SM/13/168
Correction 4

August 1, 2013

To: Members of the Executive Board

From: The Acting Secretary

Subject: **2013 Pilot External Sector Report—Individual Economy Assessments**

The attached corrections to SM/13/168 (6/20/13) have been provided by the staff.

Typographical Errors

Page 7, Current Account, line 6:

for "The cyclically adjusted current account appears (-1¾ to -2¼ percent of GDP) weaker"
read "The cyclically adjusted current account appears (-1¾ to -2¾ percent of GDP) weaker"

Page 7, Current Account, line 8:

for "Various methods suggest a current account norm in a range of 2 to -1 percent of GDP."
read "Various methods suggest a current account norm in a range of -2 to -1 percent of GDP."

Questions may be referred to Mr. Robinson, AFR (ext. 35691), Mr. Phillips, RES (ext. 37187), and Ms. Stuart, SPR (ext. 37897).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

	Brazil	Overall assessment
Current account	**Background**. Despite subdued growth and some real depreciation, Brazil's current account deficit increased slightly in 2012 on the back of weakening terms of trade, strong domestic consumption and supply-side constraints. The cyclically adjusted current account deficit was -1.8 percent of GDP. A large sustained fall in commodity prices could widen sharply the current account deficit. On the upside, important oil discoveries should boost exports and help stabilize the current account deficit in the longer term. **Assessment**. The cyclically adjusted current account appears (-1¾ to -2~~¼~~ ¾ percent of GDP) weaker than would seem consistent with medium term fundamentals and desirable policies. Various methods suggest a current account norm in a range of -2 to -1 percent of GDP. However, the envisaged pickup in growth and investment in the short to medium-term is likely to increase the current account deficit to between 3½ and 4 percent of GDP for some time.	Brazil's external position appears moderately weaker than implied by medium-term fundamentals and desirable policy settings, **Potential policy responses** Further efforts to increase national saving than the ones currently contemplated are needed, including by advancing with pension reform and shifting the structure of public spending away from consumption towards investment. It will be important to maintain a macro policy stance and a policy mix that moderates demand and facilitates rebalancing, along with use of capital flow management measures to manage volatile capital flows.
Real exchange rate	**Background**. Brazil's real effective exchange rate has appreciated by about 25 percent (on average) in the last 10 years. **Assessment**. A combination of indicators suggests that the real exchange rate is overvalued by some 10-15 percent. Model-based estimates suggest that the real effective exchange rate is above the level implied by medium-term fundamentals and desirable policies, partly reflecting sizable net capital inflows.	
Capital and financial accounts: flows and measures	**Background**. Brazil has attracted sizable capital inflows. Until recently, the pickup in FDI flows has been broadly commensurate with the widening current account deficit. Net portfolio inflows have been moderate in the past 12 months. Looking forward, net portfolio inflows may increase if growth picks up and the interest rate differential increases. A wide range of macro policy tools has been deployed to manage large capital flows pressures. Since 2010, capital account restrictions have been applied to moderate flows and influence their composition. There is some evidence that these measures have helped reduce portfolio inflows though the evidence for persistent effects on the exchange rate is less clear. **Assessment**. The composition of flows has a favorable risk profile, but this can change quickly and managing flows will likely remain a challenge.	
FX intervention and reserves	**Background**. The flexible exchange rate has been an important shock absorber with central bank intervention focused on reducing the pace and volatility of exchange rate changes. **Assessment**. Reserves have increased to more than adequate levels with respect to various criteria including the IMF's composite adequacy metric. There is no need for further reserve accumulation for precautionary purposes, although temporary further accumulation could be part of an overall strategy to manage capital inflows.	
Foreign asset and liability position	**Background**. Brazil's NFA position has improved over recent years on the back of falling external debt, reaching -30 percent of GDP in 2012, but is projected to deteriorate again modestly over coming years. **Assessment**. In the longer term, as Brazil's large *pre-sal* oil reserves come on line, added efforts to increase savings and NFA would be appropriate to strengthen further Brazil's external position.	

	Canada	Overall assessment
Current account	**Background**. From 2000 to 2012 Canada's current account balance shifted from a sizable surplus to a deficit of 3.7 percent of GDP (the cyclically-adjusted current account deficit is estimated by staff to be around 2½ percent of GDP in 2012, reflecting the large negative output gap in the United States). The deterioration reflects Canada's stronger economic rebound relative to its main trade partners in recent years, but also the significant real appreciation of the Canadian dollar and its weak productivity growth. At the same time, rapidly rising supply combined with limited refining capacity and lack of transportation infrastructure led to a large pricing differentials between the Canadian and global energy markets, limiting the positive impact on the current account from the boom in unconventional energy production. **Assessment**. Analysis suggests that the cyclically-adjusted current account is some 1-3, percentage points of GDP weaker than the value implied by medium-term fundamentals and desirable policies.	The external position appears weaker than implied by medium-term fundamentals. Export performance has been disappointing and net external liabilities have increased. **Potential policy responses** Continued efforts to improve labor productivity (such as budget programs aimed at improving labor skills and fostering research and innovation and higher investments in infrastructure to transport and export natural resources — would help to gradually bring Canada's current account close to the level implied by fundamentals and desirable policy settings.
Real exchange rate	**Background**. Canada's real effective exchange rate appreciated by 32 percent between 2002 and 2012, and is some 15 percent above its 1995–2012 average. Over the last decade, Canada's exchange rate has become increasingly correlated with oil prices, as petroleum exports surged. **Assessment**. Models suggest a real effective exchange rate overvaluation of 5–15 percent relative to medium-term fundamentals and desirable policy settings.	
Capital and financial accounts: flows and measures	**Background**. The large current account deficit of recent years has been financed primarily by net portfolio inflows. Average net portfolio outflows from 2000–07 turned into *inflows* of some 4½ percent of GDP as strong growth prospects, and relatively strong fiscal position and high interest rates made Canada a safe haven, putting upward pressure on the exchange rate (along with high commodity prices). **Assessment**. Canada has a fully open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate and a strong fiscal position.	
FX intervention and reserves	**Assessment**. A free floater with minimal reserves who has not unilaterally intervened since September 1998.	
Foreign asset and liability position	**Background**. Canada's net external liabilities are modest (around -15 percent of GDP at end-2012), and would deteriorate moderately under current conditions. Canada has a positive net equity position and a negative net debt position vis-à-vis the rest of the world, reflecting sizable FDI and portfolio equity investment overseas. **Assessment**. Gross external debt, at 77 percent of GDP, is low relative to other advanced economies, and is a modest vulnerability. Canadian foreign assets are primarily in the form of FDI and portfolio equity claims whose value tend to decline during periods of global growth and stock market weakness, as well as when the Canadian dollar appreciates.	