

# 2013 Pilot External Sector Report



# Structure

## As in 2012:

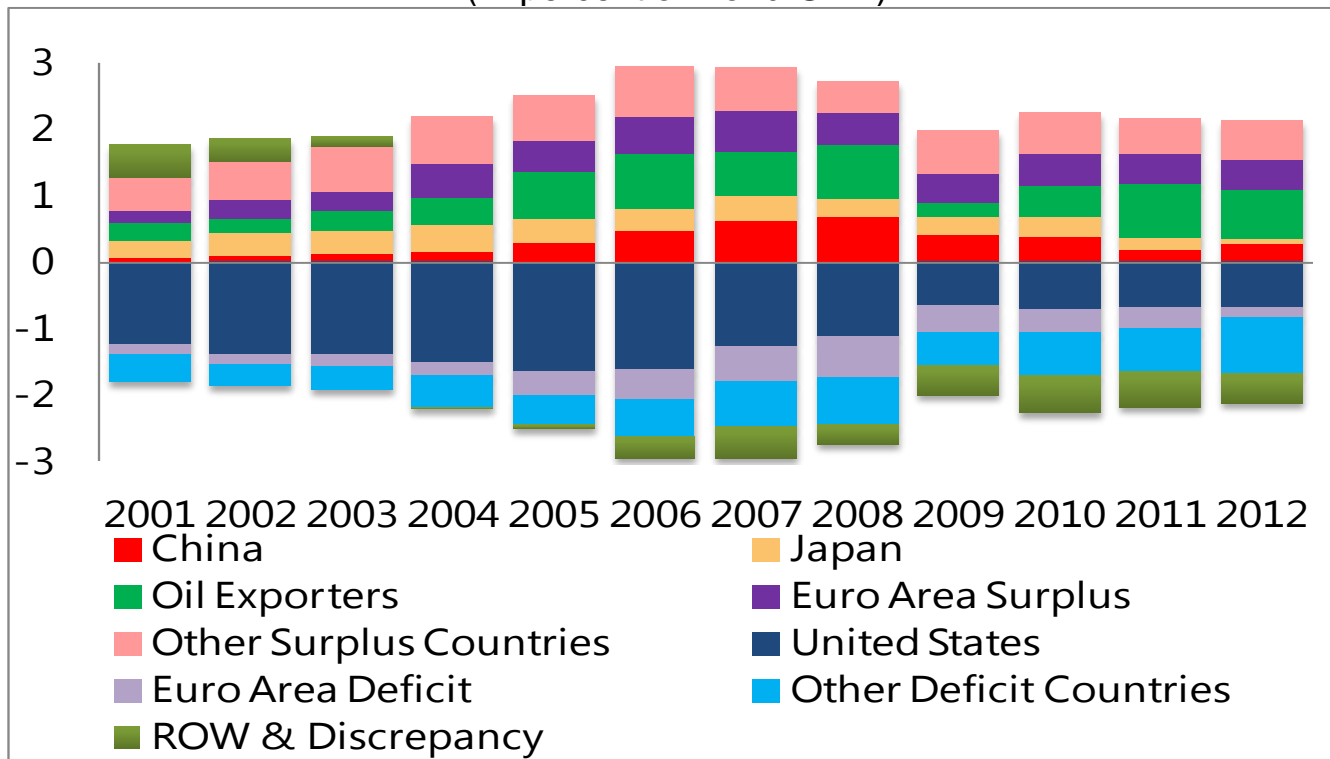
- Stock-take: multilaterally consistent assessment of external sector policies of the largest economies
- Feeds into Article IVs
- Draws on External Balance Assessment (EBA) methodology/other
- Identifies policy gaps
- Assessments cover: current account, real exchange rate, reserves, capital account and external assets/liabilities

## New in 2013:

- Greater emphasis on capital flows
- Refinements to EBA methodology
- Individual country assessments

# Global Current Account Divergences Continued to Narrow in 2012...

**Current Account**  
(In percent of world GDP)



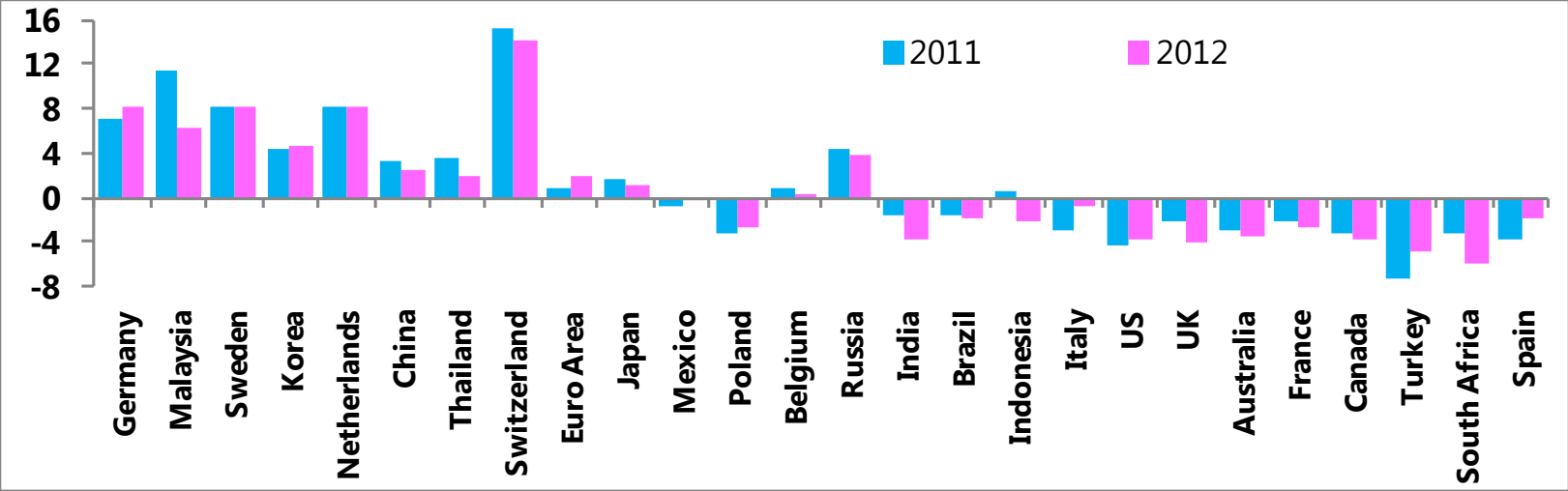
# ...All Regions Have Contributed

## Change in Current Account Divergences (2006–07 to 2012)

|                | (% of world GDP) | (% of own GDP) |
|----------------|------------------|----------------|
| <b>Surplus</b> |                  |                |
| China          | -0.26            | -6.83          |
| Japan          | -0.28            | -3.41          |
| Euro Area      | -0.10            | 0.17           |
| o/w Germany    | -0.08            | 0.12           |
| Other          | -0.04            | -1.11          |
| Oil            | 0.02             | -3.05          |
| <b>Deficit</b> |                  |                |
| United States  | 0.77             | 2.48           |
| Euro Area      | 0.19             | 1.29           |
| Other          | -0.13            | -0.69          |

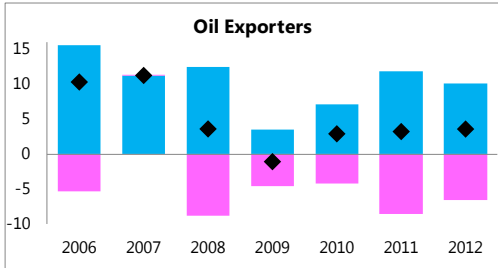
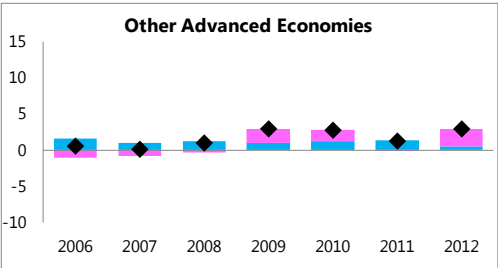
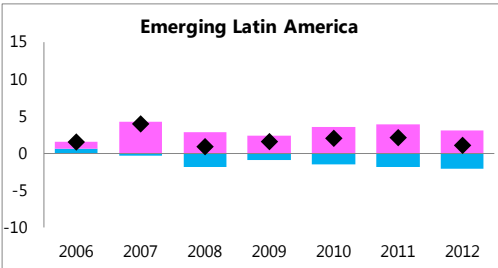
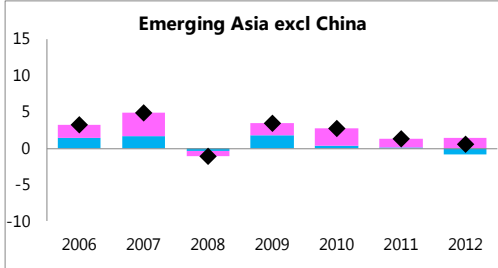
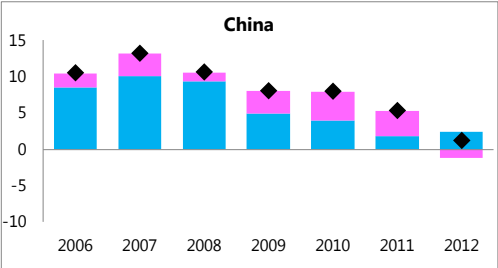
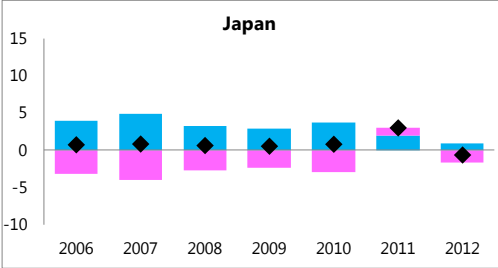
# Cyclically Adjusted Balances Suggest Reduced Divergences for Many in 2012


## Cyclically Adjusted Current Account Balances (In percent of GDP)





# Lower Current Accounts, Lower Capital Flows, and Less Reserve Accumulation

(In percent of each economy's or region's GDP)



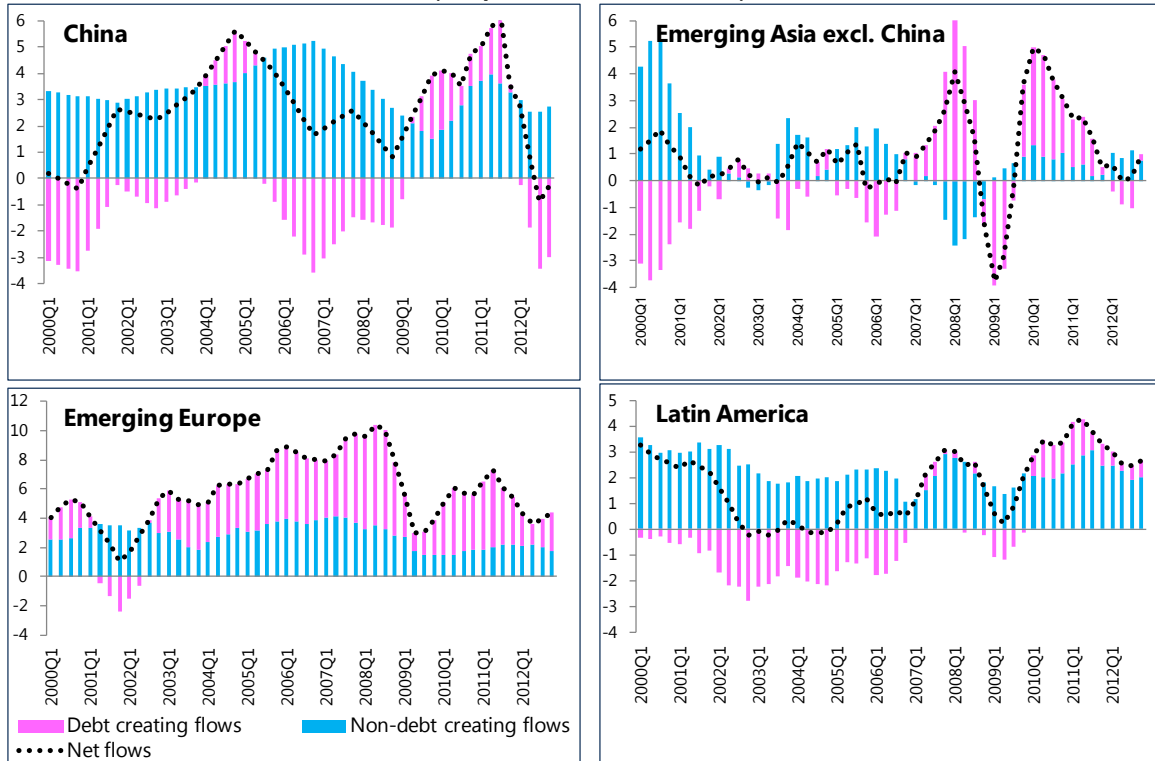
Current account 

Capital & Financial Accounts  
(includes errors and omissions) 

Reserves 

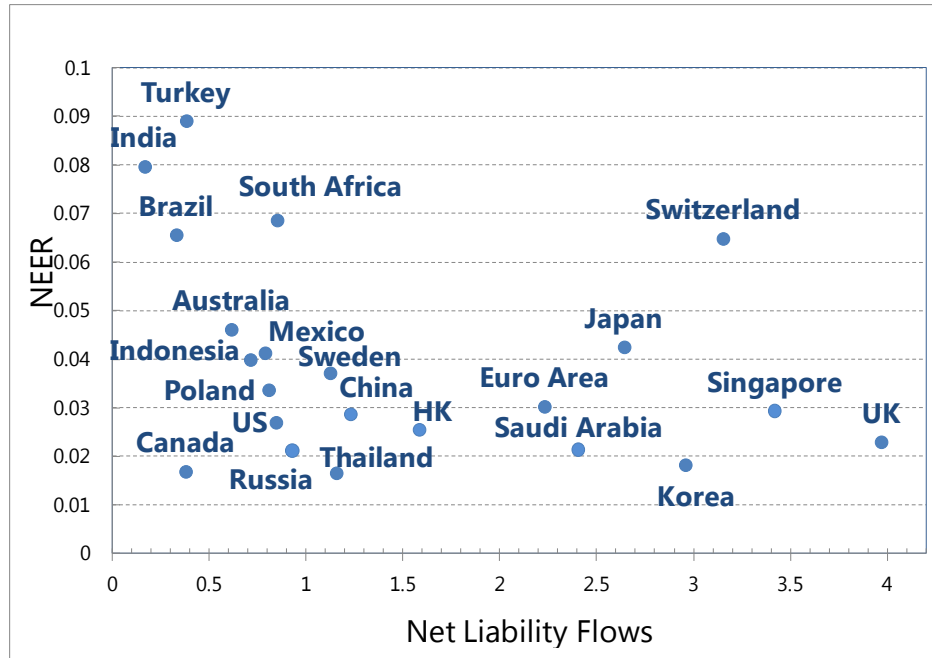
# Capital Flows to Emerging Markets Have Been Volatile, especially Debt Creating Flows

Net Capital Flows to Emerging Markets 2000Q1–2012Q4  
(In percent of GDP)



# Capital Volatility Highest for Financial Centers; Exchange Rate Volatility in Emerging Markets

Exchange Rate and Capital Flow Volatility  
Coefficient of Variation  
(2010 Q1–2012 Q4)

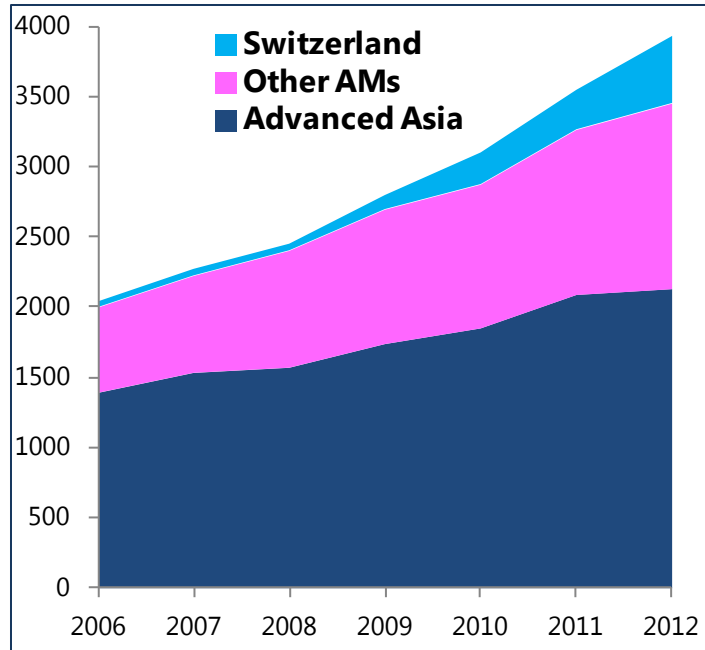




# Significant Reserve Accumulation by Some Advanced Economies

## Reserves

(In billions of US dollars)



# Assessment of Current Accounts and Exchange Rates

- Assessment relative to what standard?
- Relative to *appropriate* level, consistent with:
  - country fundamentals
  - natural temporary influences
  - and *desirable* policy settings
- *Note:* not relative to an “equilibrium.” Not a forecast
- Also: a separate exercise focused on *sustainability*

# How? Starting from EBA models

- ⦿ EBA: our tool to *estimate* current account and exchange rate gaps (imbalances)
- ⦿ A regression-based approach
  - but with a normative 2<sup>nd</sup> stage (policy distortions' role)
- ⦿ Allows each country's position to be affected simultaneously by all other countries...
- ⦿ ... and yields gaps consistent across countries

# EBA model 2.0 now incorporates:

- ◉ Fundamentals: income, growth, demography, etc.
- ◉ Other structural: institutions-related risk, oil wealth
- ◉ Financial factors: global capital market conditions (with asymmetric effects), reserve currency status (“exorbitant privilege”)
- ◉ Temporary influences: output gap (proxy for uncaptured demand shocks), commodity price cycle
- ◉ Policies: fiscal policy, public health expenditure (affects private saving incentives), monetary policy, capital controls, FX intervention, and allowing credit excesses

*Model applied uniformly across countries, but allows some effects to differ according to country characteristics*

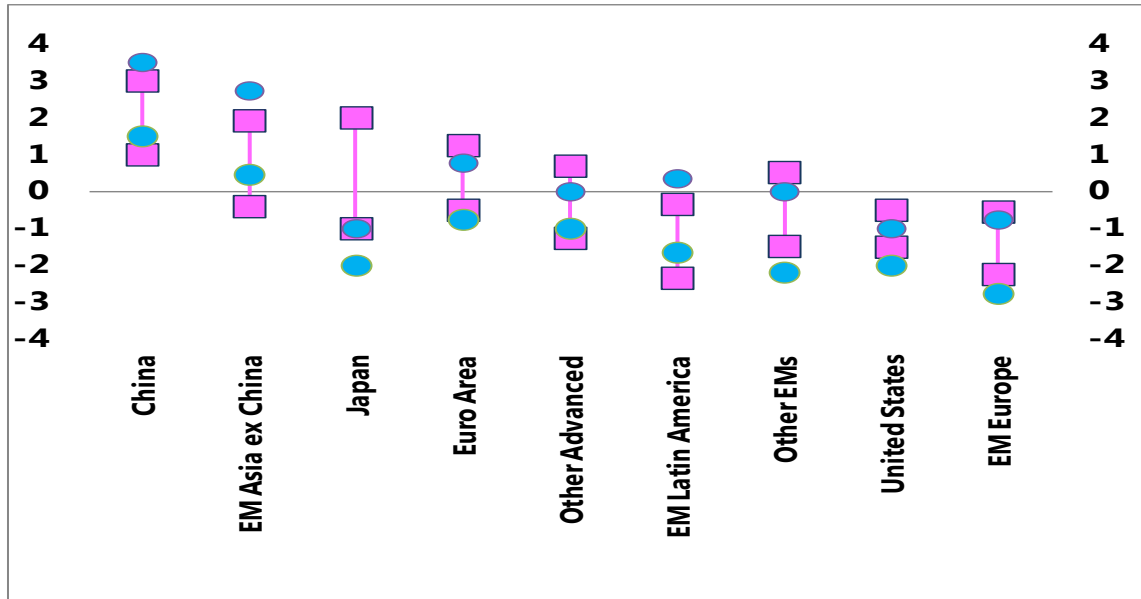
# From EBA regression to ESR assessment

- 2<sup>nd</sup> stage is normative: identify “policy gaps”
- Combine with regression → EBA norms, gaps
- EBA gaps have 2 parts:
  - contributions of identified policy gaps
  - + unidentified residual (to be interpreted)
- Weighing of models and evidence → final assessments for ESR
  - Maintaining cross-country consistency

# External Imbalances Narrowed Slightly

## Comparison of External Imbalances 2012 ESR range vs. 2013 ESR range

Cyclically-Adjusted Current Accounts: Difference between actual and norm  
(In percent of GDP)

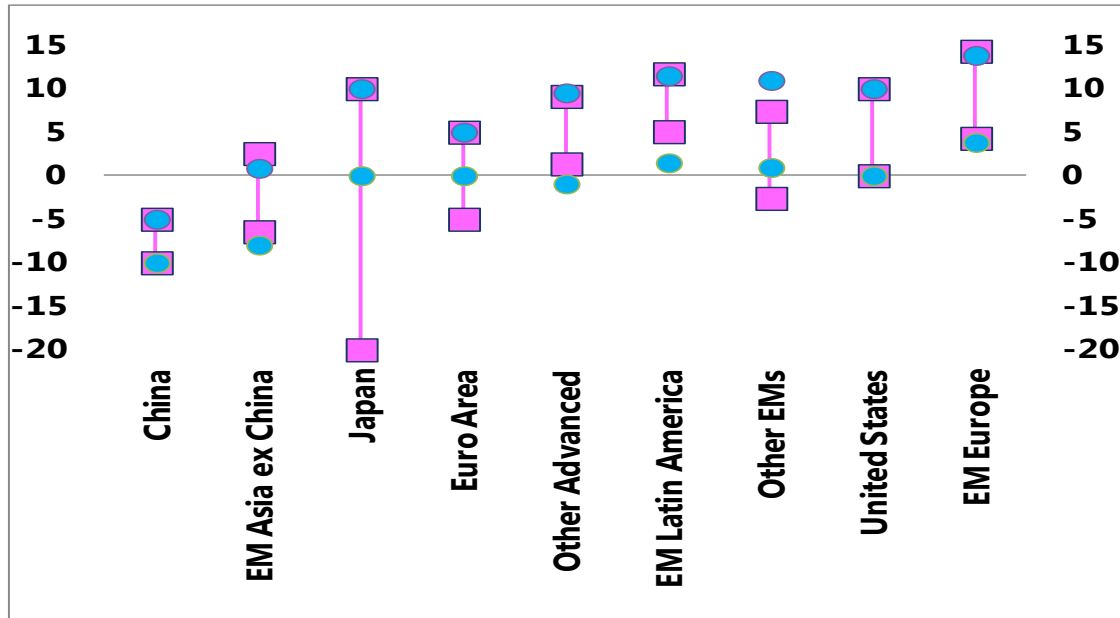


# External Imbalances Narrowed Slightly

## Comparison of External Imbalances

2012 ESR range vs. 2013 ESR range

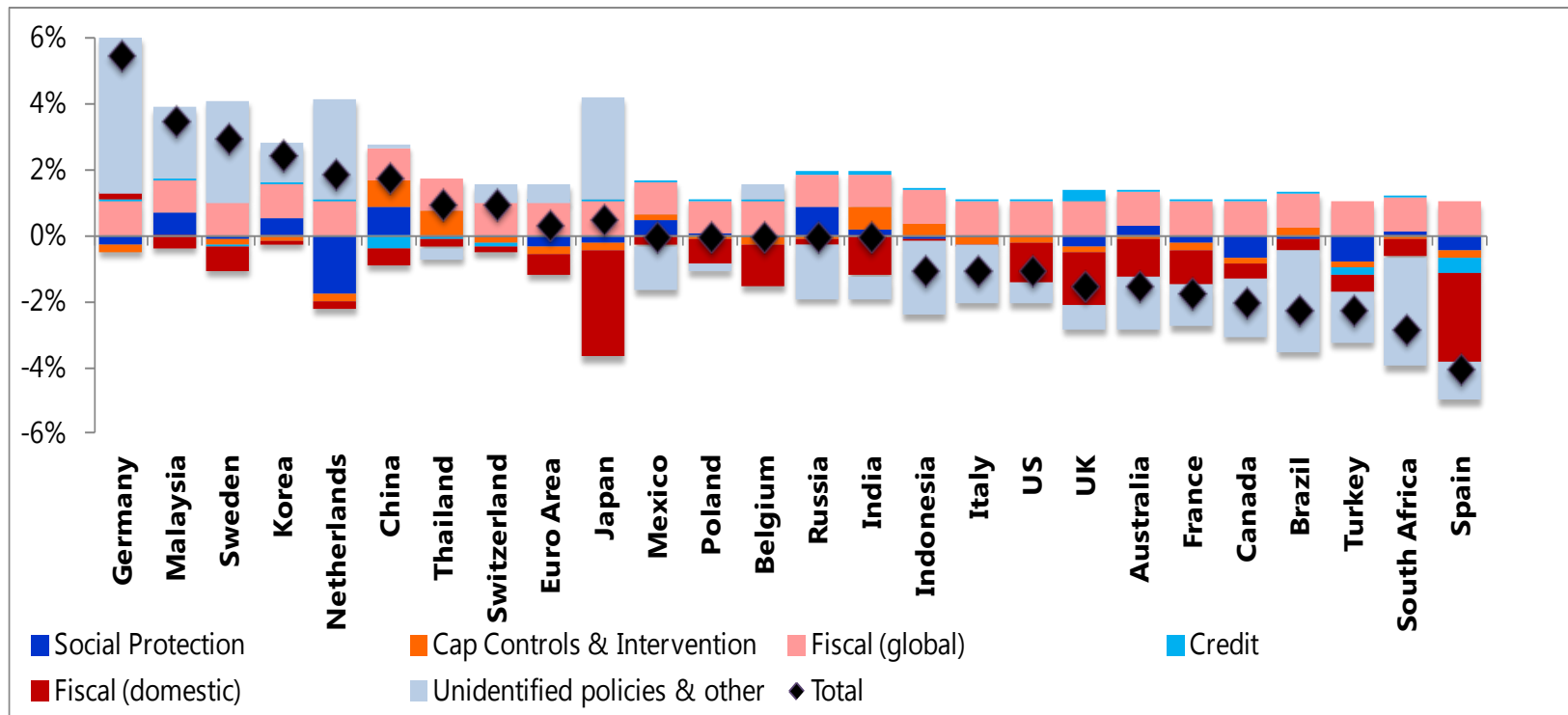
Real Effective Exchange Rate: Difference between actual and norm  
(In percent)



# Role of Policies in External Imbalances?

## Contribution of Policies to Current Account Gaps (2012)

(In percent of GDP, based on midpoint of staff estimates)





# Conclusions

- ◉ Policy responses to the weakness in growth in Advanced Economies and changes in risk sentiment have shaped the evolution of external positions and contributed to capital flow volatility
- ◉ Global imbalances have continued to narrow and are now about  $\frac{3}{4}$  percent of global GDP, significantly lower than in 2006-7
- ◉ Cyclical factors did play a role in this narrowing, but there has also been progress on closing structural policy gaps
- ◉ Capital flows have been volatile, have posed policy challenges, and will continue to do so
- ◉ International policy coordination is crucial.