INTERNATIONAL MONETARY FUND

MULTI-COUNTRY REPORT

July 2017

2017 EXTERNAL SECTOR REPORT—INDIVIDUAL ECONOMY ASSESSMENTS

IMF staff regularly produces papers covering multilateral issues and cross-country analysis. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 24, 2017 consideration of the report.
- The **2017 External Sector Report—Individual Economy Assessments** prepared by IMF staff and completed on June 23, 2017 for the Executive Board's consideration on June 23, 2017.

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IMF Executive Board Discusses the 2017 External Sector Report

On July 24, 2017, the Executive Board of the International Monetary Fund (IMF) discussed the 2017 External Sector Report (ESR).

The 2017 ESR found that *excess* current account imbalances (i.e., deficits or surpluses that deviate from levels deemed consistent with medium-term fundamentals and desired policies) represented about one-third of total global imbalances in 2016, remaining broadly unchanged since 2013, although increasingly concentrated in advanced economies. While this rotation of imbalances towards advanced economies could entail lower external financing risks in the near term, a greater concentration of excess deficits in advanced debtor economies may engender protectionist sentiment and raise the risk of disruptive corrections down the road, including due to widening external stock imbalances.

Addressing excess external imbalances in a manner that is supportive of global growth requires a recalibration of the macroeconomic policy mix and properly-targeted structural policies in deficit and surplus economies alike. In general, excess surplus countries with fiscal space should allow for greater fiscal stimulus, while advancing structural reforms that support domestic demand and foster competition. Meanwhile, excess deficit countries should move forward with fiscal consolidation, while gradually normalizing monetary policy in tandem with inflation developments and focusing on structural policies that strengthen competitiveness and overall saving. Protectionist policies should be avoided as they are unlikely to reduce external imbalances and are detrimental to domestic and global growth.

The ESR, produced annually since 2012, analyzes global external sector developments and provides assessments of economies' external positions, including current account balances, real exchange rates, external balance sheets, capital flows, and international reserves. These assessments are derived at by integrating multilateral and country-specific perspectives, while ensuring individual economy assessments add up to a multilaterally consistent view. The report, which covers 28 of the world's largest economies plus the euro area (representing over 85 percent of global GDP), comprises two papers: (i) an overview paper that covers multilateral issues, showing how individual economies fit into the global picture and discussing policies needed to reduce global imbalances; and (ii) a set of individual country pages with details on external assessments for each economy.

Executive Board Assessment[1]

Executive Directors broadly agreed with the assessment of global excess imbalances and related policy recommendations. They noted that, while global imbalances had narrowed markedly in the aftermath of the global financial crisis, with the adjustment process relying heavily on demand compression in deficit countries, progress had stalled more recently. Excess imbalances are increasingly concentrated in advanced economies, with persistent large excess surpluses in some economies. Directors noted that, absent policy actions and more effective automatic adjustment mechanisms, global excess imbalances are likely to widen over the medium term, potentially further straining the international monetary system. They agreed that addressing global excess imbalances is in the interests of all countries and requires collective efforts. Directors emphasized that both deficit and surplus countries have critical roles to play in that regard.

Directors broadly shared the view that excess imbalances have rotated toward advanced economies, and that deficits and surpluses have been concentrated in a few economies. While this points to lower deficit-financing risks in the near term, the widening of deficits in key economies, if unaddressed, could potentially increase protectionist sentiment, further straining global trade, investment, and growth. Directors also highlighted that diverging stock positions, coupled with continued overreliance on demand from debtor countries, could pose risks to global growth and raise the likelihood of a disruptive adjustment over the medium term.

Directors stressed the need for both deficit and surplus countries to recalibrate macroeconomic policies, with a view to achieving their domestic objectives as well as strengthening the global prospects for strong, sustainable, and balanced growth. In general, excess deficit countries should move forward with fiscal consolidation without delay, gradually normalizing monetary policy in tandem with inflation developments; while excess surplus economies with fiscal space should rely more on fiscal policy, especially to encourage investment. Where monetary policy is constrained, fiscal and structural policies could be necessary to facilitate relative price adjustments for internal and external rebalancing. Directors also stressed that countries should allow exchange rates to move in line with fundamentals. Directors underscored the importance of well-targeted structural policies to address the persistence of excess external imbalances. They concurred that structural policies in excess surplus countries should generally focus on boosting overall domestic investment, reducing saving, and promoting competition; while in excess deficit economies, policies should be directed to improving external competitiveness and overall saving. Directors urged countries to maintain open trade and investment regimes and to avoid

[1] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

using protectionist policies to address excess imbalances, noting that they are detrimental to domestic and global growth.

Directors welcomed the analysis of persistent current account surpluses and the composition of sectoral saving in advanced economies. A few Directors, noting the concentration of large excess deficits in a handful of countries, suggested that a similar focus on external deficits would be useful, while others pointed to the extensive studies on the issue. Directors observed the large difference in gross corporate saving behavior across advanced economies and the role it plays in driving imbalances. They called for more research on the drivers of corporate and household savings.

Directors appreciated ongoing efforts by staff to better describe the external assessment methodology and improve transparency in deriving staff assessments. They saw value in a clear presentation of the different elements of the overall assessments, including the results of the models and the justification and application of country-specific judgment. They recognized that staff judgment is necessary to reflect country-specific factors not captured by the models, although further justification is warranted where large adjustments are made to current account norms. Directors called on staff to ensure that adjustments are transparent, evenhanded, and multilaterally consistent.

Directors pointed to limitations of the models, including in terms of data comparability and measurement issues, as well as methodological uncertainties inherent in the use of economic models to assess external positions. Directors thus emphasized the need for caution and nuance in interpreting the results, although some saw room for more persuasive policy recommendations. Careful and clear public communication about the nature of the exercise and role of judgment would also be essential. In this regard, Directors saw merit in sharpening key messages further for communication to a broader audience, conveying the criticality of conducting external assessments through a multilateral approach, and continuing to integrate them into the Fund's flagship reports. A number of Directors considered it a priority to clarify that external imbalances (deficits and surpluses), as opposed to excess imbalances, can be appropriate and desirable. Directors agreed that any domestic policy gaps identified by the models should be discussed thoroughly in Article IV consultations.

Directors acknowledged that although some improvements had been made to the External Balance Approach methodology, there remains scope for further refinements. They welcomed staff's intention to review the key models ahead of next year's report, with inputs from experts and country authorities across the membership and Board members, and offered many useful suggestions in this regard. Directors saw as priority areas for improvement: demographics-related variables, use of third-party indicators, and treatment of financial centers; as well as the identification of additional policy variables and other factors to reduce the unexplained components. They also offered a range of views on issues that deserve greater attention in future reports, including assessing the role of external stock positions, income balances, capital flows, reserve currencies, foreign exchange intervention, and global value chains.

Directors supported the Fund's work on external sector assessments and the External Sector Report. They underscored the role of the Fund in providing multilaterally consistent assessments of member countries' external sector positions and policies. Directors welcomed staff's continued analysis of global excess imbalances and their causes, and broader efforts to strengthen integrated surveillance. They looked forward to discussing the planned refinements to the methodology, taking into consideration Directors' suggestions made today and in the earlier informal setting.

INTERNATIONAL MONETARY FUND

June 23, 2017

2017 EXTERNAL SECTOR REPORT—INDIVIDUAL ECONOMY ASSESSMENTS

Prepared by the respective country teams with input from the External Sector Coordinating Group comprising:

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INDIVIDUAL ECONOMY ASSESSMENTS

A. The External Sector Assessments

The external sector assessments use a wide range of methods, including the External Balance Assessment (EBA) developed by the IMF's Research Department to estimate desired current account balances and real exchange rates (see IMF Working Paper WP/13/272 for a complete description of the EBA methodology and Annex I of the 2015 External Sector Report for a discussion of more recent refinements). In all cases, the overall assessment is based on the judgment of IMF staff drawing on the inputs provided by these model estimates and other analysis. Since estimates are subject to uncertainty, overall assessments are presented in ranges. The external sector assessments are based on data and IMF staff projections as of June 15th, 2017.

The external assessments discuss a broad range of external indicators: the current account, the real effective exchange rate, capital and financial accounts flows and measures, FX intervention and reserves and the foreign asset or liability position.[1] The individual economy assessments are discussed with the respective authorities as a part of bilateral surveillance.

B. Selection of Economies Included in the Report

The 29 systemic economies analyzed in detail in this Report and included in the individual economy assessments are listed below. They were chosen on the basis of an equal weighting of each economy's global ranking in terms of purchasing power GDP, as used in the Fund's *World Economic Outlook*, and in terms of the level of nominal gross trade.

Australia	Indonesia	Singapore
Belgium	Italy	South Africa
Brazil	Japan	Spain
Canada	Korea	Sweden
China	Malaysia	Switzerland
Euro area	Mexico	Thailand
France	The Netherlands	Turkey
Germany	Poland	United Kingdom
Hong Kong SAR	Russia	United States
India	Saudi Arabia	

[1] 2017 REERs are estimated based on data available as of June 15, 2017.

C. Domestic and Foreign Policies and Imbalance Calculations: An Example

The thought experiment. A simplified example could help to clarify how policy distortions are analyzed in a multilateral setting and how the analysis can distinguish between domestic policy distortions where a country might need to take action to reduce its external imbalance and those that are generated abroad and where no action by the home country is needed (but where action by others would help reduce the external imbalance).

Take a stylized example of a two country world.

Country A has a large current account deficit, a large fiscal deficit and high debt.

Country B has a current account surplus (matching the deficit in Country A), but it has no policy distortions.

External imbalances. The analysis would show that Country A has an external imbalance reflecting its large fiscal deficit. Country B would have an equal and opposite surplus imbalance. Country A's exchange rate would look overvalued and Country B's undervalued.

Policy gaps. The analysis of policy gaps would show that there is a domestic policy distortion in Country A that needs adjustment. However, the analysis for Country B would show that there were no domestic policy gaps—instead adjustment by Country A would automatically eliminate the imbalance in Country B.

Individual economy write-ups. While the estimates of the *overall external sector position*, needed *current account adjustment*, and associated *real exchange rate over/undervaluation* would be equal and opposite given there are only two economies in the world, the *individual economy assessments* would clearly identify the quite different issues and risks facing the two economies. In the case of Country A, the *capital flows and foreign asset and liability position* sections would note the vulnerabilities arising from international liabilities and the *potential policy* response section of the *overall assessment* would focus on the need to rein in the *fiscal deficit* and *limit asset price excesses*. For Country B, however, if there were no domestic policy distortions the write up would find no fault with policies and would note that adjustment among other economies would help to reduce the imbalance.

Implications. At the current time, fiscal policy is the area where it is most important to distinguish between domestic and foreign policy gaps (as the contribution of foreign policy is most marked). As discussed later an elimination of the fiscal policy gap in deficit advanced economies could help reduce surplus imbalances in other economies by around 3/4 percent of GDP.

Table 1. Summary of EBA and Staff-Assessed CA Gaps, 2016
(in percent of GDP)

Country	Actual CA [A]	Cycl Adj. CA [B]	EBA Norm [C]	EBA Gap [D=B-C]	Staff CA Gap 1/ [E]	Staff Adjustments [F=D-E] 2/ Total	Norm	Other	Staff CA Gap Range	Staff REER Gap	Staff REER Gap Range
Australia	-2.6	-2.0	-1.5	-0.5	-1.0	0.5	...	0.5	+/-1	5.0	+/-5
Belgium	-0.4	-0.5	2.6	-3.2	-3.3	0.1	...	0.1	+/-1	7.5	+/-2.5
Brazil	-1.3	-2.1	-2.5	0.5	-0.5	1.0	1.0	...	+/-1	5.0	+/-10
Canada	-3.3	-2.5	0.6	-3.1	-1.6	-1.5	-1.5	...	+/-1	6.0	+/-4
China	1.7	1.8	0.2	1.5	1.5	0.0	...	0.0	+/-1	0.0	+/-10
Euro Area	3.3	2.9	3.1	-0.2	0.3	-0.4	-0.4	...	+/-0.75	-1.0	+/-4
France	-1.0	-1.7	1.2	-2.9	-2.8	-0.1	...	-0.1	+/-1	11.0	+/-3
Germany	8.3	8.5	4.5	4.0	4.5	-0.5	-0.5	...	+/-1.5	-15.0	+/-5
India	-0.7	-1.1	-4.2	3.1	0.8	2.3	1.7	0.6	+/-1	2.5	+/-7.5
Indonesia	-1.8	-0.9	-0.9	0.0	0.0	0.0	...	0.0	+/-1	0.0	+/-5
Italy	2.6	1.5	4.0	-2.5	-2.0	-0.5	-0.5	...	+/-1	9.0	+/-3
Japan	3.8	3.1	3.4	-0.3	1.0	-1.3	-1.1	-0.2	+/-1	-7.0	+/-7
Korea	7.0	6.0	1.7	4.3	3.6	0.7	...	0.7	+/-2	-10.0	+/-5
Malaysia	2.4	3.6	1.1	2.5	2.3	0.2	...	0.2	+/-1	-8.0	+/-3.5
Mexico	-2.7	-2.0	-1.9	-0.1	0.0	-0.1	...	-0.1	+/-1	-10.0	+/-5
Netherlands	8.4	8.5	5.3	3.2	3.0	0.2	...	0.2	+/-1	-9.0	+/-3
Poland	-0.3	-0.1	-0.7	0.6	0.9	-0.3	...	-0.3	+/-1	-5.0	+/-5
Russia	1.9	4.2	6.3	-2.0	-1.0	-1.0	-1.0	...	+/-1	5.0	+/-5
South Africa	-3.3	-3.1	-0.7	-2.4	-1.5	-0.9	-0.9	...	+/-1	5.0	+/-5
Spain 3/	2.0	1.1	1.8	-0.7	-2.0	1.3	1.3	...	+/-1	7.5	+/-2.5
Sweden	4.5	5.0	-1.4	6.4	2.0	4.4	1.0	3.4	+/-1	-7.5	+/-2.5
Switzerland	10.7	10.5	7.5	3.0	0.8	2.3	...	2.3	+/-2	-1.5	+/-4
Thailand	11.5	11.2	1.2	10.0	5.0	5.0	...	5.0	+/-2	-8.0	+/-3
Turkey	-3.8	-3.7	-0.6	-3.0	-2.5	-0.5	-0.5	...	+/-1	11.3	+/-3.75
United Kingdom	-4.4	-4.1	0.0	-4.0	-2.5	-1.5	...	-1.5	+/-1.5	7.5	+/-7.5
United States	-2.4	-2.3	-1.3	-1.0	-1.2	0.2	...	0.2	+/-0.5	15.0	+/-5
Hong Kong SAR	4.6	2.5	...	...	0.0	...	...	...	+/-1.5	0.0	+/-5
Singapore	19.0	18.5	...	...	5.5	...	...	...	+/-3	-11.0	+/-6
Saudi Arabia	-3.9	-3.7	...	...	-7.7	...	...	...	+/-2	20.0	+/-5
Discrepancy 4/	...	...	...	...	**-0.07**	...	...	...	...	...	...

Source: Fund staff estimates.

1/ Refers to the mid-point of the CA Gap.

2/ Breakdown between norm and other factors (namely temporary or measurement errors) is approximate in some cases.

3/ For Spain, we report the CA level required to reduce NIIP by 5 percentage points of GDP annually. The NFA stabilizing CA is -1.6 percent of GDP.

4/ Weighted average sum of staff-assesed CA gaps.

D. Individual Economy Assessments—by Economy

	Australia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Compared to most other advanced economies, Australia has a high negative net international investment position (NIIP), reaching -60 percent of GDP in 2016. The ratio has varied in a range between -40 and -60 percent of GDP since 1988. Liabilities are largely denominated in Australian dollars while assets are in foreign currency. Foreign liabilities are composed of around one quarter of FDI, one half of portfolio investment (principally banks borrowing abroad and foreign holdings of government bonds), and one quarter of other investment and derivatives. The NIIP has deteriorated somewhat in 2016 (by 1¾ percent of GDP relative to 2015), driven mainly by valuation effects, as the current account (CA) deficit narrowed to -2.6 percent of GDP in 2016. The NIIP to GDP ratio is expected to remain around -60 percent of GDP over the medium term. **Assessment**. The NIIP level and trajectory are sustainable. The External Stability (ES) approach suggests that the NIIP would be stabilized at near present levels with a CA deficit of between 2½-3 percent, which is close to the cyclically-adjusted CA deficit recorded in 2016. The structure of Australia's external balance sheet reduces the vulnerability associated with its large negative NIIP. Since Australia's NIIP liabilities are mainly in Australian dollars and there is a net foreign currency asset position, a nominal depreciation tends to strengthen the external balance sheet, all else equal. The banking sector has a net foreign currency liability position but it is fully hedged. The maturity of banks' external funding has improved since the global financial crisis, and even in a tail risk event where domestic banks suffer a major loss, the government's strong balance sheet position allows it to offer credible support.	**Overall Assessment** *The external position of Australia in 2016 was assessed to be moderately weaker than the level consistent with medium term fundamentals and desirable policies. The current account deficit narrowed through 2016 from an unexpectedly large deficit the year before.* The narrowing reflects in part the contribution of strong service exports as the currency-commodity adjustment mechanism plays out following the decline in the terms of trade, and increased resource exports from newly established capacities. The depreciation of the Australian dollar observed over 2014-15 has been partly reversed since September 2015, though it remains some 15 percent below the peaks observed in 2011-2013. The depreciation in 2014-15 likely reduced the overvaluation of the Australian dollar. Some remaining exchange rate overvaluation might be accounted for by the relative attractiveness of highly-rated Australian assets. **Potential Policy Responses** If growth remains on the weak side, or commodity prices fall further driven by weaker global demand conditions, further monetary accommodation would be warranted. The government's planned gradual fiscal consolidation over the longer term should help improve the current account by boosting national savings.
Current account	**Background**. Australia has run CA deficits for most of its history, reflecting a structural saving-investment imbalance with very high private investment relative to a saving rate which is already high by advanced country standards. Since the early 1980s, deficits have averaged around 4 percent of GDP. The narrowing of the CA deficit in 2016 (to -2.6 percent of GDP) reflected the lagged effects of currency depreciation in 2014/15, which has boosted services and non-resource exports, new resource export capacity coming on stream, and a sharp and persistent improvement in the terms of trade late in the year. Over the medium term, the deficit is expected to widen slightly to around 3 percent of GDP as the non-mining investment recovery progresses with economic rebalancing. This is lower than the historical average of around 4 percent, given the end of the prolonged import-intensive mining investment boom and record high terms of trade. With over half of Australia's exports going to emerging Asia, a key risk is a sharper than expected slowdown in China which could result in a further sharp decline in commodities prices. **Assessment**. The EBA CA regression approach for 2016 estimates a CA norm of -1.5 percent of GDP, with a standard deviation of 0.7. Taking improvements in the terms of trade into account, the cyclically adjusted CA for 2016 is estimated to be -2.0 percent of GDP, indicating a CA gap with a mid-point of -0.5 percent of GDP. However, our assessment is that the CA gap is in the range of -2 to 0 percent of GDP, since part of the recent CA improvement reflects other temporary factors not fully captured in the model (e.g. unusually low net dividend and interest payments on external liabilities). as well as a recent decline in the ratio of non-mining business investment to GDP that is expected to reverse as the economy completes its transition to non-mining based growth). This assessment is subject to uncertainty given that it depends on how non-oil commodity prices evolve. Further, the estimates of the CA norm may not capture Australia-specific factors such as the attractiveness of Australian assets to overseas investors.	
Real exchange rate	**Background**. After depreciating by 17 percent between 2012 and 2015, the real effective exchange rate (REER) appreciated by 1 percent in 2016 relative to its 2015 average. Compared to its thirty-year average, the REER is some 14 percent higher, although well off the peak in 2012. Continued substantial capital inflows and favorable interest rate differentials may have contributed to the continued relative strength of the Australian dollar. Through May 2017, the currency is up 1.1 percent in real effective terms relative to the 2016 average. **Assessment**. Considering estimates of the CA gap based on the EBA CA regression, the estimated REER gap, and the estimated CA gap relative to the NFA stabilizing CA deficit, staff assesses the REER to be 0 to 10 percent above the level implied by medium-term fundamentals and desirable policy settings. The recent appreciation of the exchange rate, accompanying the increase in terms of trade, suggests that the REER would remain somewhat overvalued. 1/	
Capital and financial accounts: flows and policy measures	**Background**. The mining investment boom has been funded predominantly offshore. Net FDI inflows into this sector have partially offset the reduced need for the banking sector to borrow abroad. As investment in new mining projects winds down, related demand for imports will decrease, buffering the impact on the overall balance of payments. Australia also received large inflows in recent years into bond markets given its sound fiscal position relative to other advanced economies, and owing to relatively high interest rate differentials. The weighted average maturity of government bonds is 6.6 years, and has lengthened over time, with 90 percent of the issue maturing by 2027. **Assessment**. Credible commitment to a floating exchange rate and a strong fiscal position limit the vulnerabilities.	
FX intervention and reserves level	**Background**. A free-floater since 1983. The central bank undertook brief but large intervention in 2007–08 when the market for Australian dollars became illiquid (bid-ask spreads widened) following banking sector disruptions in the U.S. The authorities are strongly committed to a floating regime which reduces the need for reserve holding. **Assessment**. Although domestic banks' external liabilities are sizable, they are either in local currency or hedged with little or no counterparty risks, so reserve needs for prudential reasons are also limited.	

	Australia (continued)
Technical Background Notes	1/ Using the EBA estimated CA-to-REER elasticity of 0.19, the -1 percent of GDP mid-point estimate of the CA gap under the CA regression approach is consistent with an exchange rate overvaluation of around 5.4 percent in 2016. The ES approach implies a medium-term CA gap of around ½ percent of GDP relative to NIIP stabilizing level of around -2.8 percent, which translates into an exchange rate overvaluation of around 3.1 percent using the same elasticity. The EBA REER index regression approach, and the EBA REER level regression provide estimates of a gap encompassing a wide range from 4.1 to 16 percent in 2016.

	Belgium	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) remains strong at 50 percent in 2016, reflecting very healthy private balance sheets. Despite Belgium's decline as a financial center, gross foreign assets are large (averaging 487 percent of GDP). Gross foreign assets of banks stood at 97 percent of GDP, down considerably from the pre-crisis peak. The external debt of the public sector was around 67 percent of GDP, predominantly denominated in euro. Short-term debt accounted for 28 percent of total external debt in 2016. **Assessment**. Belgium's large gross international asset and liability positions are bloated by the presence of corporate treasury units, without creating macro-relevant mismatches. The remaining risk exposures on the asset side mostly relate to financial sector claims. Risk exposures on the liability side are related to external public debt. Based on the projected current account and growth paths, the NIIP to GDP ratio is expected to increase gradually going forward. The strongly positive NIIP and its trajectory do not raise sustainability concerns.	**Overall Assessment** *The external position in 2016 was weaker than medium-term fundamentals and desirable policy settings would imply*. The strengthening recovery in the euro area as well as recent measures to improve competitiveness point towards some strengthening of the external position in 2017, conditional on the euro depreciation and policies not being reversed. The strong net international investment position mitigates vulnerabilities associated with the high external public debt. **Potential Policy Responses** Planned steady fiscal consolidation, reductions in labor taxes and continued wage moderation will help towards making the external position fully consistent with fundamentals and policy settings. To protect against a reversal of the projected improvements, productivity enhancing structural reforms (in the product and labor markets, particularly to address the severe labor market fragmentation) would be useful.
Current account	**Background**. After declining since the early 2000s and reaching deficits of around 1 percent of GDP during the crisis, the CA has been close to balance during the past several years. 1/ This masks significant movements in the trade balance and investment income balance since 2013. While the goods balance improved sharply, partly driven by low oil prices, the primary income balance deteriorated, driven by a worsening in the net investment income balance which in part reflects relatively low returns on direct investment assets. The CA registered a small deficit in 2016 (0.4 percent of GDP), after posting a small surplus in 2015, and despite a pickup in food and machinery exports. **Assessment**. The EBA model estimates a cyclically adjusted CA of -0.5 percent of GDP and a CA norm of 2.6 percent of GDP, resulting in a CA gap of -3.2 percent of GDP for 2016. The contribution of policy gaps of -0.7 percent is mainly arising from the fiscal policy gap. The staff assessment is similar, estimating a CA gap in the range of -4¼ to –2¼ percent of GDP. 2/ The projected CA evolution of returning to a moderate surplus is consistent with a fiscal consolidation and a recovery in the household saving rate, which are offset by a more gradual increase in both private and public investment.	
Real exchange rate	**Background**. Unit labor costs point to a gradual loss of competitiveness since 2005. Most of this loss has come from lower productivity growth, with a smaller contribution from wage growth exceeding that of trading partners. Real wage moderation has reduced the annual average ULC-based REER by almost 3 percent between 2013 and 2016 with the largest impact in 2015 somewhat offset in 2016 by slower productivity growth. Since end-2016, the ULC-based REER has appreciated by 0.6 percent. The CPI-based REER has depreciated by 2.9 percent since end-2013. **Assessment**. Estimates of the EBA model for 2016 point to a REER overvaluation of 5.2 percent and 6.0 percent according to the index and REER models, respectively. The staff assessment consistent with the EBA REER regression model estimates and the CA assessment is a 2016 REER gap in the range of 5 to 10 percent.	
Capital and financial accounts: flows and policy measures	**Background**. Gross financial outflows and inflows were on an upward trend during the pre-crisis period along the expansion of banks' cross-border operations. Since 2007, alongside the bank deleveraging they have shrunk and have been more volatile. Short-term debt accounts for about 39 percent of the external liabilities and financing need. The capital account is open. **Assessment**. Belgium remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities. The strong NIIP reduces the vulnerabilities associated with the high public debt.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	Belgium (continued)
Technical Background Notes	1/ The historical CA data have undergone major revisions recently, complicating the comparison with previous ESR assessments. Revisions reflect mainly ongoing efforts to improve measures of investment income, as well as updated information on goods trade related to the residency of suppliers and customers and classification of processing activities. 2/ Belgium’s status as a center of corporate treasury activities and its resulting large gross foreign asset and liability positions complicate the measurement of the current account especially with respect to resulting income flows, and thus are a source of uncertainty about the CA assessment.

	Brazil	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Brazil's NIIP deteriorated to -39 percent of GDP at end-Q4 2016 reflecting in part valuation effects (on BRL denominated liabilities) related to the sharp appreciation of the BRL during 2016. 1/ The NIIP hovered around -30 percent of GDP throughout 2011-15. The NIIP is projected to gradually strengthen over the medium term to around -30 percent of GDP reflecting stable CA deficits (around 1-2 percent). While FDI accounts for about half of all liabilities, the rise in external debt since the global financial crisis (to about 37 percent of GDP and 300 percent of exports) is a source of risk. **Assessment**. While Brazil's NIIP is comparable to that of its peers, the shift in composition of liabilities toward FX external debt over the last several years is a concern. Short-term gross external financing needs, however, are moderate at 8 percent of GDP annually over the medium-term.	**Overall Assessment** *Brazil's external position in 2016 was, on average, broadly consistent with medium-term fundamentals and desirable policies.* The appreciation of the REER during 2016 reflects both improved ToT and the positive market response to the new government's reform agenda. The current account deficit will likely gradually widen starting in 2017 as demand recovers after the end of a deep recession during 2015-16. **Potential Policy Responses** Efforts to raise national savings are needed to provide room for a sustainable expansion in investment. Fiscal consolidation, including from the new federal spending cap and social security reform, should contribute to boosting net public savings. Structural reforms to reduce the cost of doing business would also help strengthen competitiveness and attract more FDI rather than debt financing. Foreign exchange intervention, including through the use of derivatives, can be appropriate to alleviate disorderly market conditions in the foreign exchange market.
Current account	**Background**. The current account (CA) deficit narrowed further in 2016 owing in part to the continued drop in domestic demand, especially investment, and some improvement in ToT. 2/ The CA deficit is down from 4.2 percent of GDP in 2014 to 1.3 percent in 2016 despite a neutral cyclically-adjusted fiscal stance. The CA deficit is expected to increase slightly in 2017, and gradually widen to about 2 percent of GDP in the medium term as demand recovers. However, declines in ToT and a sharp slowdown in trading partner growth remain a downside risk. 3/ 4/ **Assessment**. Staff assesses the CA norm consistent with fundamentals and desirable policies in 2016 to range from -0.5 to -2.6 percent of GDP, primarily based on the external sustainability approach and considering structural breaks in the supply side of the economy. With a cyclically-adjusted CA balance of -2.1 percent, the 2016 CA gap ranged between -1.5 and 0.5 percent of GDP. 5/	
Real exchange rate	**Background**. The REER (INS) on average appreciated by 7 percent during 2016, after weakening by 16 percent during 2015. The appreciation in 2016 reflects improvements in ToT and the positive response of markets to the new government's reform agenda. The annual average ULC-based REER also appreciated by some 5 percent during the first three quarters in 2016 relative to 2015. As of May 2017, the REER has appreciated an additional 16 percent relative to the average for 2016, although the currency remains volatile due to lingering political uncertainties. **Assessment**. Staff's assessment is that the real was *on average* broadly consistent with the level implied by fundamentals and desirable policy settings in 2016, with a REER gap in the [-5, 15] percent range. 5/	
Capital and financial accounts: flows and policy measures	**Background**. Brazil continues to attract sizable capital flows, but their composition changed recently. Equity liability flows remained strong while debt liabilities showed outflows. Net DI fully financed the CA deficit (DI liabilities totaled 4 percent of GDP), partly supported by intercompany loans counted in DI liabilities. 6/ Net portfolio debt liabilities, having exceeded 1 percent of GDP in previous years, turned to net outflows despite shrinking sovereign spreads and the positive reaction of markets to the new government's reform agenda (in particular, nonresident holdings of sovereign debt have been gradually declining). Interest differentials, still large despite recent monetary easing, should help to attract inflows. Still, rigidities in the Brazilian economy, if not properly addressed, may weaken investors' interest. **Assessment**. The composition of flows has a favorable risk profile; outflows on the liability side may pose some concerns, but this is tempered by a more stable outlook for credit risk.	
FX intervention and reserves level	**Background**. Brazil has a floating exchange rate. Since mid-2011, reserves have remained broadly stable. The preannounced intervention program the central bank initiated in 2013 ended in March 2015. Intervention in 2015 continued to rely on the use of FX swaps and repos, but was symmetric over the course of the year and generally more limited compared to previous years. 7/ In 2016, as the currency strengthened, the BCB reduced the rollover rate of maturing FX swaps and started auctioning reverse FX swaps, significantly reducing its net forward position to 1.4 percent of GDP at end-2016 from over 5 percent of GDP at end-2015. Brazil's gross reserves remained broadly constant in 2016, at $365 billion, some 20 percent of GDP and 260 percent of short term debt at remaining maturity. **Assessment**. The flexible exchange rate has been an important shock absorber. Reserves are adequate relative to various criteria including the IMF's composite reserve adequacy metric (about 166 percent). While Brazil's reserve holdings in principle provide some space to intervene, the authorities should aim to retain strong buffers and a net creditor FX position, with intervention limited to alleviating disorderly market conditions.	

	Brazil (continued)
Technical Background Notes	1/ The real appreciated by about 20 percent vis-à-vis the US dollar from end 2015 to end 2016. 2/ Import volumes fell by 8 percent in 2016 adding to a 14 percent decline in 2015. Export volumes rose by 4 percent in 2016, after increasing by 8 percent in 2015. 3/ Brazil currently runs a small oil deficit; in the short run, falling oil prices thus strengthen the CA, other things equal, while they depress the outlook for oil production in the medium term. Also, the development of Brazil's off-shore oil potential is no longer projected to contribute significantly to export growth in the medium term, as exploration and development plans to expand production over the medium term have been drastically cut back. 4/ A significant slowdown in China, which remains Brazil's most important export destination (19 percent) is a key external risk. 5/Estimates suggest a CA norm between -2.5 percent (EBA CA approach) and -1.2 percent (NIIP-stabilizing approach). Staff's assessment of the CA norm ranges from -0.5 to -2.5 percent (from where a REER gap can be derived using an elasticity of 0.1). This reflects, primarily, the need to maintain a CA balance that stabilizes the NIIP position and contain related vulnerabilities. The impact of large investment cuts in Petrobras, reflecting lower oil price projections over the medium term, and elevated uncertainty related to fiscal policy and political developments add uncertainty to the assessment. EBA REER methodologies do not provide support for a gap in either direction—indicating a 10.7 percent undervaluation (index) and 8.5 percent overvaluation (level). 6/ The strong decline in proceeds from overseas borrowing by foreign incorporated subsidiaries of Brazilian parent companies—chiefly Petrobras—illustrates that the risk profile of these flows is more similar to that of portfolio debt flows than to other types of DI liabilities. 7/ For details of the Brazilian FX swap and FX repo, see Saborowski and Nedeljkovic (2017) "The Relative Effectiveness of Spot and Derivatives Based Intervention: The Case of Brazil," IMF Working Paper No. 17/11.

	Canada
Foreign asset and liability position and trajectory	**Background**. Canada's net international investment position (NIIP) declined from 21.7 percent of GDP in 2015 to 9.3 percent of GDP in 2016. This decline reflected net borrowing from abroad and valuation changes due to the stronger performance of the Canadian stock market relative to most major foreign stock markets. Gross external debt reached 116 percent of GDP, 5 percentage points of GDP higher than in 2015, with foreign portfolio investment accounting for most of this increase. About a third of external debt is short-term. The NIIP is projected to decline in the medium term, in line with a reduction in the current account deficit. **Assessment**. Despite rising external debt, Canada remains a net creditor to the rest of the world. Canada's foreign assets have a higher foreign currency component than its liabilities which provides a hedge against currency depreciation. The NIIP level and trajectory are sustainable.
Current account	**Background**. Canada's current account (CA) balance recorded a marginal improvement from -3.4 percent of GDP in 2015 to -3.3 percent of GDP in 2016. Higher merchandise trade deficit was offset by a slightly higher services trade balance due to stronger sales of commercial and travel services. Underlying the change in the CA was a worsening of the general government savings-investment balance by 0.6 percentage points of GDP (from -1 percent to -1.6 percent of GDP), as the government embarked on fiscal expansion to support the economy. This was more than offset by an improvement of the private sector's balance by 0.7 percentage point (from -2.4 percent to -1.7 percent of GDP). **Assessment.** The EBA estimates a CA norm of 0.6 percent of GDP, consistent with a cyclically adjusted CA gap of -3.1 percent of GDP for 2016. This gap has narrowed compared to last year, but still likely overstates the desirable external adjustment. Staff estimates the CA norm to be lower, at about -0.9 percent of GDP, with the CA gap between -2.6 and -0.6 percent of GDP. Staff adjusted the CA norm to take into account mainly the erosion in external competitiveness and productive capacity in the non-resource sector. 1/
Real exchange rate	**Background.** The real effective exchange rate (REER) depreciated by 2 percent on an annual average basis between 2015 and 2016. As of May 2017, the REER has depreciated further by 2.3 percent compared to the average for 2016. **Assessment.** Both the EBA REER index and level approaches point to the currency being undervalued, by 9.5 and 19.9 percent respectively in 2016, which is different from the implied EBA CA results. In staff's view, the REER approaches overstate the extent of undervaluation, as they do not fully capture the structural factors behind Canada's export underperformance and the need to restore external competitiveness in non-resource sectors.2/ Consistent with the assessed CA gap, staff estimates that the real effective exchange rate is overvalued by about 2 to 10 percent relative to medium-term fundamentals and desirable policies.3/
Capital and financial accounts: flows and policy measures	**Background.** The CA deficit in 2016 has been financed by net portfolio inflows (7.3 percent of GDP). Non-resident investors mostly purchased corporate debt securities (44 percent of portfolio net inflows). Foreign acquisition of Canadian equities and government debt securities stood at 51 and 5 percent, respectively. In 2016 foreign direct investment recorded a higher net outflow of 2.1 percent of GDP (1.6 percent of GDP in 2015). **Assessment**. Canada has a fully open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate and, while the government is running fiscal deficits in the order of 1 percent of GDP in the near term, there is strong and credible commitment to fiscal consolidation over the medium term.
FX intervention and reserves level	**Background.** Canada has a free-floating exchange rate regime, and has not intervened in the foreign exchange market since September 1998 (with the exception of participating in internationally concerted interventions). Canada has limited reserves but its central bank has standing swap arrangements with the U.S. Federal Reserve and four other major central banks (it has not drawn on these swap lines). **Assessment**. Policies in this area are appropriate to the circumstances of Canada. The authorities are strongly committed to a floating regime which, together with the swap arrangement, reduces the need for reserve holding.

Overall Assessment
Overall Assessment *The external position in 2016 remained moderately weaker than implied by medium-term fundamentals and desirable policies.* The depreciation of the currency over the past two years has helped improve Canada's external competitiveness, but it will take time for the economy to adjust to structural shifts in the allocation of resources, restore lost production capacity, and address productivity underperformance. Recent developments do not suggest a change in the assessment of the external position for 2016. *In the medium term, the external position is expected to strengthen as non-energy exports gradually benefit from improved price competitiveness and investment in services and manufacturing capacity.* **Potential Policy Responses** Policies to boost Canada's non-energy exports include measures geared at improving labor productivity; investing in R&D and physical capital; promoting FDI; developing services exports; and diversifying Canada's export markets. The planned increase in public infrastructure investment should boost competitiveness, and improve the external position over time. A credible medium-term consolidation plan for fiscal policy will also be necessary to support the external rebalancing. Maintaining tight macroprudential policies to ensure financial stability should also support private sector saving.

	Canada (continued)
Technical Background Notes	1/ This adjustment is consistent with staff's estimate of the CA in the medium-term macroeconomic framework and reflects the following key factors: (i) the structural loss in trade competitiveness (see Agur, Itai, 2016 "Products and provinces: a disaggregated panel analysis of Canada's manufacturing exports", WP/16/193, International Monetary Fund). A long period of low labor productivity growth and the appreciation of the Canadian dollar during the oil boom worsened external competitiveness, depressed business investment outside the energy sector, and led to a decline in productive capacity in the non-resource sector. (ii) the EBA does not capture the increasing attractiveness of Canadian assets to overseas investors as a "safe haven". 2/ The approach also includes commodity terms of trade rather than oil prices as an explanatory variable, while Canada's REER has mirrored movements in oil prices much more closely than its commodity terms of trade. 3/ The semi-elasticity of the CA with respect to the REER is estimated at 0.27.

	China	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP), while positive, has deteriorated to 16 percent of GDP at end-2016 after peaking at 33 percent of GDP in 2007. This deterioration is driven by much-reduced current account (CA) surpluses, valuation changes, and sustained high GDP growth. Gross foreign assets (58 percent of GDP by end-September 2016) are dominated by foreign reserves, while gross liabilities (42 percent of GDP) mainly represent inward FDI, largely because direct investment has been the most open part of the capital account. Reserve assets fell to US$3.0 trillion by end-2016 (about 27 percent of 2016 GDP), from US$3.3 trillion at end-2015 (about 29 percent of 2015 GDP), due to net sales of reserve assets and valuation changes. **Assessment**. The NIIP-to-GDP ratio is expected to remain around current levels over the medium term, consistent with projected CA surpluses. The NIIP is not a major source of risk at this point, given the large foreign reserves and FDI-dominated liabilities. However, capital outflow pressure may persist and reserves fall further as the private sector seeks to accumulate foreign assets faster than non-residents seek to accumulate domestic assets.	**Overall Assessment** *The external position in 2016 was moderately stronger compared with the level consistent with medium-term fundamentals and desirable policies.* The renminbi, despite moving closer to the level consistent with overall assessment, remained broadly in line with fundamentals and desirable policies. Moreover, even though the RMB is assessed to be in line with fundamentals, the external position remains moderately stronger, reflecting remaining distortions and policy gaps that affect the saving-investment balance, such as inadequate social spending, as well as the result of exchange rates reacting more quickly to short-term market sentiment and not translating rapidly into elimination of the current account gap. Going forward, there are potential risks related to protectionist policies by key trading partners. **Potential Policy Responses** External imbalances have declined considerably since the global financial crisis. Achieving a lasting balance in the external position will require continued progress in closing the remaining domestic policy gaps and addressing distortions. Success will move the economy to a more sustainable growth path, with higher consumption and lower overall saving. This can be achieved through successful implementation of the authorities' reform agenda as well as consistent macroeconomic policies. Priorities include improving the social safety net; SOE reform and opening markets to more competition; creating a more market-based and robust financial system; taking steps to attract more inward FDI, including by ensuring that foreign investors receive the same treatment as domestic investors; and achieving a flexible, market-based exchange rate with a better communication strategy. Continuing the move toward a more market-based and transparent monetary policy framework is a key element in ensuring an orderly transition to an effective float, which may also require use of foreign exchange reserves to smooth excessive volatility.
Current account	**Background**. The CA surplus declined to 1.7 percent of GDP in 2016 (1.8 percent of GDP cyclically adjusted), which was about 1.0 percent of GDP lower than in 2015. The decrease of the CA surplus was mainly due to shrinking trade balance (driven by high import volume growth), notwithstanding REER depreciation. From a longer perspective, the CA surplus has fallen substantially relative to its peak of about 10 percent of GDP in 2007, reflecting strong investment growth, REER appreciation, weak demand in major advanced economies, and, more recently, a trend widening of the services deficit. **Assessment**. The EBA-estimated CA gap narrowed to about 1.5 percent of GDP in 2016 from 2.4 percent in 2015, primarily due to the declining actual CA surplus. The remaining total gap is mostly accounted for by the residual, reflecting factors other than policy gaps identified in the EBA model, including distortions that encourage excessive savings. The contribution of identified policy gaps is on net mutually offsetting, with loose fiscal policy and excessive credit growth contributing to narrowing the CA gap, largely offset by inadequate health spending and capital controls (which widen the CA gap). There is large uncertainty about China's cyclical position and possible underestimation of the CA (outbound tourism figures may be somewhat overstated). Also, given the ongoing rebalancing away from investment and high and sticky savings in the short term, the downward trend of the CA could be reversed. Overall, staff assesses the CA remains ½ to 2½ percent of GDP stronger than implied by medium-term fundamentals and desirable policies.	
Real exchange rate	**Background**. In 2016, the average REER depreciated by about 5.1 percent relative to 2015, driven by the depreciation in the NEER (6.5 percent), and reflecting in part the strengthening of the US dollar. As of May 2017, the REER is 2.8 percent weaker relative to the average 2016 level. **Assessment**. The EBA REER index regression estimates China's REER to be 2.7 percent weaker than levels warranted by fundamentals and desirable policies in 2016, compared to 3.9 percent stronger in 2015. 1/ The move to a marginally negative gap reflects the depreciation of the REER in 2016. However, this assessment is subject to large uncertainties related to the outlook and shifts in portfolio allocation preferences. 2/ Overall, staff assesses the REER to be broadly consistent with fundamentals and desirable policies, with the gap being in the range of -10 to +10 percent.	
Capital and financial accounts: flows and policy measures	**Background**. After a long period of net capital inflows, the financial account recorded a net outflow of US$647.4 billion in 2015 and US$639.7 billion in 2016. Net direct investment inflows shrank, as FDI inflows slowed and Overseas Direct Investment surged in 2016. The substantially negative errors and omissions (2.0 percent of GDP) are included as capital outflows as they are likely to be unrecorded capital rather than CA transactions. Notwithstanding some new inflow liberalization measures in 2016, China's capital account remains relatively closed in a de jure sense and the authorities have materially increased the enforcement of existing measures to help reduce outflow pressure. Following measures taken in 2016Q4, outflows have moderated in recent months. **Assessment**. Over the medium term, the sequence of capital control loosening, consistent with exchange rate flexibility should carefully take into account domestic financial stability. The further opening of the capital account is likely to lead to sizable gross flows in both directions. The adjustment path is hard to predict, and equilibrating such balance sheet adjustments and shifts in market sentiment argues for prioritizing the move to an effective float (while using foreign reserves to a limited degree to smooth excessive volatility) and strengthening domestic financial stability, over substantial further liberalization of the capital account. Efforts should be stepped up to encourage inward FDI, which would generate positive growth spillovers from the import of foreign technology and improving corporate governance standards.	
FX intervention and reserves level	**Background**. After a long period of reserve accumulation, FX reserves declined in 2015 and 2016 by US$513 billion and US$320 billion, respectively, of which intervention accounted for about US$342 billion and US$448 billion. **Assessment**. Reserves stood at 105 percent of the IMF's composite metric unadjusted for capital controls at end-2016 (down from 118 in 2015); relative to the metric adjusted for capital controls, reserves stood at 171 percent (down from 190 in 2015). The decline of the ratio is driven not only by lower reserves but also by higher broad money (M2) growth which is driving up the metric. Given that the progress made in capital account liberalization over time was partly reversed by the recent capital account tightening measures, the capital account is considered partially open. Consequently, reserves would be considered adequate in the range indicated by the adjusted and unadjusted metrics. Overall, staff assesses the current level of reserves to be adequate.	

	China (continued)
Technical Background Notes	1/ The EBA REER Level model estimates a total REER gap of 6.3 percent, with identified policy gaps of 3.4 percent. However, the model fit of the EBA REER Level model is very poor for China. 2/ Changing expectations about monetary and exchange rate policy, re-evaluation of the government's reform agenda, or a desire by residents to diversity into foreign assets can trigger large changes in capital flows and exchange rate pressures, even in the absence of significant changes in fundamentals as captured by EBA.

	Euro Area
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) of the euro area fell to about -18 percent of GDP by the end of 2008, but has since recovered, improving to around -6 percent in 2016. The rise has been driven by stronger current account balances and modest nominal GDP growth. Growth in both gross asset and liability positions remains low, but relatively steady after sharply slowing in 2008, coincident with the broader global slowdown in international financial flows. Gross positions are now about 237 percent of GDP for assets and 243 percent of GDP for liabilities in 2016. **Assessment**. Projections of continued current account surpluses suggest that the NIIP-to-GDP ratio will continue to improve at a moderate pace, with the euro area expected to become a net external creditor within the next few years, absent large differences in valuation changes on gross external assets versus liabilities. The region's overall NIIP financing vulnerabilities appear low. Despite improved current accounts, large net external debtor countries still bear a greater risk of a sudden stop of gross inflows.
Current account	**Background**. The current account (CA) balance for the euro area was higher at 3.3 percent of GDP (cyclically adjusted 2.9 percent) in 2016. Nearly all euro area countries are now running current account surpluses (apart from [Belgium, Cyprus, Finland, France, Greece, and Lithuania]). Although the drivers of the improvements differ across countries, lower commodity prices have provided a broad-based boost to euro area current accounts. Import compression in the immediate aftermath of the crisis and external competitiveness gains from price and wage adjustments have strengthened the current accounts of net external debtors, like Spain and Portugal. The continued growth of the surpluses of some large creditor countries, such as Germany and the Netherlands, reflect strong corporate and public saving and weak investment. **Assessment**. The EBA model estimates a CA gap of -0.2 percent of GDP for 2016, with a cyclically adjusted CA norm of 3.1 percent of GDP. The elevated norm reflects in particular demographics (population aging) and its impact on desirable saving. Underlying heterogeneity in the estimated gaps across countries largely offsets in aggregate, with positive estimated gaps in some countries (e.g., Germany, the Netherlands) roughly equaling total of the negative estimated gaps for other countries (e.g., France, Italy). Taking into account the uncertainties in model-based estimates and consistency with the euro area member country-level assessed CA gaps, staff assesses the euro area CA gap to be in the range of -0.5 to 1.0 percent of GDP for 2016, leaving the underlying CA broadly consistent with the level implied by medium-term fundamentals and desirable policies. 1/ 2/
Real exchange rate	**Background**. The CPI-based real effective exchange rate appreciated by about 1.1 percent from 2015 to 2016, reflecting the gradual strengthening of the euro area's recovery. Weaker inflation in the euro area relative to its trading partners accounts for a real appreciation lower than the nominal appreciation of about 3.3 percent. As of May 2017, the REER is down by about 1 percent relative to its 2016 average level, essentially unwinding the 2016 appreciation. **Assessment**. The EBA index REER model points to an overvaluation of about 2.4 percent in 2016, while the level REER model suggests an undervaluation of about 4.5 percent. On balance, staff assesses the euro area 2016 average real exchange rate to have been broadly aligned, between an undervaluation of 5 percent and an overvaluation of 3 percent. As with the CA, the aggregate masks a large degree of heterogeneity in REER gaps across euro area member states, ranging from an undervaluation of 10-20 percent in Germany to overvaluations of 5-20 percent in a number of small to mid-sized euro area member states. The large differences in REER gaps within the euro area highlight the continuing need for net debtor countries to improve their external competitiveness and for net creditor countries to boost domestic demand.
Capital and financial accounts: flows and policy measures	**Background**. Mirroring the 2016 CA surplus, the euro area experienced net capital outflows, largely driven by portfolio debt and FDI outflows. These were somewhat tempered by inflows into portfolio equity and loans and other bank-related instruments. The geography of gross capital inflows shifted with the global financial and sovereign debt crises, with inflows from the core euro area economies into the rest of the euro area diminishing. **Assessment**. Capital outflows in portfolio debt and inflows into portfolio equity over the past couple years likely arose in large part from the ECB's monetary accommodation through its asset purchase program, which has lowered yields on debt and spurred interest in equity.
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.

Overall Assessment

Overall Assessment

The external position of the euro area in 2016 was broadly in line with the level implied by medium-term fundamentals and desirable policies. In 2017, the current account surplus is projected to shrink very slightly as the region's economic recovery continues. Imbalances at the national level remain sizeable and progress in reducing them slow (see related pages for individual euro area member countries). Further adjustment is needed by net external creditors to strengthen domestic demand (reducing surpluses) and net external debtors to raise productivity and competitiveness (raising surpluses or lowering deficits). The euro area's external position may be affected by the UK's eventual exit from the EU and possible policy changes in the global policy mix, including in the United States. As their precise nature becomes clearer, these will be assessed in the context of future ESR reports.

Potential Policy Responses

Continued monetary accommodation remains key to increase demand and lift inflation closer to the ECB's medium-term price stability objective, while facilitating relative price adjustments at the national level by enabling greater inflation differentials across monetary union members. Country-level efforts to address imbalances, including policies to strengthen private sector balance sheets, structural reforms to enhance productivity and improve competitiveness, and a more growth-friendly composition of national fiscal policies, must accompany region-wide measures. Countries with fiscal space should expand investment and promote structural reforms to raise their potential and reduce their current accounts, while those without it should continue consolidating to reduce their debt and increase their buffers, while undertaking desirable structural reforms. At the regional level, expanding centralized investment schemes would support such rebalancing. A more balanced policy mix with the implementation of priority institutional and structural reforms at the country level, would better boost domestic demand and rebuild policy buffers, helping to reduce external imbalances, including within the euro area.

	Euro Area (continued)
Technical Background Notes	1/ The IMF EBA analysis for the euro area covers 11 euro area members, which are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, and Spain. The assessments of CA and REER gaps for the euro area are derived from GDP-weighted averages of the assessments of the individual countries listed above, as well as from estimates for the euro area as a whole. 2/ When applying GDP-weighted aggregation for the euro area, the CA is corrected for reporting discrepancies in intra-area transactions, as the CA of the entire euro area is about ½ percent of GDP less than the sum of the individual 11 countries' CA balances.

	France	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. After broad balance in the four years before the global crisis, the net international investment position (NIIP) has deteriorated to around -16 percent of GDP by 2016Q4. The deterioration in NIIP has been mainly driven by increases in public sector liabilities, reflecting rising public debt held by foreigners. In fact, TARGET2 liabilities are small, reaching €14 billion (0.6 percent of GDP) by end-2016. However, the net position masks large gross positions, particularly for financial institutions, reflecting their global activities. The gross asset position has been increasing since 2014, and stood at over 300 percent of GDP in 2016. More than three-quarters of French bank exposures are to advanced economies, with the share of major emerging market exposures now reaching 4 percent of total foreign claims. The value of emerging market exposures could fall in the medium-term, causing a moderate decline in the gross asset position and in the net IIP. Public external debt and bank liabilities accounts for about respectively 19 and 40 percent of the gross liability position. **Assessment**. The NIIP is negative but its size and trajectory do not raise sustainability concerns. However, there are vulnerabilities due to the external public debt and bank funding on the liability side.	**Overall Assessment** *The external position in 2016 was weaker than the level consistent with medium-term fundamentals and desirable policy settings.* The weakening of the external position since the late 1990s has been associated with an increase in fiscal deficits, a decline in private net savings, robust real wage growth, and a strong appreciation of the euro in the pre-crisis years. However, recent developments suggest that the external position is strengthening. **Potential Policy Responses** Continued wage moderation (especially of the minimum wage), additional reforms of the labor market, and productivity-enhancing measures (increasing competition in product markets and further regulatory simplification) would help strengthen competitiveness. Along with the planned gradual elimination of the fiscal deficit over the medium term, these measures should help correct the external imbalance (as well as promote growth).
Current account	**Background**. The current account (CA) has deteriorated from a surplus of almost 4 percent of GDP in the late 1990s to an estimated deficit of 1.0 percent in 2016 (the cyclically-adjusted deficit is estimated at 1.7 percent of GDP), driven by a progressive weakening of the goods balance and growing deficits in net current transfers between residents and non-residents (net secondary income). This deterioration was associated with declines in both private net savings and an increase in government deficits. Exports in 2016 were particularly weak, although this partly reflected temporary factors including a drop in tourism revenues following the terror attacks, and lower exports of grains and wine due to unfavorable weather. The CA is projected to deteriorate in 2017 to -1.3 percent of GDP, reflecting the adverse effect of higher oil prices. This effect is expected to dominate the positive combined effect of the unraveling of the 2016 one-off shocks and of the strengthening of global demand. **Assessment**. The staff assesses the 2016 cyclically-adjusted CA to be 1.8 to 3.8 percent of GDP below its norm. This is consistent with the EBA model estimate that the cyclically-adjusted CA is about 2.8 percent of GDP weaker than the value consistent with medium-term fundamentals and desirable policy settings. 1/ Recent developments, including the depreciation of the euro, more favorable terms of trade, and a gradual rebound from one-off shock, suggest some moderate strengthening of the external position after 2017. Over the medium term, the CA deficit is projected to gradually move into balance as exports grow along with external demand, imports pick up in line with private domestic demand, while the fiscal deficit narrows.	
Real exchange rate	**Background**. Following a gradual decline after the global financial crisis that amounted, cumulatively, to about 10 percent, the REER, measured on both ULC and CPI bases, appreciated modestly in 2016, by about ½ percent compared to 2015. **Assessment**. The EBA Level REER regression model estimates a 6.8 percent overvaluation, while the overvaluation suggested by the staff's assessment of the CA gap is a range of about 8 to 14 percent using standard trade elasticities. The EBA Index REER model, on the other hand, estimates an undervaluation of -2.4 percent. Taking into account the superior fit of the CA model for France, as well as the evidence from ULC and the Level regression model, the staff assessment is that the REER is 8-14 percent overvalued. 2/	
Capital and financial accounts: flows and policy measures	**Background**. The current account deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Flows in financial derivatives have grown sizably on both the asset and liability side since 2008. The capital account is open. **Assessment**. France remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	France (continued)
Technical Background Notes	1/The new assessed CA gap midpoint of -2.8 percent (about 1.9 percentage points wider than last year) reflects proportionally a wider estimate of the gap from the EBA model, given a larger cyclically-adjusted deficit and broadly unchanged fundamentals. 2/ The ULC-based REER has appreciated slightly in recent quarters, adding to past competitive losses. Taking all these inputs into account, staff assesses the 2016 REER to be 8–14 percent overvalued.

	Germany	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Germany's positive net international investment position (NIIP) reached 52 percent of GDP in end-2016, about twice the 2011 level. The net rise in foreign assets over this period has however fallen short of the accumulation of current account (CA) surpluses. The NIIP of financial corporations other than MFIs is large and positive (50 percent of GDP), while that of the general government is large and negative (34 percent of GDP), partly reflecting Germany's safe haven status. The NIIP is expected to reach 85 percent of Germany GDP and 3.5 percent of world GDP by 2021, as the projected CA surplus remains sizable through the medium term. Foreign assets are well diversified by instrument. The stock of Germany's net (Target2) claims on the Eurosystem has been on an upward trend since the beginning of 2015 and reached almost €857 billion in May 2017 (27 percent of GDP), after declining consistently between 2012 and 2014. **Assessment**. With the implementation of quantitative easing measures by the ECB, Germany's exposure to the Eurosystem has widened again.	**Overall Assessment** *Germany's external position in 2016 remained substantially stronger than implied by medium-term fundamentals and desirable policy settings.* The current account surplus has narrowed slightly relative to 2015 levels as cyclical conditions improved in Germany and globally. Staff projects a gradual narrowing in the medium run as energy and other import prices recover, and private investment keeps strengthening. Without nominal exchange rate flexibility, stronger wage growth relative to euro area trading partners is expected to contribute to realign price competitiveness within the monetary union, but at a slow pace. The projected adjustment is, however, partial and additional policy actions will be necessary to fully rebalance the economy. **Potential Policy Responses** A more growth-oriented fiscal policy, making use of fiscal space to stimulate potential growth, as well as pension reforms prolonging working lives would reduce savings, stimulate investment, and reduce external imbalances
Current account	**Background**. The CA surplus has been widening since 2001. It averaged 7.5 percent of GDP over the last five years and reached 8.3 percent of GDP in 2016, a 0.3 p.p. decline relative to 2015, while the nominal balance remained virtually unchanged. The increase in net exports in 2016 was roughly equally split between euro area and non-euro area trade partners. The bulk of the CA surplus reflects large saving-investment surpluses of non-financial corporations and households, with rising net savings of non-financial corporations and fiscal consolidation accounting for the upward trend. **Assessment**. The cyclically-adjusted CA balance reached 8.5 percent of GDP in 2016, slightly below the 2015 level and 3–6 percentage points of GDP stronger than the value implied by fundamentals and desirable policies. Staff assesses the CA norm at 2½–5½ percent of GDP, with a midpoint slightly lower than the CA norm implied by the EBA model of 4½ percent. 1/ The sensitivity of the norm to demographic factors and uncertainties regarding the evolution of these factors explain the relatively wide range around the assessed CA norm.	
Real exchange rate	**Background**. The yearly average CPI based real effective exchange rate (REER) was broadly unchanged relative to 2015, as have the nominal effective exchange rate and the ULC-based REER, as the euro remained stable vis-à-vis the U.S. dollar, but appreciated relative to the sterling and the renminbi. The REER through May 2017 showed a very minor depreciation relative to the 2016 average. **Assessment**. Staff's assessment for 2016 is of a REER undervaluation of 10–20 percent. The EBA REER Level model yields an undervaluation of about 18 percent. The undervaluation implied by the CA regression model using standard trade elasticities is 11–16 percent. 2/	
Capital and financial accounts: flows and policy measures	**Background**. In 2016, net portfolio and other investment flows, constituted about ½ and ⅓ of the capital and financial account balance, respectively. On a regional basis, about 2/3 of the net outflows were toward European countries and 1/3 toward the Americas (mostly the U.S.), with small net inflows from emerging countries and offshore centers. Net direct foreign investment declined reflecting both a decrease in outward investment and an increase in flows into Germany. **Assessment**. Safe haven status and the strength of Germany's current external position limit risks.	
FX intervention and reserves level	**Background**. The euro has the status of global reserve currency. **Assessment**. Reserves held by Euro area countries are typically low relative to standard metrics. The currency is freely floating.	

	Germany (continued)
Technical Background Notes	1/ The rapid aging of the population contributes 3 percentage points to the estimated EBA CA norm of 4½ percent of GDP. The difference between the EBA norm and the mid-point of the staff assessed norm (-0.5 percentage points) reflects staff's judgement that demographic projections used in the EBA model are somewhat pessimistic in light of the most recent developments in immigration and fertility. Most of the EBA-estimated gap for 2016 reflects the regression's residual rather than gaps in the policies variables included in the EBA model. 2/ The EBA REER Index model has an unusually poor fit for Germany. The result for 2016 is an estimate of overvaluation (of 4 percent) that has been discarded from the assessment as implausible, including in light of the assessment that the CA is too strong.

	Hong Kong SAR	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) reached around 368 percent of GDP as of end-2016, up from 291 percent in 2010. Both external financial assets (about 1,425 percent of GDP) and liabilities (about 1057 percent of GDP) are high, reflecting Hong Kong SAR's status as a major international financial center. Given the large gross assets and liabilities, annual fluctuations in the NIIP due to valuation changes have been sizable and positive. The GDP share of the NIIP is projected to decline moderately, chiefly driven by the interest-growth differential—as nominal GDP is expected to grow faster than the effective returns on the NIIP. **Assessment**. Vulnerabilities are low given the size of NIIP and its favorable composition, with large stock of reserve assets and more than half of total liabilities in the form of direct investment.	**Overall Assessment** *The external position in 2016 was broadly consistent with medium-term fundamentals and desirable policy settings.* Developments through June 2017 do not suggest a change in this assessment. The current account surplus has declined relative to its pre-2010 level on account of structural factors, including opening of the Mainland capital account and changes in offshore merchandise trade activities. As a result of Hong Kong SAR's Linked Exchange Rate System (LERS), short-term movements in the REER largely reflect U.S. dollar developments. The recent REER appreciation is expected to be offset over time by Hong Kong SAR's strong self-equilibrating economy stemming from flexible goods, factor, and asset markets. 3/ **Potential Policy Responses** Macroeconomic policies are broadly appropriate. Maintaining policies that support wage and price flexibility is crucial particularly as the tightening cycle of U.S. monetary policy continues with concomitant U.S. dollar appreciation risks. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the Linked Exchange Rate System have worked well to keep the external position broadly in balance. Continuation of these policies, therefore, will help keep the external position broadly in line with medium-term fundamentals.
Current account	**Background**. The current account (CA) surplus is estimated to be 4.6 percent of GDP in 2016 (2.5 percent of GDP after cyclical adjustment), although it continues to be substantially lower than the pre-GFC average (around 10 percent in 2000-08). From a sectoral perspective, the gradual decline of private saving (from the peak of 34.4 percent of GDP in 2006 to 24.6 percent of GDP in 2014 and 2015), driven by robust consumption growth, tight labor market and wealth effects related to strength in the housing market, accounted for most of the drop in the CA surplus. The higher CA surplus in 2016, reflects favorable terms of trade shock from lower commodity prices (1 percent of GDP) and a temporary surge in the primary income balance (contributing 1 percent of GDP to the cyclical adjustment) The CA surplus is projected to be 3.0 percent of GDP in 2017. **Assessment**. The CA is broadly consistent with medium-term fundamentals and desirable policies. Staff's quantitative assessment finds that the cyclically-adjusted CA is roughly in the mid-point of the CA norm range of 1 to 4 percent of GDP. The CA gap is hence in a range of -1½ to 1½ percent of GDP. The large decline of the CA surplus (relative to pre-2010) is mainly driven by structural changes related to weaker growth and rebalancing in mainland China as well as the opening of the Mainland capital account. Such changes are not fully reflected in the EBA implied norm. 1/	
Real exchange rate	**Background**. The REER appreciated by about 5 percent in 2016, relative to the average REER in 2015. The REER appreciation was mainly driven by the HKD/USD peg and the higher inflation in Hong Kong SAR relative to most other advanced economies. The appreciation trend continued thus far in 2017: as of May 2017, the REER was about 4.2 percent stronger than its 2016 average. However, it should be noted that the recent appreciation in REER came after a decade-long REER depreciation (from 1998 to 2011). The current REER level is broadly the same as the level in 2004-2005 (when the current account surplus of Hong Kong SAR was above 10 percent of GDP). **Assessment**. The real exchange rate is broadly consistent with medium-term fundamentals and desirable policies. Based on elasticity estimates for similar economies and factoring in the uncertainties and variability of an offshore trading and financial center, the exchange rate is assessed by staff to be from -5 to +5 percent different from the level consistent with medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. As a financial center, Hong Kong SAR has a fully open capital account without capital controls. Non-reserve financial flows moved from sizeable inflows in 2015 to net outflows up to 2016: Q3. The financial account is typically very volatile both in terms of portfolio and direct investment. 2016 serves as an illustration, with portfolio investment shifting from large inflows in the first half of the year to large outflows in Q3. Direct investment saw almost the reverse pattern with inflows intensifying through the third quarter. These large movements are likely associated with both financial volatility in the Mainland, transmitted through growing cross-border financial linkages 2/ as well as shifting expectations of a U.S. policy rate hike that materialized in December. **Assessment**. Large financial resources and proactive financial supervision and regulation limit the risks from potentially volatile capital flows. The greater financial exposure to mainland China could pose risks to the banking sector if mainland growth slows sharply and financial stress emerges in some key sectors in the Mainland, such as export-oriented manufacturing or real estate. However, given the high origination and underwriting standards that Hong Kong SAR banks have maintained, the credit risk appears manageable. The ongoing U.S. dollar appreciation will also affect Hong Kong SAR's capital flow outlook in 2017, given its linked exchange rate system and position as an international financial center.	
FX intervention and reserves level	**Background**. Hong Kong SAR has a currency board arrangement. International reserves have been built up in a nondiscretionary way as a result of a long-standing commitment to the Linked Exchange Rate System. The stock of reserves in end-2016 was equivalent to around 120 percent of 2016 GDP or just above US$386 billion. **Assessment**. Currently, reserves are adequate for precautionary purposes and should continue to evolve in line with the automatic adjustment inherent in the currency board system. Hong Kong SAR also holds significant fiscal reserves built up through a track record of strong fiscal discipline.	

	Hong Kong SAR (continued)
Technical Background Notes	1/ Hong Kong SAR is not in the EBA sample as it is an outlier along many dimensions of EBA analysis, thus one possibility with obvious drawbacks is to use EBA estimated coefficients and applying them to Hong Kong SAR. Following that approach, the cyclically-adjusted CA is estimated to be about 10 percent of GDP weaker than that consistent with fundamentals and desirable policies. The CA gap was mainly driven by EBA regression residual (about 12 percent of GDP) with the policy gap at around 2 percent of GDP. The large residual likely reflects a combination of structural factors which are relevant for Hong Kong SAR but are not captured by EBA. Two structural factors appear to account for some of the difference: (i) the structural decline in the transport services balance tied to a reduction of re-exporting activity from and to China; and (ii) the structural reversal of Hong Kong SAR's gold trade balance tied to the opening of the Precious Metals Depository. Two additional EBA-specific factors are also of note. First, EBA's adjustment for financial centers (which contributes 2.7 percent of GDP to the norm) should not be applied to HKSAR since the CA likely underestimates (rather than overstates) actual changes in net wealth. Second, EBA's coefficient for NFA to GDP captures average income effects across countries, while in fact Hong Kong SAR has had a systematically lower income balance relative to its NFA compared to other economies. Adjusting for all of these factors, staff estimate that the CA gap is close to zero, corresponding to a norm in the range of 1 to 4 percent of GDP. 2/ The financial linkages with the Mainland have deepened in recent years with the increase in cross-border bank lending, securities issuance in Hong Kong SAR by mainland entities and the internationalization of the RMB. As of 2016: Q2, the banking system claims on mainland banks and nonbank entities amounted to HK$ 6.1 trillion, or about 250 percent of 2015 GDP, although part of the exposure is accounted by foreign banks. 3/ See SIP in the 2016 AIV staff report and IMF WP17/09.

	India	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. India's net international investment position (NIIP) has improved slightly since 2013, going from -18.5 percent of GDP at end FY2013/14 to -17.0 percent of GDP at end-2016. Gross foreign assets and liabilities are relatively modest, at 25 and 42 percent of GDP, respectively, and reflect India's gradual approach to capital account liberalization (most recently focused on FDI). The bulk of assets are in the form of official reserves and FDI, and liabilities mostly include FDI and portfolio equity. **Assessment**. With current account deficits of under 2¼ percent of GDP projected for the medium term and rising GDP growth, the NIIP-to-GDP ratio is expected to remain broadly stable. India's external debt, at about 21 percent of GDP, is moderate compared to some other emerging market economies, and its maturity profile is favorable as the share of long-term external debt in total debt is about 82 percent and the ratio of short-term external debt to FX reserves is low.	**Overall Assessment** *The external sector position in 2016/17 is broadly consistent with medium-term fundamentals and desirable policy settings.* India's low per capita income, favorable growth prospects, and development needs justify running CA deficits. External vulnerabilities remain, although they have been reduced since 2013. India's economic risks stem from intensified global financial volatility including from a faster-than-anticipated normalization of monetary policy in key advanced economies, longer-than-expected cash normalization following the currency exchange initiative, as well as slower global growth. Like other EMs, too great a reliance on debt financing and portfolio inflows would create significant external financing vulnerabilities. Therefore, there is need to remain vigilant to safeguard the Indian economy. The flexible exchange rate policy followed by the Reserve Bank of India is sound, and the current policy of at times smoothing exchange rate volatility is appropriate. It is also important to maintain adequate levels of international reserves. **Potential Policy Responses** An increase in non-debt creating capital flows through FDI will help improve the CA financing mix and contain external vulnerabilities. In particular, further efforts to revamp the business climate and ease domestic supply bottlenecks are essential to improve investment prospects, attract FDI, and boost exports. Further liberalization of ECBs should proceed cautiously and be carefully monitored, given continuing corporate vulnerabilities. Monetary policy framework has been strengthened, but further supply-side reforms and continued fiscal consolidation are key requirements to achieve a low and stable rate of inflation in the medium-term as well as to keep gold imports contained. Continued fiscal consolidation is needed, including by implementation of the goods and services tax and further subsidy reforms. Safeguarding financial stability and enhancing the ability of the financial sector to contribute to growth are also necessary policy steps.
Current account	**Background**. The current account (CA) deficit remained compressed at 0.7 percent of GDP in FY2016/17, slightly lower than that of FY2015/16, helped by relatively low commodity-import prices. After a decline of 15.9 percent in FY2015/16, exports of goods have recently rebounded. Meanwhile, any recovery in imports will happen with a lag, reflecting sluggish private investment and continued fiscal consolidation. The CA deficit is expected to widen to under 2¼ percent of GDP over the medium term on the back of strengthening domestic demand. **Assessment**. The EBA CA regression estimates a norm of -4.2 percent of GDP for India in FY2016/17, but the estimate is subject to uncertainty. 1/ As discussed in previous External Sector Reports and Article IV Staff Reports, in staff's judgment, drawing on the experience of financial turmoil during the mid-2013 taper tantrum period, global financial markets cannot be counted on to reliably finance a deficit of that size in light of India's current vulnerabilities. Given the risks from global financial market volatility, staff judges that a smaller deficit of about 2½ percent of GDP is a more appropriate norm. 2/ Given the EBA-estimated cyclically adjusted CA deficit of 1.1 percent of GDP and taking into account the temporary part of the terms of trade gain 3/, the underlying CA deficit in FY2016/17 stood at 1.4 percent of GDP. Thus, the CA gap is in the range of -0.2 to +1.8 percent of GDP.	
Real exchange rate	**Background**. The average REER in 2016 appreciated by about 3 percent over its 2015 average. As of May 2017, the REER appreciated a further 7.2 percent relative to its 2016 average. **Assessment**. The EBA Index REER and Level REER regression approaches estimate a gap of about +7.2 and +12.6 percent for the 2016 average REER, respectively. However, staff assesses the gap to be smaller, given that the recent appreciation reflects positive terms of trade shocks not fully captured by the model. In addition, the CA gap implies a REER gap of -4.4 percent for FY2016/17. Overall, staff assesses the REER to be in line with fundamentals, with the REER gap in a range of -5 to +10 percent. 4/	
Capital and financial accounts: flows and policy measures	**Background**. The sum of FDI, portfolio, and financial derivatives flows on a net basis has remained broadly unchanged at about 2.3 percent of GDP in FY2016/17. The financing mix, nevertheless, continues to improve with an increase in FDI inflows since the 2013 taper tantrum episode. Net FDI flows, mostly representing equity investments, have increased to 1.6 percent of GDP in FY2016/17 from 1.2 percent in FY2013/14, largely due to the ongoing liberalization of FDI caps in most sectors. 5/ Portfolio investment flows together with financial derivatives largely offset other investment flows on a net basis. Debt flows, particularly in the form of external commercial borrowings (ECB) by Indian corporates, have stabilized after increasing in recent years. In 2016, the Reserve Bank of India (RBI) allowed infrastructure companies and infrastructure-related finance and investment companies to raise ECB with minimum average maturity period of 5 years, subject to 100 percent hedging. **Assessment**. Given that portfolio debt flows have been volatile and the exchange rate has been sensitive to these flows and changes in global risk aversion, attracting more stable sources of financing is needed to reduce vulnerabilities. Caps on FDI inflows have been largely liberalized in recent years. Further initiatives on creating a more conducive business environment, particularly the implementation of long-standing labor market and power sector reforms, are necessary to attract greater FDI flows.	
FX intervention and reserves level	**Background**. The evolution of the rupee is consistent with a floating arrangement. Foreign exchange interventions, which were relatively small both on spot and forwards markets in 2016, are guided by the need to limit volatility and gradually build buffers to maintain adequate precautionary reserve levels. International reserves have been stable over 2016, increasing by $32 billion since January 2016 to reach $381 billion as of early-June 2017. Reserve coverage currently stands at about 16.6 percent of GDP, and about 8.0 months of prospective goods and services imports. **Assessment**. Reserve levels are adequate for precautionary purposes. International reserves represent 176 percent of short-term debt and 156 percent of the IMF's composite metric. 6/	

	India (continued)
Technical Background Notes	1/ The standard deviation of the estimated current account norm is about 1 percent of GDP. 2/See IMF (2014), *India: Staff Report for 2014 Article IV Consultation*, IMF Country Report No. 14/57 and IMF (2017), *India: Staff Report for the 2017 Article IV Consultation*, IMF Country Report No. 17/54 for additional model-based estimates and description of the CA deficit norm in India. 3/ The temporary part of the recent terms of trade gain amounts to about ½ of one percent of GDP. 4/ The mid-points of the REER gap and the CA gap have the same sign, partly reflecting India's exchange rate-inelastic oil and gold imports, and binding supply-side constraints (including energy shortages) which may dampen relative-price responsiveness in the short-term. 5/ See Chapter 5 in IMF (2016), *India: Selected Issues*, IMF Country Report No. 16/76 and Chapter 6 in IMF (2017), *India: Selected Issues*, IMF Country Report No. 17/55. 6/ Reserves stand at 191 percent of the metric adjusted for capital controls, the construction of which is explained in the IMF policy paper, *Assessing Reserve Adequacy—Specific Proposals*. Staff has argued that using the metric adjusted for capital controls is inappropriate for India, as the de jure measures of capital controls used in the new IMF metric provide a misleading picture of the significance of capital account restrictions in India. See Annex IV in IMF (2016), *India: Staff Report for the 2016 Article IV Consultation*, IMF Country Report No. 16/75 and Chapter 5 in IMF (2016), *India: Selected Issues*, IMF Country Report No. 16/76.

	Indonesia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. At end- 2016, Indonesia's net international investment position (NIIP) stood at -34½ percent of GDP, compared to -43¾ percent of GDP at end-2015 (and -39¼ percent at end-2012). The less negative net liability position in 2016 was largely due to the disclosure of external financial assets held by residents under the tax amnesty program. At end-2016, gross external assets stood at 31¾ percent of GDP (close to 40 percent being reserve assets) and gross external liabilities at 66¼ percent of GDP. Indonesia's gross external debt was moderate at 34 percent of GDP at end-2016, with 17½ percent of external debt denominated in rupiah. About one-third of government's external debt (at 17 percent of GDP at end-2016) was denominated in rupiah. **Assessment**. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable, but nonresident holdings of rupiah denominated government bonds, with a 39 percent share of the total stock (or 6 percent of GDP) at end-May 2017, could be affected by global volatility. Private external debt has started to decline since early 2016 on the back of the implementation of BI's FX hedging regulations and expected tightening of global financial conditions. Staff projections for the current account suggest that the NIIP position will strengthen over the medium term.	**Overall Assessment** *The external position of Indonesia in 2016 was assessed to be broadly consistent with medium-term fundamentals and desirable policies.* Low commodity prices and weak trading partner demand for commodity exports have been compensated by import compression. The recovery of commodity prices and relatively low projected world oil prices should help to contain the current account deficit. External financing appears sustainable, although the large share of foreign portfolio holdings makes the country vulnerable to external shocks. **Potential Policy Responses** Continued flexibility of the exchange rate and use of market-determined interest rates would continue to underpin external stability, supported by monetary policy focused on containing inflation within Bank Indonesia's target band. Fiscal policy can help contain vulnerability to funding pressures through a largely fiscally-neutral reform emphasizing social and health spending, keeping the overall deficit within the statutory limit over the medium term. Easing trade and investment restrictions while bolstering infrastructure can help ease supply bottlenecks and bolster exports and external competitiveness over the medium term., while deepening financial markets would help to strengthen resilience to external shocks.
Current account	**Background**. Indonesia's current account deficit narrowed to 1.8 percent of GDP in 2016, an improvement from the peak of 3.2 percent in 2013, as the decline in commodity exports was largely offset by lower imports due to low oil prices and cyclical weakness in investment. Exports and imports started to pick up in Q4: 2016, as commodity prices bottomed out. Over the medium term, a moderate increase in the current account deficit is expected from a rise in capital goods and raw material imports tied to infrastructure investment and a pickup in domestic demand. A gradual increase in manufacturing exports, stronger demand from trading partners, and relatively low projected world oil prices should help limit the current account deficit. **Assessment**. The EBA CA model suggests a zero gap for 2016, consistent with an estimated cyclically-adjusted CA balance of -0.9 percent of GDP and a norm of -0.9 percent of GDP. Taking normal uncertainties around the estimates into account, staff believes a norm of -1.9 percent to 0.1 percent of GDP is appropriate. 1/ This suggests that the CA gap range of about -1 percent to 1 percent of GDP for 2016. Domestic policy gaps, including in social spending and policy gaps in partner countries (particularly fiscal) are fully offset by other distortions not captured by the model.	
Real exchange rate	**Background**. Compared to the 2015 average, the average REER appreciated by 4.1 percent in 2016, a result of slight appreciation of the NEER (by 1 percent) and relatively higher inflation rate than its trading partners. As of May 2017, the REER had appreciated by about 2.4 percent relative to 2016. **Assessment**. EBA index and level REER results point to an REER gap of about -1.1 percent to 3.7 percent for 2016, respectively, in line with staff's REER gap assessment in the range of -5 percent to 5 percent (based on the CA assessment and estimated elasticities).	
Capital and financial accounts: flows and policy measures	**Background**. In 2016, net capital and financial account inflows (3.0 percent of GDP) have been supported by net FDI inflows (1.7 percent of GDP), and net portfolio inflows (2.0 percent of GDP) while net other investment inflows were at -0.7 percent as the private sector continued to deleverage. **Assessment**. Net and gross financial flows have been steady since the global financial crisis despite some short periods of volatility. The narrower current account deficit and strengthened policy framework, including exchange rate flexibility, since mid-2013 have also helped reduce capital flow volatility. Continued strong policies focused on strengthening the fiscal position, keeping inflation in check, and easing supply bottlenecks would help sustain capital inflows in the medium term.	
FX intervention and reserves level	**Background**. Since mid-2013, Indonesia has had a more flexible exchange rate policy framework. Its floating regime has better facilitated adjustments in exchange rates to market conditions. Exchange rate flexibility has been broadly maintained in 2016, with some intervention during episodes of inflow surges and outflows to prevent disorderly market conditions, including the latest bout of EM volatility in November 2016. At end-2016, reserves were US$116.4 billion (equal to 12.5 percent of GDP, about 130 percent of IMF's reserve adequacy metric, and about 8 months of prospective imports of goods and services) compared to US$105.9 billion at end-2015. In addition, contingencies and swap lines amounting to about US$81½ billion are in place. **Assessment**. Volatile capital flows could cause reserves to decline significantly. While the composite metric may not adequately account for commodity price volatility, the current level of reserves (US$125 billion at end-May) should be sufficient to absorb most shocks, with predetermined drains also manageable. Intervention should aim primarily at preventing disorderly market conditions, while allowing the exchange rate to adjust to external shocks.	

	Indonesia (continued)
Technical Background Notes	1/ A range of +/- 1 percent is added to reflect the fact that the EBA-regression estimates are subject to normal uncertainty.

	Italy	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Italy's net international investment position (NIIP) has deteriorated since Italy joined the Euro area. Compared with a position of -6 percent of GDP at end 2000, the NIIP deteriorated to about -25 percent of GDP in 2013. It has since recovered to around -15 percent of GDP in end-2016, driven by stronger current account balances and modest nominal GDP growth. Gross assets and liabilities have grown notably, reaching 149 and 164 percent of GDP respectively, 51 and 59 percentage points higher than in 2000. TARGET2 liabilities rose from 15 to 25 percent of GDP between end-2015 and May 2017, in part reflecting residents' net purchases of foreign assets and the creation of liquidity by the Bank of Italy within the framework of the Eurosystem's asset purchase program. External debt represents about ¾ of gross external liabilities. While the level of external debt is in line with the Euro area as a whole, its composition—half is owed by the public sector—underscores the vulnerabilities related to the high level of government debt. Modest current account surpluses forecast over the medium term should gradually shrink Italy's net liability position as a share of GDP. **Assessment**. Although the current account has shifted into a surplus, further strengthening of balance sheets is desirable, given the high levels of public debt and the potential negative feedback loops between the debt stock and debt servicing costs.	**Overall Assessment** *The external position in 2016 was in the upper range of moderately weaker than suggested by medium-term fundamentals and desirable policy settings*. The overall assessment reflects Italy's continued weak productivity growth and need for balance sheet repair. Stronger growth, consistent with reducing high unemployment and public debt, while strengthening the external balance sheet, would require a weakening of the real effective exchange rate from average 2016 levels and sustained improvements in competitiveness. **Potential Policy Responses** Strong implementation of structural reforms, including to improve the wage bargaining mechanism to better align wages with productivity at the firm level, as well as efforts to strengthen bank balance sheets will be critical to improving competitiveness and boosting potential growth. Progress in fiscal consolidation will also help narrow the external gap and maintain investor confidence. Combined, these measures will support growth and employment over the medium term.
Current account	**Background**. Italy's current account (CA) averaged a deficit of 1¼ percent of GDP in the decade following the adoption of the euro. Starting in 2013, it moved into balance and, by 2016, it registered a surplus of 2.6 percent of GDP (as compared to 1.4 percent of GDP in 2015). The improvement in the current account is driven mainly by Italy's growing trade surplus, which reached 3.6 percent of GDP in 2016, owing to a large commodity terms of trade gain in the last three years. In terms of saving and investment, declining investment accounted for ⅔ of the improvement in the CA since 2010, while higher public saving contributed most of the rest. **Assessment**. Notwithstanding the recent improvement in the current account, the EBA model suggests that the cyclically-adjusted level, which stood at 1.5 percent of GDP in 2016, was about 2.5 percent of GDP below the EBA norm implied by medium-term fundamentals and desirable policy settings. Demographics is the largest contributor to the CA norm of 4 percent of GDP and its increase about one percentage point relative to 2015 (reflecting faster-than-previously-expected population aging). Given these estimates and the need for stronger growth to reduce public debt and unemployment over the medium term, while improving the external balance sheet, staff assesses a CA gap of about -3 to -1 percent of GDP for 2016.1/	
Real exchange rate	**Background**. The CPI-based and the ULC-based real effective exchange rates appreciated by about 1 percent and 0.4 percent from 2015 to 2016, respectively. From a longer-term perspective, stagnant productivity and rising labor costs has led to a gradual appreciation of the real effective exchange rate (REER) since Italy joined the Euro area both in absolute terms and relative to the euro area average (by about 0 to 10 percent using price-based REER indices). As of May 2017, the REER is unchanged relative to 2016 average. **Assessment**. The EBA methodologies provide a relatively wide range of REER gap estimates in 2016. The REER regression methods suggest gaps of –3.1 percent (EBA Level REER model) and -0.2 percent (EBA Index REER model), while the CA regression method, which has a generally better fit, implies an overvaluation of about 10 percent. ULC-based indicators also point to sizable and persistent wage-productivity differentials vis-à-vis key trading partners; these differentials, alongside nominal rigidities, have contributed to a slower recovery of real exports and investment. Taken together, staff assesses an REER gap of 6–12 percent.	
Capital and financial accounts: flows and policy measures	**Background**. Portfolio and other-investment inflows typically have financed the current account deficits of the past, despite a modest net FDI outflow, without much difficulty. Italy's financial account posted net outflows of about 3 percent of GDP in 2016, largely reflecting residents' net purchases of foreign assets, even as foreign investment in Italian portfolio securities continued. **Assessment**. While supported by exceptional monetary accommodation by the ECB, Italy remains vulnerable to market volatility, owing to the large refinancing needs of the sovereign and banking sectors, and the potentially tight credit conditions from the high stock of NPLs in the banking sector.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	Italy (continued)
Technical Background Notes	1/ Staff assesses the current account norm at 3.5 percent of GDP, reflecting the automatic adjustment of retirement age in 2016 and its expected future revisions as legislated that for 2016 can outweigh otherwise lower effective retirement age.

	Japan	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) has increased from 55 to 61 percent of GDP between 2011 and 2016 (assets: 164 percent; liabilities: 103 percent). In the medium term it is projected to rise to about 85 percent with current account (CA) surpluses, before gradually stabilizing due to population aging. **Assessment**. Vulnerabilities are limited (equity and direct investment comprise a rising share of liabilities, now at 32 percent of total). Assets are diversified geographically and by risk classes. The NIIP generated net annual investment income of 3.4 percent of GDP in 2016.	**Overall Assessment** *The 2016 external position was moderately stronger than the level consistent with medium-term fundamentals and desirable policies.* Japan's current account has strengthened somewhat relative to 2015, reflecting the reduction in its energy import bill and some decline in consumption goods imports. On the other hand, the REER appreciated substantially between 2015 and 2016 moving it to a level consistent with medium-term fundamentals. A continued accommodative stance by the BoJ is consistent with the objective of reflating the economy, and needs to be accompanied by bold structural reforms and a credible and specific medium-term fiscal consolidation plan to deliver an external position consistent with medium-term fundamentals. **Potential Policy Responses** A more forceful and coordinated policy package is needed to raise growth and inflation. This includes measures to boost wages and labor supply, reduce labor market duality, enhance risk capital provision, and accelerate agricultural and services sector deregulation. Fiscal consolidation should proceed in a gradual manner anchored by a concrete plan to achieve the medium-term target, and its conduct attuned to economic conditions and prospects. These 'desirable' policies are expected to support growth, imports and prices, and help bring back the external position in line with fundamentals over the medium term.
Current account	**Background**. The CA surplus was about 2 percent of GDP in 2011 and about 1 percent in 2012-14. In 2016, the CA increased to 3.8 percent of GDP - from 3.1 percent in 2015 - due to an improvement in the goods trade balance (by about 1.2 percent of GDP). Exports of goods as a share of GDP decreased in 2016 (to 12.9 percent) but imports of goods decreased by more (to 11.8 percent of GDP) with value and volume of energy imports declining and imports of consumption goods also decreasing. The income balance continues to account for most of the current account surplus (89 percent in 2016). **Assessment**. The CA assessment uses the EBA estimates, but makes adjustments to both the cyclically-adjusted CA and the CA norm to reflect factors that are not fully captured in the EBA model. In particular: - EBA estimates the 2016 cyclically-adjusted CA at 3.1 percent of GDP which is adjusted to reflect temporary factors (elevated energy imports with the nuclear power plant shutdown, adjusted for the decline in energy prices), to compute an underlying, cyclically-adjusted CA of 3.3 percent of GDP. 1/ - EBA estimates the 2016 CA norm at 3.4 percent of GDP, with a high degree of uncertainty (the standard deviation of the estimated CA norm is 1.8 percent). Staff adjusts this estimate to account for factors not captured by EBA—anticipated effect from structural reforms and removal of domestic distortions holding back demand and imports, and structurally lower exports reflecting production offshoring—to compute a norm of 1.3-3.3 percent of GDP. 2/ The underlying CA gap in 2016 is therefore assessed to be 0.0-2.0 percent of GDP, with a midpoint estimate of 1.0, leaving it just moderately stronger than warranted by desirable policies and medium-term fundamentals. The 2017 surplus is expected to rise to about 3.9 percent of GDP under the current policy mix, due to higher goods trade balance.	
Real exchange rate	**Background**. The real effective exchange rate (REER) appreciated 13.3 percent between 2015 and 2016, reflecting the safe-haven status of Yen amid heightened risk aversion, and despite the introduction of negative rates on marginal excess reserves and the adoption of QQE with yield curve control in Japan. As of May 2017, the REER has depreciated 3.9 percent relative to its 2016 average, reflecting partly the US dollar appreciation. **Assessment**. The EBA REER Level model estimates the 2016 average REER to be 11.3 percent weaker (EBA Index REER model: 20.9 percent weaker) than the level consistent with fundamentals and desirable policies, mainly from a large unexplained residual as the model does not include fiscal policy and so the estimated policy gap is close to zero. Other Japan-specific factors that affect the REER— JGB-UST spread, portfolio rebalancing, and temporary speculative short positions against the yen—are also not included. Because of these missing factors, the EBA REER model is not used in Japan's assessment. Using the staff-assessed CA gap range as reference and a semi-elasticity of 0.14 yields an indicative range of the REER gap as -14 to 0 percent (with a midpoint of 7 percent). Taking into consideration this very broad REER gap range (due to the low semi-elasticity) alongside the significant appreciation during 2016, the REER is assessed as broadly in line with medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. Portfolio outflows continued during most of 2016 as institutional investors continued to diversify overseas and FDI outflows continued. Net long yen positions prevailed during most of 2016 but turned into net short positions in December. More recently these positions have eased, contributing to exchange rate strengthening. **Assessment**. Vulnerabilities are limited (inward investment tends to be equity-based and home bias of Japanese investors remains strong). So far there have been no large spillovers from YCC to financial conditions in other economies (interest rates, credit growth). If outflows from Japan accelerate, they could provide an offset to tighter domestic financial conditions in the region due to normalization of policy rates in other advanced economies.	
FX intervention and reserves level	**Background**. Reserves are about 24 percent of GDP, on legacy accumulation. There has been no FX intervention in recent years. **Assessment**. The exchange rate is free floating. Interventions are isolated (last in 2011) to reduce short-term volatility and disorderly exchange rate movements.	

	Japan (continued)
Technical Background Notes	1/ Last year, staff adjusted the EBA estimate of Japan's cyclically-adjusted CA to account for the reliance on energy imports after the 2011 earthquake that temporarily reduced the CA. This year staff reduced this adjustment to reflect the decline in energy prices. 2/ Japan's norm is positive because of high corporate saving in excess of domestic investment opportunities, low residential investment, and a sizable income account owing to the large NFA position. Adjustments to the EBA CA norm reflect the need to capture the anticipated effect from structural reforms and removal of domestic distortions (not captured by the EBA model) and to account for structurally lower exports due to production offshoring, although this latter adjustment has been reduced to reflect recent trends, including the leveling off of production offshoring.

	Korea	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) turned positive for the first time in 2014 and has continued to rise. In end-2016, it reached 20 percent of GDP, with gross liabilities totaling 68 percent of GDP, of which 27 percent was gross external debt. **Assessment**. The positive NIIP position strengthens external sustainability and should increase further as the current account remains in surplus. Risks from currency mismatches are much reduced, as short-term external liabilities of banks, which rose to relatively high levels in the wake of the global financial crisis, declined back to below pre-crisis levels. Also, in the non-financial sector the bulk of short-term external debt is held by exporters who typically hedge their currency risk.	**Overall Assessment** *The external position in 2016 was assessed to be in the upper portion of stronger than warranted by medium-term fundamentals and desirable policies. This reflects excessive saving, including for precautionary purposes, as well as relatively weak private investment.* Developments as of May 2017 point to a further decline in the CA surplus this year, although it is expected to remain large in the absence of strong fiscal support and well-targeted structural measures. **Potential Policy Responses** Significantly more expansionary fiscal policy to boost domestic demand in the short and longer run is needed to reduce imbalances given the available fiscal space. This will also contribute to a recalibration of the policy mix, thereby gradually reducing reliance on monetary policy. Structural policies should also play an important role by facilitating rebalancing of the economy toward services and boosting domestic demand growth. These include strengthening the social safety net to lessen incentives for precautionary savings and addressing bottlenecks to investment The exchange rate should remain market determined, with intervention limited to addressing disorderly market conditions.
Current account	**Background**. The current account (CA) surplus in 2016 was 7.0 percent of GDP. The surplus remained significantly above its 5-year average as savings increased and the share of investment in GDP declined. The latter may be due to firms shifting investment abroad, reflected in lower domestic investment and higher FDI abroad, and Korea's recent integration into the global value added chain. 1/ That said, the CA surplus fell 0.7 percentage point in 2016, reflecting a combination of temporary and structural factors as well as policies. Shipping services exports, a key sector which has been losing competitiveness, fell by 0.5 percentage point of GDP in 2016. An accommodative monetary stance helped boost investment demand, especially construction and facilities (machinery and equipment), resulting in a strong pick up in imports, despite the tight fiscal stance. The CA surplus is projected to decline further this year but remain large in the absence of strong fiscal support and well targeted structural measures. **Assessment**. The EBA model estimates the 2016 cyclically adjusted CA surplus to be 6 percent of GDP, and the cyclically adjusted EBA CA norm to be 1.7 percent of GDP. The EBA estimated CA gap is adjusted for net retained earnings on equity investments, which are not recorded in the investment income balance of the CA. This factor is estimated to unduly increase the CA gap by about ¾ percent of GDP. Including this adjustment, staff estimates the CA gap midpoint to be 3.6 percent of GDP with a range of 1½–5½ percent of GDP that is based on the EBA standard deviation. This is in the upper portion of the stronger-than-warranted range of 2 to 4 percent. There is also a high degree of uncertainty surrounding the temporary versus structural factors contributing to the large current account surplus. The CA gap reflects identified policy gaps and an unexplained component. A key contributor to the policy gap are tighter than-desired fiscal policy and relatively low social spending, reflected in a smaller social safety net compared to other EBA countries, which significantly increases precautionary savings and the current account surplus. To durably reduce the CA surplus, significant policy adjustment is required. The fiscal stance is tighter than warranted, and a significantly more expansionary policy is needed using Korea's ample fiscal space.	
Real exchange rate	**Background**. The REER has been on a gradual appreciating trend since 2013 until 2016, when the REER depreciated by 2.3 percent relative to its 2015 average on a trade-weighted basis. However, the REER appreciated by 3 percent in 2017 (first quarter average vs. 2016 average). **Assessment**. EBA's REER regressions suggest a wide range of estimated gaps. The REER regression methods suggest gaps of –16.6 percent (EBA Level REER model) and -1.5 percent (EBA Index REER model). The CA regression direct approach, which produces a more reliable estimate, implies a gap of 10 percent, which is used as the mid-point of the estimated range. Overall, the REER for 2016 is assessed to be 5 to 15 percent below the level consistent with fundamentals and desired policies, with this range reflecting the high degree of uncertainty in the CA regression model.	
Capital and financial accounts: flows and policy measures	**Background**. Net capital outflows have been relatively stable over the medium term despite significant shifts in composition. In 2016, they decreased to 7 percent of GDP, from 8 percent of GDP in 2015, as larger outward FDI and portfolio outflows by residents were balanced by renewed portfolio and other investments inflows by non-residents attracted by Korea's relatively strong fundamentals. **Assessment**. The present configuration of net and gross capital flows appear sustainable over the medium term. Korea has demonstrated the capacity to absorb short term capital-flow volatility in magnitudes occurred over the last few years.	
FX intervention and reserves level	**Background**. Korea has a floating exchange rate. FX intervention appears to have been two-sided since early 2015, based on staff estimates. Reserves increased steadily from 2009 through mid-2014, but have since remained broadly stable. In 2016, reserves increased by $3 billion and stood at 26.3 percent of GDP, while the forward position declined by $12 billion (0.84 percent of GDP). **Assessment**. Intervention appears to have been limited to smoothing excessive volatility since 2015. Foreign exchange reserves were around 120 percent of the IMF's composite reserve adequacy metric at end 2016, which provides sufficient buffer against a wide range of possible external shocks.	

	Korea (continued)
Technical Background Notes	1/ For a multilaterally consistent approach, see "Global Value Chain Participation and Current Account Imbalances" by Johannes Brumm et. al. (2015).

	Malaysia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Malaysia's net international investment position (NIIP), as a percent of GDP, averaged around 1¾ percent of GDP since 2010, rising in recent years mainly on valuation effects. In 2016, the NIIP was at about 5¼ percent of GDP (2015: 8¾ percent of GDP), consisting largely of official reserve assets, and net portfolio and other investment liabilities. Net IIP declined slightly in 2017:Q1. Total external debt was at 67½ percent of GDP in 2017:Q1 (2016: 69 percent of GDP), of which about 70 percent was in foreign currency and 45 percent in short-term debt. 1/ **Assessment**. The NIIP is expected to rise gradually over the medium term reflecting projected moderate current account (CA) surpluses. Malaysia's balance sheet strength along with exchange rate flexibility would help support resilience to a variety of shocks, including potential outflows associated with external liabilities. 2/	**Overall Assessment** *The external position in 2016 was stronger than the level consistent with fundamentals and medium-term desirable policies*. An adverse terms-of-trade effect contributed to a softening of the current account balance in 2016, while the depreciation of the REER cushioned some of the impact. **Potential Policy Responses** Over the past few years Malaysia's growth model has shifted more to domestic demand and its current account surplus and current account gap have narrowed significantly. Going forward, macroeconomic policy adjustments, including exchange rate flexibility, and structural policies should address the existing policy gaps. The planned fiscal consolidation should be accompanied by further improvements in social protection—including through the introduction of an unemployment insurance system—and higher public healthcare spending. At the same time, addressing the structural bottlenecks (for example, labor market frictions in terms of skills mismatch; low female participation; and weak education quality) and further improving the physical infrastructure will help support a rise in private investment and productivity.
Current account	**Background**. Malaysia's CA surplus has declined by about 7½ percentage points since 2010 to 2.4 percent of GDP in 2016 (2015: 3 percent of GDP), driven mainly by a decline in national saving, while investment also rose. 3/ In 2016, the decline in the CA balance mainly reflected a lower goods account surplus. In 2017, the CA surplus is projected at 1¾ percent of GDP, with a recovery in exports is offset by stronger imports, supported by resilient domestic demand. **Assessment**. The EBA CA regression estimates the 2016 CA norm at 1.1 percent of GDP. With the 2016 cyclically-adjusted CA at about 3.6 percent of GDP, the EBA CA gap is about 2½ percent of GDP. The identified policy gaps account for one-half of this CA gap. However, EBA's cyclical adjustments for commodity terms of trade changes do not fully capture the recent decline in Malaysia's commodity export weights. Considering this country-specific factor, staff assesses the 2016 CA gap at slightly above 2¼ percent of GDP (±1 percent of GDP). 3/	
Real exchange rate	**Background**. The average real effective exchange rate (REER) depreciated by 4 percent in 2016 relative to 2015. As of May 2017, the REER had depreciated by about 3.0 percent relative to its 2016 average. 4/ **Assessment**. The EBA REER models (index and level based) estimate Malaysia's REER to be 26.4–34.6 percent below what is warranted by fundamentals and desirable policies. However, the usual macroeconomic stresses associated with such undervaluation are absent, for example, high inflation, wage pressure, or FX reserve build up. REER depreciation since 2014 reflects impact on NEER from capital outflows, while the CA surplus fell. Consistent with the assessed CA gap, the REER gap for 2016 was about –8 percent (± 3½ percent). 5/	
Capital and financial accounts: flows and policy measures	**Background**. In 2016, Malaysia recorded a small deficit in the financial account balance of about 0.1 percent of GDP, as compared to deficits of nearly 5 percent GDP in 2015 and 7¼ percent of GDP in 2014. A small net surplus earlier in the year was offset by a reversal in portfolio flows later, particularly in the aftermath of the U.S. presidential election. Net direct investment turned positive for the first time in a decade. Since late 2016, Bank Negara Malaysia has announced a series of measures aimed at developing the onshore FX market. Net portfolio inflows returned in April 2017. 6/ **Assessment**. Macroeconomic policy adjustments should continue to play the central role in response to capital flow volatility. The authorities should keep the new FX market measures under review, recognizing their costs and benefits.	
FX intervention and reserves level	**Background**. Foreign reserves in 2016 stood at US$94.6 billion, roughly unchanged relative to 2015 (US$95.3 billion). While reserves went up in the first ten months of 2016, they declined later amidst capital outflows. Malaysia faced significant reserve losses in the previous two years. Reserves were at US$98 billion in May 2017. **Assessment**. Under the IMF's composite reserve adequacy metric, which uses a binary classification of the exchange rate regime and classifies Malaysia's regime as "other managed", end-2016 reserve adequacy was at about 80 percent of the metric. Under the metric for "floating" regimes, reserves would be within the adequacy range at 115 percent of the metric. In practice, the exchange rate appears to have been closer to floating and the authorities expressed that market forces would determine the direction and level of the exchange rate. Furthermore, not all short-term external debt creates a claim on reserves (for example, banks' short-term external assets have risen in tandem with such liabilities). Against this backdrop, staff assesses FX reserves to be adequate. However, in case of disorderly market conditions reserves could be deployed. With this in mind, reserves could be accumulated as opportunities present during more normal market conditions, while remaining cognizant of the needed adjustments in the real exchange rate.	

	Malaysia (continued)
Technical Background Notes	1/ The ratios to GDP are based on staff estimates using U.S. dollar values and may vary with the authorities' data mainly due to different exchange rate assumptions for converting the nominal GDP in U.S. dollar terms. As of end-2016, external assets were about 130 percent of GDP and liabilities were about 124¾ percent of GDP. 2/ Close to one-third of external debt is denominated in local currency and largely of medium-term maturity, helping to reduce FX and rollover risks. Malaysia's local currency external debt reflects holdings of domestically-issued debt (mainly Malaysian Government Securities-MGS) by nonresident investors (about 17 percent of GDP as of end-2016). Short-term FX-denominated debt largely belongs to the banking system and a good portion is matched by short-term foreign currency assets, which is being closely supervised by BNM, including through frequent liquidity stress tests. Stress test analysis by staff suggests that the Malaysian economy could be resilient to a large reversal due to the depth of the domestic financial markets and the role of institutional investors. 3/ Malaysia's CA surplus is partly supported by the relatively high saving from the mandatory contributions to the fully-funded Employees Provident Fund (EPF), whose net assets (at about 60 percent of GDP in 2016) are large for emerging economy standards. EPF's active membership from the private sector and non-pensionable public sector employees is close to about one-half of total employment. Contributions are also expected from non-permanent workers and workers aged between 55 and 75 years. Members are encouraged to achieve a minimum savings balance by the age of 55 years. 4/ Since 2000, movements in the REER have been driven almost entirely by the nominal exchange rate rather than inflation differentials. In 2016, most of the depreciation in the NEER took place in the second half of the year, driven mainly by a strengthening of the U.S. dollar against the Malaysian ringgit and major global currencies. 5/ The REER gap is based on the estimated semi-elasticity of CA to REER at –0.29 and considers Malaysia's trade openness and commodity exports. 6/ On December 2, 2016, the Financial Markets Committee announced a package of measures aimed at facilitating onshore FX risk management and enhancing the depth and liquidity of onshore financial markets. They include relaxing documentation requirements in onshore hedging market trading, conversion requirement for exporters, and extension of the prudential limits on outward investments for exporters. On April 13, 2017, additional liberalization measures on short-selling of government securities and onshore hedging activities were announced.

	Mexico	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Mexico's NIIP reached -46.1 percent of GDP in 2016 (gross foreign assets and liabilities were 55.6 percent and 101.7 percent of GDP, respectively), up from -41.0 percent in 2010. Portfolio liabilities stood at 42.5 percent of GDP, of which around one fourth were holdings of local-currency government bonds. Of the estimated outstanding federal government FX liabilities in 2016 (8 percent of GDP), 77 percent was denominated in US-dollars, 15 percent in euro and 6 percent in yen. A predominantly large share of private sector external liabilities is denominated in US-dollars. The ratio of NIIP to GDP is projected to decline to 44.9 percent of GDP in 2017 and to about -40 percent of GDP by 2022. **Assessment**. While the NIIP is sustainable, the large gross foreign portfolio liabilities holdings could be a source of vulnerability to global financial volatility. A significant further weakening of the peso could complicate policy making through balance sheet exposures.	**Overall Assessment** *In 2016, Mexico's external sector position was broadly consistent with medium-term fundamentals and desirable policies.* The depreciation of the peso in 2016 largely reflected risks of rising protectionism in key trading partners, implying limited benefits for the external position. Taking this into account, while the CA remains broadly in line with medium-term fundamentals and desirable policies, the REER appears to be moderately weaker than suggested by fundamentals. The weaker REER had only minor positive effects on the CA in 2016, consistent with staff estimates showing a somewhat lower CA to REER elasticity for Mexico. A moderate further weakening of the peso would have a similar small effect this year. **Potential Policy Responses** Staff assessment is that the temporary weakness of the peso is largely driven by risks of rising protectionism. When uncertainty recedes, the CA and the REER positions are expected to converge. However, further structural reforms to improve competitiveness and strengthen non-oil exports will be essential for boosting growth while maintaining external sustainability. The authorities have committed to reducing the public sector borrowing requirement from 4.6 percent of GDP in 2014 to 2.5 percent of GDP in 2018, and have met the corresponding 2015 and 2016 targets. The central bank sets monetary policy to ensure that the inflation remains close to the 3-percent target. The authorities have a free-floating exchange rate policy, and use foreign exchange intervention occasionally to prevent disorderly market conditions. The FCL provides an added buffer against global tail risks.
Current account	**Background**. In 2016, the current account (CA) deficit narrowed to 2.7 percent of GDP, from 2.9 percent in 2015, with a deterioration of the hydrocarbons balance being more than compensated for by stronger non-hydrocarbon goods and services balances and an increased inflow of remittances. The cyclically-adjusted CA deficit is estimated at 2.0 percent of GDP.1/ **Assessment**. Mexico's CA deficit remains broadly in line with the level consistent with medium-term fundamentals and desirable policies. The EBA model estimates a cyclically-adjusted current account norm of -1.9 percent in 2016, implying a CA gap of -0.1 percent of GDP in 2016. The staff assessment is similar, with a gap between -1 and 1 percent of GDP.	
Real exchange rate	**Background**. The average REER in 2016 was 13 percent weaker than the 2015 average, reflecting a reduction in net oil exports, weaker medium-term growth prospects, and global uncertainties, in particular risks of rising protectionism in key trading partners. The free-floating exchange rate has been a key shock absorber in an unsettled global environment. As of May 2017, the REER has appreciated by 0.6 percent relative to the 2016 average. **Assessment**. The EBA level REER regression estimates an undervaluation of 16.9 percent in 2016. The index approach yields higher undervaluation (30.7 percent). Staff puts less weight on the index approach as it has shown the peso to be persistently undervalued for the last 8 years. The external sustainability approach suggests a marginal overvaluation by 1 percent. Considering all estimates and the uncertainties around them, staff assesses Mexico's real effective exchange rate to be undervalued in the range of 5 to 15 percent (under a baseline where protectionism risk do not fully materialize) and hence moderately weaker than suggested by fundamentals. This undervaluation would reverse should risks of rising protectionism dissipate.	
Capital and financial accounts: flows and policy measures	**Background**. During 2010-14, a large share of capital inflows went into purchases of locally-issued government paper and other portfolio investments. In 2015-16 gross portfolio inflows slowed markedly, and there were net outflows from local currency government papers in the first half of 2016, which were reversed during the second half of the year. Going forward, structural reforms are expected to lead to higher FDI, while portfolio inflows are unlikely to return to the previous high growth rates. **Assessment**. The long duration of sovereign debt and the high share of local currency financing reduce the exposure of government finances to depreciation risks. The banking sector is well capitalized and liquid and assessed to be resilient to large shocks. Non-financial corporate debt levels are low and foreign exchange risks well covered by natural and financial hedges. Nonetheless, the strong presence of foreign investors leaves Mexico exposed to greater risk of capital flow reversals and risk premium increases. The authorities have refrained from capital flow management measures, in line with their view that an open capital account reduces policy uncertainty and supports long-term growth. Capital flow risks are also mitigated by prudent macroeconomic policies.	
FX intervention and reserves level	**Background**. The central bank remains committed to a free-floating exchange rate, which has been the key shock absorber to help the economy adjust to external shocks, using discretionary intervention only to prevent disorderly market conditions. In the past, the central bank usually built up reserves through purchases of the net foreign currency proceeds of the state oil company, but with the recent decline in oil production the oil company's net export proceeds have declined substantially. The central bank also occasionally used auctions to build up reserves as needed. At end-2016, FX reserves were unchanged at US$178 billion (17.0 percent of GDP). 2/ In February 2017, the Foreign Exchange Commission announced a new FX hedging program, enabling the Bank of Mexico to offer up to US$20 billion of non-deliverable forwards with a maturity of up to 12 months and settled in pesos. The new program adds to the authorities' toolkit to counter disorderly market conditions, and is aimed at reducing short-term volatility of the peso vis-à-vis the U.S. dollar during times of market dislocation. A first auction of US$1billion was completed in early March, 2017. **Assessment**. At 118 percent of the ARA metric and 270 percent of short-term debt (at remaining maturity), the current level of foreign reserves remains adequate for normal times. The FCL arrangement has been an effective complement to international reserves, providing protection against global tail risks.	

	Mexico (continued)
Technical Background Notes	1/All data are as of June 15th, 2017 and do not reflect subsequent transition to BPM6. 2/ Rules-based intervention mechanisms were in place between December 8, 2014 and February 17, 2016. During this time, pre-announced amounts were automatically offered for auction when the exchange rate depreciated by more than a threshold (1 or 1.5 percent) on a given day. Regular auctions with no minimum price were also used. Since February 17, 2016, the authorities moved to discretionary intervention and used it only once in 2016 and once in 2017 (US$2 billion) through end-May. Data on intervention amounts are published weekly.

	The Netherlands	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The Netherlands' positive net international investment position (NIIP) has continued to strengthen and reached 76 percent of GDP at end 2016. As in previous years, the increase chiefly reflects the net FDI position which rose from 566 billion in 2010: Q1 to 741 billion at end 2016. Over the medium term, the NIIP is expected to continue growing in line with the projected sizeable current account surpluses. The stock of the Netherlands's claims on the Eurosystem (Target 2 balances) has increased since 2014 to reach €87bn by 2016 (12.5 percent of GDP), still below the peak reached in 2011-2012. **Assessmen**t. While its exposure to the Eurosystem has increased, the Netherland's safe haven status and its sizeable foreign assets limit risks from its large foreign liabilities.	**Overall Assessment** The external position in 2016 was stronger than the level consistent with medium-term fundamentals and desirable policy settings. The Netherlands' status as a trade and financial center and natural gas exporter make an external assessment more uncertain than usual. **Potential Policy Responses** Supporting domestic demand and reducing external imbalances requires action on several fronts, including: (i) using any available fiscal space to support the recovery and boost potential growth; (ii) adopting structural reforms to raise the productivity of small domestic firms; and (iii) progress in repairing household balance sheets, and strengthening the banking system. A shift towards more domestic productive investment as the Dutch and global economies recover would also help in the rebalancing.
Current account	**Background**. The current account is estimated to have stabilized at 8.4 percent of GDP in 2016 (8.5 percent cyclically adjusted) as a rebound in net primary income (investment income) offset a decline in the trade balance by 0.7 pp to 11.3 percent of GDP. Beyond 2016, the CA surplus is projected to decline in line with the trade balance, as a lackluster foreign environment and lower gas production due to earthquakes in extraction areas dampen exports, and robust domestic demand tends to boost imports. The current account has been in surplus since 1981—a reflection of a positive goods and services balance—and until 2000 was mainly driven by household savings. Since 2001, non-financial corporate net savings have progressively taken over as the main driver of current account surpluses, with large and global corporate savings financing substantial FDI outflows. Households savings have nonetheless also increased as a result of deleveraging following the sharp declines in housing prices starting in mid-2008 as well as an increase in mandatory contributions to the second-pillar pension funds. Netherland's status as a trade and financial center and natural gas exporter also likely plays a role to account for the strong structural position. **Assessment**. As the current account surplus essentially reflects the high corporate savings and liquidity of Netherlands-based multinationals, partly due to some favorable tax treatment for corporate income, as well as more recent but possibly long lasting increases in household saving rates following the sharp decline in real estate prices and financial difficulties of the pension funds, the assessment of the EBA estimated current account gap is particularly uncertain. Taking these factors into account, staff assesses the norm in a range of 5–7 percent of GDP and a corresponding CA gap of 2–4 percent of GDP. 1/ In the medium to long term, the CA surplus is likely to decline, supported by a recovery in domestic demand, progress in household deleveraging, declining gas exports, and demographic trends, including divestment by pension funds.	
Real exchange rate	**Background**. Following a year and a half long depreciation trend (that primarily followed the euro depreciation) the CPI-based REER started to appreciate again from May 2015 on. In April 2017 the REER was 1.2 percent above its April 2015 trough. **Assessment**. The 2016 EBA REER gaps range from -3.0 percent (index) to -13.2 percent (level), exclusively attributable to unexplained residuals. The REER elasticity approach to the current account would imply an undervaluation of 6 to 12 percent (relying on an elasticity of 0.33 and a current account gap of 2 to 4 percent). Taking into account all estimates and the uncertainty surrounding the EBA REER results, staff assesses that the REER remained undervalued by around 9 percent within a range of 6–12 percent.	
Capital and financial accounts: flows and policy measures	**Background**. Net FDI and portfolio outflows dominate the financial account. FDI outflows are driven by the investment of corporate profits abroad. On average, gross FDI outflows largely match corporate profits. 2/ **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.	
FX intervention and reserves level	**Background**. The euro is a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	The Netherlands (continued)
Technical Background Notes	1/ In comparison with last year, the EBA-estimated CA gap in 2016 (unexplained residual plus the contribution of identified policy gaps) widened by 0.8 percentage point to 3.2 percent of GDP, mostly reflecting unidentified residuals. The larger gap reflects a higher cyclically adjusted CA surplus (up from 8.3 to 8.5 percent of GDP) and a slightly lower CA norm from 5.9 to 5.3 percent of GDP. 2/The larger external balance sheet, presence of large international corporations, and issues related to the measurement of the current account add uncertainty to this assessment. According to the DNB, half of the positions in assets and liabilities are attributable to subsidiaries of foreign multinationals.

	Poland	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. A large negative net international investment position (NIIP) has remained broadly stable around 60 percent of GDP over the last five years, with both assets and liabilities growing in 2016, to 52 percent and 111 percent of GDP, respectively. The NIIP is projected to improve towards -49 percent of GDP over the medium term as nominal GDP grows faster than the current account (CA) deficit, which is financed largely by non-debt creating FDI and EU fund flows. In the near term, both domestic and external policy uncertainties point to the risk of further depreciation of the zloty, which, combined with the potential strengthening of the US dollar vis-à-vis the euro (due to policy divergence in the US and the euro area), may lead to large valuation effects. **Assessment**. Vulnerabilities exist, but sustainability concerns surrounding the large negative NIIP are mitigated by diversified FDI liabilities and associated intra-company lending (over 40 percent of foreign liabilities are FDI), and the projected improvement of the NIIP under the baseline. Adequate reserves and the FCL arrangement also help mitigate liquidity risks (ST debt is about 23 percent of the total) that may arise from the large negative NIIP.	**Overall Assessment** *The external position in 2016 was broadly consistent with medium-term fundamentals and desirable policies.* Improvements in the CA balance in 2016 have been driven mostly by stronger demand in the euro area, and supported by weaker currency and marginally better terms of trade. A widening of the CA deficit is expected in 2017 on the back of stronger domestic demand and investment as well as a rebound in oil prices. Reserves are adequate, while the FCL arrangement continues to provide an added buffer in the event of external shocks. **Potential Policy Responses** The current policy settings—with an accommodative monetary policy stance and a gradual fiscal consolidation—are broadly appropriate under the baseline, given Poland's cyclical position and the need to maintain fiscal sustainability in the longer term. Domestic policy gaps could be closed in the medium term by fiscal consolidation and supportive credit growth. In the event of external shocks, flexible exchange rate should be the first line of defense, while monetary tightening could be warranted if inflationary pressures (from the exchange rate depreciation and domestic demand pressures) lead to inflation overshooting the target. Vigilance with respect to bank funding (including foreign exchange swaps) is also important, including by standing ready to extend FX liquidity. In the medium term, risks of fiscal slippages and monetary policy being too loose for too long (to support growth) should be properly managed. The macro-prudential and bank resolution frameworks need to be implemented to address any systemic risks. Structural reforms are crucial to boost potential growth.
Current account	**Background**. Poland's current account deficit was broadly unchanged at 0.3 percent of GDP in 2016, with improvements in trade balance (by 0.6 percent of GDP) offset by a larger income deficit. The higher trade surplus reflected improved terms of trade, stronger export performance on the back of continued demand recovery in the euro area, and subdued non-oil import growth as domestic demand remained relatively weak. In 2017, the CA deficit is projected to widen on the back of a pickup in domestic demand, and a deterioration in the terms of trade. **Assessment**. The CA level is broadly consistent with fundamentals and desirable policies. The ES model gives a CA gap of 1 percent. The CA approach estimates a gap between cyclically-adjusted CA (-0.1 percent of GDP) and the CA norm (-0.7 percent of GDP) of around 0.6 percent of GDP, reflecting the sum of offsetting domestic and partners' policy gaps and a residual. The staff assessment is similar, with a CA gap range for 2016 centered on 0.9 (plus or minus 1) percent of GDP. 1/ 2/	
Real exchange rate	**Background**. The annual average real effective exchange rate (REER) depreciated 7¾ percent cumulatively over 2014-16 (weakening by around 4 percent in 2016 relative to the 2015 average), largely explained by nominal depreciation vis-à-vis the US dollar and the Swiss Franc. The depreciation was a result of NBP policy rate cuts in response to deflationary pressures, as well as domestic policy uncertainties in the run-up and after the 2015 elections. The REER has been on a depreciation trend since mid-2015, but has appreciated slightly in 2017:Q1. As of May 2017, the REER is up by 2.5 percent relative to the 2016 average. **Assessment**. The EBA models suggest undervaluation between 1 and 10 percent for 2016. The REER gap implied by the CA EBA model is -1 percent. Other approaches suggest a larger undervaluation: the ES EBA estimates a REER gap of -2.6 percent; the REER index model shows a gap of -9.6 percent. 3/. Overall, staff assesses Poland's real exchange rate in 2016 to have been close to a level consistent with fundamentals and desirable policy settings, with a range for the REER gap of -10 to 0.	
Capital and financial accounts: flows and policy measures	**Background**. The capital account is dominated by EU structural fund inflows, even though there was a temporary slowdown in EU funds absorption in 2016 due to transition to the new EU funds cycle. In recent years, inflows in the financial account were particularly volatile and centered on portfolio and FDI flows. Net capital inflows remained weak in 2016, with the largest net inflows driven by the repo transactions of the NBP as part of their reserve management strategy. **Assessment**. High foreign holdings (around 40 percent) of government bonds indicate potential vulnerabilities, but the ratio has declined recently as domestic banks are increasing their holdings in response to the new bank asset tax, which excludes government bonds. The diversified foreign investor base is another mitigating factor.	
FX intervention and reserves level	**Background.** Gross Reserves have increased from USD 95 billion at end-2015 to 114 billion at end-2016, partly due to a significant increase in NBP's repo transactions. Based on staff calculation, net reserves have increased from USD 87 billion at end-2015 to about 92 billion at end-2016. 4/ The zloty has floated freely. **Assessment.** Gross Reserves are adequate, standing at about 128 percent of the IMF's composite reserve adequacy (ARA) metric in 2016 (net reserves stood at 103 percent of the IMF's ARA metric). The recently approved FCL arrangement of SDR 6.5 billion also provides insurance against external tail risks.	

	Poland (continued)
Technical Background Notes	1/ Poland's EBA CA gap (including residual) 0.6 percent of GDP. The contribution of identified policy gaps is 0.9 percent. The domestic fiscal policy gap is -0.7 percent but is offset by fiscal gaps in trading partners that result in 0.2 percent net contribution of fiscal policies to the current account gap. The credit gaps contribute 0.2 percent to the total CA gap, with health spending, domestic capital controls and reserves also contribute positively. 2/ Staff assesses the mid-point CA norm to be slightly lower (by 0.2 percent of GDP), but well within the 90 percent confidence interval of [-2.3, 0.9] percent of GDP suggested by the EBA CA model, possibly due to somewhat higher-than-estimated medium term investment needs. 3/ The level REER model for Poland suggests an undervaluation of 18.2 percent, however has large residuals of 14.0 percent, and may not be adequately capturing the dynamics over the estimated period. 4/ Net reserves are calculated as a difference between gross reserves (official and other FX reserves) and FX liabilities, based on IFS data.

	Russia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) at end-September 2016 was at 18 percent GDP (up from 10 percent in 2013), with gross assets of 96 percent of GDP and liabilities of 78 percent of GDP. Total external debt was at 41.6 percent of GDP at end-2016. There are no obvious maturity mismatches between the gross asset and liability position. Historically, the NIIP position has not kept pace with the CA surpluses due to unfavorable valuation changes and the treatment of “disguised” capital outflows. 1/ **Assessment**. The projected current account surpluses suggest that Russia will continue to maintain a positive IIP, which minimizes risks to external stability. Moreover, reserve assets should increase further, as accumulation of fiscal savings in the oil funds is resuming. External deleveraging by the private sector since 2014 reduces risks further.	**Overall Assessment** *The external position in 2016 was moderately weaker than suggested by medium-term fundamentals and desirable policy settings.* Since 2016 the REER has appreciated, sharply as oil prices bottomed out, economic uncertainty declined, and appetite for Russian assets resumed. The structural implications of sanctions create exceptional uncertainty when assessing the external position, although on balance they would suggest the equilibrium REER should be lower. **Potential Policy Responses** The weaker external position calls for greater diversification. The non-oil fiscal deficit remains significantly higher than its long-term desirable level and needs to adjust to facilitate a rebalancing from public to private activity, and a re-allocation of government expenditure from current to capital spending. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase on a net basis savings, and yet create some room for somewhat higher private and public sector investment over the medium-term.
Current account	**Background**. From 2000 to 2013, the current account (CA) surplus fell from 16 to 1.5 percent of GDP, despite rising oil prices, as consumption increased rapidly. The 2014 oil price shock triggered a brief correction: the CA rose to 5 percent of GDP in 2015, as reduced oil export revenues (approximately 7 percent of GDP) were more than offset by falling absorption. However, in 2016, as the decline in absorption stopped amid still-falling energy export revenues, the CA surplus shrunk to 1.9 percent of GDP, although the non-oil current account deficit remained stable. In the medium-term, the projected increase in oil prices and authorities’ fiscal consolidation plans should support a gradual improvement in the CA. **Assessment**. The EBA CA model yields a norm for 2016 of 6.3 percent of GDP, compared to a cyclically adjusted CA surplus of 4.2 of GDP, thus yielding a CA gap of -2 percent of GDP. There are particular uncertainties with the external assessment when oil plays such a dominant role in the economy and oil price movements have been very large, which are compounded by the uncertain long-term impact of sanctions on saving-investment decisions and therefore the normative external position. Staff assesses the 2016 CA gap to have been between -2 to 0 percent of GDP, and therefore somewhat less than the EBA CA model. 2/ The identified fiscal gap accounts for almost all of the CA gap. Thus, in the medium term, fiscal policy should be tightened to rebuild buffers and save more of the oil wealth for future generations.	
Real exchange rate	**Background**. The sustained oil price boom and related expansion of domestic demand led to a strong real effective exchange rate (REER) appreciation between 2000 and 2013. Following the dual shocks of oil prices and sanctions, and the floating of the ruble in November 2014, the REER has depreciated over 35 percent between mid-2014 and February 2016. In 2016, the average REER remained largely unchanged compared to 2015. However, from the fourth quarter of 2016, the exchange rate has sustained a significant appreciation, and as of May 2017 the REER was 26.2 percent above the 2016 average due largely to oil price increases. **Assessment**. Consistent with the CA assessment, staff assess that the 2016 REER was between 0 to 10 percent, above its equilibrium, and therefore moderately overvalued. 3/	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows continued in 2016 though the pace has significantly slowed relative to 2014 and 2015, as confidence has resumed. Private sector external deleveraging has continued in the face of limited access to international capital markets. Nonetheless, volatile oil prices will continue to weigh on the outlook. Over the medium term, structural outflows are expected to decline if Russia improves its investment climate. **Assessment**. While Russia is exposed to risks of accelerated capital outflows because of the uncertain geopolitical context, the floating exchange rate regime and large international reserves provide substantial buffers to help absorb these potential shocks.	
FX intervention and reserves level	**Background**. Since adopting a free floating exchange rate regime in November 2014, FX interventions have been limited. International reserves rose to USD378 billion in 2016, up from USD368 billion in 2015, due mostly to valuation effects. **Assessment**. International reserves at end-2016 were equivalent to 235 percent of the Fund’s basic reserve adequacy metric, considerably above the adequacy range of 100-150 percent. However, taking into account Russia’s vulnerability to commodity shocks, the adjusted adequacy metric falls to 206 percent of the metric, still above the adequacy level. Small regular purchases to replenish reserves could be justified by the high level of uncertainty related to sanctions and oil prices. Large FX interventions should be limited to episodes of market distress.	

	Russia (continued)
Technical Background Notes	1/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. “Disguised” capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The CBR includes estimates of “disguised” capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level and this treatment of “disguised” outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position. 2/ The high EBA estimated CA norm of 6.3 percent of GDP reflects the need to save out of income from non-renewable oil exports. Staff’s assessment shares this basic logic, but acknowledges that not allof such saving (i.e., refraining from consumption) would necessarily have to take a financial form and could in part take the form of productive investment spending. This justifies a somewhat lower CA surplus (by about one percent of GDP) than the EBA-estimated norm. Sanctions and geopolitical tensions have introduced an additional level of complexity in the external assessment. 3/ The EBA Level REER model suggests an *under*valuation of 18.1 percent, and the EBA Index REER regression model an undervaluation of 23.6 percent. For commodities exporters, the fit of the REER models tends to be relatively poor, however, hence staff puts more weight on the results implied by the CA model.

	Saudi Arabia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Net external assets were 93 percent of GDP at end-2016. 1/ External assets declined by 7.3 percent of GDP during 2016 and by 12.5 percent since their peak in 2014: Q4 largely due to a decline in central bank FX reserves. External liabilities rose by 6.3 percent of GDP in 2016 mainly because of new borrowing. Projections suggest that the NIIP-to-GDP ratio will decline further over the medium-term to around 54 percent of GDP in 2022. 2/ No details are available on the composition of external assets. **Assessment**. The external balance sheet remains very strong. Substantial accumulated assets represent both savings of the exhaustible resource revenues for future generations and protection against vulnerabilities from oil price volatility.	**Overall Assessment** *The external position in 2016 remained substantially weaker than the level consistent with desirable medium-term fiscal policy settings. Planned fiscal adjustment needs to be successfully implemented over the medium-term to reduce the current account deficit and support the peg.* The pegged exchange rate provides Saudi Arabia with a credible policy anchor, but with the U.S. dollar strengthening, the REER has appreciated at a time of lower oil prices. Given the close link between the fiscal and external balance and the structure of the economy, with exports dominated by oil and oil-related products and limited substitutability between imports and domestically produced goods, external adjustment will be driven primarily by fiscal policy. The external balance sheet remains very strong. Despite the substantial drawdown since 2015, reserves remain very comfortable when judged against standard Fund metrics, although external savings are not sufficient from an intergenerational equity perspective. Under the government's planned fiscal adjustment, reserve loss will slow over the medium term. **Potential Policy Responses** Fiscal consolidation is necessary over the short- and medium term to strengthen the CA and support the exchange rate peg. The government has set out a fiscal consolidation plan in its Fiscal Balance Program (FBP). This planned adjustment is based on further energy price reforms, new non-oil revenue measures, and continued expenditure compression. The non-oil primary fiscal deficit is expected to narrow substantially over the medium-term and reduce the external gap. Structural reforms that help diversify the economy and boost the non-oil tradeable sector over the medium-term will also support a stronger external position over time.
Current account	**Background**. The current account (CA) deficit narrowed to 3.9 percent of GDP in 2016 from 8.7 percent of GDP in 2015. Imports of goods fell by 22 percent as the government cut spending and exports declined by 10 percent largely due to lower oil prices (import volumes fell by 18 percent while export volumes increased by 2 percent), leading to an improvement in the goods and services balance of 5 percent of GDP. The CA balance is projected to move into a small surplus in 2017 as oil revenues increase and be in a surplus of 1.2 percent of GDP in 2022. 3/ **Assessment**. The reliance on oil subjects the CA to wide swings and the external assessment to considerable uncertainty. The estimated CA gap varies with the methodology used and largely reflects a current fiscal policy stance that is away from that seen as desirable by staff over the medium-term. The estimated CA gap is -8 percent of GDP using the macro-balance approach and between-4.3 and -10.2 percent of GDP using the external sustainability approach. 4/ Staff assesses a CA gap of -7.7 percent of GDP, with a range of -5.7 to -9.7 percent of GDP.	
Real exchange rate	**Background**. The Riyal has been pegged to the U.S. dollar at a rate of 3.75 since 1986. The REER strengthened by 4 percent in 2016 and by 20 percent since mid-2014 as the U.S dollar appreciated. As of May 2017, the REER was unchanged relative to its 2016 average. The terms of trade fell by 44 percent in 2015 and by 12 percent in 2016, but is projected to improve by 15 percent in 2017. The REER in 2016 was 20 percent above its 10-year average. **Assessment**. The REER has appreciated at a time of a sharp decline in the terms of trade. Most exports, however, are oil or oil-related products, and exchange rate movements have a limited impact on competitiveness. With limited substitutability between imports and domestically-produced products, which in turn have significant imported labor and intermediate input content, exchange rate movements have only a small impact on import demand through the substitution channel. Staff estimates a REER gap in the range of 15-25 percent. As fiscal consolidation proceeds, it would be expected that the REER gap would narrow.	
Capital and financial accounts: flows and policy measures	**Background**. Net financial outflows slowed in 2016. Financial inflows picked-up, dominated by the issuance of government debt. Errors and omissions remained large (6.2 percent of GDP). FX reserves continued to fall. **Assessment**. Analysis of the financial account is complicated by the very large errors and omissions in the balance of payments. The strong reserves position limits immediate risks and vulnerabilities.	
FX intervention and reserves level	**Background**. The government is developing a SWF by broadening the mandate of the Public Investment Fund (PIF). Nevertheless, most of the government's foreign assets are held at the central bank within international reserves. Reserves fell to $529 billion (82 percent of GDP, 32 months of imports, and 566 percent of the IMF's reserve metric) at end-2016, down from $724 billion in 2014. **Assessment**. Reserves play a dual role—savings for both precautionary motives and for future generations. Reserves are more than adequate for precautionary purposes (measured by the Fund's metrics). Nevertheless, a substantial fiscal adjustment is needed over the medium-term to help moderate the decline in reserves, support the exchange rate peg, and achieve intergenerational equity. A CA surplus and the resulting NIIP accumulation will be needed over the medium-term to ensure an equitable intergenerational saving of oil revenues.	

	Saudi Arabia (continued)
Technical Background Notes	1/ The NIIP is likely underestimated given large errors and omissions in the balance of payments (6.3 percent of GDP in 2016) and inconsistencies between the BoP and IIP data. If the errors and omissions reflect financial outflows, the NIIP will be under-recorded. The cumulative CA balance between 1987 and 2016 was $1 trillion, while the net asset position in the IIP is $0.6 trillion. 2/ The decline in the NIIP over the forecast period is due to the assumption of continued large errors and omissions rather than recorded CA flows. 3/At current oil production levels, a $1 change in the oil price results in a 0.4 percent of GDP first-round change in the CA balance. The oil price is assumed to be $50.3 in 2017, rising to $52.0 in 2022 ($41.5 in 2016). 4/ EBA methodology assessments are not available for Saudi Arabia. Staff considered two methodologies, including one that incorporates the special intertemporal considerations that are dominant in economies in which exports of non-renewable resources are a very high share of output and exports. Estimates suggest that CA norms under the external sustainability (ES) approach were 6.3 percent of GDP and 0.4 percent of GDP under the constant real per capita annuity and constant real annuity allocation rules, respectively. Using the macro-balance approach, the norm is estimated at 4.4 percent of GDP under the EBA-lite approach. An alternative specification estimated on a sample of oil-exporting countries and a narrower set of control variables (see Behar and Fouejieu, 2016) suggests a CA norm of 4.1 percent of GDP. The CA deficit in 2016 was 3.9 percent of GDP. The corresponding CA gaps are estimated at, respectively, -10.2 and -4.3 percent of GDP under the ES approach and around -8 percent of GDP under the macro-balance approach. The estimated fiscal gap is -18.5 percent of GDP (constant real per capita allocation rule) and -14.1 percent of GDP (constant real annuity allocation rule), with both derived as the difference between the adjusted fiscal balance and that consistent with intergenerational equity under the respective allocation rule.

	Singapore	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) stood at about 214 percent of GDP in 2016, 26 percentage points higher than at end-2015, driven mainly by the current account (CA) surplus. Despite large and persistent CA surpluses, the NIIP to GDP ratio stands slightly below its 2010 level, and is significantly lower than the pre-Global Financial Crisis (GFC) peak of 265 percent of GDP in 2006. Projections on the CA balance and growth imply that the NIIP is likely to rise beyond the pre-GFC peak over the medium term. 1/ **Assessment**. The external balance sheet is not a major source of risk. Potential vulnerabilities posed by the large gross non-FDI liabilities (453 percent of GDP at the end of 2016)—predominantly cross-border deposit taking by foreign bank branches—are mitigated by banks' large short-term external assets and the authorities' close monitoring of banks' liquidity risk profiles. Singapore also has large official reserves and other official liquid assets. 2/	**Overall Assessment** The external position in 2016 was *substantially stronger than what is consistent with fundamentals and desirable policies*. The current account balance rose in 2016, driven mainly by improvements in the income balance, and strength of goods and services balance. The assessment for 2016 and the size of the imbalance are subject to a wide range of uncertainty reflecting Singapore's very open economy and position as a global trading and financial center. **Potential Policy Responses** While fiscal policy is providing welcome support to activity, more fiscal stimulus than envisaged, including on public healthcare, would be useful to boost domestic demand, close the output gap, and provide insurance against downside risks to growth. In this context, consideration should also be given to a time-bound unemployment insurance. Attuning the fiscal rule to the business cycle rather than the political cycle and including all the government's investment income in the budget's revenue stream would help address medium-term fiscal needs. Infrastructure spending could be accelerated; means-tested, categorical income transfers to families could be further expanded; and more could be done to help dynamic, innovative businesses, especially credit constrained ones. Finally, Singapore's ongoing structural reforms, along with the restrictions on foreign worker inflows (which puts upward pressure on firms' wage/rental ratios) should contribute to higher investment over the medium term.
Current account	**Background**. The large CA surplus of 19 percent of GDP in 2016, up by about 1 percent of GDP from 2015, reflects a strong goods balance that is somewhat offset by deficits in the services and income account balances. 3/ The recent oil price decline caused the oil trade deficit to narrow to near balance from an average deficit of 5 percent of GDP over 2010–14. 4/ However, the gains from lower oil price have been largely offset by weakness in marine engineering exports (oil rigs) and deterioration in the services and income accounts. Structural factors and policies that boost savings such as the financial center status, a limited social safety net, high income inequality and the rapid pace of aging combined with a mandatory defined-contribution pension scheme (whose assets were about 70 percent of GDP in 2015) are the main drivers of Singapore's high saving rate and strong external position. 5/ Fiscal policy in recent years has been associated with increased social and infrastructure spending, the continuation of which should support a lower CA surplus over the medium term. **Assessment**. Singapore is a small, very open economy, with a large positive NIIP and very high per capita income, that is aging rapidly. Such non-standard factors make a quantitative assessment of its CA balance subject to a wide range of uncertainty. Guided by the EBA framework, staff assesses the 2016 CA balance as *substantially stronger* than the level consistent with fundamentals and desirable policies, by 2½ to 8½ percent of GDP. 6/	
Real exchange rate	**Background**. The average real effective exchange rate (REER) depreciated by 1 percent in 2016 with respect to 2015. This modest depreciation followed a secular, 29 percent appreciation in the REER between 2004 and 2013. As of May 2017, the REER weakened by 2.2 percent relative to its 2016 average. The nominal effective exchange rate (NEER) did not fluctuate much in 2016 (depreciating by about 0.9 percent relative to 2015) and has fluctuated in a narrow range since end 2016. **Assessment**. Notwithstanding the nonstandard factors that make a quantitative assessment difficult, staff assesses that the REER is around 5 to 17 percent weaker than warranted by fundamentals and desirable policies. This estimate is drawn from the CA assessment and a semi-elasticity of –½ of the CA balance with respect to the REER, consistent with Singapore's high level of openness. This assessment is subject to a wide range of uncertainty with regard to both the underlying CA assessment and the semi-elasticity of the CA balance with respect to the REER.	
Capital and financial accounts: flows and policy measures	**Background**. Singapore has a fully open capital account. The financial account deficit tends to rise during periods of lower uncertainty in global financial markets. It reflects in part reinvestment abroad of income from the foreign assets of the official sector. Financial flows also encompass sizable net inward FDI and smaller but more volatile net bank-related flows. 7/ In 2016, the deficit on the capital and financial account widened by about 2½ percentage points to 20 percent of GDP, the largest deficit in two decades, led by rising "other investment outflows". However, these were partially offset by a significant slowdown in portfolio investment outflows and largely stable direct investment inflows, with the latter increasing in the last two years. As a trade and financial center in Asia, negative sentiment in emerging and low-income countries in the region can affect Singapore significantly. **Assessment**. The financial account is likely to remain in deficit as long as the trade surplus remains large.	
FX intervention and reserves level	**Background**. With the NEER as the intermediate monetary policy target, intervention is undertaken to achieve inflation and output targets. Official reserves held by the Monetary Authority of Singapore (MAS) declined marginally in 2016, to US$ 246.6 billion (83 percent of GDP). Reserves peaked in 2013 and declined in 2014 and 2015, reflecting also valuation changes. As a financial center, prudential motives call for a large NIIP buffer, also in the form of reserves. Reserves were at US$264.5 billion in May 2017. **Assessment**. In addition to FX reserves held by the MAS, Singapore also has access to other official foreign assets managed by Temasek and the GIC. 8/ The current level of official external assets appear adequate, even taking into account prudential motives, and there is no clear case for further accumulation for precautionary purposes.	

	Singapore (continued)
Technical Background Notes	1/ Staff estimates in U.S. dollar terms. Valuation changes have been an important negative drag on the NIIP, suggesting CA measurement complexities typical of financial centers. 2/ Singapore's official reserves held by the Monetary Authority of Singapore (MAS) amounted to about 83 percent of GDP in 2016. 3/ Singapore has a negative income balance despite its large and positive NIIP position. This reflects the lower rate of return earned on its foreign assets relative to the return paid on its foreign liabilities. The lower return on foreign assets may reflect the fact that the composition of Singapore's assets is tilted toward safer assets which yield lower returns. 4/ Singapore is a net oil importer, with a net oil trade deficit of about ¼ percent of GDP in 2016. The oil trade deficit would be smaller if one takes into account the high imported petroleum product content in Singapore's exports of petrochemicals and other oil intensive products and services like water transportation. In addition, Singapore has some sectors that are closely linked to investment in the oil sectors such as production of oil rigs. The decline in investment in the oil sector is expected to reduce Singapore's exports of these products, in particular if the oil price decline is sustained. 5/ Monetary policy has been eased in three steps since January 2015. The last monetary policy easing decision, announced in April 2016, involved lowering the trend appreciation of the NEER band from about 1 percent to zero percent per annum, and was motivated by the deceleration of core inflation. This easing appears to have had a limited positive effect on the CA balance. 6/ Nonstandard factors make quantitative assessment of Singapore's external position difficult and subject to significant uncertainty. Singapore is not included in the sample used to estimate the EBA models because it is an outlier along several dimensions (e.g., large external asset and liability positions, highly positive NFA position). Estimates from regression models that are guided by the EBA CA framework suggest that Singapore's CA surplus is mainly explained by the high level of productivity, fiscal surplus, status as a financial center, and its large NFA position. The model estimated CA gap is about 5½ percent of GDP (relative to a cyclically-adjusted level of the CA of about 18½ percent of GDP in 2016 and a norm of about 13percent of GDP). Identified policy gaps under the regression models are driven largely by the need for more fiscal spending to strengthen the social safety net. However, the estimated CA surplus norm could be overstated, in particular if the high NFA level is interpreted as a byproduct of past excessive surpluses. 7/ The latter is the result of considerably larger gross inflows and outflows. 8/ The reserves-to-GDP ratio is also larger than in most other financial centers, but this may reflect in part that most other financial centers are located in reserve-currency countries or currency unions. External assets managed by the government's investment corporation and wealth fund (GIC and Temasek) amount to at least 70 percent of GDP.

	South Africa	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. South Africa's economy is highly integrated in international financial markets, with large external assets and liabilities. Although valuation effects led to a marked improvement of the net international investment position (NIIP) in 2015 (from -8 percent of GDP at end-2014 to 16 percent of GDP one year later), this has since moderated, with the NIIP at 3.6 percent of GDP as of end-2016. The IIP is expected to weaken further over the medium term on account of current account deficits.[1] External assets and liabilities were equivalent to 131 and 128 percent of GDP, respectively. For FDI (usually considered harder to liquidate), liabilities were lower than assets (43 and 55 percent of GDP, respectively), owing to valuation gains on FDI assets in China. Gross external debt rose to 48.5 percent of GDP at end-2016 from 26 percent of GDP at end-2008 on the back of an increase in long-term debt. Short-term external debt (residual maturity) amounted to 15½ percent of GDP. **Assessment**. Large gross external liabilities pose risks. Mitigating factors include the large external asset position and the sizable rand-denominated share of external debt (about half of total external debt).	**Overall Assessment** *The external position in 2016 was moderately weaker than implied by fundamentals and desirable policy settings.* In 2016, the current account gap remained broadly unchanged and South Africa remains highly reliant on non-FDI flows to finance its relatively high CA deficit. Despite the REER depreciation of recent years, structural rigidities result in a relatively slow pace of CA adjustment as well as a somewhat narrower estimated CA deficit norm than would be expected for an emerging economy. **Potential Policy Responses** Several measures would help to reduce the gap related to the external position by speeding up the pace of external adjustment, improving competitiveness, and increasing employment and savings. These measures include fostering entry into key product markets (such as power generation, transportation, and telecommunications); upgrades in infrastructure and education/skills; and greater financial inclusion. Reducing policy uncertainty, preserving government debt sustainability, and accelerating labor and product market reforms are also essential to continue to attract foreign inflows, especially durable inflows such as FDI. Seizing opportunities—such as large FDI inflow transactions—to build up reserves would strengthen the country's ability to deal with FX liquidity shocks.
Current account	**Background.** The current account (CA) deficit narrowed to 3.3 percent of GDP in 2016 from 4.4 percent in 2015, owing to an improvement in the trade balance as domestic demand growth weakened. The CA deficit is projected to further narrow to 3 percent of GDP in 2017 as the trade balance strengthens. **Assessment.** The CA regression model estimates a CA norm of -0.7 percent of GDP, implying a CA gap of -2.4 percent of GDP for 2016. The CA gap is largely explained by structural factors not captured by the model. The ES approach estimates an NFA-stabilizing CA of -1.3 percent of GDP and a CA gap of -2.2 percent of GDP. Staff assesses the overall CA gap to be somewhat narrower, because (i) policy uncertainty is expected to unwind after key elections and (ii) net transfers to other members of the Southern African Customs Union (SACU) (not accounted for in the regression analysis) reduce the CA balance. Combined with estimation uncertainty, staff assesses the cyclically adjusted CA to be ½–2½ percentage points of GDP weaker than implied by fundamentals and medium-term desirable policy settings—broadly as assessed in 2015.[2]	
Real exchange rate	**Background.** The CPI-REER depreciated by 7 percent on average in 2016 relative to 2015. However, as of May 2017, the REER had appreciated 15 percent relative to the 2016 average. **Assessment**. The REER is assessed through two REER-based regressions and by computing the implied REER gap from the CA gaps. Based on the 2016 REER-average, the REER approaches point to undervaluation of between 12.6 percent (level approach) and 28.8 percent (index approach). However, as gauging the appropriate REER for South Africa is challenging, owing to its structural changes since 1994, staff's assessment puts much greater weight on the CA approaches, while acknowledging the results of the REER approaches. For the CA approaches, the estimated CA/REER elasticity applied to the CA gap range above points to overvaluation of between 2 and 9 percent.[3] Combining all these methods, staff assesses a REER overvaluation of 0–10 percent for 2016, broadly consistent with the CA gap.[4]	
Capital and financial accounts: flows and policy measures	**Background.** Net FDI flows were less negative at -0.4 percent of GDP in 2016, down from -1.3 percent of GDP in 2015. Portfolio investment picked up markedly to 5.9 percent of GDP, financing the CA deficit. Gross external financing needs stood at 18 percent of GDP in 2016. **Assessment.** High reliance on non-FDI flows and high nonresident holdings of local financial assets pose risks. These are mitigated by a floating exchange rate, the fact that nonresident portfolio holdings are mainly denominated in local currency, and a large domestic institutional investor base.	
FX intervention and reserves level	**Background**. South Africa has a floating exchange rate regime. Foreign exchange intervention is rare. Reserves cover six months of imports but are below the IMF's composite adequacy metric (77 percent of the metric without considering capital flow management measures and 84 percent of the metric after considering them). **Assessment**. As conditions allow, reserve accumulation is desirable to strengthen the external liquidity buffer, subject to maintaining the primacy of the inflation objective.	

	South Africa (continued)
Technical Background Notes	1/ Of the 128 percent of GDP in total external liabilities as of end-2016, 51 percent were portfolio investment liabilities, 34 percent were direct investments, and the remaining 15 percent were financial derivatives and other investments. Total external assets amounted to 131 percent of GDP as of end-2016, of which 42 percent were direct investments, 36 percent were portfolio investment assets, 11 percent were reserve assets, and the remaining 11 percent were financial derivatives and other investment assets. 2/ The CA gap presented here results from the CA regression and External Sustainability (ES) approaches as well as staff's judgment. • Net current transfers related to the Southern African Customs Union (SACU), which are assessed to have a net negative impact on the CA, are not accounted for in the regression model and therefore warrant an adjustment of the estimated CA cap. In addition, 0.3 percentage points of GDP of the improvements in the CA norm since 2014 are attributable to a worsening of the indicator of perceived political uncertainty and institutional quality, which is assessed to be temporary, and is expected to unwind following the December 2017 elections. In sum, and considering also the uncertainty surrounding the estimated norm (standard deviation of 0.9 percent of GDP), staff believes the regression-based CA gap is smaller than what the model suggests. • The ES approach compares the CA balance expected to prevail in the medium term with the one that would stabilize South Africa's stock of net foreign assets at its EM peers' benchmark (-35 percent of GDP). According to this approach, to stabilize South Africa's net IIP at this level, South Africa's CA deficit would need to be -1.3 percent of GDP, compared to staff's medium-term projection of a CA deficit of below 4 percent of GDP, thus resulting in a CA gap of -2.2 percent of GDP. • Overall, while the model-based CA gaps for 2016 range from -2.2 to -2.4 percent of GDP, staff believes the CA gap is somewhat smaller at between ½ and 2½ percentage points of GDP. 3/ The EBA REER regressions (which use the CPI-based REER) point to undervaluation for 2016. However, gauging the appropriate REER for South Africa is challenging as the pre-2000 average REER was at a more appreciated level than the post-2000 average. In this context, REER regression-based models are likely to point to undervaluation, unless they can link the full downward trend of the REER to deteriorating fundamentals. In addition, it appears that the level of the REER that is consistent with a given level of the current account has declined over time but that empirical models are unable to fully explain this shift. Other indicators, including the EBA CA regression model and South Africa's declining share in world exports, suggest overvaluation. 4/ Using staff's assessment of the CA gap range and applying a long-run elasticity estimate of 0.27 would suggest a REER overvaluation of 2–9 percent. However, considering the uncertainty regarding the estimates as well as the REER-regression results, staff assesses REER overvaluation in the order of 0–10 percent.

	Spain	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) dropped from -35 percent of GDP in 2000 to -98 percent of GDP in 2009, driven mostly by substantial current account (CA) deficits but also reflecting valuation effects. The CA improved subsequently, but the NIIP remains elevated at -86 percent at end-2016 which is a 12 percentage points improvement relative to at end-2014. Gross external debt is still high at 167 percent of GDP at end-2016. The share of public external debt in the gross liability position increased from 15 percent in 2010 to around 34 percent in 2016. Part of this increase is accounted for by TARGET2 liabilities, which reached €333 billion (30 percent of GDP) by end-2016. 1/ **Assessment**. The large negative NIIP comes with external vulnerabilities, including from large gross financing needs from external debt and valuation changes. Mitigating factors are a favorable maturity structure of Spain's outstanding sovereign debt (averaging 6½ years) and current ECB measures such as QE.	**Overall Assessment** *The external position in 2016 is estimated to be weaker than consistent with medium-term fundamentals and desirable policy settings.* In 2016, the CA has continued to improve, helped by lower oil import price, low interest rates, and regained competitiveness from wage moderation and larger firms' internationalization efforts. Spain recorded its fourth consecutive annual CA surplus, unprecedented in recent Spanish history. Despite the strong improvement in the CA since the pre-crisis peak deficit in 2007, achieving both a sufficiently declining NIIP and further reduction in unemployment would require a sustained weaker real effective exchange rate. **Potential Policy Responses** The authorities' recent structural reforms, in particular the labor market reform with the resulting wage moderation, as well as the Market Unity Law to reform product markets, and fiscal deficit reductions are in line with reducing imbalances. In the medium term, further growth-friendly fiscal adjustment and moving forward with structural reforms of the labor market and faster implementation of product market reforms would be required to accelerate the adjustment. Continued monetary accommodation at the euro area level to lift inflation closer to the ECB's medium-term price stability objective should help increase external demand, which would also support Spain's adjustment efforts.
Current account	**Background**. After a peak CA deficit in 2007 of 9.6 percent of GDP, corrected initially by a sharp contraction in imports, exports and imports have since grown strongly along with the economic recovery leading to CA surpluses in 2013-16. The CA surplus is estimated to have reached 2 percent of GDP in 2016 (or 1.1 percent of GDP cyclically adjusted); and is projected to moderate somewhat in 2017 as domestic demand continues to recover. Regained competitiveness from price and wage moderation, and the depreciation of the euro positively contributed to Spain's healthy exports growth and resilient export shares. ECB measures have helped to drive down interest rates on external debt, and the sharply lower oil price has reduced import costs. **Assessment**. The EBA CA model suggests a norm of 1.8 percent of GDP for 2016, which is somewhat higher than the observed cyclically-adjusted CA balance (1.1 percent of GDP). However, given external risks from a large and negative NIIP, staff's assessment puts more weight on external sustainability, and is guided by the objective of strengthening the NIIP position to above -50 percent over the medium term in an uncertain environment. This yields a CA norm of about 3 percent of GDP, with a range of 2-4 percent of GDP, implying that the cyclically-adjusted CA was about 1 to 3 percent of GDP weaker than desirable. 2/ Another factor supporting a relatively elevated CA norm is uncertainty about the output gap: if the output gap is larger (for example, reflecting a structural level of unemployment closer to international peers), the cyclically-adjusted CA would be lower and thus the gap with respect to the desirable level would be larger. Reducing the still sizable structural fiscal deficit will be a key policy requirement to lower the remaining imbalances.	
Real exchange rate	**Background**. In 2016 the CPI-based real effective exchange rate (REER) remained broadly unchanged (0.1 percent higher) from its average 2015 level, but it is still about 8 percent lower than its 2009 peak. This partially reversed the 17 percent appreciation from the euro entry in 1999 until 2009. The ULC-based REER shows the appreciation has been substantially reversed since euro entry, initially as a result of substantial labor shedding and, more recently, of wage moderation and the euro depreciation. After reaching its peak level in 2008, the ULC-based REER depreciated by 18 percent. As of May 2017, the CPI-based REER was down 0.1 percent relative to the 2016 average. **Assessment**. The two EBA REER regression model approaches, the index and level REER tools, estimate an overvaluation of 6.5 and -0.4 percent for 2016, respectively (with reference to the CPI-based REER). Taking into account also the historical REER (CPI and ULC based) and model-based analysis that considers NIIP sustainability, on balance, staff assesses a 2016 gap of around 5 to 10 percent above the level consistent with medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. Financing conditions have continued to be favorable, with sovereign bond yields near historical lows. At the same time, the private sector has continued its deleveraging against the rest of the world. TARGET2 liabilities, accumulated by banks over 2011-12, increased during 2015-16 (by an annual average of 6 percent of GDP), reflecting the creation of liquidity by the Bank of Spain within the framework of the Eurosystem's asset purchase program. In this context of higher liquidity, some resident agents increased their investment in foreign assets or reduced their external debt. Recent capital outflows are also explained by a net FDI outflow. **Assessment**. The ECB's actions as well as domestic reforms and fiscal consolidation have greatly helped improve investor sentiment. However, large external financing needs both in the public and private sector leave Spain vulnerable to sudden changes in market sentiment and spillovers from Europe.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

	Spain (continued)
Technical Background Notes	1/ Based on data available through 2016:Q4. 2/ The EBA CA regression-based approach estimate would suggest a CA surplus of 1.8 percent of GDP. The estimated EBA CA norm is roughly 1 percentage points of GDP higher than in 2015 largely as a result of revised demographic projections, which point to a faster aging speed than previously anticipated. That said, the empirically-based EBA norm does not fully account for the very negative NIIP, with around a quarter of liabilities in the form of equity. Given external stability considerations, a CA norm in the range of 2-4 percent of GDP is necessary to strengthen the NIIP by about 5 percent of GDP annually over the next 5-10 years.

	Sweden	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The Swedish net IIP rose to 15.8 percent of GDP, up 12.5 percentage points in the year. It is expected to rise further in the medium term, reflecting the outlook for continued current account surpluses. But in the last decade, the average increase in the net IIP was only about 2.6 percent of GDP annually, well below the average surplus of 5.8 percent of GDP. This gap may in part reflect negative valuation effects, but may also reflect some overstatement of the surplus given errors and omissions averaging -3.3 percent of GDP in the past decade. Hence it is appropriate to project a smaller IIP rise than the cumulative surplus. **Assessment**. Gross liabilities were 267 percent of GDP in 2016, with over a third being external debt (94 percent of GDP). Although rollovers of external debt (which include banks' covered bonds) pose some vulnerability, risks are moderated by the banks' liquidity and capital buffers. Sweden's strong FX reserves and low public debt help ensure capacity to manage pressures.	**Overall Assessment** Sweden's external position in 2016 was stronger than the level consistent with medium-term fundamentals and desirable policies. As of February 2017, subsequent developments do not point to a clear change in the external position. Staff assesses the Sweden's current account norm to be relatively high due to structural factors, including its fully-funded pension schemes its role as a hub for merchanting trade, and its status as a regional financial center. There is an absence of obvious policy distortions affecting the current account or the exchange rate. **Potential Policy Responses** Under current and prospective policies, a decline in the current account surplus can be expected in the medium-term. Expansionary monetary policy supports strong domestic demand growth and some appreciation of the krona is likely when inflation returns to target. Fiscal policy has accommodated a sizable increase in migrant-related spending in 2015-16, and going forward it appears that a neutral fiscal stance will be sufficient to meet the medium-term surplus target. Overall investment is solid, but it remains important to implement reforms to bolster residential investment. Efforts to facilitate migrant integration into the labor market should continue in order to raise potential output and also reduce household uncertainties around the sustainability of Sweden's strong social model.
Current account	**Background**. The current account balance was 4.5 percent of GDP in 2016, modestly below its average in the past decade. Some appreciation of the krona is expected in the medium term as monetary policy eventually normalizes, tending to lower the CA surplus compared with its recent trend. **Assessment**. The cyclically-adjusted current account was 5.0 percent of GDP in 2016—slightly below its average for the past decade—but 6.4 percentage points above the cyclically-adjusted EBA norm of -1.4 percent of GDP. However, policy distortions impacting the current account do not appear to be significant. Sweden's mandatory contributions to fully-funded pension schemes of 5 percent of GDP may be contributing to the relatively high level of overall household savings rate (18.5 percent for 2016). Therefore, a number of country specific-factors need to be taken into account to ascertain the CA gap: - The contributions of demographics to the norm might be some 1 percent of GDP higher than estimated by EBA, as the ageing speed variable does not properly capture life expectancy trends for Sweden. Moreover, the relatively high employment of persons over 65 years old in Sweden would also support this adjustor. - Measurement issues would reduce the actual CA by about 3½ percent of GDP, via the contribution of merchanting trade to the CA (averaging about 2 percent of GDP in recent years) and income flows from Sweden's systemically important financial center (with banking assets over 400 percent of GDP, of which about 170 percent of GDP in assets are outside Sweden). Taking these factors into consideration, staff assesses Sweden's adjusted CA gap at about 2 percent of GDP in 2016, with a range of +/- 1 percent of GDP.	
Real exchange rate	**Background**. The Swedish krona was mostly unchanged in 2016 in real effective terms relative to its average level in 2015, as monetary policy in Sweden helped keep the yield curve broadly aligned with that of German bunds. As of May 2017, the REER has weakened by 1.9 percent relative to the 2016 average. **Assessment**. EBA analysis suggest a gap of -20 and -18 percent using the REER index and level approaches, respectively, for 2016. In contrast, a Total Competitiveness Weights index is only 4 percent below its 23-year average. Relying primarily on the assessment of the CA gap, staff assesses the *krona* to be undervalued by 5 to 10 percent. This REER gap is expected to be temporary, with the krona likely to appreciate once the monetary easing cycle ends.	
Capital and financial accounts: flows and policy measures	**Background**. Given their size and funding model, Sweden's large banks remain vulnerable to liquidity risks stemming from global wholesale markets even though banks have improved their structural liquidity measures in recent years. **Assessment**. A further decline in banks' short-term funding in favor of longer maturities is desirable over time. Macroprudential policies, including planned increases in capital buffers of domestic banks, raising funding stability standards, and mortgage amortization regulations on the household side, can help contain vulnerabilities and hence potential liquidity risks.	

	Sweden (continued)
FX intervention and reserves level	**Background**. The exchange rate is freely floating—Riksbank statements regarding their potential to intervene have not as yet been implemented. Foreign currency reserves stood at USD 59.8 bn in December 2016, which is equivalent to 25 percent of the short-term external debt of monetary and financial institutions (primarily banks) and about 12 percent of GDP. **Assessment**. In view of the high dependence of Swedish banks on wholesale funding in foreign currency, and the disruptions in such funding that have occurred at times of international financial distress, it would not be appropriate to reduce Sweden's existing reserves. A further tightening of FX liquidity requirements on banks should be evaluated.

	Switzerland	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Switzerland is a financial center with a positive net international investment position (NIIP) of 131 percent of GDP and gross foreign asset and liability positions of 689 and 558 percent of GDP, respectively, at end-2016. The NIIP to GDP ratio is about unchanged from its peak in 2011 at 134 percent, having subsequently declined steadily—despite CA surpluses averaging about 10 percent of GDP—reflecting mainly persistent negative valuation effects, but recovered by 35 percentage points in 2016 partly on account of valuation gains. 1/ Valuation changes reflect fluctuations in exchange rates and prices of securities and precious metals that interact with mismatches between assets and liabilities in terms of currencies and financial instruments (the bulk of foreign assets is denominated in foreign currencies while the majority of foreign liabilities are denominated in Swiss francs, and equities held by foreign investors in Switzerland are much larger than those of Swiss residents held abroad). 2/ **Assessment**. Switzerland's large gross international liability position and the volatility of financial flows present some risk, but these are mitigated by Switzerland's large net asset position, including foreign exchange reserves, and that most international liabilities are denominated in Swiss francs. Nonetheless, given the large stock imbalance and compositional mismatch between assets and liabilities, relatively modest changes in exchange rates and asset prices can have a material effect on the NIIP.	**Overall Assessment** *The external position of Switzerland in 2016 was broadly consistent with medium-term fundamentals and desirable policies, although this assessment is subject to especially high uncertainty. Earlier REER overvaluation, partly reflecting the overshooting following the exit from the floor in 2015, has decreased somewhat.* **Potential Policy Responses** *Macroeconomic policies should be geared toward greater reliance on domestic demand while sustainably exiting deflation and moving toward the SNB's inflation target. These objectives would be supported by maintaining a sufficiently large negative interest rate differential against other major central banks, with intervention reserved for addressing inflow surges, while also allowing some easing of the fiscal stance.*
Current account	**Background**. Switzerland has tended to run large CA surpluses, averaging about 10 percent of GDP since 2006. The composition of the current account has changed considerably during this period. While in earlier years the largest component tended to be the income balance, in recent years this has been replaced to a large extent by the trade balance. Within the trade balance, goods (which includes merchanting) have been responsible for an increasing share of the surplus, particularly the chemical and pharmaceutical categories. The CA surplus decreased to 10.7 percent of GDP in 2016 from 11.5 percent of GDP in 2015, with the trade balance increasing marginally and accounting for just over 100 percent of the overall CA surplus. **Assessment**. Based on a cyclically-adjusted CA surplus of 10.5 percent of GDP and an EBA CA regression-estimated norm of 7.5 percent of GDP (which reflects to some extent the demand for saving by the rapidly aging population), the EBA CA gap was around 3.0 percent of GDP in 2016. A number of factors relevant to Switzerland's saving-investment behavior but not captured in the EBA analysis or balance of payments statistics are likely to reduce the CA gap, including: (i) net retained earnings on portfolio equity investment in publicly-listed companies and (ii) merchanting trade. 3/ Including these factors, staff estimates a residual CA gap of about 0.75 percent of GDP (with a range of ±2 percentage points). 4/	
Real exchange rate	**Background**. The CPI-based REER appreciated by a cumulative 26 percent during 2007–16, including two episodes of very rapid appreciation, most recently at the beginning of 2015, which has been partly unwound. The first spike occurred in July 2011 in response to safe haven inflows, and led the SNB to establish a floor of 1.20 for the CHF/EUR exchange rate in September 2011. After appreciating sharply following the exit from the floor on January 15, 2015, the REER moderated, initially on account of a partial unwinding of the overshooting of the nominal effective exchange rate and, subsequently, lower inflation in Switzerland than in its trading partners. The average REER for 2016 weakened by 2½ percent relative to the 2015 average, and as of May 2017, it has weakened another 0.9 percent (compared with the 2016 average). **Assessment**. The EBA REER index and level regression-based estimates suggest that the average REER in 2016 was 12.6–15.5 percent overvalued, with policy gaps accounting for a miniscule amount of the total gap. This finding is consistent with the slow, partial unwinding of the sharp appreciation that followed the Swiss franc's exit from the exchange rate floor. The REER gap implied by the CA gap is estimated at -5.5 to +2.5 percent.	
Capital and financial accounts: flows and policy measures	**Background**. In recent years, Switzerland has experienced large inflows in the form of currency and deposits, in part due to Switzerland's status as a safe haven. Since 2007, cumulative net inflows of currency and deposits amounted to about 75 percent of GDP, including several episodes of inflow surges, channeled mostly to the banking sector. To reduce the attractiveness of these inflows, since January 15, 2015 banks' placements at the SNB (above a certain threshold) have been subject to a negative interest rate of 0.75 percent. There are no restrictions on financial flows. **Assessment**. Financial flows are large and volatile, reflecting Switzerland's status as a financial center and a safe haven, with flows tending to accelerate during periods of heightened global and regional uncertainty.	
FX intervention and reserves level	**Background**. Foreign exchange reserves amounted to USD707 bn (107 percent of GDP) at end 2016, up USD 90 bn since end 2015. About 80 percent was accumulated during 2009–15, including to defend the previous exchange rate floor. Since exiting the floor, the SNB has intervened periodically, purchasing large volumes in response to safe haven surges, as well as more frequently but in smaller amounts. **Assessment**. Reserves are large relative to GDP but more moderate when compared with foreign liabilities. The high level of reserves reflects monetary policy operations aimed at avoiding persistent undershooting of inflation (which averaged -0.5 percent during 2012–16) as a result of capital inflow surges, given the limited scope for significant further easing via other monetary policy tools. In particular, the supply of domestic assets available for purchase is very limited, and the interest rate on banks' deposits at the SNB is -0.75 percent, which is the lowest in the world. Interventions have also helped to avert further exchange rate overvaluation.	

	Switzerland (continued)
Technical Background Notes	1/ Other stock-flow adjustments include changes in statistical sources, such as changes in the number of entities surveyed and items covered, although their quantitative importance is not known. 2/ As a result, an appreciation (depreciation) of the Swiss franc has a negative (positive) effect on the NIIP, while a symmetric percentage increase in share prices in Switzerland and abroad would reduce the NIIP. 3/ In the BPM framework, retained earnings on FDI are recorded as an outflow in the income account of the current account (with an offsetting inflow in the financial account). No similar current account payment imputation is made for retained earnings on portfolio investment, which instead, leads to revaluation of portfolio investment securities in the IIP. Adopting a similar treatment for net retained earnings on portfolio equity investment in publicly-listed firms as for FDI would reduce the Swiss current account by about 1.2 percent of GDP. Income from merchanting (which accrues from trading goods that do not enter the country, mostly by foreign-owned firms), amounted to 4 percent of GDP in 2016, partly reflecting mismeasurement of income attributable to non-Swiss nationals. Adjusting for the latter is estimated to further reduce the current account by about 1.2 percent of GDP. 4/ The CA gap range reflects the uncertainty inherent in the assessment.

	Thailand	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) improved steadily from -48 percent of GDP in 2000 to -2 percent of GDP in 2009. Subsequently, the NIIP declined to -24 percent of GDP in 2014, despite CA surpluses averaging 1.6 percent of GDP, largely due to valuation changes and other stock-flow adjustments. 1/ The NIIP halved to around -10 percent of GDP in 2015-16, accompanied by a rising CA surplus and subdued FDI, amid steadily rising outward investment by residents. **Assessment**. In 2016, gross liabilities were 101.8 percent of GDP and external debt stood at 32.5 percent of GDP (short term debt stood at 13 percent of GDP). There are limited risks to external debt sustainability as external debt is projected to continue declining over the medium term and net foreign liabilities (as a percent of GDP) are expected to stabilize.	**Overall Assessment** *The external position in 2016 was substantially stronger than warranted by medium-term fundamentals and desirable policy settings.* However, the size of the 2016 CA and REER gap are subject to a wide margin of error reflecting Thailand-specific transitory factors not fully captured in the EBA model, such as the sharp improvement in ToT, the boom in tourism, and political uncertainty. The fast demographic transition may increase savings going forward. **Potential Policy Responses** Mutually reinforcing monetary and fiscal stimulus, coupled with structural reforms, should support domestic demand and help lower the current account gap over time. The boost to public infrastructure within available fiscal space should crowd-in private investment. The authorities should continue addressing structural rigidities by reforming social safety nets, notably the fragmented pension schemes compounded by widespread informality, and reducing barriers to investment, especially in the services sector. The exchange rate should move flexibly as the key shock absorber. Intervention should be limited to avoiding disorderly market conditions. Reserves exceed all adequacy metrics, thus there is no need to build up reserves for precautionary purposes.
Current account	**Background**. Thailand's current account (CA) has been volatile over the last decade, ranging from a deficit of 4 percent of GDP in 2005 to a surplus of 7¼ percent of GDP in 2009. The CA then dropped to a deficit of 1¼ percent of GDP by 2013 and rose back to a record surplus of 11.5 percent of GDP in 2016. The 12.6 percent of GDP turnaround in the CA between 2013-16 can be largely accounted for by a 5.8 percent of GDP decline in net oil imports and a 3 percent of GDP rise in the services balance (mainly tourism). Net oil imports and tourism also account for the bulk (two-thirds) of the increase in the CA in 2016. Import volume declined, while goods exports were stagnant. **Assessment**. The EBA CA model estimated a small (0.3 percent of GDP) terms-of-trade (ToT) cyclical adjustment in 2016, with a cyclically-adjusted 2016 CA of 11.2 percent of GDP and a CA norm of 1.2 percent of GDP. The CA gap of 10.1 percent of GDP consists of an identified policy gap of 2.3 percent of GDP (1.5 percent of GDP from domestic policy gaps), and an unexplained residual of 7.7 percent of GDP. The large unexplained residual partly reflects Thailand-specific features not fully captured by the EBA model. Notwithstanding continued improvement in ToT and the boom in tourism, private domestic demand remained weak, reflecting a cautious response to these positive shocks during the ongoing political transition that weighed on private sector confidence. Considering these factors, staff assesses the CA gap within 3 percent to 7 percent of GDP of the level consistent with medium-term fundamentals and desirable policies.2/ The CA gap is expected to narrow over the medium term, as policy stimulus is deployed, political uncertainty dissipates, private confidence recovers, and steps are taken to reform the safety net.	
Real exchange rate	**Background**. The baht has been on a broadly stable real effective exchange rate (REER) appreciation trend since the mid-2000s. Exceptional periods where the Fed's tapering talk in mid-2013 and the domestic monetary policy easing cycle in 2015: Q1, when the bath depreciated for several quarters. The REER resumed its gradual real appreciation trend in 2016:Q1. By May 2017, the REER had appreciated by 1.7 percent relative to 2016. The correlation between the REER and the CA in Thailand has been weak over the last decade, likely due to the Thailand-specific factors outlined above, the buildup of global value chains, and volatile capital flows. **Assessment**. The EBA index REER gap in 2016 is estimated at -6.3 percent; the EBA level REER gap is estimated at -16.5 percent, but with a large unexplained residual. Using an elasticity of 0.6, staff assesses the 2016 REER to be 5 percent to 11 percent below levels consistent with medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. The capital and financial account balance has been negative since 2013. In 2016, the negative balance increased to $25.7 billion due to Thai firms' overseas investment, subdued FDI inflows, and other investment outflows despite portfolio inflows. The authorities continued with financial account liberalization, encouraging outward investment by residents. **Assessment**. Up to 2013, Thailand enjoyed overall portfolio inflows benefiting from its strong fundamentals. But from 2013, Thailand has faced headwinds, including the Fed's interest rate lift-off, China's slowdown, and political uncertainty. Capital outflows are manageable considering the resilient external sector and the flexibility of the baht, partially offsetting the current account surplus.	
FX intervention and reserves level	**Background**. The exchange rate regime is classified as (de jure and de facto) floating. International reserves gradually declined from 52 percent of GDP in 2012 to 49 percent of GDP in 2016, but stand at over three times short-term debt, 211 percent of the IMF's reserve metric unadjusted for capital controls, and 250 percent of the metric adjusted for capital controls. Staff considers the unadjusted adequacy metric to be more appropriate. (The adjusted metric relies on de jure capital controls, which fail to capture recent liberalization measures and the extent to which controls are binding). **Assessment**. Interventions appear to have been two-sided, as shown by changes in reserves and the net forward position (the only proxies for intervention, as actual intervention data are not published) that have been positive (7 months) and negative (5 months) throughout 2016, while gross reserves increased by US$29.4 billion (7.2 percent of GDP) during that period. Reserves are higher than the range of IMF's adequacy metrics and there is no need to build up reserves for precautionary purposes. The exchange rate should move flexibly, acting as a shock absorber, with intervention limited to avoiding disorderly market conditions.	

	Thailand (continued)
Technical Background Notes	1/ These persistent negative valuation effects during 2010-14 have been driven mainly by capital inflows contributing to the growth of asset prices and baht appreciation. 2/ The EBA model has a very large (and rising since 2013) unexplained residual for Thailand, likely driven by imperfect measurement of the large, positive ToT shock, the boom in tourism, and political uncertainty. Staff adjustments improve the measurement of these Thailand-specific cyclical and transitory factors through (i) updated weights in the EBA terms of trade index; (ii) an estimate of the cyclical component in the recent boom in tourism; and (iii) an estimate of the transitory impact of the ongoing political transition not captured by the institutional quality variables included in the EBA model (see Selected Issues Paper). Moreover, the public health expenditure variable does not fully reflect the largely underdeveloped social safety nets, including low minimum pensions accruing to the large informal sector, which contribute to the current high levels of precautionary savings.

	Turkey
Foreign asset and liability position and trajectory	**Background**. Turkey's net international investment position (NIIP) improved slightly from -44 percent of GDP in 2015 to -42 percent of GDP at end-2016. 1/ Total foreign liabilities amount to 67 percent of GDP and the external debt is sustainable over the medium-term. Debt maturity improved, but risks remain significant, given that the short-term debt and portfolio investment in debt securities amount to around 24 percent of GDP and 42 percent of long-term debt has adjustable interest rates. In addition, a large portion of private domestic debt is denominated in FX. **Assessment**. The composition of foreign liabilities exposes Turkey to liquidity shocks, shifts in investor sentiment, and increases in global interest rates. Turkey's NIIP is projected to deteriorate further by about 15 percentage points of GDP over the medium term on account of sustained current account deficits. The FX component of domestic debt also comprises a balance sheet risk for corporates with the potential to worsen bank asset quality with a negative feedback on growth and financial stability.
Current account	**Background**. The current account (CA) deficit widened slightly to 3.8 percent of GDP in 2016 (-3.7 percent on a cyclically adjusted basis). Weak tourism season, Russian trade sanctions and strong real growth of non-oil imports outweighed the effect of lower energy costs. The economic slowdown partly associated with these external factors broadly closed the output gap in 2016, which was negative in early 2017. **Assessment**. The EBA model estimates that in 2016 the cyclically-adjusted CA was some 3 percent of GDP weaker than the level implied by medium-term fundamentals and desirable policies. The external sustainability (ES) approach suggests that the CA deficit was about 1.1 percent of GDP higher than the level consistent with stabilizing the NIIP at the current level. Staff assesses that the 2016 CA gap to be in the range of -1.5 to -3.5 percent of GDP. This is consistent with a CA norm in the range of -0.4 to -2.4 percent of GDP. 2/ 3/
Real exchange rate	**Background**. In 2016, the average REER depreciated by 2 percent from the year before, standing 16 percent below its 2010 peak. Both the EBA REER index and level approaches suggest that the REER was broadly fairly valued in 2016. Based on the ES approach, about 6 percent REER adjustment is required to stabilize the current NIIP. As of May 2017, the REER has depreciated by 9.7 percent relative to its 2016 average, against the backdrop of heightened political and economic uncertainty. **Assessment**. Large errors suggest that the REER models do not fit Turkey well. For this reason, staff prefers to use the CA models, which assesses that the REER was overvalued by about 7.5–15 percent on average in 2016.
Capital and financial accounts: flows and policy measures	**Background**. Significant external financing needs have been comfortably met due to ample global liquidity and attractive yields. Lower rollover ratios on syndicated bank loans were offset by net portfolio inflows, which turned positive in 2016 as a whole. In the last quarter of 2016, the emerging markets rout gave rise to portfolio and other investment outflows. Turkey has not made use of capital controls on either inflows or outflows. **Assessment**. A still large share of short-term debt exposes Turkey to significant rollover risks. The sustainability of financing of the CA deficit is weakened by the fact that one third of the 2015-16 CA deficits were covered by unaccounted inflows (BOP errors and omissions). Gross external financing needs of over 20 percent of GDP make Turkey vulnerable to changes in global market conditions.
FX intervention and reserves level	**Background**. The exchange rate is floating. Since April 2016, the central bank has not sold foreign exchange to commercial banks through regular auctions and significantly reduced direct sales of FX to energy importing SOEs. This helped replenish net reserves (NIR) to US$35.4 billion at end-2016. Gross international reserves (GIR) declined by 3.8 billion in 2016 and were just below 90 percent of the ARA metric, with coverage of short-term debt of about 65 percent. Net international reserves, which can be freely used at the central bank (CBRT)'s discretion to support the system as a whole, make up only a third of GIR. 4/ **Assessment**. Given low net international reserves, further reserve accumulation is warranted. Foreign exchange sales should be restricted to periods of disorderly market conditions.

Overall Assessment

Overall Assessment

In 2016, Turkey's external position was weaker than the level consistent with medium-term fundamentals and desirable policies. [The REER depreciation since 2016, if sustained, would help narrow the identified CAD gap].

Net international reserves are low, and the NIIP is projected to deteriorate further. Moreover, given large financing needs and a high share of short-term capital inflows, Turkey remains vulnerable to capital flow reversals.

Potential Policy Responses

Reducing the CA deficit is necessary to diminish vulnerabilities. The deceleration in credit and demand growth have helped the external rebalancing. The temporary fiscal loosening, while appropriate to avoid excessive slowdown, would slow the correction of external imbalances. Thus, a credible medium-term fiscal consolidation plan to shore up public saving remains necessary. Meanwhile, monetary policy should aim to keep inflation within target which would help support private savings. Macroprudential measures should be strengthened to lower foreign currency risk in the economy. The CBRT should continue to increase net international reserves, limiting foreign exchange sales to periods of excessive Lira volatility.

	Turkey (continued)
Technical Background Notes	1/ Despite persistent CA deficits, the NIIP has fluctuated with no clear upward trend in 2009-16, due to a mix of positive valuation effects and large net BOP errors and omissions. 2/ Due to significant data revisions and relevant changes in desirable policy parameter, the CA norms and gaps are non-comparable with previous assessments. In December 2016, the Turkish Statistical Institute (TurkStat) announced a major revision of national accounts data. The revisions primarily affect 2009–15 data, with the 2015 nominal GDP having been revised up by 20 percent. As a result, the 2015 CA deficit and NIIP are now 0.7 and 9 percentage points of GDP lower than before, respectively. However, data revisions also imply lower export revenues relative to the size of the economy. 3/ Staff's midpoint estimate of the CA norm range is around 0.5 percent of GDP lower than the estimated EBA CA norm. This reflects the lower estimates of REER overvaluation obtained from the ES approach, which suggests a narrower CA gap than indicated by the EBA CA model. 4/ Net international reserves net out from the GIR CBRT's FX liabilities to banks. The latter include the Reserve Option Mechanism (ROM). which allows banks to meet reserve requirements on Lira liabilities with foreign exchange and gold. The ROM balances are held at blocked accounts at CBRT for 14 days, and may be fully substituted with Lira liquidity after this maintenance period. Domestic banks may also use FX deposits at the CBRT as collateral for Lira liquidity facilities, including swaps with maturities of up to 1 month.

	United Kingdom	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) strengthened by about 29 percentage points in 2016 to 24 percent of GDP. 1/ This significant improvement is mostly due to sterling depreciation, as the UK's external assets have a higher foreign-currency component than its external liabilities. Staff projections for the current account suggest that NIIP is expected to weaken moderately over the medium term, although the importance of valuation effects implies significant uncertainty around these estimates. **Assessment**. The sustainability of NIIP is not a concern, although fluctuations in the underlying gross positions are a potential source of vulnerability (both gross assets and liabilities amount to over 500 percent of GDP).	**Overall Assessment** *The external position in 2016 was weaker than implied by medium-term fundamentals and desirable policy settings.* The current account deficit remained high in 2016, reflecting low public and private savings. Over the medium term, the deficit is set to narrow helped by the recent sterling depreciation and ongoing fiscal consolidation. However, the uncertainty around this assessment is significant, reflecting uncertainty about the future trade arrangement with the EU and its possible effect on growth and trade flows. **Potential Policy Responses** The current fiscal consolidation plan implemented within a medium-term framework will continue to support the external rebalancing. Further structural reforms focused on broadening the skill base and investing in public infrastructure should boost productivity, improving the competitiveness of the economy. Maintaining financial stability through macroprudential policies should also support private-sector saving. These efforts are particularly important in light of expectations that access to the EU market will become more restrictive.
Current account	**Background**. The CA balance remained broadly unchanged in 2016 at -4.4 percent of GDP, significantly below its average historical values. The wider CA deficits since global financial crisis reflect mostly losses on the income balance, due in part to lower earnings on the UK's foreign direct investment abroad (especially in the euro area). By contrast, the trade balance has been stable at around -2 percent of GDP. From a savings-investment perspective, the current account deficit reflects a still elevated general government deficit (3.1 percent of GDP in 2016) and a decline in private sector savings, especially of households. **Assessment**. The EBA CA regression approach estimates a CA gap of -4.0 percent of GDP for 2016 (a 2016 cyclically adjusted CA balance of -4.1 percent of GDP compared with a CA norm of 0.0 percent of GDP). The CA balance is set to improve in 2017 as the positive valuation effect of the recent sterling depreciation on net income inflows (already observed at the end of 2016) is reflected in the full year data (accounting for 1 percent of GDP). In addition, the post-crisis deterioration in gross income inflows is not likely to be permanent, suggesting a smaller underlying CA deficit and a smaller gap than implied by the EBA model. Looking ahead, the recovery of global growth should translate into higher net income inflows. The global recovery and the depreciation should also support the trade balance, although the effects could materialize with a lag. Furthermore, the elasticity of exports to exchange rate changes could be below historical levels due to uncertainty about the future trade arrangements with the EU and other countries. This uncertainty complicates the assessment of the external position. Overall, staff assesses the 2016 cyclically-adjusted CA balance to be 1 to 4 percent of GDP weaker than the current account norm, with a mid-point of 2½ percent of GDP.	
Real exchange rate	**Background**. Sterling depreciated by 10 percent in 2016 in real effective terms relative to its average level in 2015. Moreover, as of May 2017, the REER depreciated by additional 4.2 percent relative to its 2016 average. The depreciation may reflect in part an unwinding of past overvaluation, and in part market expectations of more restrictive access to the EU market in the future. **Assessment**. EBA estimates using the REER level and index approaches suggest a gap of 2.8 and 3.2 percent, respectively, for 2016. In comparison to previous years, the REER assessment is subject to a greater margin of uncertainty due to uncertainty about the UK's new trading relationship with the EU and its effects on the equilibrium level of REER. Overall, staff assesses the REER to be between 0 and 15 percent above the level consistent with fundamentals and desirable policy settings. This range takes into account the CA assessment above.	
Capital and financial accounts: **flows and policy measures**	**Background**. Given the UK's role as an international financial center, portfolio investment and other investment are the key components of the financial account. **Assessment**. Large fluctuations in capital flows are inherent to financial transactions in countries with a large financial sector. This volatility is a potential source of vulnerability, although it is mitigated by sound financial regulation and supervision and a strong financial sector. An additional risk is that FDI and portfolio investment inflows may decelerate driven by concerns about the UK's future trade relations with the EU.	
FX intervention and reserves level	**Background**. The pound has the status of a global reserve currency. **Assessment**. Reserves held by the UK are typically low relative to standard metrics, and the currency is free floating.	

	United Kingdom (continued)
Technical Background Notes	1/ The official NIIP data might understate the true position—attempts to value FDI at market values suggest a higher NIIP. Market value estimates of FDI assets assume that values move in line with equity market indices in the UK and abroad. These estimates are uncertain, as actual FDI market values could evolve differently from equity markets.

	United States	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) declined from -16.8 per cent of GDP in 2010 to -43.7 percent of GDP in 2016. This reflects continuous current account deficits, stronger performance of the U.S. stock market relative to trading partners, and valuation changes of foreign currency denominated assets. 1/ Under staff's baseline scenario, U.S. NIIP would deteriorate by about 6 percentage points of GDP over the next five years, as a consequence of persistent current account deficits. **Assessment**. Financial stability risks could surface due to an unexpected decline in foreign demand for U.S. debt securities, which represent the major component of the country's external liabilities. This could, for example, result from a failure to reestablish long-run fiscal sustainability. Although such risks have risen, they remain moderate given the dominant status of U.S. dollar as a reserve currency (accounting for 60 percent of global reserves). Most U.S. foreign assets are denominated in foreign currency and over 50 percent are in the form of FDI and portfolio equity claims, the value of which tends to decline when global growth and stock markets are weak, and when the U.S. dollar appreciates.	**Overall Assessment** *The U.S. external position was moderately weaker than implied by medium-term fundamentals and desirable policies in 2016.* The U.S. external position, assessed imbalances, and fiscal policy gaps have improved considerably since the crisis. However, the U.S. economy's performance and the divergence of U.S. growth and monetary policy prospects from key trading partners have led to a strengthening of the U.S. dollar since 2014. There is a risk that a shift in the policy mix toward a larger fiscal deficit could lead to a further weakening of the CA and a strengthening of the currency, away from levels justified by medium term fundamentals and desirable policies. However, the possible adoption of far-reaching policy measures (e.g., a corporate tax overhaul, imposition of tariffs, changes in immigration policies) adds substantial uncertainty to this year's assessment. **Potential Policy Responses** Over time, fiscal consolidation will be necessary to lower the debt-GDP ratio and should aim for a general government primary surplus of about ¾ percent of GDP (a federal government primary surplus of about 1 percent of GDP). Structural policies should be implemented, within the budgetary envelope implied by a declining fiscal deficit, to raise productivity. These would include infrastructure investment, tax reform, better schooling and training of workers, measures to support the working poor, and policies to increase growth in the labor force. On net, such policies should, over time, raise efficiency, lift productivity, and reduce the CA deficit.
Current account	**Background**. The U.S. current account (CA) deficit has narrowed from its pre-crisis maximum of 6 percent of GDP to 2.4 percent of GDP in 2016, owing to a reduction in the fiscal deficit, higher private saving, lower investment in the aftermath of the financial crisis, and a stronger energy trade balance (reflecting both lower oil prices and the rapid increase of unconventional energy production). 2/ The CA deficit is expected to increase from 2016 through the medium-term as a consequence of a stronger U.S. economy, the recent appreciation of the U.S. dollar and an assumed fiscal expansion. **Assessment**. The EBA model estimates show a cyclically-adjusted CA gap of -1.0 percent of GDP for 2016, partly reflecting policy gaps, but mainly the result of an unidentified policy residual of -0.6 percent of GDP. There is, however, uncertainty about the magnitude of the gap; for instance, related to the discovery of shale oil, which could entail a wealth effect, likely lowering the CA norm and reducing the CA gap somewhat. 3/ The staff's view is that, on balance, the 2016 cyclically-adjusted CA is between -0.7 and -1.7 percent weaker than the level implied by medium-term fundamentals and desirable policies.	
Real exchange rate	**Background**. The real effective exchange rate (REER) appreciated in 2016 by about 3.1 percent compared to 2015. This is due to stronger U.S. economic performance relative to other countries and divergence of U.S. growth and monetary policy prospects from key trading partners. As of May 2017, the REER has appreciated about 0.7 percent relative to the 2016 average. **Assessment**. Indirect estimates of the REER (based on the EBA current account assessment) imply that the exchange rate was overvalued by between 10 to 20 percent in 2016. The EBA REER index analysis suggests an overvaluation of 15.8 percent. Considering all the estimates and their uncertainties, staff assess the 2016 average REER as moderately overvalued within a range of 10 to 20 percent, compared to the level implied by medium-term fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. Net financial inflows were about 3 percent of GDP in 2016 substantially below pre-crisis levels of about 5 percent of GDP. Portfolio inflows increased by about 1 percent of GDP, year over year, in 2016 but were offset by weaker direct investment and other inflows. There were also further increases in U.S. portfolio investment overseas, but less such outflows than the previous year. The foreign demand for U.S. Treasury securities is likely to be supported further by the stronger outlook for the U.S. economy compared to key trading partners, the status of the dollar as reserve currency and safe haven motives. **Assessment**. The U.S. has a fully open capital account. Vulnerabilities are limited by the dollar's status as a reserve currency and the U.S. role as a safe haven.	
FX intervention and reserves level	**Assessment**. The dollar has the status of a global reserve currency. Reserves held by the U.S. are typically low relative to standard metrics but the currency is free floating.	

	United States (continued)
Technical Background Notes	1/ The U.S. has a positive net equity position, with sizable portfolio equity and direct investment abroad, and a negative debt position vis-à-vis the rest of the world, owing to sizeable foreign holdings of U.S. Treasuries and corporate bonds. 2/ The oil and gas portion of the CA had a deficit of 0.4 percent of GDP in 2016, compared to a deficit of 0.6 percent of GDP in 2015. 3/ For instance, at an oil price of $60 price per barrel, the implied wealth gains owing to the shale discovery are estimated to lower the current account norm by about 0.25 percentage points of GDP.