

**EXECUTIVE
BOARD
MEETING**

SM/21/122
Correction 2

July 14, 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 24 and 33

Questions:

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

Table 3.18. The Netherlands: Economy Assessment

<p>Overall Assessment: <i>The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies.</i> The Netherlands' status as a trade and financial center and natural gas exporter makes an external assessment particularly challenging.</p> <p>Potential Policy Responses: The use of available fiscal buffers by the authorities to provide ongoing support to the health care sector and to households and businesses affected by the COVID-19 pandemic remains appropriate, also against the backdrop of the additional space provided by the sustained activation of the escape clause from the EU Stability and Growth Pact. Even after the pandemic subsidies, it appears that the government will command room to pursue a growth-oriented fiscal policy. Therefore, policies should avoid a rush to consolidate, thereby promoting and safeguarding the recovery while also supporting public and private investment in physical and human capital to foster potential robust growth, which would also contribute to external rebalancing.</p>						
<p>Foreign Asset and Liability Position and Trajectory</p>	<p>Background. The NIIP of The Netherlands reached <u>444113.8-9</u> percent of GDP at the end of 2020, reflecting gross assets and liabilities of <u>1,170-865.5</u> and <u>1,056-01.6</u> percent of GDP, respectively, rising from a nearly balanced NIIP at the end of 2009. The largest component of the NIIP comes from the net FDI stock—about €1,<u>404-111</u> billion (<u>437138.9</u> percent of GDP) at the end of 2020. According to the latest Coordinated Direct Investment Survey, the inward and outward FDI positions of The Netherlands were second only to those of the United States at the end of 2019, with the largest gross bilateral stocks accounted for by the United States (US\$1.85 trillion), the United Kingdom (US\$1.06 trillion), and Luxembourg (US\$0.87 trillion). The central bank's net TARGET2 claims on the ECB amounted to €38 billion at the end of 2020. Reflecting a persistent CA surplus, the NIIP is expected to increase as a ratio to GDP in 2021, likely keeping it considerably above the 100 percent mark in the absence of large revaluation effects, despite a rising denominator on the back of a rebound in GDP.</p> <p>Assessment. The Netherlands' safe haven status and its sizable foreign assets limit risks from its large foreign liabilities.</p>					
	2020 (% GDP)	NIIP: <u>114-83.9</u>	Gross Assets: <u>1,170-865.5</u>	Debt Assets: <u>263260.86</u>	Gross Liab.: <u>1,056051.06</u>	Debt Liab.: <u>340308.32</u>
<p>Current Account</p>	<p>Background. In 2020 the CA surplus, in place since 1981, declined to 7.0 percent of GDP (7.5 percent cyclically adjusted). The historically positive goods and services balance, primarily the result of surpluses vis-à-vis EU trading partners, improved at the margin. By contrast, the primary income balance turned into a 1.7 percent of GDP deficit in 2020, despite the positive NIIP, as lower net investment income on FDI was only partly compensated for by a reduction in payouts on net portfolio investment. Likewise, the secondary income balance deteriorated to -1.7 percent of GDP, mainly on the back of other current transfers by the nongovernment sector abroad. Substantial FDI outflows have been the key driver of the financial account since 2000, constituting the counterpart to high nonfinancial corporate net saving (gross saving minus domestic business investment), whereas household net saving (gross saving minus residential investment) has played a comparatively smaller role due to the offsetting impact of substantial mandatory contributions to second-pillar pension funds and high real estate investment. The Netherlands' status as a trade and financial center and natural gas exporter also contribute to a structurally strong external position. In 2021 the CA surplus is projected to rebound to 9.0 percent of GDP.</p> <p>Assessment. The EBA CA model estimates a CA norm of 3.4 percent of GDP and a CA gap of 4.0 percent of GDP in 2020, with an unexplained residual of 1.1 percent of GDP that primarily reflects the high gross saving of multinationals based in The Netherlands. In addition, measurement errors or biases in official statistics may also contribute to an overstatement of the net accumulation of wealth that is attributed to Dutch residents, an issue of particular relevance for The Netherlands as the foreign ownership of publicly listed Dutch corporations has been consistently above 85 percent over the past 10 years. An IMF staff adjustment of -1.4 percent of GDP to offset this bias is approximated with the help of historical data about the foreign ownership structure of Dutch firms provided by the central bank. Moreover, another -0.2 percent of GDP adjustment is applied to account for the (temporary) effects of the COVID-19 pandemic, reflecting lower spending on travel services, including tourism, by Dutch residents abroad (-0.3 percent of GDP) and higher-than-usual trade in medical goods (0.1 percent of GDP). Taking these factors into consideration, and against a norm in a range of 1.4 to 5.4 percent of GDP, the IMF staff assesses a CA gap of 0.4 to 4.4 percent of GDP.¹</p>					
2020 (% GDP)	CA: <u>7.0</u>	Cycl. Adj. CA: <u>7.5</u>	EBA Norm: <u>3.4</u>	EBA Gap: <u>4.0</u>	COVID-19 Adj.: <u>-0.2</u>	Other Adj.: <u>-1.4</u> Staff Gap: <u>2.4</u>
<p>Real Exchange Rate</p>	<p>Background. The annual average CPI-based REER appreciated by 2.0 percent in 2020, with part of the rise in the euro NEER offset by inflation in The Netherlands staying below that of its trading partners, while the average ULC-based REER appreciated by 3.8 percent. However, drawing conclusions from both indicators about shifts in competitiveness in 2020 is hampered by the distortions the COVID-19 pandemic implied for the measurement of consumer prices and ULCs across different countries. As of May 2021 the CPI-based REER was 0.6 percent above its 2020 average.</p> <p>Assessment. Assuming a semi-elasticity of 0.7, the IMF staff CA gap of 2.4 percent of GDP implies a REER undervaluation of about 3.5 percent. The EBA REER models indicate an overvaluation between 4.2 percent (level model) and 17.8 percent (index model) in 2020, predominantly reflecting unexplained residuals. Taking into account all estimates and the uncertainty surrounding the EBA REER results, the IMF staff views the REER as undervalued by about 0.5 to 6.5 percent, with a midpoint of 3.5 percent, based on its assessment of the CA gap and its range.</p>					
<p>Capital and Financial Accounts: Flows and Policy Measures</p>	<p>Background. Net FDI and portfolio outflows dominate the financial account. FDI outflows are driven by the investment of corporate profits abroad, largely by multinationals. More than 40 percent of gross FDI assets and liabilities are attributable to subsidiaries of multinationals.</p> <p>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.</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 euro area economies are typically low relative to standard metrics, but the currency is free floating.</p>					

Table 3.27. Thailand: Economy Assessment

<p>Overall Assessment: <i>The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies.</i> The CA surplus narrowed relative to 2019 due to the COVID-19 shock, reflecting a dramatic fall in the tourism-driven services balance partially offset by a strengthening trade balance as weak domestic demand drove a sharper contraction in imports than in exports.</p> <p>Potential policy responses: In order to bring the CA more in line with medium-term fundamentals and desirable policies, the IMF staff recommends an accelerated, mutually reinforcing macro policy stimulus, led by a fiscal expansion, given available fiscal space, to revitalize domestic demand. This should be deployed toward targeted social transfers to mitigate the effects of the pandemic on the most vulnerable, as well as infrastructure investment to support the recovery and reorientation of affected sectors. In addition, the exchange rate should move flexibly as the key shock absorber, with intervention limited to disorderly market conditions. Further efforts to reform social safety nets should continue, and steps to address widespread informality should reduce precautionary saving and support consumption.</p>							
Foreign Asset and Liability Position and Trajectory	<p>Background. Thailand's NIIP strengthened in 2020 to 11 percent of GDP from 0.3 percent in 2019. Gross assets rose to about 120 percent of GDP (driven by the increase in reserve assets to 51 percent of GDP), while gross liabilities increased slightly to 109 percent of GDP, comprising direct (about one-half) and portfolio (one-third) investment. Falling inward investment kept net FDI low; outward direct and portfolio investment recovered strongly by the end of the year, offsetting midyear outflows.</p> <p>Assessment. The NIIP is projected to remain in a small creditor position over the medium term given CA surpluses. External debt rose to a still-contained 38 percent of GDP, of which short-term debt (on a remaining maturity basis) amounts to 15 percent of GDP; risks to external debt sustainability and liquidity are limited.</p>						
2020 (% GDP)	NIIP: 11	Gross Assets: 120	Res. Assets: 51	Gross Liab.: 109	Debt Liab.: 38		
Current Account	<p>Background. Thailand's CA surplus declined from 7.0 percent of GDP in 2019 to 3.23 3.3 percent of GDP in 2020, reflecting the impact of the pandemic. Containment measures weighed on domestic demand, which led to a larger contraction in imports than exports, which softened due to weak global demand and supply chain disruptions, notwithstanding a surge in net gold exports (gold is widely used as a store of wealth in Thailand, and many households without access to social safety nets had to rely on gold sales in 2020 to meet extraordinary liquidity needs). This led to a strengthening of the trade balance. However, the services account collapsed as international tourism arrivals fell to zero between April and October 2020. The CA in 2021 is expected to narrow to 0.5 percent of GDP as the recovery in domestic and external demand narrows the trade balance and tourism receipts are still slow to recover.</p> <p>Assessment. The EBA CA model estimates a cyclically adjusted CA of 1.0 percent of GDP and a CA norm of 1.2 percent of GDP for 2020. The CA gap of -0.2 percent of GDP consists of an identified policy gap of 1.3 percent of GDP (mainly due to fiscal policy and FX intervention) and an unexplained residual of -1.5 percent of GDP, which partly reflects the unique nature of the COVID-19 shock as well as structural factors not fully captured by the EBA model. In this regard, adjustors to account for the large shocks to the travel services (including tourism) and oil sectors of 3.7 and -0.5 percent of GDP, respectively, are applied, as they are not accounted for by the standard EBA cyclical adjustment. Further adjustments regarding the global shift in household consumption composition from services toward consumer goods (-0.3 percent of GDP), net exports of medical supplies triggered by the health emergency (-0.2 percent of GDP), and the aforementioned surge in gold exports (-0.3 percent of GDP) are also applied. Overall, the IMF staff assesses the CA gap to be in the range of 0.7-3.7 percent of GDP, with a midpoint of 2.2 percent of GDP. This gap is expected to narrow over the medium term as policy stimulus is deployed, domestic demand recovers, and the social safety net is enhanced.</p>						
2020 (% GDP)	CA: 3.3	Cycl. Adj. CA: 1.0	EBA Norm: 1.2	EBA Gap: -0.2	COVID-19 Adj.: 2.4	Other Adj.: 0.0	Staff Gap: 2.2
Real Exchange Rate	<p>Background. The baht has been on a gradual real appreciation trend since the mid-2000s, despite occasional bouts of volatility. In 2020 the REER depreciated 6.9 percent by April, relative to the end of December 2019, as emerging markets faced increased capital outflows due to the outbreak of the pandemic. The REER has since broadly resumed its appreciation, as the virus was controlled in Thailand through the year, and buttressed by positive sentiment about the vaccine, ending the year about 2.6 percent lower relative to its 2019 average. As of end-May 2021, the REER had depreciated by 3.7 percent compared to the 2020 average.</p> <p>Assessment. Using an elasticity of 0.56 and based on the IMF staff CA gap, the IMF staff assesses the REER to be undervalued in the 1.5-6.5 percent range, with a midpoint of 4.0 percent. The EBA index REER gap in 2020 is estimated at 10.8 percent; the EBA level REER gap is estimated at -5.2 percent.</p>						
Capital and Financial Accounts: Flows and Policy Measures	<p>Background. In 2020 the capital and financial account balance strengthened to -0.7 percent of GDP from -2.9 percent in 2019, driven by other investment flows. Nonresident holdings of Thai bonds and equities declined in March/April, but recovered by the end of the year, reflecting Thailand's strong external position relative to other emerging markets. Through the year, the authorities accelerated plans to liberalize FX outflows, including easing restrictions on resident holdings of foreign currency securities and deposits.</p> <p>Assessment. Since 2013 Thailand has experienced episodes of volatility, reflecting external financial and political conditions. Nevertheless, Thailand has been able to weather such episodes well, given strong external buffers and fundamentals. The IMF staff encourages the prudent liberalization of the financial account and recommends a phaseout of the 2019 reduction in the limits on nonresident baht accounts. Instead, a comprehensive package of macroeconomic, financial, and structural policies should be pursued, complemented by continued efforts to liberalize capital outflows.</p>						
FX Intervention and Reserves Level	<p>Background. The exchange rate regime is classified as (de jure and de facto) floating. International reserves (including net forward position) increased to 57.3 percent of GDP in 2020, which is more than three times short-term debt and 12 months of imports, and more than 200 percent of the IMF's standard reserve adequacy metric. In response to the COVID-19 shock, the exchange rate has been allowed to adjust, with some FX sales in outflow episodes.</p> <p>Assessment. Gross international reserves (including net forward position) increased by more than US\$28.7 billion in 2020. While official intervention data are not published, estimates suggest two-sided intervention for the year. Reserves are higher than the range of the IMF's adequacy metrics, and there is still no need to build up reserves for precautionary purposes. The exchange rate should move flexibly to act as a shock absorber, with intervention limited to avoiding disorderly market conditions.</p>						