreign assets faster than nonresidents accumulate Chinese assets. Over the medium term, the sequence of further capital account opening consistent with exchange rate flexibility should carefully consider domestic financial stability. Specifically, further capital account opening is likely to create substantially larger two-way gross flows. Hence, the associated balance sheet adjustments and the shifts in market sentiment require prioritizing the shift to an effective float (while using FX intervention to counter disorderly market conditions) and strengthening domestic financial stability prior to substantial further opening. Efforts should be redoubled to encourage inward FDI, which would support growth, and to improve corporate governance. CFM measures should not be used to actively manage the capital flow cycle or substitute for warranted macroeconomic adjustment and exchange rate flexibility.</p>						
FX Intervention and Reserves Level	<p>Background. FX reserves continued to increase (by US\$134 billion in 2020) to US\$3.4 trillion, mainly reflecting valuation effects and adjustments in net forward positions, with no sign of large FX intervention.</p> <p>Assessment. The level of reserves—at 75 percent of the IMF's standard composite metric at the end of 2020 (85 percent in 2019) and 120 percent of the metric adjusted for capital controls (135 percent in 2019)—is assessed to be adequate. The decline in the ratios reflects higher exports, broad money, external debt, and other liabilities, all of which raised the metric.</p>						

Table 3.14. Japan: Economy Assessment

Overall Assessment: <i>The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.</i> Japan's CA surplus is mainly driven by its income surplus arising from a large positive NIIP and high net returns, which are expected to continue over the medium term.							
Potential Policy Responses: The policy response to the ongoing COVID-19 shock has appropriately prioritized support to affected households, workers, and firms while maintaining the smooth functioning of financial markets. A coordinated policy package will be needed to ensure that the external position remains in line with fundamentals. As the recovery strengthens, extraordinary policy support should gradually be withdrawn. In particular, post-pandemic policies should shift toward structural reforms and fiscal sustainability, and fiscal consolidation should proceed in a gradual manner. A well-specified medium-term fiscal framework, accommodative monetary policy, and structural reforms are needed to mobilize investment, reduce debt, and support inflation and growth. Priority should be given to reforms to increase labor supply, boost productivity and wages, reduce barriers to entry in some industries, and accelerate agricultural and professional services sector deregulation.							
Foreign Asset and Liability Position and Trajectory	<p>Background. The NIIP has grown since 2016, largely driven by an increase in foreign assets related to outward FDI and portfolio outflows. Due to a decline in foreign liabilities and the GDP contraction, the NIIP-to-GDP ratio at the end of 2020 rose to 66.3 percent from 63.8 percent at the end of 2019. On the back of CA surpluses, the NIIP is projected to rise to about 70 percent of GDP in the medium term. Japan holds the world's largest stock of net foreign assets, valued at US\$3.3 trillion at the end of 2020.</p> <p>Assessment. Japan's foreign asset holdings are well diversified, both by geography and risk classes. Portfolio investment accounts for nearly one-half of gross foreign assets. By currency, 21 percent of portfolio investment is yen-denominated and about one-half is denominated in US dollars. In the event of yen appreciation against the US dollar, the risk of negative valuation effects could materialize. Liabilities' vulnerabilities are limited, with equity and direct investment accounting for 33 percent of gross foreign liabilities. The NIIP generated net annual investment income of 3.6 percent of GDP in 2020. The large positive NIIP, in part, is driven by asset accumulation for old-age consumption, which is expected to be gradually unwound over the long term.</p>						
2020 (% GDP)	NIIP: 66.3	Gross Assets: 212.8	Debt. Assets: 84.4	Gross Liab.: 146.5	Debt. Liab.: 90.5		
Current Account	<p>Background. Japan's CA surplus reflects a high private sector saving-investment balance that more than compensates for the low government saving-investment balance. It also reflects a sizable income balance, owing to its large net foreign asset position. The CA surplus narrowed to 3.3 percent of GDP in 2020 compared with an average of 3.8 percent of GDP during 2016–19. The narrowing in the 2020 CA surplus was largely driven by a decline in the services trade balance amid international travel restrictions. In contrast, the goods trade balance remained in surplus, as a decline in imports caused by the negative domestic demand shock and lower energy prices outweighed a fall in exports. From the saving-investment perspective, the narrowing in the CA reflects a larger fall in saving, particularly for the public sector, relative to the investment-to-GDP ratio. The income balance continued to contribute the most to the CA surplus, at 3.6 percent of GDP in 2020. After the COVID-19 shock dissipates, the CA balance is projected to stabilize at a level slightly above 3 percent of GDP.</p> <p>Assessment. The 2020 CA assessment uses the EBA model, in which the estimated cyclically adjusted CA is 3.2 percent of GDP and the cyclically adjusted CA norm is estimated at 3.6 percent of GDP, with a standard error of 1.2 percent of GDP. The IMF staff estimates a 2020 CA norm range between 2.4 and 4.8 percent of GDP. After factoring in the transitory impacts of the COVID-19 crisis on the CA in relation to the oil, travel services (including tourism), and medical goods sectors (–0.1, 0.3, and 0.1 percent of GDP, respectively), the 2020 CA gap midpoint is assessed at –0.1 percent of GDP, with the CA gap range between <u>–1.3</u>–<u>–4.4</u> and <u>1.1</u>–<u>0.9</u> percent of GDP. The EBA-identified policy gaps reflect relatively greater medium-term fiscal consolidation needs, as well as a positive credit gap, in relation to medium-term desired policy. The overall gap is accounted for by the residual, potentially reflecting structural impediments and country-specific factors not included in the model, such as investment bottlenecks, including entrepreneurship entry barriers and corporate savings distortions.</p>						
2020 (% GDP)	CA: 3.3	Cycl. Adj. CA: 3.2	EBA Norm: 3.6	EBA Gap: –0.4	COVID-19 Adj.: 0.3	Other Adj.: 0.0	Staff Gap: –0.1
Real Exchange Rate	<p>Background. The REER appreciated by 0.9 percent in 2020, relative to the 2019 average. This reflects changes in global risk aversion and the monetary policy stances of key central banks in response to the pandemic. As of end-May 2021, the REER had depreciated by 8.7 percent compared to the 2020 average.</p> <p>Assessment. The IMF staff CA gap implies a REER gap of 0.7 percent in 2020 (applying an estimated elasticity of 0.13). The EBA REER level and index models deliver REER gaps of –12 and –20 percent, respectively, for the 2020 average REER. However, the EBA REER level and index models are not used for the assessment because they do not capture Japan-specific factors well. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be in the range of –8.3 to 9.7 percent, with a midpoint of 0.7 percent.</p>						
Capital and Financial Accounts: Flows and Policy Measures	<p>Background. Amid increased global financial volatility, portfolio and FDI outflows decreased sharply in 2020: portfolio outflows to Central and South America and outward FDI flows to Europe and Asia recorded the largest declines. Net FDI and portfolio flows comprise the bulk of the 2020 financial account (2.1 and 0.7 percent of GDP, respectively). Other investments (net) recorded outflows of 0.1 percent of GDP in 2020 compared with inflows of 2 percent of GDP in 2019. At the onset of the pandemic, net short yen positions increased. Nevertheless, this reversed beginning in mid-March, helped by a coordinated policy response by major central banks to enhance the provision of US dollar liquidity.</p> <p>Assessment. Vulnerabilities are limited. Inward investment tends to be equity-based, and the home bias of Japanese investors remains strong. So far, outward spillovers from Japan's policies to financial conditions in other economies (interest rates, credit growth) are contained.</p>						
FX Intervention and Reserves Level	<p>Background. Reserves are about 28 percent of GDP, reflecting legacy accumulation. There has been no FX intervention in recent years.</p> <p>Assessment. The exchange rate is free floating. Interventions are isolated (last occurring in 2011), intended to reduce short-term volatility and disorderly exchange rate movements.</p>						

Table 3.22. Singapore: Economy Assessment

Overall Assessment: <i>The external position in 2020 was substantially stronger than is consistent with fundamentals and desirable policies.</i> The assessment is subject to a wide range of uncertainty, reflecting Singapore's very open economy and status as a global trading and financial center.							
Potential Policy Responses: A sizable fiscal policy response to the COVID-19 pandemic helped reduce external imbalances in 2020, and expected execution of major infrastructure projects should contribute to further reduction of external imbalances in the near term. Over the medium term, Singapore's economy will be undergoing structural transformation, in light of a rapidly aging population and its transition to a new digital economy, while facing challenges linked to climate change. Higher public investment addressing these issues, including spending on health care and investments in physical infrastructure and human capital, would help keep CA imbalances moderate over the medium term by lowering net public saving. Structural reforms are also necessary to improve productivity.							
Foreign Asset and Liability Position and Trajectory	<p>Background. The NIIP stood at 308 percent of GDP in 2020, up from 208 percent of GDP in 2019 and the average level of 212 percent of GDP in 2015–19. Gross assets and liabilities are high, reflecting Singapore's status as a financial center. About a half of foreign liabilities is in FDI, and about a third quarter is in the form of currency and deposits. The CA surplus has been a main driver since the global financial crisis, but valuation effects were material in some years. CA and growth projections imply that the NIIP will rise over the medium term. The large positive NIIP in part reflects the accumulation of assets for old-age consumption, which is expected to be gradually unwound over the long term.</p> <p>Assessment. Large gross non-FDI liabilities (508 percent of GDP in 2020)—predominantly cross-border deposit taking by foreign bank branches—present some risks, but these are mitigated by large gross asset positions, banks' large short-term external assets, and the authorities' close monitoring of banks' liquidity risk profiles. Singapore has large official reserves and other official liquid assets.</p>						
2020 (% GDP)	NIIP: 307.8	Gross Assets: 1,361.2	Debt Assets: 617.0	Gross Liab.: 1,053.4	Debt Liab.: 417.6		
Current Account	<p>Background. The CA surplus was 17.6 percent of GDP in 2020, up from 14.3 percent in 2019. This rise was led by a large decline in service imports, a narrower oil trade deficit, and an increase in the goods balance a decrease in net payments of primary income related to the COVID-19 shock. The CA balance is slightly higher than the average of 16.6 percent since 2015 and significantly lower than the post-global-financial-crisis peak of 22.9 percent in 2010. Singapore's large CA balance reflects a strong goods balance and small surplus in the services balance that is partly offset by a deficit in the income account balance.¹ Structural factors and policies that boost savings, such as Singapore's status as a financial center, consecutive fiscal surpluses in most years, and the rapid pace of aging—combined with a mandatory defined-contribution pension program (whose assets were about 98.5 percent of GDP in 2020), as well as relatively high productivity—are the main drivers of Singapore's strong external position. The CA surplus is projected to narrow over the medium term on the back of increased infrastructure and social spending. In 2020 public saving decreased with a sizable fiscal expansion in response to the pandemic, while private saving increased.</p> <p>Assessment. Guided by the EBA framework, the IMF staff assesses the 2020 CA gap to be in the range of 1.2 to 7.2 percent of GDP.² The identified policy gaps narrowed significantly to close to zero in 2020, reflecting the sizable fiscal package and an increase in health care expenditure.</p>						
2020 (% GDP)	CA: 17.6	Cycl. Adj. CA: 16.9	EBA Norm: —	EBA Gap: —	COVID-19 Adj.: -1.9	Other Adj.: —	Staff Gap: 4.2
Real Exchange Rate	<p>Background. The REER depreciated by 2.6 percent in 2020, reflecting the depreciation of the NEER by 1.2 percent. This followed a depreciation of the REER by 0.3 percent and an appreciation of the NEER by 2.4 percent, both cumulative, between 2017 and 2019. As of May 2021, the REER had depreciated by 0.3 percent relative to the 2020 average.</p> <p>Assessment. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the range of 2.5 to 14.5 percent, with a midpoint of 8.5 percent in 2020 (applying an estimated elasticity of 0.5).</p>						
Capital and Financial Accounts: Flows and Policy Measures	<p>Background. Singapore has an open capital account. Because it is a trade and financial center in Asia, changes in market sentiment can affect Singapore significantly. Increased risk aversion in the region, for instance, may lead to inflows to Singapore given its status as a regional safe haven, whereas global stress may lead to outflows. The financial account balance reflects in part reinvestment abroad of income from official foreign assets, as well as sizable net inward FDI and smaller but more volatile net bank-related flows. In 2020 the capital and financial account switched to inflows of 4.2 percent of GDP from outflows of 16.5 percent in 2019 (outflows ranged from 10 to 18 percent in 2015–19). This reflects lower net outflows of portfolio investment led by resident banks switching from a net outflow position in 2019 to a net inflow position in 2020, as well as "other investment" turning from net outflows to net inflows among domestic nonbanks.</p> <p>Assessment. The unusual capital inflows in 2020 are likely to be transitory, reflecting regional safe haven flows, and are likely to turn to outflows as the effect of the pandemic subsides in subsequent years.</p>						
FX Intervention and Reserves Level	<p>Background. With the NEER as the intermediate monetary policy target, intervention is undertaken to achieve inflation and output objectives. Because Singapore is a financial center, prudential motives call for a larger NIIP buffer. Official reserves held by the Monetary Authority of Singapore (MAS) reached US\$362 billion (106.6 percent of GDP) in 2020. Aggregate data on FX intervention operations have been published since April 2020.</p> <p>Assessment. In addition to FX reserves held by the MAS, Singapore also has access to other official foreign assets managed by Temasek and GIC.³ The current level of official external assets appears adequate, even after considering prudential motives, and there is no clear case for further accumulation for precautionary purposes.</p>						

Table 3.24. Spain: Economy Assessment

<p>Overall Assessment: <i>The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. In 2020 the CA remained in surplus for the ninth consecutive year. Further strengthening the NIIP will require sustaining a relatively high CA surplus over the coming years.</i></p> <p>Potential Policy Responses: To keep the CA balance in line with its norm, policies need to support investment and foster competitiveness to facilitate the recovery, while carefully managing the public debt load. Using financing from Next Generation EU funds to boost medium-term investments will be important to raise potential growth and support decarbonization and digitalization. Boosting competitiveness through productivity gains would entail continued wage flexibility, reforms to address labor market duality, implementation of product and service market reforms, and actions to enhance education outcomes and innovation.</p>							
<p>Foreign Asset and Liability Position and Trajectory</p>	<p>Background. The NIIP dropped significantly during 2000–09, driven mostly by high CA deficits but also by valuation effects. Following a 15 percentage point increase in 2015–19 due to sustained CA surpluses, the NIIP declined again, reaching –84 percent of GDP in 2020, mainly due to the contraction in GDP. Gross liabilities stood at 290 percent of GDP in 2020, with slightly over two-thirds in the form of external debt. Whereas the private sector has deleveraged since the 2008–12 crisis, the NIIP accounted for by the general government and the central bank increased markedly, particularly in the context of the COVID-19 crisis, raising its share to 93 percent in 2020 (including TARGET2 liabilities, which reached 44 percent of GDP by the end of 2020).¹</p> <p>Assessment. The large negative NIIP comes with external vulnerabilities, including from large gross financing needs and potentially adverse valuation effects. Mitigating factors are a favorable maturity structure of outstanding sovereign debt (averaging almost eight years) and current ECB measures, such as quantitative easing, which lower the cost of debt.</p>						
2020 (% GDP)	NIIP: <u>-84.53</u>	Gross Assets: <u>205.96-4</u>	Debt Assets: <u>94.87</u>	Gross Liab.: 290.4	Debt Liab.: 179.7		
<p>Current Account</p>	<p>Background. After a peak CA deficit in 2007, corrected initially by a sharp contraction in imports, increased competitiveness from wage moderation and greater internationalization efforts contributed to strong export growth, leading to CA surpluses in 2012–20. As a result of historical data revisions, the average annual CA surplus during 2013–18 was revised from 1.5 to 2.3 percent of GDP. The COVID-19 crisis was associated with a stronger decline in exports than imports, largely due to the sharp decline in receipts from travel services, including tourism. As a result, the CA surplus declined significantly, from 2.1 percent in 2019 to an estimated 0.7 percent of GDP in 2020. With high uncertainty, in 2021 the CA surplus is projected to increase slightly as the pandemic recedes, supported by a gradual recovery in exports, notably tourism. Weaker-than-expected exports—particularly tourism receipts—are a key downside risk around this projection. Moderate CA surpluses are projected to continue in the medium term.</p> <p>Assessment. The cyclically adjusted CA balance is –1.3 percent of GDP, yielding a CA gap of –1.6 percent of GDP. However, the weakening of the CA also partly mainly reflects the pandemic’s transitory impact due to shocks not captured by the EBA model, which amount to 2.6 percent for travel services, including tourism; –0.3 percent for oil; 0.3 percent for medical goods; and –0.3 percent for the global shift of household consumption from services to consumer goods. Adjusting for these effects, the 2020 cyclically adjusted CA balance is 1.1 percent of GDP. The EBA CA model suggests a norm of 0.3 percent of GDP for 2020. However, given external risks from a large and negative NIIP, the IMF staff views the appropriate CA norm to be 1.8 percent of GDP, with a range of 0.8 to 2.8 percent of GDP. This yields a CA gap of –1.7 to 0.3 percent of GDP. The IMF staff assessment puts more weight on external sustainability and is guided by the objective of raising the NIIP to below –50 percent over the medium to long term. With a sustained CA surplus of about 1.8 percent of GDP, the NIIP is projected to reach –50 percent of GDP over the medium term under current policies, though with high uncertainty, as zero valuation effects are assumed.²</p>						
2020 (% GDP)	CA: 0.7	Cycl. Adj. CA: -1.3	EBA Norm: 0.3	EBA Gap: -1.6	COVID-19 Adj.: 2.4	Other Adj.: -1.5	Staff Gap: -0.7
<p>Real Exchange Rate</p>	<p>Background. In 2020 the CPI-based REER appreciated by 0.5 and the ULC-based REER depreciated by 4.6 percent from their average 2019 levels. The CPI-based REER is still moderately lower than its 2009 peak, partially reversing the significant appreciation from euro entry in 1999 until 2009. The ULC-based REER shows that the appreciation between 1999 and 2008 has been almost fully reversed, initially because of labor shedding, and thereafter due to wage moderation and strong output growth until 2019. After reaching its peak in 2008 the ULC-based REER depreciated by 24 percent. As of May 2021, the CPI-based REER had appreciated by 1.4 percent, and the ULC-based REER had depreciated by 0.2 percent relative to their 2020 averages.</p> <p>Assessment. The IMF staff CA gap implies an overvaluation of 2.6 percent, using an elasticity of 0.28, while the EBA REER models estimate a small overvaluation of 4.0 (level) to 6.2 (index) percent for 2020. Therefore, based on the IMF staff CA gap, the IMF staff assesses the REER gap to be in the range of –1.4 to 6.6 percent, with a midpoint of 2.6 percent.³</p>						
<p>Capital and Financial Accounts: Flows and Policy Measures</p>	<p>Background. Financing conditions have eased following some increase in sovereign bond yields in the early stages of the COVID-19 crisis. And by the third quarter of 2020 the private sector was continuing its deleveraging against the rest of the world. In 2020 the financial account balance was largely driven by the substantial increase in liquidity creation by the Eurosystem through the expansion of asset purchase programs and the refinancing of Spanish banks, as well as by net outflows of loans and other bank-related instruments from sectors other than the central bank. Consequently, the accumulation of TARGET2 liabilities, reflecting liquidity creation within the framework of the Eurosystem, was the highest since 2012 (13 percent of GDP in 2020), after having been negative in 2019 for the first time since 2015.</p> <p>Assessment. As a result of the pandemic crisis, investor sentiment deteriorated in 2020, notably toward banks. Furthermore, large external financing needs leave Spain vulnerable to sustained market volatility, although the ECB’s policies to maintain favorable liquidity conditions and monetary accommodation remain a mitigating factor.</p>						
<p>FX Intervention and Reserves Level</p>	<p>Background. The euro has the status of a global reserve currency.</p> <p>Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>						

Table 3.28. Turkey: Economy Assessment

<p>Overall Assessment: <i>The external position in 2020 was moderately weaker than the level implied by medium-term fundamentals and desirable policies.</i> Expansionary monetary policy and rapid provision of credit by state-owned banks put pressure on the lira last year through dollarization, import, and financial account channels, which led in turn to sales of foreign exchange reserves to support the lira. Despite the marked real exchange rate depreciation, the CA deficit resurfaced because of lower exports (including tourism) and robust imports (including gold). The monetary tightening beginning in late 2020 saw a return of capital inflows and modest reserves buildup, but outflows and reserves losses resumed in March 2021, amid rising policy uncertainty and lira depreciation. Policy uncertainty, large gross external financing needs, and relatively low reserves increase Turkey's vulnerability to shocks. Only over time will the REER undervaluation, with its usual lags, help move the current account back toward its norm, aided by less expansionary policies.</p> <p>Potential Policy Responses: Policies that could support Turkey's external rebalancing and bring the current account balance closer to its norm include (i) keeping credit growth at sustainable rates; (ii) maintaining a firm monetary policy stance, with additional measured tightening if inflation expectations increase further, to, at a minimum, keep the ex-ante real policy rate unchanged, which would also help ensure sustainable credit growth; (iii) enhancing the fiscal anchor with a credible commitment to future consolidation to bring debt down over time—which would also create greater space for meeting pandemic-related needs in 2021 and minimize scarring; and (iv) taking additional steps to build policy credibility, which would encourage capital inflows and support de-dollarization and a buildup of reserves.</p>							
Foreign Asset and Liability Position and Trajectory	<p>Background. In 2020, Turkey's NIIP declined from -46 to -56.4 percent of GDP, driven entirely by foreign liabilities, which rose from 79 to 90 percent of GDP.¹ External debt increased from 57 to 63 percent of GDP, driven by lower US dollar GDP. Over 70 percent of external debt is held by the private sector, and about one-third is short term (on a remaining maturity basis). Debt is expected to remain sustainable over the medium term, but debt servicing remains vulnerable to global and domestic financial conditions.</p> <p>Assessment. Turkey's NIIP has become more negative since the 2000s, with 2020 affected by one-off factors related to the pandemic. The size and composition of external liabilities, coupled with low reserves, increases Turkey's vulnerability to liquidity shocks, sudden shifts in investor sentiment, and a global upswing in interest rates. The FX exposure of nonfinancial companies, including short-term loans, is high, with the potential to affect bank asset quality. NIIP is projected to improve to about -45 percent of GDP in 2025, driven by a decline in liabilities, mainly loans.</p>						
2020 (% GDP)	NIIP: -56.4	Gross Assets: 33.6	Res. Assets: 13.1	Gross Liab.: 90.1	Debt Liab.: 62.8		
Current Account	<p>Background. After posting a surplus for the first time in nearly two decades in 2019, the CA registered a deficit of 5.1 percent of GDP in 2020, driven by weaker goods and services exports—including tourism—and robust imports. Credit-driven consumption and investment fueled imports, more than offsetting the lower oil import bill. Gold imports increased from 1½ percent 2019 to 3½ percent of GDP in 2020, driven by policy uncertainty, a weakening currency, and elevated inflation.</p> <p>Assessment. The EBA CA model estimated norm is -1.5 percent of GDP (with a standard error of $\pm 4.7-1.8$ percent of GDP). The CA deficit of 5.1 percent of GDP narrows to 4.7 percent of GDP after cyclical adjustment. Adjusting for temporary pandemic-related shocks (1.6, -0.3, and -0.2 percent of GDP for travel services, including tourism, the global shift from services to tradable goods, and oil prices, respectively) and the surge in gold imports (1 percent of GDP) yields an IMF staff CA gap of -1.2 percent of GDP relative to the CA norm. One-off shocks and the range surrounding the norm increase the uncertainty around this assessment.</p>						
2020 (% GDP)	CA: -5.1	Cycl. Adj. CA: -4.7	EBA Norm: -1.5	EBA Gap: -3.3	COVID-19 Adj.: 1.1	Other Adj.: 1.0	Staff Gap: -1.2
Real Exchange Rate	<p>Background. The average REER depreciated for a third consecutive year, with a depreciation of more than 10 percent in 2020. The nominal depreciation against the dollar in 2020 was 23.6 percent. As of end-May 2021, the REER had depreciated by 9.0 percent compared to the 2020 average.</p> <p>Assessment. The IMF staff CA gap implies a REER gap of 4.9 percent in 2020 (applying an estimated elasticity of 0.24). The EBA REER level and index approaches suggest that the REER was undervalued in 2020 by about 31 to 35 percent. Considering the recent sharp depreciation of the REER, which is expected to support a rise in Turkey's CA balance toward its norm over the coming years, the IMF staff gives more weight to the EBA REER approaches as the CA continues to adjust. The IMF staff assesses the REER to have been undervalued by about 15–25 percent, with a midpoint of 20 percent and large uncertainties surrounding these estimates.</p>						
Capital and Financial Accounts: Flows and Policy Measures	<p>Background. Net capital inflows increased only modestly in 2020, from US\$5.5 to US\$8.2 billion. Errors and omissions remained negative, likely reflecting unrecorded capital outflows. The modest increase in net inflows was driven by other investment (notably the increased bilateral currency swap agreement with Qatar), which more than offset larger net portfolio outflows and lower net FDI. Turkey introduced limits on bank swaps and other derivative transactions with foreign counterparties as well as export surrender/repatriation requirements (both CFMs) in August 2018. These were being unwound when new bouts of volatility resurfaced in late 2019. Limits on bank swaps and other derivative transactions with foreign counterparties were thus reintroduced and tightened in December 2019 and February–April 2020. These were relaxed in November 2020.</p> <p>Assessment. The quality of financing continued to worsen in 2020, with increased reliance on short-term financing and reserve drawdown. With annual gross external financing needs projected at about 24 percent of GDP on average in 2021–26 (29.4 percent of GDP in 2020), Turkey remains vulnerable to adverse shifts in global investor sentiment. Remaining CFMs should be phased out as conditions improve to increase market liquidity and support dedollarization.</p>						
FX Intervention and Reserves Level	<p>Background. The de jure exchange rate is classified as free floating. The central bank undertook significant FX sales in 2020 to contain pressure on the lira. Gross reserves declined from US\$105.7 billion at the end of 2019 to US\$93.5 billion by the end of December. Net international reserves dropped by US\$26.2 billion to US\$14.5 billion by the end of 2020.² The composition of reserves has also changed, with an increasing share of gold and non-SDR-basket currencies.</p> <p>Assessment. Gross reserves decreased from 84 to 74 percent of the IMF's ARA metric during 2020, falling further below the floor of the recommended 100–150 percent ARA adequacy range and covering only 54 percent of short-term external debt (at remaining maturity). Steady reserve accumulation over the medium term is needed given Turkey's large external liabilities, dependence on short-term and portfolio funding, and large domestic FX deposits.</p>						