REPORT TO CONGRESS

Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States

U.S. DEPARTMENT OF THE TREASURY
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Contents

This Report reviews developments in international economic and exchange rate policies and is submitted pursuant to the Omnibus Trade and Competitiveness Act of 1988, 22 U.S.C. § 5305, and Section 701 of the Trade Facilitation and Trade Enforcement Act of 2015, 19 U.S.C. § 4421.[1]

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[1] The Treasury Department has consulted with the Board of Governors of the Federal Reserve System and International Monetary Fund management and staff in preparing this Report.

Executive Summary

The global economy experienced a significant negative shock at the beginning of 2020 when the SARS-Cov-2 (COVID-19) pandemic spread throughout the world. Global growth in 2019 slowed to 2.8%, but the impact of the virus led to a deep contraction in the first half of 2020. Governments implemented public health policies and restrictions on mobility to arrest the spread of the virus, and households and business became more cautious in spending and investment decisions. Governments also provided historic economic support to offset the damaging effects of the virus through direct fiscal spending as well as indirect measures. Central banks also took prompt actions to support economic conditions through expansions and extensions of monetary easing as well as policies aimed at stabilizing financial markets.

Global economic conditions have stabilized relative to earlier in the year, but the sharp slowdown in economic activity in the first half of the year indicates that real GDP will decline in 2020. The International Monetary Fund (IMF) forecasts the global economy to contract 4.4% in 2020, the worst recession since the Great Depression. The IMF expects global growth to return in 2021, but the level of GDP in many economies is expected to remain below end-2019 levels in 2021 and beyond. Against this backdrop, it is critical that fiscal and monetary policies in the major economies remain supportive of near-term activity, while structural policies are used to boost medium-to-long-term growth.

With global growth prospects subdued, it is important that governments bolster domestic-led growth rather than seek to raise exports and increase contributions from their external sectors. Over the four quarters through June 2020, a number of economies have experienced significant expansions in their current account surpluses, including China, Taiwan, and Vietnam, while other countries, including Germany and Switzerland, have maintained large trade and current account surpluses, which allowed for external asset stock positions to widen further. The total U.S. goods trade deficit widened to 4.5% of GDP in the second quarter of 2020 from 3.6% of GDP in the first quarter. The current account deficit expanded to 3.5% of GDP in the second quarter, 1.4 percentage points larger than in the first quarter and the largest U.S. deficit since the final quarter of 2008. Treasury remains concerned by these persistent and excessive trade and current account imbalances.

Treasury is also concerned by certain economies raising the scale and persistence of foreign exchange intervention to resist appreciation of their currencies. Treasury continues to press other economies to uphold the exchange rate commitments they have made in the G-20, the G-7, and at the IMF. All G-20 members have agreed that strong fundamentals, sound policies, and a resilient international monetary system are essential to the stability of exchange rates, contributing to strong and sustainable growth and investment. G-20 members have also committed to refrain from competitive devaluations and not target exchange rates for competitive purposes. G-7 economies, meanwhile, remain committed to market-determined exchange rates, using domestic tools to meet domestic objectives, and consulting closely and cooperating as appropriate with regards to action in foreign exchange markets. IMF members have committed to avoid manipulating exchange rates to gain an unfair competitive advantage over other members.

Nevertheless, a number of countries have conducted foreign exchange market intervention in a persistent, one-sided manner that exceeds Treasury criteria pursuant to the Trade Facilitation and Trade Enforcement Act of 2015 (the "2015 Act"). These actions occurred mostly during a period of dollar weakness as countries sought to limit appreciations of their currencies. Over the four quarters through June 2020, four major U.S. trading partners – Vietnam, Switzerland, India, and Singapore – intervened in the foreign exchange market in a sustained, asymmetric manner. Two of these economies – Vietnam and Switzerland – exceeded the two other objective criteria established by Treasury to identify potentially unfair currency practices or excessive external imbalances, which could weigh on U.S. growth or harm U.S. workers and firms.

Treasury Analysis Under the 1988 and 2015 Legislation

The Omnibus Trade and Competitiveness Act of 1988 (the "1988 Act") requires the Secretary of the Treasury to provide semiannual reports to Congress on international economic and exchange rate policy. Under Section 3004 of the 1988 Act, the Secretary must:

> *"consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."*

This determination may encompass analysis of a broad range of factors, including not only trade and current account imbalances and foreign exchange intervention (criteria under the second piece of legislation discussed below), but also currency developments, the design of exchange rate regimes and exchange rate practices, foreign exchange reserve coverage, capital controls, monetary policy, and trade policy actions, as well as foreign exchange activities by quasi-official entities that may be undertaken on behalf of official entities, among other factors.

The 2015 Act calls for the Secretary to monitor the macroeconomic and currency policies of major trading partners and conduct enhanced analysis of and engagement with those partners if they meet certain objective criteria that provide insight into possibly unfair currency practices.

In this Report, Treasury has reviewed 20 major U.S. trading partners with bilateral goods trade with the United States of at least $40 billion annually against the thresholds Treasury has established for these three criteria:

(1) A significant bilateral trade surplus with the United States is one that is at least $20 billion over a 12-month period.[2] This threshold captures a group of trading partners that represented roughly 80% of the value of all trade surpluses with the United States in 2019. It also captures all trading partners with a trade surplus with the United States that is larger than about 0.1% of U.S. GDP.

(2) A material current account surplus is one that is at least 2% of gross domestic product (GDP) over a 12-month period. This threshold captures a group of economies that accounted for about 86% of the nominal value of current account surpluses globally in 2019.

(3) Persistent, one-sided intervention occurs when net purchases of foreign currency are conducted repeatedly, in at least 6 out of 12 months, and these net purchases total at least 2% of an economy's GDP over a 12-month period.[3] Looking over the last two decades, this quantitative threshold would capture all significant instances of sustained, asymmetric foreign exchange purchases by major U.S. trading partners.

Treasury's goal in establishing these thresholds is to identify where potentially unfair currency practices or excessive external imbalances that could weigh on U.S. growth or harm U.S. workers and businesses may be emerging.

Because the standards and criteria in the 1988 Act and the 2015 Act are distinct, an economy could be found to meet the standards identified in one of the Acts without being found to have met the standards identified in the other.

Treasury Conclusions Related to Vietnam

Vietnam met all three criteria under the 2015 Act over the four quarters through June 2020. Treasury has conducted enhanced analysis of Vietnam in this Report and will also commence enhanced bilateral engagement with Vietnam in accordance with the Act. The bilateral engagement will include urging the development of a plan with specific policy actions to address the underlying causes of Vietnam's undervaluation of its currency.

Vietnam has tightly managed the value of the dong relative to the dollar at an undervalued level since 2016. Vietnam has applied this policy consistently in periods of both appreciation and depreciation pressure. Additionally, Vietnam entered 2019 with a relatively low level of reserves. Over the four quarters through June 2020, however, Vietnam conducted large-scale and protracted intervention, much more than in previous periods, to prevent appreciation of the dong, in the context of a larger current account

[2] The Report covers data from the 12-month period ending in June 2020. Given data limitations, Treasury focuses in this Report on trade in goods, not including services. The United States has a surplus in services trade with many economies in this Report, including China, Japan, Korea, Singapore, and Switzerland. Taking into account services trade would reduce the bilateral trade surplus of these economies with the United States.

[3] These quantitative thresholds for the scale and persistence of intervention are considered *sufficient* on their own to meet this criterion. Other patterns of intervention, with lesser amounts or less frequent interventions, might also meet this criterion depending on the circumstances of the intervention.

surplus and a growing bilateral trade surplus with the United States. Intervention has also contributed to undervaluation of the dong on a real, trade-weighted basis, with the real effective exchange rate undervalued in 2019. Treasury therefore assesses based on a range of evidence and circumstances that at least part of Vietnam's exchange rate management over the four quarters through June 2020, and particularly its intervention, was for purposes of preventing effective balance of payments adjustments and gaining unfair competitive advantage in international trade. Hence, Treasury has determined under the 1988 Act that Vietnam is a currency manipulator. Consistent with the 1988 Act, in the context of forthcoming negotiations with the Vietnamese authorities, Treasury will press for the adoption of policies that will permit effective balance of payments adjustments and eliminate the unfair advantage created by Vietnam's actions.

- Vietnam enacted a prompt, aggressive response to the COVID-19 outbreak, including closing the northern border with China in January, banning flights starting in February, and imposing a nationwide lockdown. These actions helped contain the outbreak, though the pandemic and public health response have weighed heavily on growth. The authorities enacted countercyclical fiscal measures totaling approximately 3.6% of GDP, which included cash transfers, tax deferrals, and a cut in the corporate income tax rate for small and medium enterprises (SMEs). The effectiveness of Vietnam's initial public health response enabled the government to loosen many of the restrictions on domestic activity, facilitating a bounce-back in the third quarter of 2020.

  Vietnam's trade surplus continued to expand year-over-year in the first half of 2020, helping push the current account surplus over the four quarters through June 2020 to 4.6% of GDP.[4] Over the same period, Vietnam's goods trade surplus with the United States reached $58 billion, the fourth largest among the United States' trading partners. The Vietnamese authorities have conveyed credibly to Treasury that net purchases of foreign exchange in the four quarters through June 2020 were $16.8 billion, equivalent to 5.1% of GDP. The majority of these purchases occurred in the second half of 2019, prior to the onset of the COVID-19 pandemic.

  Vietnam should move expeditiously to strengthen its monetary policy framework to facilitate greater movement in the exchange rate to reflect economic fundamentals, while reducing intervention and allowing for the appreciation of the real effective exchange rate. Vietnam should also increase the transparency of foreign exchange intervention and reserve holdings.

  Vietnam should also work to durably reduce its external imbalances and strengthen domestic demand by leveling the playing field for the domestic private sector through measures such as improving its access to land and credit, reducing the role of state-owned enterprises in the economy, and improving financial supervision to

[4] Vietnam is in the process of revising its GDP figures, resulting in significant revisions to GDP levels. However, quarterly revised figures are not available. In this Report, we estimate a revised series of quarterly GDP based on the degree of revisions to the annual figures used when calculating current account balances and foreign exchange intervention as a share of GDP.

help facilitate more productive lending and spur private domestic investment. Vietnam also needs to dismantle barriers to U.S. companies and U.S. exports in Vietnam to reduce the bilateral trade imbalance.

Treasury Conclusions Related to Switzerland

Switzerland met all three criteria under the 2015 Act over the four quarters through June 2020. Treasury has conducted enhanced analysis of Switzerland in this Report and will also commence enhanced bilateral engagement with Switzerland in accordance with the Act. The bilateral engagement will include urging the development of a plan with specific policy actions to address the underlying causes of Switzerland's external imbalances.

The Swiss franc has long been considered a safe haven currency that investors acquire during periods when global risk appetite recedes or financial volatility accelerates. These large safe haven flows pose challenges for Swiss macroeconomic policymakers, particularly in a period of negative interest rates and deflation. The Swiss National Bank (SNB) over the years has employed a range of tools to try to offset appreciation pressure on the franc and limit any associated negative impacts on inflation and domestic growth. Over the second half of 2019 and particularly in the first six months of 2020, Switzerland conducted large-scale one-sided intervention, significantly larger than in previous periods, to resist appreciation of the franc and reduce risks of deflation, as the SNB's policy interest rates were significantly negative. While we recognize the extraordinary financial volatility in the first half of 2020 resulting from the COVID-19 crisis, the intervention was taken in the context of an extremely large current account surplus along with a growing bilateral trade surplus with the United States and contributed to stemming the appreciation of the franc on a real, trade-weighted basis. Further franc appreciation would help facilitate gradual adjustment of Switzerland's excessive current account surplus. Treasury therefore assesses, based on a range of evidence and circumstances, that at least part of Switzerland's exchange rate management over the four quarters through June 2020, and particularly its foreign exchange intervention, was for purposes of preventing effective balance of payments adjustments. Hence, Treasury has determined under the 1988 Act that Switzerland is a currency manipulator. In the context of forthcoming negotiations with the Swiss authorities, Treasury will press for the adoption of policies that will permit effective balance of payments adjustments.

- Switzerland was one of the countries in Europe hit early and hard by COVID-19, leading the government to declare a national state of emergency in mid-March. The number of active and new cases declined sharply from mid-to-late April but started rising again from mid-June as the authorities eased public health and mobility restrictions. Since mid-October, the number of new COVID-19 cases has surged, with new infections significantly above spring 2020 highs, leading the Swiss Federal Council to re-introduce several containment measures.

  Switzerland has for many years run extremely large current account surpluses, with the surplus reaching 10.9% of GDP in 2019. The current account surplus declined marginally, but remained elevated, at 8.8% of GDP over the four quarters through

June 2020. The United States' goods trade deficit with Switzerland widened notably over the last year, reaching $49 billion over the four quarters through June 2020, due partially to an increase in Swiss gold exports in the first half of 2020. The SNB disclosed that it spent $93 billion (90 billion francs) on currency interventions in the first half of 2020. Between July 2019 and June 2020, Treasury estimates that SNB net foreign purchases have totaled $103 billion (or 14% of GDP).

Switzerland should employ a more balanced macroeconomic policy mix. Monetary policy continues to be relied on heavily despite the reduced effectiveness of unconventional tools, especially against a backdrop of persistent deflationary risks. We urge the SNB to deploy a broader and more balanced mix of monetary policy instruments, including domestic quantitative easing. Central to this recommended recalibration of monetary policy, we continue to urge the SNB to limit foreign exchange intervention to lean against large appreciation surges and allow real appreciation in line with the long-term trend. Treasury welcomes the SNB's recent step to disclose foreign exchange intervention on a quarterly basis. Increased frequency of these disclosures – such as on a monthly basis – will help further improve transparency of the SNB's actions. Fiscal policy should be deployed to reduce the economy's reliance on the SNB's policy measures, rebalance its external sector, and boost potential growth. The authorities should also take steps to raise potential growth by raising labor force participation rates and productivity growth, actions that would reduce Switzerland's external imbalances and reliance on unconventional monetary policy.

Treasury Assessments of Other Major Trading Partners

Pursuant to the 2015 Act, Treasury has found in this Report that no major trading partner other than Vietnam and Switzerland met all three criteria during the four quarters ending June 2020. Treasury has also concluded that no major trading partner of the United States other than Vietnam and Switzerland met the standards identified in Section 3004 of the 1988 Act during the relevant period.

Regarding the 2015 Act, Treasury has established a Monitoring List of major trading partners that merit close attention to their currency practices and macroeconomic policies. An economy meeting two of the three criteria in the 2015 Act is placed on the Monitoring List. Once on the Monitoring List, an economy will remain there for at least two consecutive Reports to help ensure that any improvement in performance versus the criteria is durable and is not due to temporary factors. As a further measure, the Administration will add and retain on the Monitoring List any major U.S. trading partner that accounts for a large and disproportionate share of the overall U.S. trade deficit even if that economy has not met two of the three criteria from the 2015 Act. **In this Report, the Monitoring List comprises China, Japan, Korea, Germany, Italy, Singapore, Malaysia, Taiwan, Thailand, and India, the last three being added in this Report.**

Ireland has been removed from the Monitoring List in this Report, having met only one out of three criteria – a significant bilateral surplus with the United States – for two consecutive

Reports. After Ireland ran a sizable current account surplus in 2018, the current account swung into deficit over the four quarters through June 2020.

With regard to the ten economies on the Monitoring List:

- China's real GDP contracted 6.8% year-over-year in the first quarter of 2020, as a result of the COVID-19 outbreak and strict containment measures, but grew 3.2% year-over-year in the second quarter and 4.9% year-over-year in the third quarter, with industrial activity leading the recovery. The authorities initially responded to the COVID-19 outbreak with targeted fiscal stimulus focused on health spending and fee waivers, but announced infrastructure investment measures in May, bringing the total discretionary fiscal measures announced to around 4.7% of GDP. Monetary stimulus has been moderate, with a focus on supporting small- and medium-sized enterprises. As Chinese policymakers work to contain future outbreaks of the virus and boost economic activity, they will need to rely on on-budget fiscal measures and balance monetary stimulus against increasing financial stability risks. To solidify the near-term recovery and strengthen long-term growth prospects, China should take measures to enhance social safety nets, support household demand and reduce precautionary savings, and permit a greater role for market forces.

  China's bilateral goods trade surplus with the United States remains by far the largest of any U.S. trading partner but has contracted over the past year. Over the four quarters through June 2020, China's bilateral goods trade surplus with the United States totaled $310 billion, compared to $400 billion over the four quarters through June 2019. Over the four quarters through June 2020, China's current account surplus rose to 1.1% of GDP, supported by a rapidly increasing overall trade balance and a large current account surplus of 3.1% in the second quarter of 2020. Given the longstanding challenges posed by China's extraordinary levels of both saving and investment, China needs to adjust its macroeconomic policies to support domestic consumption more forcefully and reduce further the Chinese economy's reliance on investment and exports.

  On January 15, 2020, the United States and China signed a Phase One trade agreement that requires changes to China's policies and practices in several key areas, including currency issues. In this agreement, China has made commitments to refrain from competitive devaluation and to not target its exchange rate for competitive purposes. Since the last Report in January, when Treasury lifted its designation of China as a currency manipulator, the renminbi (RMB) has appreciated 3.0% against the dollar through end-October.

  China provides limited transparency regarding key features of its exchange rate mechanism, including limited transparency regarding the policy objectives of its exchange rate management regime, the relationship between the central bank and foreign exchange activities of the state-owned banks, and its activities in the offshore RMB market. China does not publish foreign exchange intervention data, forcing Treasury staff to estimate the scale of China's intervention, both directly by the People's

Bank of China (PBOC) and indirectly through state-owned banks. The PBOC appears to have refrained from intervening in foreign exchange markets in 2019, but financial entities beyond the PBOC (notably state banks) purchased foreign exchange on net over the four quarters through June 2020. While intervention proxies do not provide definitive evidence that the PBOC intervened in foreign exchange markets over the review period, this issue warrants further investigation. In particular, the small scale of foreign reserve accumulation relative to China's substantial trade and portfolio inflows in the second quarter of 2020, coupled with the RMB's relative stability over the same time period, raises concerns. China should publish its foreign exchange intervention and increase public understanding of the relationship between the PBOC and the foreign exchange activities of the state-owned banks, including the use of foreign exchange derivatives and activities in the offshore RMB market. In addition, China should report fully FX derivatives data in line with the IMF's Standards for Data Dissemination template.

- Japan has employed a range of public health measures to contain the COVID-19 outbreak. Even so, amid the pandemic, economic activity contracted sharply, with the IMF projecting that GDP will decline 5.3% this year. A series of large fiscal spending measures including cash transfers to households and businesses, coupled with additional monetary easing, helped to mitigate the collapse in aggregate demand. The yen appreciated 4% against the dollar in 2020 through end-October, strengthening 1.5% in real effective terms over the same period. Japan has not intervened unilaterally in the foreign exchange market since 2011. Japan posted a sizable current account surplus of 3.1% of GDP over the four quarters ending in June 2020 and a bilateral goods trade surplus of $57 billion with the United States over the same time period. As economic recovery takes hold, Japan should pursue reforms that raise productivity, increase potential output, and facilitate strong and balanced growth.

- Korea implemented comprehensive public health measures that limited the spread of COVID-19. Nevertheless, Korea's financial markets experienced volatility, and its growth outlook deteriorated as the pandemic spread worldwide. The authorities eased monetary policy, took steps to stabilize financial markets, and enacted cumulative direct fiscal stimulus totaling 3.9% of GDP through September 2020. Korea's large external surpluses have continued to narrow, with the current account surplus falling to 3.5% of GDP over the four quarters ending in June 2020. Korea's goods trade surplus with the United States contracted over the same time period to $20.0 billion, as the pandemic weighed on exports. Over the four quarters through June 2020, Korea reports that it intervened on net to support the won in the spot market with foreign exchange sales of $9.1 billion (0.6% of GDP), including substantial net foreign currency selling as depreciation pressures intensified amidst the COVID-19 outbreak. Treasury welcomes Korea's steps to increase the transparency of its foreign exchange intervention, including by transitioning to quarterly disclosure from semiannual in December 2019. Given the slowdown in growth that was already underway prior to the pandemic, a stronger fiscal response seems warranted, particularly if growth wanes or further risks materialize.

- In Germany the economic impact of the COVID-19 pandemic has been severe, but the government has taken swift and targeted fiscal measures to mitigate the impact on employment, credit flow, and consumption. The government has approved 8.3% of GDP in direct fiscal support and has on offer liquidity support totaling 30.8% of GDP for firms seeking loans, equity, or guarantees. Germany's current account surplus stood at 6.8% of GDP over the four quarters through June 2020, and, at $253 billion, remains the largest in the world in nominal terms. Germany maintained a large bilateral goods trade surplus with the United States, at $62 billion over the same time period. The persistence of the massive current account surplus and the large bilateral trade imbalance with the United States continues to result from persistently weak domestic demand in Germany and an undervalued real effective exchange rate. While Germany's COVID-19 response measures should meaningfully support domestic demand in the near term, Germany still needs to undertake permanent reforms to unleash robust domestic investment and consumption. This would help underpin domestically driven growth and reduce large external imbalances. The European Central Bank (ECB) has not intervened unilaterally in foreign currency markets since 2001.[5]

- Italy's economy has contracted sharply this year, as Italy is among the countries hit earliest and hardest by the COVID-19 pandemic. To date, the authorities have responded with direct fiscal support totaling around 6.5% of GDP and loan guarantees approaching 50% of GDP. Fiscal support at both the Italian and European level remain critical to help Italy weather the pandemic and recover from the economic impact. Italy recorded a current account surplus of 3.0% of GDP over the four quarters through June 2020, while its goods trade surplus with the United States stood at $30 billion over the same period. Once the public health crisis abates and the economic recovery takes hold, it is important for Italy to undertake structural reforms to raise long-term growth — consistent with reducing high unemployment and public debt — and safeguard fiscal and external sustainability. The NextGenerationEU fund, including an unprecedented amount of grants, provides a key opportunity for Italy to tackle longstanding structural impediments to durably raising long-term growth. The ECB has not intervened unilaterally in foreign currency markets since 2001.

- Singapore was one of the first countries hit by COVID-19 once the virus spread beyond China, and the economy contracted sharply over the first half of 2020. The government responded with substantial fiscal support totaling approximately 20% of GDP, alongside monetary easing and temporary regulatory forbearance to help cushion the blow to businesses and households. Singapore had one of the largest current account surpluses in the world as a share of GDP at 16% in the four quarters through June 2020. Notwithstanding this large overall external surplus, Singapore has consistently run a bilateral goods trade deficit with the United States, which stood at $0.8 billion in the four quarters through June 2020. Singapore's central bank disclosed publicly its foreign exchange intervention, totaling $74.3 billion in the same period, equivalent to 21.3% of GDP. As economic recovery from the pandemic takes hold, Singapore should undertake

[5] For the purposes of Section 701 of the 2015 Act, policies of the ECB, which holds responsibility for monetary policy for the euro area, will be assessed as the monetary authority of individual euro area countries.

reforms to lower its high saving rate and boost low domestic consumption, including allowing the real effective exchange rate to appreciate, in order to help narrow its large and persistent external surpluses and reduce the need for such large-scale foreign exchange intervention.

- Malaysia's economy faced supply chain disruptions and weaker exports due to the COVID-19 pandemic, contracting sharply over the first half of 2020. The authorities responded with monetary easing, direct fiscal support of around 5% of GDP, and liquidity support that brings the total stimulus to around 20% of GDP. Malaysia has made substantial progress on external rebalancing over the last decade. Following a modest uptick in 2019, the current account surplus declined to 2.5% of GDP in the four quarters ending in June 2020, reflecting lower earnings from oil and gas and a wider services deficit. Malaysia also maintains a significant bilateral goods trade surplus with the United States, which totaled $29 billion in four quarters ending in June 2020. Malaysia does not publish foreign exchange intervention data, forcing Treasury staff to estimate the scale of Malaysia's intervention. Treasury estimates that net purchases of foreign exchange amounted to $3.7 billion, or 1.1% of GDP, in the four quarters through June 2020. Malaysia should allow the ringgit to appreciate to help reduce its large and durable external surpluses. As economic recovery from the pandemic takes hold, Malaysia can advance further external rebalancing through targeted policies that encourage quality investments and maintain sufficient social spending, which can help spur domestic demand and avoid excessive precautionary saving. Treasury also urges the Malaysian authorities to increase the transparency of foreign exchange intervention.

- Thailand's economy has been significantly affected by the COVID-19 pandemic, compounding the negative effects of a severe drought. Thailand was one of the first countries outside of China to experience an outbreak, and containment measures included a full border closure from late March to early July and significant restrictions on activity. Thai authorities are implementing a comprehensive monetary and fiscal package of approximately 15% of GDP to help cushion the impact of the pandemic. Coming into 2020, Thailand had run large current account surpluses for several years, reaching 7% of GDP in 2019, buoyed by large surpluses in both goods and services. The collapse of tourism receipts in 2020 caused the current account surplus to moderate to 6% of GDP in the four quarters though June 2020. In contrast, Thailand's bilateral goods trade surplus with the United States has continued to grow, reaching $22 billion during the same four quarters. The Thai authorities have credibly conveyed to Treasury that net purchases of foreign exchange amounted to 1.8% of GDP during this period. Thailand should allow the baht to appreciate to help reduce its large and durable external surpluses. The authorities should also take steps to reduce Thailand's external imbalances through policies that encourage private investment, reduce precautionary saving, and promote greater openness in domestically oriented sectors.

- Taiwan's swift and effective public health response to the COVID-19 pandemic helped it contain the outbreak and limit economic damage compared to many other economies. Real GDP growth contracted 0.6% year-over-year in the second quarter of 2020, weighed down by declines in consumption and investment, before recovering to 3.3% year-over-year growth in the third quarter. The central bank implemented several measures to ease monetary conditions and stabilize financial markets, and the authorities approved a cumulative fiscal package of 5.5% of GDP to support public health, vulnerable firms, and household consumption. Taiwan's persistently large current account surplus expanded in the first half of 2020, reaching 10.9% of GDP over the four quarters through June 2020. Its bilateral goods trade surplus with the United States expanded sharply over the four quarters through June 2020, rising to $25 billion from $18 billion a year prior. Taiwan disclosed net foreign exchange purchases totaling $10.5 billion over the four quarters ending in June 2020, equivalent to 1.7% of GDP. In March 2020, Taiwan disclosed publicly its foreign exchange intervention earlier this year in addition to its monthly swap position. Taiwan should allow the new Taiwan dollar to appreciate to help reduce its large and durable external surpluses. The Treasury welcomes Taiwan's recent steps toward transparency and looks forward to continued efforts in this area.[6]

- India's economy contracted sharply in the first half of 2020 due to the collapse in domestic demand brought on by the COVID-19 pandemic. The authorities responded with modest direct fiscal support of around 2% of GDP and substantial monetary easing. India's deep domestic demand contraction and slower recovery relative to its key trading partners contributed to the economy's first four-quarter current account surplus since 2004 (0.4% of GDP over the year to June 2020). India for several years has maintained a significant bilateral goods trade surplus with the United States, which totaled $22 billion in the four quarters through June 2020.

  Based on the central bank's regularly published intervention data, India's net purchases of foreign exchange accelerated notably in the second half of 2019, and following sales during the initial onset of the pandemic, India sustained net purchases for much of the first half of 2020. This pushed net purchases of foreign exchange to $64 billion, or 2.4% of GDP, over the four quarters through June 2020. Treasury continues to welcome India's long-standing transparency in publishing foreign exchange purchases and sales. Treasury encourages the authorities to limit foreign exchange intervention to periods of excessive volatility, while allowing the rupee to adjust based on economic fundamentals. By further opening the economy to foreign investors, India can also support economic recovery and bolster long-term growth.

Treasury continues to track carefully the foreign exchange and macroeconomic policies of U.S. trading partners under the requirements of both the 1988 and 2015 Acts. Treasury also continues to stress the importance of all economies publishing data related to external balances, foreign exchange reserves, and intervention in a timely and transparent fashion.

[6] Taiwan is the only major economy in Asia not to publish the full details of international reserves in accordance with the IMF's Standard Data Dissemination Standards.

Section 1: Global Economic and External Developments

This Report covers economic, trade, and exchange rate developments for the four quarters through June 2020 and, where data are available, developments through end-October 2020. This Report covers developments in the 20 largest trading partners of the United States, whose bilateral goods trade with the United States exceeded $40 billion over the four quarters through June 2020. These economies' total goods trade with the United States amounted to more than $3.2 trillion in the four quarters through June 2020, more than 80% of all U.S. goods trade during that period. For assessments of the criteria in Section 701 of the 2015 Act, data over the four quarters through June 2020 are considered.

U.S. Economic Trends

Before the emergence of SARS-Cov-2 (COVID-19), the United States was in an historically strong economic position. In the year before the pandemic, the expansion became the longest in history, and the overall unemployment rate fell to a five-decade low. In the year before the pandemic, unemployment rates for African Americans, Asian Americans, and Americans of Hispanic and Latino ethnicity reached record lows. Moreover, pro-growth policies yielded the fastest wage growth in two decades for the bottom decile of earners, and low-wage earnings have frequently grown faster than earnings for workers at the median, third quartile, or top decile since 2017.

However, COVID-19's rapid spread around the world severely affected U.S. and global economic performance, especially in March and April. In the United States, stay-at-home orders, mandated business closures, and other measures caused significant declines in real GDP growth in the first and second quarters. The unemployment rate rose to a post-World War II high; activity in the manufacturing and services sectors contracted; and consumer sentiment deteriorated sharply. At the same time, deflationary pressures mounted, reflecting a sharp decline in energy prices and weaker aggregate demand.

As economic activity resumed in May and the Administration's stimulus policies took hold, employment rebounded more rapidly than expected: from May through October, employers added almost 12.3 million payroll jobs, or 56% of what was lost in March and April. This rebound compares favorably with that experienced after the previous recession, when only 9% of lost jobs were regained in the first six months of labor market recovery. Retail sales have recovered fully to their pre-COVID-19 levels, even growing 5.7% year-on-year through end-October. Further, manufacturing and services have expanded in the past five months, at rates above 2019 averages, and deflationary pressures have abated.

Real GDP growth in the third quarter was substantial as well as historic: the economy grew by 33.1 percent at an annualized rate, the fastest quarterly pace in seventy years, and recovered roughly two-thirds of the cumulative loss of output during the first half of 2020. Even so, the economy will take time to recover fully given the severity of the recession. In early November, a consensus of private forecasters did not expect economic activity to recover to pre-pandemic levels until 2021 Q4 or later. They predicted that real GDP would decline 2.6% in 2020 on a fourth quarter over fourth quarter basis, before rebounding 3.4% in 2021.

Onset of U.S. Recession

The economy had shown resilience during the latter half of 2019, growing 2.5% at an annual rate despite headwinds such as slowing global growth, policy uncertainty, and the grounding of the Boeing 737 MAX aircraft. However, the spread of the COVID-19 virus and the measures to contain it led to a historically severe and sharp economic contraction. In early June, the National Bureau of Economic Research's Business Cycle Dating Committee identified the peak of the most recent U.S. expansion as having occurred in February 2020 – making it the longest expansion on record at 128 months.

During the latter part of March, stay-at-home orders and closures of non-essential businesses caused a steep deterioration in economic activity, and real GDP dropped 5.0% at an annual rate during the first quarter of 2020. According to the third estimate for second quarter economic activity, real GDP fell 31.4% at an annual rate, marking the first back-to-back quarterly declines in real GDP in over a decade.

Combined, real GDP dropped 19.2% at an annual rate during the first half of 2020, contrasting with the 2.5% advance during the latter half of 2019. Domestic final demand fell 20.2% during the first half of 2020, after rising 2.1% in the second half of 2019. Consumer spending decelerated precipitously during the first half of this year, dropping 21.1%, after growing 2.1% in the second half of 2019. After rising 0.8% during the second half of 2019, business fixed investment plunged 17.6% during the first half of 2020. The latter decline reflected a number of factors in the first and second quarters, including slowing international growth, policy uncertainty, decreased investment in oil and gas drilling rigs related to low oil prices, and company-specific difficulties (such as at Boeing and a labor dispute at GM). During the second half of 2019, residential investment constituted a bright spot in the economy and rose 5.2%, but it turned negative in the first half of 2020 and decreased 12.4%. Overall government spending growth slowed to 1.9% during the first half of 2020, following 2.3% growth during the latter half of 2019. However, the pace of federal government spending roughly doubled, accelerating from 4.4% during the latter half of 2019 to 8.7% during the first half of 2020. In contrast, state and local government spending growth declined 2.2% during the first half of 2020, after rising 1.0% during the second half of 2019. Net exports contributed an average 0.9 percentage point to growth during the first half of this 2020, after adding an average 0.8 percentage point to growth during the second half of 2019. Inventory accumulation subtracted 2.4 percentage points from growth during the first half of 2020, after shaving an average 0.5 percentage point from growth during the second half of 2019.

U.S. Government Policy Response

The U.S. government responded quickly with unprecedentedly bold fiscal and monetary actions to support American households and small businesses during the pandemic. This degree of coordination has been significantly greater in scale, and faster in implementation, than what was deployed following the 2008 financial crisis.

On the fiscal side, Congress has authorized record-setting economic aid packages of roughly $2.7 trillion through October. The Federal Government has aided Americans through Economic Impact Payments and has helped the unemployed by adding a temporary weekly federal benefit to normal state unemployment compensation and expanding eligibility for benefits to the self-employed and gig workers. The Administration also postponed tax payments and delayed loan payments for borrowers of federally backed student loans to boost disposable incomes and help American households weather the pandemic.

In addition, Treasury and the Small Business Administration launched the Paycheck Protection Program (PPP) less than a week after its authorization at the end of March. The Administration worked directly with private lenders and used their infrastructure to hasten businesses' receipt of funds. In less than two weeks, the PPP had exhausted its initial funding: it had processed nearly 1.7 million loans worth $342 billion. After a second appropriation, the PPP provided nearly 5 million loans, worth over $520 billion. Lenders have reported that PPP loans supported over 51 million jobs throughout the United States.

On the monetary side, the Federal Reserve swiftly cut its interest rate target to zero and implemented large-scale purchases of Treasury securities and agency mortgage-backed securities. Also, with the consent and backing of the Treasury Department, the Federal Reserve established emergency lending facilities through its Section 13(3) authority. Though current usage on these facilities is modest, their presence as a backstop helped to assuage the acute market stresses that arose in March and promote private lending to the economy. More recently, the Federal Reserve adopted a "flexible average inflation target" strategy that intends to better ensure that its 2-percent inflation target is an average to be maintained over time rather than a ceiling. This strategy, if successful, is expected to help expedite economic recoveries from downturns.

The Economy Remains Resilient

Due in part to the federal government's robust response, the economy started to recover in May after just two months of contraction. In the third quarter, real GDP rebounded 33.1% at an annualized rate, led by private consumption, private fixed investment, and the change in private inventories. Domestic final demand advanced 38.1% at an annualized rate in the third quarter. Personal consumption expenditures grew 40.7% at an annualized rate, recovering 71% of the household spending lost in the first and second quarters due to state and local lockdowns. Business fixed investment rose 20.3% at an annualized rate, driven by a 70.1% surge in equipment investment. Residential investment jumped 59.3% at an annualized rate in the third quarter, its largest advance since 1983. The change in private inventories added 6.6 percentage points to growth in the third quarter. Although government spending was down 4.5% at an annualized rate in the third quarter, the decline was from an elevated base in the second quarter, when implementation of the CARES Act boosted public expenditures significantly. Net exports subtracted 3.1

percentage points from growth in the third quarter, although the widening of the trade deficit also reflected the recovery of domestic demand, including demand for imports.

The recovery was also robust in labor markets. Before the pandemic, nonfarm payroll employment grew 207,000 jobs per month on average during the second half of 2019, accelerating to 233,000 jobs per month on average during the first two months of 2020. The unemployment rate trended lower over the course of 2019, ending the year at a half-century low of 3.5%, where it stood in February 2020. The labor force participation rate (LFPR) has trended higher in recent years, rising to a six-year high of 63.4% in February 2020. Among prime-age (ages 25-54) workers, the LFPR in January 2020 was 83.1%, its highest level since September 2008. Compensation growth remained solid through early 2020: nominal average hourly earnings for production and nonsupervisory workers rose 3.3% year-over-year in early 2020.

During March and April, however, the economy lost nearly 22.2 million jobs. Widespread business closures and declining aggregate demand pushed the unemployment rate up to 14.7% by April – a post-WWII high. Moreover, the LFPR fell to 60.2%, its lowest level since January 1973, and the prime-age LFPR declined to a 37-year low of 79.9%.

By November, 56% of the jobs lost had been recovered, and the unemployment rate had dropped 8.0 percentage points to 6.7%. The LFPR had rebounded to 61.5% in November, while the prime-age LFPR had recovered to 80.9%.

Nominal average hourly earnings for production and nonsupervisory workers were up 3.2% over the year through December 2019, then advanced 4.5% over the year through November 2020, as the loss of lower-wage jobs boosted the average. In real terms, earnings growth accelerated as the pace of inflation slowed during the pandemic. Real average hourly earnings rose 0.9% over the year through December 2019, and growth accelerated to 3.2% over the 12 months through October 2020. Wages and salaries for private industry workers, as measured by the Employment Cost Index, advanced 3.0% over the four quarters ending in December 2019 and rose by 2.7% over the four quarters ending in September 2020.

Deflationary pressures emerged in March 2020 due to the pandemic but dissipated quickly. Nonetheless, 12-month inflation measures remain below year-ago levels. The Consumer Price Index (CPI) rose 1.2% over the year through October 2020, slower than the 1.8% year-earlier pace. The core CPI, which excludes food and energy, rose 1.6% over the 12 months through October 2020, slowing from 2.3% over the year through October 2019.

Due to the shutdown of the economy as well as uncertainty about the COVID-19 virus, consumers' and businesses' outlooks deteriorated in the first half of 2020. Consumer sentiment, as measured by the Reuters/Michigan index, fell from 101.0 in February 2020 to 71.8 in April. However, sentiment trended higher as government financial assistance and the re-opening of the economy boosted incomes and jobs. By November the index rose to 76.9. Consumer confidence, as measured by the Conference Board index, exhibited a similar pattern.

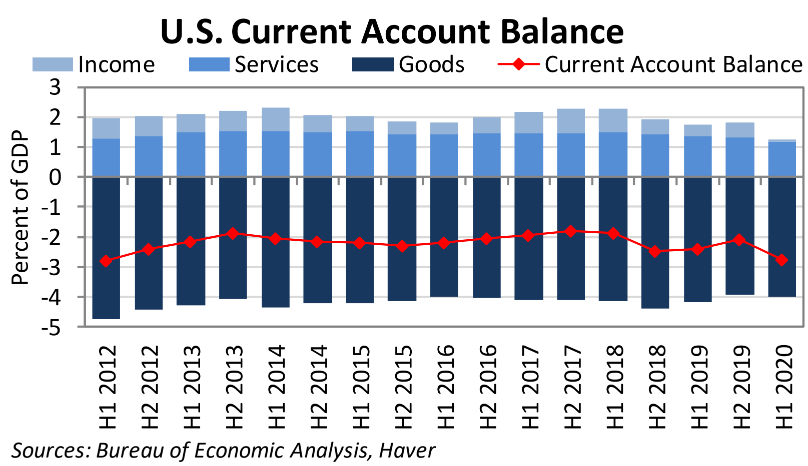
After rising to multi-year highs in 2018, measures of business activity trended lower in 2019. In August 2019, the Institute for Supply Management's (ISM) manufacturing index slipped below the growth threshold for the first time since 2016, and remained below, or essentially even with, that threshold through May 2020. Nonetheless, as of November 2020, the ISM's manufacturing index stood at 57.5, signaling expansion for the fifth consecutive month, and also rising well above the 2019 average level of 51.2. Non-manufacturing business growth also slowed in 2019 but continued to signal business activity expansion throughout the year and into 2020, save for a dip into negative territory in April and May. However, the continued uncertainty surrounding the pandemic, as well as possible new actions to combat the recent sharp rise in cases, could soften an economic recovery in the near-term.

Public Finances

The Federal Government's deficit and debt were trending higher before the pandemic but rose sharply as a result of the fiscal response to combat the pandemic's effect on the economy. At the end of fiscal year 2019, the deficit rose to 4.6% of GDP ($984 billion) and excluding net interest payments, the deficit was 2.9% of GDP. Federal debt as a share of GDP held by the public, or federal debt less that held in government accounts, increased to 79.2% of GDP in FY 2019.

For FY 2020, the federal deficit was $3.13 trillion, up $2.15 trillion from FY 2019. Federal net outlays totaled $6.55 trillion in FY 2020, up $2.10 trillion (47.3%) from FY 2019, largely due to the fiscal measures enacted to counter the pandemic and consequent recession. In addition, total revenues were down $44 billion (1.3%) from FY 2019.

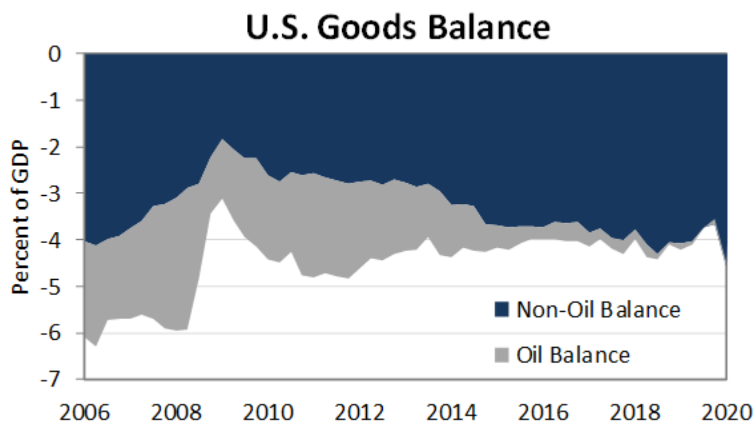
U.S. Current Account and Trade Balances



Sources: Bureau of Economic Analysis, Haver

The U.S. current account deficit rose in the second quarter of 2020 to 3.5% of GDP, up 1.4 percentage points from the first quarter. This was the largest deficit since the final quarter of 2008. In the second quarter of 2020, all major current account transactions declined when compared to the prior quarter. This mainly reflects the economic disruptions of the pandemic, as many businesses were operating at limited capacity or ceased operations completely, and the movement of travelers across borders was restricted. Both exports and imports of goods fell, with the decline in exports outpacing the drop in imports. Receipts of income fell more rapidly than payments of income resulting in a reduced income surplus. Prior to the second quarter of 2020, the headline U.S. current account deficit had been quite stable, around 2-2.5% of GDP since 2015.

The U.S. goods trade deficit widened to 4.5% of GDP in the second quarter of 2020 from 3.6% of GDP in the first quarter. Relative to the first quarter, goods exports declined 28.4% while imports fell 14.6%, mainly as a result of pandemic-induced demand weakness and supply disruptions both in the United States as well as abroad. The goods trade deficit has been relatively stable in recent years, in the range of 4-4.5% of GDP, with the exception of the narrower deficit in the first quarter of 2020.



Source: Bureau of Economic Analysis, Haver

Note: Trade growth calculated as year-over-year percentage change in the sum of exports and imports.
Source: U.S. Census Bureau, Haver

At the end of the second quarter, the U.S. net international investment position marked a net liability of $13.0 trillion (a record 66.9% of GDP), a deterioration of $0.9 trillion compared to the first quarter. The value of U.S.-owned foreign assets was $28.9 trillion, while the value of foreign-owned U.S. assets stood at $41.9 trillion. Deterioration in the net position in the second quarter of 2020 was due in part to the outperformance of U.S. equity markets relative to global peers.

International Economic Trends

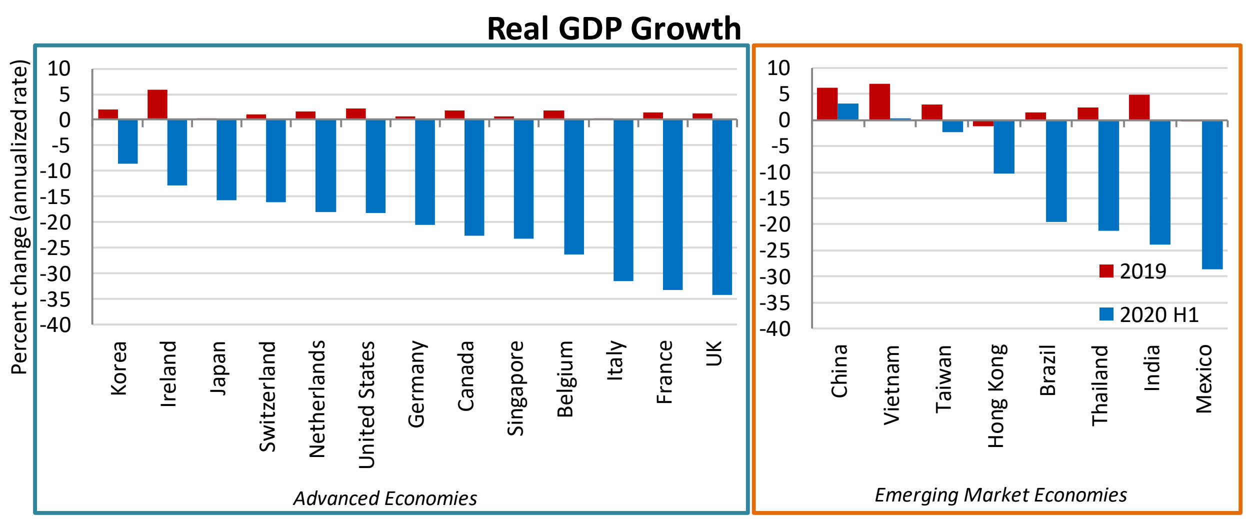
World economic growth was decelerating prior to the pandemic. Global growth slowed from 3.5% in 2018 to 2.8% in 2019, with the deceleration evident in both advanced and emerging market economies. A wide range of factors weighed on global activity in 2019, including political uncertainty in Europe and Latin America, financial turbulence in some large emerging markets, China's efforts to address corporate debt vulnerabilities, and ongoing geopolitical tensions.

The outbreak of COVID-19 at the end of 2019 and its spread across the world in early 2020 altered drastically the economic landscape, pushing the global economy into its sharpest and deepest recession since World War II. Efforts to arrest the spread of the virus —

including mass lockdowns as well as widespread voluntary social distancing — brought many forms of economic activity to a halt during the first half of the year. Equity markets fell precipitously in February and March, capital fled from emerging markets, and financial conditions tightened. During the second quarter, output fell at a historic rate. While many economies experienced sharp rebounds in activity during the third quarter as their economies reopened, efforts to prevent the virus from resurging will continue to weigh on activity. The IMF has forecasted that the global economy will contract by 4.4% in 2020.

Given the unprecedented nature of the shock, many governments and central banks have taken extraordinary actions to support their economies. Advanced economy central banks have lowered interest rates, resumed or accelerated asset purchases, and implemented a variety of programs to ease credit conditions. Emerging market central banks have likewise eased financial conditions by lowering interest rates. Some emerging market central banks have also pursued quantitative easing for the first time, albeit to a more modest extent than in advanced economies. Governments have used fiscal policy to support the unemployed, increase demand, and extend credit to keep businesses afloat. The IMF projects government deficits of advanced economies to more than quadruple from 3.3% of GDP in 2019 to 14.4% of GDP in 2020.

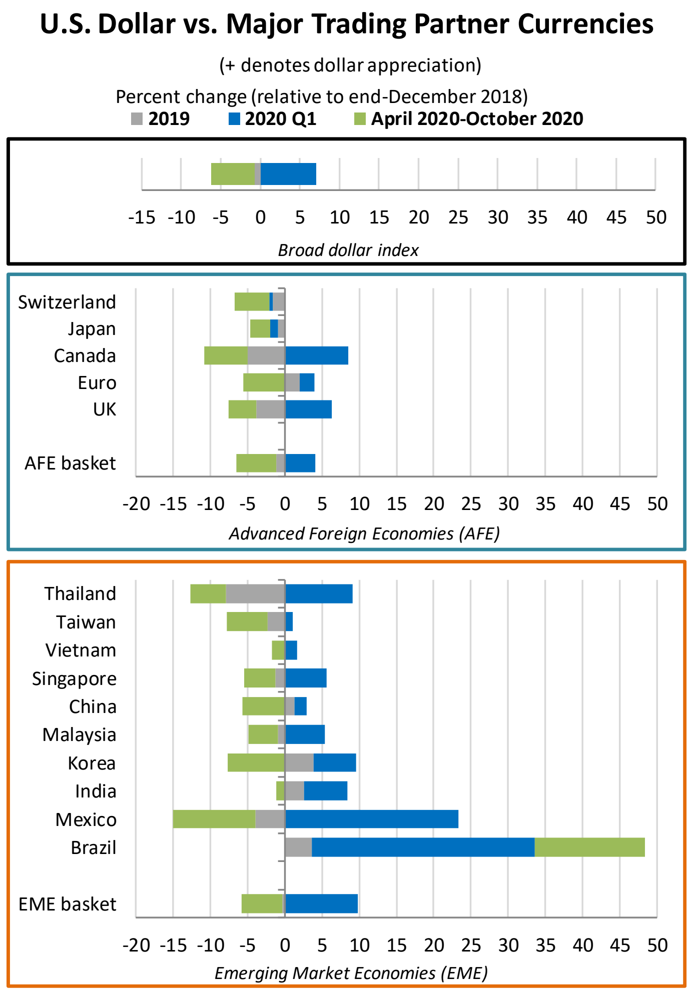
All of the aforementioned policies to boost domestic demand support wider growth across the globe as well. It is imperative that policymakers continue with such policies and do not turn to beggar-thy-neighbor actions that could hamper global recovery. Moreover, while the focus must remain on assistance and stimulus right now, policymakers also need to begin thinking through how support programs should evolve once economic recoveries become more established.



Note: Based off semester average of Q/Q SAAR growth rates. China, India, and Vietnam based off Y/Y NSA data for the final quarter of each period.
Sources: National Authorities, Haver

Foreign Exchange Markets[7]

After strengthening notably over 2018, the U.S. dollar depreciated slightly on net in 2019, with the nominal effective (trade-weighted) dollar 0.7% weaker at end-2019 compared to end-2018. Across other major currencies, the pound was 4.0% stronger against the dollar, driven by Brexit-related developments, while the euro continued to be weighed down by concerns about slowing growth in Europe, particularly in Germany. Across emerging market currencies, the dollar appreciated nearly 4% against the Korean won and the Brazilian real over 2019 as slowing economic growth and expectations of monetary easing weighed on both currencies.



Sources: FRB, Haver

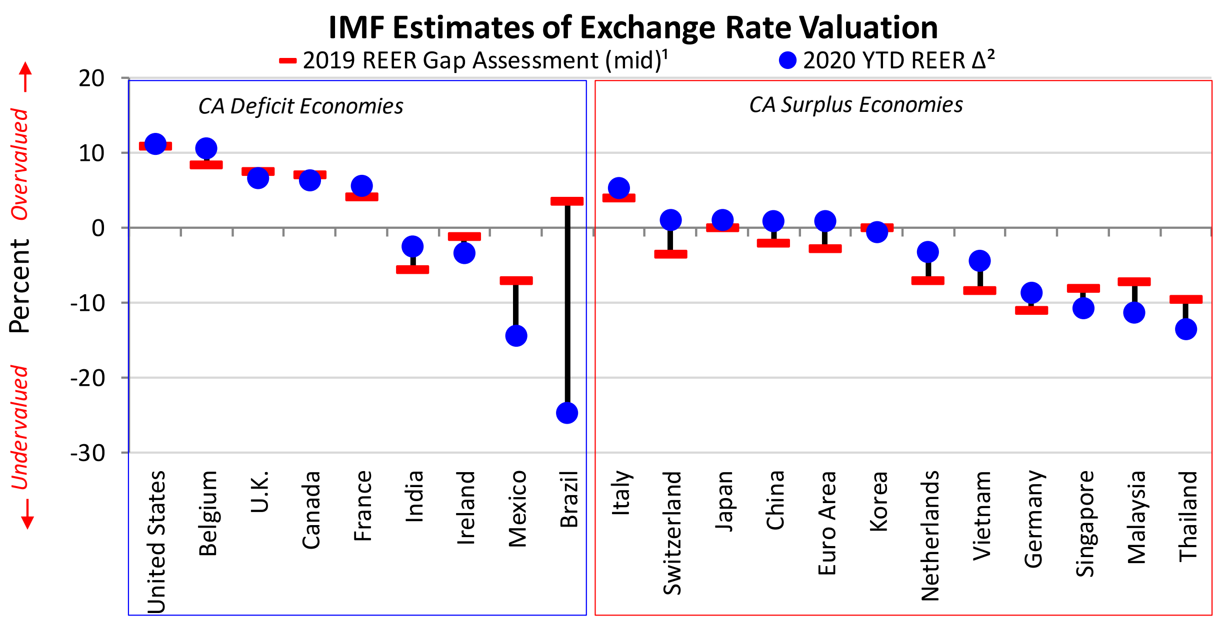
In the early months of 2020, the spread of COVID-19 set off a dash for safety to the dollar. Dollar funding markets tightened and the dollar experienced a sharp appreciation, with the nominal trade-weighted dollar spiking 10.2% from the beginning of the year to a recent peak on March 23. The dollar strengthened against the currencies of nearly every major trading partner, including more than 20% against the Brazilian real and Mexican peso and more than 10% against the British pound and many other currencies. Since mid-March, central bank action to ease dollar funding strains and support the economy, fiscal stimulus, stabilization of financial markets, and a gradual reopening of economies have helped lessen the rush to the dollar. The nominal trade-weighted dollar weakened 7.9% from March 23 to the end of October, leaving it 1.6% stronger for the first ten months of the year.

Sustained dollar strength is concerning given that the IMF continues to judge that the dollar is overvalued on a real effective basis (see chart below). Though the real effective value of the dollar weakened by

[7] Unless otherwise noted, this Report quotes exchange rate movements using end-of-period data. Bilateral movements against the dollar and the nominal effective dollar index are calculated using daily frequency or end-of-period monthly data from the Federal Reserve Board. Movements in the real effective exchange rate for the dollar are calculated using monthly frequency data from the Federal Reserve Board, and the real effective exchange rate for all other currencies in this Report is calculated using monthly frequency data from the Bank for International Settlements (BIS) or JP Morgan if BIS data are unavailable.

0.5% on net in 2019, as worries regarding global uncertainty eased at the end of the year, it remained elevated at roughly 7% above its 20-year average. Sustained dollar overvaluation could exacerbate persistent trade and current account imbalances. It is also concerning that the real effective exchange rates of several surplus economies that the IMF assesses to be undervalued depreciated further in 2020 (e.g., Thailand, Malaysia, and Singapore). Since the start of 2020, the real dollar has strengthened 0.3% on net and at end-October was nearly 8% above its 20-year average.

Treasury judges that foreign exchange markets continued to function smoothly in 2019. Though market functioning deteriorated in the early months of 2020 in response to the COVID-19 shock, swift central bank action calmed conditions and markets have been functioning more smoothly in the period since. The dollar continues to be the world's principal currency in international foreign exchange markets, reflecting its dominant global position both in terms of market turnover (being bought or sold in 88% of all currency trades) and trade settlement.[8]



Sources: IMF 2020 External Sector Report, IMF 2019 Article IV Consultation Staff Reports for Vietnam and Ireland, BIS REER Indices, JP Morgan, FRB
1/The IMF's estimate of real effective exchange rate (REER) gap (expressed as a range) compares the country's average REER in 2019 to the level consistent with the country's medium-term economic fundamentals and desired policies. The midpoint of the gap range is depicted above. For Ireland and Vietnam, the 2018 REER gap is used.
2/Change through October 2020 versus 2019 average. For Ireland and Vietnam, change through October 2020 versus 2018 average.
Note: The IMF does not provide an estimate of Taiwan's REER gap.

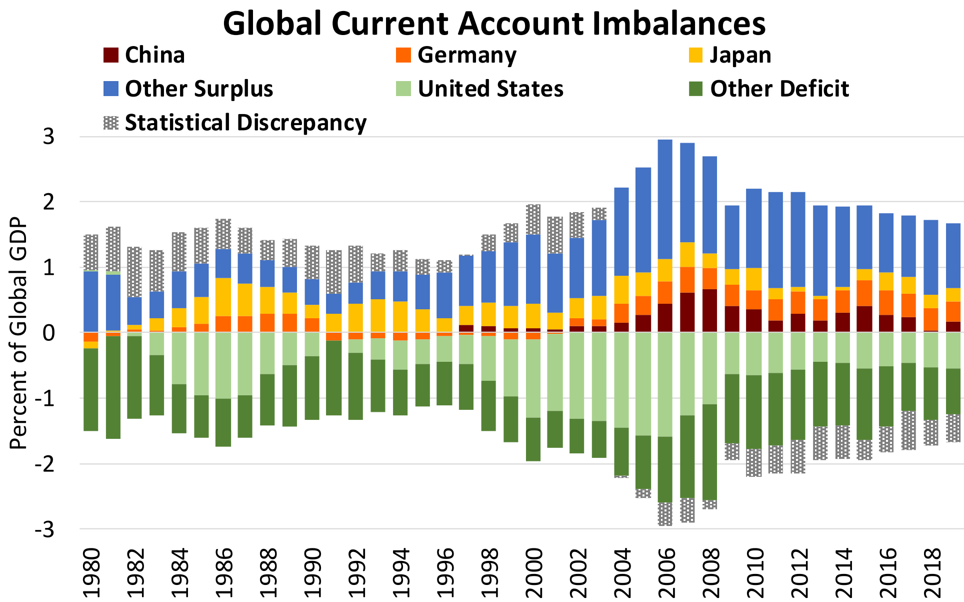
[8] Currency market turnover according to the 2019 Bank for International Settlement *Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives*.

Global Imbalances

Global current account imbalances have been broadly stable between 2017 and 2019, averaging around 1.7% of global GDP.[9] Although some very large surpluses have narrowed in recent years, many remain high. Furthermore, while the IMF forecasts that current account surpluses and deficits will narrow in 2020 to their lowest levels in two decades, recent balance of payments and trade data for the United States and other countries suggest persistent imbalances, potentially offsetting any reduction due to contractions in trade earlier this year. Among major U.S. trading partners, the very large surpluses of Germany, Netherlands, Singapore, Switzerland, Taiwan, and Thailand have each remained significant as a share of GDP, with the combined surpluses of these economies totaling $558 billion over the four quarters through June 2020 (roughly equivalent to 0.7% of global GDP). Japan's surplus is slightly smaller than in the same period in 2019 as a share of GDP at 3.1%, but in dollar terms is comparatively high at $158 billion. China's surplus, while relatively low as a share of GDP, also remains high in dollar terms at $157 billion in the four quarters through June 2020. Moreover, external stock positions continue to widen, reaching historical peaks.

In many cases, these imbalances reflect past policy distortions. Meanwhile, the recent rise in China's trade surplus is likely to continue weighing on global imbalances. In general, and especially at a time of slowing global growth, adjustments to reduce imbalances should occur through a symmetric rebalancing process that sustains global growth momentum rather than through asymmetric compression in deficit economies — the channel which too often has dominated in the past. In 2020, global imbalances have been affected by saving and investment shifts driven by the COVID-19 crisis and policy responses. As the global economic recovery path stabilizes, it is critical to adopt policies that allow for a narrowing of both surplus and deficit imbalances.

[9] Specifically, global current account surpluses have totaled 1.7% of global GDP in recent years. Correspondingly, global current account deficits, along with the statistical discrepancy (which has consistently been negative for more than a decade), also equal 1.7% of global GDP.

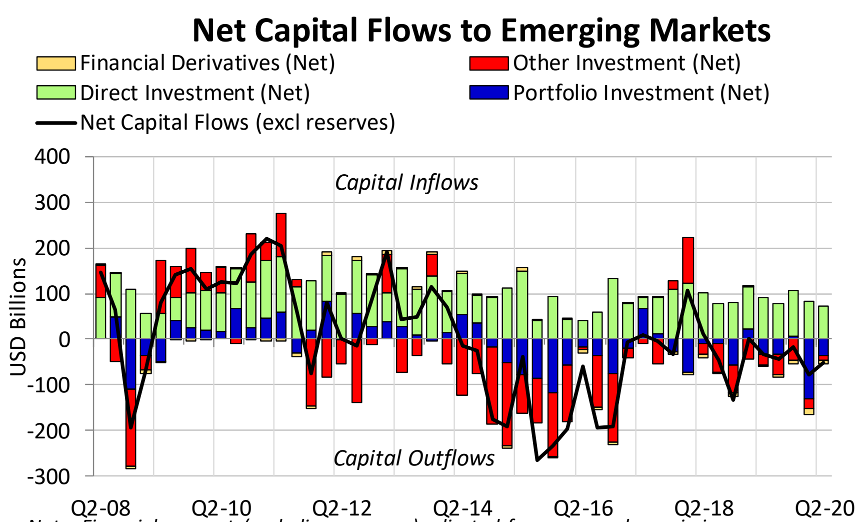


Sources: IMF WEO, Haver

Capital Flows

Relaxed global liquidity conditions in the first quarter of 2019, brought on by major central banks taking steps to address negative growth outlooks, led to strong inflows into emerging market economies. As the global growth outlook was marked down further and risk sentiment deteriorated in the second quarter of 2019, net outflows accelerated over the remainder of the year. Net portfolio and other flows to emerging markets totaled -$197 billion over 2019, remaining relatively unchanged compared to 2018, where emerging markets experienced a slow yet sustained pullback of nonresident portfolio flows. Foreign direct investment to emerging markets remained resilient in 2019 and was more than sufficient to offset portfolio and other outflows over the course of the year.

With the onset of the COVID-19 pandemic, global financial conditions tightened sharply in the first quarter of 2020, with emerging market sovereign bond spreads widening and currencies depreciating against the dollar. This precipitated a selloff of portfolio debt and equity flows unprecedented both in scale and pace. On net, portfolio outflows from



Note: Financial account (excluding reserves) adjusted for errors and ommissions. 2020 reflects data through the end-June where available.
Source: National Authorities, U.S. Department of the Treasury Staff Calculations

emerging markets increased to $131 billion in the first quarter of 2020 (based on data available as of mid-December), marking the largest quarterly outflow in decades. Meanwhile, net foreign direct investment inflows remained buoyant, while net other investment continued to flow out of emerging markets at comparable levels prior to the onset of the pandemic.

Global dollar funding strains began to relax in late March after the Federal Reserve announced the enhanced provision of dollar liquidity through swap lines with other major central banks and its new repo facility. Since then, dollar funding pressures have eased, although financial stress remains elevated relative to early 2020. Consequently, net capital flows began to recover as nonresident portfolio flows rebounded in the second quarter of 2020. Higher frequency data (from sources beyond quarterly balance of payments data) suggest that, since end-June, the pace of outflows has slowed substantially. Despite these more muted flows in recent months, cumulative portfolio outflows from the COVID-19 shock are on track to be one of the most severe episodes of recent decades.

Foreign Exchange Reserves

With the onset of the COVID-19 pandemic, global foreign currency reserves declined to $11.7 trillion at the end of the first quarter of 2020, a fall of $122 billion relative to end-2019 levels. This resulted largely from valuation effects (which reduced reserves $119 billion) caused by the appreciation of the dollar against other currencies over the first quarter of 2020. Meanwhile, net foreign exchange purchases only offset minimally the decline in the global level of reserves. Global foreign currency reserves have since risen slightly, reaching $12.0 trillion at the end of the second quarter of 2020. This rise was

Table 1: Foreign Exchange Reserves

	FX Reserves (USD Bns)	1Y Δ FX Reserves (USD Bns)	FX Reserves (% of GDP)	FX Reserves (% of ST debt)
China	3,112.3	-6.9	22%	267%
Japan	1,306.5	50.1	26%	39%
Switzerland	896.1	117.9	123%	86%
Taiwan	488.7	21.7	79%	258%
India	465.8	65.1	18%	444%
Korea	398.6	6.3	25%	258%
Brazil	336.8	-41.3	20%	471%
Singapore	309.8	38.3	89%	25%
Thailand	230.3	23.7	44%	439%
Mexico	183.1	9.1	16%	359%
UK	134.9	9.3	5%	2%
Malaysia	98.8	0.0	29%	103%
Vietnam	83.4	19.5	25%	334%
Canada	74.7	-0.2	4%	11%
France	53.8	4.9	2%	2%
Italy	43.0	1.8	2%	4%
Germany	37.9	1.1	1%	2%
Belgium	10.9	0.4	2%	2%
Netherlands	4.0	-0.2	0%	0%
Ireland	3.3	0.3	1%	0%
World	12,007.5	272.3	n.a.	n.a.

Foreign exchange reserves as of June 2020.
GDP caluclated as sum of rolling 4Q GDP through Q2-2020.
Short-term debt consists of gross external debt with original maturity of one year or less, as of the end of Q2-2020.
Sources: National Authorities, World Bank, IMF, BIS

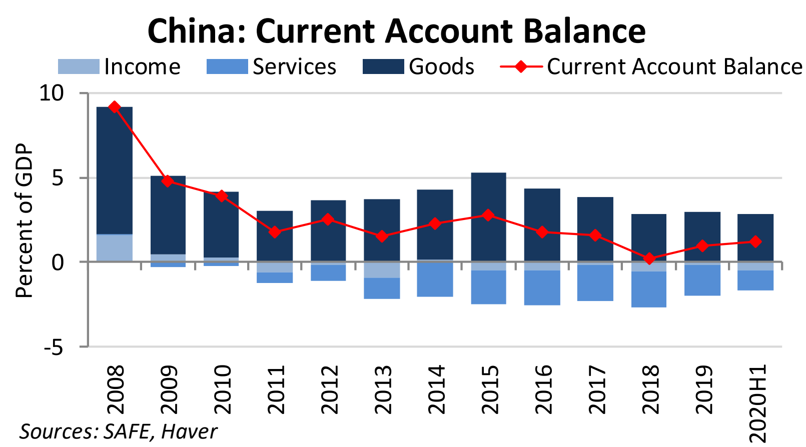
chiefly a product of large net foreign exchange purchases, with modest valuation effects ($78 billion) caused by the depreciation of the dollar against other currencies contributing to the rise in reserve levels.

The economies covered in this Report continue to maintain ample — or more than ample — foreign currency reserves compared to standard adequacy benchmarks. Reserves in most economies are more than sufficient to cover short-term external liabilities and anticipated import costs. Excessive reserve accumulation imposes costs both on the local economy (in terms of sterilization costs and foregone domestic investment) and the world. Economies should focus on enhancing resilience through stronger policy frameworks, as recommended by the IMF, rather than through increasing reserves to excessive levels.

Economic Developments in Selected Major Trading Partners

China

China's economy was the first to be impacted significantly by the COVID-19 outbreak and associated containment measures. The impact was broad-based, with China's real GDP growth falling from 6.0% year-over-year in the fourth quarter of 2019 to a contraction of 6.8% year-over-year in the first quarter in 2020 – the first recorded contraction since 1976 – driven by a sharp decline in consumption. Surveyed urban unemployment peaked at 6.2% in February, from 5.2% in December, but the actual level of unemployment may likely be much higher given data limitations. China's real GDP subsequently increased 3.2% year-over-year in the second quarter and 4.9% year-over-year in the third quarter, though the recovery itself has been highly imbalanced with private demand lagging industrial output.



These shocks to activity have generated a marked swing in China's external position in 2020. China's current account swung to a deficit of 1.1% of GDP in the first quarter of 2020, with both imports and exports contracting sharply.[10] This was followed by a large current account surplus of 3.1% of GDP in the second quarter, as China's goods surplus increased by nearly 54% year-over-year and the services deficit decreased by over 55% year-over-year as outbound tourism suffered as a result of global travel restrictions. Overall, in the four quarters through June 2020, China's current account surplus widened to 1.1% of GDP ($157 billion), compared to a surplus of 0.9% of GDP ($127 billion) in the four quarters through June 2019. More recently, in preliminary balance of payments data for the third quarter, China recorded a current account surplus of

[10] Seasonal adjustment issues, as well as the timing of the lunar new year holiday with the beginning of the COVID-19 outbreak, may have also played into the swing in the current account in the first quarter.

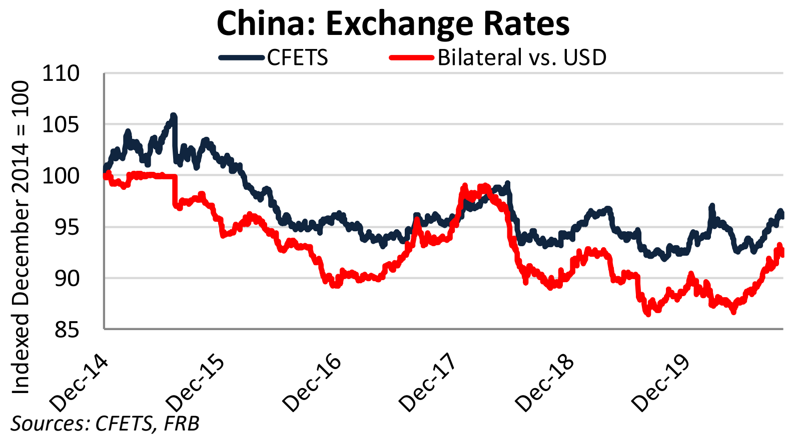
around 2.4% of GDP ($94 billion), supported by a substantial goods trade surplus of $155 billion, a 27% year-over-year increase, while the services deficit of over $40 billion, a 44% year-over-year decrease, continued to reflect subdued outbound tourism due to travel restrictions. China appears likely to run a larger external surplus this calendar year relative to the previous year, even though global demand remains weak.

China's bilateral goods trade surplus with the United States remains the largest by far of any U.S. trading partner, although it has been trending downward. Since peaking at almost $420 billion in 2018, China's bilateral goods trade surplus with the United States has declined steadily, reaching $345 billion in 2019 and narrowing further in the four quarters through June 2020 to $310 billion. China continues to run a deficit in its bilateral services trade with the United States, which totaled $30 billion in the four quarters through June 2020, compared to $36 billion in the four quarters through June 2019.

China's fiscal response to the COVID-19 crisis has been more targeted and smaller compared to most other G20 economies. The initial response focused on health spending and fee reductions, followed by the authorities' announcement of additional fiscal stimulus at the May National People's Congress, including cuts to the value added tax and corporate social insurance payments, and plans for infrastructure investment. Although the authorities announced a relatively small increase in the general government deficit (to 3.6% from 2.8% of GDP), total discretionary stimulus amounts to more than 4.7% of GDP when accounting for additional spending in the broad budget (which includes social security and other government funds). Authorities also issued special treasury bonds, for the first time since 2007, as well as proposed increasing the local government bond issuance quota to help finance the fiscal response.

China's monetary policy response to the pandemic has also been restrained relative to developed economies, with greater emphasis on facilitating indirect support through bank lending. Measures include liquidity injections through open market operations, cuts to key policy rates and reserve ratio requirements and expanding re-lending and re-discounting facilities to ease financial conditions, and window guidance to direct banks to increase lending, especially to the private sector and small- and medium-sized enterprises (SMEs). The authorities have also relied heavily on regulatory forbearance measures, including delaying loan repayments for SMEs, and permitting banks to maintain higher levels of non-performing loans. Credit growth has thus increased across the board, mainly driven by household loans and government and corporate bond issuances.

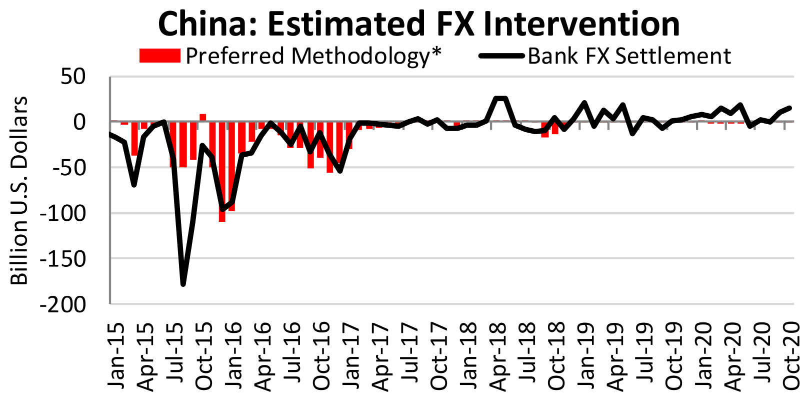
This year, the RMB has appreciated 4.0% against the dollar and 4.2% against the PBOC China Foreign Exchange Trade System nominal basket through the end of October.[11] The real effective exchange rate has strengthened by 2.8% through the end of October. In the first half of this year, the RMB remained relatively stable compared to other emerging market currencies, depreciating only 1.5% against the dollar despite significant market volatility that led to increased capital outflows in the first quarter of 2020, followed by a large current account surplus and portfolio inflows in the second quarter of 2020. More recently, the RMB has strengthened 5.6% against the dollar since the end of June through the end of October supported by favorable interest rate differentials, increased investment inflows, and positive economic data, including a substantial trade surplus.



China provides very limited transparency regarding key features of its exchange rate mechanism, including the policy objectives of its exchange rate management regime, the relationship between the central bank and foreign exchange activities of the state-owned banks, and its activities in the offshore RMB market. The PBOC manages the RMB through a range of tools, including the setting of the central parity rate (the "daily fix") that serves as the midpoint of the daily trading band. In May 2017, the authorities introduced a "counter-cyclical factor" that allowed for more discretion in the setting of the daily fix. In October, the authorities announced that use of the counter-cyclical factor would be suspended, although whether this is a permanent suspension is unclear. This follows a decision earlier that month by the authorities to remove the risk reserve ratio on foreign exchange forwards first imposed in 2018. While both announcements appear consistent with the authorities' desire to reform the exchange rate mechanism, in the near term, these changes may also limit the RMB's appreciation against the dollar. The PBOC can manage the RMB through other tools, including by influencing the interest rates of RMB-denominated assets that trade offshore, influencing the timing and volume of forward swap sales and purchases by China's state-owned banks, and through direct intervention in foreign exchange markets.

[11] The China Foreign Exchange Trade System (CFETS) RMB index is a trade-weighted basket of 24 currencies published by the People's Bank of China (PBOC).

China does not publish its foreign exchange market interventions, forcing Treasury staff to estimate China's direct intervention in the foreign exchange market. Official foreign exchange reserves have remained roughly unchanged on net since the beginning of 2019, standing at $3.1 trillion as of June 2020. Reserves did fluctuate briefly this spring, decreasing by $46.1 billion in March – the largest monthly decrease since November 2016 – and subsequently bouncing back by $30.8 billion in April. More comprehensive measures that proxy for intervention, however, have been less volatile. Monthly changes in the PBOC's foreign exchange assets have been modest so far this year, while net foreign exchange purchases by financial entities beyond the PBOC, notably state banks, have moderately increased this year through June. Given China's substantial trade and portfolio inflows in the second quarter of 2020 and the RMB's relative stability over the same time period, the lack of substantial official foreign exchange reserve accumulation in the second quarter merits close attention. Treasury will be monitoring closely foreign exchange intervention proxies and related data for signs of possible intervention by the PBOC or the state banks.



Sources: PBOC, SAFE, U.S. Treasury Estimates
**Based on change in FX-denominated assets on PBOC balance sheet*

China's growth had been slowing prior to the COVID-19 shock, with real GDP rising 6.1% in 2019 amidst the authorities' deleveraging campaign. Capital outflow pressures increased modestly but remain far below the peak levels witnessed in previous years. Treasury estimates that, in the four quarters through June 2020, net capital outflows (excluding flows accounted for by trade and direct investment) totaled $297 billion, compared to $256 billion in outflows for the four quarters through June 2019. Separately, in the second quarter of 2020 China recorded a large net errors and omissions deficit of nearly $76 billion, suggesting an uptick in undocumented capital outflows that are not captured within the conventional components of the financial account.[12] Overall pressure on the financial account has been curbed in recent years by relatively tight controls on outbound flows and, more recently, by strong portfolio inflows.

As the authorities attempt to balance supporting economic activity and containing future outbreaks of the virus, they will need to rely on budget fiscal measures and balance monetary stimulus against increasing financial stability risks. To strengthen long-term growth prospects, China should take decisive steps to further rebalance its economy and allow for greater market openness by implementing structural reforms to reduce state intervention, strengthen household consumption growth, and permit a greater role for market forces. Structural reforms should include measures to enhance social safety nets

[12] China's reporting of its net errors and omissions data has historically lagged behind reporting of other balance of payments data, raising additional questions about data quality and disguised capital outflows.

and increase spending on social welfare, including healthcare, to lower precautionary savings and support greater household consumption growth to rebalance the economy.

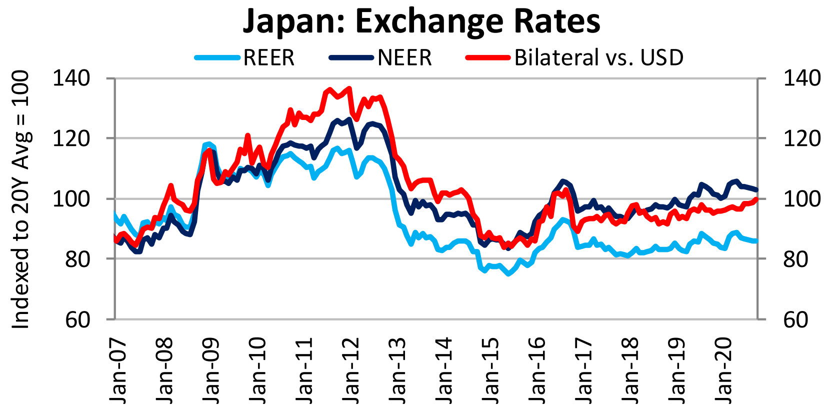
Japan

At the beginning of 2020, Japan's economy was on weak footing having already contracted 7.2% at an annualized rate in the fourth quarter of 2019 following last October's consumption tax hike. In Q1 2020, at the onset of the pandemic, real GDP contracted 2.1% at an annualized rate. The implementation of state of emergency measures in Q2 2020, coupled with lower business investment, flagging net exports, and public reluctance to engage in various economic activities, contributed to a historic annualized contraction of real GDP of 29.2%. Output rebounded strongly by a 22.9% annualized rate in the third quarter, and higher frequency data suggest additional gains in the fourth quarter. Nevertheless, according to the IMF, economic output in Japan will not fully recover to end-2019 levels until 2024. Over the first half of 2020, state of emergency measures encouraging citizens to stay home and public reluctance to engage in various economic activities amid the pandemic drove an acute slowdown in private consumption and investment amid the pandemic.

Japan's government has responded to the crisis with three large supplemental budgets that are among the largest stimulus packages announced by any advanced economy, totaling more than 50% of GDP in both direct and indirect support. Direct spending accounts for roughly one-quarter of the total fiscal response and includes measures to ease hardships for households and businesses through the provision of cash transfers to those affected by the downturn. The more substantial indirect measures include tax payment deferrals and concessional loans to businesses, with specific support for small-and-medium enterprises. The Bank of Japan (BOJ) has taken a number of measures to further ease monetary conditions including by removing the ceiling on government bond purchases and increasing asset purchase limits for exchange-traded funds, Japan real estate investment trusts, commercial paper, and corporate bonds. The BOJ also implemented multiple financing initiatives to support bank lending. In March 2020, the USD/JPY cross-currency basis plummeted about 120 basis points on a three-month basis amid emerging dollar liquidity pressures.[13] On March 17, to ease dollar liquidity constraints among Japanese banks, the BOJ drew upon its standing swap line arrangement with the Federal Reserve. As dollar liquidity demands eased over the following months, BOJ drawing on the swap fell from $223 billion in May to $750 million as of end-November 2020.

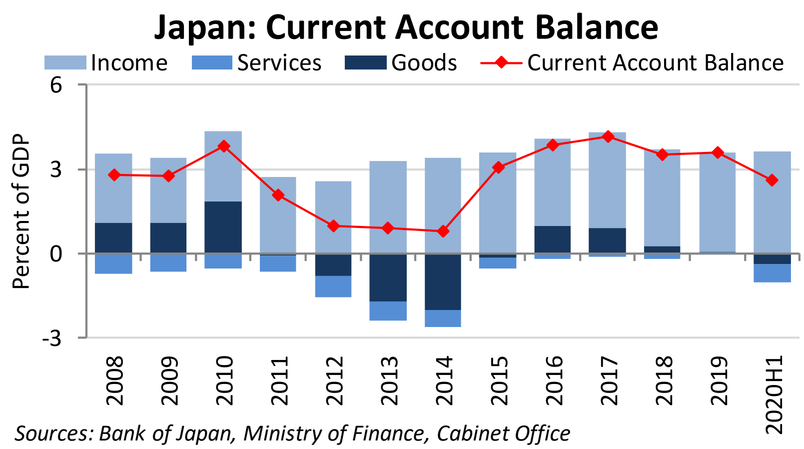
[13] A cross-currency basis swap is the simultaneous exchange of a loan in dollars for a one in a foreign currency. The interest rate on the dollar principal is based on the dollar reference rate, while that of the foreign principal is tied to the reference rate of the foreign currency plus a spread, which is commonly referred to as the basis. The counterparty that borrows foreign currency pays the basis, while the one that borrows dollars receives the basis.

After appreciating close to 1% against the dollar in 2019, the yen appreciated an additional 4.0% against the dollar through end-October, as the deterioration in global risk sentiment sparked by the spread of COVID-19 drove flows into traditional safe haven currencies. On a real effective basis, the yen rose 1.5% through end-October, after appreciating 1.5% in 2019. Despite the recent appreciation, the real effective yen remains weaker than average historical levels. Japan publishes its foreign exchange interventions and has not intervened in foreign exchange markets since 2011. Treasury's firm expectation is that in large, freely traded exchange markets, intervention should be reserved only for very exceptional circumstances with appropriate prior consultations.



Sources: FRB, Bank for International Settlements

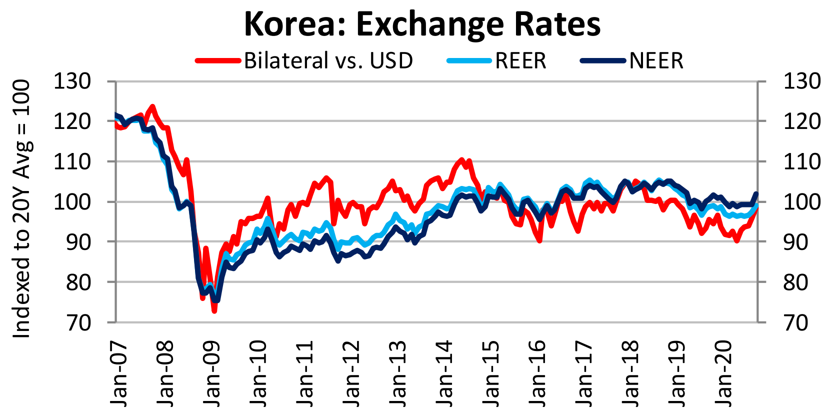
Japan's current account surplus was 3.6% of GDP in 2019. The drag on global trade from the COVID-19 shock weighed modestly on Japan's trade balance in the first half of 2020, pulling the current account surplus down to 3.1% of GDP over the four quarters through June 2020. Japan's current account surplus continues to be driven primarily by income on its substantial net foreign assets. Earnings remained the same over the four quarters ending June 2020 compared to calendar year 2019, but net exports of goods and services fell into deficit by 0.4% of GDP. The goods trade surplus with the United States over the four quarters ending in June 2020 was $57 billion, down 18% over the same period in 2019 year-over-year.



Sources: Bank of Japan, Ministry of Finance, Cabinet Office

Looking ahead, the IMF projects Japan's real GDP will contract 5.3% in 2020 and rebound to 2.3% positive growth in 2021. Policymakers should prioritize containing COVID-19 and mitigating its economic impact while smoothing a transition to longer-term objectives. Once economic activity normalizes, Japanese authorities should pursue structural reforms to reduce macroeconomic imbalances, increase productivity, and raise potential growth while maintaining fiscal flexibility to support growth in the near-term.

Korea



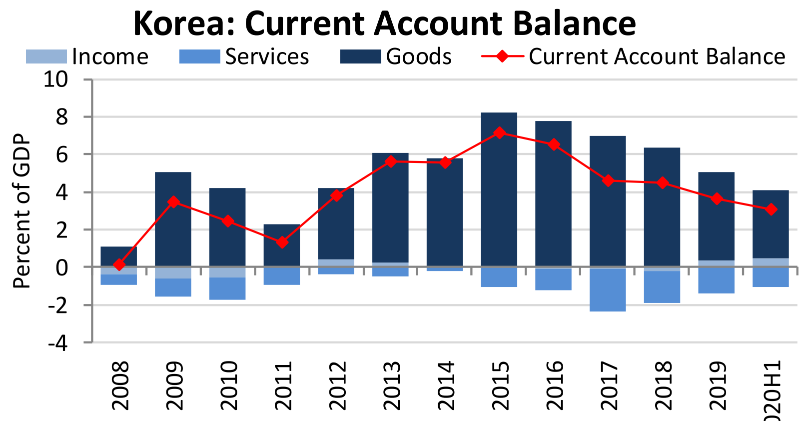
Sources: FRB, Bank for International Settlements

In early 2020, Korea experienced one of the first COVID-19 outbreaks outside of China. By mid-March, Korea implemented comprehensive public health measures which limited the spread of the virus without large-scale mobility restrictions. Nonetheless, the escalation of COVID-19 cases in Europe and the United States spurred marked volatility in global and Korean financial markets, with foreign investors selling $10.5 billion in Korean equities in the first quarter of 2020. Dollar liquidity pressures also emerged, with the FX swap basis spread between the won and dollar widening to over 400 basis points in early March. The Federal Reserve announced a temporary $60 billion swap line with the Bank of Korea (BOK) on March 19, which supported nearly $20 billion in dollar auctions through May, helping alleviate liquidity pressures. Nonetheless, from January through May, the won depreciated 6.6% against the dollar.

Depreciation pressures began to abate in May, supported by slowing non-resident outflows from Korean equities and continued non-resident inflows into Korean debt. Inflows into Korean debt remained stable throughout the year. The BOK ceased foreign exchange auctions through the Federal Reserve swap line on May 8, and the outstanding balance of Federal Reserve swap line positions declined to zero by July 30.

The BOK has taken several measures to ease monetary conditions and stabilize financial markets, including lowering the policy rate by a cumulative 75 basis points to 0.5%. Korea also enacted emergency fiscal measures from March to September to address the health and economic crisis totaling 3.9% of GDP in direct stimulus. These measures included support for disease prevention and treatment, loans and guarantees for affected firms, and direct transfers to households. Though historically large for Korea, these measures are small relative to other advanced economies. With a relatively low debt-to-GDP ratio of approximately 44%, Korea has ample fiscal space to support growth.

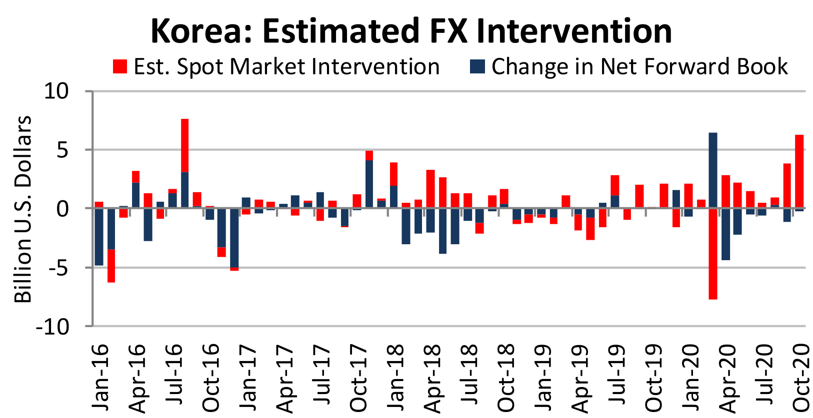
Prior to the pandemic, growth of the Korean economy was already slowing. Growth in 2019 was 2.0% year-over-year, a seven-year low. In the face of simultaneous supply and demand shocks caused by COVID-19, Korea's GDP contracted 8.6% at an annual rate in the first half of 2020, its sharpest drop since the fourth quarter of 2008.



Sources: Bank of Korea, Haver

Exports were particularly hard hit, falling 31.4% at an annualized rate over the first half of the year. The Korean economy returned to growth in the third quarter of 2020, with output rising 8.8% at an annual rate. Third quarter growth was led by a large positive contribution from the external sector, with real exports increasing 81.0% (annualized) from the second quarter. Korea's current account balance continued to narrow over the four quarters through June 2020 to 3.5% of GDP, as a large goods trade surplus has narrowed steadily from its peak in 2015. Korea's bilateral goods trade surplus with the United States contracted in the four quarters through June 2020 to $20.0 billion. Downside risks such as weak global demand may continue to weigh on the goods surplus going forward, though this may be offset to some degree by a narrowing of the services (particularly tourism) deficit.

Korea reported net foreign exchange sales of $9.1 billion (0.6% of GDP) in the spot market to support the won over the four quarters ending in June 2020. Over the same period, the won depreciated 3.8% against the dollar and depreciated 2.2% on a real effective basis. Korea has well-developed institutions and markets and should limit currency intervention to only exceptional circumstances of disorderly market conditions. Korea maintains ample reserves at $408 billion as of September 2020, equal to 2.6 times gross short-term external debt. Treasury welcomes Korea's steps to report foreign exchange intervention in a more transparent and timely manner, including by transitioning to a quarterly from a semiannual disclosure schedule in December 2019.[14]



Sources: Bank of Korea, U.S. Treasury estimates

[14] Treasury's estimates are more frequent and are based on valuation-adjusted changes in foreign exchange reserves as well as changes in the central bank's forward position. For the four quarters ending in June 2020,

Given the scale and duration of the economic shock emanating from the pandemic, it will be important for the authorities to continue to calibrate policy support measures — particularly fiscal support — to facilitate a full recovery. Moreover, given the slowdown to growth that was underway even prior to the pandemic, a stronger fiscal response (more in line with other advanced economies) seems warranted, particularly if growth wanes or further risks materialize. Structural measures will also be required to increase potential growth over the medium term, including comprehensive labor reforms that address duality in the labor market and expanding social safety net programs in order to reduce old-age poverty and support domestic demand.

The Euro Area

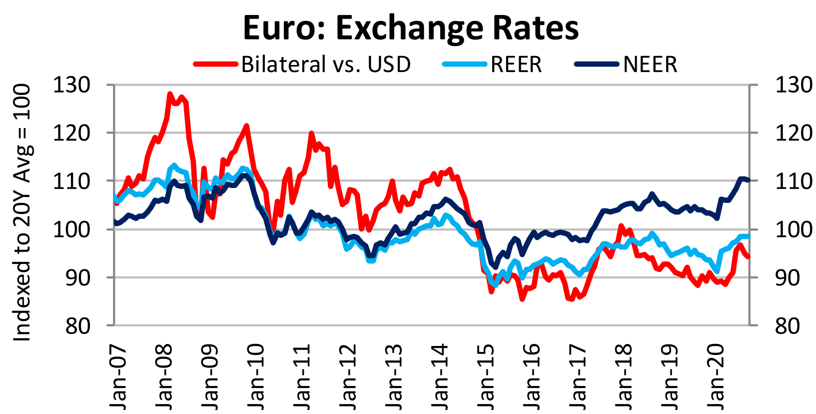
The COVID-19 pandemic has triggered the biggest economic slump in Europe since World War II. Euro area economic output shrank by a record 15.1% from the fourth quarter of 2019 to the second quarter of 2020 as activity ground to a halt for much of March and April due to the pandemic and broad implementation of restrictive health measures. Economic activity regained momentum over the summer as infection rates and lockdown measures eased across the euro area, but the nascent recovery has been put at risk by a resurgence in coronavirus infections in the fall and the corresponding reintroduction of containment measures across the euro area.

Policymakers have launched an unprecedented combined monetary and fiscal response to ease the retrenchment in private demand and alleviate potential supply disruptions, in hopes of maintaining the foundations for a restoration in economic activity as restrictions ease. At the national level, this includes country-level discretionary fiscal measures amounting to around 4.5% of euro area GDP in 2020, and loans and guarantees or capital injections with a total envelope of around 24% of euro area GDP. At the European Union (EU) and euro area level, it includes a number of monetary and fiscal measures. Most notably, the European Central Bank (ECB) created a new bond buying program, the Pandemic Emergency Purchase Program (PEPP) with an envelope of up to €1.35 trillion ($1.6 trillion) running through June 2021, and massively expanded ECB term lending to euro area banks at highly favorable rates to support the monetary policy transmission mechanism. On the fiscal side, in April the EU agreed a €540 billion ($650 billion) package of loans. This was followed by agreement in July on a €750 billion ($900 billion) recovery fund to be funded by the issuance of long-term bonds and consisting of grants and loans to member countries and sectors hardest hit by the pandemic. The recovery fund, in particular its grant portion, should help promote a more symmetric recovery across European countries and, together with ECB policy, further reduce tail risks related to the viability of the monetary union. Still, the future path for the euro area economies is difficult to gauge given the exceptional nature of the shock, and will depend on the path of the virus

Treasury estimated $5.2 billion by Korea in spot purchases in addition to $1.1 billion in forward contracts, for a net of $6.3 in estimated foreign exchange purchases. Increases in Korean domestic banks' foreign exchange deposits with the BOK and realized capital gains from the BOK's sales of foreign currency securities amid volatile market conditions appeared to drive the unusually large gap between Treasury's estimate and the Korean authorities' reported intervention figure.

itself, the nature and duration of public health measures, their impact across sectors, and the speed at which economic activity normalizes.

The European Commission projects that the euro area current account surplus will narrow modestly to 2.6% of GDP in 2020 (from 3.1% of GDP in 2019), led by falling manufacturing exports in Germany and the Netherlands and sharp declines in services exports among tourism-oriented economies.



Sources: FRB, Bank for International Settlements

As global financial market volatility rose this spring amid the widening COVID-19 pandemic, spot rate swings and option-implied volatility between the euro-dollar currency pair reached multi-year highs in March. On March 15, the Federal Reserve, the ECB, and four other major central banks announced adjustments to their standing U.S. dollar liquidity swap line arrangements to enhance the availability and effectiveness of U.S. dollar liquidity operations. Subsequently, European banks through the ECB drew up to $145 billion through the swap line arrangement.[15] In combination with other actions by the Federal Reserve, this helped alleviate global dollar liquidity pressures, and by the end of April, market pricing and volatility had receded closer to normal historical levels. On net in 2020 the euro is stronger against the dollar (3.7% through end-October), having gradually strengthened since late April. The euro has strengthened somewhat more on a trade-weighted basis, rising 6.6% and 5.0% on a nominal and real effective basis, respectively, over 2020 though end-October. The IMF's most recent assessment judged the euro area's external position to be moderately stronger than warranted by medium-term economic fundamentals and desirable policies.

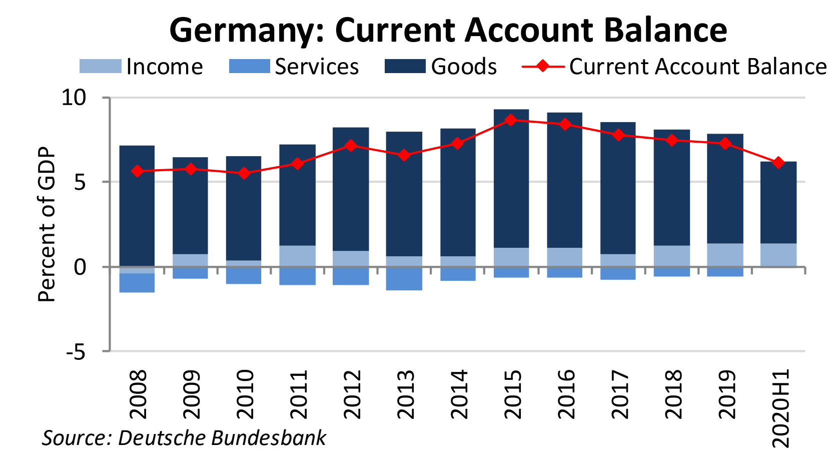
The ECB publishes its foreign exchange intervention and has not intervened unilaterally in foreign exchange markets since 2001.

Germany

Germany acted swiftly to contain the initial spread of COVID-19 in the spring, allowing the government to gradually reopen the economy in early May and limit the economic consequences of the pandemic relative to other countries in Europe. However, in November Germany again closed most commercial activities to stem the second wave of COVID-19 infections. The partial lockdown will last until at least December 20 and halt GDP growth in the fourth quarter, with the government forecasting that the German

[15] As of end-October, outstanding amounts under the swap line with the ECB stood at $0.9 billion.

economy will contract 5.1% in 2020.[16] Germany has demonstrated its willingness to abandon, at least temporarily, its prior strict fiscal stance by adopting large fiscal stimulus measures and suspending its constitutional debt brake to take on unprecedented deficit spending.[17] Germany has approved $316 billion (8.3% of GDP) in direct assistance for shuttered businesses, targeted sectors, and supplemental wages. In addition, Germany has approved $1.2 trillion (30.8% of GDP) in loans, equity, and guarantees to firms, even though take up remains low due to lower financing needs and higher use of direct assistance, as well as the higher cost of certain guarantee schemes. These early and large fiscal measures contributed to a strong recovery in German economic activity in the third quarter, particularly on the demand side. Current measures in place to support closed businesses and affected workers through the latest closures include grants to firms for up to 75% of their November 2019 sales, subsidies for the automotive and airline sectors, and extending financing for small- and medium-sized firms until June 2021. Other stimulus measures introduced by the German government, including the temporary cut in the VAT rate, have also supported domestic demand.



Germany's large current account surplus has narrowed somewhat in 2020 as the shock to global trade has weighed on exports. The current account surplus stood at 6.8% of GDP over the four quarters through June 2020 (down from 7.2% of GDP in 2019). Nonetheless, Germany's current account surplus remains the largest in the world in nominal terms (at $253 billion over the four quarters through June 2020). While German domestic demand contributed substantially to growth from 2015-2019, helping gradually narrow the current account surplus, it was not sufficient to reduce appreciably external imbalances. There are signs, however, that the current crisis is accelerating the shift of Germany's growth composition toward domestic demand, which has held up well in recent months amid fiscal stimulus measures, compared to the precipitous drop in exports. For this shift to take hold beyond the current crisis, Germany will need to implement economic policies to address the structural factors that contribute to high domestic saving and low consumption and investment.

Germany's bilateral goods trade surplus with the United States stood at $62 billion over the four quarters through June 2020, down modestly from $67 billion over the period one year prior.

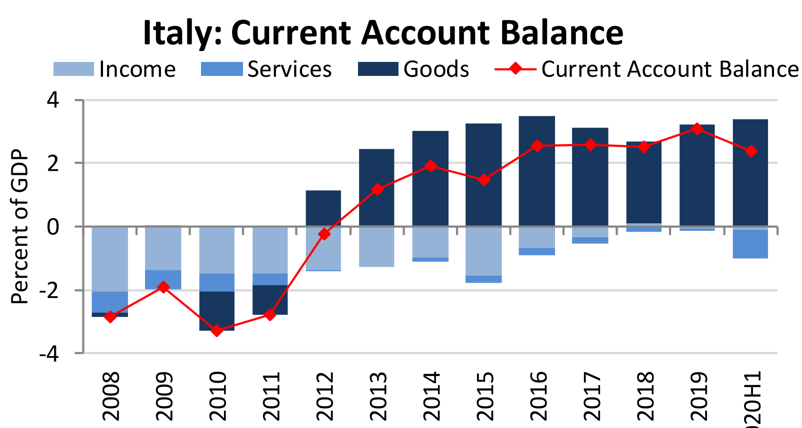
[16] Source: Germany Council of Economic Experts.
[17] In its 2021 proposed budget, the German Parliament plans for nearly $215 billion in new debt.

Germany's economic policies — notably excessively tight fiscal policy emanating from high tax levels — have for many years restrained domestic consumption and investment. The measures announced in response to COVID-19, including the VAT cut and the suspension of the national fiscal rules to allow for new debt issuance, are steps in the right direction but are temporary in nature. These measures fail to address the overly conservative budget processes which have played a role in Germany's excessively tight fiscal stance. Since 2014, Germany's approved budgets have called for fiscal balance, but stronger-than-forecast revenues and under-execution of spending plans have meant that in fact fiscal surpluses have averaged 1.2% of GDP over this time period, while reaching historic records of 1.9% of GDP in 2018 before declining modestly to 1.4% of GDP last year. As the public health crisis is overcome and recovery takes hold, Germany's substantial fiscal space should be deployed through structural fiscal measures that will bolster current activity, reduce the burden of taxation — particularly through tax cuts that would lower the labor tax wedge — and reinvigorate investment, which would help external rebalancing proceed at a reasonable pace.

Italy

Italy was first among European countries hit by COVID-19 (with the outbreak first confirmed on February 21), and it is among the countries hardest hit. In the second quarter of 2020, real GDP contracted a record 42.7% annualized rate (-18% year-over-year) as the government-imposed lockdowns and other restrictive measures to stem the pandemic. While Italy saw a stronger-than-expected rebound in the third quarter, the recent resurgence of COVID-19 will weigh on the growth outlook. In its autumn forecast, the European Commission projects Italian GDP to contract nearly 10% in 2020. To counter the immediate crisis, the government has passed three fiscal packages totaling $100 billion in direct support (around 5.3% of GDP), as well as around $912 billion (close to 50% of GDP) in authorized loan guarantees. Total fiscal response measures will likely widen the fiscal deficit to around 11% of GDP and increase public debt to over 160% of GDP in 2020.

Italy's current account has been broadly stable in recent years and stood at 3% of GDP over the four quarters through June 2020 (roughly unchanged from its 2019 level). The United States is Italy's third-highest export destination, and Italy's goods trade surplus with the United States stood at $30 billion over the four quarters through June 2020. The IMF's most recent assessment describes Italy's external position as broadly in line with medium-term economic fundamentals and policies.



Sources: Ufficio Italiano dei Cambi, Banca d'Italia

Italy's persistently anemic growth and pre-pandemic fundamentals highlight the difficult road towards economic recovery. These longstanding trends have been further exacerbated by the second COVID-19 wave and the reintroduction of containment measures. In light of the unfolding circumstances, Italy should continue to provide fiscal support to impacted households and firms. EU-level fiscal support – including European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) and NextGenerationEU funding – should also help Italy weather the crisis, with Italy set to receive as much as $246 billion in grants and loans. The crisis has only further demonstrated the need, once the pandemic is past and economic recovery takes hold, for Italy to undertake fundamental structural reforms to tackle deep-rooted rigidities and boost competitiveness and potential growth.

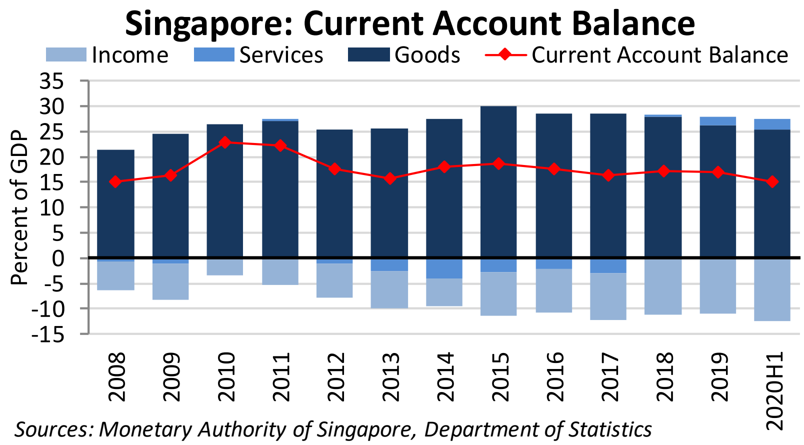
Singapore

Singapore was one of the first countries hit by COVID-19 once the virus spread beyond China, and its status as a small, open economy makes it particularly suspectable to changes in the global economy. The Singapore economy contracted sharply over the first half of the year, with real output falling 6.8% year-over-year over the first half of 2020. The GDP contraction in the second quarter was particularly pronounced, with economic activity falling 13% year-over-year. Strict lockdown and social distancing measures enacted during the second quarter impacted severely the construction and tourism sectors and slowed consumer demand. These factors, coupled with low oil prices and a weak labor market, have resulted in several months of headline and core deflation. Despite a GDP rebound in the third quarter on a quarter-over-quarter basis, the economic outlook remains subdued as the effects of the pandemic will continue to weigh on growth over the coming year.

In response to the COVID-19 outbreak, Singapore introduced unprecedented measures to support the economy. Multiple rounds of fiscal stimulus yielded over $70 billion in support, equivalent to approximately 20% of GDP, half of which was funded by Singapore's sovereign wealth fund reserves. The measures aim to alleviate the economic damage to both households and businesses, with a particular focus on maintaining employment. The government signaled it may take additional measures during the coming year.

While fiscal policy has been the authorities' primary tool to respond to the economic effects of the pandemic, the Monetary Authority of Singapore (MAS) has also taken supportive measures. In March, MAS eased monetary policy by adopting a 0% annual rate of appreciation of its exchange rate policy band and reducing the midpoint to the prevailing nominal effective exchange rate. Earlier the same month, the Federal Reserve and MAS announced the establishment of a $60 billion currency swap facility, which MAS has used to provide dollar liquidity to Singapore banks through weekly auctions. Outstanding amounts on the swap facility totaled nearly $600 million as of early November. In addition, MAS adjusted regulatory and supervisory requirements to enable financial institutions to better cope with the downturn while also allowing for individuals and certain types of businesses to secure temporary forbearance on loans and other payments.

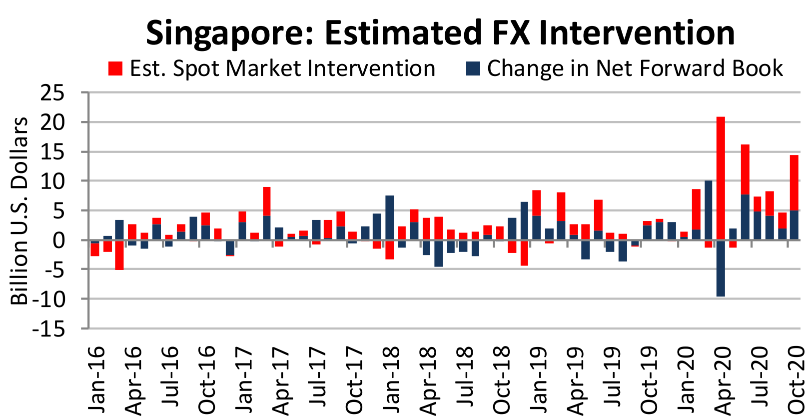
Singapore's outsized current account surplus averaged 18% of GDP over the last decade and totaled 16% in the four quarters through June 2020, driven by a very large goods trade surplus, partly offset by a sizable deficit in its income balance. The IMF's August 2020 External Sector Report (ESR) found Singapore's 2019 external position to be substantially stronger than warranted by medium-term fundamentals and desirable policies. Moreover, the IMF has assessed the Singapore dollar to be undervalued since it began publishing the ESR in 2012.



Sources: Monetary Authority of Singapore, Department of Statistics

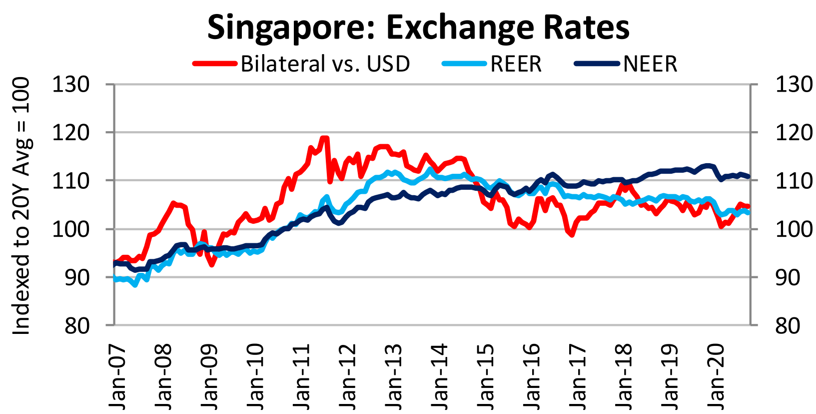
The United States has run a steady bilateral goods trade surplus with Singapore, which totaled $0.8 billion in the four quarters ending June 2020. However, this was well below the prior year's surplus of $4.2 billion, owing in part to a decline in U.S. exports to Singapore starting in March and a temporary uptick in imports from Singapore. In the four quarters ending June 2020, the top U.S. exports to Singapore included advanced machinery and parts, aircraft, and mineral fuel and oil. The U.S. goods trade surplus with Singapore reflects, in part, Singapore's role as a regional transshipment hub, with some U.S. exports to Singapore ultimately intended for other destinations in the region.

MAS uses the nominal effective exchange rate of the Singapore dollar (the S$NEER) as its primary tool for monetary policy and executes its policy by purchasing and selling currency in the foreign exchange market. MAS, in a welcome step toward greater transparency, began to disclose its foreign currency intervention earlier this year. MAS announced it will continue to disclose net purchases of foreign exchange on a six-month aggregated basis, with a three-month lag from the end of the reporting period. In April and October 2020, MAS published data on intervention covering the second half of 2019 and first half of 2020, indicating net purchases of $29.9 billion and $44.4 billion, respectively. This substantial increase in net purchases in the first half of 2020 may have reflected the broader recovery in international liquidity during the second quarter,



Sources: Monetary Authority of Singapore, U.S. Treasury estimates combined with Singapore's efforts to prevent sustained appreciation and maintain its exchange rate policy band.

Amid the COVID-19 shock, the Singapore dollar, like most emerging market currencies, came under pressure, weakening 5.4% in the first quarter. However, it subsequently recovered much of the decline, strengthening 4.1% over the next two quarters. On net, the Singapore dollar depreciated 1.5% against the U.S. dollar over the first ten months of the year, while weakening 2.0% and 2.8% on a nominal and real effective basis, respectively, over the same period. The IMF's August 2020 External Sector Report noted Singapore's 2019 real effective exchange rate is 2-14% weaker than warranted by fundamentals.



Sources: FRB, Bank for International Settlements

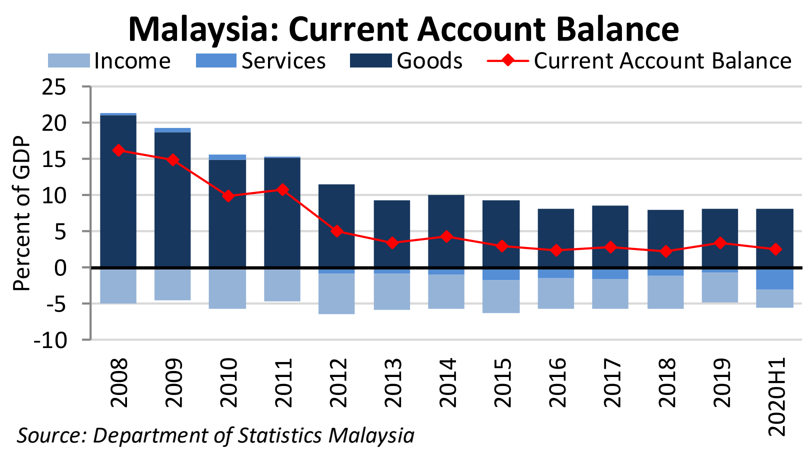
As the public health situation and economy begin to improve, a number of reforms would help reduce external imbalances. Expanding the provision of social services in areas like healthcare, unemployment insurance, and retirement would help reduce incentives for private saving and support stronger consumption. Reductions in the high rates for mandatory contribution to the government pension scheme would have similar benefits in strengthening domestically driven growth. Further appreciation of the nominal and the real effective exchange rate over the medium term, consistent with economic fundamentals, should also play a role in facilitating external rebalancing.

Malaysia

The Malaysian economy contracted sharply during the first half of 2020, owing initially to supply chain disruptions and weaker exports due to the COVID-19 pandemic, and later due to a contraction in domestic demand as strict lockdown orders and social distancing requirements unveiled in March curtailed strongly domestic activity. Growth collapsed in the second quarter of 2020, with GDP falling 17.0% year-on-year, as Malaysia experienced its first GDP contraction since the Global Financial Crisis. Malaysia's real GDP rebounded in the third quarter, contracting only 2.7% year-on-year. However, a recent resurgence of COVID-19 cases and renewed social distancing measures will continue to weigh on near-term growth.

In response to the downturn, the authorities introduced a wide range of fiscal, monetary, and financial sector measures to alleviate the impact of the pandemic. Direct fiscal support of approximately 5% of GDP focused on cash transfers to households and support to businesses intended to maintain payroll and employment. The authorities also enacted a number of financial sector policies to alleviate cash flow and balance sheet strains on individuals and small businesses, including a moratorium on loan repayments, loan guarantees for businesses, flexible repayment schemes, tax relief measures, and a relaxation of regulations to allow individuals penalty-free access to a portion of pension savings. At the same time, the authorities have introduced incentives to support hiring, promote new investments, and boost select industries. The Malaysian authorities have estimated the total stimulus, including measures provided through the financial sector and accelerated drawdowns in savings, reached approximately 20% of GDP. Bank Negara Malaysia (BNM) has also cut the policy interest rate by a cumulative 125 basis points to 1.75%. To counteract the tightening of financial conditions, BNM also lowered bank reserve requirements and allowed banks to use government bond holdings to meet these requirements, while increasing significantly its own holdings of government securities.

Malaysia has made substantial progress rebalancing its external sector over the past ten years as savings rates declined gradually on stronger consumption amid a strengthened labor market, rising household borrowing, and increased government transfers. In the face of the effects of the pandemic, Malaysia recorded its first monthly trade deficit in 22 years in April 2020, led by substantial contractions in exports of manufactured goods, palm oil, natural gas, and petroleum. With exports equal to almost 70% of GDP in the four quarters ending in June 2020, disruptions to supply chains and low global demand for petroleum and gas have significantly weakened Malaysian exports, with knock-on effects on growth.

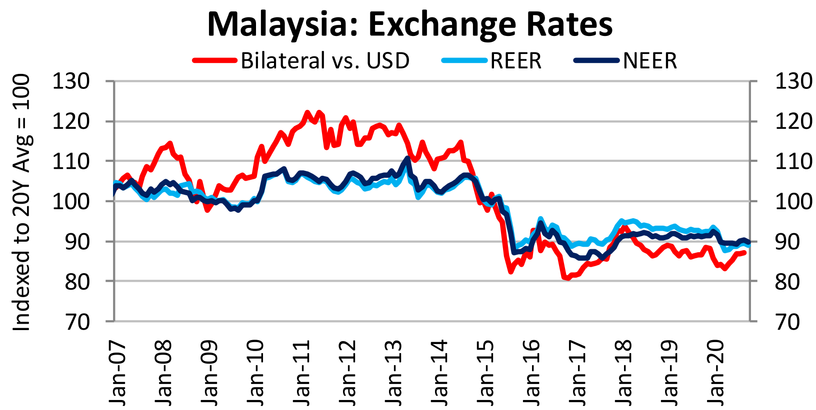


Source: Department of Statistics Malaysia

Prior to the pandemic, Malaysia's current account surplus widened in 2019 to 3.4% of GDP after several years in which the surplus remained below 3% of GDP. The expansion was primarily driven by a narrowing of the income deficit, reflecting higher remittances and profits from overseas investments, alongside a decline in capital imports as large public infrastructure projects were postponed. However, in the four quarters ending in June 2020, the current account surplus declined to 2.5% of GDP, reflecting lower earnings from oil and gas and a wider services deficit.

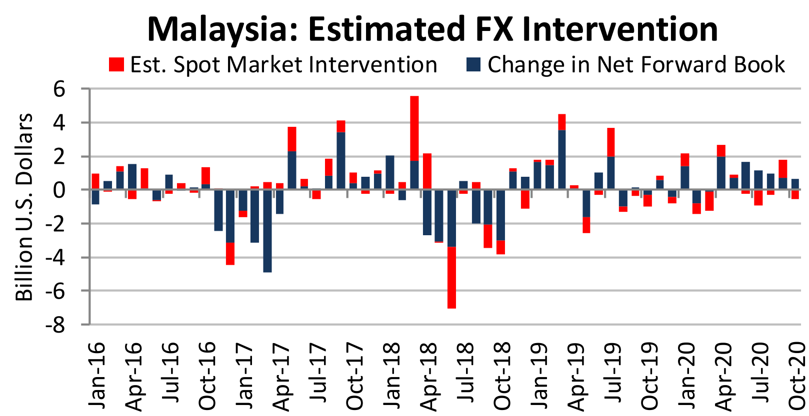
Malaysia's bilateral goods trade surplus with the United States reached $29 billion in the four quarters ending in June 2020. Malaysia and the United States have strong supply chain linkages, and as a result the bilateral trade balance is driven by supply integration in key industries such as electrical machinery parts, nuclear reactor and boiler parts, and optical and medical instruments. Malaysia's growing trade surplus with the United States reflects, to a degree, the growing sophistication of its manufacturing and its increasing importance in global supply chains.

Malaysia's historical external imbalances have in part reflected a ringgit that has been misaligned with fundamentals. The IMF has assessed the ringgit to be undervalued for over a decade; its August 2020 External Sector Report puts the ringgit around 7% undervalued for 2019. Like most other emerging market currencies, the ringgit came under considerable pressure in 2020 at the outset of the COVID-19 shock, but subsequently recovered much of the decline. On net, the ringgit depreciated 1.4% against the U.S. dollar over the first ten months of the year, while falling 1.7% and 3.8% on a nominal and real effective basis, respectively, over the same period.



Sources: FRB, Bank for International Settlements

Malaysia does not publish foreign exchange intervention data, forcing Treasury staff to estimate the scale of Malaysia's intervention. Based on Treasury estimates of BNM intervention activity, BNM has demonstrated a pattern of intervening on both sides of the market. Treasury estimates net purchases of foreign exchange amounted to $3.7 billion, or 1.1% of GDP, in the four quarters ending in June 2020.



Sources: Bank Negara Malaysia, U.S. Treasury estimates

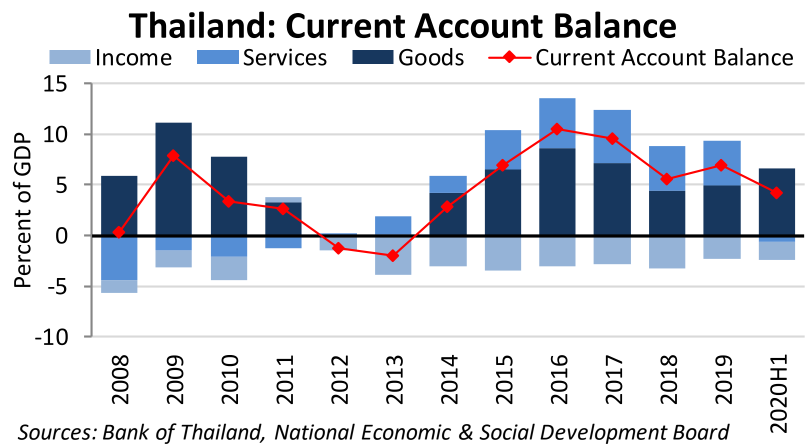
As the public health situation and economy improve, the authorities should take steps to strengthen growth and entrench rebalancing by continuing to promote efficient and well-targeted social spending to avoid excessive levels of precautionary saving, and supporting quality investments which will also help spur domestic demand. The authorities should continue to allow the exchange rate to move to reflect economic fundamentals and limit foreign exchange intervention to circumstances of disorderly market conditions, while increasing transparency of foreign exchange intervention.

Thailand

The COVID-19 pandemic has deeply affected the Thai economy, most notably the travel and tourism sector, which provides nearly a fifth of export receipts. Tourist arrivals collapsed in the first half of 2020 due to restrictions on international travel, driving disruptions in tourism-dependent sectors, including hospitality, aviation, and the informal sector. The manufacturing sector has also been affected negatively due to the closure of factories and borders, supply chain disruptions, and the contraction in global demand.

In response to the pandemic, the government is implementing an ambitious relief package of approximately 15% of GDP combining fiscal stimulus and liquidity support. The fiscal stimulus measures seek to address the lack of a social safety net for Thailand's large informal economy, remedy weaknesses in the healthcare system, and provide tax relief as well as financial aid to workers. The Bank of Thailand (BOT) is implementing $30 billion in monetary and credit measures to support businesses and stabilize the financial sector, including through soft loans for banks to on-lend to SMEs, and facilities to purchase corporate debt, treasury bills, bonds, and other assets.

Thailand has for the most part run current account surpluses over the two decades since the Asian financial crisis, with surpluses averaging 4% of GDP between 1998 and 2019. In the aftermath of the late 1990s crisis, a surge in foreign direct investment in manufacturing and integration into global supply chains helped support over the next decade an expansion of the manufacturing sector and merchandise exports. More recently, tourism has evolved into a key export, supporting steady surpluses in services trade since 2013. With a resurgence in the goods trade surplus in recent years, the current account surplus rose to an average of 8% of GDP from 2015 to 2019.

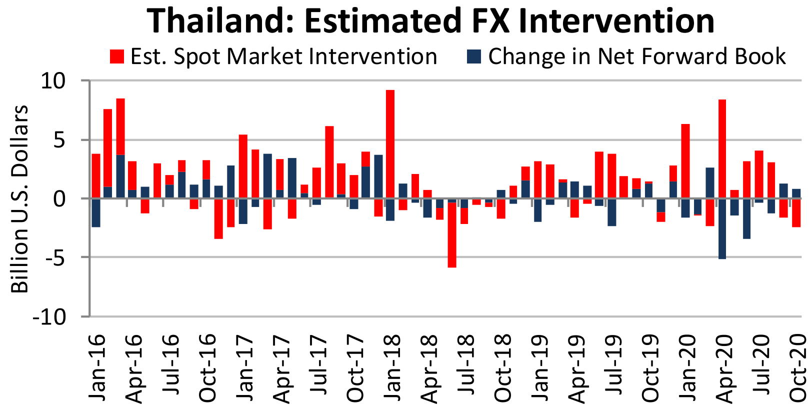


Sources: Bank of Thailand, National Economic & Social Development Board

Over the four quarters through June 2020 Thailand's current account surplus shrank to 6.3% of GDP primarily due to the collapse in tourism receipts after the outbreak of the pandemic. The pandemic likely will continue to weigh on both manufacturing trade and (particularly) tourism, placing downward pressure on the current account surplus. At the same time, a slowdown in domestic investment (and associated capital imports) and a lower import bill due to weak consumer confidence and lower oil prices should partially offset these factors.

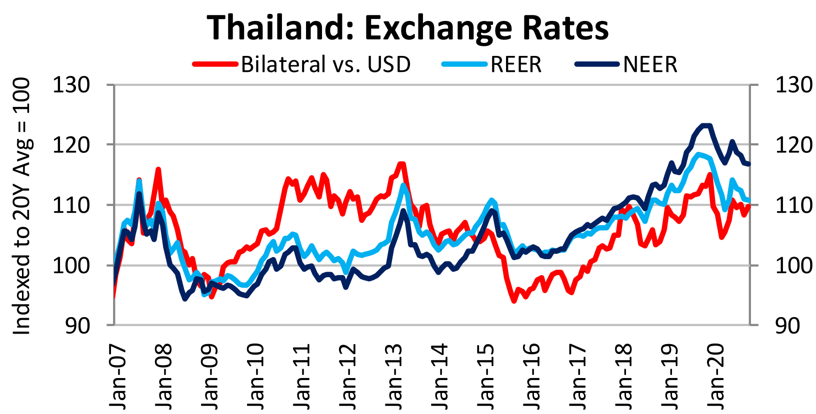
Thailand's goods trade surplus with the United States has grown steadily over the last decade, reaching $22 billion during the 12 months through June 2020, as Thailand has increased exports of tires, vehicle parts, and electronic equipment, among other goods. Thailand maintains significant barriers that impede U.S. firms trying to access the domestic Thai market, including relatively high tariffs in many sectors.

Thailand intervenes frequently in foreign exchange markets in both directions. However, intervention activity has been skewed heavily towards purchases since 2016, with reserves rising to over $230 billion as of June 2020. The Thai authorities have conveyed credibly to Treasury that net purchases of foreign exchange over the 12 months through June 2020 were 1.8% of GDP. This figure is equivalent to almost $10 billion.



Sources: Bank of Thailand, U.S. Treasury estimates

The baht appreciated steadily from 2015 to 2019, with the real effective exchange rate rising almost 15% from end-2015 through end-2019. However, the IMF still estimates that Thailand's external position in 2019 was substantially stronger than warranted by medium-term fundamentals and desired policies, and that the real effective exchange rate was 9.5% undervalued. After appreciating 8.6% against the dollar in 2019, the baht fell by 9.0% against the dollar in the first quarter of 2020, as emerging market currencies were weighed down by the sharp deterioration in global risk appetite. The baht subsequently retraced much of this decline, and as of end-October stood 4.6% weaker against the dollar year-to-date in 2020, and 5.9% weaker on a real effective basis.



Sources: FRB, Bank for International Settlements

During recent periods of baht appreciation, the BOT took steps to limit short-term capital inflows and accelerate medium-term plans to increase capital outflows. In July 2019, the BOT reduced the limit on non-resident baht accounts by one-third (to 200 million baht or $6.5 million), and increased reporting requirements for non-resident accounts. In November 2019, the BOT permitted outward transfers based on a negative rather than positive list, allowed retail investors to invest directly up to $200,000 abroad annually, approved gold trading in foreign currency, and raised the threshold for FX proceeds that do not need to be repatriated to $200,000 from to $50,000. In February 2020, the central bank further raised the repatriation threshold to $1 million. In November 2020, following three weeks of baht appreciation, the BOT raised further the ceiling on retail investors' overseas investments to $5 million, eliminated outbound investment limits for institutional investors, permitted residents to freely deposit funds in foreign-currency accounts, and imposed new registration requirements on foreign investors in Thai debt securities. In the run-up to the introduction of these most recent measures, both the Ministry of Finance (MOF) and BOT had expressed concern with the baht's appreciation.

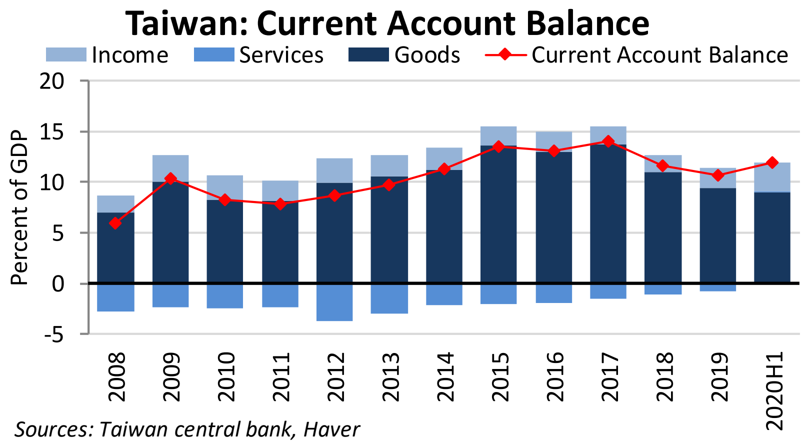
The authorities should take steps to reduce Thailand's external imbalances through policies that encourage private investment, reduce precautionary savings, and promote greater openness in domestically oriented sectors. Thailand should continue to ensure that its foreign exchange policy does not resist appreciation of the baht in line with economic fundamentals in the context of large and durable external surpluses. Thailand is well-positioned to pursue such policies, which also would help to support domestic growth, given its large external buffers and low share of public debt held by nonresidents.

Taiwan

Taiwan's swift public health response to the COVID-19 pandemic helped it contain quickly its domestic outbreak, but external shocks weighed on Taiwan's economy and contributed to moderate volatility in its financial markets. Private consumption declined 4.9% year-over-year in the second quarter of 2020, driving a 0.6% year-over-year contraction in real GDP. Net portfolio outflows in the first half of 2020 totaled $39 billion, an increase from outflows of $23 billion in same period of 2019 but a decrease from outflows of $53 billion in the first half of 2018. Government measures such as an initiative introduced in 2019 to encourage Taiwanese companies to bring accumulated offshore FX holdings back onshore appear to have played a mitigating role. Taiwan's central bank implemented several measures to ease monetary conditions and stabilize financial markets, including lowering the discount rate 25 basis points to 1.125% in March, a record low and its first rate cut since 2016. The authorities also approved cumulative fiscal measures totaling $35 billion (5.5% of GDP), which included measures to support public health, vulnerable firms, and coupons to support consumption.

Taiwan's external balances remained broadly steady in the first half of 2020. Taiwan's current account balance stood at 10.9% of GDP over four quarters through June 2020, roughly equal to the 11.0% of GDP balance recorded over the previous four-quarter period. Exports of electronic goods have remained resilient during the pandemic as external demand for computing equipment partially offset the decline in non-electronic goods exports.

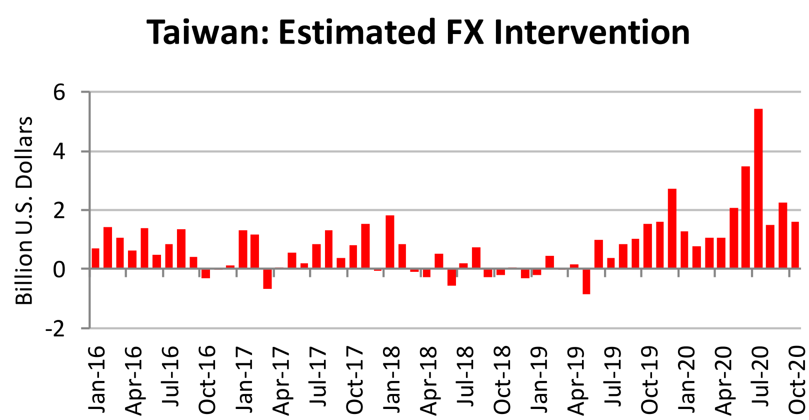
Taiwan has run large external surpluses for many years, with the current account balance averaging above 10% of GDP over the last decade and peaking at 14.1% of GDP in 2017. Taiwan's goods trade surplus with the United States expanded sharply in the 12 months through June 2020 to $25 billion, growing by $7 billion compared to a year prior.



Sources: Taiwan central bank, Haver

Taiwan officially maintains a managed float exchange rate and the new Taiwan dollar (TWD) has appreciated steadily against the dollar in 2020. While many currencies depreciated against the dollar over the first half of 2020 amid the COVID-19 shock, the TWD appreciated 1.6% over this period. As of end-October, the TWD had appreciated 3.0% on a real effective basis.

In March, Taiwan took the welcome steps of disclosing publicly its foreign exchange intervention, initially covering activity in 2019, and its outstanding swap position (see box).[18] Treasury welcomes Taiwan's efforts to make its foreign exchange operations and reserve management more transparent. Taiwan disclosed net foreign exchange purchases totaling $3.9 billion (0.6% of GDP) over the first half of 2020 to resist appreciation pressures, following net foreign exchange purchases totaling $6.6 billion over H2 2019 (1.1% of GDP).[19] Taiwan has abundant foreign exchange reserves, totaling $489



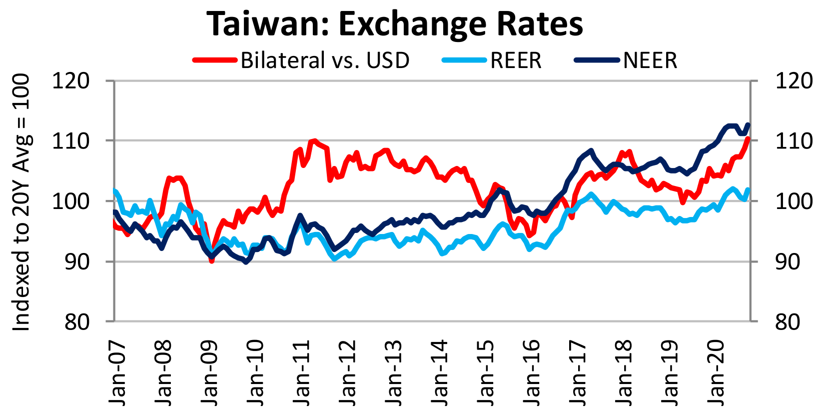
Sources: Taiwan central bank, U.S. Treasury estimates

[18] The central bank reported net purchases of $5.5 billion in 2019 in its semi-annual report to Taiwan's Legislative Yuan (https://www.cbc.gov.tw/dl-141986-dc3350360f3644cb86c1d4ac4df65b01.html). On October 15, 2020, the central bank disclosed net purchases of $6.6 billion in H2-2019 and net purchases of $3.9 billion in H1-2020 in its second semi-annual disclosure to the Legislative Yuan (https://www.cbc.gov.tw/tw/dl-159657-4b8126ec19eb4fa3897ccaa9cda0e232.html).

[19] Treasury's estimates are more frequent and cover activity in the spot market as well as in the central bank's forward position. For the six months ended June 2020, Treasury estimated $9.8 billion in FX purchases by Taiwan in the spot market before subtracting $4.1 billion to account for the decrease in the central bank's outstanding USD receivables swaps position, resulting in an estimated $5.7 billion in estimated net FX intervention.

billion (78% of GDP) as of June 2020. Treasury urges the authorities to limit foreign exchange intervention to only exceptional circumstances of disorderly market conditions and to avoid asymmetrical intervention to resist appreciation in line with economic fundamentals. We also encourage the Taiwanese authorities to take further action, particularly with respect to reporting foreign exchange reserves in the widely accepted format of the IMF's Special Data Dissemination Standard.

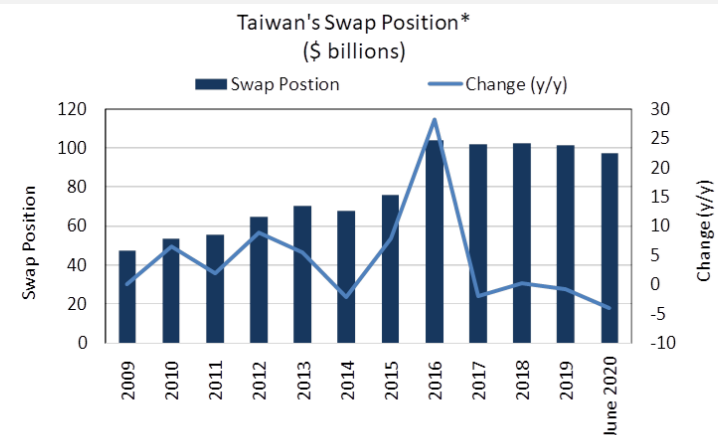
The IMF does not currently publish a valuation assessment of the TWD. External analysts assessed in 2018 that the TWD was undervalued by as much as 21%, an assessment that is consistent with a sustained, large external surplus, and relatively limited adjustment of the real exchange rate over time.[20]



Sources: FRB, Bank for International Settlements

Box 1: The Swap Position of Taiwan's Central Bank

Taiwan's large life insurance industry generates demand for foreign assets such as corporate bonds, which offer higher yields than Taiwanese domestic bonds. Taiwan's life insurers partially hedge their exposure to these foreign assets through the local banking system. Taiwan's central bank, in turn, provides foreign currency liquidity to the local banking system through the foreign exchange swap market.[21] The accumulation of a large net long position in foreign currency swaps has also had the effect of sterilizing a portion of the central bank's foreign



*Swap position includes non-NTD swap positions, which were subsequently unwound within a 12-month period.
Source: CBC

[20] "Estimates of Fundamental Equilibrium Exchange Rates," William R. Cline, Economic International Inc., November 2018.

[21] The central bank's 2018 Annual Report notes: "…to facilitate smooth corporate financing and provide sufficient foreign currency liquidity within the banking system, the Bank continued to conduct foreign currency swap transactions with banks…" https://www.cbc.gov.tw/en/public/Attachment/961318214371.pdf.

exchange intervention.[22] External analysts have previously written on the potential size of Taiwan's swap position.[23] In a welcome development, Taiwan's central bank began disclosing publicly information on its foreign exchange swap position, initially on an annual basis covering 2009-2019 and then on a monthly basis beginning in March 2020.[24] The position stood at $101.3 billion at the end of 2019 (16.6% of GDP). Taiwan has added $50 billion to its swap position since 2009, with the largest increase of $28.2 billion in 2016. Since 2016, the trend has moderated, with its outstanding swap position remaining relatively flat between 2017 and 2019 before declining by $4 billion in the first six months of 2020.

India

In the first half of 2020, India experienced one of the world's largest COVID-19 outbreaks and the steepest quarterly growth contraction among G20 economies. India's GDP shrank 24% year-over-year in the second quarter as domestic demand and supply chains collapsed during a strict lockdown, which began March 25. Economic activity has started to return slowly since reopening began at the end of May and the pace of the country's COVID-19 spread began slowing in the middle of September.

India's federal government has offered a modest fiscal stimulus while the central bank has pursued substantial easing measures. The central government's direct fiscal support has amounted to about 2% of GDP, balancing the need to support the economy with avoiding a larger fiscal deficit and risks to its credit outlook. The direct stimulus targets low-income households and the healthcare sector while the government has used indirect fiscal measures to help ease the flow of credit to small businesses. Meanwhile, the Reserve Bank of India (RBI) reduced its policy rate 115 bps to 4.0% before pausing in August in the face of stubbornly high inflation — which reached 7.3% year-on-year in September — above the monetary authority's 4±2% target. RBI liquidity measures equivalent to 5.9% of GDP and a temporary loan repayment moratorium have supported corporates, small businesses, and non-bank financial companies.

India's current account registered a 0.4% of GDP surplus in the four quarters through June 2020, the country's first 12-month surplus since 2004, as imports fell faster than exports reflecting India's weak domestic demand during the COVID-19 lockdown. The surplus was

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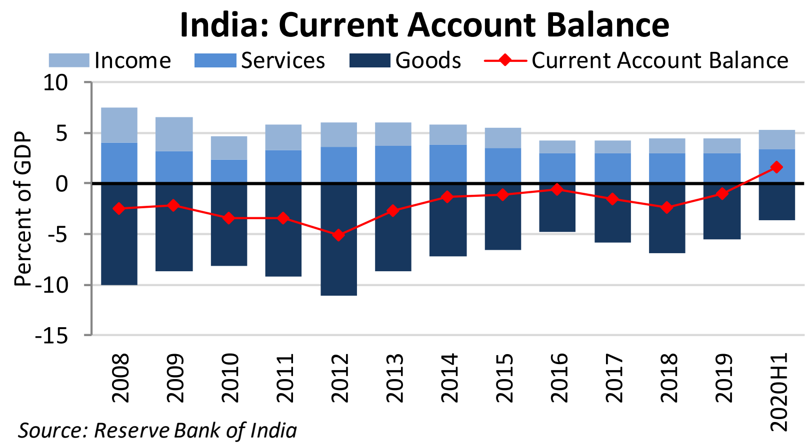
[22] A central bank can buy foreign currency spot, then enter a foreign exchange swap contract in which it provides foreign currency in the front leg and receives it on the back leg. The resulting net forward position has no visible impact on gross foreign exchange reserves on the balance sheet until it is closed but is publicly disclosed by central banks using the IMF's Special Data Dissemination Standard Template on International Reserves and Foreign Currency Liquidity. Taiwan does not currently report foreign exchange reserves according to this template. Because of the manner in which changes in net forward positions can mask buying and selling of foreign exchange in the spot market, Treasury includes such positions when estimating foreign exchange intervention.

[23] Setser, Brad and S.T.W., "Looking for the Mysterious Hedging Counterparty of Taiwan's Lifers," *Council on Foreign Relations,* 29 October 2019, https://www.cfr.org/blog/looking-mysterious-hedging-counterparty-taiwans-lifers.

[24] Outstanding USD/TWD swaps stood at $97.3 billion as of June 2020 (https://www.cbc.gov.tw/dl-141986-dc3350360f3644cb86c1d4ac4df65b01.html).

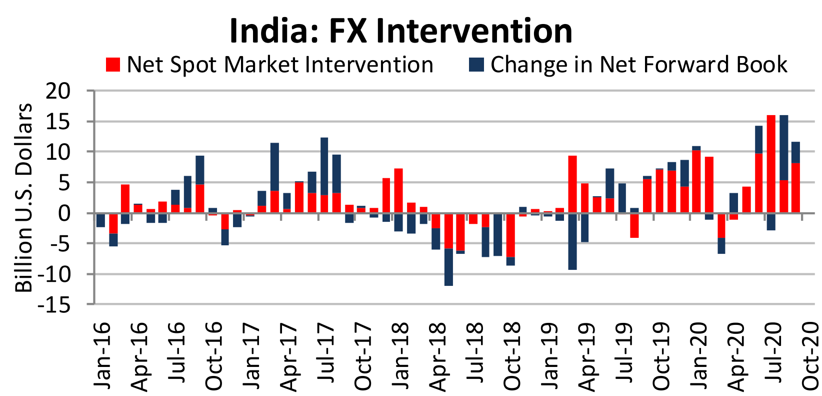
also supported by low oil prices, relatively resilient remittance inflows, and steady services exports. India typically runs a current account deficit as the country is a large importer of commodities such as gold and petroleum.



Source: Reserve Bank of India

India's goods trade surplus with the United States was $22 billion for the four quarters through June 2020, broadly in line with its average level over the preceding five years. India also ran a $5 billion services trade surplus with the United States in 2019. India's exports to the United States are concentrated in sectors that reflect India's global specialization (notably diamonds, pharmaceuticals, and IT services), while U.S. exports to India reflect India's domestic needs (fuels, aircraft, higher education, and software).

India has been exemplary in publishing its foreign exchange market intervention, publishing monthly spot purchases and sales and net forward activity with a two-month lag. The RBI states that the value of the rupee is broadly market-determined, with intervention used only to curb undue volatility in the exchange rate.

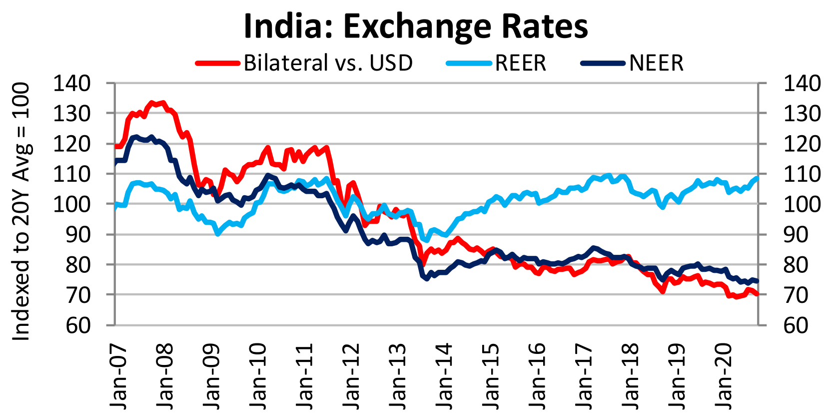


Source: Reserve Bank of India

The RBI purchased foreign exchange on net in 10 of the 12 months through June 2020, with net intervention (both spot and forward intervention) reaching $64 billion, or 2.4% of GDP. While purchases slowed during the onset of the pandemic, and the RBI engaged in net sales in March 2020, the RBI's net purchases again accelerated in mid-2020 as portfolio inflows resumed and foreign direct investment remained strong. Rupee volatility did not appear to have been particularly elevated in the four quarters through June 2020, however.

These purchases have led to a rapid rise in total reserves that are now well in excess of standard reserve adequacy benchmarks. As of June 2020, foreign currency reserves stood at $466 billion, equal to 4.4 times gross short-term external debt. Reserves have continued to grow in recent months, reaching $502 billion in September 2020 as purchases accelerated further in July and August. By comparison, at end-2018, foreign currency reserves were valued at $370 billion, equal to 3.6 times gross short-term external debt. India also maintains ample reserves (163% of ARA metric in 2019) according to IMF metrics for reserve adequacy, particularly given that India maintains some capital controls.

Like most emerging market currencies, the rupee has been buffeted this year by swings in global risk appetite and associated shifts in capital flows. After depreciating 3.4% against the dollar in the second half of 2019, the rupee depreciated an additional 5.5% during the first half of 2020. The rupee weakened 6.6% and 1.7% on a nominal and real effective basis, respectively, over the four quarters through June 2020. The rupee has diverged somewhat from peer currencies, however, amid RBI intervention. While many emerging market currencies started to rebound from their March lows in May and June, the rupee remained relatively rangebound as the RBI resumed large foreign exchange purchases. The rupee has appreciated somewhat since late August, but it has still not recovered as much lost ground as its emerging market peers have. In its August 2020 External Sector Report covering 2019, the IMF assessed the real effective exchange rate to be in line with economic fundamentals.



Sources: FRB, Bank for International Settlements

The authorities should allow the exchange rate to move to reflect economic fundamentals and limit foreign exchange intervention to circumstances of disorderly market conditions. India can also leverage the recovery period to pursue structural reforms that will open its market further to foreign investment and trade, including foreign portfolio investment in Indian sovereign and sub-sovereign bonds, thereby fostering stronger long-term growth.

Enhanced Analysis Under the 2015 Act

Vietnam

Recent Developments

Vietnam enacted a prompt, aggressive response to the COVID-19 outbreak, including closing the northern border with China in January, banning flights starting in February, and imposing a nationwide lockdown. This helped contain the outbreak to fewer than 1200 cases and 50 deaths through October, though the pandemic and public health response have weighed heavily on growth.

The government's fiscal response to the pandemic totals approximately 3.6% of GDP. Key measures include: a cash transfer program for households and workers impacted by COVID-19; deferrals on value-added tax, corporate income tax, and land rental fees; and a reduction in the corporate income tax rate for SMEs. Accompanying these actions, the government allowed companies and workers to defer contributions to the state pension fund for up to one year, without interest penalties. Finally, the government is aiming to fully execute its public investment budget of 5.8% of GDP.

Monetary policy has also been eased, with the State Bank of Vietnam (SBV) lowering its policy rate 200 basis points in 2020 as of end-November. The SBV also issued guidelines for commercial banks to reduce or eliminate interest payments, as well as to provide forbearance, on loans to companies facing losses due to COVID-19. By mid-September, banks had registered a total credit package valued at 3.8% of GDP through such measures, including the extension of new loans. While most regional peer currencies were relatively volatile in 2020, depreciating sharply against the dollar in the early phases of the COVID-19 shock and then recovering somewhat over the summer and fall, the Vietnamese dong remained virtually flat against the dollar over the first ten months of 2020. The Vietnamese authorities have conveyed credibly to Treasury that net purchases of foreign exchange in the four quarters through June 2020 were $16.8 billion, which is equivalent to 5.1% of GDP. The majority of these purchases occurred in the second half of 2019, prior to the onset of the COVID-19 pandemic.

Vietnam's growth fell to its slowest pace in at least 30 years in Q2 2020, at 0.4% year-over-year, after slowing to 3.7% year-over-year in Q1, as the pandemic impacted the manufacturing and tourism sectors, which are highly dependent on the global economy. Goods exports fell 6% year-over-year in the second quarter of 2020, while imports fell 9%, resulting in an overall goods trade surplus of $4 billion in the second quarter of 2020. The effectiveness of Vietnam's initial public health response enabled the government to loosen many of the restrictions on domestic activity. Recent data show tentative signs of rising economic activity. Vietnamese authorities reported Q3 GDP growth to be 2.6% year-over-year and the IMF projects Vietnam's economy will grow 2.4% for full year 2020. Downside risks include a resurgence in COVID-19 cases domestically and more widespread or persistent outbreaks globally that would weigh on external demand.

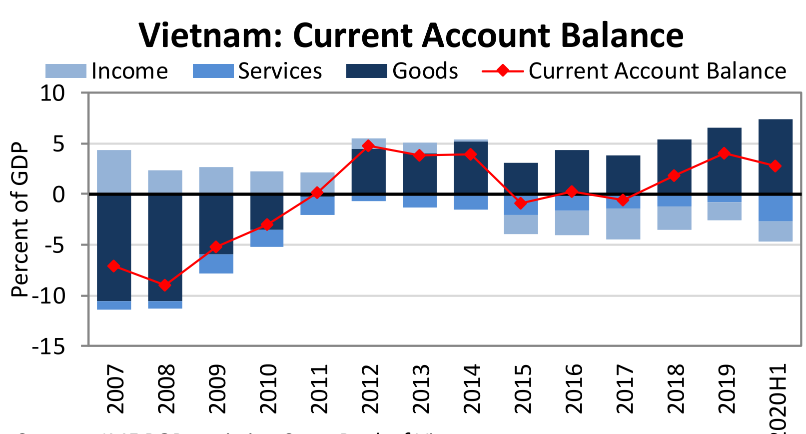
Enhanced Analysis

Economic liberalization has transformed Vietnam from one of the poorest countries in the world to a lower middle-income country within a quarter of a century. From 1990 to 2019, real growth has averaged almost 7% annually. Over the same time period, the ratio of population in poverty has fallen from over 50% to less than 2%, with substantial gains in health and education outcomes.

Since Vietnam joined the World Trade Organization in 2007, foreign direct investment (FDI) has helped integrate Vietnam into global and Asian supply chains. Vietnam's large and skilled labor force, competitive wages, young and well-educated population, combined with its undervalued exchange rate have produced substantial comparative advantages that have drawn large numbers of foreign invested enterprises (FIEs) to Vietnam. As a result, Vietnam's inbound FDI stock, the majority of which is concentrated in export sectors, has grown five times larger since 2007. In 2019, inbound FDI flows reached a record $16 billion, about 5% of GDP. Vietnam has ambitiously pursued trade agreements, including with the Association of Southeast Asian Nations (ASEAN), Japan, China, and Korea. A trade agreement with the EU entered into force in August. Vietnam is also party to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, a multilateral trade agreement among 11 economies in Asia and the Western Hemisphere, as well as the 15-member Regional Comprehensive Economic Partnership (RCEP) that was signed in November 2020.

Vietnam's rapid growth over the past two decades was accompanied by rising financial vulnerabilities, creating challenges for macroeconomic management and financial stability. Credit as a share of GDP tripled from 2000 to 2009, with particular vulnerabilities building in the real estate sector. During this period of rapidly rising leverage, under-developed monetary policy and supervisory tools made it difficult for Vietnamese economic officials to prevent economic overheating. This situation contributed to bouts of double-digit inflation in both 2008 and 2011. Macroeconomic instability helped burst a real estate asset bubble in 2011, and non-performing loans surged to over 15% of banking system assets. The lack of macroeconomic stability, combined with substantial dollarization and use of gold in the economy, also compounded volatility and weakness of the exchange rate.

In more recent years, macroeconomic conditions have been relatively stable, and the Vietnamese economy has grown strongly, with real GDP growth averaging above 6% annually from 2014 through 2019. Nonetheless, some financial vulnerabilities remain. In the wake of a severe downturn in the real estate sector in 2012-2013, leverage has continued to climb, with domestic credit to the private sector reaching 138% of GDP in 2019. Further, public debt remains relatively high following many years of significant fiscal deficits, though over 2018 and 2019 a combination of fiscal consolidation and strong growth resulted in public debt declining from a peak of 60% of GDP in 2016 to 54% in 2019. The IMF's most recent assessment put Vietnam at low risk of debt distress.



Sources: IMF BOP statistics, State Bank of Vietnam

The rapid growth of the FIE sector has transformed Vietnam's external position. Whereas until 2011 a large deficit in goods trade kept the current account in deficit, the goods trade balance swung into surplus beginning in 2012, with the goods surplus consistently above 3% of GDP since then (and 6.6% of GDP in 2019). The FIE sector drives the goods trade surplus, particularly in electronics and other manufacturing. In recent years, there has been a large gap between the trade surplus in the FIE sector and a trade deficit in the non-FIE domestic economy. For example, the IMF estimated that the FIE manufacturing sector generated a trade surplus of 15% of GDP in 2018, while the domestic non-FIE sector ran a trade deficit of 8% of GDP.

The swing in the goods trade balance has pushed the broader current account into surplus since 2011, though typically at a level below the elevated goods surplus. In part, this is because Vietnam has run consistent, modest deficits in services trade over the last two decades. Moreover, an increasingly important factor in recent years has been a substantial deficit in the primary income balance (with the deficit averaging above 5% of GDP from 2015-2019), as the FIE sector remits profits to foreign owners abroad.

The other notable feature of the current account is the sizable surplus in secondary income, as Vietnam is a significant recipient of remittances. The World Bank estimates that Vietnam's remittance inflows in 2019 reached $17 billion (6.5% of GDP), up from $7 billion in 2008. The United States is the largest source of remittances, followed by Australia and Canada. On their own, these remittance inflows should boost demand for Vietnam's currency, though in recent years remittances have been outweighed by the large income payments to non-residents, leaving the income balance overall in modest deficit.

In 2019, the current account surplus was 4.0% of GDP. The goods surplus was substantial in the second half of 2019 and Q1 2020. This dynamic pushed the current account surplus over the four quarters through June 2020 to 4.6% of GDP.

The IMF's most recent assessment of Vietnam's external position, based on 2018 data, found it to be substantially stronger than warranted by fundamentals and desirable policies, reflecting the relatively unproductive domestic economy and constraints on private investment coupled with significant levels of foreign investment and productivity growth in the export sector. Due to the pandemic, the IMF had not published an assessment for 2019 as of November 2020.

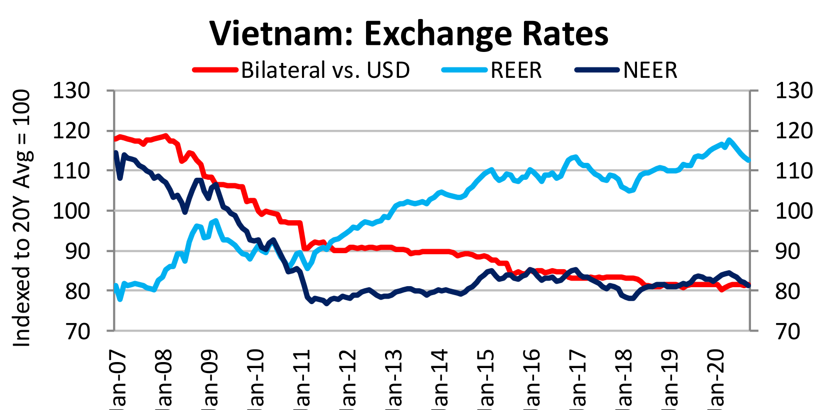
Vietnam has accounted for a growing share of U.S. trade over the last decade, and its trade surplus with the United States has expanded rapidly in recent years. The growing trade surplus with the United States reflects a large expansion of Vietnam's export capacity in apparel and technology, and its growing global supply chain integration. The growing surplus also reflects some degree of transshipment, and tariff and non-tariff barriers that have impeded U.S. companies' and agricultural producers' access to the Vietnamese market in automobiles, agricultural products, digital trade, electronic payments, and other areas. Over the four quarters through June 2020, Vietnam's goods trade surplus with the United States reached $58 billion, the fourth largest among the United States' trading partners and a 25% increase over the annual surplus of $47 billion in the four quarters through June 2019.

Recent trade developments have also been impacted by ongoing shifts in regional supply chains. There was a continued rise over 2019 in U.S. imports of certain goods from Vietnam, which tracks the fall in U.S. imports of similar goods from China. This included both some lower value-added products such as apparel, shoes, and bags, as well as higher value-added electronics and electrical equipment. Notably, U.S. imports of cell phones and other household goods from Vietnam more than doubled in 2019, to $12 billion.

Some of these supply chain migration effects may be overstated because of illicit transshipment to avoid tariffs on Chinese imports. The Vietnamese authorities have stated that the products most susceptible to transshipment are textiles, footwear and leather bags, computers, electronic devices and parts, and aluminum and steel. The Vietnamese authorities have acknowledged this problem and claim to have prosecuted a significant number of cases of trade-related fraud since early 2019. In addition, Vietnam and the United States signed a Customs Mutual Assistance Agreement in December 2019 to strengthen bilateral cooperation on security and the facilitation of lawful trade, and updated regulations regarding country-of-origin labeling. Also, in December 2019, Vietnam introduced a resolution intended to address increasing cases of transshipment and origin fraud by promoting cooperation among Vietnamese government agencies and completing more rigorous product origin checks. Vietnam should continue to strengthen enforcement measures to reduce illicit transshipment.

The most significant categories of U.S. exports to Vietnam are cotton and other agricultural commodities, and computer components. As Vietnam's GDP per capita has risen rapidly in recent years, Vietnamese consumers' demand for U.S. goods has also increased significantly, albeit from a low base, with U.S. goods exports to Vietnam totaling almost $11 billion in 2019. In 2020, U.S. goods exports to Vietnam totaled $7.4 billion through September, down from $8.1 billion in the first nine months of 2019.

Vietnam's authorities tightly manage the value of the dong. Since January 2016, the official policy of the SBV is to allow the dong to float +/- 3% against a basket of currencies within a previously established trading band, with daily updates to the reference rate. Based on cross rates between the dong and the currencies in the basket, however, the SBV still appears to manage the dong far more closely to the U.S. dollar than to any other reference, and the dong reached the edge of the band during trading in very few instances.



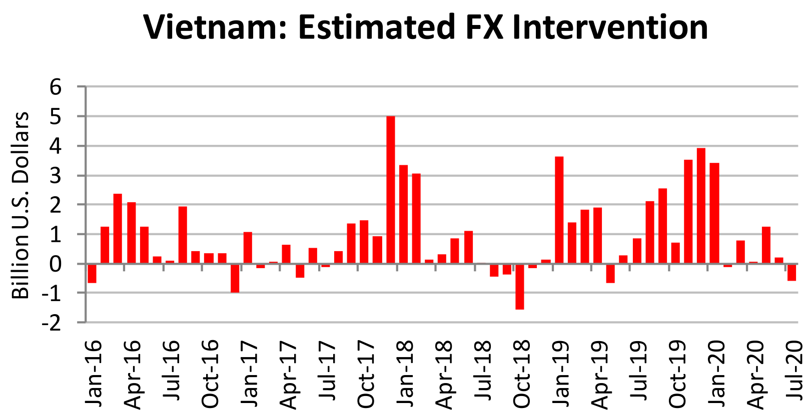
Sources: Vietcombank, JP Morgan

The dong has been relatively stable on a nominal basis since 2011, both against the dollar and on a broad, trade-weighted basis. In this context, and amid strong productivity growth with the rise of the FIE sector and bouts of much higher inflation than trading partners, the real effective exchange rate appreciated notably from end-2010 to end-2015, rising by 22%. Appreciation of the real effective exchange rate moderated after

2015, though the real effective exchange rate has risen gradually over the last two years. The most recent IMF assessment indicated that the dong was 8.4% undervalued on a real effective basis in 2018.

The dong was virtually flat against the dollar in 2019, as well as during the first ten months of 2020. On a trade weighted basis, the dong appreciated in nominal and real terms in the first half of 2020, but has weakened in recent months, resulting in year-to-date depreciation of 1.9% and 2.2% in nominal and real terms, respectively, over the first ten months of 2020.

Vietnam does not publish data on foreign exchange intervention. However, the Vietnamese authorities have conveyed credibly to Treasury that net purchases of foreign exchange in the four quarters through June 2020 were $16.8 billion, equivalent to 5.1% of GDP.[25] Vietnam intervened largely in one direction in 2019 and the outset of 2020, purchasing large amounts of foreign exchange reserves during a period of ample global liquidity, while net purchases then declined notably as global financial conditions tightened amid the COVID-19 pandemic. Throughout this period and amid drastically changing global conditions, the authorities allowed almost no movement of the dong against the U.S. dollar.



Sources: State Bank of Vietnam, U.S. Treasury estimates

Coming into 2019, Vietnam's foreign exchange reserves had been below standard adequacy metrics for several years. During the period of currency market stress in 2015, reserves declined to $29 billion, equivalent to 12% of GDP and roughly 60% of the IMF's metric for assessing reserve adequacy for countries with fixed exchange rate regimes. The central bank rebuilt reserves from that point forward. At the beginning of 2019, the IMF's metric for assessing reserve adequacy for countries with a fixed exchange rate regime indicated that Vietnam's reserves stood at 76% of adequate levels. By comparison, the IMF's metric for floating exchange rate regimes would have assessed Vietnam's reserves to be fully adequate entering 2019. Since the beginning of 2019, Vietnam's foreign exchange reserves have increased rapidly and stood at $83.4 billion at the end of H1 2020. Although the IMF has not yet published an updated estimate as of October 2020, Vietnam's reserves likely are at least at roughly adequate levels now relative to the IMF metric for fixed exchange rate regimes given the substantial purchases over the last 18 months.

[25] Forward intervention is included on a trade date basis.

In the context of an increasingly open economy, Vietnam has limited tools to accomplish the multiple and sometimes conflicting aims of its monetary and exchange rate policies—controlling inflation, maintaining macroeconomic and exchange rate stability, and supporting economic growth, including through an undervalued exchange rate. A number of factors constrain the transmission of Vietnamese monetary policy and affect the degree of exchange rate volatility that the SBV is willing to tolerate, including historically high levels of dollarization and widespread reliance on gold.

Treasury assesses that on balance Vietnam's capital control measures are primarily designed to limit outflows and are generally in line with Vietnam's stage of development. The greatest restrictions are on individuals, who can hold foreign currency accounts but can only transfer funds abroad for specific reasons (and with authorization). Firms have wider latitude in the use of foreign currency, allowing for the export and import of goods, services, and investment and legal capital with foreign individuals and institutions. Vietnam allows investment funds to generally move more freely, though there are limits to foreign ownership of public companies and limits on individual investments abroad.

Vietnam has actively pursued policies to reduce the level of dollarization in its economy, including mandating the use of local currency for all local transactions as well as requiring that foreign currency denominated deposits in the local banking system not earn interest. The SBV has also prohibited all domestic lending in foreign currency in 2019. These policies have shown some success, as the level of foreign currency deposits in the banking system has fallen from almost 15% in 2013 to about 11% in 2019. Anecdotally, however, there may still be significant dollar holdings outside of the formal financial system.

Gold also remains an important medium of exchange and hedge against inflation and currency volatility in Vietnam. Gold trades at a price premium in Vietnam to world market prices, explained in large measure by the fact that Vietnamese households actually take physical possession of gold, unlike world markets where custody is maintained by a central depository. Gold deposits are accepted by banks, and Vietnamese homes are frequently priced in gold. Gold has also historically played a central role in Vietnamese investment portfolios.

Vietnam should reduce its currency intervention and allow for movement in the exchange rate in line with economic fundamentals, including more rapid appreciation of the real effective exchange rate, which will help reduce external imbalances. Treasury also urges the authorities to enhance the transparency and timeliness of data on intervention, foreign exchange reserves, and external balances. A stronger, modernized monetary policy framework would allow the SBV to transition to an inflation-targeting monetary policy regime, rather than relying so heavily on the exchange rate to serve as a nominal anchor.

Rebalancing Vietnam's economy also requires leveling the playing field for the domestic private sector by improving its access to land and credit and reducing the role of state-owned enterprises in the economy. While the export-oriented sectors of the economy have thrived in spite of periodic macroeconomic instability, the domestic economy has underperformed, held back by significant structural impediments. Large state-owned enterprises enjoy monopolies in many sectors of the economy, and over time they have received significant government subsidies, preferential tax treatment, and privileged access to land, finance, and government procurement contracts. Declining productivity and high leverage within the state-owned enterprises, exacerbated by the misallocation of investment and over-concentration among a few conglomerates, has dramatically reduced economic efficiency across the domestic economy. The creation of an independent body to oversee all large state-owned enterprises should help improve accountability and efficiency, but political will is crucial for this effort to succeed where past efforts have failed.

As the pandemic eventually subsides and related measures expire, Vietnam should move more quickly to ensure capital adequacy in the banking sector and to resolve non-performing loans held by the state asset management company. Currently, most state-owned banks lend primarily to the large state-owned enterprises, which has resulted in undercapitalization because of high non-performing loans and poor risk controls. A stronger and better-supervised banking system can also create additional room for private investment in the domestic sector. Vietnam should prioritize improving the quality and accuracy of financial data, which will allow the SBV to better monitor and respond to financial vulnerabilities. Reducing the reliance on credit growth targets, which contributes to financial sector risks, will enable financial institutions to better allocate capital and manage risks.

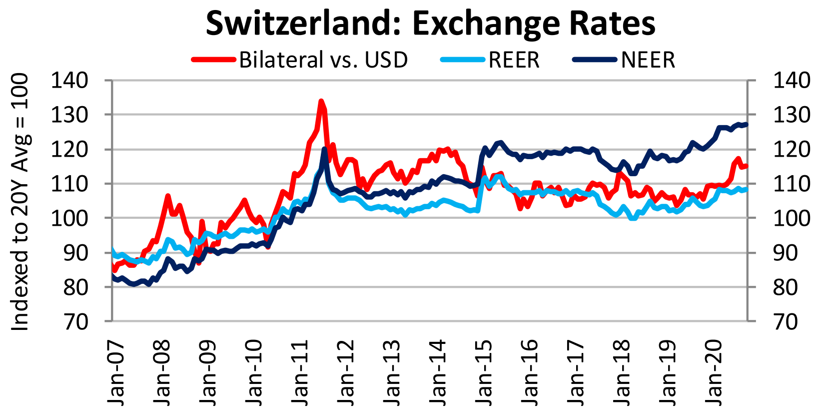
Vietnam also should level the playing field for American workers and firms by diligently dismantling the barriers to U.S. companies and U.S. exports. Vietnam should focus on administrative reforms that enhance the transparency, clarity, and predictability of trade- and tax-related processes. Legislation that entrenches Vietnamese monopolies, imposes onerous requirements on U.S. companies, or otherwise restricts their ability to compete through exports from the United States, will only exacerbate the growing trade imbalance.

Switzerland

Recent Developments

Switzerland was one of the countries in Europe hit early and hard by COVID-19, leading the government to declare a national state of emergency in mid-March. The number of active and new cases declined sharply from mid-to-late April but started rising again from mid-June as the authorities eased public health and mobility restrictions. Since mid-October, the number of new COVID-19 cases has surged, with new infections significantly above spring 2020 highs, leading the Swiss Federal Council to re-introduce several containment measures.

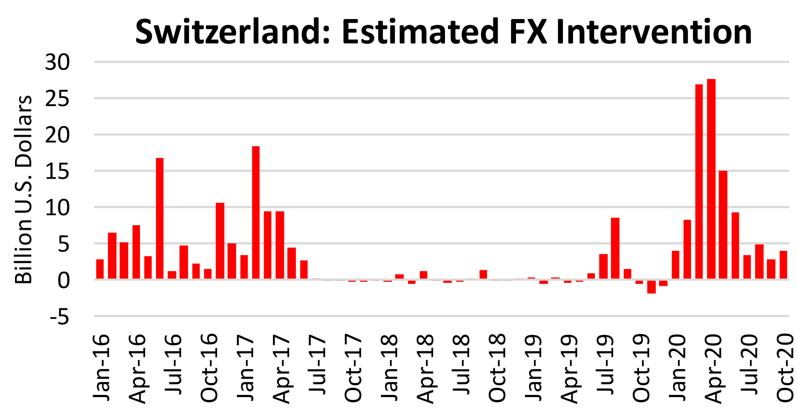
Economic activity has been hard hit by the pandemic and associated containment efforts, with Switzerland's economy contracting 4.1% year-over-year in the first half of 2020. Growth rebounded in the third quarter by 7.2% quarter-over-quarter as restrictions to combat COVID-19 were lifted, but the resurgence of cases in the fall across Europe presents downside risks to the fourth quarter. The Swiss National Bank (SNB) projects the real economy will contract 5% in 2020, roughly in line with the IMF's growth forecast of -5.3%, and this forecast remains subject to significant downside risks.



Sources: FRB, Bank for International Settlements

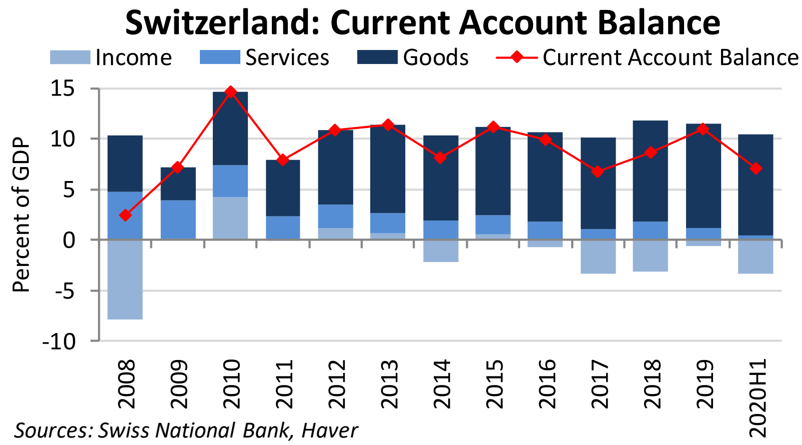
The sharp pullback in global risk appetite this spring amid the widening pandemic generated safe haven capital flows into Switzerland, putting pressure on the Swiss franc to strengthen and weighing on domestic inflation pressures. Over the first ten months of 2020, the Swiss franc (CHF) remained broadly unchanged against the euro, appreciated 5.6% against the dollar, and around 4.3% on a real effective basis.

To buffer the economic impact of the pandemic, Switzerland eased macroeconomic policy significantly. The federal government's announced fiscal response amounts to nearly 11% of GDP, including both direct and indirect measures. Direct fiscal measures include partial unemployment compensation and aid to affected firms. These were implemented in conjunction with larger indirect fiscal measures in the form of loan guarantees to small- and medium-sized enterprises and start-ups, temporary deferral of social security payments for affected companies, and an extension of tax and other payments owed to the federal government. However, the take-up of bridge loans under the federal guarantee program, as well as assistance to the self-employed, has been lower than budgeted.



Sources: Swiss National Bank, U.S. Treasury estimates

Monetary policy was also eased through a range of available measures to buffer the shock to activity, limit franc appreciation, and combat deflationary risks. The SNB increased massively its intervention in foreign exchange markets over the spring, purchasing $93 billion (90 billion francs) in foreign exchange over the first half of 2020 (equivalent to 26% of H1 2020 GDP). In April, the SNB raised the exemption threshold from negative interest rates for sight deposits to 30 times minimum reserves (up from 25 times previously). The SNB introduced a COVID-19 refinancing facility that would operate in tandem with surety and loan guarantee programs offered by the federal government and cantons to allow banks to obtain liquidity from the SNB. Since April, the SNB has been providing liquidity via the repo market, and, in July, adjusted the rate calculation to effectively lower the borrowing cost from its liquidity shortage facility. The SNB also drew on its standing U.S. dollar swap line with the Federal Reserve for the first time since spring 2012.[26] In its September Monetary Policy Committee meeting, the SNB maintained its main policy rate at -0.75% and reasserted that it considers the franc to be "highly valued." While the SNB's inflation outlook has improved since the June assessment due to higher oil prices, the SNB projects deflation (-0.6%) in 2020 and a slow return to barely positive inflation in 2021.



Enhanced Analysis

Switzerland has long been one of the most wealthy, productive, and innovative economies in the world. Switzerland's high labor productivity and high employment rates generate the fourth-highest GDP per capita in the OECD. Switzerland is a major global financial center, with a large and stable banking sector. The Swiss authorities have a history of restrained macroeconomic management, particularly a conservative fiscal policy approach that has prioritized debt reduction over the last two decades. Moreover, the country's highly competitive corporate tax system has made Switzerland a destination for multinational enterprises, contributing to Switzerland's outsized role in some high value-added global industries (e.g., pharmaceuticals). These factors have contributed to persistent, and often extremely large, current account surpluses over four decades.

The Swiss franc has been one of the global reserve currencies throughout the modern era of international finance, though its share of global foreign exchange reserves has been relatively low. The franc has also long been a safe haven currency that investors acquire during periods when global risk appetite recedes, or financial volatility accelerates which can pose challenges for Swiss macroeconomic policymakers.

Switzerland is a small, open economy with significant exposure to external factors, and exchange rate movements can often have a major impact on inflation. The Swiss franc is a managed-floating currency, and the SNB sets monetary policy to keep inflation stable. In times of heightened regional and global risk, large safe haven inflows can put considerable appreciation pressure on the franc, and sustained appreciation will weigh on domestic inflation.

[26] Drawings on the swap line peaked at $10.7 billion in April and stood at $2.1 billion as of October.

Over the last 15 years, the franc has been subject to notable pressures from large swings in global risk appetite, particularly emanating from the global financial crisis, the euro area sovereign debt crisis, and most recently the COVID-19 pandemic. The SNB has employed a range of tools to try to offset appreciation pressure on the franc and limit negative impacts on inflation and domestic growth. Key tools have included negative interest rates, an exchange rate floor, and large-scale unsterilized foreign exchange intervention. Price stability, however, has remained a challenge for the SNB, with annual inflation below the midpoint of the SNB's 0-2% target range throughout the last decade, and outright deflation in five of ten years. The weakness of domestic price pressures has also been reinforced by tight fiscal policies that have prioritized debt reduction coming out of the global financial crisis. Despite the persistence of deflationary pressures and negative short-term interest rates, the Swiss government ran fiscal surpluses most years over the last decade. This has increased the reliance on certain monetary policies to support the economy and combat deflation.

At the onset of the global financial crisis, the SNB was one of the first major central banks to engage in quantitative easing, expanding the money supply by increasing its holdings of a range of assets, including Swiss franc securities. The SNB abandoned the use of domestic quantitative easing relatively quickly, as it was concerned about creating domestic distortions across Swiss franc asset markets. The relatively limited stock of Swiss government debt (exacerbated by strict fiscal discipline) reinforced the SNB's concerns. As a result, the SNB's balance sheet did not experience the same significant expansion of domestic asset holdings that has been seen over the last decade across other advanced economy central banks. Instead, the SNB shifted its focus and relied increasingly on unsterilized foreign exchange purchases to absorb safe haven flows, limit franc appreciation, and support inflation.

In 2010-2011, the euro area sovereign debt crisis, budget discussions in the U.S. Congress, and weak global economic data combined to lead the franc to appreciate against the dollar and the euro. The pace of appreciation of the real effective franc accelerated to a rate of 2.5% per month between April and August 2011, causing the SNB to express concern over the franc's rapid appreciation. The SNB's concern about the franc's strength versus the euro was particularly acute as the EU is Switzerland's main trading partner. The SNB responded by taking a series of extraordinary policy steps, including driving interest rates to near zero by flooding the market with liquidity, significant foreign exchange intervention, and establishing a floor on the franc against the euro to prevent the currency from appreciating past 1.20 francs per euro.

In August 2011, the SNB lowered the upper limit of its target range for the three-month LIBOR to 0-0.25% (from 0-0.75%) and announced additional measures to increase liquidity, including injecting more liquidity into the Swiss money market and conducting foreign exchange swap transactions (a policy previously used in late 2008). The franc nonetheless continued to strengthen, and the SNB increased its volume of foreign exchange intervention. In August 2011 alone, the SNB's net purchases totaled $211 billion according to Treasury estimates. On August 11, 2011, an SNB official said that a temporary peg to the euro was possible and the comment resulted in a 4.5% depreciation of the franc against the euro the following day. The franc continued to depreciate through August, but by early September franc resumed strengthening. On September 6, 2011, the SNB announced its CHF1.20 per euro exchange rate floor. In the announcement, the SNB stated it was "aiming for a substantial and sustained weakening of the Swiss franc," and was prepared to buy foreign currency in "unlimited quantities" to enforce the floor.

The exchange rate floor remained in place until early 2015. For most of 2013-2014, the floor faced little pressure. However, in late 2014, the SNB resumed intervening heavily to defend the floor in response to increased capital inflows driven by a combination of events, including anticipation of the ECB's quantitative easing program. At the same time, the SNB also cut the interest rate on SNB deposits to -0.25% from zero to discourage new inflows, but it still needed to engage in heavy intervention to defend the peg. On January 15, 2015, concerned that continued intervention would cause SNB balance sheet losses as the franc depreciated against the dollar and that publication of the magnitude of interventions would lead to increased market speculation that the SNB would eventually abandon the peg, the SNB abandoned the floor and returned to a managed float exchange rate regime. At the same time, the SNB lowered the policy rate deeper into negative territory and engaged in sizable intervention to prevent the franc from appreciating against the euro. Over the first half of 2015, the NEER appreciated 10.8% and the REER appreciated 9.4%, although most of this strength emerged in the immediate aftermath of the SNB's removal of the franc floor.

From mid-2017 to mid-2019, the scale and frequency of the SNB's foreign exchange purchases decreased notably and the franc remained broadly stable on a real effective basis. By spring 2018, the REER returned to the level that prevailed during the exchange rate floor period and was around 11% stronger than the level in 2000. The IMF's assessment of 2019 external positions found that the Swiss current account surplus was over 5% of GDP stronger than the level implied by medium-term fundamentals and policies. IMF staff, however adjusted that amount down significantly for Swiss-specific factors,[27] which had the impact of significantly reducing the size of IMF's estimate of exchange rate undervaluation. Even so, IMF staff found the franc to be undervalued by about 3.5 percent on a real effective basis. Between July and August 2019, foreign exchange purchases by the SNB increased markedly as global risk appetite deteriorated amid geopolitical tensions and further ECB monetary stimulus. While purchases declined towards end-2019, Switzerland experienced intensified pressure from safe haven inflows in the first half of 2020 as a result of the COVID-19 crisis. The SNB responded by stepping up its foreign exchange purchases significantly to stem franc appreciation.

In September 2020, the SNB also signaled its intention to intervene "more strongly" in the foreign exchange market as circumstances necessitate. This followed a marked increase in SNB foreign exchange purchases during July and August of 2019, and again from early 2020 as global risk appetite deteriorated. The SNB is concerned with the long-term trend of franc appreciation and the concurrent deflationary pressure. Between 2008 and 2019, the REER strengthened around 18%, including two episodes of rapid appreciation due to safe-haven inflows in July 2011 during the euro area crisis as well as immediately after

[27] These factors include the inclusion of estimated retained earnings on portfolio equity investment and compensation for valuation losses on fixed-income securities arising from inflation.

Switzerland removed its exchange rate floor in January 2015. While the SNB's foreign exchange purchases have been contained largely to periods of inflow surges, they nonetheless have been relied upon as a key policy tool and resulted in a significant increase in the SNB's balance sheet and foreign reserves.

In late-September 2020, the SNB announced it would start reporting the volume of foreign exchange market operations on a quarterly basis (compared to its previous annual disclosure). The SNB disclosed that it spent $93 billion (90 billion francs) on currency interventions in H1 2020. Between July 2019 and June 2020, Treasury estimates that SNB net foreign purchases have totaled $103 billion (or 14% of GDP). As a result of interventions and valuation changes, the SNB's foreign exchange reserves had grown to $896 billion (around 123% of GDP) by the end of June 2020 (up from $798 billion at end-2019).

As a result of the SNB's monetary policy actions from the global financial crisis onwards, the SNB's balance sheet and foreign exchange reserves have increased significantly. Between 2007 and Q2 2020, the SNB's balance sheet expanded from 21% of GDP to 126% of GDP, mainly through foreign asset purchases, making it one of the largest central bank balance sheets in the world relative to GDP. As of Q2 2020, Switzerland's foreign currency reserves stood at $896 billion, or 123% of GDP. The SNB's reserves portfolio, which includes gold and highly rated sovereign bonds, as well as other assets, also rose. As of Q2 2020, gold accounts for around 5% of the SNB's foreign assets. Broken down by currency, around 41% of the SNB's foreign currency investments is in euros, 35% in dollars, 8% in yen, and around 16% in other currencies. By the IMF's metric for assessing reserve adequacy, Switzerland's foreign exchange reserves are considered adequate (despite its large financial sector), covering 86% of short-term debt.

Since 2006, Switzerland's fiscal balance has been in surplus almost every year (except for 2013 and 2014, and now 2020 as a result of the COVID-19 crisis), and Switzerland's debt ratio has since declined to 41% of GDP in 2019 from 57% in 2003. Switzerland's tight fiscal policy is a result, in part, of its federal "debt brake" rule. The debt brake rule was first included in the 2003 federal budget – prompted by the rapid growth in its debt-to-GDP ratio in the 1990s from 31% in 1990 to 54% in 1998 – and emanating from a 1998 constitutional amendment that sought to eliminate the federal deficit by 2001 ('*Stabilisierungsprogramm'*). The debt brake rule intends to establish a sustainable and stable fiscal trajectory over the long term, while avoiding a pro-cyclical fiscal stance. It calls for a structural fiscal balance on an *ex ante* basis, and in the case of *ex post* spending overruns, requires offsetting structural surpluses in the following years. The federal debt brake rule is reinforced further by separate fiscal rules implemented by Swiss cantons, which vary substantially across regions.

The debt brake rule's design and implementation tend to skew towards tighter fiscal policy than warranted, due to consistently conservative forecasting of structural revenue and under-execution of expenditures. Switzerland ends almost each year with a larger budget surplus than expected, and Switzerland has seen significant debt reduction since implementing the debt brake rule, rather than the original intent of debt stabilization. In addition, the rule is applied asymmetrically, as it mandates an offset requirement in case of *ex post* overspending, but not for *ex post* underspending. Due to these factors, Switzerland's fiscal policy has consistently overperformed the rule's objective, thereby weighing on economic growth and complicating efforts to maintain positive inflation. Between 2006 and 2019, the IMF estimates that structural surpluses averaged 0.5% of GDP (rising cumulatively to around 6% of 2018 GDP), significantly above the debt brake rule's balanced position mandate. Consequently, Switzerland's fiscal policy framework leads to an over-reliance on monetary policy to provide support to growth.

Switzerland has for many years run extremely large current account surpluses, with the surplus reaching 10.9% of GDP in 2019. The current account surplus declined marginally but remained elevated at 8.8% of GDP over the four quarters through June 2020. The United States' goods trade deficit with Switzerland widened notably over the last year, reaching $49 billion over the four quarters through June 2020, due partially to an increase in Swiss gold exports in H1 2020.

Consistent government saving is a significant driver of Switzerland's large and persistent current account surpluses. Other structural factors also play a role, including high per capita income; a large prime-saver-aged and aging population; a high household savings rate; limited domestic investment opportunities; and a large net international investment position (NIIP), whose returns increase the income balance. The current account surplus has averaged nearly 10% of GDP over the past decade, although it has declined since the global financial crisis (when it reached nearly 15% of GDP). Since the global financial crisis, the composition of the current account has evolved with the primary income and services trade surpluses declining, and the goods surplus expanding due to merchanting and the pharmaceutical sector.

In 2019, Switzerland's goods trade surplus with the United States reached $27 billion, a 41% increase over the annual surplus of $19 billion in 2018. Switzerland maintains a large and rising goods trade surplus with the United States, but this has been mirrored largely by a services trade deficit. Switzerland's bilateral goods trade surplus with the United States expanded in 2020, growing 180% year-over-year to $34 billion over the first six months of 2020, up from $12 billion in the first six months of 2019. Over the four quarters through June 2020, the bilateral surplus stood at $49 billion. This large increase can be attributed partially to a surge of gold exports to the United States as the COVID-19 pandemic worsened and U.S. investors increased gold bullion purchases. At end-2019, Switzerland's bilateral services trade deficit with the United States stood at $22 billion. This figure remained broadly unchanged year-over-year in the first half of 2020.

Switzerland maintains tariff and nontariff barriers that limit U.S. firms' access to Swiss markets, particularly with respect to agriculture, but also for intellectual property. In agriculture, U.S. market access is restricted by high tariffs on certain products, preferential tariff rates for products from other trading partners, and certain government regulations. Swiss agriculture is highly subsidized and regulated with price controls, production quotas, import restrictions, and tariffs, all of which support domestic production. With respect to intellectual property, Switzerland has taken measures to address copyright protection and enforcement and the United States is monitoring measures to address copyright piracy. Switzerland has not implemented capital controls in recent years.

Switzerland should employ a more balanced macroeconomic policy mix. Switzerland continues to rely heavily on monetary policy despite the reduced effectiveness of unconventional tools, especially against a backdrop of persistent deflationary risks. We urge the SNB to deploy a broader and more balanced mix of monetary policy instruments, including domestic quantitative easing. Central to this recommended recalibration of chosen monetary policies, we continue to urge the SNB to limit foreign exchange intervention to lean against large appreciation surges and allow real appreciation in line with the long-term trend. Treasury welcomes the SNB's recent step to disclose foreign exchange intervention on a quarterly basis. Increased frequency of these disclosures – such as on a monthly basis – will help further improve the transparency of the SNB's actions.

We strongly urge Switzerland to use its substantial fiscal space to reduce the economy's reliance on the SNB's policy measures, rebalance its external sector, and boost potential growth.

Switzerland's fiscal expenditures remain well below its OECD peers, and its entire yield curve is in negative territory. Increased public investment would lower government net savings and help Switzerland meet its long-term challenges associated with an ageing population. According to the OECD, net public investment in Switzerland averaged 0.25% of GDP over 2013-2017, relative to 0.5% in the median OECD country. The high level of household savings could also be addressed via amending the pension system to reduce barriers to working longer; equalizing and then raising male and female retirement ages; and, continued efforts to contain rising healthcare costs.

We also urge the Swiss authorities to re-examine the debt brake rule to reorient its purpose towards debt stabilization. In particular, the debt brake should operate symmetrically to reduce persistent under-execution of the budget and lower Swiss fiscal policy's bias towards subtracting from growth. Examining estimation methods to avoid underestimating structural revenue and investigating causes of systematic underspending in the annual budget could also improve the rule's efficacy without jeopardizing fiscal sustainability.

The authorities should also take steps to raise potential growth by raising labor force participation rates and productivity growth. Specifically, raising the female participation rate, which is well below that for males, can be supported by expanding affordable childcare, facilitating access to early childhood education – which would allow for women to expand their working hours – and narrowing gender pay gaps. Switzerland's labor productivity is relatively high, but productivity growth has been weak since the global financial crisis (like in many other advanced economies). To raise overall productivity, the Swiss authorities could target measures in less-productive sectors through corporate income tax reform to lower investment costs for small- and medium-sized enterprises, provide funding for STEM education, and incentivize R&D activities.

Section 2: Intensified Evaluation of Major Trading Partners

The Omnibus Trade and Competitiveness Act of 1988 (the "1988 Act") requires the Secretary of the Treasury to provide semiannual reports to Congress on international economic and exchange rate policy. Under Section 3004 of the 1988 Act, the Secretary must:

> *"consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade."*

This determination may encompass analysis of a broad range of factors, including not only trade and current account imbalances and foreign exchange intervention (criteria under the second piece of legislation discussed below), but also currency developments, the design of exchange rate regimes and exchange rate practices, foreign exchange reserve coverage, capital controls, monetary policy, and trade policy actions, as well as foreign exchange activities by quasi-official entities that may be undertaken on behalf of official entities, among other factors.

The Trade Facilitation and Trade Enforcement Act of 2015 (the "2015 Act") requires the Secretary of the Treasury to provide semiannual reports on the macroeconomic and foreign exchange rate policies of the major trading partners of the United States. Section 701 of the 2015 Act requires that Treasury undertake an enhanced analysis of exchange rates and externally-oriented policies for each major trading partner "that has— (1) a significant bilateral trade surplus with the United States; (2) a material current account surplus; and (3) engaged in persistent one-sided intervention in the foreign exchange market." Additionally, the 2015 Act establishes a process to engage economies that may be pursuing unfair practices and impose penalties on economies that fail to adopt appropriate policies.

Key Criteria

Pursuant to Section 701 of the 2015 Act, this section of the Report seeks to identify any major trading partner of the United States that has: (1) a significant bilateral trade surplus with the United States, (2) a material current account surplus, and (3) engaged in persistent one-sided intervention in the foreign exchange market. Required data for the period of review (the four quarters through June 2020, unless otherwise noted) are provided in Table 1 (p. 23) and Table 2 (p. 64).

As noted earlier, Treasury reviews developments in the 20 largest trading partners of the United States whose bilateral goods trade exceeds $40 billion annually; these economies accounted for more than 80% of U.S. trade in goods in 2019. This includes all U.S. trading partners whose bilateral goods surplus with the United States in 2019 exceeded $20 billion. Treasury's goal is to focus attention on those economies whose bilateral trade is most significant to the U.S. economy and whose policies are the most material for the global economy.

The results of Treasury's latest assessment pursuant to Section 701 of the 2015 Act are discussed below.

Criterion (1) – Significant bilateral trade surplus with the United States:

Column 1 in Table 2 provides the bilateral goods trade balances for the United States' 20 largest trading partners for the four quarters through June 2020.[28] China has the largest trade surplus with the United States by far, after which the sizes of the bilateral trade surpluses decline notably. Treasury assesses that economies with a bilateral goods surplus of at least $20 billion (roughly 0.1% of U.S. GDP) have a "significant" surplus. Highlighted in red in column 1 are the 14 major trading partners that have a bilateral surplus that met this threshold the four quarters through June 2020. Table 3 provides additional contextual information on bilateral trade, including services trade, with these trading partners.

[28] Although this Report does not treat the euro area itself as a major trading partner for the purposes of the 2015 Act – this Report assesses euro area countries individually – data for the euro area are presented in Table 2 and elsewhere in this Report both for comparative and contextual purposes, and because policies of the ECB, which holds responsibility for monetary policy for the euro area, will be assessed as the monetary authority of individual euro area countries.

Table 2. Major Foreign Trading Partners Evaluation Criteria

	Bilateral Trade	Current Account			FX Intervention			
	Goods Surplus with United States (USD Bil., Trailing 4Q) (1)	Balance (% of GDP, Trailing 4Q) (2a)	3 Year Change in Balance (% of GDP) (2b)	Balance (USD Bil., Trailing 4Q) (2c)	Net Purchases (% of GDP, Trailing 4Q) (3a)	Net Purchases (USD Bil., Trailing 4Q) (3b)	Net Purchases (USD Bil., Trailing 2Q) (3c)	Net Purchases 6 of 12 Months† (3d)
China	**310**	1.1	-0.3	157	-0.1	-10	-8	No
Mexico	**96**	-0.2	1.9	-2	0.0	0	0	No
Germany	**62**	**6.8**	-0.9	253	..	..	..	..
Vietnam	**58**	**4.6**	6.5	15	**5.1***	17	5	**Yes**
Japan	**57**	**3.1**	-0.8	158	0.0	0	0	No
Ireland	**55**	-5.5	6.4	-22	..	..	..	..
Switzerland	**49**	**8.8**	-0.3	64	**14.2**	103	93	**Yes**
Italy	**30**	**3.0**	0.4	55	..	..	..	..
Malaysia	**29**	**2.5**	-0.2	9	1.1	4	4	Yes
Taiwan	**25**	**10.9**	-1.5	68	1.7	11	4	Yes
Canada	**24**	-1.9	0.7	-31	0.0	0	..	No
Thailand	**22**	**6.3**	-3.1	33	1.8**	10	4	Yes
India	**22**	0.4	1.6	10	**2.4**	64	33	**Yes**
Korea	**20**	**3.5**	-1.3	57	-0.6	-9	-6	Yes
France	15	-1.6	-0.7	-41	..	..	..	..
Singapore	-1	**16.1**	-1.1	56	**21.3**	74	44	**Yes**
United Kingdom	-8	-2.8	1.9	-76	0.0	0	..	No
Belgium	-11	0.6	0.9	3	..	..	..	..
Brazil	-13	-2.8	-1.9	-47	-2.3	-39	-37	Yes
Netherlands	-18	**9.4**	-0.2	83	..	..	..	..
Memo: Euro Area	152	2.1	-0.5	271	0.0	0	0	No

Note: Current account balance measured using BOP data, recorded in U.S. dollars, from national authorities.

Sources: Haver Analytics; National Authorities; U.S. Census Bureau; and U.S. Department of the Treasury Staff Estimates

† In assessing the persistence of intervention, Treasury will consider an economy that is judged to have purchased foreign exchange on net for 6 of the 12 months to have met the threshold.

* Vietnam does not publish FX intervention. Authorities have conveyed bilaterally to Treasury the size of net FX purchases during the four quarters ending June 2020.

** Thailand does not publish FX intervention. Authorities have conveyed bilaterally to Treasury that net FX purchases were less than 2% of GDP during the four quarters ending June 2020.

Table 3. Major Foreign Trading Partners - Expanded Trade Data

	Bilateral Trade					
	Goods Surplus with United States (USD Bil., Trailing 4Q) (1a)	Goods Surplus with United States (% of GDP, Trailing 4Q) (1b)	Goods Trade (USD Bil., Trailing 4Q) (1c)	Services Surplus with United States (USD Bil., Trailing 4Q)* (1d)	Services Surplus with United States (% of GDP, Trailing 4Q)* (1e)	Services Trade (USD Bil., Trailing 4Q)* (1f)
Economies with quarterly services trade data through Q2 2020						
China	310	2.2	518	-30	-0.2	64
Mexico	96	8.3	549	-5	-0.5	53
Germany	62	1.7	177	0	0.0	67
Japan	57	1.1	199	-12	-0.2	79
Italy	30	1.6	74	1	0.0	17
Taiwan	25	4.0	87	-3	-0.5	17
Canada	24	1.5	551	-24	-1.5	96
India	22	0.8	80	6	0.2	49
Korea	20	1.2	130	-11	-0.7	31
France	15	0.6	81	-3	-0.1	36
Singapore	-1	-0.2	59	-13	-3.7	34
United Kingdom	-8	-0.3	122	-13	-0.5	127
Brazil	-13	-0.8	66	-14	-0.8	27
Netherlands	-18	-2.1	78	-5	-0.6	33
Memo : Euro Area	152	1.2	608	-53	-0.4	284
Economies with annual services trade data through 2019						
Vietnam	58	17.6	80	-1	-0.4	4
Ireland	55	13.9	74	-34	-8.6	81
Switzerland	49	6.7	80	-22	-3.0	72
Malaysia	29	8.4	55	-1	-0.2	5
Thailand	22	4.3	48	-1	-0.2	6
Belgium	-11	-2.1	50	-1	-0.2	10

Source: U.S. Census Bureau, Bureau of Economic Analysis

*Quarterly services data is through Q2 2020. For trading partners where quarterly bilateral services trade data are not available, annual services data through 2019 is used. Services data is reported on a balance of payments basis (not seasonally adjusted), while goods data is reported on a census basis (not seasonally adjusted).

Criterion (2) – Material current account surplus:

Treasury assesses current account surpluses in excess of 2% of GDP to be "material" for the purposes of enhanced analysis. Highlighted in red in column 2a of Table 2 are the 11 economies that had a current account surplus in excess of 2% of GDP in 2019. In the aggregate, these 11 economies accounted for nearly two-thirds of the value of global current account surpluses in 2019. Column 2b shows the change in the current account surplus as a share of GDP over the last three years, although this is not a criterion for enhanced analysis.

Criterion (3) – Persistent, one-sided intervention:

Treasury assesses net purchases of foreign currency, conducted repeatedly, in at least 6 out of 12 months, totaling at least 2% of an economy's GDP to be persistent, one-sided intervention.[29] Columns 3a and 3d in Table 2 provide Treasury's assessment of this

[29] Notably, this quantitative threshold is sufficient to meet the criterion. Other patterns of intervention, with lesser amounts or less frequent interventions, might also meet the criterion depending on the circumstances of the intervention.

criterion.[30] In economies where foreign exchange interventions are not published, Treasury uses estimates of net purchases of foreign currency to proxy for intervention. Vietnam, Switzerland, India, and Singapore met this criterion over the four quarters through June 2020, per Treasury estimates.

Summary of Findings

Pursuant to the 2015 Act, Treasury finds that Vietnam and Switzerland met all three criteria in the current review period of the four quarters through June 2020 based on the most recent available data. Additionally, nine major trading partners met two of the three criteria for enhanced analysis under the 2015 Act in this Report or in the January 2020 Report. Further, one major trading partner, China, constitutes a disproportionate share of the overall U.S. trade deficit. **Ten economies — China, Japan, Korea, Germany, Italy, Singapore, Malaysia, Thailand, Taiwan, and India — constitute Treasury's Monitoring List.**

- China has met one of the three criteria in every Report since the October 2016 Report, having a significant bilateral trade surplus with the United States, with this surplus accounting for a disproportionate share of the overall U.S. trade deficit.
- Japan and Germany have met two of the three criteria in every Report since the April 2016 Report (the initial Report based on the 2015 Act), having material current account surpluses combined with significant bilateral trade surpluses with the United States.
- Korea has met two of the three criteria in every Report since April 2016 with the exception of the May 2019 Report, having a material current account surplus and a significant bilateral trade surplus with the United States. While Korea's bilateral trade surplus with the United States briefly dipped below the threshold in 2018, it rose back above the threshold in 2019.
- Italy and Malaysia have met two of the three criteria since the May 2019 Report, having a material current account surplus and a significant bilateral trade surplus with the United States.
- Singapore has met two of the three criteria since the May 2019 Report, having a material current account surplus and engaged in persistent, one-sided intervention in the foreign exchange market.
- Switzerland met two of the three criteria in the January 2020 Report, having a material current account surplus and a significant bilateral trade surplus with the United States. Switzerland previously was included on the Monitoring List in every Report between October 2016 and October 2018, having a material current account surplus and

[30] Treasury uses publicly available data for intervention on foreign asset purchases by authorities, or estimated intervention based on valuation-adjusted foreign exchange reserves. This methodology requires assumptions about both the currency and asset composition of reserves in order to isolate returns on assets held in reserves and currency valuation moves from actual purchases and sales, including estimations of transactions in foreign exchange derivatives markets. Treasury also uses alternative data series when they provide a more accurate picture of foreign exchange balances, such as China's monthly reporting of net foreign assets on the PBOC's balance sheet and Taiwan's reporting of net foreign assets at its central bank. To the extent the assumptions made do not reflect the true composition of reserves, estimates may overstate or understate intervention. Treasury strongly encourages those economies in this Report that do not currently release data on foreign exchange intervention to do so.

engaged in persistent, one-sided intervention in the foreign exchange market. Switzerland met all three of the criteria in this Report.

- Thailand and Taiwan met two of the three criteria in this Report, having a material current account surplus and a significant bilateral trade surplus with the United States. Taiwan previously was included on the Monitoring List in every Report between April 2016 and April 2017, having a material current account surplus and engaged in persistent, one-sided intervention in the foreign exchange market.
- Vietnam met two of the three criteria in the May 2019 Report, having a material current account surplus and a significant bilateral trade surplus with the United States, and met one of the three criteria in the January 2020 Report, having a significant bilateral trade surplus with the United States. Vietnam met all three of the criteria in this Report.
- India met two of the three criteria in this Report, having a material current account surplus and engaging in persistent, one-sided intervention over the reporting period.

Treasury will closely monitor and assess the economic trends and foreign exchange policies of each of these economies.

In Ireland, the current account swung from a sizable surplus in 2018 to a deficit in 2019 due to a substantial widening of the services deficit in the second quarter of 2019. Ireland did not meet the criteria for having a material current account surplus in either the January 2020 Report or this Report. Ireland has been removed from the Monitoring List.

Further, based on the analysis in this Report, Treasury has concluded that China no longer meets the standard in the 1988 Act of manipulating the rate of exchange between its currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade during the period covered in the Report. However, Treasury has concluded that Vietnam meets the standard in the 1988 Act of manipulating the rate of exchange between its currency and the United States dollar for purposes of preventing effective balance of payments adjustments and gaining unfair competitive advantage in international trade during the current review period. Similarly, Treasury has concluded that Switzerland meets the standard in the 1988 Act of manipulating the rate of exchange between its currency and the United States dollar for purposes of preventing effective balance of payments adjustments during the current review period.

Global growth continues to be held back by the lack of adequate policy support, especially from fiscal policy, and from slow progress in implementing growth-friendly structural reforms. Moreover, the global economy remains marked by persistent and excessive trade and current account imbalances. Subdued real interest rates across the global economy are a symptom of substantial excess saving that is not being productively employed within the domestic economies of Germany, the Netherlands, China, and other major economies. Global growth would be both stronger and more balanced if key economies that have maintained large and persistent external surpluses would reduce the burden of taxation, roll back regulatory impediments to investment and innovation, and dismantle barriers to trade. This would establish a firmer foundation for strong, domestically driven growth across the global economy.

Glossary of Key Terms in the Report

Exchange Rate – The price at which one currency can be exchanged for another. Also referred to as the bilateral exchange rate.

Exchange Rate Regime – The manner or rules under which an economy manages the exchange rate of its currency, particularly the extent to which it intervenes in the foreign exchange market. Exchange rate regimes range from floating to pegged.

Floating (Flexible) Exchange Rate – An exchange rate regime under which the foreign exchange rate of a currency is fully determined by the market with intervention from the government or central bank being used sparingly.

Foreign Exchange Reserves – Foreign assets held by the central bank that can be used to finance the balance of payments and for intervention in the exchange market. Foreign assets consist of gold, Special Drawing Rights (SDRs), and foreign currency (most of which is held in short-term government securities). The latter are used for intervention in the foreign exchange markets.

Intervention – The purchase or sale of an economy's currency in the foreign exchange market by a government entity (typically a central bank) in order to influence its exchange rate. Purchases involve the exchange of an economy's own currency for a foreign currency, increasing its foreign currency reserves. Sales involve the exchange of an economy's foreign currency reserves for its own currency, reducing foreign currency reserves. Interventions may be sterilized or unsterilized.

Nominal Effective Exchange Rate (NEER) – A measure of the overall value of an economy's currency relative to a set of other currencies. The effective exchange rate is an index calculated as a weighted average of bilateral exchange rates. The weight given to each economy's currency in the index typically reflects the amount of trade with that economy.

Pegged (Fixed) Exchange Rate – An exchange rate regime under which an economy maintains a set rate of exchange between its currency and another currency or a basket of currencies. Often the exchange rate is allowed to move within a narrow predetermined (although not always announced) band. Pegs are maintained through a variety of measures, including capital controls and intervention.

Real Effective Exchange Rate (REER) – A weighted average of bilateral exchange rates, expressed in price-adjusted terms. Unlike the nominal effective exchange rate, it is further adjusted for the effects of inflation in the countries concerned.

Trade Weighted Exchange Rate – see Nominal Effective Exchange Rate.