

**EXECUTIVE
BOARD
MEETING**

SM/20/105
Correction 1

July 22, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **2020 External Sector Report—Chapter 1**

Board Action: The attached corrections to SM/20/105 (7/9/20) have been provided by the staff:

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

Pages 7 (second para., lines 12–13), 8, 9, 17, 39, 42, 43, 45

Typographical Errors

Pages 7 (charts), 13, 14, 16, 23, 24, 32, 33, 37, 48

Questions:

Mr. Leigh, RES (ext. 34747)
Mr. Adler, RES (ext. 35648)
Mr. Rabanal, RES (ext. 36784)

percent to 21.1 percent. The announcement and implementation of these trade policy changes during 2018 and 2019 triggered significant declines in equity prices and offsetting currency movements, with much of the depreciation in the renminbi during this period driven by trade policy announcements (Box 1.2). In early 2020 the United States and China agreed to a “Phase One” economic and trade agreement, with a partial rollback of previously implemented tariffs and a truce on new tariffs. Trade tensions also deescalated on other fronts in late 2019 with the signing of the United States-Mexico-Canada Agreement, which went into effect on July 1, 2020.

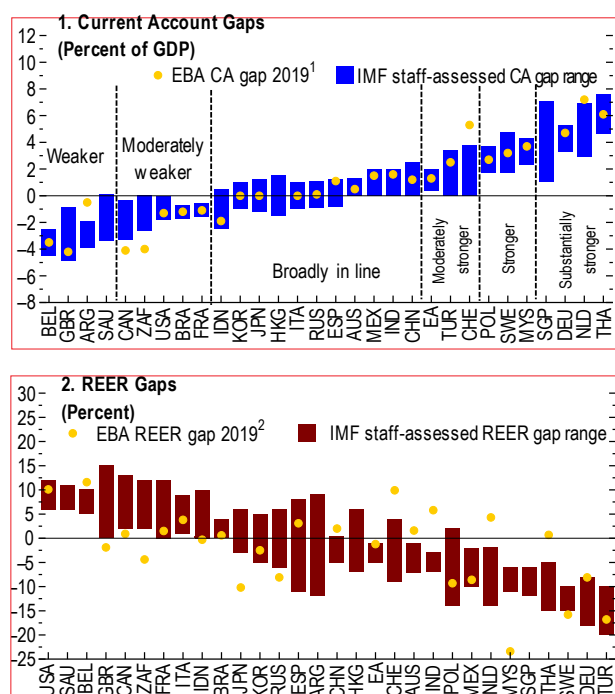
Furthermore, the stocks of external assets and liabilities have reached historic highs, with attendant risks to both debtor and creditor economies. External assets and liabilities as a share of GDP more than tripled from the early 1990s to the years preceding the COVID-19 crisis (Figure 1.2). This sharp increase, both in gross and net terms, has raised questions regarding its sustainability, as well as the associated macroeconomic vulnerabilities. The widening stock positions reflect the persistence of the associated current account surpluses and deficits of the world’s systemic economies. The United States has the largest net debtor position as a share of world GDP. The largest net creditor economies in percent of world GDP are China, Germany, and Japan, ~~Germany, and China~~ (Table 1.2). In terms of currency exposures, most emerging market and developing economies went from having short positions in foreign currency in 1990 to long positions in 2017, reflecting a shift in foreign liabilities from foreign currency debt to equity financing and, in general, sustained accumulation of foreign exchange reserves. Most advanced economies were already long in foreign currency in 1990, and their net positions have continued to grow.

Normative Assessment of External Positions in 2019

IMF staff external sector assessments for 2019 provide a benchmark for assessing external positions as they were before the onset of the COVID-19 crisis. The assessment of external positions requires a multilateral approach that matches positive and negative excess external imbalances. The IMF’s external assessment framework

Figure 1.3. IMF Staff-Assessed and External Balance Assessment Estimated Current Account and Real Effective Exchange Rate Gaps, 2019

The IMF staff combines the numerical inputs from the EBA methodology with country-specific judgment and other indicators to arrive at multilaterally-consistent assessments of the 29 largest systematically important economies and the euro area.



Source: IMF staff assessments.

Note: CA = current account; EBA = IMF External Balance Assessment model; REER = real effective exchange rate. Data labels use International Organization for Standardization (ISO) country codes.

¹Hong Kong SAR, Saudi Arabia, and Singapore do not have EBA estimates.

²EBA REER gap is defined as the average gap from REER-index, REER-level, and REER gap implied from staff CA gap using estimated elasticities (see details in Cubeddu and others 2019).

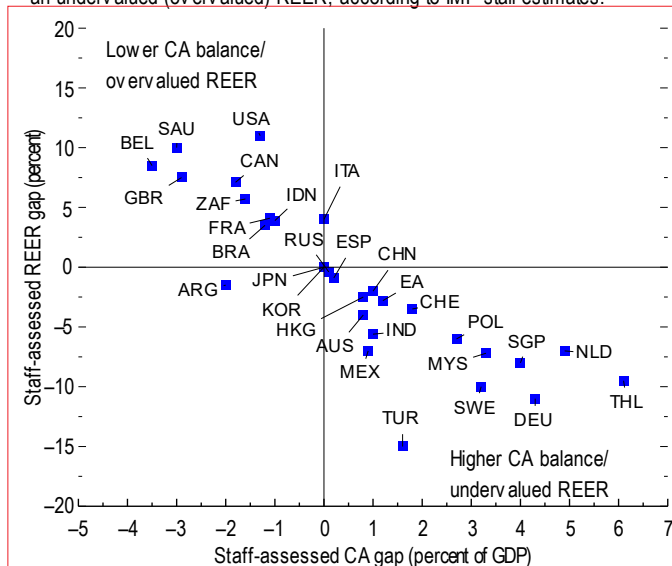
combines numerical inputs from the latest vintage of the EBA methodology with a series of external indicators and country-specific judgment (see Box 1.2 and Chapter 3). The EBA methodology produces multilaterally consistent estimates for current account and real exchange rate *norms* (or benchmarks), which depend on country fundamentals and desired policies.¹ The IMF staff estimates current account and real effective exchange rate *gaps* by comparing actual current accounts (stripped of temporary components) and real effective exchange rates with their staff-assessed norms, using judgment and country-specific insights where appropriate. The IMF staff arrives at a holistic overall *external sector assessment* for the world's 30 largest economies based on the estimated gaps as well as consideration of other external sector indicators, such as the net international investment position, capital flows, and foreign exchange reserves.

For most of the 30 economies, overall external position assessments for 2019 remained broadly similar to those for 2018. About one-third of economy assessments changed categories in 2019 (Tables 1.4 and 1.5). Economies with estimated excess current account surpluses (deficits) generally also had an undervalued (overvalued) real effective exchange rate, according to IMF staff estimates (Figures 1.3 and 1.4).² The configuration of overall external positions compared with their estimated desirable levels was as follows.

Stronger than the level consistent with medium-term fundamentals and desirable policies: The 10 economies with such positions were the euro area, Germany, Malaysia, the Netherlands, Singapore, and Thailand, as well as Poland, Sweden, Switzerland, and Turkey, which entered this category in 2019, driven by increases in their current account balances.³

Figure 1.4. IMF Staff-Assessed Current Account and Real Effective Exchange Rate Gaps, 2019

Countries with estimated excess CA surpluses (deficits) generally also had an undervalued (overvalued) REER, according to IMF staff estimates.



Source: IMF staff calculations.

Note: REER gap is based on 2019 average REER. CA = current account; REER = real effective exchange rate. Data labels use International Organization for Standardization (ISO) country codes.

¹For instance, advanced economies with higher incomes, older populations, and lower growth prospects have positive current account norms. Conversely, current account norms are negative for most emerging market and developing economies, as they are expected to import capital to invest and exploit their higher growth potential.

²Figure 1.5 reports the ranges for staff-assessed current account gaps as well as the EBA model-based current account gap estimates. As reported in Table 1.5, the EBA and staff-assessed current account gaps differ in a number of cases, reflecting the use of country-specific judgment. Figure 1.5 also reports the staff real effective exchange rate (REER) gaps, which are arrived at using multiple inputs that vary across countries, including (1) estimates derived from mapping IMF staff views on the current account gap using country-specific trade elasticities; (2) estimates from the EBA REER index and level models; and (3) other indicators, including unit-labor-cost-based exchange rates. As reported in Table 1.7, the overall staff-assessed REER gaps thus differ from these individual inputs.

³For Turkey, the “moderately stronger” external position assessment reflects the lagged adjustment of external balances following the sharp depreciation of the real exchange rate in 2018.

Weaker than the level consistent with medium-term fundamentals and desirable policies: The nine economies with such positions were Belgium, Canada, the United Kingdom, the United States, and a number of emerging market and developing economies (Argentina, South Africa), as well as commodity exporters (Brazil, Saudi Arabia) and France, which entered this category in 2019.⁴

Broadly in line with the level consistent with medium-term fundamentals and desirable policies:

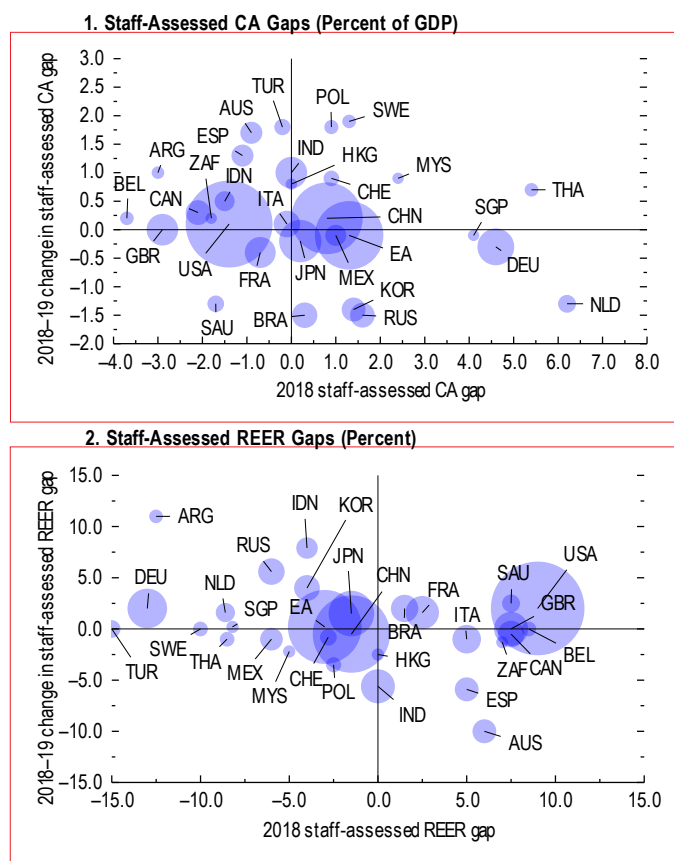
The 11 economies with such positions were, as in the previous year, Australia, China, Hong Kong SAR, India, Italy, Japan, and Mexico, as well as Indonesia, Korea, Russia, and Spain, which entered this category in 2019.

Global excess imbalances (the sum of absolute excess surpluses and deficits) represented about 1.2 percent of world GDP in 2019, about 40 percent of overall current account surpluses and deficits, only slightly less than in 2018. Addressing underlying structural distortions has been challenging, resulting in persistent excess global imbalances. IMF staff-assessed current account gaps moved down (smaller excess surpluses or larger deficits) for commodity exporters, such as Brazil, Russia, and Saudi Arabia, as well as for euro area economies, such as the Netherlands (Figure 1.5). These changes largely mirrored increased current account gaps for emerging market and developing economies, such as Argentina and Turkey, and, to a lesser extent, emerging market and developing economies in Asia. IMF staff-assessed real effective exchange rate gaps generally moved consistently with current account gaps (Figure 1.5, panel 2).

Overall, the combination of persistent excess global imbalances and stocks of assets and liabilities at historically high levels implied vulnerabilities and remaining policy challenges on the eve of the pandemic.

Figure 1.5. Evolution of IMF Staff-Assessed Current Account and Real Effective Exchange Rate Gaps, 2018–19

Staff-assessed CA gaps narrowed for some economies in 2019, but the global sum of excess imbalances in percent of world GDP was broadly unchanged. Staff-assessed REER gaps generally moved consistently with the CA gaps.



Source: IMF staff estimates.

Note: Bubble sizes proportional to US dollar GDP. A positive (negative) REER gap denotes overvaluation (undervaluation). CA = current account; REER = real effective exchange rate. Data labels use International Organization for Standardization (ISO) country codes.

⁴ The change in the assessment for Brazil between 2018 to 2019 is primarily due to statistical revisions.

Indonesia, Mexico, South Africa, and Russia occurred with a more limited change in foreign currency reserves and currency movements allowed by the authorities to more fully reflect market pressure (Figure 1.8).

Outlook for Current Account Balances

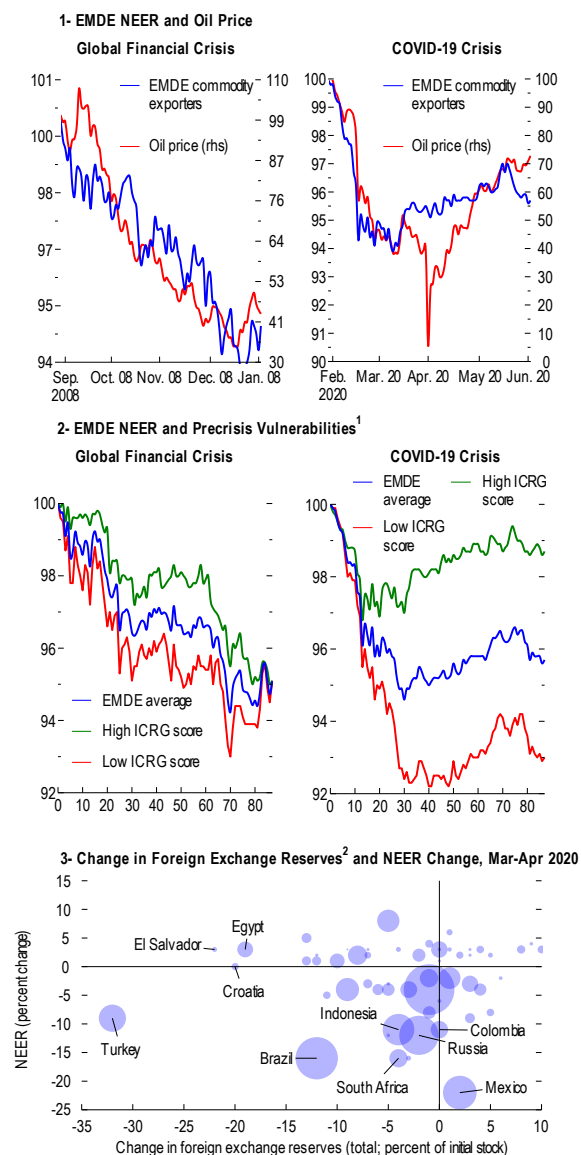
The outlook for current account balances remains highly uncertain, given the limited balance of payments data currently available for 2020, but recent data and the latest IMF staff forecasts point to a modest narrowing in current account surpluses and deficits on average, although with high uncertainty and substantial cross-country variation. Central channels affecting the evolution of current account balances in 2020 include the aforementioned contraction in economic activity and tightening in global financial conditions as well as lower commodity prices, the contraction in tourism, and the decline in remittances. This section offers a perspective on the latter three factors and reports the latest IMF staff forecasts for 2020–21.

Impact on Commodity Trade Balances

The price of crude oil has fluctuated in recent months and is expected to be 41 percent lower in 2020 than in 2019. The prices of metals, food, and raw materials are also expected to decline, but by significantly less than the price of oil. The decline in the volume of oil imports in economies affected by the pandemic has also been substantial, with global oil demand expected to be about 8 percent lower in 2020 than in 2019. The overall estimated direct impact on oil trade balances ranges widely across economies—from –7 percent to 3 percent of GDP—reflecting differences in dependence on oil exports and imports (Figure 1.9). Estimated trade balance losses are concentrated among economies with significant net oil exports, including Norway, Russia, and

Figure 1.8. Currency Movements and Country Characteristics

Variation across EMDE currency movements during the COVID-19 crisis has reflected dependence on commodity exports and precrisis vulnerabilities, as was also the case during the global financial crisis



Sources: IMF, Global Data Source; IMF, Information Notice System; IMF, International Financial Statistics; International Country Risk Guide; and IMF staff calculations.

Note: EMDE= emerging market and developing economies; ICRG = International Country Risk Guide; NEER = nominal effective exchange rate; rhs = right scale.

¹The figure is based on the International Country Risk Guide composite risk score for the year before the crisis based on three subcategories of risk: political, financial, and economic. The indicator is based in part on expert opinions. "High (low) ICRG score" denotes average NEER change for economies with a precrisis composite score above (below) the EMDE sample median, where a higher score indicates a more favorable risk rating.

²The change in foreign exchange reserves is based on the change in the stock of reserves, adjusted for valuation changes and reserve income flows, and operations with foreign exchange derivatives.

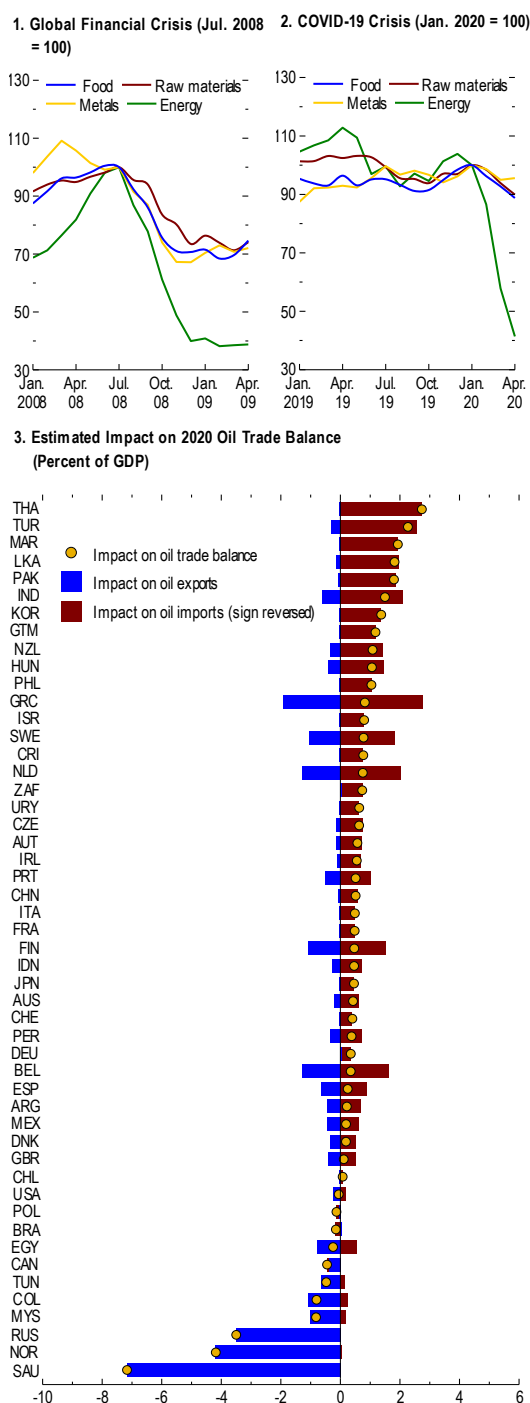
Saudi Arabia, where they are expected to exceed 3 percent of GDP. Positive effects on trade balances are spread more evenly across net oil importers, although they are expected to exceed 2 percent of GDP for Thailand and Turkey.

Impact on Tourism Trade Balances

International tourism has been among the hardest hit sectors during the COVID-19 crisis, reflecting travel restrictions, although discussions on measures for lifting restrictions are under way. During the first four months of 2020 international tourism arrivals were about 50 percent lower than over the same period in 2019, with deeper declines for related indicators, such as international flight arrivals and hotel reservations (Figure 1.10). The projected direct impact on tourism trade balances in 2020 will depend critically on the pace of tourism recovery, which is highly uncertain. A recent study ([UNWTO 2020 UN World Tourism Organization 2020](#)) includes a scenario involving a gradual lifting of travel restrictions starting in September. This scenario implies tourism receipts 73 percent below their 2019 levels, with a direct impact on tourism trade balances ranging from –6 percent of GDP to 2 percent of GDP (Figure 1.10). Losses in tourism proceeds exceeding 2 percent of GDP are expected to be concentrated among large net tourism exporters, such as Costa Rica, Egypt, Greece, Morocco, New Zealand, Portugal, Spain, Sri Lanka, Thailand, and Turkey. The rise in tourism trade balances is expected to be spread more evenly across tourism services net importers. Although uncertainty is high, the effects on tourism may persist to some extent in 2021 and beyond. Forty percent of respondents to a [United Nations World Tourism Organization](#) survey (see [UN World Tourism Organization WTO 2020](#)) expect international tourism demand to start recovering only in 2021, with professionals in the Americas being slightly more pessimistic.

Figure 1.9. Evolution of Commodity Prices and Oil Trade Balances

Commodity prices declined in the spring of 2020, with oil prices falling sharply. The direct impact on current account balances of lower oil prices and lower oil consumption could be substantial for some oil-exporting economies.



Sources: IMF, Global Data Source; IMF, Information Notice System; IMF, *World Economic Outlook* (WEO); *International Country Risk Guide*; and IMF staff calculations.

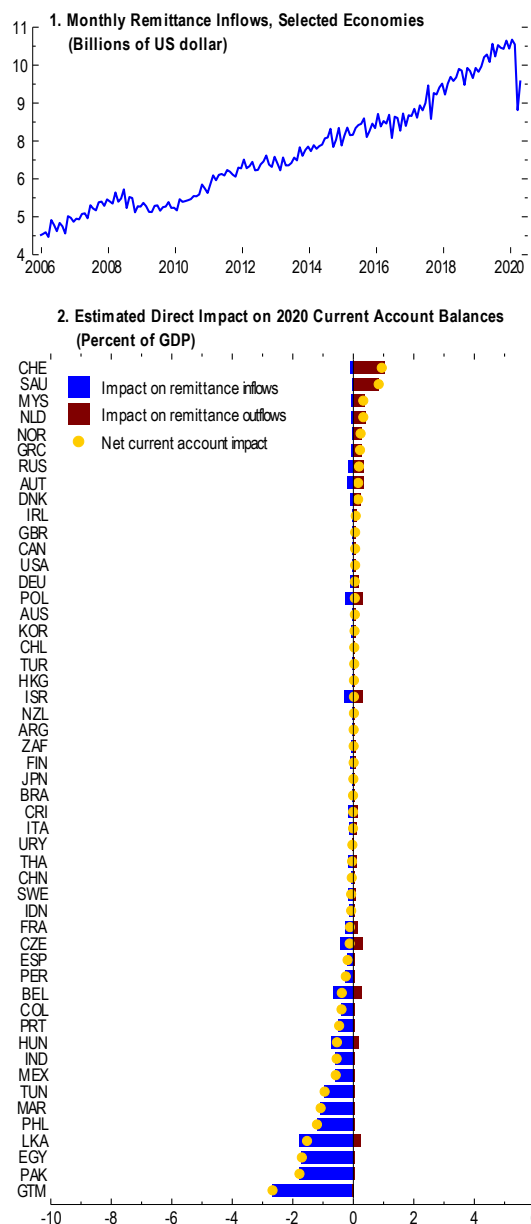
Note: The figure reports the impact on the 2020 oil trade balance based on the latest IMF staff forecast compared with the October 2019 WEO forecast for 2020. Data labels use International Organization for Standardization (ISO) country codes.

with lower surpluses for oil exporters and narrower trade deficits for a number of emerging market and developing economies.

Changes in current account balances vary widely across economies. Among the five largest economies, the expected changes in current account balances in 2020 compared with 2019 are modest—below ½ percent of GDP. In the United States, the fiscal expansion in the wake of the COVID-19 crisis is expected to be offset by higher private sector saving. Higher net exports due to import compression are projected to offset a weaker income account, with the current account deficit narrowing by 0.3 percentage point of GDP to about 2.0 percent of GDP. In China, the current account surplus is expected to increase by 0.3 percentage point of GDP to 1.3 percent of GDP, reflecting the combined effects of the disruptions caused by the pandemic (including on tourism, with lower service imports reflecting international travel disruptions), weaker global demand (partly mitigated by increased demand for personal protective and medical equipment), lower commodity prices, and a higher income deficit. In the euro area, the current account surplus is projected to narrow by 0.4 percentage point of GDP to a surplus of 2.3 percent of GDP amid the decline in global trade and investment income. The current account deficit of the United Kingdom is projected to narrow by 0.3 percentage point of GDP to ~~at~~ 3.5 percent of GDP. Japan's current account surplus is projected to narrow by 0.4 percentage point of GDP to 3.2 percent of GDP, with the pandemic significantly depressing both exports and imports and the income balance falling due to a reduction in net credit. The largest expected change in the current account balance is, in absolute terms, that for Saudi Arabia, with a decline of more than 10 percent of GDP to a deficit of 4.9 percent of GDP, reflecting the sharp decline in oil revenues.

Figure 1.11. Remittances: Recent Developments and Direct Impact on Current Account Balances

Remittances declined sharply in April 2020, before partially rebounding in May. The direct annual impact on current account balances for some economies could exceed 1 percent of GDP.



Sources: IMF, *World Economic Outlook*; national authorities; World Bank Global Knowledge Partnership on Migration and Development (KNOMAD); and IMF staff calculations.

Note: Selected economies with available monthly remittance data up to May 2020 (Mexico, Colombia, Guatemala, El Salvador, Dominican Republic, Pakistan, Bangladesh, Sri Lanka, Morocco and Georgia) account for about 22 percent of world remittances. Underlying series are seasonally-adjusted, and Pakistan series is adjusted for Ramadan. The second figure reports estimated direct impact on current account balances based on the World Bank (2020) projection of a 20 percent decline in remittance flows between 2019 and 2020. Actual changes may differ depending on other factors at play (for example, currency depreciation). Data labels use International Organization for Standardization (ISO) country codes.

At the global level, the latest IMF staff forecasts imply a modest narrowing in current account balances (the sum of absolute surpluses and deficits) by some $\frac{1}{3}$ percent of world GDP, although subject to high uncertainty. This narrowing is smaller than the 1.4 percent of global GDP decline observed in 2009 during the global financial crisis. Factors that explain a more limited narrowing this time include the fact that initial global current account surpluses and deficits were significantly smaller in 2019 (2.9 percent of world GDP in absolute value) than before the global financial crisis (5.8 percent of world GDP in 2006) (Figure 1.1). In addition, while larger reductions in public saving are expected in 2020 than in 2009, reflecting exceptional levels of fiscal support, these are, as a share of world GDP, concentrated among current account deficit economies and expected to be offset to a greater extent than in 2009 by increases in private saving, including precautionary saving, implying little net effect on global current account deficits and surpluses (Figure 1.13). Also, in 2009, lower investment by a large current account deficit economy—the United States—played a central role in narrowing global imbalances following the housing and asset price boom. In contrast, the broadly synchronized global downturn in 2020 from simultaneous lockdowns in economies affected by COVID-19 has resulted in a sharper decline in global GDP, with the fall in the ratio of investment to world GDP less concentrated among current account deficit economies.

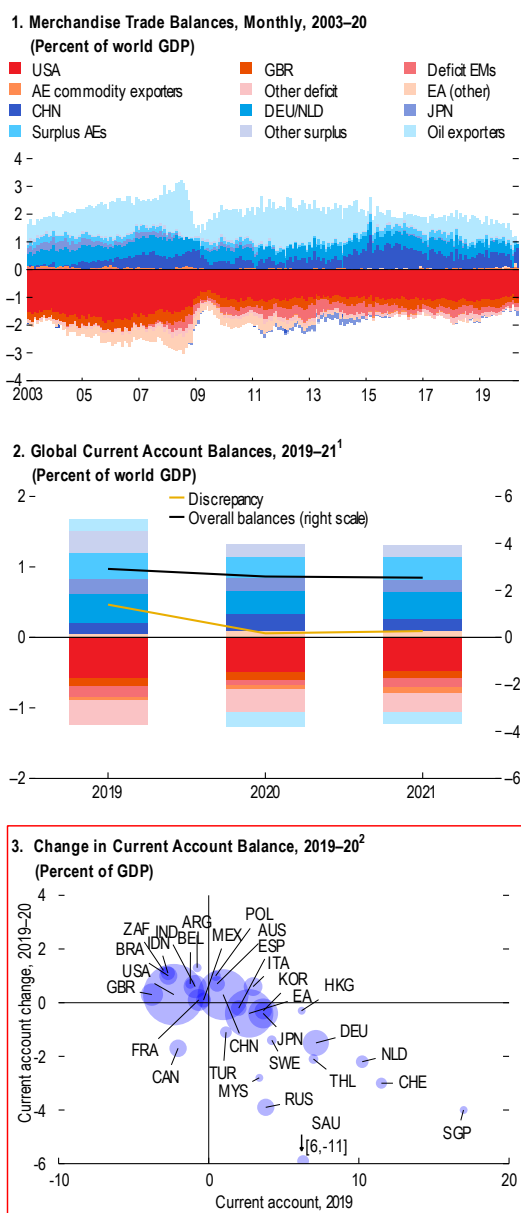
Significant Uncertainty Surrounds the External Outlook

The outlook for trade, currencies, and current account balances is highly uncertain, with significant risks.

Near-term uncertainties: If the fall in economic activity, global trade, and commodity prices is more persistent than currently assumed, the associated effects on current account balances,

Figure 1.12. Evolution of Trade and Current Account Balances (Percent of GDP)

Recent data and IMF staff forecasts suggest a narrowing in global current account surpluses and deficits.



Sources: IMF, Information Notice System; IMF, *International Finance Statistics*; IMF, *World Economic Outlook* (WEO); national authorities (customs data); and IMF staff calculations.

Note: AE = advanced economy; EA = euro area; EM = emerging market. Data labels use International Organization for Standardization (ISO) country codes.

¹Overall balance is the absolute sum of global surpluses and deficits. Surplus AEs comprise Hong Kong SAR, Korea, Singapore, Sweden, Switzerland, Taiwan Province of China; AE commodity exporters comprise Australia, Canada, New Zealand; deficit EMs comprise Brazil, India, Indonesia, Mexico, South Africa, Turkey; oil exporters comprise WEO definition plus Norway.

²Bubble size is relative to 2019 nominal GDP in US dollars. Sample includes IMF, *External Sector Report* sample economies. Change in trade balance is reported for Argentina.

instances. It could also complicate any effective dialogue and economic surveillance over the underlying macro-structural distortions affecting external positions.

More generally, policies that distort trade should be avoided. Countries should refrain from using tariffs to target bilateral trade balances, as they are costly for trade, investment, and growth, and are generally not effective for reducing excess external imbalances, which requires addressing underlying structural distortions. Tariff barriers should be rolled back, and trade and investment disagreements with other countries should be resolved in a manner that supports an open, stable, and transparent global trading system. Efforts should also focus on modernizing the multilateral rules-based trading system to capture the increasing importance of e-commerce and trade in services, strengthen rules in such areas as subsidies and technology transfer, and ensure continued enforceability of World Trade Organization (WTO) commitments through a well-functioning WTO dispute settlement system. To foster support for such initiatives, social safety net policies and policies to promote flexibility in adjustment can also play a role. There is limited evidence that trade integration itself—in particular greater import competition in external markets—drives economic inequality ([see the](#) October 2019 WEO) but it can cause job dislocations. A robust social safety net is thus important for facilitating regional adjustment and protecting particular regions and segments of the labor force. Place-based policies targeted at lagging regions may also play a role, but they must be carefully calibrated to ensure they help rather than hinder beneficial adjustment.

Avoiding Excess External Imbalances over the Medium Term

Distortions that affected external positions before the COVID-19 crisis may, in some cases, persist after the crisis, implying the need for policy reforms (Tables 1.6 and 1.8).

- *Economies with weaker-than-warranted external positions:* In cases where excess current account deficits in 2019 partly reflected larger-than-desirable fiscal deficits (as in the United States) and where such imbalances persist beyond the crisis, fiscal consolidation over the medium term that safeguards growth-enhancing items and social safety nets and prioritizes entitlement reform would both promote debt sustainability and reduce the current account gap. In a number of emerging market and developing economies with larger-than-warranted current account deficits in 2019 (such as Argentina) fiscal consolidation would also support raising international reserves to adequate levels, enhancing resilience to global foreign currency liquidity shocks. Structural policies to increase export competitiveness—and, in the case of commodity exporters (such as Saudi Arabia), diversification—would further support rebalancing. Infrastructure investment and active labor market policies may be widely needed to address the scars of the crisis. Countries with lingering competitiveness challenges would also benefit from upgrading infrastructure to reduce bottlenecks; labor market policies, such as enhancing schooling, training, and mobility of workers; supporting the working poor; and encouraging growth in the labor force (including through skill-based immigration reform).
- *Economies with stronger-than-warranted external positions:* In economies where excess current account surpluses that existed before the COVID-19 crisis persist after the crisis,

prioritizing reforms that encourage investment and discourage excessive private saving are warranted. In economies with remaining fiscal space, a growth-oriented fiscal policy, with greater public sector investment in such areas as digitization, infrastructure, and climate change mitigation, would support private investment, promote potential growth, make the economy more resilient, and narrow the excess current account surplus. Germany announced a new package (€130 billion, or 4 percent of GDP, over 2020–21) in June to support the recovery, with measures to boost activity in green and digital economies. The European Union has proposed an additional €750 billion (6 percent of its GDP) in support over 2021–27, including a grant-based recovery fund, which, if approved, could promote green recovery and reduce the uneven impact of the pandemic on member states' debt sustainability. In other cases, structural reforms to boost corporate investment, competition, and productivity, along with active labor market policies to facilitate access to skilled labor and raise potential growth (as in Poland) would further reduce external imbalances. In some cases, reforms to discourage excessive precautionary saving by expanding the social safety net (as in ~~Thailand and~~ Malaysia and Thailand) may also be warranted.

- *Economies with external positions broadly in line with fundamentals:* In such cases, policies should continue to address domestic imbalances to prevent excessive external imbalances. Former excess surplus countries should, where relevant, address domestic imbalances by gradually narrowing larger-than-desirable fiscal deficits while engaging in reforms of state-owned enterprises and opening markets to more competition (as in China), relaxing restrictions on foreign direct investment, and strengthening the social safety net. Former excess deficit countries (such as Indonesia and Spain) should, where relevant, carefully manage the public debt load, enhance competitiveness through productivity gains and continued wage flexibility, and implement reforms to enhance education outcomes and innovation.

As more data become available to assess the effects of the crisis, comprehensive and multilaterally consistent analysis will remain necessary to promote a shared understanding of underlying distortions and reforms needed to continue rebalancing the global economy.

Box 1.4 (continued)

also important. For example, cumulative outflows are estimated to have been about 20 percent larger in economies with a current account deficit of 3 percent of GDP or more than in an economy with a current account surplus of 3 percent of GDP or more, indicating that investors withdrew from economies that were more vulnerable to a drying up of external financing. Outflows were nearly 30 percent lower for economies with high rather than low reserves-to-imports ratios.

- In addition, results suggest that capital outflows were 30 percent lower for economies whose central banks obtained access to the US Federal Reserve's swap lines during the episode relative to other economies.

COVID-19-related factors also amplified the sudden stop. In particular,

- Economies that were structurally more vulnerable to travel bans and lockdown measures because of their dependence on tourism revenues also faced larger outflows. For example, capital outflows were 20 percent larger in economies with 20 percent of exports concentrated in tourism, relative to those with no tourism proceeds.
- The speed of spread of the virus, measured by the weekly change in confirmed cases, also played a role, with a 20 percent difference in the magnitude of outflows between extreme (10th and 90th percentiles) cases. This result, while somewhat tenuous at this point, suggests that as the health crisis unfolds and lockdown measures ease or tighten at different paces, there might be more differentiation in the recovery of outflows across countries.

Additional analysis suggests that the COVID crisis shares some features with the global financial crisis. In particular, capital outflows from emerging market and developing economies were also driven largely by heightened risk aversion and external vulnerabilities (reserve adequacy and external financing needs) during the global financial crisis. These factors were, however, somewhat less relevant during the 2013 taper tantrum, which featured strong risk appetite as the US economy was on a recovery path. A caveat to this analysis is that it focuses on mutual fund portfolio flows, given the limited data availability on other types of flows at this point. The role of other flows—including cross-border banking flows, which played an important role in the global financial crisis—is still unknown.¹² In addition, while foreign direct investment was more resilient relative to other flows during the global financial crisis, the risk of these flows being lower during this episode is not negligible.

Overall, the analysis indicates that preventing another tightening of global financial conditions and maintaining healthy liquidity buffers in emerging market and developing economies—including through cross-country financial arrangements—will be essential to the support of healthy capital flows to these economies.

¹²See, for example, Avdjiev and others (2018).

Box 1.5. Emerging Market and Developing Economy Currency Movements during the COVID-19 Crisis¹³

The currency depreciations among emerging market and developing economies during the COVID-19 crisis reflected the worsening global economic outlook and tighter financial conditions. Preexisting country economic and financial fundamentals as well as perceived institutional quality played a significant role in amplifying or mitigating the impact of these global factors.

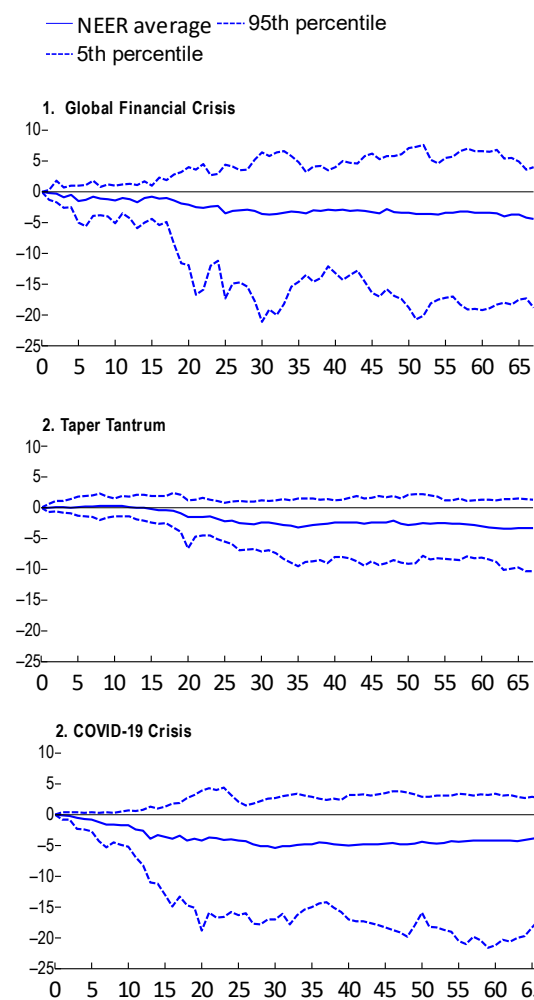
The currencies of emerging market and developing economies depreciated sharply during the turmoil in global financial and commodity markets in early 2020. From mid-February to late March, these economies' currencies depreciated by an average of 5 percent; some depreciated more than 20 percent. These currencies, in many cases, have partially recovered since March. The range of emerging market and developing economy currency movement was broadly comparable to what was seen during the global financial crisis and significantly larger than during the 2013 taper tantrum (Figure 1.5.1).

To shed light on what drove the currency movements during the COVID-19 crisis, a panel equation is estimated that relates the change in the nominal effective exchange rate (NEER) over a 30-day period with global factors, country-specific variables, and their interactions (Table 1.5.1).

$$\begin{aligned}\Delta NEER_{i,t} = & \alpha + \beta_1 VIX_t + \beta_2 \Delta Oil Price_t \\ & + \gamma_1 Floater_i + \gamma_2 Oil Exporter_i \\ & + \gamma_3 Fundamentals_i \\ & + \theta_1 \Delta Oil Price_t Oil Exporter_i \\ & + \theta_2 VIX_t Fundamentals_i + \varepsilon_{i,t}\end{aligned}$$

Global factors have driven currency depreciation in emerging market and developing economies. The estimation results indicate that a rise in equity market volatility, as measured by the Chicago Board Options Exchange Volatility Index (VIX), is significantly associated with

Figure 1.5.1. Emerging Market and Developing Economy Nominal Effective Exchange Rate Movements
(Percent change from start of episode; days on x-axis)



Sources: IMF, Global Data Source; and IMF staff calculations.

Note: Global financial crisis indicates evolution starting September 10, 2008. Taper tantrum indicates episode starting May 22, 2013. COVID-19 crisis indicates episode starting February 19, 2020. NEER= nominal effective exchange rate.

¹³The author of this box is Christina Kolerus.

Box 1.6 (continued)

Scenario 2: A Faster Recovery

The second scenario assumes that the economic recovery is faster than expected, as greater confidence in efficient post-lockdown measures (social distancing and more effective testing, tracing, and isolation practices) lead to effective containment and less precautionary behavior by households and firms once the lockdowns are lifted. With the faster recovery, financial conditions loosen more than in the baseline. The discretionary fiscal measures already included in the baseline are maintained but automatic fiscal stabilizers imply less fiscal support as they respond endogenously to a faster dissipation of excess supply.

Results

Results are presented in Figure 1.6.1 as deviations from the June 2020 WEO *Update* projections (the baseline) for advanced economies, emerging market economies that are not net oil exporters, and emerging market net oil exporters.

In the second outbreak scenario, global trade declines by an additional 6 percent in 2021 compared with the baseline, reflecting the weakness in domestic demand as a result of containment measures. Global GDP declines by about 5 percent compared with the baseline in 2021, as reported in the June [2020](#) WEO *Update* downside scenario, and oil prices are higher by about 12 percent. The recovery in global trade thereafter reflects two factors. The first is the need to rebuild the capital stock and the import-rich nature of the associated rise in investment. The second is the import intensity of exports, which adds further momentum to trade during the recovery.

Regarding movements in current account balances, for emerging market economies, the higher borrowing costs, combined with lower oil prices and subdued domestic demand, raise current account balances toward surplus. For net oil exporters, the lower oil prices reduce current account balances. At the same time, for advanced economies, the relatively limited tightening in external financing conditions and greater fiscal policy space to support incomes translates into less import compression than among emerging market economies and lower current account balances. Overall, this pattern implies an uphill flow of capital from emerging market economies to advanced economies, highlighting the unequal impact of the crisis and the need for a global policy response to support more vulnerable countries. In addition, as advanced economy status correlates little with initial balances, the pattern of current account movements among advanced economies and emerging markets implies little narrowing in overall global current account surpluses and deficits.

In the faster recovery scenario, global trade rises by an additional 4 percent in 2021 compared to the baseline, reflecting the stronger economic activity, with oil prices higher by 8 percent. For emerging market economies, the additional easing in global financial conditions and improved investor sentiment lowers borrowing costs, which, combined with higher oil prices and rising domestic demand, reduces current account balances toward deficit. For net oil exporters, the higher oil prices raise current account balances. In advanced economies, the on average greater

Table 1.1. Selected Economies: Current Account Balance, 2017–20

	Billions of USD				Percent of World GDP				Percent of GDP			
	2017	2018	2019	2020 Projection	2017	2018	2019	2020 Projection	2017	2018	2019	2020 Projection
Advanced Economies												
Australia	-35	-29	8	15	0.0	0.0	0.0	0.0	-2.6	-2.0	0.6	1.2
Belgium	6	-8	-7	-3	0.0	0.0	0.0	0.0	1.2	-1.4	-1.2	-0.6
Canada	-46	-43	-35	-57	-0.1	-0.1	0.0	-0.1	-2.8	-2.5	-2.0	-3.7
France	-20	-16	-18	-12	0.0	0.0	0.0	0.0	-0.8	-0.6	-0.7	-0.5
Germany	287	292	275	199	0.4	0.3	0.3	0.2	7.8	7.4	7.1	5.6
Hong Kong SAR	16	14	23	21	0.0	0.0	0.0	0.0	4.6	3.7	6.2	5.9
Italy	50	52	59	61	0.1	0.1	0.1	0.1	2.6	2.5	3.0	3.6
Japan	203	177	184	157	0.3	0.2	0.2	0.2	4.2	3.6	3.6	3.2
Korea	75	77	60	51	0.1	0.1	0.1	0.1	4.6	4.5	3.6	3.4
Netherlands	90	99	93	66	0.1	0.1	0.1	0.1	10.8	10.9	10.2	8.0
Singapore	56	64	63	44	0.1	0.1	0.1	0.1	16.3	17.2	17.0	13.0
Spain	35	28	28	22	0.0	0.0	0.0	0.0	2.7	1.9	2.0	1.8
Sweden	17	14	22	14	0.0	0.0	0.0	0.0	3.1	2.5	4.2	2.8
Switzerland	44	58	81	57	0.1	0.1	0.1	0.1	9.8	9.8	11.5	8.5
United Kingdom	-93	-111	-107	-88	-0.1	-0.1	-0.1	-0.1	-3.5	-3.9	-3.8	-3.5
United States	-440	-491	-498	-402	-0.5	-0.6	-0.6	-0.5	-2.3	-2.4	-2.3	-2.0
Emerging Market and Developing Economies												
Argentina	-31	-27	-3	...	0.0	0.0	0.0	...	-4.8	-5.2	-0.8	...
Brazil	-15	-42	-49	-22	0.0	0.0	-0.1	0.0	-0.7	-2.2	-2.7	-1.7
China	195	25	141	195	0.2	0.0	0.2	0.2	1.6	0.2	1.0	1.3
India ¹	-49	-57	-27	-9	-0.1	-0.1	0.0	0.0	-1.8	-2.1	-0.9	-0.3
Indonesia	-16	-31	-30	-18	0.0	0.0	0.0	0.0	-1.6	-2.9	-2.7	-1.6
Malaysia	9	8	12	2	0.0	0.0	0.0	0.0	2.8	2.2	3.4	0.5
Mexico	-20	-25	-4	-2	0.0	0.0	0.0	0.0	-1.8	-2.1	-0.3	-0.2
Poland	0	-6	3	9	0.0	0.0	0.0	0.0	0.0	-1.0	0.5	1.5
Russia	32	114	65	-2	0.0	0.1	0.1	0.0	2.1	6.8	3.8	-0.1
Saudi Arabia	10	72	47	-32	0.0	0.1	0.1	0.0	1.5	9.2	5.9	-4.9
South Africa	-9	-13	-11	-5	0.0	0.0	0.0	0.0	-2.5	-3.5	-3.0	-1.8
Thailand	44	28	38	25	0.1	0.0	0.0	0.0	9.6	5.6	7.0	4.9
Turkey	-41	-21	9	0.1	-0.1	0.0	0.0	0.0	-4.8	-2.7	1.2	0.0
Memorandum item:²												
Euro Area	393	426	359	274	0.5	0.5	0.4	0.3	3.1	3.1	2.7	2.3
Statistical Discrepancy	394	315	387	39	0.5	0.4	0.4	0.0	...	...	...	...
Overall Surpluses	1,439	1,495	1,465	1,078	1.8	1.7	1.7	1.3	...	...	...	...
Of which: Advanced Economies	1,038	1,074	1,042	824	1.3	1.3	1.2	1.0	...	...	...	...
Overall Deficits	-1,045	-1,180	-1,078	-1,039	-1.3	-1.4	-1.2	-1.3	...	...	...	...
Of which: Advanced Economies	-650	-721	-721	-607	-0.8	-0.8	-0.8	-0.7	...	...	...	...

Sources: IMF, *World Economic Outlook*; and IMF staff calculations.¹For India, data are presented on a fiscal year basis.²Overall surpluses and deficits (and the o/w advanced economies) include non-*External Sector Report* countries.

Table 1.4. External Sector Report Economies: Summary of External Assessment Indicators, 2019

Economy	Overall Assessment	Current Account (Percent of GDP)		Staff CA Gap (Percent of GDP)		Staff REER Gap (Percent)		International Investment Position (Percent of GDP) ¹			CA NFA Stabilizing (Percent of GDP) ²	SE of CA Norm (Percent) ³
		Actual	Cycl Adj.	Midpoint	Range	Midpoint	Range	Net	Liabilities	Assets		
Argentina	Weaker	-0.8	-1.7	-2.0	+/-1	-1.5	+/-5	26	63	89	0.6	0.8
Australia	Broadly in line	0.6	0.3	0.8	+/-0.5	-4.0	+/-2.5	-46	197	151	-2.3	1.0
Belgium	Weaker	-1.2	-1.1	-3.5	+/-1	8.5	+/-2.5	38	387	425	1.3	0.5
Brazil	Moderately weaker	-2.7	-3.7	-1.2	+/-0.5	3.5	+/-7.5	-40	88	49	-1.4	0.9
Canada	Moderately weaker	-2.0	-1.9	-1.8	+/-1.5	7.1	+/-5.6	44	209	253	1.7	0.9
China	Broadly in line	1.0	0.8	1.0	+/-1.5	-2.0	+/-10	14	38	52	1.1	1.5
Euro Area ⁴	Moderately stronger	2.7	2.7	1.2	+/-0.8	-2.8	+/-2.9	-1	244	243	-0.3	0.8
France	Moderately weaker	-0.7	-0.5	-1.1	+/-0.5	4.1	+/-1.9	-19	318	299	-0.7	0.5
Germany	Substantially stronger	7.1	7.3	4.3	+/-1	-11.0	+/-5	71	203	273	2.1	0.8
Hong Kong SAR	Broadly in line	6.2	...	0.8	+/-1.5	-2.5	+/-5	427	1109	1537	...	...
India	Broadly in line	-0.9	-1.4	1.0	+/-1	-5.6	+/-5.5	-15	40	25	-2.4	1.3
Indonesia	Broadly in line	-2.7	-2.7	-1.0	+/-1.5	3.9	+/-5.1	-31	64	33	-2.2	1.3
Italy	Broadly in line	3.0	2.7	0.0	+/-1	4.0	+/-4	-2	165	163	-0.3	0.8
Japan	Broadly in line	3.6	3.5	0.0	+/-1.2	0.0	+/-9	67	132	198	3.6	1.2
Korea	Broadly in line	3.6	3.3	0.0	+/-1	0.0	+/-3	30	73	103	1.2	0.8
Malaysia	Stronger	3.4	3.5	3.3	+/-1	-7.2	+/-2	-1	113	111	-0.4	0.7
Mexico	Broadly in line	-0.3	-0.7	0.9	+/-1.1	-7.0	+/-8	-52	100	48	-1.9	1.1
Netherlands	Substantially stronger	10.2	10.5	4.9	+/-2	-7.0	+/-2.9	89	1037	1126	2.5	0.9
Poland	Stronger	0.5	0.6	2.7	+/-1	-6.0	+/-2	-50	99	49	-2.8	0.6
Russia	Broadly in line	3.8	3.8	0.1	+/-1	-0.4	+/-5	21	68	89	0.9	1.6
Saudi Arabia	Weaker	5.9	...	-3.0	+/-1.2	13.0	+/-3	86	60	146	...	...
Singapore	Substantially stronger	17.0	...	4.0	+/-3	-8.0	+/-6	241	894	1135	...	...
South Africa	Moderately weaker	-3.0	-3.2	-1.5	+/-1.1	5.7	+/-4	8	129	137	0.4	1.2
Spain	Broadly in line	2.0	2.2	0.2	+/-1	-0.9	+/-4	-73	250	176	-3.0	0.8
Sweden	Stronger	4.2	4.5	3.2	+/-1.5	-10.0	+/-5	21	263	284	0.3	1.1
Switzerland	Moderately stronger	11.5	11.5	1.8	+/-2	-3.5	+/-3.9	117	644	761	8.7	1.3
Thailand	Substantially stronger	7.0	6.6	6.1	+/-1.5	-9.5	+/-2.5	-2	99	98	-0.2	1.6
Turkey	Moderately stronger	1.2	0.8	1.6	+/-1.8	-15.0	+/-8	-47	80	34	-3.1	1.8
United Kingdom	Weaker	-3.8	-3.8	-2.9	+/-2	7.5	+/-7.5	-25	534	509	-0.5	0.7
United States	Moderately weaker	-2.3	-2.0	-1.3	+/-0.5	11.0	+/-3	-51	188	137	-0.8	1.0

Sources: Bureau of Economic Analysis; IMF, *World Economic Outlook (WEO)*; IMF, *International Financial Statistics*; and IMF staff assessments.

Note: CA = current account; NFA = net foreign assets; NIIP = net international investment position; REER = real effective exchange rate; SE = standard error.

¹The NIIP estimates come from the *WEO* and the Bureau of Economic Analysis.

²The current account balance that would stabilize the ratio of NFA to GDP at the benchmark NFA/GDP level.

³The standard error of the 2019 estimated current account norms.

⁴The staff-assessed euro area CA gap is calculated as the GDP-weighted averages of IMF staff-assessed CA gaps for the 11 largest euro area economies.

Table 1.5. External Sector Report Economies: Summary of IMF Staff-Assessed Current Account Gaps and Staff Adjustments, 2019
(Percent of GDP)

Economy	Assessment 2019	Actual CA Balance	Cycl Adj. CA Balance	EBA CA Norm	EBA CA Gap ¹	Staff-Assessed CA Gap ²	Staff Adjustments ³			Comments
		[A]	[B]	[C]	[D=B-C]	[E]	Total [F=G+H]	CA [G]	Norm [H]	
Argentina	Weaker	-0.8	-1.7	-1.2	-0.5	-2.0	-1.5	0.0	1.5	NIIP/financing risks considerations
Australia	Broadly in line	0.6	0.3	-0.1	0.5	0.8	0.3	-0.7	-1.0	Terms of trade (CA); large investment needs (Norm)
Belgium	Weaker	-1.2	-1.1	2.3	-3.5	-3.5	0.0	0.0	0.0	
Brazil	Moderately weaker	-2.7	-3.7	-2.5	-1.2	-1.2	0.0	0.0	0.0	
Canada	Moderately weaker	-2.0	-1.9	2.2	-4.1	-1.8	2.3	2.0	-0.3	Measurement biases and terms of trade (CA); demographics (Norm)
China	Broadly in line	1.0	0.8	-0.4	1.2	1.0	-0.2	-0.2	0.0	Impact of trade tensions
Euro Area ⁴	Moderately stronger	2.7	2.7	1.4	1.3	1.2	-0.1	0.1	0.3	Country-specific adjustments
France	Moderately weaker	-0.7	-0.5	0.6	-1.1	-1.1	0.0	0.0	0.0	
Germany	Substantially stronger	7.1	7.3	2.5	4.7	4.3	-0.4	0.0	0.4	Demographics (uncertainty related to large and sudden immigration)
India	Broadly in line	-0.9	-1.4	-3.0	1.6	1.0	-0.6	0.0	0.6	NIIP/financing risks considerations
Indonesia	Broadly in line	-2.7	-2.7	-0.8	-1.9	-1.0	0.9	0.0	-0.9	Demographics (high mortality risk)
Italy	Broadly in line	3.0	2.7	2.6	0.0	0.0	0.0	0.0	0.0	
Japan	Broadly in line	3.6	3.5	3.5	0.0	0.0	0.0	0.0	0.0	
Korea	Broadly in line	3.6	3.3	3.3	0.0	0.0	0.0	0.0	0.0	
Malaysia	Stronger	3.4	3.5	-0.2	3.7	3.3	-0.4	-0.4	0.0	Postponement of large infrastructure projects with high import content
Mexico	Broadly in line	-0.3	-0.7	-2.2	1.5	0.9	0.6	0.6	0.0	Effects of trade diversion
Netherlands	Substantially stronger	10.2	10.5	3.3	7.2	4.9	-2.3	-2.3	0.0	Measurement biases
Poland	Stronger	0.5	0.6	-2.1	2.7	2.7	0.0	0.0	0.0	
Russia	Broadly in line	3.8	3.8	3.7	0.1	0.1	0.0	0.0	0.0	
South Africa	Moderately weaker	-3.0	-3.2	0.9	-4.0	-1.5	2.5	1.5	-1.0	SACU transfers and measurement biases (CA); demographics (high mortality risk, Norm)
Spain	Broadly in line	2.0	2.2	1.1	1.1	0.2	-0.9	0.0	0.9	NIIP/financing risks considerations
Sweden	Stronger	4.2	4.5	1.2	3.2	3.2	0.0	0.0	0.0	
Switzerland	Moderately stronger	11.5	11.5	6.3	5.3	1.8	-3.5	-3.5	0.0	Measurement biases
Thailand	Substantially stronger	7.0	6.6	0.4	6.1	6.1	0.0	0.0	0.0	
Turkey	Moderately stronger	1.2	0.8	-1.7	2.5	1.6	0.9	0.9	0.0	Temporarily large receipts from travel services
United Kingdom	Weaker	-3.8	-3.8	0.4	-4.2	-2.9	1.3	1.3	0.0	Measurement biases
United States	Moderately weaker	-2.3	-2.0	-0.7	-1.3	-1.3	0.0	0.0	0.0	
Hong Kong SAR	Broadly in line	6.2	...	...	...	0.8	...	...	...	...
Singapore	Substantially stronger	17.0	...	...	...	4.0	...	...	...	...
Saudi Arabia	Weaker	5.9	...	...	...	-3.0	...	...	...	...
Absolute sum of excess surpluses and deficits ⁵						1.2				
Discrepancy ⁵						0.02	...	...	...	...

Source: IMF staff estimates.

Note: CA = current account; EBA = external balance assessment; NIIP = net international investment position; SACU = Southern African Customs Union.

¹Figures may not add up due to rounding effects.

²Refers to the midpoint of the staff-assessed CA gap.

³Total staff adjustments include rounding in some cases. The breakdown between the norm and other factors (which affect the underlying CA) is tentative.

⁴The EBA euro area current account norm is calculated as the GDP-weighted average of norms for the 11 largest euro area economies, adjusted for reporting discrepancies in intra-area transactions (which were equivalent to 0.43 percent of GDP in 2019). The staff-assessed CA gap is calculated as the GDP-weighted average of staff-assessed gaps for the 11 largest euro area economies.

⁵GDP-weighted average sum of staff-assessed CA gaps in percent of world GDP.

Table 1.7. External Sector Report Economies: Summary of IMF Staff–Assessed Real Effective Exchange Rate and External Balance Assessment Model Gaps, 2019

Economy	Staff-Assessed REER Gap ¹	REER Gap Implied from Staff-Assessed CA Gap ²	EBA REER-Level Gap	EBA REER-Index Gap	CA/REER Elasticity ³	REER (Percent Change)	
						Avg 19/Avg 18	May 20/Avg 19
Argentina	-1.5	14.6	...	-6.4	0.14	-10.7	18.2
Australia	-4.0	-4.0	10.2	-1.4	0.20	-4.5	-1.9
Belgium	8.5	8.3	17.1	9.3	0.42	-1.5	0.8
Brazil	3.5	11.4	2.3	-10.7	0.10	-1.9	-26.8
Canada	7.1	6.8	-6.0	2.1	0.27	-1.0	-3.6
China	-2.0	-4.4	11.4	-1.1	0.23	-0.8	1.8
Euro Area	-2.8	-3.4	-0.7	4.2	0.35	-3.1	0.9
France	4.1	4.1	3.2	-2.7	0.27	-1.7	0.2
Germany	-11.0	-11.8	-16.0	3.6	0.36	-1.7	1.0
India	-5.6	-5.6	10.2	13.4	0.18	5.8	-0.4
Indonesia	3.9	5.6	-9.0	2.1	0.18	4.3	-0.1
Italy	4.0	0.0	4.4	6.8	0.24	-2.4	0.3
Japan	0.0	0.0	-12.5	-18.0	0.14	2.8	4.1
Korea	0.0	0.0	-8.0	0.6	0.36	-4.5	-3.6
Malaysia	-7.2	-7.2	-38.0	-25.0	0.46	-1.4	-3.5
Mexico	-7.0	-6.9	-3.5	-15.4	0.13	3.3	-15.0
Netherlands	-7.0	-7.1	4.2	16.1	0.69	-0.1	1.1
Poland	-6.0	-6.1	-18.6	-2.7	0.44	-1.3	-2.2
Russia	-0.4	-0.4	-14.5	-9.3	0.27	2.5	-5.0
South Africa	5.7	5.7	-3.3	-15.7	0.26	-3.5	-14.7
Spain	-0.9	-0.9	4.9	5.2	0.22	-1.9	-0.3
Sweden	-10.0	-9.1	-19.0	-19.4	0.35	-4.0	0.0
Switzerland	-3.5	-3.5	19.7	13.5	0.52	1.0	3.9
Thailand	-9.5	-9.8	-1.3	14.0	0.62	5.6	-4.2
Turkey	-15.0	-7.3=	-20.5	-22.8	0.22	-2.2	-7.8
United Kingdom	7.5	11.7=	-5.6	-12.6	0.25	-0.5	-0.4
United States	11.0	10.8	10.9	8.1	0.12	2.8	4.9
Hong Kong SAR	-2.5	...	...	...	0.40	4.0	3.6
Singapore	-8.0	...	...	...	0.50	0.1	-2.8
Saudi Arabia	13.0	...	...	...	...	-1.1	2.9
Discrepancy ⁴	2.0	...	...	...	...	...	...

Sources: IMF, Information Notice System; and IMF staff estimates.

Note: CA = current account; EBA = external balance assessment; REER = real effective exchange rate.

¹Refers to the midpoint of the staff-assessed REER gap.

²Implied REER gap = -(staff-assessed CA gap/CA-to-REER elasticity).

³CA-to-REER semi-elasticity used by IMF country teams.

⁴GDP-weighted average sum of staff-assessed REER gaps.

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