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July 27, 2016

2016 EXTERNAL SECTOR REPORT—INDIVIDUAL ECONOMY ASSESSMENTS

IMF staff regularly produces papers covering multilateral issues and cross-country analysis. The following document has been released and is included in this package:

- The **2016 External Sector Report—Individual Economy Assessments** prepared by IMF staff and completed on June 30, 2016 for the Executive Board's consideration on July 18, 2016.

Informal Session to Engage:

The Executive Board met in an informal session, and no decisions were taken at this meeting. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

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2016 EXTERNAL SECTOR REPORT— INDIVIDUAL ECONOMY ASSESSMENTS

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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 Annex I of the 2015 External Sector Report, also IMF Working Paper WP/13/272 for a complete description of the EBA methodology). 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 and the estimates are subject to uncertainty.

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

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.

D. Individual Economy Assessments—by Economy

<table>
<tr><th></th><th>Australia</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Australia has a high negative net international investment position (NIIP) of -59 percent of GDP (as of end-2015). 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. With the current account deficit expected to narrow to around 3 percent of GDP over the medium term, the NIIP to GDP ratio would steady at around 60 percent of GDP.
Assessment. The NIIP level and trajectory are sustainable. 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.</td><td rowspan="5">Overall Assessment
In 2015 the external position was assessed to be moderately weaker than the level consistent with medium term fundamentals and desirable policies.
The widening of the current account deficit in 2015, notwithstanding substantial currency depreciation in 2014-15, was likely temporary, partly reflecting exceptionally large terms of trade declines in the context of commodity price declines and stronger-than-expected domestic demand growth in a weaker external environment. The Australian dollar has depreciated with the large deterioration in the terms of trade and supported expenditure switching, including by boosting services and non-resource exports. The depreciation in 2014-15 likely reduced the overvaluation of the Australian dollar, although the correction has stalled in recent months. 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.</td></tr>
<tr><td>Current account</td><td>Background. Australia has run current account (CA) deficits for most of its history. Since the early 1980s, deficits have averaged around 4 percent of GDP. In 2015, the deficit widened by 1¾ percentage points to 4.8 percent, reflecting an unusually large decline in the terms of trade (iron ore prices fell by over 40 percent in 2015), stronger domestic demand in Australia, and relatively weaker external demand. The current account deficit is expected to narrow in 2016, partly reflecting the lagged effects of currency depreciation in 2014/15, which has boosted services and non-resource exports, and new resource export capacity coming on stream. Over the medium term, the deficit is expected to be around 4 percent of GDP, with a moderately smaller trade deficit. However, 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. Australia's persistent CA deficits reflect a structural saving-investment imbalance with very high private investment relative to a saving rate which is already high by advanced country standards. After accounting for Australia-specific factors driving investment, the staff assessment is that the cyclically-adjusted current account is some 0-2 percent of GDP below the level implied by medium-term fundamentals and desirable policy settings in 2015This assessment is subject to uncertainty, given that it depends on how non-oil commodity prices evolve. 1/</td></tr>
<tr><td>Real exchange rate</td><td>Background. The real effective exchange rate (REER) depreciated 7 percent in 2015 relative to its 2014 average. As of June 2016, the REER had further depreciated 1 percent compared to its 2015 averages. Compared to its thirty-year average, the REER is some 8 percent higher. Continued substantial capital inflows and favorable interest rate differentials may have contributed to the continued relative strength of the Australian dollar. Since mid-2015, the currency has been broadly stable in real effective terms.
Assessment. Taking into account these factors including the attractiveness of highly rated Australian assets, staff assesses the REER to be 0 to15 percent above the level implied by medium-term fundamentals and desirable policy settings. 2/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>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.
Assessment. Credible commitment to a floating exchange rate and a strong fiscal position limit the vulnerabilities.</td></tr>
<tr><td>FX intervention and reserves level</td><td>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.</td></tr>
</table>

	Australia (continued)
Technical Background Notes	1/ The EBA CA regression approach for 2015 estimates a CA norm of -0.9 percent of GDP and a CA gap of -3.4 percent of GDP. Using estimated elasticities, the current account approach would be consistent with an exchange rate overvaluation of around 12-15 percent in 2015. However, the estimates of the CA norm may not capture Australia-specific factors such as the attractiveness of Australian assets to overseas investors. If such factors were considered, the current account norm might be for a deficit larger than 1 percent of GDP. The current account stabilizing deficit is closer to 2½-3 percent of GDP. Our assessment is therefore that the current account gap is in the range of -2 to 0 percent of GDP. 2/ The EBA REER regression approach, the EBA REER level regression, and the ES approach provide estimates of a gap encompassing a wide range from -1 to 14 percent in 2015.

	Belgium	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) remains strong, averaging 62 percent of GDP in 2015, reflecting very healthy private balance sheets. Despite Belgium's decline as a financial center, gross foreign assets are large (averaging 493 percent of GDP). Gross foreign assets of the financial sector stood at 108 percent of GDP, down considerably from the pre-crisis peak. The external debt of the public sector was around 70 percent of GDP. **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 2015 was moderately weaker than medium-term fundamentals and desirable policy settings would imply.* The positive trend compared to previous years as well as recent measures to improve competitiveness point towards some strengthening of the external position in 2016, 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 last four years. 1/ The effect on the trade balance of falling dollar-denominated energy prices was smaller than expected due to the simultaneous depreciation of the euro and the importance of energy re-exporting, both as raw material and as input in other exports. The cyclically-adjusted CA balance has deteriorated slightly in 2015. **Assessment**. The EBA model estimates a CA gap of -3.1 percent of GDP for 2015. The staff assessment is similar, estimating a CA gap in the range of -2.5 to -0.5 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 since 2013 had only limited effects on the ULC-based REER, which continued to appreciate between 2013 and 2014.The CPI-based REER depreciated by less than 1 percent between 2013 and 2014. However, the nominal effective depreciation in early 2015 lowered the 2015 average REER by approximately 4.5 percent compared to its 2014 average. As of May 2016, however, the ULC-based REER had appreciated 1.7percent relative to its 2015 average. **Assessment**. Estimates of the EBA model for 2015 point to a REER overvaluation of around 3-4 percent (both index and level models). The staff assessment, consistent with the EBA REER regression model estimates and the CA assessment, is a 2015 REER gap in the range of 2 to 10 percent. 3/	
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 40 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 Belgian CA numbers have undergone major revisions in 2015 and 2016, complicating the comparison with the previous ESR assessment. 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, and thus are a source of uncertainty about the CA assessment. 3/ The REER gap assessment is consistent with the staff's CA gap assessment, considering the relatively high ratios of exports and imports to GDP, which tend to make the CA more responsive to the REER.

	Brazil	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Brazil's NIIP improved to -27 percent of GDP in 2015 reflecting in part the real's depreciation. It is projected to remain broadly unchanged over the medium term. 1/ DI accounts for close to half of liabilities (which are 69.7 percent of GDP). Of concern is the rise in external debt since the global financial crisis (to some 350 percent of exports). **Assessment**. The NIIP is comparable to that of Brazil's peers, but the shift in composition of liabilities toward external debt over the last several years is a concern.	**Overall Assessment** *The external position of Brazil in 2015 was moderately weaker than the level consistent with medium-term fundamentals and desirable policy settings.* The subsequent appreciation of the REER as of June 2016 suggests that the REER remains above the level suggested by fundamentals and desirable policies. The current account-to-GDP ratio will likely improve further in 2016 amid subdued domestic demand and the delayed impact of the 2015 depreciation, and despite further worsening of Brazil's ToT. **Potential Policy Responses** Efforts to raise national savings are needed to provide room for a sustainable expansion in investment. Fiscal consolidation, including from social security reform, should contribute to shifting the structure of spending away from consumption. Structural reforms to reduce the cost of doing business would also help strengthen competitiveness. Foreign exchange intervention, including through the use of derivatives, can be appropriate to punctually alleviate disorderly market conditions in the foreign exchange market. The authorities should aim to preserve their foreign reserve buffers.
Current account	**Background**. The current account deficit adjusted sharply in 2015 owing to the real's depreciation and the drop in domestic demand, despite the ToT deterioration. 2/ The deficit fell from 4.3 percent of GDP in 2014 to 3.3 percent in 2015 against a broadly neutral structural fiscal stance. 3/ The deterioration in prices for Brazil's major commodity exports reduced export values by around 1.5 percent of GDP. The CA is projected to improve in 2016 and going forward due to the delayed impact from the depreciation and the slow recovery in demand, even without closing all policy gaps (e.g. fiscal). Brazil's ToT are expected to weaken further under the baseline and remain a downside risk. 4/ However, a larger-than-expected recovery in private demand could widen the deficit unless public savings strengthen. The development of Brazil's off-shore oil potential is no longer projected to contribute significantly to the external adjustment as investment in expansion has been cut back. 5/ **Assessment**. Staff estimates that the CA norm is consistent with fundamentals and desirable policy settings range from 0.25 to -1.5 percent of GDP. 6/ With a cyclically adjusted CA of -2.8 percent, the 2015 CA gap ranged between -1.3 and -3.1 percent of GDP, wider than the EBA gap estimate of 0.1 percent.	
Real exchange rate	**Background**. The REER on average depreciated by 15 percent between 2014 and 2015. After some oscillations, by June 2016, it was some 6 percent above its average 2015 level. The annual average ULC based REER also depreciated by some 15 percent between 2014 and 2015, due to both labor shedding and improvements in cost competitiveness. The nominal exchange rate has been sensitive to political developments and global trends in 2016. **Assessment**. Staff's assessment is that the real was on average some 5-15 percent above the level implied by fundamentals and desirable policy settings in 2015. 6/	
Capital and financial accounts: flows and policy measures	**Background**. Brazil continues to attract sizable capital flows but their composition changed in 2015. Equity liability flows remained strong while debt liability flows fell sharply. Net DI fully financed the CA deficit (DI liabilities totaled 4.3 percent of GDP). The share of intercompany loans in DI liabilities dropped sharply. 7/ Net portfolio debt liabilities, having accounted for more than 1 percent of GDP in previous years, fell to close to zero reflecting downgrades of Brazil's sovereign credit rating and associated corporate downgrades. Interest differentials will continue to attract inflows, but the recession and growing vulnerabilities are expected to weaken investor interest. **Assessment**. While the composition of flows has a favorable risk profile, there is a risk that outflows may increase amid the prolonged recession and growing domestic risks. The currently higher appetite for equity over debt investments may reflect a combination of the depreciation and investors taking a longer-term view.	
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 FX repos but was symmetric over the course of the year and generally more limited compared to previous years. 8/ During the market turmoil in September, the authorities reacted to excessive volatility largely by providing FX liquidity through FX repos. In March and April of 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 some $62 billion as of early June. Brazil's gross reserves remained broadly constant in 2015, at $358 billion, some 20 percent of GDP and 200 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 (185 percent). While Brazil's reserve holdings in principle provide some space to intervene, the authorities should aim to retain these buffers and their net creditor position in foreign exchange. Staff would advise only punctually alleviating disorderly market conditions as needed.	

	Brazil (continued)
Technical Background Notes	1/ The projection takes valuation effects into account. 2/ Import volumes fell by 15 percent in 2015 due to both import compression and the real's depreciation (between a third and a half of the fall in import demand is attributable to the depreciation). Export volumes rose by 8 percent, but the bulk of the impact of the 2015 depreciation in expected to materialize in 2016, especially for manufacturing exports. 3/ While the cyclically adjusted overall balance would signal a significantly expansionary fiscal stance in 2015, a structural perspective (excluding e.g. BCB losses on FX swaps and the net settlement of previously unreported commitments to public banks) suggests a broadly neutral stance. 4/ At 19 percent of the total, China remains Brazil's most important export destination and accounts for the bulk of Brazil's major commodity exports 5/ Brazil currently features a small oil balance deficit; in the short run, falling oil prices thus strengthen the current account ceteris paribus while they may depress the outlook for oil production in the medium term. 6/ Staff's assessment centers on the current account norm. Estimates suggest a current account norm between -2.7 percent (EBA current account approach) and -1.2 percent (NIIP-stabilizing approach). Staff's assessment of a current account norm range from 0.25 to -1.5 percent (higher than in previous years due to the significant downward revision in the growth outlook) reflects low potential growth, commodity price downside risks, and the objective of avoiding a deterioration in the NIIP over the medium term, and facilitates expenditure switching away from consumption and towards investment. In contrast, EBA REER level and index approaches suggest that the real was undervalued by 2-19 percent on average in 2015. 7/ 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 portfolio debt flows than to other types of DI liabilities. 8/ In the Brazilian FX repo, the Central Bank sells dollars with the commitment to repurchase them at a pre-determined future date. That is, the Central Bank retains a long dollar position following execution of the repo. In the Brazilian FX swap, the Central Bank enters into a contract whereby it agrees to pay the onshore dollar rate on a given notional value plus the variation in the exchange rate, and to receive the SELIC rate on the BRL equivalent (at the moment of initiation) of the given notional value. The net value of these payments is redeemed in local currency. Under this mechanism, the Central bank pays the holder if the BRL depreciates by more than the difference between the SELIC rate and the onshore dollar rate, and receives payment from the holder in the opposite case. This instrument provides hedging to agents with prospective hard currency needs.

	Canada	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Canada posted a positive net international investment position (NIIP), which rose to C$485.0 billion by end-2015, equivalent to 24.5 percent of GDP. This is in spite of the fact that the increase in foreign liabilities exceeded the increase in foreign assets by C$57 billion. The gain in the NIIP thus resulted entirely from valuation effects of a weaker Canadian dollar. Gross external debt rose by 18.6 percentage points to 108.5 percent of GDP between 2014 and 2015. Banks and other private sector hold 71 percent of the external debt, of which a half is short-term. **Assessment**. The NIIP is sustainable with limited near term risk. External debt has risen sharply but remains modest relative to other advanced economies. Canada's foreign assets provide a hedge against currency depreciation.	**Overall Assessment** *The external position in 2015 was moderately weaker than implied by medium-term fundamentals and desirable policy settings.* The depreciation of the currency has helped improve Canada's external competitiveness, but it will take time for the economy to adjust to the structural reallocation of resources from the energy to the non-energy sector. Recent developments do not suggest a change in the assessment of the external position in 2015. In the medium term, the external position is expected to strengthen as non-energy exports gradually benefit from improved price competitiveness and structural improvements in manufacturing capacity. **Potential Policy Responses** Significantly boosting Canada's non-energy exports would require addressing a variety of structural issues in manufacturing and promoting the development of services exports. Policies that could improve Canada's trade competitiveness include measures geared at improving labor productivity; investing in R&D and physical capital; promoting FDI; and diversifying Canada's export markets. A credible medium-term consolidation plan for fiscal policy will also support the external rebalancing.
Current account	**Background**. Canada's current account (CA) deteriorated from -2.3 percent of GDP in 2014 to -3.2 percent of GDP in 2015. Despite the sharp depreciation of the Canadian dollar (30 percent in the past two years) and a compression in imports, a broad-based pickup in non-energy exports did not materialize to offset the decline in oil exports. This is because manufacturing capacity was eroded during the oil boom years (2002-2012) when the real effective exchange rate appreciated by 57 percent. It will take time to reallocate resources from the energy to the non-energy sector and rebuild manufacturing capacity. In terms of the savings-investment balance (S-I), the deterioration in the CA was consistent with a worsening of both the general government S-I balance (by 0.8 percentage points) and the private sector's S-I balance (0.1 percentage points). **Assessment**. The EBA estimates a cyclically adjusted CA gap of -3.3 percent of GDP for 2015. This, however, likely overstates the desirable external adjustment, because it overestimates the norm. 1/ Staff assesses that the CA gap is between -2 and -1 percent of GDP.	
Real exchange rate	**Background**. Canada's exchange rate is highly correlated with oil prices. The real effective exchange rate has depreciated by 8.4 percent on an annual average basis between 2014 and 2015. As of June 2016, the REER has remained stable at its 2015 average level. Assessment. Both the EBA REER index and level approaches estimate the currency to be undervalued, by 10-21 percent respectively in 2015. In staff's assessment, however, the extent of undervaluation could be exaggerated for two reasons. First, given Canada's lost manufacturing capacity, further depreciation may be needed to restore competitiveness. Second, Canada's competitors in the U.S. market have also seen their currencies depreciate by similar magnitudes, thus limiting any net gain for Canada. 2/ Given the CA gap, staff estimates that the real effective exchange rate is, in fact, overvalued by 0 to 5 percent relative to medium-term fundamentals and desirable policy settings.	
Capital and financial accounts: flows and policy measures	**Background**. The CA deficit in 2015 has been financed primarily by net portfolio inflows. Foreign holdings of Canadian stocks declined largely due to stock market capital losses, but this was offset by an increase in foreign holdings of corporate bonds. Nearly three-quarters of corporate bonds held by non-residents are denominated in foreign currencies compared with one-third of government bonds, and are therefore more sensitive to currency fluctuations. Foreign direct investment recorded a net outflow in 2015. **Assessment**. Canada has a fully open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate and a strong and credible fiscal position.	
FX intervention and reserves level	**Background**. Canada has a free floating exchange rate regime, and it has not intervened in the foreign exchange market since September 1998 (with the exception of participating in internationally concerted interventions for other purposes). 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 in the past). **Assessment**. Policies in this area are appropriate to the circumstances of Canada.	

	Canada (continued)
Technical Background Notes	1/ There are three reasons why the Canada's CA norm may be below EBA's estimated CA norm. First, the model adjusts for the business cycle using Canada's output gap relative to the world (GDP-weighted average) output gap, while a more relevant measure for Canada is the output gap relative to the United States. Using the US as the benchmark would reduce the CA norm for Canada because the output gap for the United States is slightly larger (more negative) than the world output gap. Second, the EBA overestimates Canada's trade balance by using the WEO global oil prices rather than the lower market price for Canadian oil, particularly, heavy crude oil from western Canada's oil sands (the lower price reflects lower quality). Third, the EBA does not take into account the structural loss in trade competitiveness. 2/ The EBA REER approach does not fully capture the loss in Canada's structural competitiveness for a number of reasons: First, the approach includes commodity terms of trade rather than oil prices as an explanatory variable. However, Canada's REER has mirrored movements in oil prices much more closely than its commodity terms of trade. Second, protracted structural rebalancing in the non-energy sector, in conjunction with a long-term erosion of market share among US imports imply a less competitive economy than the EBA fit could account for. While Canada's currency has depreciated versus the US dollar, so have the currencies of some its key competitors on the US market, like Mexico. Estimates of an adjusted REER that takes account of Canada's relative competitiveness in third markets suggest that Canada's REER has depreciated considerably less than the unadjusted REER. The EBA's estimated REER gap would thus be smaller (less negative). More than half the gain in price competitiveness is undone when competitors are taken into account. See Barnett, Charbonneau and Poulin-Bellisle, "A New Measure of the Canadian Effective Exchange Rate", Bank of Canada Staff Discussion Paper 2016-1.

	China	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Gross foreign assets, at 56 percent of GDP by end-2015, are dominated by foreign reserves, while gross liabilities, at 41 percent of GDP, mainly represent FDI liabilities. Reserve assets fell to US$3.33 trillion by end-2015 and to US$3.19 by May 2016 (about 28.5 percent of 2015 GDP), from US$3.84 trillion at end-2014 (about 36.4 percent of 2014 GDP), due to net sales of reserve assets and valuation losses. Net IIP has declined from 15.2 percent of GDP in 2014 to 14.3 percent of GDP at end-2015; the ratio has been declining since the global financial crisis in light of the much reduced current account (CA) surpluses, valuation changes, and still fast growth of GDP. **Assessment**. The NIIP to GDP ratio is expected to be close to 15 percent of GDP over the medium term, consistent with the CA surplus. The NIIP is not a major source of risk at this point, given the large foreign reserves and FDI-dominated liabilities. However, there is a possibility that capital outflow pressure could persist and reserves fall further.	**Overall Assessment** *The external position in 2015 was moderately stronger compared with the level consistent with medium-term fundamentals and desirable policy settings.* The renminbi was broadly in line with fundamentals and desirable policies, although its assessment is subject to a high degree of uncertainty. Developments through June 2016 do not suggest a change in this assessment. The assessment of the external position reflects still-large policy gaps that affect the saving-investment imbalance, such as social spending. The uncertainties about the assessment of renminbi reflect factors outside the models such as shifts in expectations and the nature of recent capital flows. **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. 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; increasing on-budget fiscal support; SOE reform and opening markets to more competition; creating a more market-based financial system; 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 a float, which may also require use of foreign exchange reserves to some degree to smooth excessive volatility not justified by fundamentals.
Current account	**Background**. The CA surplus in 2015 was 3.0 percent of GDP (3.0 percent of GDP cyclically adjusted), which was about 0.3 percent of GDP higher than 2014. The increase of the CA surplus was mainly due to weak real import growth and favorable terms of trade (the gain was about 1 percent of GDP in 2015), and occurred despite sizeable REER appreciation and a rise in outward tourism. In 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, weakness in major advanced economies, and, more recently, a trend widening of the services deficit. **Assessment**. The EBA CA regression approach estimates that the cyclically-adjusted CA is stronger (by about 2.3 percent of GDP) than consistent with medium-term fundamentals and desirable policies. While the estimated total policy gap has declined substantially, mainly driven by the change in FX intervention, fiscal policy, social spending and credit growth gaps remain. The total gap is mostly driven by the residual, reflecting factors not captured by EBA, including distortions that encourage excessive savings. There is also large uncertainty about China's cyclical position. As a result, staff assesses the CA gap is 1-3 percent of GDP stronger than implied by fundamentals and desirable policies. 1/	
Real exchange rate	**Background**. In 2015, the average REER appreciated by about 10 percent relative to the 2014 average, mainly driven by the appreciation in the NEER, and reflecting the link to the US dollar. Through June 2016, again driven by the change of NEER, the REER has depreciated by 6 percent relative to its 2015 average. 2/ **Assessment**. The EBA REER index regression estimates China's REER to be 3.9 percent stronger than levels warranted by fundamentals and desirable policies. This gap (as well as the minus 0.1 percent policy gap) is small relative to the statistical errors of EBA regressions, suggesting that the REER is broadly in line with fundamentals and desirable policy settings. However, this assessment is subject to large uncertainties. This is because the EBA framework, with its focus on factors underlying the savings-investment balance, does not capture other factors potentially affecting demand for a country's assets, such as diverging market views on the outlook and shifts in portfolio allocation preferences. 3/ Overall, staff assesses the REER to be -10 to +10 percent different from the level consistent with fundamentals and desirable policies.	
Capital and financial accounts: flows and policy measures	**Background**. In the past year, China has liberalized its financial account further, including the granting of onshore access to official sector investors. China's financial account has been relatively open in FDI and other investment. Nonetheless, restrictions remain, particularly with respect to portfolio flows. After a long period of net capital inflows (averaging US$80 billion per year over 2000-14), the financial account recorded a net outflow of US$673 billion in 2015. Net direct investment flows remained positive—at US$62 billion—but well below the 2000-14 average (US$114 billion). The large deficit in errors and omissions are included as capital outflows as they are likely to be unrecorded capital rather than current account transactions. **Assessment**. Over the medium term, a well-sequenced loosening of capital controls consistent with domestic financial liberalization and exchange rate flexibility would be appropriate. 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 moving to a flexible exchange rate as soon as practical, while also using foreign reserves to a limited degree in the interim to smooth excessive volatility not justified by fundamentals.	
FX intervention and reserves level	**Background**. After a long period of reserve accumulation, FX reserves declined by US$513 billion (4.6 percent of GDP) in 2015, of which intervention accounted for about US$342 billion (3.1 percent of GDP). FX reserves further declined by US$139 billion to US$3.19 trillion (about 28.5 percent of 2015 GDP) at end-May 2016. **Assessment**. Reserves stood at 118 percent of the IMF's composite metric unadjusted for capital controls at end 2015 (down from 149 percent in 2014); relative to the metric adjusted for capital controls, reserves stood at 190 percent (down from 238 percent in 2014). Given China's progress in capital account liberalization, the appropriate metric is shifting toward the one unadjusted for capital controls. By any metric, the current reserve level thus remains adequate, although the rapid decrease of reserves since August, if continued, could alter this assessment.	

	China (continued)
Technical Background Notes	1/ The total CA gap from EBA is 2.4 percent of GDP for 2015, smaller than the gap in 2014 (3.1 percent of GDP). The contribution of identified total policy gaps is minus 0.3 percent of GDP (versus 1.8 percent of GDP in 2014), but individual policy gaps remain in health expenditure, fiscal policy, FX intervention and capital controls. The EBA REER Index model estimates a total REER gap of 4.1 percent, with identified policy gaps of 0 percent. The EBA REER Level model estimates a total REER gap of 16.5 percent, with identified policy gaps of 2.9 percent. However, that estimate is discarded from consideration, as the model fit of the EBA Level model is very poor for China. 2/ In August 2015, the PBC required market makers to submit quotes that take account of the closing (onshore) spot rate of the previous day as well as supply and demand in the market, for determining the central parity of the +/-2 percent trading band that it announces before the market opens. Previously, market makers were supposed to quote to the PBOC exchange rates based on their sense of the market in the morning, an opaque system that allowed substantial discretion and, in practice, resulted in the central parity barely moving from day to day, even though the market rate had often closed at some distance from it the previous day. 3/ For example, changing expectations about monetary and exchange rate policy, re-evaluation of a 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 (GDP growth, employment, etc). China currently appears to have recently experienced such capital account pressures on the exchange rate that are not well explained by the EBA framework.

	Euro Area	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) of the euro area deteriorated to-17 percent of GDP in 2009, but has since recovered to around -4 percent in 2015. The improvement was driven by stronger current account balances and modest nominal GDP growth. On a gross basis, the steady rise in both asset and liability positions in the pre-crisis period reversed sharply in 2008, due to a sudden stop of financial flows. Since 2009, gross positions have rebounded, reaching 225 percent of GDP for assets and 229 percent of GDP for liabilities in 2015. **Assessment**. Projections of continued current account surpluses suggest that the NIIP-to-GDP ratio will continue to improve at a moderate pace, while gross positions will likely remain sensitive to swings in asset prices. Despite recent improvements, some countries with sizable net foreign liabilities still remain vulnerable to a sudden stop in capital flows.	**Overall Assessment** *The external position of the euro area in 2015 was broadly consistent with the level implied by medium-term fundamentals and desirable policies. In 2016, the current account is projected to remain broadly unchanged.* Given still sizeable imbalances at the national level, 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 UK's decision to exit the EU may affect euro area's external position through trade, financial and confidence channels, which will be assessed in the context of future ESR reports. **Potential Policy Responses** Continued monetary accommodation is appropriate to lift inflation closer to the ECB's medium-term price stability objective, which should also help increase demand and facilitate relative price adjustments at the national level. Monetary easing should be complemented with policies to strengthen private sector balance sheets, structural reforms to enhance productivity and improve competitiveness, and more growth-friendly fiscal policy. Countries should fully use fiscal space where available to expand investment and promote structural reforms, while those without fiscal space should continue consolidating. At the regional level, centralized investment schemes should be explored to support growth. A more balanced policy mix would better boost domestic demand, lift inflation, and rebuild policy buffers, helping to reduce external imbalances, including within the euro area.
Current account	**Background**. The current account (CA) balance for the euro area strengthened in 2015 to 3.2 percent of GDP (cyclically adjusted 2.7 percent), up from 2.5 percent of GDP in 2014, with two-thirds of the improvement reflecting a higher energy balance from lower oil prices. The CA increase was broad based but reflects different drivers at the national level. The current account of debtor countries, such as Spain and Portugal, improved during the crisis but mainly through import compression. More recently, external competitiveness gains from price and wage adjustments have strengthened these current accounts. On the other hand, the surpluses of some large creditor countries, such as Germany, continue to grow, reflecting still-weak investment and stronger fiscal positions. **Assessment**. The EBA model estimates a CA gap of -0.3 percent of GDP for 2015, with a CA norm of 2.9 percent of GDP. This calculation of the CA norm, however, does not fully account for factors such as the recent improvements in Germany's demographic outlook reflecting in part the recent refugee wave or the still-large need in Spain to improve the NIIP. Taking into account these factors and the uncertainties in model-based estimates, staff assesses the CA gap to be in the range of -0.5 to 1.5 percent of GDP for 2015, 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 depreciated by 8.6 percent from 2014 to 2015, reflecting the euro area's weak cyclical position, lower inflation, and the accommodative monetary policy. Compared to the 2015 average, the REER has appreciated by 1 percent as of June 2016, as the modest nominal effective appreciation has been offset only partly by weaker inflation in the euro area relative to its trading partners. The euro depreciated in the days after the UK decided to exit the EU. This decision does not affect staff's external assessment for 2015, but may have implications for the assessment going forward, which will be assessed in the context of future ESR and euro area reports. **Assessment**. The EBA index REER model points to an overvaluation of 1.3 percent, while the level REER model suggests an undervaluation of around 6 percent; the CA regression model using standard trade elasticities indicates a 1 percent overvaluation. On balance, staff assesses the euro area average real exchange rate in 2015 to be undervalued by 0-10 percent. The REER gaps are large in many member countries, ranging from an undervaluation of 10-20 percent in Germany to an overvaluation of 5-10 percent in Spain. The large differences in REER gaps within the euro area highlight the continuing need for debtor countries to improve their external competitiveness and for creditor countries to boost domestic demand.	
Capital and financial accounts: flows and policy measures	**Background**. The rise of the CA surplus in 2015 was mirrored by financial outflows on a net basis. In particular, the financial account deficit was driven predominantly by portfolio debt outflows, which were partly offset by increases in portfolio equity inflows. **Assessment**. The trend of financial flows has followed closely developments in the current account. Capital outflows arise in the context of easing financial conditions due primarily to the ECB's monetary accommodation. Looking ahead, reducing capital outflows would depend crucially on improving domestic growth prospects and institutional and structural reforms that strengthen the resilience of the EMU and raise potential growth.	
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.	

	Euro Area (continued)
Technical Background Notes	1/ The IMF EBA analysis for the euro area covers 11euro 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 (for which no such correction is available).

	France	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. After averaging near balance in the four years before the global crisis, the net international investment position (NIIP) deteriorated to around 17 percent of GDP in 2015Q4, reflecting current account deficits and valuation losses (the latter accounting for almost 20 percent of the deterioration in the NIIP since 2007). The deterioration in NIIP has been mainly driven by increases in public sector liabilities, reflecting rising public debt held by foreigners. However, the net position masks large gross positions, particularly for banks, reflecting their global activities which grew steadily in the pre-crisis period. Since the crisis, the gross asset position has declined moderately and stood at 295 percent of GDP in 2015. More than three-quarters of French bank exposures are to advanced economies, with the share of major emerging market exposures now reaching 8 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 accounts for about 19 percent of the gross liability position. Stability of the French public debt market is an important element of euro-zone financial stability. **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 on the liability side.	**Overall Assessment** *The external position in 2015 was moderately weaker than the level consistent with medium-term fundamentals and desirable policy settings*. Recent developments, including the depreciation of the euro and lower oil prices, have helped strengthen the external position. However, it is still moderately weaker than implied by fundamentals, given high unit labor costs and fiscal deficits. The labor tax wedge cuts undertaken since 2013 (equivalent to 3 percent of total labor costs, spanning 2014–17) have contributed somewhat to improve cost competitiveness. Efforts to improve non-cost competitiveness were reinforced by further labor and product market reforms (Macron and Rebsamen Law) in 2015. **Potential Policy Responses** Continued wage moderation (especially of the minimum wage), continued reform of the labor market, and productivity-enhancing reforms (increasing competition in product markets and further regulatory simplification) would help restore 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 has deteriorated from a surplus of almost 4 percent of GDP in the late 1990s to an estimated deficit of 0.2 percent in 2015, mostly due to structural factors (the cyclically-adjusted deficit is estimated at -0.8 percent of GDP). The deterioration originates from a worsening net saving position of the private sector and higher government deficits in equal proportions, but it has attenuated between 2014 and 2015 by virtue of positive shocks to the terms of trade (notably oil) and because of a weakening of the euro in real effective terms. The current account is projected to deteriorate marginally in 2016 to 0.5 percent of GDP, reflecting in part higher projected oil prices. **Assessment**. The staff assesses the 2015 cyclically-adjusted current account to be ½ to 2½ percent of GDP below its norm. This is consistent with the EBA model estimate that the cyclically-adjusted current account is about 1¾ percent of GDP weaker than the value consistent with medium-term fundamentals and desirable policy settings. Recent developments, including the depreciation of the euro and lower oil prices, suggest some strengthening of the external position in 2016. Over the medium term, the current account deficit is projected to remain closely around balance, as imports pick up in line with domestic demand. The gradual elimination of the fiscal deficit will help narrow the EBA-estimated gap.	
Real exchange rate	**Background**. The trend deterioration in unit labor costs (9.3 percent cumulative appreciation of the ULC-based real effective exchange over the last 10 years) points to a loss of competitiveness consistent with the assessment of an imbalance in the current account. However, such loss of competitiveness is less evident based on relative price indicators, such as CPI-based real effective exchange rate (REER), as firms appear to have squeezed profit margins to retain price competitiveness. Compared to its average level in 2015, the ULC-based REER has appreciated by close to 2 percent as of June 2016. The CPI-based REER depreciated 4 percent in 2015 relative to its 2014 average level, but as of April 2016 had appreciated 1 percent relative to its 2015 average. **Assessment**. The EBA Level REER regression model estimates a 4.6 percent overvaluation, while the overvaluation suggested by the staff's assessment of the CA gap is a range of about 3 to 9 percent using standard trade elasticities. The EBA Index REER model on the other hand estimates an undervaluation of -5.4 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 3–9 percent overvalued. 1/	
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 ULC-based REER recent modest appreciation adds marginally to past competitive losses. Taking all these inputs into account, staff assesses the 2015 REER to be 3–9 percent overvalued.

	Germany	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Germany's positive net international investment position (NIIP) reached 49 percent of GDP at end-2015. The NIIP of financial corporations other than MFIs is large and positive (48 percent of GDP), while that of the general government is large and negative (35 percent of GDP), partly reflecting Germany's safe haven status. The NIIP is expected to reach 80 percent of Germany GDP and 3 percent of world GDP by 2021, as the projected CA surplus remains sizable in the medium term. The implicit rate of return on foreign assets has exceeded that on liabilities by 0.6 percent on average over 2010–15. Foreign assets are well diversified by instrument, and the exposure to emerging market is small. **Assessment**. Safe haven status and the strength of Germany's current external position limit risks.	**Overall Assessment** *Germany's external position in 2015 was substantially stronger than implied by medium-term fundamentals and desirable policy settings.* The current account gap has widened relative to 2014 reflecting the delayed response of consumption to the windfall from lower energy prices, and REER depreciation. Current account surplus modestly narrowed in early 2016 together with small appreciation of the REER. These developments do not alter the overall assessment of 2015. Staff projects some gradual rebalancing in the medium run as the terms of trade windfall is gradually spent, energy prices partially recover, private investment keeps strengthening, and stronger wage growth relative to euro area trading partners contributes to realign price competitiveness. **Potential Policy Responses** Fiscal resources available within the fiscal rules should be used to boost public investment and growth-enhancing structural reforms. This would raise Germany's potential output and generate positive demand spillovers to the rest of the euro area while reducing the German current account surplus.
Current account	**Background**. The current account averaged 6.1 percent of GDP over the last decade and reached 8.5 percent of GDP in 2015, a 1.2 pp. increase relative to 2014. Sixty percent of this increase is accounted for by the improvement in the gas and oil balance supported by lower commodity prices. The non-energy trade surplus grew by 0.2 percent of GDP owing to a depreciation of the REER and boosted automobile exports due to lower oil prices. After declining substantially in previous years, the surplus vis-à-vis the rest of the euro area expanded by 0.7 percent of GDP relative to 2014, mainly because the energy deficit with the Netherlands shrank. The bulk of the surplus reflects large saving-investment surpluses of non-financial corporations and households. The government contributed about ⅓ percent of GDP to the improvement in the current account in 2015. **Assessment**. The cyclically-adjusted current account balance stood at 8.7 percent of GDP in 2015, which is 3–6 percentage points of GDP stronger than the value implied by fundamentals and desirable policies. Staff assesses the norm at 2½–5½ percent of GDP. The norm implied by the EBA model is 5.0 percent. 1/ The staff assessment departs from the EBA norm to incorporate a more favorable demographic outlook reflecting new scenarios from the German statistical agency as well as staff assumptions on the impact of the recent refugee wave. These factors bring down the assessed CA norm by 1.1 percentage point. The sensitivity of the norm to demographic factors, and uncertainties regarding to the evolution of these factors, explain the wider range around the assessed CA norm. 2/	
Real exchange rate	**Background**. By end of 2015, the CPI based real exchange rate had depreciated in effective terms by 5.3 percent from its 2014 average primarily because of nominal bilateral depreciations vis-à-vis the USD and the RMB. These exchange rate movements are related to the monetary tightening in the U.S. and the implementation and expansion of quantitative easing in the euro area. As of June 2016, the REER has appreciated 1 percent over its 2015 average. **Assessment**. Staff's assessment for 2015 is of a REER undervaluation of 10–20 percent. The EBA REER Level model yields an undervaluation of about 21 percent. The undervaluation implied by the CA regression model using standard trade elasticities is 10–15 percent. 3/	
Capital and financial accounts: flows and policy measures	**Background**. In 2015, 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 mainly reflecting an increase in flows into Germany. The stock of Germany's net (Target2) claims on the Eurosystem went down from a peak of €749 billion in August 2012 to €603 billion in April 2016. **Assessment**. Reduced euro area financial stress has led to the resumption of private capital outflows and a declining exposure to the Eurosystem, though the latter remains well above pre-crisis levels.	
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 3.9 percentage points to the estimated EBA CA norm of 4.9 percent of GDP. Most of the EBA-estimated gap for 2015 reflects the regression's residual rather than gaps in the policies included in the EBA model. 2/ In this separate assessment, staff assumes projected refugee inflows unchanged in other countries, including in large absorbers of refugee flows in Europe (such as Sweden and Austria). 3/ The EBA REER Index model has an unusually poor fit for Germany, predicting a depreciating trend that has not occurred. The result for 2015 is an estimate of *over*valuation (of 3.1 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) amounted to around 320 percent of GDP as of end-2015. Both external financial assets (about 1395 percent of GDP) and liabilities (about 1075 percent of GDP) are high, reflecting Hong Kong SAR's status as a major international financial center with considerable cross-territory investment. The GDP share of the NIIP is projected to follow a trend that gradually converges to levels broadly in line with the average prior to the global financial crisis, driven by expected returns and valuation changes. The trend decline mainly reflects the interest-growth differential—as nominal GDP is expected to grow faster than the effective returns on the NIIP (net investment income as a share of the NIIP). Given the large gross assets and liabilities, annual fluctuations in the NIIP due to valuation changes have been sizable. **Assessment**. Given the large size of NIIP with a relatively favorable mix - low proportion of short-term liabilities (at most 30 percent of total external liabilities); liquid (non DI) assets in excess of 50 percent of total assets; and FX reserves about 117 percent of GDP by Apr-2016), vulnerabilities are generally low.	**Overall Assessment** *The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policy settings.* Developments through June 2016 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. The recent REER appreciation is expected to be offset by Hong Kong SAR's strong self-equilibrating tendencies resulting from flexible goods, factor, and asset markets. 3/ **Potential Policy Responses** Macroeconomic policies are broadly appropriate. 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 surplus is estimated to be 3.1 percent of GDP in 2015 (2.5 percent of GDP after cyclical adjustment), which continues to be substantially lower than in the pre-GFC years. 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) accounted for most of the drop in the current account surplus. The favorable terms of trade shock from lower commodity prices improved the current account surplus by about 0.5 percent of GDP in 2015. The current account surplus is projected to be 3.1 percent of GDP in 2016. **Assessment**. The current account is broadly consistent with medium-term fundamentals and desirable policies. Staff's quantitative assessment suggests that the difference between the cyclically-adjusted current account in 2015 and that consistent with fundamentals and desirable policies is between -2 and 2 percent of GDP (EBA-type results indicate a larger deviation, but are in this case subject to uncertainty and potential biases). The large decline of the current account surplus (relative to pre-2010) is mainly driven by demographic factors in Hong Kong SAR and structural changes related to weaker growth and rebalancing in Mainland as well as the opening of the Mainland capital account. 1/	
Real exchange rate	**Background**. The REER appreciated by about 9 percent in 2015, relative to the average REER in 2014. 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 in 2016: as of June 2016, the REER was about 4 percent stronger than its 2015 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 2006 (when the current account surplus of Hong Kong SAR reached 13 percent of GDP). **Assessment**. The real exchange rate is broadly consistent with medium-term fundamentals and desirable policies. Based on empirical EBA-type estimates and factoring in the uncertainties and variability of an offshore trading and financial center, the exchange rate is assessed by staff to be from -7 to 7 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. Although Hong Kong SAR experienced net private inflows in 2015, overall, the capital flow pattern was volatile during the year: a sharp increase in portfolio investment and financial derivatives position (in both the asset and liability side) in the first half of the year and a subsequent sharp decline since Q3. These large movements are likely associated with financial volatility in the Mainland, transmitted through growing cross-border financial linkages. 2/ **Assessment**. Large financial resources and proactive financial supervision and regulation limit the risks from potentially volatile capital flows. The greater financial exposure to Mainland 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.	
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 is equivalent to around US$361 billion (about 117 percent of 2015 GDP) as of Apr-2016. **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. Taking into consideration variability of the current account in an international trading and financial center, application of EBA methodology to Hong Kong SAR's current account provides a poor fit. The cyclically-adjusted current account is estimated to be about 11 percent of GDP weaker than that consistent with fundamentals and desirable policies. The gap was mainly driven by EBA regression residual (about -12 percent of GDP) and the policy gap is around 1 percent of GDP. The large residual likely reflects a combination of structural factors which are not captured by EBA. These structural factors include the ongoing and expected future opening of the Mainland capital account (which will create more demand for office and residential space and hence the imports related to construction), rebalancing on the Mainland and structurally lower re-exports, which affects the credits from transportation services and re-export)and the surge of Mainland tourist spending (which will reduce measured current account surplus if the measured increase of service credits cannot fully offset the increase of goods imports). Given all these factors and the change of demographics, staff estimate that the current account norm has declined to a range of 1/2 to 4 ½ 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 2015Q2, the banking system claims on Mainland banks and nonbank entities amounted to about 285 percent of GDP, although part of the exposure is accounted by foreign banks. 3/ This is reflected in lower inflation rates in 2015 compared to previous years and relatively slower nominal wage growth (from 2011 to 2015, nominal wages increased by 19 percent while nominal GDP increased by about 24 percent).

	India	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. India's net international investment position (NIIP) remained stable, going from -18 percent of GDP at end 2014 to -17.5 percent of GDP at end 2015. Gross foreign assets and liabilities are relatively modest, at 26.6 and 44.0 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 include FDI, portfolio equity, and increasingly debt. Reserves (at US$360 billion), having dipped during the period of exchange market turmoil in mid-2013, are now well above May 2013 levels. **Assessment**. With current account deficits of under 2½ percent of GDP projected for the medium term and higher GDP growth, the NIIP-to-GDP ratio is expected to remain broadly stable. India's external debt, at about 24 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 80 percent and the ratio of short-term external debt to FX reserves is low.	**Overall Assessment** *The external sector position in 2015/16 is broadly consistent with medium-term fundamentals and desirable policy settings*. As of June 2016, subsequent developments do not point to a significant change in the external position. India's low per capita income, favorable growth prospects, and development needs justify running CA deficits, but too great a reliance on debt financing and portfolio inflows would create significant external financing vulnerabilities. Furthermore, despite a reduction in external vulnerabilities, there is need for vigilance given commodity price volatility and the recent REER appreciation. Current reserve levels are adequate. 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. **Potential Policy Responses** To reduce external vulnerabilities and reach the authorities' fiscal deficit goal of 3 percent of GDP by 2017/18, continued fiscal consolidation is needed, including by passage of a goods and services tax and further subsidy reforms. Easing domestic supply bottlenecks would also boost exports and improve investment prospects. Strengthening the new monetary framework, through a strong institutional design of the RBI's Monetary Policy Committee and further reducing impediments to monetary transmission, and a continued focus on low inflation will be important to keeping gold imports contained. The CA financing mix would be improved by further enhancing the environment for FDI. Given the potential risks to corporate balance sheets, including from significant unhedged FX exposures, further relaxation of limits on ECB (especially for sectors without natural hedges) should be implemented cautiously.
Current account	**Background**. The current account (CA) deficit narrowed further in FY2015/16, to 1.1 percent of GDP, helped by lower commodity-import prices. The oil trade balance fell from -5.5 percent of GDP in 2013/14 to -4 percent of GDP in 2014/15, and further to -2 percent of GDP in 2015/16. In terms of the savings-investment balance, the improvement in the CA deficit is consistent with sluggish private investment. The CA deficit is expected to widen to about 2½ percent of GDP over the medium term on the back of strengthening domestic demand and the real rupee appreciation to date. **Assessment**. The EBA CA regression estimates a norm of -4.2 percent of GDP for India in FY2015/16. However, 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. 1/ This level is larger than the estimated underlying CA deficit of 2 percent of GDP in 2015/16. 2/ Thus, staff assess the CA gap to be in a range of –½ to +1½ percent of GDP.	
Real exchange rate	**Background**. The average REER in 2015 appreciated by about 10 percent over its 2014 average, with the appreciation pressures due in part to the terms of trade gain. As of June 2016, the REER was about 2 percent appreciated from its 2015 average. **Assessment**. The EBA Index REER and Level REER regression approaches estimate a gap of about +8 and +13 percent for the 2015 average REER, respectively. However, staff assesses the gap to be smaller, given the extent to which the appreciation reflects the positive terms of trade shock. In addition, the staff assessed CA gap implies a gap of -2.5 percent for the FY2015/16 average REER. Overall, staff assesses the REER gap to be in a range of -5 to +10 percent. 3/	
Capital and financial accounts: flows and policy measures	**Background**. India's financial account is dominated by portfolio equity and FDI flows. FDI flows as a share of GDP have been increasing since 2014/15, as the authorities have liberalized the caps on FDI in most sectors. Debt flows, particularly in the form of external commercial borrowings (ECB) by Indian corporates, have stabilized after increasing in recent years. After large net portfolio flows in 2014/15, amid easy global financial conditions, portfolio flows have been moderately negative in 2015/16. As of February 2015, all future investment by foreign portfolio investors in the debt market in India is to be made in securities with a minimum residual maturity of three years. The implementation of a gradual increase in the foreign investor quota for domestic government bonds began in October 2015. **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 would reduce vulnerabilities. In addition to the steps taken to liberalize FDI, further initiatives on creating a more conducive business environment are necessary to attract greater FDI.	
FX intervention and reserves level	**Background**. The evolution of the rupee is consistent with a floating arrangement. Foreign exchange intervention is guided by the need to limit volatility and build buffers for precautionary purposes. International reserves have been stable over 2015/16, increasing by $15 billion since April 2015 to reach $360 billion as at end-May 2016. Reserve coverage currently stands at about 17.5 percent of GDP, and about 8.5 months of prospective goods and services imports, an increase from 8 months a year earlier. **Assessment**. Reserve levels are adequate for precautionary purposes. International reserves represent 180 percent of short-term debt and 151 percent of the IMF's composite metric. 4/	

	India (continued)
Technical Background Notes	1/ See IMF (2014), *India: Staff Report for 2014 Article IV Consultation*, IMF Country Report No. 14/57 and IMF (2016), *India: Staff Report for the 2016 Article IV Consultation*, IMF Country Report No. 16/75 for additional model-based estimates and description of the CA deficit norm in India. 2/ The estimated underlying CA here incorporates the EBA-estimated cyclical adjustment and also takes account of the temporary impact of higher tariffs on gold imports as well as the temporary part of the recent terms of trade gain (about ½ of one percent of GDP). 3/ 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. 4/ 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 previously 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 2015, Indonesia's net international investment position (NIIP) position stood at -43¼ percent of GDP, same as at end 2014, mainly reflecting the rupiah's depreciation which had lowered GDP in U.S. dollar terms. Significant declines in net portfolio equity and net FDI inflows more than offset stronger net portfolio debt inflows in 2015, resulting in an improvement in the NIIP. At end 2015, gross external liabilities stood at 69 percent of GDP (up from 67 percent of GDP at end 2014). Indonesia's gross external debt is moderate at about 36 percent of GDP, with about 5 percent of GDP denominated in rupiah as of end 2015. **Assessment**. The level and composition of the NIIP and gross external debt indicate that Indonesia's external position is sustainable, but non-resident holdings of rupiah debt could be affected by global volatility. Public external debt may increase above the current baseline if the government increases reliance on external financing (including multilateral loans) to help fund infrastructure projects. With the exception of borrowing by SOEs, which may also be used for infrastructure development, the growth in private external debt is expected to slow owing mainly to a tightening in global financial conditions.	**Overall Assessment** *In 2015, Indonesia's external position was assessed to be broadly consistent with medium-term fundamentals and desirable policy settings*. Recent appreciation of the REER is not significant enough to change the assessment. Policy actions since mid-2013 (monetary policy tightening, fuel subsidy reform, exchange rate and bond yield flexibility) have helped improve the external position. External financing appears sustainable, but could be affected by domestic or external shocks. **Potential Policy Responses** Monetary policy should continue to focus on containing inflation within Bank Indonesia's target band. Fiscal policy can help support external adjustment and contain vulnerability to funding pressures by aiming for a small primary deficit over the medium term, led by reforms aimed at increasing the tax take, while providing space for health spending and increased infrastructure spending to help ease supply bottlenecks. Continued flexibility of the exchange rate and use of market-determined interest rates would also help facilitate adjustment and absorb shocks. Easing trade and investment restrictions, deepening financial markets, and improving labor markets would also help promote growth and strengthen competitiveness over the medium term.
Current account	**Background**. Despite a decline in commodity exports, Indonesia's CA deficit improved to 2.1 percent of GDP in 2015 from 3.1 percent in 2014, mainly from merchandise import compression due to cyclical weakness in the domestic economy and sharply lower oil prices. The oil and gas trade balance was -0.8 percent of GDP and the non-oil and gas trade balance 2.1 percent of GDP. The services and income balances remain at -1 and -2.6 percent of GDP, respectively, more or less unchanged from the year before. In 2016, a further decline in commodity prices and weak trading partner demand for commodity exports are expected to offset the benefits of lower oil prices and exchange rate depreciation. Over the medium term, a moderate increase in the CA deficit is expected from lower energy and mining exports, as well as a rise in capital goods and raw material imports tied to infrastructure investment and a pickup in domestic demand. Relatively low projected world oil prices should also help limit overall import increases. Adjustment would be supported over time by continued exchange rate flexibility and a prudent monetary and fiscal stance, in keeping with a moderate increase in domestic saving. **Assessment**. The EBA CA model suggests a gap of 0.2 percent of GDP for 2015 (based on an estimated cyclically-adjusted CA balance of -1.4 percent of GDP and a norm of -1.6 percent of GDP), smaller than -1.9 percent for 2014. Since much of the recent improvement in the current account was cyclical (particularly from substantially lower oil prices which reduced oil imports by almost 2 percent of GDP), staff believes the underlying cyclically-adjusted current account balance is around -1.9 percent of GDP for 2015. 1/ In the same vein, the EBA cyclically-adjusted CA norm estimate may not capture the effect of declines in commodity prices fully, and staff adjusted the mid-point of the norm to -2.0 percent. Taking uncertainties and Indonesia's investment needs into account, staff believes a norm of -1.0 to -3.0 percent of GDP is appropriate. 2/ This suggests that the CA gap range of about -0.5 to 1.5 percent of GDP for 2015, which reflects the domestic policy gaps including in social spending and policy gaps (particularly fiscal deficits) in partner countries.	
Real exchange rate	**Background**. Compared to the 2014 average, the REER appreciated by 3 percent in 2015, a result of a temporary increase in inflation related to the reduction in domestic fuel price subsidies. As of June 2016, the REER has appreciated an additional 2 percent relative to its average level in 2015. **Assessment**. EBA level and index REER results suggest the REER gap to be about -5.6 and -6.2 percent, respectively. Consistent with the EBA REER estimates and the CA assessment, using standard trade elasticities staff assesses the REER gap to be in the range of -7.5 percent to 2.5 percent in 2015.	
Capital and financial accounts: flows and policy measures	**Background**. Indonesia's gross external financing requirement is expected to be about 9 percent of GDP in 2015, with amortization at about 7 percent of GDP. Net FDI and new borrowing are projected at 1.4 percent and 7.8 percent of GDP, respectively. **Assessment**. Net and gross financial flows appear sustainable, but could dissipate or reverse in the event of large domestic or external shocks. 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. As of end-2015, reserves were US$105.9 billion (equal to 119 percent of IMF's reserve adequacy metric—assuming a floating exchange rate—and about 7½ months of prospective imports of goods and services). In addition, the authorities have in place contingencies and swap lines amounting to about US$70 billion. **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 should be sufficient to absorb most shocks, with predetermined drains also manageable. Intervention should aim primarily at smoothing volatility, while allowing the exchange rate to adjust to external shocks.	

	Indonesia (continued)
Technical Background Notes	1/ The commodity shares used by the EBA in commodity terms of trade gap estimate for Indonesia has not fully reflected the rising share of oil in commodity imports. Therefore, a recent sharp oil price decline means the commodity terms of trade may be less than the EBA implies due to positive changes to the oil terms of trade, indicating a slightly larger improvement (about 0.3 percent of GDP) in the current account than warranted from a cyclical perspective in 2015. 2/ Making the same commodity terms of trade adjustment of 0.3 percent of GDP, staff estimates the cyclically adjusted CA norm at -1.8 percent of GDP, to which a range of +/- 1 percent is added to reflect uncertainty.

<table>
<tr><th></th><th>Italy</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Italy's net international investment position (NIIP) has deteriorated significantly since joining the Euro area, with net liabilities of 24 percent of GDP (December 2015) as compared with 7 percent at end 2000, reflecting mainly current account deficits and valuation adjustments. Gross assets and liabilities grew steadily during this period, reaching 144 and 169 percent of GDP respectively, 47 and 64 percentage points higher than in 2000. 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. Looking forward, modest current account surpluses forecast over the medium term should gradually shrink Italy's net liability position as a share of GDP.
Assessment. In light of the current account's shift into a surplus, overall external sustainability is not a major concern. Nonetheless, further strengthening of balance sheets is desirable, as Italy is vulnerable to financial contagion given its large stock of government debt.</td><td rowspan="5">Overall Assessment
The external position in 2015 was broadly consistent but likely still weaker than suggested by medium-term fundamentals and desirable policy settings.
While there was an improvement in 2015 on price-based competitiveness indicators, 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 modest weakening of the real effective exchange rate from average 2015 levels. The recent small appreciation of the REER does not alter the overall assessment for 2015.

Potential Policy Responses
Continued implementation of structural reforms as well as efforts to strengthen bank balance sheets will be critical to improving competitiveness and boosting potential growth. Further progress in medium-term fiscal consolidation will also help improve competitiveness and maintain investor confidence. Combined, these measures will support growth and employment over the medium term.</td></tr>
<tr><td>Current account</td><td>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 2015, it registered a surplus of 2.2 percent of GDP (as compared to 1.9 percent of GDP in 2014). The improvement in the current account is mainly driven by Italy's growing trade surplus, which reached 3.2 percent of GDP in 2015. 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. Despite the recent improvement in the current account, the EBA model suggests that the cyclically-adjusted level, which stood at 1.1 percent of GDP in 2015, was about 1.8 percent of GDP below the norm implied by medium-term fundamentals and desirable policy settings. 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 gap of -2 to 0 percent of GDP for 2015.</td></tr>
<tr><td>Real exchange rate</td><td>Background. Stagnant productivity and rising labor costs had led to a gradual appreciation of the real effective exchange rate (REER) since Italy's joining 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). In 2015, the fall in the value of the euro contributed to a sizable depreciation of the REER, bringing its value close to 1999 levels. 1/ As of June 2016, the REER has appreciated 1 percent over its 2015 average.
Assessment. The EBA methodologies provide a relatively wide range of REER gap estimates in 2015. The REER regression methods suggest an overvaluation of 0.8 percent (EBA Level REER model) and –0.4 percent (EBA Index REER model) in 2015. The CA regression method yields an overvaluation of about 7 percent. On balance, and consistent with the staff assessment of the CA in 2015, staff assesses that a modest real effective depreciation of 0–10 percent would support further adjustment and address economic imbalances over the medium term.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>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 2 percent of GDP in 2015, largely reflecting residents' net purchases of foreign assets, even as foreign investment in Italian portfolio securities continued. TARGET2 liabilities, accumulated by banks over 2011-12, widened in 2015, reflecting the creation of liquidity by the Bank of Italy within the framework of the Eurosystem's asset purchase program.
Assessment. While supported by QE, 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.</td></tr>
<tr><td>FX intervention and reserves level</td><td>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.</td></tr>
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	Italy (continued)
Technical Background Notes	1/ Depending on the measure used, Italy's REER depreciated by 3-10 percent between 2014 and 2015 (year average on year average).

	Japan	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) position has doubled in the last ten years to close to 70 percent of GDP in 2015 (assets: 190 percent; liabilities: 122 percent). In the medium term it is projected to rise close to 75 percent with higher 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 35 percent of total). Assets are diversified geographically and by risk classes. The NIIP generates net annual investment income at around 4 percent of GDP, keeping the current account balance positive amid a narrowing trade surplus.	**Overall Assessment** *The 2015 external position was moderately stronger than the level consistent with medium-term fundamentals and desirable policies.* Japan's external position has strengthened moderately relative to 2014, reflecting the reduction in its oil import bill, the REER depreciation, and some pickup in exports. The REER appreciation compared to the average of 2015 has moved the REER towards a level consistent with medium-term fundamentals while it may undermine the effort to lower deflation risks. Going forward, continued easing by the BoJ while the US tightens, combined with the lack of bolder structural reforms and the absence of a credible and specific medium-term fiscal consolidation plan, could further strengthen the external position. **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, without overreliance on yen depreciation, and help prevent the external position from moving out of line with fundamentals over the medium term.
Current account	**Background**. The 2015 CA increased to about 3⅓ percent of GDP from 0.8 percent of GDP in 2014, due to a significant decline in the energy import bill (by about 2 percent of GDP) and an improvement in the services balance reflecting higher tourism receipts (by ⅓ percent of GDP). Exports of goods increased by 0.9 percent in volume terms, despite the slowdown in global trade, which reflects strength in the transportation equipment sector driven by a combination of modest recovery in advanced economies, moving of production onshore and the release of new models. Import volumes were weak, with goods imports declining by 1.1 percent. **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 2015 cyclically-adjusted CA at 2.8 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 get an underlying, cyclically-adjusted CA of 3.1 percent of GDP. 1/ - EBA estimates the 2015 CA norm at 3.4 percent of GDP. Staff adjusts this estimate to account for factors not captured by EBA - structurally lower exports reflecting production off-shoring and permanently higher domestic demand and imports under structural reforms that would be implemented under complete Abenomics—to get a norm of 1.4-2.7 percent of GDP. 2/ The underlying CA in 2015 is therefore assessed to be 0.4-1.7 percent of GDP higher than the norm, and moderately stronger than the level consistent with desirable policies and medium-term fundamentals. 3/ The 2016 surplus is expected to rise to about 3.5 percent of GDP under the current policy mix and due to lower oil prices. 4/	
Real exchange rate	**Background**. The real effective exchange rate (REER) depreciated 6.7 percent between 2014 and 2015, reflecting expansion of monetary easing in Japan and policy normalization in the US. As of June 2016, the REER has appreciated 15 percent relative to its 2015 average, reflecting the safe-haven status of Yen amid heightened risk aversion and the narrowing of the interest rate differential relative to the US due to expectations of a more gradual increase in US interest rates, and despite the introduction of negative rates on marginal excess reserves in Japan. **Assessment**. The EBA REER Level model estimates the 2015 average REER to be 27 percent weaker (EBA Index REER model: 33 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, temporary speculative short positions against the yen, and the shock requiring higher energy imports - are also not included. Because of these missing factors, the EBA REER model is not used in Japan's assessment. Instead, using the staff-assessed CA gap range as reference, staff assesses a 2015 REER gap midpoint of -11 percent with an indicative range of -4 to -17 percent.	
Capital and financial accounts: flows and policy measures	**Background**. There has been a pick-up in portfolio outflows as institutional investors have begun to diversify overseas, while FDI outflows also increased. Net short yen positions have eased from their extreme highs of last year and have recently turned into net long yen positions, which could be a driver of the recent 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 QQE to domestic 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 30 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 factors that temporarily reduced the CA. Those factors were delayed J-curve effects, regional tensions and higher reliance on energy imports after the 2011 earthquake. This year the effects of these factors have dissipated except higher fuel imports. In fact, part of the increase in Japan's CA balance can be attributed to these factors dissipating. Furthermore, staff adjusted the impact of elevated energy imports down 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 and favorable return differential on assets relative to liabilities. Staff makes two downward adjustments to the EBA CA norm: 1) Adjustment to account for the structurally lower exports due to production off-shoring; 2) Adjustment to capture structural policies under complete Abenomics that would permanently raise domestic demand and imports. Although fiscal and monetary policies are captured in EBA, desirable structural policies that would lift domestic demand are not. 3/ The uncertainty in the CA gap results from (i) hard-to-quantify implications of Abenomics policies for the norm; and (ii) uncertain effects of structural changes—higher off-shoring, reduced competitiveness of some tradable sectors—on the trade balance. 4/ The energy balance deficit is projected to decline from 3.2 percent of GDP in 2015 to 2.5 percent in 2016.

<table>
<tr><th></th><th>Korea</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Korea’s net international investment position (NIIP) increased to 14½ percent of GDP in 2015, after turning positive for the first time in 2014. This position is expected to strengthen further to 19½ percent of GDP in 2016 as the current account is in strong surplus. The net external debt position was -23½ percent of GDP in 2015. Banks’ short-term external debt remains below pre-crisis levels. The risk of currency mismatch in the non-financial sector is also limited, since the bulk of short-term external debt is in the hands of exporters who hedge using forward contracts.
Assessment. The NIIP position and dynamics present little risk to external sustainability.</td><td rowspan="5">Overall Assessment
The external position in 2015 was substantially stronger than that implied by medium-term fundamentals and desirable policies.
Developments as of June 2016 point to a broadly similar external position in 2016. This assessment is subject to uncertainty related to the persistence of the large fall in oil prices—Korea being one of the largest oil importers in the ESR—and the sharp movements of relevant cross rates.

Potential Policy Responses
Building domestic demand growth momentum in the near term could have some impact on reducing imbalances, and the recent monetary, fiscal, and other policy steps to boost domestic demand are steps in the right direction. A more durable reduction will require a steady shift away from Korea’s heavy reliance on manufacturing exports for growth—increasing productivity in the non-traded sector, aided by structural reforms (particularly those focused on the labor market), would help. The authorities’ more expansionary fiscal policy stance, both this year and over the medium term, could narrow imbalances, all the more so if coupled with an expanded social safety net that reduces the need for precautionary savings. Real exchange rate appreciation over time should also play a role, and the rate should remain market determined with intervention limited to smoothing excessive volatility.</td></tr>
<tr><td>Current account</td><td>Background. The current account (CA) in 2015 was around 7¾ percent, 1½ p.p. higher than in 2014 and significantly above the average over the last 5 years. This increase is fully explained by cyclical factors such as more favorable terms-of-trade (in particular, lower oil prices) and a larger negative output gap, which are expected to revert somewhat in 2016 leading to a slight decline in the CA. The CA is expected to decline moderately over the medium term as the output gap narrows and, especially, as the projected rapid aging of the population sets in.
Assessment. The EBA regression model puts the cyclically adjusted CA norm for 2015 at just above 1¼ percent, implying a CA gap of about 6 percentage points of GDP. A small part of this estimated gap could be accounted for by relatively low public social spending in Korea and the fiscal policy gaps of other countries, but there are also important Korea-specific factors not fully captured by the model’s variables - these include prospective costs of reunification with North Korea, demographic factors, and certain BOP accounting anomalies - all of which may result in higher-than-expected savings. Accounting for these considerations, staff assess the 2015 current account gap at 1¾ to 4¼ percent of GDP. 1/</td></tr>
<tr><td>Real exchange rate</td><td>Background. The won has been on a gradual appreciating trend on a trade-weighted basis since 2012, having appreciated by 1½ percent in 2015 relative to its 2014 average. (This, however, masks important movements in cross rates—in particular, the won depreciated against both the U.S. dollar and the yen, but strengthened vis-à-vis the euro and most emerging market currencies.) The REER as of June 2016 has depreciated by 4 percent from its 2015 average.
Assessment. EBA’s REER regressions suggest a wide range of estimated gaps. According to the index model, the won is stronger than fundamentals and desired policies, by 1½ percent, whereas the level model estimates the won to be substantially weaker, by 14¼ percent. The REER for 2015 is assessed to be 4 to 12 percent weaker than the level consistent with fundamentals and desired policies. The assessed range uses as inputs EBA’s level model and estimated elasticities (top of the range), as well as staff’s estimated elasticity (bottom of the range). 2/</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. Net capital outflows increased to 8 percent of GDP in 2015, driven chiefly by a decrease of portfolio investments of non-residents in Korea in 2014. The Korean government launched a plan to promote both residents’ overseas investment and to attract inflows from nonresidents in mid-2015.
Assessment. Korea has experienced moderate bouts of capital-flow volatility in the past year, but net and gross flows appear sustainable.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. Korea has a floating exchange rate. Reserves increased steadily from 2009 through mid-2014 but have since remained stable at around 121 percent of the IMF’s composite reserve adequacy metric. In dollar terms, reserves increased by $4 billion in 2015.
Assessment. Intervention should be limited to smoothing excessive volatility. The stock of reserves should be sufficient to buffer against a range of possible external shocks.</td></tr>
</table>

	Korea (continued)
Technical Background Notes	1/ **Current Account**. EBA estimates that Korea's cyclically adjusted CA remained roughly unchanged from 2014 at 7 percent, while the EBA norm stood at 1.3 percent. The resulting EBA gap of 5.7 percent is, for the most part, unexplained by the EBA model (4 percent), while the remaining 1½ percent can be attributed to policy gaps. The assessed CA gap range of 1¾ to 4¼ percent of GDP takes into account Korea-specific factors not in EBA, namely it accounts for precautionary savings tied to prospective reunification with North Korea, demographic factors—Korea is undergoing rapid population aging while having a disproportionate share of its population in prime saving ages (see Kwon, Kyooho (2015), "Impact of Demographic Changes on the Current Account," KDI working paper)—and adjustments to the treatment of foreigners' share of retained earnings in BPM6. 2/ **REER**. Staff's assessment of the REER gap is subject to a high degree of uncertainty related to both the difficulty in predicting when and by how much Korea's exports will respond to exchange rate movements, as well as the diversity of estimates produced by the EBA's exchange rate regression models. Staff analysis suggests that Korean export volumes have become highly inelastic to exchange rate movements in the short run, and where the longer term implications of the won's recent real appreciation are particularly difficult to project.

	Malaysia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The international investment position (NIIP) rose to a net asset position of about 8½ percent of GDP in 2015, improving for two consecutive years from a net liability position of about 4½ percent of GDP in 2013 on the back of capital outflows and valuation effects. Total external debt was about 65½ percent of GDP (2014: 63 percent of GDP), of which 64 percent were in foreign currency. Short-term debt accounted for 42 percent of the total external debt (2011-14 average: 48.3 percent), as nonresident holdings of central bank bills declined since late 2014. 1/ **Assessment**. The NIIP has strengthened and is expected to rise further in the medium term reflecting projected current account (CA) surpluses. The country has a large institutional investor base that has behaved counter-cyclically in past episodes of outflows.	**Overall Assessment** *The external position in 2015 was stronger than that consistent with medium-term fundamentals and desirable policy settings.* The modest appreciation of the REER between December 2015 and June 2016 does not change this assessment. An adverse terms-of-trade effect contributed to a softening of the external position in 2015. The depreciation of the currency helped boost export volumes in 2015, partially offsetting the negative terms-of-trade shock. **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. Looking ahead, over the medium term, increased public sector saving, as the Federal Government consolidates its Budget, will be offset by sustained private consumption and investment and is expected to result in a current account surplus of 1½ -2 percent of GDP, further narrowing the gap with the norm. Staff views policy gaps as reflecting high precautionary savings and further need for investment facilitation (notwithstanding recent increases in the investment ratio). It would be useful to continue to improve social protection and the risk sharing characteristics of the pension system; increase private investment, including in physical infrastructure; and address labor force skill mismatches and rigidities in the labor market. Consistent with the authorities' intentions, stronger social safety nets and efforts to further boost private investment would help to further moderate the current account surplus.
Current account	**Background**. Malaysia's CA surplus has declined by 8 percentage points since 2011 to 3 percent of GDP in 2015 (2014: 4.3 percent of GDP), following the emergence of a deficit in the nonoil and gas trade balance on the back of a rise in investment (which bodes well for medium-term growth), and a decline in national saving. In 2015, depreciation of the currency helped boost exports volume, including in oil and gas, but a stronger impact from a negative terms-of-trade on oil and gas exports led to a drop in the CA surplus. In 2016, the CA surplus is projected to decline further to 2.1 percent of GDP, primarily reflecting the negative price impact on the oil-and-gas trade balance, while the nonoil-and-gas balance is expected to improve on the back of a softening in domestic demand. **Assessment**. The EBA CA regression approach estimates that the cyclically-adjusted CA is stronger (by about 3½ percent of GDP) than consistent with fundamentals and desirable policies. The estimated policy gap was about zero and the rest was accounted for by a regression residual requiring interpretation. In the EBA CA regression, Malaysia's CA is consistently underestimated across time, reflecting country-specific structural factors that are not well captured, for example, insufficient social safety nets (not fully captured by public health spending) and structurally low investment since the Asian financial crisis. It is difficult to separate the above factors into slow-moving structural ones (that are given in the short run and add to the gap) and controllable policy variables that explain the gap. Taking these factors and the uncertainty surrounding the model estimates into account, staff assesses the norm to be 1.8 percent of GDP and the CA gap to be 2.3 percent of GDP (plus or minus 1 percent of GDP) in 2015.	
Real exchange rate	**Background**. The average real effective exchange rate (REER) depreciated by 8 percent in 2015 relative to its 2014 average. 2/ As of June 2016, the REER had appreciated since its end-2015 level, but is about 3 percent weaker than its 2015 average. **Assessment**. The EBA REER index regression estimates Malaysia's REER to be 31 percent below levels warranted by fundamentals and desirable policies. The analysis of the level REER provides an estimate of 25 percent undervaluation. Based on staff's assessment of the CA gap and the semi-elasticity of the current account with respect to the REER, the REER gap for 2015 is estimated to be 8 percent (plus or minus 5 percent) 3/.	
Capital and financial accounts: flows and policy measures	**Background**. Malaysia has typically recorded net capital outflows. Net foreign direct investment (FDI) flows are generally small as gross FDI outflows are large, reflecting the growing importance of Malaysia as a direct investor abroad. However, the pace of FDI investment abroad slowed down in 2015. Net total capital outflows increased in 2014 and 2015, though at a slower pace in 2015, amidst global uncertainty and domestic political concerns. Over the medium term, Malaysia is expected to receive net inflows, supported in part by further slowdown in outbound FDI. **Assessment**. The authorities should continue to liberalize FX administration, including via greater flexibility for resident companies to undertake FDI abroad and obtain loans from related resident and nonresident companies.	
FX intervention and reserves level	**Background**. Substantial capital outflows and a sharp drop in oil prices during 2014-15 put considerable pressure on the ringgit. Intervention by Bank Negara Malaysia (BNM) was significant, employing reserves accumulated during the capital inflow surges over 2010-13. BNM sought to avoid ringgit overshooting, ensure orderly adjustment to a more depreciated exchange rate, and maintain orderly market conditions. Official reserves declined by nearly US$ 37 billion (about 28 percent) between August 2014 and end-2015. As of mid-June 2016, FX reserves were up by nearly US$ 2 billion from their end-December 2015 level. 4/ **Assessment**. As of end-2015 official reserves stood at 80 percent (2013: 98 percent) of the IMF's composite reserve adequacy metric (RAM), and covered 75 percent and 24 percent of short-term external debt by remaining maturity (staff estimate) and broad money, respectively. With reserves below the RAM, the authorities may gradually accumulate more reserves to bring them closer to 100 percent of the RAM.	

	Malaysia (continued)
Technical Background Notes	1/ The ratios to GDP are based on staff estimates at 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. Ringgit-denominated debt held by nonresidents, including Malaysian government securities and Bank Negara bills and notes, increased rapidly in the aftermath of the global financial crisis, but since August 2014 has declined as foreign investors largely reduced their exposures to Bank Negara bills and notes. Short-term foreign-currency denominated external debt has risen in the last few years, largely due to banking sector activity, matched by an increase in short-term external assets. 2/ Since 2000, movements in the REER have been driven almost entirely by the nominal exchange rate rather than inflation differentials. 3/ The semi-elasticity is estimated at 0.29 and takes into account Malaysia's trade openness and commodity exports. 4/ During the global financial crisis foreign reserves fell by about 28 percent between August 2008 and March 2009, but then registered a strong increase in early 2011; a decline was again recorded in August–September 2011. Gradual increases continued until mid-2013, when reserves declined. Between August 2014 and December 2015 reserves fell by nearly 28 percent.

<table>
<tr><th></th><th>Mexico</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Mexico's NIIP was -36 percent of GDP in 2015 (gross foreign assets and liabilities are 48 percent and 84 percent of GDP, respectively). Portfolio liabilities were 40 percent of GDP, of which around one third are holdings of local-currency government bonds. The ratio of NIIP to GDP is projected to rise slightly and then stabilize over the medium term.
Assessment. While the NIIP is sustainable, the large gross foreign portfolio liabilities holdings could be a source of vulnerability to global financial volatility.</td><td rowspan="5">Overall Assessment
In 2015, Mexico's external sector position was broadly consistent with medium-term fundamentals and desirable policy settings. Since mid-2015 the peso has depreciated further, partly reflecting further oil price declines. If sustained, this would imply a moderate undervaluation of the REER. The positive effects of the weaker exchange rate on the current account may materialize with a lag.
The FCL provides an added buffer against global tail risks.

Potential Policy Responses
As the external sector position is broadly consistent with medium-term fundamentals, there is no reason to alter the planned policy settings. 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 first milestone of a reduction to 4.0 percent in 2015. The consolidation relies on raising fuel excises and expenditure rationalization. Private investment is expected to rise, counteracting the impact of rising public savings on the current account. The central bank sets monetary policy to ensure that the inflation remains close to the 3 percent target. The authorities have a flexible exchange rate policy, and use foreign exchange intervention occasionally to prevent disorderly market conditions.</td></tr>
<tr><td>Current account</td><td>Background. In 2015, the current account deficit reached 2.8 percent of GDP, mostly due to a weakening of the hydrocarbon trade balance. The cyclically-adjusted current account deficit was estimated to be 2.2 percent of GDP. Over the medium term, private investment related to the structural reforms is expected to rise, matched by greater public sector savings.
Assessment. Mexico's CA appears to be broadly in line with the level consistent with medium term fundamentals and desirable policy settings. The EBA model estimates a cyclically-adjusted current account norm of -2.3 percent in 2015, implying a CA gap of 0 percent of GDP in 2015. The staff assessment is similar, with a gap between 0 and 1 percent of GDP.</td></tr>
<tr><td>Real exchange rate</td><td>Background. The 2015 REER depreciated by 9.2 percent relative to the average 2014 value. There was further depreciation since then, and in June 2016 the REER was 14 percent weaker than the 2015 average. The depreciation reflects partially the sharp appreciation of the U.S. dollar vis-à-vis most currencies and the high volatility in emerging market asset prices, and partially Mexico's weaker medium-term growth prospects. The floating exchange rate has been a key shock absorber in an unsettled global environment.
Assessment. The EBA level REER regression estimates a moderate undervaluation of 9 percent in 2015. The index approach yields higher undervaluation (19 percent). Staff puts less weight on the index approach as it has shown the peso to be persistently undervalued for the last 8 years. Considering all the estimates, and the uncertainties around them, staff assesses Mexico's real effective exchange rate to be broadly in line with the level that would be consistent with fundamentals (with a gap of 0 to -10 percent). Following the additional depreciation since mid-2015, the exchange rate appears moderately undervalued.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. During 2010-14, a large share of capital inflows has gone into purchases of locally-issued government paper and other portfolio investments. During 2015 capital inflows slowed markedly, but there have not been net outflows. Going forward, the structural reforms are expected to lead to higher FDI, while portfolio inflows are unlikely to return to the previous high growth rates.
Assessment. While the rising local currency share and long duration of sovereign debt reduce the exposure of government finances to depreciation risks, the strong presence of foreign investors leaves Mexico exposed to a reversal of capital flows and an increase in risk premiums. 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 the prudent macroeconomic policies.</td></tr>
<tr><td>FX intervention and reserves level</td><td>Background. The central bank remains committed to a floating exchange rate, using discretionary intervention to prevent disorderly market conditions.1/ The central bank usually builds up reserves through purchases of the net foreign currency proceeds of the state oil company, but at current oil prices this is minimal. Occasionally the central bank also used auctions to build up reserves as needed. In 2015, FX reserves declined to US$178 billion (15.5 percent of GDP), mostly due to FX intervention totaling US$ 24.5 billion to address disorderly market conditions.
Assessment. At 106 percent of the ARA metric and 191 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 against global tail risks.</td></tr>
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	Mexico (continued)
Technical Background Notes	1/ Rules-based intervention mechanisms were operated 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 intervention has become discretionary again, and took place so far only once. Data on intervention amounts are published weekly.

	The Netherlands	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Since 2000, the NIIP has continuously strengthened and reached 66.6 percent of GDP in 2015, up from 54.1 percent in 2014. The increase chiefly reflects large net FDI outflows and a strong other investment position as well as valuation effects on overseas holdings due to higher equity asset prices and the euro's depreciation. Over the medium term, the NIIP is expected to continue growing, given the projected sizeable current account surpluses. **Assessment**. The Netherland's safe haven status and its sizeable foreign assets limit risks from its large foreign liabilities. About half of the external liabilities are in the form of external debt.	**Overall Assessment** *The external position in 2015 was stronger than the level consistent with medium-term fundamentals and desirable policy settings.* The modest REER appreciation so far in 2016 may curb the strengthening of the external position. The Netherlands' status as a trade and financial center and natural gas exporter make an external assessment more uncertain than usual. **Potential Policy Responses** Any available fiscal space with respect to the Medium-Term Objective (MTO) should be used to increase spending on the government's priority areas (e.g., human-capital related spending) or further reducing the labor tax wedge to bolster the recovery so long as the economy remains below potential. Also, structural reforms to raise the productivity of smaller, domestic firms and progress in repairing household balance sheets and strengthening the banking system will support domestic demand and contribute to reducing external imbalances. A shift towards more productive investment as the Dutch and global economies recover will also help in the rebalancing.
Current account	**Background**. The current account (CA) has been in surplus since 1981, and is expected to reach 8.9 percent of GDP in 2016, following 9.1 percent of GDP in 2015. Declining oil and commodity prices contributed to improve the CA surplus in 2015, as the energy balance strengthened by 0.7 percent of GDP in spite of lower gas exports (-0.5 percent of GDP) due to production cuts in reaction to earthquakes in the Groningen area. The lower projected CA surplus in 2016 is explained by a higher service deficit, the lower primary income, and declining export prices in a context of low profit margins. The Dutch non-financial corporate sector accounts for a large part of the CA surpluses, given its size (it is the second-largest among EU countries as a share of GDP) and its comparatively low level of profit distribution. The large corporate savings have been used to finance substantial FDI outflows by global firms in the Netherlands. The high CA surplus also results from institutional pensions held by households, albeit offset in part by health expenditure above OECD average, and Netherland's status as a trade and financial center and natural gas exporter. Household savings have also increased as a result of deleveraging following the sharp declines in housing prices starting in mid-2008. Declining export prices in a context of low profit margins are expected to reduce the CA surplus in 2016. **Assessment**. Staff assesses that the current account gap is smaller than that estimated in the EBA model due to the following country-specific factors: (i) unlike many other advanced economies, the Netherlands has a fully funded pension system which has probably increased household saving rates above the level that households would save voluntarily 1/, and (ii) following the real estate collapse, household deleveraging has also kept saving rates high. Taking account these factors, staff assessment of the current account gap is in the range of 1-3 percent of GDP. 2/ In the medium 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. 3/	
Real exchange rate	**Background**. Both the ULC and CPI based REERs appreciated by 0.6 and 1.0 percent respectively in June 2016 relative to the average 2015, mainly due to the 1.5 percent nominal effective depreciation during the same period, primarily reflecting a 1 percent euro appreciation. **Assessment**. The EBA REER gaps estimates for 2015 are -4.9 percent and -13.9 percent respectively for the EBA index and level models. Taking into account the EBA REER results, staff assesses that the REER remained undervalued by around 5 percent within a range of 2-10 percent. The further depreciation of the euro in 2015 is likely to have increased the undervaluation of the exchange rate.	
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. **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/ A fully funded pension system is one which holds sufficient assets to pay for the full present value of the liabilities created by participants' entitlements in the event of a plan termination. Accordingly, the savings collected through a fully funded pension system with mandatory contributions proportional to incomes would be much higher than those collected through voluntary pension schemes. Thus, in the Netherlands, the absence of individual pension accounts, a conservative coverage ratio at 105 percent, and tight operating buffers tends to raise saving above what they would be otherwise. This is confirmed by the fact that self-employed persons in the Netherlands who are not covered by the Pillar II system tend to save much less in their Pillar III alternatives, suggesting that the Ricardian equivalence does not hold. 2/ The EBA-estimated CA gap in 2015 (unexplained residual plus by the contribution of identified policy gaps) was lower than that in 2014. The gap reflects a lower cyclically adjusted CA surplus (down from 9.5 percent to 8.3 percent of GDP) and a higher estimated CA norm of 5.9 percent of GDP (after 5.7 percent in 2014). 3/ 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, which are identified as Special Financial Institutions (SFIs).

	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 in 2014 and 2015 (assets at 48 percent and liabilities at 108 percent of GDP), as the valuation effects resulting from depreciation of the zloty against the USD and the Swiss Franc is offset by weaker financial inflows. The NIIP is projected to improve towards 50 percent of GDP over the medium term as nominal GDP grows faster than a moderate widening of the current account (CA) deficit, which is financed largely by non-debt creating EU fund flows. Going forward, there can be a risk of further depreciation against safe-haven currencies, resulting in valuation losses. This risk can be mitigated by potential capital inflows on the back of the ongoing ECB QE program. **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. Broadly adequate reserves and the FCL arrangement also help mitigate liquidity risks (ST debt is about 20 percent of the total) that may arise from the large negative NIIP.	**Overall Assessment** *The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policies.* The moderate depreciation of the REER in early 2016 does not change this assessment. Improvements in the CA balance in 2015 have been driven mostly by improved terms of trade and somewhat weaker non-oil import volumes. A widening of the CA deficit is expected in 2016 on the back of stronger domestic demand supported by fiscal policy easing. In addition, the REER depreciation since April 2015 was in part driven by election-related uncertainties, which are proving to be temporary. Reserves are broadly adequate, and the FCL arrangement provides an added buffer in the event of external shocks. **Potential Policy Responses** Gradual fiscal consolidation in Poland should continue, although some near-term easing might be appropriate for cyclical considerations. Vigilance with respect to bank funding (including foreign exchange swaps) is warranted including by standing ready to extend FX liquidity in the event of external shocks. The exchange rate should be allowed to play its appropriate cushioning role.
Current account	**Background.** Poland's current account deficit declined from 2 percent of GDP in 2014 to 0.2 percent of GDP in 2015, largely reflecting improved terms of trade and somewhat weaker non-oil import volume. The oil deficit declined from 3.2 percent of GDP in 2014 to 2 percent in 2015 as oil prices fell by close to 50 percent. Non-oil imports also slowed down modestly driven by lower import prices and a temporary slowing of domestic demand. In 2016, the CA deficit is projected to widen on the back of a pickup in domestic demand, supported in part by the new child benefit scheme; and despite continued improvement in the oil balance. **Assessment.** The CA level is broadly consistent with fundamentals and desirable policies. The CA approach estimates a gap between actual cyclically-adjusted CA (0 percent of GDP) and the CA norm (-0.9 percent of GDP) of around 1 percent of GDP, reflecting the sum of offsetting domestic and partners' policy gaps (a reduction in Poland's structural fiscal deficit will be needed to reduce its domestic policy gap) and a residual. The staff assessment is similar, with a CA gap range for 2015 centered on +1 (plus or minus 1) percent of GDP. 1/	
Real exchange rate	**Background.** The average real effective exchange rate (REER) depreciated by 3 percent in 2015 relative to 2014, largely reflecting nominal depreciation vis-à-vis the US dollar and the Swiss Franc. The depreciation responded to cuts in policy rates in response to deflationary pressures, as well as political uncertainties in the run-up to the elections. The REER has depreciated about 5 percent as of June 2016 relative to its end 2015 level. **Assessment.** The EBA models suggest undervaluation between 2 and 15 percent. The REER gap implied by the CA approach is -2 percent. Other approaches suggest an undervaluation between 5 and 15 percent: the ES estimate of the REER gap is -2 percent; -5 percent using the REER index and -15 percent using level REER. Due to large residuals in the REER-level regressions, we give more weight to the other approaches. Staff assesses Poland's real exchange rate in 2015 to be close to a level consistent with fundamentals and desirable policy settings with the REER gap centered around -5 percent within a range of -10 to 0.	
Capital and financial accounts: flows and policy measures	**Background.** The capital account is dominated by EU structural fund inflows. In recent years, inflows in the financial account were centered on portfolio flows (government bonds), as FDI slowed. Capital inflows remained weak in 2015, in tandem with a narrowing of the CA deficit. **Assessment.** High foreign holdings, 40 percent of total government bonds, indicate potential vulnerabilities. Pension modifications, which mechanically increased the share of foreign investors in the domestic government bond market, may exacerbate the vulnerabilities. The diversified investor base is a mitigating factor.	
FX intervention and reserves level	**Background.** Reserves have increased from USD 93 billion in 2010 to 108 billion at end-May 2016. The zloty has floated freely. **Assessment.** Reserves are broadly adequate, standing at about 107 percent of the IMF's composite reserve adequacy metric in 2015. The FCL also provides insurance against external tail risks.	

	Poland (continued)
Technical Background Notes	1/ Poland has a total current account gap (including residual) of 0.9 percent. The contribution of identified policy gaps are -0.1 percent. The domestic fiscal policy gap is -0.7 percent but is offset by fiscal gaps in trading partners that result in 0.1 percent net contribution of fiscal policies to the current account gap. The credit gaps contribute -0.2 percent to the current account gap. Health spending, capital controls and reserves contribute positively to the CA gap, offsetting the credit gap.

	Russia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) at end-September 2015 was at about 23 percent GDP (up from 6 percent in 2013), with gross assets of 89 percent of GDP and liabilities of 66 percent of GDP. Total external debt is at 37.8 percent of GDP. 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, assets should increase further, as accumulation of fiscal savings in the oil funds resumes in the medium-term. The external deleveraging since 2014 reduces risks further.	**Overall Assessment** *The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policy settings.* The structural implications of sanctions create exceptional uncertainty when assessing the external position. Relative to 2015, the REER has appreciated mildly, reflecting a pickup in oil prices and reduced idiosyncratic risks. Nevertheless, staff's view is that the REER remains near medium-term fundamentals. **Potential Policy Responses** The nonoil 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. The consolidation should be gradual to avoid undermining domestic demand. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase public saving that would be matched by both higher private and public sector investment over the medium-term.
Current account	**Background**. From 2000 to 2013, the current account (CA) surplus fell from 18 to 2 percent of GDP, despite rising oil prices, as consumption increased rapidly. A correction, however, is underway with the CA improving to 2.9 percent in 2014 and 5.0 percent in 2015. This improvement took place despite the negative terms of trade shock, as reduced oil export revenues (approximately 7 percent of GDP) was offset by falling absorption (due to the real depreciation of the ruble) and lower income payments. In the medium-term, the increase in oil prices will support gradual improvement in the CA. **Assessment**. 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, compounded now by the uncertain long-term impact of sanctions on saving-investment decisions and therefore the normative external position. 2/ Staff assesses that the 2015 CA gap was between -2 to 2 percent of GDP. 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. The REER has since depreciated 18 percent between 2014 and 2015. This reflects the impact of lower terms of trade, sanctions, and the move to a floating exchange rate regime in November 2014. The REER at end-January 2016 reached new lows as oil prices fell to their lowest level in a decade. The REER has strengthened 1 percent through June 2016 compared to its 2015 average. **Assessment**. Based on the CA gap, staff assesses that the REER was not far from medium-term fundamentals in 2015 with a REER gap of about -7 +7. 3/ The REER is now below the historical average and at the levels it was before the increases in oil prices. Nevertheless, in staff's view, the REER equilibrium could be lower should the oil price shock become permanent.	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows continued in 2015 though the pace has significantly slowed relative to 2014, as domestic confidence has resumed. External deleveraging has continued in the face of limited access to international capital markets. Nonetheless, volatile and lower 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, large international reserves provide substantial buffers and the new floating exchange rate regime will help absorb these shocks.	
FX intervention and reserves level	**Background**. Since adopting a free floating exchange rate regime, FX interventions have been limited. In May 2015, the CBR started rebuilding reserves for few months as uncertainty remained elevated. **Assessment**. International reserves stood at USD368 billion at end-2015, equivalent to 266 percent of the Fund's basic reserve adequacy metric, exceeding the adequacy minimum of 150 percent. Taking into account Russia's vulnerability to commodity shocks, the adjusted adequacy metric falls to 199 percent of the metric, remaining above the minimum adequacy threshold. A policy of small regular reserve purchases to replenish reserves could be justified by the heightened level of uncertainty related to sanctions and as a buffer given Russia's vulnerability to oil shocks. 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 EBA-estimated 2015 CA norm was 6.3 percent of GDP and the cyclically adjusted CA was 6.4 percent of GDP. The difference in the model-based gap relative to 2014 reflects both an improvement in the 2015 CA (from 2.9 percent in 2014) and an increase in the estimated current account norm (from 5 percent in 2014). The EBA estimated CA norm of 6.3 percent of GDP rests mostly on the need to save out of income from non-renewable oil exports. Staff's assessment shares this basic logic in also calling for a CA surplus for Russia but acknowledges that such saving (i.e., refraining from consumption) would not necessarily have to take a financial form and could in part take the form of productive investment spending, which could justify a somewhat lower CA surplus than the EBA-estimated norm. Sanctions and geopolitical tensions have introduced an additional level of complexity in the external assessment as they introduce exceptional uncertainty that model based estimates do not adequately account for. 3/ The EBA Level REER model suggests an undervaluation of 20 percent, and the EBA Index REER regression model an undervaluation of 23 percent. The estimates impact of commodity terms of trade may, however, be less reliable in these models as they are derived from the historical relationships, which quite significantly understate the impact of the recent large oil price shock on the REER gap.

	Saudi Arabia
Foreign asset and liability position and trajectory	**Background**. Net external assets were estimated at 109 percent of GDP at end-2015, with external assets at 154 percent of GDP and external liabilities at 45 percent of GDP. 1/ Net external assets declined by 12 percent of GDP during 2015 after increasing significantly over the previous decade. This was largely due to a decline in central bank fx reserves. Projections suggest that the NIIP-to-GDP ratio will decline further over the medium-term under the current oil price baseline and current fiscal policy settings, but would remain above 60 percent of GDP in 2021. No details are available on the composition of external assets. **Assessment**. The external balance sheet is very strong at present. Substantial accumulated assets represent both savings of the exhaustible resource revenues for future generations and protection against vulnerabilities from oil price volatility given the high reliance on oil revenues.
Current account	**Background**. Preliminary estimates suggest the current account (CA) recorded a deficit in 2015 of 8.3 percent of GDP compared to a surplus of 9.8 percent of GDP in 2014. This change largely reflected lower oil revenues (down by 14 percent of GDP) and weaker petrochemical prices. The CA deficit is projected at 6.4 percent of GDP this year, and then it narrows further as oil prices increase (to about 0.3 percent of GDP in 2021). 2/ **Assessment**. The heavy reliance on oil subjects the CA to wide swings and the assessment of its external position to considerable uncertainty. The estimated size of the CA gap varies with the methodology used and is largely driven by current fiscal policy settings being away from those seen as desirable by staff over the medium-term. The estimated gap varies from -9.8 percent of GDP using EBA-lite to -8.8 and -14.8 percent of GDP using the external sustainability (ES) approach). 3/ In line with these estimates and considerable uncertainties, staff assesses a large negative CA gap within this range of estimates. The CA gap is largely driven by the fiscal policy gap.
Real exchange rate	**Background**. The Riyal has been pegged to the U.S. dollar at a rate of 3.75 since 1986. As the U.S. dollar has appreciated, the NEER and REER have strengthened by 14 percent and 18 percent respectively since July 2014. The terms of trade fell by 43 percent in 2015 and has declined further in 2016. The REER is currently 22 percent above its average over the past decade. **Assessment**. Most exports are oil or oil-related products, and exchange rate movements have a limited impact on competitiveness. With a limited substitutability between imports and domestically-produced products, which in turn have significant imported labor and intermediate input content, exchange rate movements are expected to have a small impact on the demand for imports through the substitution channel given the very limited availability of domestically-produced goods.
Capital and financial accounts: flows and policy measures	**Background**. Inflows are dominated by FDI, while outflows are largely trade credits, accumulation of foreign assets by banks, and portfolio investment overseas. The equity market was opened to direct investment by registered foreign investors in mid-2015, but activity to date has been limited. In mid-January, SAMA instructed banks to halt the sale of foreign exchange options contracts on riyal forwards. **Assessment**. While financial outflows remained high in 2015 despite the decline in oil prices, the strong reserves position limits immediate risks or vulnerabilities associated with capital flows.
FX intervention and reserves level	**Background**. Saudi Arabia does not have a SWF. The government's foreign assets are held at the central bank within international reserves. Reserves were $609 billion (94.3 percent of GDP, 32 months of imports, and 689 percent of the IMF's reserve metric) at end-2015. Reserves fell by $115 billion during 2015. **Assessment**. Reserves play a dual role—for both precautionary motives and as savings for future generations. Reserves are more than adequate for precautionary purposes (measured by the Fund's metrics) at present. Nevertheless, a substantial fiscal adjustment is needed to help moderate the decline in reserves and support the exchange rate peg. A return to a CA surplus and the resulting NIIP accumulation will be needed over the medium-term to ensure an equitable intergenerational transfer of oil revenues.

Overall Assessment

Overall Assessment

The external position in 2015 was substantially weaker than suggested by fundamentals and desirable medium-term fiscal policy settings. Substantial fiscal adjustment is needed over the medium-term to reduce the current account deficit and support the peg.

Given the close link between the fiscal and external balance and the structure of the Saudi Arabian economy, with exports dominated by oil and oil-related products and a limited substitutability between imports and domestically produced goods, external adjustment will be driven by fiscal policy rather than the exchange rate.

The external balance sheet remains very strong at present. Despite the substantial drawdown in 2015, reserves remain very comfortable when judged against standard Fund metrics. Nevertheless, under current fiscal policy settings, reserves will continue to decline over the medium-term if oil prices stay low, and substantial fiscal adjustment is therefore needed.

Potential Policy Responses

A substantial and sustained fiscal consolidation is necessary to strengthen the CA over the medium-term and support the exchange rate peg. This consolidation is underway, but more is needed. The government should set out a credible medium-term fiscal consolidation plan based on further energy price reforms, non-oil revenue measures, and continued expenditure compression. Despite recent adjustment, the non-oil primary fiscal deficit remains significantly above the level implied by intergenerational equity models. Fiscal adjustment should be supported by reforms to strengthen the fiscal framework.

	Saudi Arabia (continued)
Technical Background Notes	1/ The NIIP may be underestimated given large errors and omissions in the balance of payments data and inconsistencies between the BoP and IIP data. Errors and omissions have exceeded 6 percent of GDP in some years and stood at 3 percent of GDP in 2015. These likely reflect either an under-recording of imports and/or financial outflows. 2/ At current oil production levels, a $1 change in the oil price results in a 0.5 percent of GDP first round change in the current account balance. Historically, the current account and fiscal balance have been closely related (correlation of 0.9 from 1995 to 2014). 3/ 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 6.5 percent of GDP and 0.5 percent of GDP under the constant real per capita annuity and constant real annuity allocation rules respectively. The norm was 1.5 percent of GDP under the EBA-lite approach. The preliminary estimate of the CA deficit in 2015 is 8.3 percent of GDP. The corresponding CA gaps are estimated at, respectively, -14.8, -8.8, and -9.8 percent of GDP. The estimated fiscal gap is -19.7 percent of GDP (constant real per capita allocation rule) and -14.6 percent of GDP (constant real annuity allocation rule), with both derived as the difference between the actual 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 210 percent of GDP at the end of 2015, about 13 percent higher than in 2014, driven by outflows in 2015. It stands at the level of 2010, but is significantly lower than the pre-GFC peak of 256 percent of GDP in 2006. Current account and growth projections imply that the NIIP to GDP ratio is likely to rise substantially 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 (438 percent of GDP at the end of 2015)—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 2015 was substantially stronger than what is consistent with medium-term fundamentals and desirable policies*. Developments in 2015; including the decline in the energy prices and lower regional trade had an important impact on the current account. The assessment for 2015 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. Since end 2015 the NEER has remained broadly unchanged, and thus assessment of the external position is unlikely to have changed. **Potential Policy Responses** Consistent with the authorities' current policies, increased public spending, a stronger social safety net, a more-even distribution of consumption across generations, helped by an expected slower absorption of foreign workers would contribute to moderate the current account over the medium term. Fiscal policy in recent years has already made progress in this direction as social spending has increased.
Current account	**Background**. The large current account (CA) surplus of 19.8 percent of GDP in 2015, up by 2.3 percent of GDP relative to 2014, reflects a strong goods balance that is somewhat offset by remittance outflows and a negative income balance. 3/ The recent oil price decline caused the oil trade deficit to narrow by 3.7 percentage points of GDP, to 1.7 percent of GDP in 2015. 4/ Amid a regional trade slowdown, weaker external demand and buoyant private and public consumption partially offset the resulting CA improvement. The recent easing of monetary policy through a slightly lower trend appreciation of the nominal effective exchange rate (NEER) band is likely to have had a limited positive effect on the current account.5/ Structural factors and policies that boost the saving rate such as financial center status, limited social safety nets, high income inequality and the rapid pace of aging combined with a defined-contribution pension scheme are the main drivers of Singapore's strong external position. Fiscal policy in recent years has increased social spending which should contribute to a lower CA surplus. **Assessment**. Singapore is a small, very open economy that has a large positive NIIP, very high per capita income and is aging at a very high speed. Such non-standard factors make a quantitative assessment of its CA subject to a wide range of uncertainty. Considering a range of estimates (based on EBA and other models) staff assesses the 2015 CA as substantially stronger than the level consistent with medium-term fundamentals and desirable policies, by 3 to 9 percent of GDP. 6/	
Real exchange rate	**Background**. The average REER has depreciated by 2 percent between in 2015 with respect to 2014. This modest depreciation followed a secular appreciation of the exchange rate which amounted to 29 percent appreciation in real effective exchange rate (REER) terms between 2004 and 2013. Since end 2015 the NEER has depreciated by 2 percent. **Assessment**. While non-standard factors make a quantitative assessment difficult, staff assesses that the real exchange rate is around 6 to 18 percent weaker than warranted by medium-term fundamentals and desirable policies. This estimate is drawn from the CA assessment and relies on a semi-elasticity of the CA with respect to the REER of about 0.5, consistent with Singapore's high level of openness. This assessment is subject to a wide range of uncertainty reflecting the uncertainty in the underlying CA assessment and the semi-elasticity of the CA 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 co-move with the global financial cycle. 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/ Inflows on account of "Other Investment, liabilities," which averaged US$50 billion per annum during the first five years after the global financial crisis turned negative in 2015 (-US$4 billion). In all, reflecting international investors' reassessment of risk across regions and asset classes and the resulting unwinding of carry trades, the capital and financial accounts in 2015 recorded the largest net outflow in at least 30 years, both in absolute terms and relative to Singapore's GDP. 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 is likely to remain 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. Singapore's official reserves declined by 9 percent (25 billion USD) 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. **Assessment**. At end 2015, official reserves covered about 26 percent of non FDI short-term external debt. However, reserves are far in excess of thresholds for other adequacy metrics. 8/ While non-standard factors warrant generous reserve buffers, current levels appear adequate and there is no case for further accumulation for precautionary purposes.	

	Singapore (continued)
Technical Background Notes	1/ Valuation changes have been an important driver of changes in the NIIP, given the large gross assets and liabilities. 2/ Singapore's official reserves amounted to about 87 percent of GDP in 2015. 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 1.7 percent of GDP in 2015. 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/ The monetary policy easing in 2015 involved two slight declines in the trend appreciation of the NEER band from an estimated 2 percent to less than 1 percent per annum, and was motivated by the deceleration of inflation amid a closing output gap and weak external demand. 6/ Non-standard factors make quantitative assessment of Singapore's external position difficult and subject to significant uncertainty. Singapore is not in the sample used to estimate the EBA models because it is an outlier along several dimensions (e.g. the NFA position, per capita income, fiscal balance and the aging speed) and nonlinearities in their impacts on the CA would not be captured in the EBA framework. That said, the EBA CA framework, appropriately adjusted for the special characteristics of Singapore, can still be informative. Applying the EBA coefficients to Singapore suggests that the CA surplus is mainly explained by the high level of productivity, the large fiscal surplus, a dummy regressor for status as a financial center, and its large NFA position. The EBA-estimated CA gap is about 6.4 percent of GDP (relative to a cyclically-adjusted level of the CA of about 22 percent of GDP in 2015 and a norm of 15.6). Of that, about ¾ percentage points of GDP is identified as policy gaps (driven by the fiscal balance and public spending on health care) and the remaining 5.7 percentage point of GDP is the residual. However, that estimated CA surplus norm could be overstated, in particular if the high NFA level is interpreted as a byproduct of past excessive surpluses. The CA gap increased by 1 percentage point with respect to last year's assessment. The norm increased by 3 percentage points driven mostly by the contribution of terms of trade (1.5 percentage points) and domestic credit (0.6). The EBA-Lite model gives a very similar assessment. 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.

	South Africa
Foreign asset and liability position and trajectory	**Background**. South Africa's net international investment position shifted to 18 percent of GDP as of end-2015 from -8 percent of GDP at end-2014, driven primarily by currency depreciation. Total gross external liabilities amounted to 139 percent of GDP,[1] up from 130 percent of GDP at end-2014. Gross external debt, which rose rapidly from 26 percent in 2008, stood at 39½ percent of GDP as of end-2015, of which 14½ percent of GDP was short-term (residual maturity). **Assessment**. Large gross external liabilities, including large holdings of local-currency denominated bonds by nonresidents, pose risks. These risks are mitigated by a large external asset position, totaling 157 percent of GDP as of end-2015 (of which 40 percent are hard-to-liquidate FDI assets), and majority large share of external debt (50½ percent) being in rand.
Current account	**Background**. The current account (CA) deficit narrowed to 4.3 percent of GDP in 2015 from 5.4 percent in 2014, as a result of lower oil prices, while the trade deficit widened in volume terms. The deterioration in the trade balance in volume terms seen in 2015, however, may not be a good indication of underlying trends in the external accounts, as it was partly due to a rebound in imports from a depressed level in 2014 when protracted strikes reduced demand for intermediate and consumption imports. The CA deficit is projected to narrow slightly to 4.1 percent of GDP in 2016. **Assessment**. The CA regression model estimates a CA norm of -1.3 percent of GDP, and a CA gap of -2½ percent of GDP for 2015, down from -3½ percent of GDP in 2014. The CA gap is largely explained by the regression residual, reflecting structural factors that are not captured by the model. Staff assesses the CA to be 1½ to 2½ percentage points weaker than implied by medium-term fundamentals and desirable policy settings in 2015.[2] Addressing structural rigidities remains key to accelerate the pace of adjustment.
Real exchange rate	**Background**. The CPI- and ULC-based REERs were broadly unchanged on average in 2015, following a depreciation of about 30 percent since 2010. While the CPI-based REER has already reversed the 2009-10 appreciation, the ULC-based REER remains about 12 percent more appreciated than at end-2008. As of June 2016, the REER has weakened by about 11 percent relative to the 2015 average **Assessment**. Consistent with the assessment of the CA gap, staff assesses a REER overvaluation of 0-10 percent for 2015, down from 5-20 percent in 2014.[3] The magnitude of the REER misalignment relies on estimates of the elasticity of the CA to the REER.[4] The REER overvaluation would come down if structural rigidities currently hampering the pace of external adjustment were addressed.
Capital and financial accounts: flows and policy measures	**Background**. Net FDI declined to -1.1 percent of GDP in 2015, from -0.5 percent of GDP in 2014. Portfolio, other investment flows (mainly bank flows), and unrecorded transactions financed the CA deficit. Gross external financing needs totaled 19 percent of GDP in 2015. **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 nonresident portfolio holdings are mainly denominated in local currency, and a large domestic institutional investor base subject to capital controls.
FX intervention and reserves level	**Background**. South Africa has a floating exchange rate regime. Foreign exchange intervention is rare. Reserves cover 96 percent of gross external financing needs and over five months of imports, but are below the IMF's composite adequacy metric (at 87 percent of the metric without considering capital flow management measures, and 96 percent of it 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.

Overall Assessment

Overall Assessment

The external position in 2015 was moderately weaker than implied by desirable policy settings and medium-term fundamentals. Lower oil prices contributed to the external adjustment.

In 2015, the current account deficit gap declined. However, South Africa remains highly reliant on non-FDI flows to finance its still relatively high CA deficit. Despite the REER depreciation of recent years, structural constraints result in a slow pace of CA adjustment. High gross external liabilities and large gross external financing requirements pose risks. A reduction in capital inflows would complicate the financing of the CA deficit and, if severe, could lower growth markedly. Subsequent developments as of June 2016 point to a broadly unchanged current account position, and do not alter the assessment of the external position.

Potential Policy Responses

Structural reforms are key to accelerate the external adjustment and boost domestic savings. Implementation of the authorities' National Development Plan, especially upgrades in infrastructure and education/skills, would help improve competitiveness over the medium term and increase employment and savings, but reducing policy uncertainty and additional labor and product market reforms are also essential.

Fiscal consolidation will help reduce the current account deficit and alleviate external vulnerabilities. A build-up of reserves would strengthen the country's ability to deal with FX liquidity shocks.

	South Africa (continued)
Technical Background Notes	1/ Of the 139 percent of GDP in total external liabilities as of end-2015, 47 percent were portfolio investment liabilities, 35 percent were direct investments, and the remainder 18 percent were financial derivatives and other investments. Total external assets amounted to 157 percent of GDP as of end-2015, of which 40 percent were direct investments, 36 percent were portfolio investment assets, 11 percent were reserve assets, and the remainder 13 percent were financial derivatives and other investment assets. 2/ The CA gap presented here results from the CA regression approach and the External Sustainability (ES) approach. 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 (-33 percent of GDP). According to this approach, to stabilize South Africa's net IIP at the peers' level, South Africa's CA deficit would need to be 1½ percent of GDP, compared to staff's projection of an adjusted CA deficit of about 2.8 percent of GDP over the medium term, thus resulting in a CA gap of about -1.3 percent of GDP. The CA regression approach yields a gap for 2014 of -2½ percent of GDP. Hence, the staff's gap range for 2015 is centered on -2 percent of GDP. 3/ The EBA REER regressions (which use the CPI-based REER) point to undervaluation for 2015. The EBA REER Index regression gives an undervaluation of 23 percent, while the REER Level regression estimates an undervaluation of 7 percent for 2015. Gauging the appropriate REER for South Africa is challenging due to its structural changes since 1994 and high REER volatility. The history of South Africa's REER divides roughly into two periods and levels: before 2000 the average level was much higher than the post-2000 average. Moreover, the REER has fallen steeply over the last several years. In this context, REER regression-based models that use CPI-based REERs are very likely to point to undervaluation, unless they can link the full downward trend of the REER to deteriorating fundamentals. Also, the sensitivity of trade flows to the exchange rate movements appears lower than implied by long-run elasticities, as structural impediments, including electricity shortages, prolonged strikes, and concentrated product markets, hamper adjustment. It appears that the level of the REER that is consistent with a given level of the current account has declined over time, but 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's exports, suggest overvaluation. 4/ Using the CA gap range and applying a long-run elasticity estimate would suggest a REER overvaluation of about 5-8 percent. However, considering the uncertainty regarding the elasticity, possible lags for REER adjustment to have effects on the current account balance, and signs that some volume adjustment is in train, staff assesses REER overvaluation in the order of 0 to10 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 –90.5 percent at end-2015 which is 5 percentage point lower than in 2014. Gross external debt is still high, around 168 percent of GDP. **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 with an average of 6½ years and current ECB measures such as QE	**Overall Assessment** *The external position in 2015 was substantially weaker than that consistent with medium-term fundamentals and desirable policy settings.* In 2016, the CA is projected to continue to gradually improve, helped by lower oil import price and low interest rates. Despite the strong improvement in the CA since the pre-crisis peak deficit in 2007, achieving both a sufficiently declining NIIP and much lower 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 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 easing 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 2013-15. In 2015, the CA surplus widened slightly to 1.4 percent of GDP (or 0.3 percent of GDP cyclically adjusted). 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**. While the EBA model-based estimates would suggest a CA norm for 2015 (0.6 percent of GDP) close to the observed cyclically adjusted CA (0.3 percent of GDP), the staff assessment considers the overriding need to sharply improve the NIIP and gauges the CA norm to remain in the range of 0-2 percent of GDP. This implies that the cyclically adjusted CA was about 0 to 1½ percent of GDP weaker than desirable. Surpluses of this magnitude will need to be maintained until the NIIP is at a safer and sustainable level. Under staff's current forecast, a gradually improving CA will strengthen the NIIP by about 4-5 percent of GDP annually in the medium term. Reducing the still sizable structural fiscal deficit will be a key policy requirement to lower the remaining imbalances.	
Real exchange rate	**Background**. In 2015 the CPI-based real effective exchange rate (REER) declined by nearly 5 percent from its average 2014 level and by about 8 percent from its 2009 peak. This partially reversed the 17 percent appreciation from the euro entry in 1999 until 2009. The ULC-based REER, however, shows the appreciation has been substantially reversed since euro entry, initially as a result of substantial labor shedding, and more recently, of wage moderation **Assessment**. The two EBA REER regression model approaches, the index and level REER tools, estimate an overvaluation of 8.8 and 2.2 percent for 2015, 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 2015 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 ease, with sovereign bond yields near historical lows. At the same time, the private sector has continued its deleveraging against the rest of the world. **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/ The EBA CA regression-based approach estimate would suggest that a broadly balanced CA (0.6 percent of GDP) would be appropriate for Spain. However, the empirically-based EBA norm is not an appropriate basis for a normative CA assessment for an economy with an extremely negative NIIP with less than 20 percent of liabilities in the form of equity. The staff assessment is thus based on higher norm level that is consistent with the overriding need to substantially strengthen the external balance sheet.

<table>
<tr><th></th><th>Sweden</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The Swedish net IIP rose by 1 percentage point in 2015 to -1.5 percent of GDP. 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 1.8 percent of GDP annually, well below the average surplus of 6.7 percent of GDP. This gap may in part reflect negative valuation effects, but may also reflect some overstatement of the surplus as discussed below. Hence it is appropriate to project a smaller IIP rise than the cumulative surplus.
Assessment. Gross liabilities were 268 percent of GDP in 2015, with more than half being external debt (178 percent of GDP). Although rollovers of external debt (which include banks' covered bonds) pose some vulnerability, risks are moderated by the banks' capital buffers, and Sweden's strong FX reserves and low public debt ensure capacity to manage pressures.</td><td rowspan="4">Overall Assessment
Sweden's external position in 2015 was moderately stronger than the level consistent with medium-term fundamentals and desirable policies. As of June 2016, 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 status as a financial center, its role as a hub for merchanting trade, and its fully funded pension schemes. Measurement issues may also overstate current account surpluses. There is an absence of obvious policy distortions affecting the current account or the exchange rate.

Potential Policy Responses
Current policies are broadly appropriate. Monetary policy is highly stimulatory, supporting strong domestic demand growth which is expected to help narrow the current account surplus modestly over the medium term. Fiscal policy is accommodating spending on migrants, making the fiscal stance expansionary in the near-term. A gradual fiscal consolidation toward the medium-term target is effectively deferred to a period when output is expected to exceed potential.</td></tr>
<tr><td>Current account</td><td>Background. The current account balance was 5.8 percent of GDP in 2015, and modestly below its average in the past decade. Over the medium term the current account is expected to gradually decline to about 5 percent in 2021, mostly reflecting a strengthening of domestic demand and appreciation of the krona as monetary policy normalizes.
Assessment. The cyclically-adjusted current account was 5.9 percent of GDP in 2015--in line with its average for the past decade -- but 7.8 percentage points above the cyclically-adjusted EBA norm estimate of -1.9 percent of GDP. However, there are no clear and substantial policy distortions impacting the current account. A number of factors may be behind the EBA estimated CA gap:
- A high saving rate, reinforced by pension and welfare reforms since the mid-1990s, including a shift to a defined contributions pension scheme and a decline in social supports.
- Structural factors: (i) Sweden is identified as a systemically important financial center for the Nordic region (with banking assets over 400 percent of GDP, of which about 170 percent of GDP in assets are outside Sweden) and (ii) the country plays a significant role in merchanting trade, contributing about 1.7 percent of GDP on average to the trade balance since 2006.
- The surplus may be overstated, with errors and omissions contributing about 2.6 percent of GDP on average to the reported surplus in the last decade.
Taking these factors into consideration, staff assesses Sweden's adjusted current account norm to be around 3 to 6 percent of GDP, implying a current account gap in the range of 0 to 3 percent of GDP in 2015.</td></tr>
<tr><td>Real exchange rate</td><td>Background. The Swedish krona depreciated 7 percent in 2015 in real effective terms relative to its average level in 2014. As of June 2016, the REER had appreciated by 2 percent compared with its 2015 average. This appears to reflect expectations for ECB policy easing and perhaps Sweden's recent strong growth led markets to expect less easy Riksbank policy in future.
Assessment. EBA estimates using the REER index and level approaches suggest a gap of -20.1 and -17 percent, respectively, for 2015. However, consistent with the assessment of the CA gap, staff assesses the krona to be undervalued by 0 to 12 percent. This REER gap is expected to be temporary, with the krona likely to appreciate once the monetary easing cycle ends.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>Background. Given their size and funding model, Sweden's large banks remain vulnerable to liquidity risk 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 aid this process.</td></tr>
</table>

	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 USD58bn in December 2015, which is equivalent to about 24 percent of short term external debt of monetary and financial institutions (primarily banks). **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, maintaining such adequate foreign currency liquidity buffers is prudent.

	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 about 95 percent of GDP and large gross foreign asset and liability positions of 667 and 571 percent of GDP, respectively, at end-2015. The NIIP to GDP ratio has declined over the last 10 years, despite CA surpluses averaging 10 percent of GDP, due to negative valuation effects and other stock-flow adjustments that have averaged -9.5 percent of GDP per year and been negative in 8 of 10 years. These persistent negative valuation effects have been driven mainly by nominal exchange rate and equity price appreciation. 1/ 2/ These negative valuation effects are projected to continue, including because inflation is projected to remain lower in Switzerland than in other AEs, and the NIIP-to-GDP ratio is projected to continue declining despite continued large CA surpluses. **Assessment**. Switzerland's large gross liabilities and the volatility of its capital flows present risks, but these are mitigated by Switzerland's large net asset position and foreign reserves.	**Overall Assessment** *The underlying external position in 2015 was moderately weaker than implied by medium-term fundamentals and desirable policy settings*. However, Switzerland's external assessment is subject to high uncertainty due to various anomalies and contrasting indicators. The modest REER depreciation in the first part of 2016 does not alter the assessment. **Potential Policy Responses** Macroeconomic policies should be geared toward promoting faster growth, exiting deflation, and avoiding imbalances. Continued monetary policy accommodation, including if necessary via purchases of foreign assets (given limited options for other methods of monetary easing) should assist these objectives.
Current account	**Background**. Switzerland tends to run large CA surpluses, which are volatile due to large temporary swings in the income balance. Preliminary estimates indicate that the CA surplus was 11.4 percent of GDP in 2015, up from 8.8 percent of GDP in 2014. The increase was mainly due to a higher income balance, with the trade balance mostly unchanged. Switzerland's terms of trade improved by less than 2 percent in 2015, with negligible effects on the CA. **Assessment**. The EBA CA regression approach estimates a CA gap of around 5 percent of GDP in 2015, reflecting a cyclically-adjusted CA surplus of 11.4 percent of GDP and an EBA CA regression-estimated norm of 6.4 percent of GDP. However, as a measure of wealth accumulation, Switzerland's CA surplus is misleadingly high due to several factors: (i) Switzerland's low inflation combined with its large net foreign-currency position, which boosts its net nominal income flows; 1/ (ii) Switzerland's negative net portfolio investment position, which results in large reductions in its NIIP due to equity price appreciation but is not captured in the CA flows; 2/ and (iii) various non-traditional flows (e.g., merchanting activities) that may be only tangentially related to the real Swiss economy. 3/ Adjusting for these effects and taking into account the negative CA gaps implied by the EBA REER models (see below), staff estimate a CA gap ranging from -4 to 2 percent of GDP. The range reflects the unusually high uncertainties related to the anomalies discussed above and the potential for large revisions to the 2015 CA estimate.	
Real exchange rate	**Background**. The REER (CPI basis) appreciated by 26 percent from 2007 to 2011. In September 2011, the SNB established a floor of 1.20 for the CHF/EUR exchange rate, and the REER depreciated by 4 percent during 2011–14. The SNB exited from the floor on January 15, 2015, and the REER immediately appreciated. For the full year 2015, the REER was 8 percent above its 2014 level. As of June 2016, the REER was 2 percent below its 2015 average. **Assessment**. The EBA REER index and level regression-based estimates suggest that the average REER in 2015 was 16-23 percent overvalued. Taking into consideration these estimates, the smaller estimates implied by staff's CA assessment, and staff's broader analysis, staff assesses the franc to be moderately above the level consistent with fundamentals and desirable policy settings in 2015 (REER gap of -5 to 25 percent).	
Capital and financial accounts: flows and policy measures	**Background**. Significant net outward FDI (mostly reinvested earnings) has been a consistent feature of the financial account in recent years, although bank lending flows have become critical since the crisis. The SNB absorbed very large safe-haven inflows (intermediated by the banking system) during 2009–12 through reserve accumulation. **Assessment**. Safe-haven capital inflows may accelerate in the event of a re-emergence of global market turmoil.	
FX intervention and reserves level	**Background**. The SNB accumulated foreign exchange reserves of about 80 percent of GDP during 2009–15 in various rounds of intervention, including to defend the CHF/EUR floor. By end-2015, the SNB's balance sheet reached 95 percent of GDP. Since the SNB exited from the floor, the franc has floated between 1.00–1.10 CHF/EUR, with the SNB intervening periodically. **Assessment**. Reserves are large relative to GDP but more moderate relative to external liabilities. Substantial reserves are explained in part by the volatility of capital flows. In recent years, interventions have been monetary policy operations aimed at avoiding persistent inflation undershooting (inflation averaged -0.5 percent during 2012-15) and given limited scope for easing via other monetary policy tools. In particular, the supply of domestic assets available for purchase is limited (the outstanding stock of federal government bonds is 12 percent of GDP), and the interest rate on central bank deposits is very low at -0.75 percent. Interventions have also helped limit exchange rate overvaluation.	

	Switzerland (continued)
Technical Background Notes	1/ Inflation in Switzerland has been, and is expected to remain, roughly 1 percentage point lower than in most other major advanced economies. Consequently, nominal returns tend to be higher on foreign-currency assets than on franc-denominated assets. This in turn boosts Switzerland's income balance given its large net foreign-currency asset position of about 400 percent of GDP. However, this is a nominal and not a real effect—the positive income flow is fully offset by a negative NIIP valuation effect due to nominal appreciation of the franc if the real exchange rate remains constant. For example, a 1 percent nominal appreciation of the franc against all other currencies (due to Swiss inflation that is 1 percentage point lower than foreign inflation) per year reduces Switzerland's NIIP by approximately 4 percent of GDP per year. 2/ Switzerland has a negative net equity portfolio position of roughly 70 percent of GDP. Most of the returns on equities are distributed via equity price appreciation (capital gains) rather than via dividends and hence are not captured via income outflows in the CA but rather via negative NIIP valuation effects. Consequently, Switzerland's CA tends to overstate the degree to which CA flows result in net wealth accumulation. For example, 5 percent equity price appreciation per year reduces Switzerland's NIIP by about 3.5 percent of GDP per year. 3/ For further discussion of non-traditional flows, see Annex 1 of the 2015 Switzerland Article IV staff report.

	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 -3 percent of GDP in 2009. Subsequently, higher foreign liabilities raised the NIIP to -23 percent of GDP in 2014. In 2015, the NIIP halved to around -11 percent of GDP due to portfolio investment outflows and subdued FDI inflows amid steadily rising outward investment by residents. **Assessment.** The deterioration of the NIIP during 2010–2014 appears to be largely due to valuation changes as, on average, the current account was in surplus. There are limited risks to external debt sustainability as Thailand's external debt is projected to remain low and net foreign liabilities (as a percent of GDP) are expected to stabilize. The improvement of the 2015 NIIP may not be auspicious as it was mainly driven by portfolio outflows and sluggish FDI. 1/	**Overall Assessment** *The external position in 2015 was stronger than warranted by medium-term fundamentals and desirable policy settings.* However, the overall assessment and the size of the 2015 CA gap are subject to a wide margin of error reflecting Thailand specific factors not sufficiently captured in the EBA model, such as political uncertainty and underdeveloped social safety nets. Developments in early-2016, including a continued surplus in the current account amid capital inflows, are not likely to change the overall assessment. **Potential Policy Responses** Accommodative macroeconomic policies and the planned boost to public infrastructure will support domestic demand and help lower the current account gap. The authorities should continue to allow the exchange rate to move flexibly as a first line of defense against external shocks. Intervention should be limited to smoothing excessive market volatility. Reserves exceed all adequacy metrics, thus there is no need to build up reserves for precautionary purposes. The authorities should reform social safety nets, notably the fragmented health insurance and pension schemes compounded by widespread informality.
Current account	**Background**. Thailand's current account (CA) has been volatile over the last decade, ranging from a 4 percent of GDP deficit in 2005 to a 7¼ percent of GDP surplus in 2009, against a broadly stable trend real appreciation. The current account surplus came down from its peak in 2009 to a deficit of 1¼ percent of GDP in 2013 and rose back to a surplus of 8 percent of GDP in 2015, with imports declining faster than exports amid record low oil prices. The decline in net oil imports between 2014 and 2015 was 2.6 percent of GDP, explaining more than half of the improvement in the CA. **Assessment**. In cyclically-adjusted terms, the EBA CA model estimated the 2015 CA at 7.6 percent of GDP and the CA norm at 1.3 percent of GDP. The CA gap of 6.3 percent of GDP consists of a policy gap of 1.5 percent of GDP, of which 0.7 percent of GDP corresponds to domestic policy gaps, and an unexplained residual of 4.8 percent of GDP. The large unexplained residual is likely due to Thailand-specific factors not well captured by the EBA model, including political uncertainty weighing on domestic demand and underdeveloped social safety nets, particularly pensions for informal workers. Considering these factors, staff assesses the CA gap within 1½ to 3½ percent of GDP of the level consistent with medium-term fundamentals and appropriate policies. 2/ The CA gap is expected to narrow over the medium term, as policy stimulus is deployed and private confidence recovers.	
Real exchange rate	**Background.** Barring the global financial crisis, the Thai baht has been appreciating in real effective terms since 2005. The real effective exchange rate (REER) weakened during the Fed's tapering talk in mid-2013 and started to appreciate from mid-2014. During 2015, the REER appreciated by 2.5 percent on average, while the CA surplus increased. The null contribution of REER appreciation to narrowing the CA gap was likely due to the Thailand-specific factors outlined above, weak domestic demand and imports, the build-up of global value chains, and volatile capital flows. As of June 2016, the REER was 5 percent lower than its average 2015 level. **Assessment**. The EBA index REER gap in 2015 is estimated at -2.9 percent; the EBA level REER gap is estimated at -11.6 percent, but with a large unexplained residual. Using an elasticity of 0.6, staff assesses the 2015 REER to be 2.5-6 percent below levels consistent with medium-term fundamentals and appropriate policies.	
Capital and financial accounts: flows and policy measures	**Background**. The capital and financial account balance has been negative since 2013. In 2015, the negative balance increased to $18 billion due to portfolio outflows in both equity and bond markets and subdued FDI 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 resilience of the external sector and the flexibility of the baht, partially offsetting the large current account surplus.	
FX intervention and reserves level	**Background**. The exchange rate is floating with intervention limited to mitigating excessive volatility. International reserves gradually declined from 52 percent of GDP in 2012 to 43 percent of GDP in 2015, but stand at over three times short-term debt, 205 percent of the IMF's reserve metric unadjusted for capital controls, and 244 percent of the metric adjusted for capital controls.3/During 2015, reserves declined by around $12 billion, mostly from the net forward position amid persistent depreciation pressures against the U.S. dollar. **Assessment.** The decline in reserves suggests possible intervention to mitigate market volatility, but there is no clear evidence of one-sided intervention considering valuation effects from the strong U.S. dollar. Thailand's gross 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 continue to move flexibly to serve as a first line of defense against adverse shocks.	

	Thailand (continued)
Technical Background Notes	1/ The valuation effect results from the difference in returns between foreign assets and liabilities. On the one hand, large capital inflows in most years in the period 2005-2012 contributed to the growth of asset prices and baht appreciation. As a result, investment returns accruing to foreign investors increased. On the other hand, a large proportion of Thailand international investment assets consist of foreign exchange reserves, which were mainly invested in foreign government bonds with lower return. 2/ The EBA model has a large (and rising since 2013) unexplained residual for Thailand, likely driven by political uncertainty not captured by available institutional quality indices and measures of global risk aversion. During 2015, political uncertainty and associated weak private sector confidence weighed on domestic demand against the backdrop of high household debt and a cautious adjustment to the sizable oil windfall. Political uncertainty, compounded by prolonged discussions with potential investors, also led to delays in the execution of large public investment projects, with public investment picking up by year-end through shovel-ready projects with relatively low import content. Moreover, the public health expenditure variable may not capture still underdeveloped social safety nets, in particular low minimum pensions accruing to the large informal sector (which accounts for over 50 percent of employment). These factors may increase private sector precautionary savings. 3/ The adjusted metric relies on de jure measures of capital controls. Using these measures to classify Thailand's capital account openness is problematic, as such de jure indices are not granular enough to measure the extent of capital account liberalization in Thailand and do not capture whether outflow controls are binding. Moreover, recent actions to further liberalize capital outflows are not incorporated in this adjusted metric. Staff considers the unadjusted adequacy metric to be more appropriate.

	Turkey	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. Despite a modest improvement in 2015 1/, at -51 percent of GDP Turkey's net international investment position (NIIP) is somewhat weaker than those of peers. Foreign liabilities are in excess of 80 percent of GDP, including about 43 percent of GDP in foreign currency. External debt is sustainable, but subject to significant risks with short-term debt and portfolio investments in debt securities accounting for about 30 percent of GDP and about half of long-term debt have floating interest rates. **Assessment**. A significant share of foreign liabilities in Turkish lira has provided a buffer during currency depreciation. However, large favorable valuation effects are unlikely to continue bolstering the IIP position. Moreover, the composition of liabilities exposes Turkey to liquidity shocks and increases in global interest rates. Unless the current account (CA) deficit improves substantially in the years ahead, Turkey's NIIP would continue to deteriorate by some 10 percentage points of GDP in the medium term.	**Overall Assessment** *In 2015, Turkey's external position was weaker than the level consistent with medium-term fundamentals and desirable policy settings.* *The external position could strengthen in 2016 due to terms of trade gain from lower oil import prices.* However, net international reserves are still low, and the NIIP will continue to deteriorate until the CA deficit is reduced. Moreover, given large financing needs and a high share of short-term capital inflows, Turkey remains vulnerable to capital flow reversal. **Potential Policy Responses** Reducing the CA deficit further is necessary to diminish vulnerabilities. Monetary policy should keep real interest rates solidly in positive territory. The CBRT should increase net international reserves, limiting foreign exchange sales to smoothing periods of excessive volatility. Structural reforms aimed at increasing private sector savings, including pension reform, are needed to enhance private savings and allow high growth with a sustainable current account deficit. These reforms should be supported by fiscal policy tightening over the medium term to increase public saving.
Current account	**Background**. The CA deficit (CAD) is estimated to have narrowed to 4.5 percent of GDP in 2015 mainly due to lower fuel prices, 2/ although the trade balance excluding gold and fuel deteriorated. The CAD is expected to narrow further in 2016 as the effect of lower energy costs is projected to outweigh the impact of weak performance of selected trading partners and strong domestic consumption. The EBA model estimates that in 2015 the cyclically-adjusted CA was some 3.8 percent of GDP weaker than the level implied by medium-term fundamentals and desirable policies. External sustainability (ES) approach suggests the CAD was 1-2 percentage points above the level consistent with stabilizing NIIP at the current level. 3/ **Assessment**. Staff assesses that the CA gap in 2015 was in the range of -1 to -4 percent of GDP. This is consistent with a CA norm in the range of -1 to -3.5 percent of GDP, reflecting the large investment needs of a fuel importing emerging economy. While lower oil prices are expected to reduce the CA deficit and narrow the CA gap for 2016, tighter monetary and fiscal policies are still necessary to address the remaining CA gap.	
Real exchange rate	**Background**. The real effective exchange rate (REER) registered a 12-year minimum in 3Q-2015, but the trend reversed in Q4 as the monetary stance remained too loose and inflation increased. On an annual average basis REER depreciated by only 2.5 percent from 2014. The EBA REER index approach estimates a 5.0 percent overvaluation in 2015; the REER level regression suggests a 16.6 percent overvaluation. Based on the ES approach, a 5-8 percent REER adjustment is required to stabilize NIIP. As of June 2016 the REER was at about its average 2015 level. **Assessment**. Consistent with the assessment of the CA gap, staff assesses that the REER was overvalued by about 5-15 percent in 2015. As of early 2016, the improved terms of trade, combined with a broadly unchanged REER, would suggest some reduction in the REER gap.	
Capital and financial accounts: flows and policy measures	**Background**. Turkey experienced a major fall in net capital inflows in 2015. Net inflows (excluding US$9.3 billion in net errors and omissions and a US$11.8 billion fall in reserves) shrank to some 1.5 percent of GDP from an average of 4.7 percent of GDP during 2010-2014. On the other hand, targeted macro prudential measures forced banks to lengthen the maturity of external financing. Turkey has not made use of capital controls on inflows or outflows. **Assessment**. A large share of short-term debt exposes Turkey to significant rollover risks. Gross external financing needs are estimated at over 26 percent of GDP in 2016, making Turkey vulnerable to changes in global market conditions.	
FX intervention and reserves level	**Background**. The exchange rate is floating. The central bank sells foreign exchange to commercial banks through regular auctions (since June 2013) and to energy importing SOEs via direct sales (since December 2014). 4/ Turkey's gross reserves fell to 92 percent of the IMF composite adequacy metric at end-2015 (from 96 percent at end-2014). Adjusting the level of reserves for ROM-related reserve holdings in foreign currency reduced it to 87 percent of the composite adequacy metric in the end of 2015. Reserve cover of short-term debt declined to 68 percent at end-2015. 5/ At US$29 billion at end 2015, net reserves available for intervention are significantly lower than gross reserves. **Assessment**. Given Turkey's low and declining net international reserves, reserve accumulation is warranted. Foreign exchange sales should be restricted to periods of disorderly market conditions.	

	Turkey (continued)
Technical Background Notes	1/ The NIIP narrowed from -55 percent of GDP in 2014 to -51 percent in 2015, despite of a CA deficit in excess of 4 percent of GDP. Large net errors and omission (about 1.3 percent of GDP) could explain part of the discrepancy; the remaining improvement is to a large extent driven by favorable valuation effects, which reflect significant share of FDI and foreign debt liabilities in Turkish lira. 2/ The windfall of lower energy prices are estimated at about 1.6 percent of GDP in 2015. The fuel trade balance was -5.8 percent of GDP on average in 2010-2014. 3/ A gap of 1 percent corresponds to an assumption of stabilizing NIIP at 50 percent of GDP, a gap of 2 percent corresponds to an assumption of reaching NIIP of 50 percent by 2024. The simulations under the ES approach included an assumption of a positive annual average capital gain of 0.5 percent of GDP. 4/ The cumulative total amount of these sales was about US$23 billion in 2015 increasing from about US$12 billion in 2014. 5/ ROM (Reserve Option Mechanism) allows commercial banks to meet their reserve requirements on lira-denominated liabilities by using foreign exchange and gold.

<table>
<tr><th></th><th>United Kingdom</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The net international investment position (NIIP) stood at -3.5 percent of GDP at end-2015. Staff projections for the current account and GDP suggest that the official NIIP to GDP ratio would fall moderately over the medium term, though the importance of uncertain valuation effects implies significant uncertainty to these estimates.1/ Gross assets and liabilities are more than 500 percent of GDP, reflecting the international activities of large financial institutions.
Assessment. The NIIP and sustainability issues are not yet a concern. But fluctuations in the underlying gross positions are a source of external vulnerability to the extent that they could lead to large changes in the net position.</td><td rowspan="5">Overall Assessment
The external position in 2015 was weaker than implied by medium-term fundamentals and desirable policy settings.
External deficits reflect insufficient public and private saving rates. The REER depreciation that has occurred so far in 2016 goes in the direction of reducing exchange rate overvaluation. However, an exit from the EU may also reduce the equilibrium real exchange rate due to higher trade barriers. The overall effect on the degree of exchange rate overvaluation is uncertain and will much depend on the nature of any new arrangements that are put in place. Such effects will be assessed in the context of future reports.

Potential Policy Responses
Sustaining strong and durable growth in the UK requires rebalancing toward greater reliance on external demand. The current fiscal consolidation plan implemented within a medium-term framework and an accommodative monetary policy stance contribute to the goal of external rebalancing. At the same time, macroeconomic policies will need to respond flexibly to changing circumstances. Further structural reforms focused on broadening the skill base and investing in public infrastructure will boost productivity, improving the competitiveness of the economy. Ensuring that macroprudential policies remain sufficiently tight to maintain financial stability should also support private-sector saving.</td></tr>
<tr><td>Current account</td><td>Background. During the recovery from the crisis, the CA balance deteriorated from -1.7 percent of GDP in 2011 to -5.1 percent of GDP in 2014. The decline in the CA balance was accounted for primarily by a lower income balance, reflecting a fall in earnings on the UK's foreign direct investment abroad, notably earnings on investment exposed to the euro area. In contrast, the trade balance has been stable at around -2 percent of GDP. In 2015, the current account balance stayed broadly unchanged at -5.2 percent of GDP. Terms of trade effects have been negligible.
From a savings-investment perspective, the current account deficit partly reflects a relatively high general government deficit (4.4 percent of GDP in 2015) and a low household saving rate (4.3 percent in 2015).
Assessment. The EBA CA regression approach estimates a CA gap of -4.3 percent of GDP for 2015. However, the post-crisis deterioration in the income balance is not expected to be all permanent, suggesting a smaller underlying CA deficit and smaller CA gap than implied by the EBA model. 2/ Taking this and other factors (such as the CA gaps implied by the REER regressions discussed below) into account, staff assesses the 2015 cyclically-adjusted CA balance to be 1.5 to 4.5 percent of GDP weaker than the current account norm.</td></tr>
<tr><td>Real exchange rate</td><td>Background. The UK's average REER for 2015 was 15 percent more appreciated than in 2013. This appreciation may have reflected the UK's relatively strong domestic demand and differences in interest rates (both current and prospective) between the UK and many advanced economies during 2013-15. However, as of April 2016, the REER had depreciated 7 percent relative to its average for 2015, which may reflect some unwinding of the overvaluation in 2015, as well as heightened uncertainty ahead of the June 2016 referendum. The exchange rate depreciated further in the days after "Leave" won the referendum. The decision will likely lower the equilibrium exchange rate, but the magnitude of this effect is uncertain, including because the nature of any new arrangements is unknown. The decision, however, does not affect staff's external assessment for 2015.
Assessment. For 2015, the EBA exchange rate assessment implied by the EBA CA regression model indicates an overvaluation of 18 percent. The EBA REER regressions estimate an overvaluation of 10-12 percent. Staff assesses the 2015 REER as 5 to 20 percent above the level consistent with fundamentals and desirable policy settings; this assessment is informed by and consistent with the staff's CA assessment.</td></tr>
<tr><td>Capital and financial accounts:
flows and policy measures</td><td>Background. Given the UK's role as an international financial center, portfolio investment and financial derivatives 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 services sector. This volatility is a potential source of vulnerability.</td></tr>
<tr><td>FX intervention and reserves level</td><td>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.</td></tr>
</table>

	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. 2/ The income balance is expected to rise somewhat as the unusually low differential between the return on UK residents' investments abroad and the return on foreigners' investments in the UK rises as this differential partially mean-reverts. See the February 2016 UK Selected Issues paper for further discussion.

	United States	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) declined from -18.7 percent of GDP in 2010 to -38.8 percent of GDP in 2015, reflecting sustained 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 10 percentage points of GDP over the next five years predominantly due to projected current account deficits. Potential valuation losses including from losses on FDI assets in overseas energy projects are a source of uncertainty. **Assessment**. A decline in foreign demand for U.S. debt securities (for example, by a protracted failure to restore long-run fiscal sustainability) would raise financial stability risks, but at the same time weaken the exchange rate and strengthen the trade balance. Given the dollar's reserve currency status, such financial stability concerns are limited. Most U.S. foreign assets are denominated in foreign currency and over 50 percent are in the form of FDI and portfolio equity claims, whose value tend to decline when global growth and stock markets are weak, as well as 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. As of May 2016 the REER has strengthened marginally relative to the 2015 average, but this does not change the overall assessment.* The U.S. external position has improved considerably in recent years, as have assessed imbalances and fiscal policy gaps. Nevertheless, solid U.S. economic performance and divergence of U.S. growth and monetary policy prospects from key trading partners has led to a strengthening of the U.S. dollar and a rise in the current account deficit. **Potential Policy Responses** Over the medium term, fiscal consolidation 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 to raise productivity, increase labor force growth, and, thus, raise saving. This would be consistent with maintaining external stability while achieving full employment.
Current account	**Background**. The U.S. current account (CA) balance has narrowed from its pre-crisis height of -6 percent of GDP to -2.6 percent of GDP in 2015 (cyclically adjusted -2.6 percent as well), reflecting a sharp reduction in the fiscal deficit, higher private saving, lower investment in the aftermath of the financial crisis, and a stronger energy trade balance (due to the rapid increase of unconventional energy production). 2/ The CA deficit is expected to rise moderately but steadily from its low point in 2014 through the medium-term as the effects of a stronger U.S. economy and the lagged effects of a more appreciated U.S. dollar are only partly offset by lower oil prices. **Assessment**. The EBA model estimates a cyclically-adjusted CA gap of 1.7 percent of GDP for 2015 which is primarily accounted for by a (policy-unrelated) residual. In staff's view, the gap is moderately overstated because the estimation of the EBA CA norm does not fully account for the discovery of shale oil, which resulted in a substantial wealth gain. Taking this factor into account, the CA norm should be smaller reducing the CA gap by about ¼ percent of GDP. 3/	
Real exchange rate	**Background**. The real effective exchange rate (REER) appreciated in 2015 by about 11 percent compared to 2014 due to solid U.S. economic performance and divergence of U.S. growth and monetary policy from key trading partners. As of May 2016, the REER was about 1 percent stronger than its average value over 2015. **Assessment.** Indirect estimates of the REER (relying on the EBA current account assessment) suggest the exchange was overvalued by almost 20 percent in 2015. Direct REER analyses suggest an overvaluation of between 14-23 percent. 4/ Considering all estimates and the uncertainties around them, staff assess the 2015 average REER to be overvalued by 10-20 percent relative 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 2 percent of GDP in 2015. 5/ Portfolio inflows increased by about 0.4 percent, year over year, in 2015 but were offset by weaker direct investment and other inflows. On the outflow side, there were further increases in U.S. portfolio investment overseas, but much less so than in 2014. The stronger outlook for the U.S. economy compared to its key trading partners, the dollar's reserve currency status and safe haven motives continue to boost foreign demand for U.S. Treasury securities. **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 & 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. Gross assets and liabilities are about 140 and 180 per cent of GDP, respectively. 2/ The oil and gas portion of the CA had a deficit of 0.5 percent of GDP in 2015, 0.5 percentage points lower than in 2014, reflecting less net imports and lower oil prices. 3/ Because of the discovery of shale and related investments to build capacity for exports, the CA norm is estimated to be about 0.25 percent of GDP smaller than the one estimated by EBA, hence narrowing the gap. 4/ The two direct EBA models are the REER Index model and the REER Level model. 5/ This is substantially below pre-crisis levels of about 5.0 percent of GDP.