



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

EXECUTIVE SUMMARY 1

SECTION 1: GLOBAL ECONOMIC AND EXTERNAL DEVELOPMENTS 10

 U.S. ECONOMIC TRENDS 10

 INTERNATIONAL ECONOMIC TRENDS..... 14

 ECONOMIC DEVELOPMENTS IN SELECTED MAJOR TRADING PARTNERS..... 20

SECTION 2: INTENSIFIED EVALUATION OF MAJOR TRADING PARTNERS 38

 KEY CRITERIA 38

 SUMMARY OF FINDINGS 41

GLOSSARY OF KEY TERMS IN THE REPORT 43

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

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 continued to slow in 2019. Growth has held up well in the United States, but has decelerated in many other major economies as a diverse range of challenges weigh on global activity. These include political uncertainty in many European and Latin American countries, financial turbulence in some large emerging markets, China's efforts to address corporate debt vulnerabilities, and ongoing geopolitical tensions. Growth has also been held back by inadequate policy support, especially from fiscal policy, as well as elevated leverage in both the private and public sectors in major economies. The International Monetary Fund (IMF) forecast global growth at 3.0 percent in 2019, its slowest pace since the global financial crisis.

In this context, it is critical that fiscal and structural policies in major economies work in tandem with monetary support to bolster near-term activity and medium-term growth prospects. Many countries, particularly Germany, the Netherlands, and Korea, have sufficient fiscal space for substantial pro-growth stimulus, which could help reduce the pressure for further monetary accommodation. Structural reforms are also needed to lay the foundation for stronger medium-term growth. While priorities vary across economies, needed measures include tax cuts to facilitate stronger investment and encourage labor force participation; regulatory reforms to boost private sector-led growth; and establishing a level playing field for trade.

The Administration is working actively to dismantle unfair barriers to trade and achieve fairer and more reciprocal trade with major U.S. trading partners. This includes combatting unfair currency practices that facilitate competitive advantage, such as unwarranted intervention in currency markets. The United States-Mexico-Canada Agreement (USMCA) incorporates commitments to avoid unfair currency practices and publish related economic information. Additionally, in March Korea for the first time began reporting publicly on its foreign exchange intervention, a development that Treasury welcomes. While transparency on foreign exchange reserves and intervention has generally improved over recent years, many economies still need to improve the transparency and quality of data on reserves and intervention.

Treasury has been engaging closely with China over developments in the Chinese renminbi (RMB). China has a long history of facilitating an undervalued currency through protracted, one-sided intervention in the foreign exchange market and other tools. Over the summer, China took concrete steps to devalue the RMB. Subsequently, Treasury determined under Section 3004 of the Omnibus Trade and Competitiveness Act of 1988 that China was a currency manipulator, given that the purpose of China's devaluation was to gain unfair competitive advantage in international trade.

Intensive trade and currency negotiations between the United States and China over the last few months resulted in a Phase One agreement that requires structural reforms and other changes to China's economic and trade regime in several key areas, including currency and foreign exchange issues. In this agreement, China has made enforceable commitments to refrain from competitive devaluation and not target its exchange rate for

competitive purposes. China has also agreed to publish relevant information related to exchange rates and external balances. Meanwhile, after depreciating as far as 7.18 RMB per U.S. dollar in early September, the RMB subsequently appreciated in October and is currently trading at about 6.93 RMB per dollar.

In this context, Treasury has determined that China should no longer be designated as a currency manipulator at this time.

Treasury continues to press other economies to uphold the exchange rate commitments they have made in the G-20, the G-7, and 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, to using domestic tools to meet domestic objectives, and to consult closely and cooperate as appropriate in regard to action in foreign exchange markets. IMF members have committed to avoid manipulating exchange rates to gain an unfair competitive advantage over other members.

While there has been a decline in the scale and persistence of foreign exchange intervention among most major U.S. trading partners in recent years, this has come during a period in which the dollar has generally been strong relative to historical averages and there have been less persistent appreciation pressures across other currencies. In this context, Treasury will continue to monitor closely the extent to which intervention by our trading partners is symmetrical, and whether economies that choose to smooth exchange rate movements resist depreciation pressure in the same manner as appreciation pressure.

Treasury remains disturbed by the persistent and excessive trade and current account imbalances that mark the global economy. The U.S. trade deficit in non-oil goods has reached new historical highs over the last year, rising above 4 percent of GDP. Meanwhile, the trade and current account surpluses of several major U.S. trading partners remain at extremely high levels. In aggregate, the current account surpluses of China combined with the major U.S. trading partners covered in this Report whose surplus exceeds 2 percent of GDP totaled \$1.1 trillion over the four quarters through June 2019, or around 1.3 percent of global GDP. 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. In order to achieve stronger and more balanced global growth, key economies that have maintained large and persistent external surpluses must pursue reforms that will revitalize domestically driven growth, create productive opportunities for investment, and spark private sector-led growth.

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 Trade Facilitation and Trade Enforcement Act of 2015 (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 trigger 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 three-fourths of the value of all trade surpluses with the United States in 2018. It also captures all trading partners with a trade surplus with the United States that is larger than about 0.1 percent of U.S. GDP.

(2) A material current account surplus is one that is at least 2 percent of gross domestic product (GDP) over a 12-month period. This threshold captures a group of economies that accounted for more than 90 percent of the nominal value of current account surpluses globally in 2018.

(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 percent of an economy’s GDP over a 12-month period.³ Looking over the last

² The report covers data from the 12 month period ending June 2019. 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, Switzerland, and Ireland. 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 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.

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 may be emerging that could weigh on U.S. growth or harm U.S. workers and businesses.

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 China

China has a long history of pursuing a variety of economic and regulatory policies that lead to a competitive advantage in international trade, including through facilitating the undervaluation of the RMB. Moreover, in recent years, China has shifted from a policy of gradual economic liberalization to one of reinforcing state control and increasing reliance on non-market mechanisms. The pervasive use of explicit and implicit subsidies as well as non-tariff barriers and other unfair practices are increasingly distorting China's economic relationships with its trading partners. This Administration has made it clear that the United States will confront China's unfair practices — including forced technology transfer, weak intellectual property rights protection, and industrial subsidies — and will strive for a fairer and more balanced economic relationship.

Over the summer, China took concrete steps to devalue its currency, while maintaining substantial foreign exchange reserves despite active use of such tools in the past. At the time, the Chinese authorities acknowledged that they had ample control over the RMB exchange rate. In August, Treasury determined under the 1988 Act that China was a currency manipulator.

Since August, Treasury has held negotiations with the PBOC over currency issues to eliminate the unfair competitive advantage created by China's latest actions. More broadly, the United States and China have negotiated and recently reached a Phase One agreement that covers selected issues on trade and currency. In this agreement, China has made enforceable commitments to refrain from competitive devaluation and not target its exchange rate for competitive purposes. China has also agreed to publish relevant information related to exchange rates and external balances. Treasury has determined that China should no longer be designated as a currency manipulator at this time.

- China needs to take the necessary steps to avoid a persistently weak currency. The depreciation over August and early September left the RMB at its weakest level against the dollar in over 11 years and weakest level on a trade-weighted basis since the introduction of PBOC's CFETS basket in 2014. The RMB subsequently appreciated in October and is recently trading at about 6.93 per dollar. Improved economic fundamentals and structural policy settings would underpin a stronger RMB over time.

China does not publish foreign exchange intervention data, leading Treasury staff to estimate the scale of China's intervention, both directly by the PBOC and indirectly through state-owned banks. The PBOC appears to have largely 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 first six months of 2019. China should also increase public understanding of the relationship between the PBOC and the foreign exchange activities of the state-owned banks, including in the offshore RMB market.

China's current account surplus rose over the first half of 2019, reaching 1.2 percent of GDP over the four quarters through June 2019, making China's surplus the third largest in the world in nominal terms at \$166 billion over this period. Moreover, China continues to run an extremely large and persistent trade surplus with the United States, dwarfing all other trade imbalances between the United States and its other major trading partners, with the bilateral goods trade surplus totaling \$401 billion over the four quarters through June 2019, equivalent to 45 percent of the total U.S. goods trade deficit over this period. China needs to take additional policy measures to stimulate domestic demand and reduce the Chinese economy's reliance on investment and exports.

Treasury Assessments of Other Major Trading Partners

Pursuant to the 2015 Act, Treasury has found in this Report that no major trading partner met all three criteria during the four quarters ending June 2019. Treasury has also concluded that no major trading partner of the United States other than China met the standards identified in Section 3004 of the 1988 Act during the relevant period.

Regarding the 2015 legislation, 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, this Administration will add and retain on the Monitoring List any major 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, in addition to China, the Monitoring List comprises Japan, Korea, Germany, Italy, Ireland, Singapore, Malaysia, Vietnam, and Switzerland, the latter being added to the Monitoring List in this Report.**

With regard to the other nine economies on the Monitoring List:

- Japan maintains the third-largest bilateral goods trade surplus with the United States, at \$69 billion over the four quarters through June 2019. Japan's current account surplus over the four quarters through June 2019 was 3.4 percent of GDP, down from 4.1 percent of GDP in the year prior. Japan has not intervened in the foreign exchange

market since 2011. Treasury's firm expectation is that in large, freely-traded exchange markets, intervention should be reserved only for very exceptional circumstances with prior consultations. Treasury considers it paramount that countries uphold the framework for foreign exchange policy management expressed in their G-7 and G-20 commitments, particularly in the event of appreciation pressures. To help bolster the economy, Japan should build upon its recent economic momentum to enact bolder structural reforms to strengthen domestic demand, support innovation and create a more sustainable growth path over the long term, which would help reduce Japan's public debt burden and trade imbalances.

- Korea's large external surpluses continued to moderate, as the current account surplus narrowed to 4.0 percent of GDP over the four quarters ending in June 2019. Korea's goods trade surplus with the United States has edged slightly up since 2018 to just above \$20 billion over four quarters through June 2019, driven by increased Korean exports to the United States. Given the still-large external surpluses and a deteriorating growth outlook, fiscal policy should be used proactively to support both near-term activity and medium-term output. Treasury assesses that on net the authorities intervened to support the won over the first half of 2019, making net sales of foreign exchange. The won depreciated 3.7 percent against the dollar in 2019, also depreciating on a real effective basis, as growth has slowed to a six-year low. Treasury welcomes Korea's commitment to increasing the transparency of its foreign exchange intervention and its disclosure in September of Korea's intervention activity in the first half of 2019. The authorities should limit currency intervention to only exceptional circumstances of disorderly market conditions.
- Germany's current account surplus declined modestly in the first half of 2019, but remains the largest in the world in nominal dollar terms at \$283 billion over the four quarters through June 2019. Meanwhile, Germany's bilateral goods trade surplus with the United States has been broadly stable and sits at \$67 billion over the four quarters through June 2019. The persistence of the massive current account surplus and the large bilateral trade imbalance with the United States has resulted from lackluster demand growth in Germany and an undervalued real effective exchange rate. The considerable moderation in Germany's growth in 2018 and the contraction in Germany's GDP in the second quarter of 2019 underscores the urgent need for Germany to cut elevated labor and value-added taxes, restore stronger purchasing power to German households, and undertake 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 2001.⁴
- Italy recorded a current account surplus of 2.8 percent of GDP in over the four quarters through June 2019, while its goods trade surplus with the United States rose to \$33 billion. Italy's competitiveness continues to suffer from stagnant productivity and

⁴ 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.

rising labor costs. The country needs to undertake fundamental structural reforms to raise long-term growth — consistent with reducing high unemployment and public debt — and safeguard fiscal and external sustainability. The ECB has not intervened unilaterally in foreign currency markets since 2001.

- Ireland’s bilateral trade surplus with the United States has expanded significantly in recent years, reaching a record high of \$50 billion over the four quarters through June 2019. This is countered in part by a sizable U.S. surplus in services trade with Ireland. Ireland’s current account balance, meanwhile, has been significantly impacted by the growing presence of foreign multinational enterprises (MNEs), which contribute both to an extremely large goods trade surplus and a substantial income deficit, as well as notable volatility in the overall balance. After running a sizable current account surplus in 2018, large income outflows in the first half of 2019 led the current account to shift into deficit by 0.8 percent of GDP over the four quarters through June 2019. The European Central Bank (ECB) has not intervened unilaterally in foreign currency markets since 2001. Given that Ireland now only meets one of the three criteria from the 2015 Act, Treasury would remove Ireland from the Monitoring List if this remains the case at the time of its next Report.
- Switzerland’s bilateral goods trade surplus with the United States has been trending upward, and reached \$21.8 billion over the four quarters through June 2019. Switzerland continues to have a very large current account surplus, which stood at 10.7 percent of GDP over the four quarters through June 2019. To help narrow its large and persistent trade and current account surpluses, Switzerland should adjust macroeconomic policies—in particular, using its ample fiscal space to more forcefully support domestic economic activity and reduce reliance on monetary policy as it approaches its limits. Switzerland’s foreign exchange purchases declined in both scale and persistence from mid-2017 through mid-2019, and Treasury estimates that net purchases of foreign exchange over the four quarters through June 2019 totaled 0.5 percent of GDP. Since mid-2019, Switzerland’s foreign exchange purchases have increased markedly as the Swiss franc has appreciated against both the dollar and the euro. Treasury continues to encourage the Swiss authorities to publish all intervention data on a higher frequency basis.
- Singapore runs one of the largest current account surpluses in the world as a share of GDP, totaling 17.9 percent of GDP over the four quarters through June 2019. Notwithstanding this large external surplus with the rest of the world, Singapore has consistently run a bilateral goods trade deficit with the United States, which stood at \$4.4 billion over the four quarters through June 2019. Singapore’s monetary policy is uncommon, since it uses the exchange rate as its primary monetary policy tool. To meet price stability objectives, the authorities use foreign exchange intervention frequently to help guide the exchange rate and keep it within a target band. Treasury estimates that over the twelve months ending June 2019, Singapore made net foreign exchange purchases of at least \$32 billion, equivalent to 9.0 percent of GDP. Treasury welcomes the Singaporean authorities’ decision to begin publicly disclosing intervention data in 2020. While certain structural factors contribute to Singapore’s large current account

surplus, Singapore should undertake reforms that will lower its high saving rate and boost low domestic consumption, while striving to ensure that its real exchange rate is in line with economic fundamentals, in order to help narrow its large and persistent external surpluses.

- Malaysia has maintained a significant bilateral goods trade surplus with the United States since 2015, registering \$26 billion over the four quarters through June 2019. After several consecutive years where the current account narrowed, Malaysia's current account has increased, rising to 3.0 percent of GDP over the four quarters through June 2019. Malaysia's central bank has over the last few years intervened in both directions in foreign exchange markets. Treasury estimates that over the four quarters through June 2019, the central bank made net sales of foreign exchange equivalent to 0.3 percent of GDP in support of the ringgit in the midst of depreciation pressures. Malaysia's broad external rebalancing in recent years is welcome, and Malaysia can further advance external rebalancing through targeted policies that encourage high-quality and transparent investment and ensure sufficient social spending, which can help minimize precautionary saving. Treasury also urges Malaysian authorities to increase the transparency of foreign exchange intervention.
- Vietnam's goods trade surplus with the United States continues to rise significantly, with the surplus reaching \$47 billion over the four quarters through June 2019. Over this same period, Vietnam's current account balance steadily narrowed, to 1.7 percent of GDP, as rising outbound income payments have increasingly offset the still-large goods trade surplus. Vietnam intervenes in foreign exchange markets frequently, and in both directions, to maintain a close link to the dollar. The Vietnamese authorities have credibly conveyed to Treasury that net purchases of foreign exchange were 0.8 percent of GDP over the four quarters through June 2019.⁵ These purchases came in a context in which reserves remained below standard adequacy metrics and there was a reasonable rationale for rebuilding reserves. Further, while purchases of foreign exchange outweighed sales over the course of these four quarters, the central bank intervened in both directions, with foreign exchange sales used to resist downward pressure on the Vietnamese dong in the second half of 2018. As Vietnam strengthens its monetary policy framework, and reserves reach adequate levels, Vietnam should reduce its intervention and allow for movements in the exchange rate that reflect economic fundamentals, including gradual appreciation of the real effective exchange rate. Vietnam should also increase the transparency of foreign exchange intervention and reserve holdings.

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, including several that are not on the Monitoring List but are close to triggering key thresholds (e.g., Taiwan, Thailand). For example, Taiwan is the only major economy in Asia that does not

⁵ Forward intervention is included on a trade date basis.

publish data on the full details of its international reserves consistent with IMF standards.⁶ Treasury 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 We have been concerned by recent analytical work published by the Council of Foreign Relations suggesting that Taiwan may have engaged in substantial undisclosed foreign exchange intervention in the swap market. Brad Setser and S.T.W. estimate that Taiwan has conducted undisclosed foreign exchange intervention in the swap market totaling approximately \$130 billion, and perhaps as much as \$200 billion.
<https://www.cfr.org/blog/shadow-fx-intervention-taiwan-solving-100-billion-dollar-enigma-part-1>

Section 1: Global Economic and External Developments

This Report covers economic, trade, and exchange rate developments for the first six months of 2019 and, where data are available, developments through the end of 2019. 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 2019. These economies' total goods trade with the United States amounted to more than \$3.4 trillion over the four quarters through June 2019, more than 80 percent of all U.S. goods trade during that period. For some parts of the analysis, especially those parts having to do with Section 701 of the 2015 Act, data over the four quarters through the second quarter of 2019 are considered.

U.S. Economic Trends

In 2019, the United States entered the longest economic expansion on record: by the end of the year, the economy had grown for 126 consecutive months. In the first three quarters of 2019, real GDP expanded 2.4 percent at an annual rate, near the solid 2.5 percent growth over the four quarters of 2018. Economic growth was driven by stronger consumption spending, stabilization in housing markets, and more robust government spending. In contrast, business fixed investment was constrained in 2019 by slowing global growth, concerns about global supply chains, and domestic and international policy uncertainty. Nonetheless, labor markets maintained strength in 2019: as of November, the unemployment rate fell to a 49-year low, labor force participation rates held at or close to multi-year highs, year-over-year productivity growth rates improved, and nominal and real wage gains were consistently robust. Headline inflation, as measured by the Consumer Price Index, held below 2.0 percent throughout most of 2019 after peaking at 2.9 percent in mid-2018; core inflation, which excludes food and energy, remained stable during the latter half of 2018 and early 2019 and picked up only modestly toward the end of the year. Interest rates, including mortgage rates, started to decline in November 2018, and despite late-year retracement, remained well below the levels of fall 2018, which helped improve affordability in the housing sector. In early December 2019, a consensus of private forecasters predicted that for 2019, real GDP would expand at a rate of 2.2 percent, fourth quarter over fourth quarter.

Solid U.S. Growth

Real GDP expanded at an annualized rate of 2.4 percent over the first three quarters of 2019, close to the 2.5 percent pace of growth over the four quarters of 2018. Private final domestic demand growth remained at a solid pace of 2.4 percent over the first three quarters of 2019, after growing by 2.8 percent over the four quarters of 2018. Consumer spending growth accelerated to 2.9 percent at an annualized rate over the first three quarters of 2019, after growing by 2.6 percent over the four quarters of 2018. Business fixed investment rose by 5.9 percent over the four quarters of 2018, but slowed sharply to an annualized rate of 0.3 percent over the first three quarters of 2019, as rates of investment in structures and equipment dropped off in response to falling oil prices and slowing global growth. After falling by 4.4 percent over the four quarters of 2018,

residential investment stabilized in 2019, growing by 0.2 percent at an annualized rate over the first three quarters of this year. Government spending growth more than doubled to an annualized rate of 3.1 percent over the first three quarters of 2019, compared with a 1.5 percent pace over the four quarters of 2018. Although net exports subtracted an average 0.4 percentage point from growth during 2018, this component made an essentially flat contribution to growth, on average, during the first three quarters of 2019. Inventory accumulation added an average 0.3 percentage point to growth during 2018 but posed a drag on growth, averaging 0.1 percentage point during the first three quarters of this year.

Fundamentals Remain Strong

Labor markets maintained strength in 2019. Nonfarm payroll employment continued to expand, with growth averaging 180,000 jobs per month during 2019 through November, after averaging 223,000 per month in 2018. The pace of job growth this year was well above estimates of the rate of long-run employment growth (90,000 to 130,000) needed to maintain a stable unemployment rate. Measures of unemployment generally declined over the course of 2018 and continued to trend lower through November 2019. After averaging around 3.9 percent during 2018, the average unemployment rate declined to 3.7 percent in the first 11 months of 2019; as of November, the rate was 3.5 percent, matching September's 49-year low. The broadest measure of unemployment, which includes those marginally attached to the labor force and those working part-time for economic reasons, declined to 6.9 percent as of November, matching September's reading as the lowest level since December 2000. Meanwhile, other measures of labor market conditions continued to improve: the labor force participation rate rose to 63.2 percent as of November 2019, just below the six-year high of 63.3 percent reached the previous month. Prime-age (ages 25-54) labor force participation rose to 82.8 percent in October 2019, a ten-year high, where it remained in November 2019.

The pace of compensation growth began to pick up during 2018 and accelerated noticeably in 2019. Nominal average hourly earnings for production and nonsupervisory workers rose 3.5 percent over the year through December 2018. By October 2019, year-over-year earnings growth accelerated to 3.8 percent, the fastest yearly pace since December 2008, before ticking down to a 3.7 percent pace over the year through November 2019. Significantly, earnings for production and nonsupervisory workers have grown at or above 3 percent for sixteen consecutive months, and for the past five consecutive months, this measure of wage growth has increased by at least 3.5 percent. Meanwhile, the slower pace of inflation in 2019 translated into consistently strong real wage growth, with the pace nearing a 4-year high. In real terms, average hourly earnings rose 1.7 percent over the year through November 2019, up from the 1.6 percent increase over the 12 months of 2018. Wages and salaries for private industry workers, as measured by the Employment Cost Index, advanced 3.0 percent over the four quarters ending in September 2019, about in line with the 3.1 percent pace over the four quarters ending in December 2018. Strong wage gains were helped by the considerable improvement in labor productivity growth: after rising 1.0 percent over the four quarters ending December 2018, productivity rose 1.5 percent over the four quarters ending in September 2019.

Consumer sentiment, as measured by the Reuters/Michigan index, stood at 99.3 in December 2019, very close to the 14-year high of 101.4 reached in March 2018 and a full point higher than in December 2018. Consumer confidence, as measured by the Conference Board index, reached an 18-year high of 137.9 in October 2018 before declining to 126.6 in December 2018. The index was little changed over the year at 126.5 by December 2019.

Measures of business activity rose to multi-year highs during the latter half of 2018 but trended lower in 2019. The Institute for Supply Management's manufacturing index ended 2018 at 54.3 – just 6.5 points below the 14-year high reached in August 2018. Twelve months later, however, the manufacturing index slipped below the growth threshold for the first time since 2016, constrained by slowing global growth as well as other domestic and international factors. The manufacturing index declined to 47.2 in December 2019, a 10-year low and the fifth consecutive month that signaled sector contraction. Non-manufacturing business growth also slowed in 2019 but continued to signal business activity expansion. After reaching a 13-year high of 60.8 in September 2018, the ISM's non-manufacturing index declined to 58.0 by the end of the year. As of December 2019, non-manufacturing index was 55.0.

By historical standards, headline inflation in 2019 has been moderate, on balance, after trending lower from mid-2018 through early this year. Over the 12 months through July 2018, the consumer price index (CPI) for all items jumped 2.9 percent. The 12-month growth rate declined to 1.9 percent by December 2018 and decreased further to 1.5 percent over the 12 months through February 2019. Since then, headline inflation has slowly picked up, reaching 2.1 percent over the year through November 2019. The headline personal consumer expenditure (PCE) price index, the basis for the Federal Reserve's 2 percent inflation target, was up 1.4 percent over the four quarters through 2019 Q3, slowing from the 1.9 percent pace over the four quarters through 2018 Q4, and nearly a full percentage point below the 2.3 percent pace over the four quarters through 2018 Q2. The four-quarter pace of growth through 2019 Q3 marked the slowest yearly PCE price increase since 2016 Q3. Meanwhile, core CPI inflation held between a relatively narrow range: after rising 2.4 percent over the year through July 2018, 12-month growth in the core CPI fluctuated between 2.0 percent and 2.2 percent during the final six months of 2018 and the first half of 2019. Over the year through November 2019, the core CPI was up 2.3 percent. Year-over-year growth in the core PCE price index also has had a relatively narrow range in 2019. For the past 11 months, core PCE inflation has ranged between 1.5 percent and 1.7 percent, and index was up 1.6 percent over the year ending in November.

Fiscal Policy and Public Finances

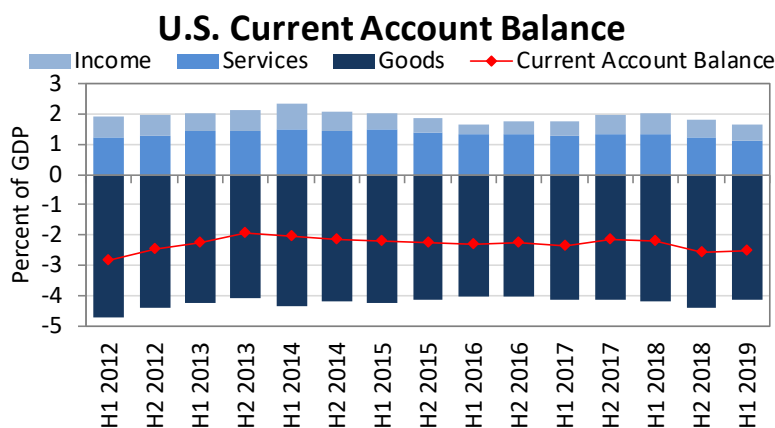
The Federal Government's deficit and debt trended up over the past few years. As the U.S. economy recovered from the 2008-09 recession and implemented spending cuts, the deficit gradually decreased to \$442.0 billion (2.4 percent of GDP) in FY 2015. Since then, the deficit has risen. At the end of the 2019 fiscal year, the deficit rose to 4.6 percent of

GDP (\$984 billion), from 3.8 percent (\$779 billion) in FY 2018. Excluding net interest payments, the deficit was 2.9 percent of GDP in FY 2019, up 0.7 percentage point from FY 2018. The increase in the deficit was driven by faster growth of outlays – largely due to higher mandatory spending from a growing number of retirees – relative to receipts. Net outlays for FY 2019 were 21.0 percent of GDP, up from 20.2 percent of GDP in FY 2018, while federal receipts were 16.3 percent of GDP in FY 2019 (down slightly from 16.4 percent in FY 2018). Federal debt held by the public, or federal debt less that held in government accounts, rose 6.6 percent to \$16.81 trillion by the end of FY 2019. Publicly-held debt as a share of GDP increased by 1.7 percentage points to 79.2 percent of GDP.

So far in FY 2020 (October 2019 to November 2019), the U.S. government has run a deficit of \$343 billion (up \$37.9 billion from the first two months of FY 2019) while the primary deficit (excluding interest payments) was \$278 billion (up \$38.5 billion). The federal government has spent \$814 billion so far in FY 2020 while collecting \$471 billion in revenue. In the *Mid-Session Review* (MSR, released in July), the Administration projected the federal deficit for FY 2020 would total \$1.05 trillion (4.7 percent of GDP) while the primary deficit would be \$624 billion (2.8 percent of GDP). The MSR forecast the government would spend \$4.68 trillion (21.0 percent of GDP), of which net interest payments would account for \$421 billion (1.9 percent of GDP). Receipts were projected to be \$3.63 trillion (16.3 percent of GDP). The Administration projected federal debt held by the public would be \$17.93 trillion (80.4 percent of GDP) by the end of FY 2020.

U.S. Current Account and Trade Balances

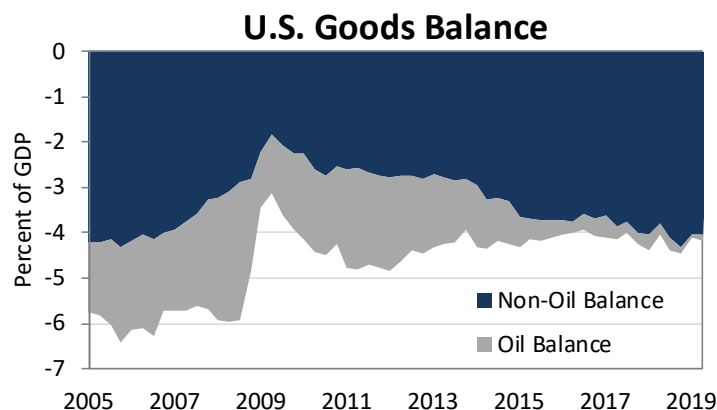
After narrowing in the post-crisis era to just below 2 percent of GDP in the second half of 2013, the headline U.S. current account deficit has been quite stable since 2015 in the ballpark of 2–2½ percent of GDP. The U.S. current account was in deficit by 2.5 percent of GDP in first half of 2019, similar to the second half of 2018 and 0.3 percent of GDP wider than the first half of 2018. The current account deficit was nearly flat in nominal terms in the first half of 2019 compared to the second half of 2018, with a slight narrowing of the goods trade deficit largely offset by small declines in the surpluses in services and income.



Sources: Bureau of Economic Analysis, Haver

Similar to the overall U.S. current account deficit, the U.S. goods trade deficit has been relatively stable in recent years, in the range of 4–4½ percent of GDP. But significant shifts have occurred within the goods balance. The U.S. petroleum deficit has fallen as domestic production has expanded, and net petroleum imports narrowed to 0.1 percent of GDP in the first half of 2019. The non-oil goods deficit, by comparison, has been widening, with

2018 marking the first year since 2006 it stood above 4 percent of GDP, where it remained over the first half of 2019. This widening has primarily reflected strong import growth and relatively stagnant export growth. The dollar's broad strength over this period has likely contributed to these developments in U.S. trade patterns.



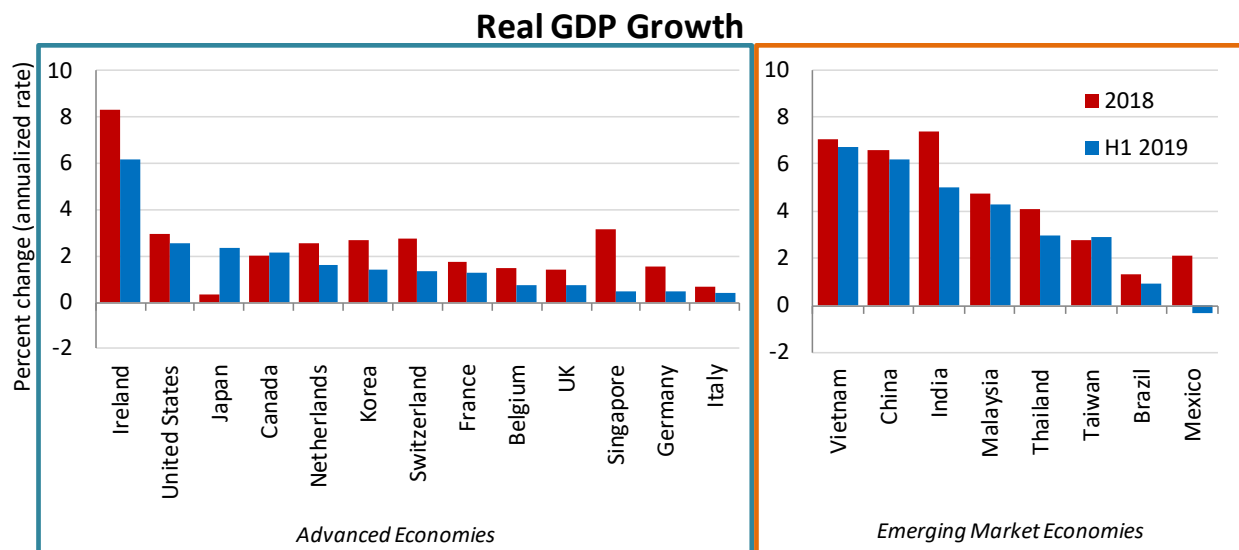
Source: Bureau of Economic Analysis

At the end of the third quarter of 2019, the U.S. net international investment position stood at -\$10.9 trillion (-50.8 percent of GDP), a deterioration of \$1.4 trillion compared to end-2018. The value of U.S.-owned foreign assets was \$28.3 trillion, while the value of foreign-owned U.S. assets stood at \$39.2 trillion. Deterioration in the net position in the first three quarters of 2019 was due in part to the relative outperformance of U.S. stock markets compared to foreign equity markets.

International Economic Trends

Global growth momentum pulled back in 2018, and has continued to slow over 2019. Fixed investment spending across the global economy has been subdued, with both businesses and households holding back on purchases of durable goods (e.g., machinery and equipment, automobiles). Business sentiment and surveys of purchasing managers point to a weak outlook for manufacturing and trade, as pessimistic views on new orders suggest skepticism about the strength of global demand. A wide range of factors have been weighing on global activity. These include political uncertainty in many European and Latin American countries, financial turbulence in some large emerging markets, China's efforts to address corporate debt vulnerabilities, and ongoing geopolitical tensions. The IMF forecast global growth at 3.0 percent in 2019, its slowest pace since the global financial crisis, with growth ticking up to 3.4 percent in 2020.

With heightened concerns about the global growth deceleration across major economies, central banks have shifted to providing more accommodation. It is critical, however, that fiscal and structural policies work in tandem with monetary support to bolster near-term activity and medium-term growth prospects. Many countries, particularly those with current account surpluses including Germany, the Netherlands, and Korea, have sufficient fiscal space for substantial pro-growth stimulus. This would help reduce the pressure on monetary policy, which in some cases is facing constraints to additional accommodation. Structural reforms continue to be needed to lay the foundation for stronger medium-term growth. While priorities vary across economies, needed measures include tax reforms to facilitate stronger investment and encourage labor force participation; regulatory reforms to boost private sector-led growth; and dismantling trade barriers to create a level playing field.



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 Markets⁷

After strengthening notably over 2018, the U.S. dollar was down slightly on net in 2019. As of end-December, the nominal trade-weighted dollar stood 0.7 percent lower year-to-date. Dollar appreciation in 2019 was concentrated in a period from late July to early September when the nominal dollar rose 3 percent. At the time, a deterioration in global risk appetite generated a flight to safety, pushing the dollar higher against most currencies other than the Japanese yen and Swiss franc. With a general decline in safe haven pressures, however, the dollar has depreciated by 3.0 percent since end-August. Across other major currencies, the pound was 4.0 percent stronger against the dollar in 2019, driven by recent developments related to Brexit, while the euro continues to be weighed down by concerns about slowing growth in Europe, particularly in Germany. The Canadian dollar, meanwhile, despite depreciating against dollar since mid-year, was up strongly against the dollar over the first half of 2019, driven by expectations of monetary policy divergence. Across emerging market currencies, the dollar gained nearly 4 percent against the Korean won over 2019, as slowing economic growth and expectations of monetary easing weighed on the won.

Continued dollar strength is concerning given that the IMF continues to judge that the dollar is overvalued on a real effective basis (see chart on page 18). After appreciating 4.5 percent in real effective terms in 2018, the real dollar was slightly below its end-2018 level

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 are calculated using monthly frequency data from the Bank for International Settlements or JP Morgan if BIS data are unavailable.

as of end-2019, as concerns regarding global uncertainty eased somewhat in recent months. However, the real dollar remains elevated at about 8 percent above its 20-year average. Sustained dollar strength would likely exacerbate persistent trade and current account imbalances. It is also concerning that the real effective exchange rates of several surplus economies that the IMF assess to be undervalued have this year either further depreciated (notably Korea, but also Germany and Malaysia), or have not moved in the direction that would correct imbalances (Singapore and the Netherlands).

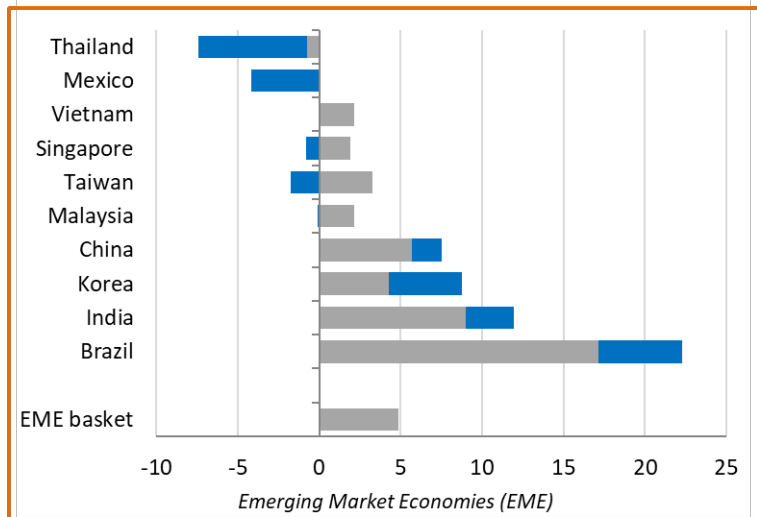
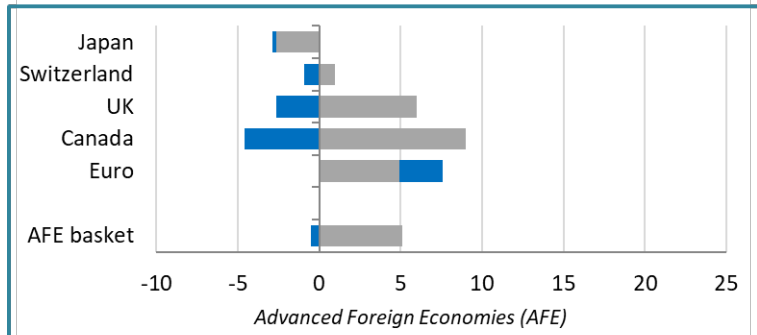
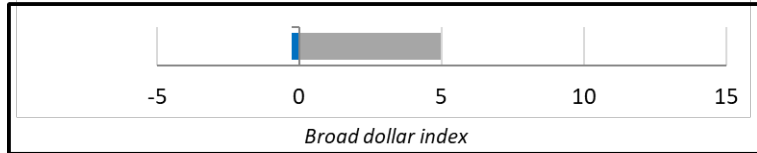
Treasury judges that foreign exchange markets have continued to function smoothly, including as China devalued the RMB to gain an unfair competitive advantage in international trade and as the Federal Reserve lowered its interest rate corridor in July and September. The dollar continues to be the world's principal currency in international foreign exchange markets, reflecting its dominant global position both in terms of market turnover (being bought or sold in 88 percent of all currency trades) and trade settlement.⁸

U.S. Dollar vs. Major Trading Partner Currencies

(+ denotes dollar appreciation)

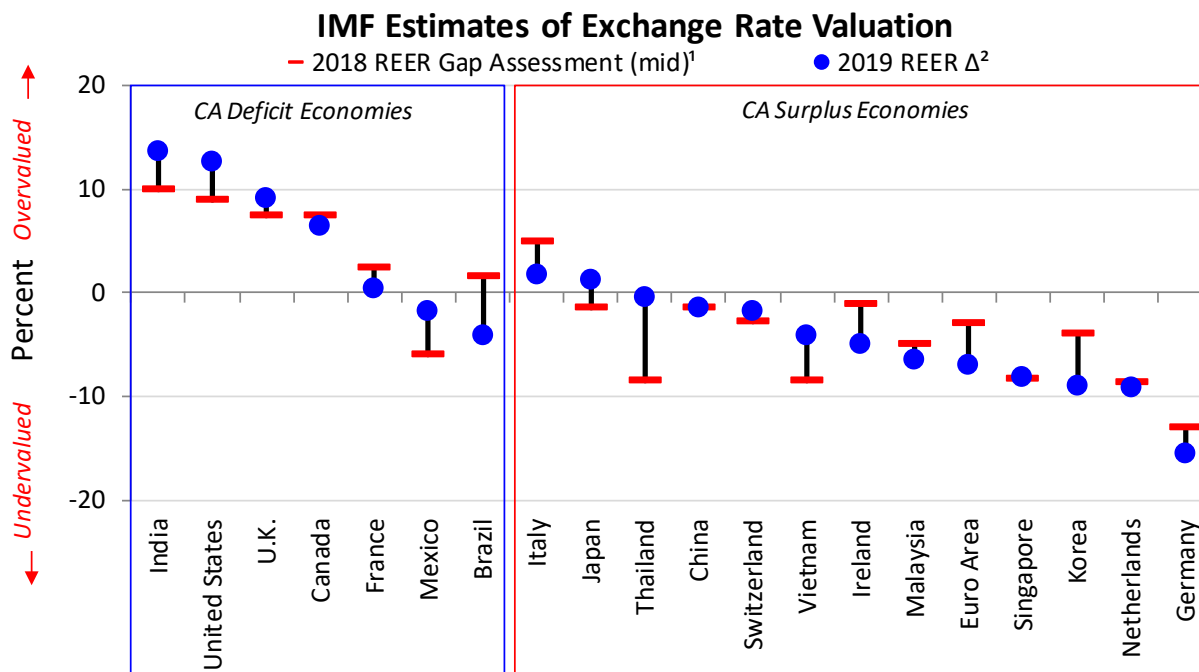
Percent change (relative to end-December 2017)

■ 2018 ■ 2019



Source: FRB, Haver

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



Sources: IMF 2019 External Sector Report, IMF 2019 Article IV Consultation Staff Reports for Vietnam and Ireland, BIS REER Indices, JP Morgan, and FRB.

1/The IMF's estimate of real effective exchange rate (REER) gap (expressed as a range) compares the country's average REER in 2018 to the level consistent with the country's medium-term economic fundamentals and desired policies. The midpoint of the gap range is depicted above.

2/Change through November 2019 versus 2018 average.

Note: The IMF does not provide an estimate of Taiwan's REER gap.

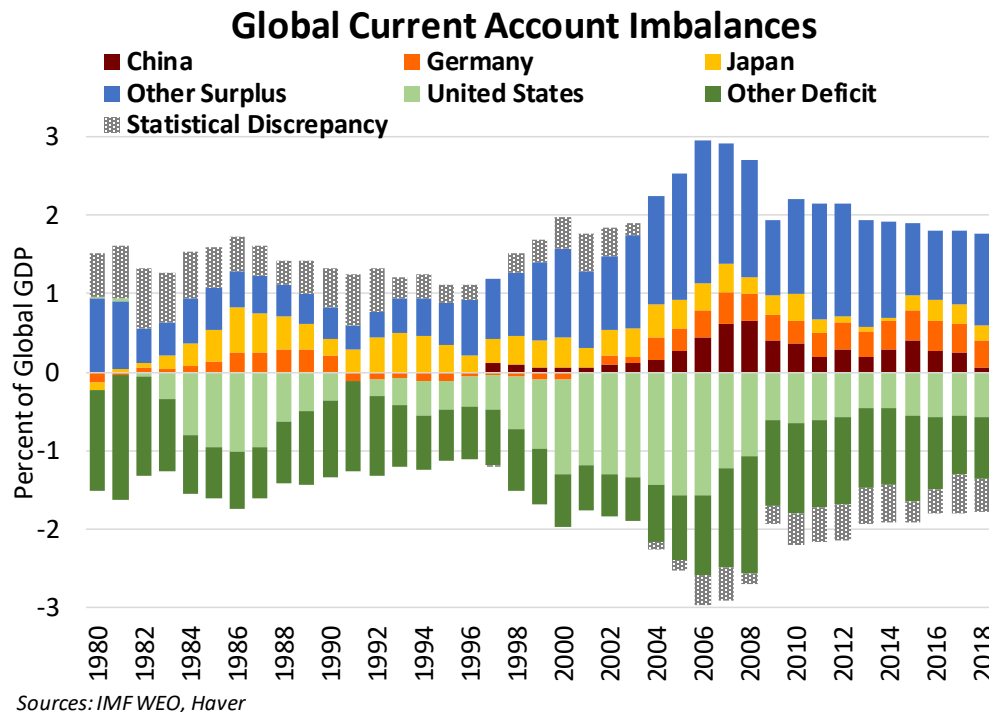
Global Imbalances

Global current account imbalances have been broadly stable the last three years, averaging around 1.8 percent of global GDP.⁹ This remains high from a historical perspective, standing nearly 0.4 percentage points (or roughly \$300 billion annually) higher than the 1980-1999 average. While some very large surpluses have come down, many remain excessively high. 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 \$609 billion over the four quarters through June 2019 (roughly equivalent to 0.7 percent of global GDP). Japan's surplus is smaller as a share of GDP at 3.4 percent, but even by this metric remains large and in dollar terms is comparatively high at \$168 billion. China's surplus, while relatively low as a share of GDP, also remains high in dollar terms at \$166 billion in the four quarters through June 2019.

In many cases, these imbalances reflect policy distortions including inappropriately calibrated fiscal policies. While excessively loose policy can result in vulnerabilities associated with debt, excessively tight policy holds back growth. It is critical, in light of

⁹ Specifically, global current account surpluses have totaled 1.8 percent 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 1.8 percent of global GDP.

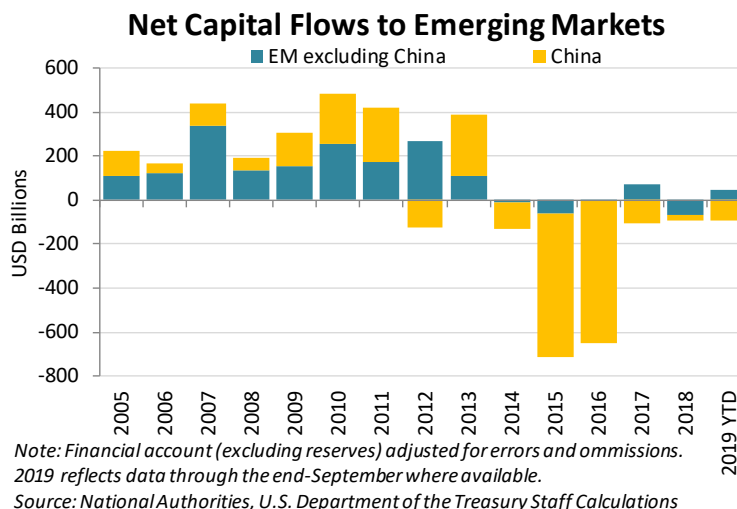
slowing global growth momentum that adjustments to lower imbalances are not driven by demand compression in deficit economies, the channel which has dominated in the past, but rather through a symmetric rebalancing process that sustains global growth momentum.



Capital Flows

Following the sustained pullback of nonresident portfolio flows from emerging markets in 2018, global liquidity conditions relaxed in early 2019 as major central banks sought to address subdued growth outlooks and in turn adopted more accommodative policy stances. This easing resulted in a resurgence in inflows to emerging market economies, but has been offset in recent months by deteriorating risk sentiment as the global growth outlook has been marked down.

Net portfolio and other flows to emerging markets (ex-China) totaled -\$112 billion over the first half of 2019 (based on data available as of mid-December), narrowing by more than \$70 billion relative to the second half of 2018. Foreign direct investment to emerging markets has remained resilient in 2019 and was more than sufficient to offset portfolio and other outflows in the first half of the



year. Higher frequency data (from sources beyond quarterly balance of payments data) suggest that emerging market risk appetite was relatively muted in the third quarter despite central banks taking steps to support growth. Against this backdrop, portfolio debt inflows have slowed considerably while net equity outflows have resumed since end-June.

In China, after slowing in mid-2018, resident capital outflows gained momentum over late 2018 and early 2019, though resident outflows remained below their level a year prior. Recent resident outflows have been driven by ongoing softening of economic growth and RMB weakness. Foreign portfolio inflows remain relatively strong, aided by the inclusion of China in some key emerging market bond and equity indices, and by increased issuance of dollar-denominated bonds by Chinese firms. Foreign direct investment inflows remain positive, though they have generally trended lower since late 2014.

Foreign Exchange Reserves

After remaining broadly stable in 2018, global foreign currency reserves increased modestly in the first half of 2019, up \$300 billion to \$11.7 trillion. With the dollar relatively stable over the period, net foreign exchange purchases contributed to the rise in reserve levels. India has been public about the need to bolster foreign currency reserves and the Reserve Bank of India purchased close to \$10 billion over the first six months of 2019. Other economies are not as transparent about their foreign exchange policies and practices, but the dollar value of

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	3,119.2	7.1	23%	268%
Japan	1,256.4	58.4	25%	42%
Switzerland	778.3	25.3	111%	79%
Taiwan	471.9	9.8	79%	268%
India	400.7	19.9	15%	365%
Korea	392.3	2.0	23%	280%
Brazil	378.1	7.8	21%	502%
Singapore	271.5	-14.3	75%	24%
Thailand	206.6	8.2	40%	388%
Mexico	174.1	7.1	14%	253%
UK	125.6	1.0	4%	2%
Malaysia	98.8	-2.3	28%	107%
Canada	74.9	3.5	4%	11%
Vietnam	63.9	6.5	25%	256%
France	48.8	0.5	2%	2%
Italy	41.2	3.0	2%	4%
Germany	36.8	0.1	1%	2%
Belgium	10.4	0.5	2%	2%
Netherlands	4.2	0.0	0%	0%
Ireland	3.1	1.0	1%	0%
World	11,732.3	254.5	n.a.	n.a.

Foreign exchange reserves as of Jun 2019.

GDP calculated as sum of rolling 4Q GDP through Q2-2019.

Short-term debt consists of gross external debt with original maturity of one year or less, as of the end of Q2-2019.

Sources: National Authorities, World Bank, IMF, BIS.

reserves rose across several major trading partners including Switzerland, Taiwan, and China.

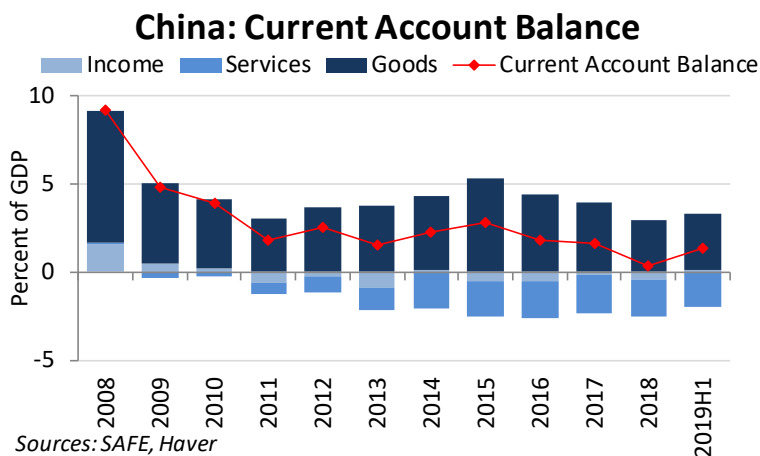
The economies covered in this Report continue to maintain ample — or more than ample — foreign currency reserves compared to standard adequacy benchmarks. Reserves in most economies are more than sufficient to cover short-term external liabilities and anticipated import costs. Excessive reserve accumulation 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.¹⁰

Economic Developments in Selected Major Trading Partners

China

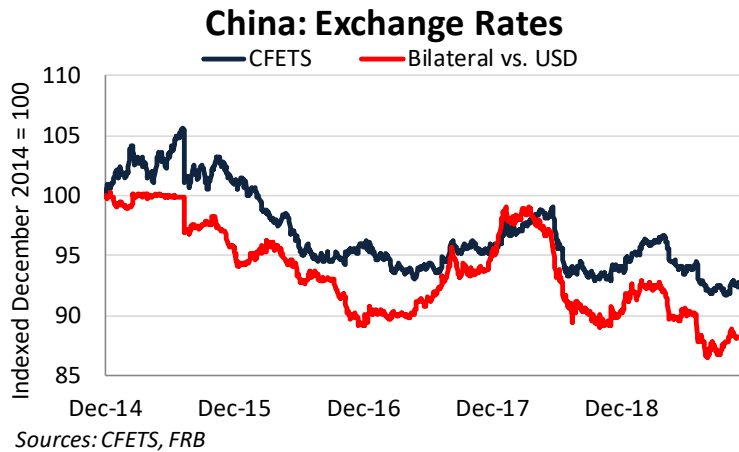
China continues to run a persistently large trade surplus with the United States, dwarfing all other trade imbalances between the United States and its other major trading partners, with the bilateral goods trade surplus totaling \$401 billion over the four quarters through June 2019. U.S. goods imports from China have declined over the four quarters through June 2019 (to \$509 billion, down \$17 billion from the same period 12 months prior), the first reversal of export growth to the United States since the same period from 2015-16. U.S. goods exports to China have declined even more (to \$108 billion, down \$27 billion from the same period 12 months prior). This decrease in U.S. goods exports to China is primarily on account of lower purchases of U.S. soybeans, liquefied natural gas, and motor vehicles, likely due to the combination of slowing domestic demand in China as well as unjustified retaliatory tariffs and non-tariff measures that were previously implemented on U.S. imports. The U.S. services trade surplus with China has slightly declined to \$37 billion over the four quarters through June 2019, after totaling \$40 billion over the same period in 2018.

China’s current account surplus declined to 0.4 percent of GDP (\$49 billion) in 2018, but has widened again in the first half of 2019 to 1.2 percent of GDP (\$88 billion over the first two quarters). As growth in China has slowed over the past year, both goods and services imports — particularly outbound tourism — have decreased over the first half of 2019. Meanwhile, goods exports have remained steady, which has led to a widening goods surplus amidst a narrowing services deficit.



¹⁰ International Monetary Fund, 2011, “Assessing Reserve Adequacy,” IMF Policy Paper, February (Washington: International Monetary Fund).

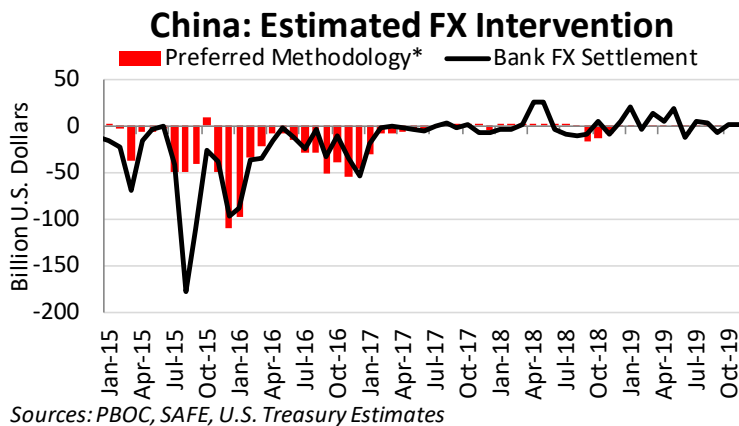
The depreciation of the RMB against the U.S. dollar in 2019 may help support China’s goods exports, further exacerbating the bilateral trade imbalance. Since the beginning of May, the RMB has depreciated against the U.S. dollar by 4.3 percent and by 4.0 percent against the People’s Bank of China (PBOC) CFETS nominal basket.¹¹ Over the summer, China took concrete steps to devalue the RMB. On August 5, the RMB depreciated below the level of 7.0 per U.S. dollar for the first time since the global financial crisis. After depreciating as far as 7.18 RMB per dollar in early September, the RMB subsequently appreciated in October and currently is trading at about 6.93 per dollar.



The PBOC manages the RMB through a range of tools, including through 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 adjustment factor” that allowed for more discretion in the setting of the daily fix. Subsequently, the daily fix has played an increasingly important role in the authorities’ management of the RMB.

In addition to the daily fix, the PBOC also manages the RMB through other tools, including by direct intervention in foreign exchange markets, influencing the interest rates of RMB-denominated assets that trade offshore, changing the reserve requirement for foreign exchange derivatives trading, and directing the timing and volume of forward swap sales and purchases by China’s state-owned banks. The Chinese authorities have acknowledged that they have ample control over the exchange rate.

China does not publish its foreign exchange market interventions leading Treasury staff to estimate China’s direct intervention in the foreign exchange market. Official foreign exchange reserves have remained roughly unchanged at \$3.1 trillion as of December 2019, suggesting that the PBOC has refrained from intervention even as the RMB has been depreciating.



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.

The United States continues to urge China to avoid exchange rate measures that promote unfair competitive advantage in global trade. China should also increase public understanding of the relationship between the PBOC and the foreign exchange activities of the state-owned banks, including in the offshore RMB market.

RMB depreciation and slowing economic activity since the second half of 2018 have reignited capital outflow pressures, with outflows significantly higher in the first half of 2019 compared to the same period last year. Treasury estimates that, in the first half of this year, net outflows (excluding flows accounted for by trade and direct investment) totaled \$110 billion, compared to \$13 billion in outflows during the first half of 2018. The rise in outflows this year still leaves them below their 2017 level, when outflows totaled \$164 billion over the first half of the year. Overall pressure on the financial account this year has been curbed by relatively tight controls on outbound flows and further mitigated by steady foreign direct investment and portfolio inflows into Chinese financial assets.

Separately, net errors and omissions in the balance of payments data have been negative for 21 consecutive quarters and stood at -\$242 billion over the four quarters through June 2019, widening by -\$68 billion compared to the same period a year earlier. This suggests an uptick in undocumented capital outflows that are not captured within the conventional components of the financial account.¹² Research suggests that China's current account surplus could also be understated — particularly due to an underreporting of services exports to foreign visitors to China — due to poor data quality.¹³ We urge China to undertake efforts to address deficiencies in its data reporting, consistent with the recommendations of the IMF.

While China's deleveraging campaign was a much needed response to growing financial sector risks, the slowdown in credit adversely impacted private sector financing and local government infrastructure spending. Officially reported real GDP growth fell to 6.2 percent in the second quarter of 2019 compared to 6.4 percent in the first quarter on a year-over-year basis. Consumption — which is mostly private but also includes government consumption — remains the largest contributor to overall growth, but its share has declined to 55 percent in the second quarter of 2019 compared to 80 percent in the second quarter in 2018. Meanwhile, net exports are once again positively contributing to growth in 2019, after having a dragging effect in 2018. Investment activity has been trending downward since early 2018, but saw an increase in the second quarter of 2019, likely due to targeted fiscal and monetary stimulus measures that the authorities implemented starting in late 2018 to respond to slowing growth. To strengthen long-term growth prospects, China must take decisive steps to further rebalance its economy and allow for greater market openness. Structural reforms that reduce state intervention, strengthen

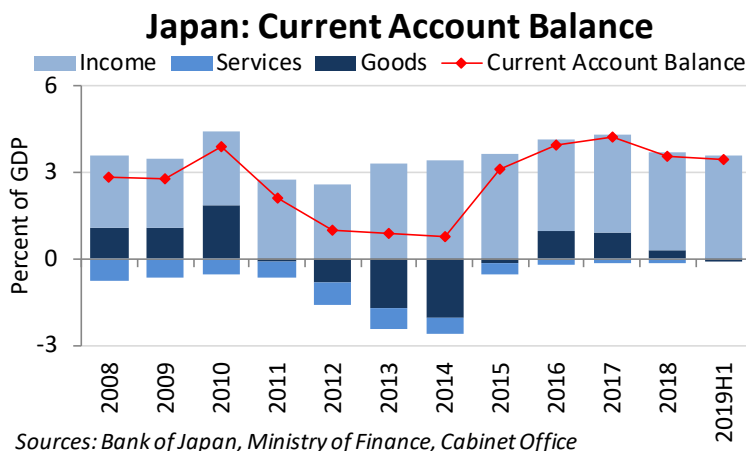
¹² China's reporting of its net errors and omissions data has historically lagged behind reporting of other balance of payments data, raising additional concerns about data quality and disguised capital outflows.

¹³ Anna Wong, "China's Current Account: External Rebalancing or Capital Flight?" (2017). International Finance Discussion Papers 1208. Board of Governors of the Federal Reserve System. Matthew Higgins, Thomas Klitgaard, and Anna Wong, "Does a Data Quirk Inflate China's Travel Services Deficit?," Federal Reserve Bank of New York *Liberty Street Economics*, August 7, 2019, <https://libertystreeteconomics.newyorkfed.org/2019/08/does-a-data-quirk-inflate-chinas-travel-services-deficit.html>.

household consumption growth, and permit a greater role for market forces will help foster a more level playing field for American firms and facilitate a more reciprocal bilateral trade relationship.

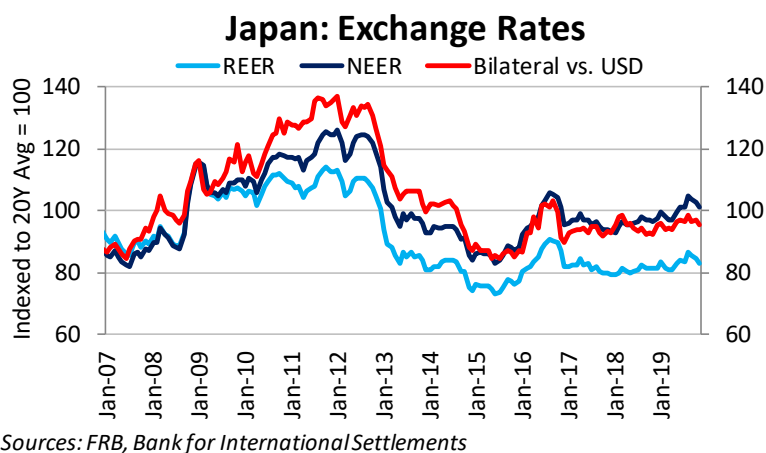
Japan

Over the four quarters through June 2019, Japan's current account surplus was 3.4 percent of GDP (down from 4.1 percent in the preceding four quarters). Japan's current account surplus continues to be driven primarily by earnings on its substantial net foreign assets: net foreign income has exceeded 3 percent of GDP while accounting for at least four-fifths of the overall current account surplus in every year since 2013. Japan has the largest net international investment position in the G-7 — 63 percent of GDP in 2018 — and the IMF projects it will rise to 70 percent of GDP in the medium term. Japan's overall goods trade balance declined to a \$3 billion deficit from July 2018 through June 2019, down from a \$42 billion surplus in the four quarters a year prior, while Japan's services deficit narrowed from a \$7 billion deficit to a \$2 billion deficit over the same period.



Japan's goods trade surplus with the United States over the four quarters through June 2019 was \$69 billion, the same as a year earlier. The United States continues to have a services trade surplus with Japan (\$10 billion over the four quarters through June 2019) resulting in Japan having a \$59 billion overall bilateral trade surplus with the United States over this period, unchanged from a year earlier. Treasury remains concerned by the persistence of the large bilateral trade imbalance between the United States and Japan.

The yen appreciated 0.9 percent against the dollar over 2019. On a real effective basis, the yen rose 1.9 percent over the first 11 months of 2019, but has remained weaker than average historical levels over the last six years. 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, in line with G-7 commitments, particularly in the face of appreciation pressures.

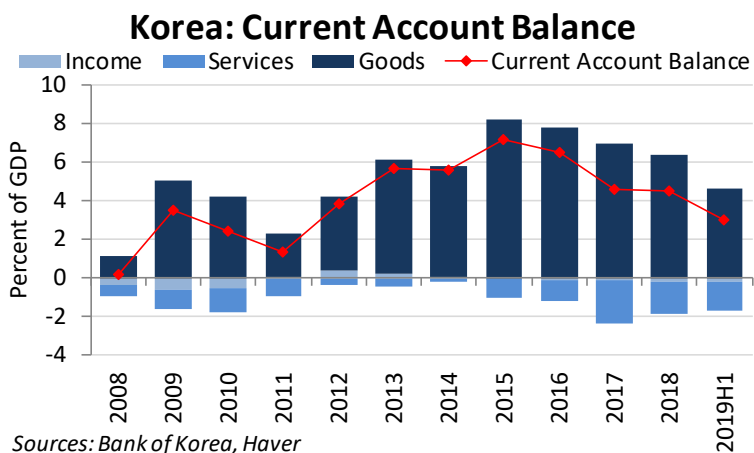
Japan’s economy remains in its longest post-war expansion, although the pace of recovery has been modest. Real GDP growth increased to 1.8 percent at an annualized rate in the first half of 2019, up from 0.8 percent in 2018 on stronger than expected consumption and public spending. The IMF October 2019 World Economic Outlook projected GDP growth of 0.9 percent in 2019 and 0.5 percent in 2020 reflecting the October 2019 consumption tax increase and accompanying countermeasures.

CPI inflation has moderated to 0.7 percent year-on-year in June 2019, after peaking at 1 percent year-on-year increases in September and October of 2018. The BOJ Policy Board forecasts inflation will remain below its 2 percent target through fiscal year 2021, and at its April 2019 meeting signaled that it would maintain its accommodative monetary stance at least through Spring 2020. The BOJ adjusted its ongoing “Quantitative and Qualitative Easing with Yield Curve Control” policy in July 2018 to allow for increased flexibility of its ETF and REIT asset purchase program, reduce the size of account balances subject to negative interest rates, and allow more movement of the 10-year bond yield around its zero percent target. In August 2019, the BOJ signaled additional flexibility in movement around the 10-year bond yield zero percent target.

Looking forward, the IMF projects annual growth of less than one percent in 2020-2024. In this context, it remains important that the Japanese authorities pursue further structural reforms to increase productivity and raise potential growth. Continued movement towards trade openness and deregulation are necessary to cement productivity gains, especially in the agriculture and service sectors, and to support small and medium enterprises. While Japan has made commendable progress on labor reforms, further efforts are needed to strengthen wage growth, expand labor participation, and address labor market duality, all especially important in the face of Japan’s declining working-age population.

Korea

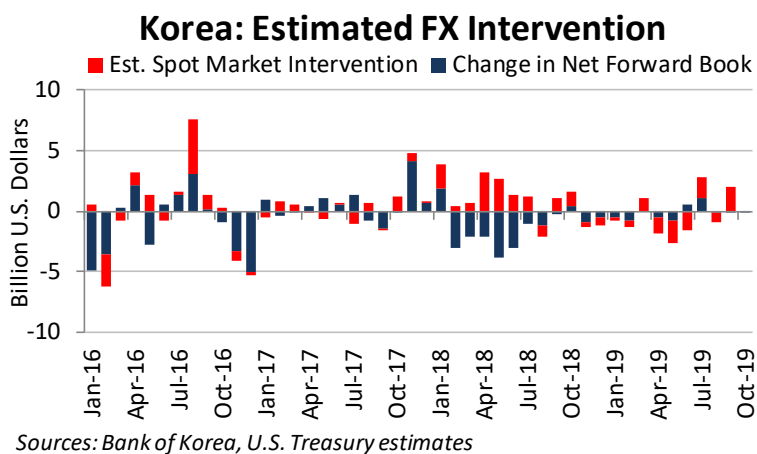
After peaking at more than 7 percent of GDP in 2015, Korea’s current account surplus has gradually declined, reaching 4.5 percent of GDP in 2018. This trend has continued this year, with the current account surplus declining to 4.0 percent of GDP through the four quarters ending in June 2019. The decline was due to a widening of Korea’s services trade deficit, a decline in the income balance, and a



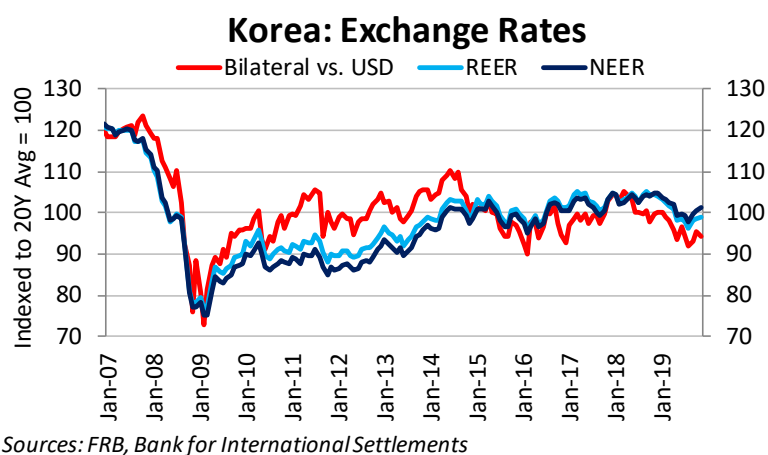
decline in the overall goods trade surplus from a peak of 8.2 percent of GDP in 2015 to 5.7 percent of GDP over the four quarters through June 2019, in line with worsening terms of trade. The IMF’s most recent assessment continued to describe Korea’s external position as moderately stronger than justified by medium-term economic fundamentals.

Korea’s goods trade surplus with the United States trended down from its 2015 peak of \$28 billion to \$18 billion in 2018, before increasing to \$20.3 billion over four quarters through June 2019. The increase over the past six months was driven by increased Korean exports to the United States, particularly of transportation equipment. The United States continues to have a surplus in services trade with Korea, at \$9.1 billion over the four quarters through June 2019.

Treasury estimates that on net the authorities intervened to support the won over the first half of 2019, making net sales of foreign exchange of \$8 billion (0.5 percent of GDP). The authorities made net sales of foreign exchange in five of the first six months of 2019, during which the won was depreciating against the dollar. Treasury supports Korea’s ongoing plans to report foreign exchange intervention in a more transparent and timely manner. Korea disclosed its foreign exchange intervention over the first half of 2019 on September 30 and will transition to a quarterly disclosure schedule in December.¹⁴



Korea has well-developed institutions and markets, and should limit currency intervention to only truly exceptional circumstances of disorderly market conditions. Korea continues to maintain ample reserves at \$392 billion as of June 2019, equal to nearly 3 times gross short-term external debt and 23 percent of GDP.



The IMF has considered the Korean won to be undervalued every year since 2010, and in its most recent evaluation considered the won to be undervalued by 1-7 percent. Over the year, the won depreciated

¹⁴ Korea reported net sales of \$3.8 billion over the first half of 2019. Treasury’s measure for intervention is more frequent and broader in scope, covering activity in the spot, forward, and swap markets.

3.7 percent against the dollar, while depreciating 5.2 percent on a real effective basis in the first 11 months of 2019.

Korea's external position has adjusted somewhat since the peak of the current account surplus in 2015, yet there remains scope for policy reforms that would support a more durable strengthening of domestic demand. Korea was strongly reliant on external demand in the first few years after the global financial crisis, with net exports accounting for more than one-third of cumulative growth over 2011-2014. Domestic demand growth has been stronger since 2015, averaging above 3 percent annually.

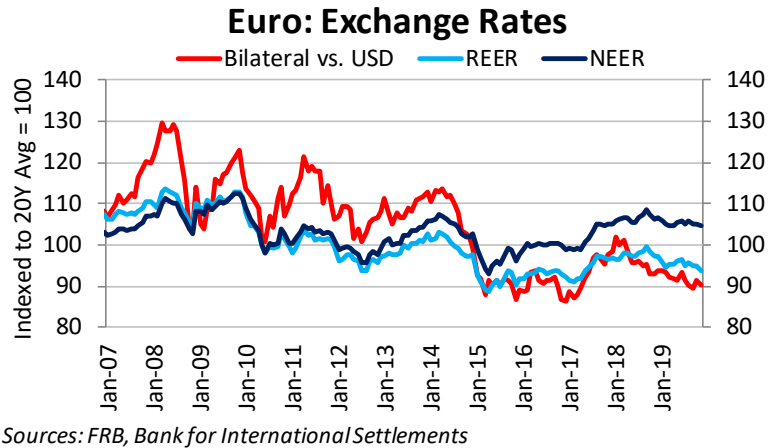
Korea's overall GDP growth slowed to a six-year low of 2.7 percent in 2018, further slowing to 1.4 percent on a seasonally-adjusted annualized rate in the first half of 2019 due to slowing external demand and investment. In response to external headwinds, Korea adopted a \$4.9 billion (0.3 percent of GDP) supplementary budget in August to address downside risks to manufacturing, in addition to providing support for construction and for air and water quality measures.

Given the continued deterioration in both current activity and forward-looking growth prospects, more forceful macroeconomic policy support — particularly through fiscal policy — is warranted. Korea maintains sufficient policy space to support domestic demand, as public sector debt remains relatively low at around 35 percent of GDP. After progressively tightening fiscal policy from 2015-2018, in December Korea adopted a budget for 2019 that included a 9.5 percent increase in fiscal spending compared to the 2018 budget. Since then, growth has slowed and the outlook has weakened further. A more proactive fiscal policy stance (with a lower structural fiscal balance) would provide needed support to domestic demand. Recent policies appear to go in this direction — the 2020 budget calls for a 9.1 percent increase in fiscal spending next year — though the ultimate growth impact will depend on how fully proposals are implemented. While it is important that fiscal policy remain supportive going forward, structural measures will also be required to increase potential growth. Korea could do more to support labor force participation by pairing new budget initiatives with comprehensive labor market reforms that also address duality in the labor market.

The Euro Area

The outlook for euro area growth and inflation deteriorated this year despite ongoing employment gains and rising wages. Slowing external demand has weighed on overall activity, while geopolitical and trade-related uncertainties have dampened economic sentiment. In response, the ECB announced in September a package of measures that included a cut in its deposit rate and the resumption of asset purchases later this year. At the same time, the cyclical positions of individual member states continue to vary considerably due to the legacies of the euro area crisis, as well as structural differences that affect competitiveness. These dynamics have weighed on the value of the euro, contributing to real exchange rate undervaluation for some of the more competitive individual member countries in the currency union (e.g., Germany).

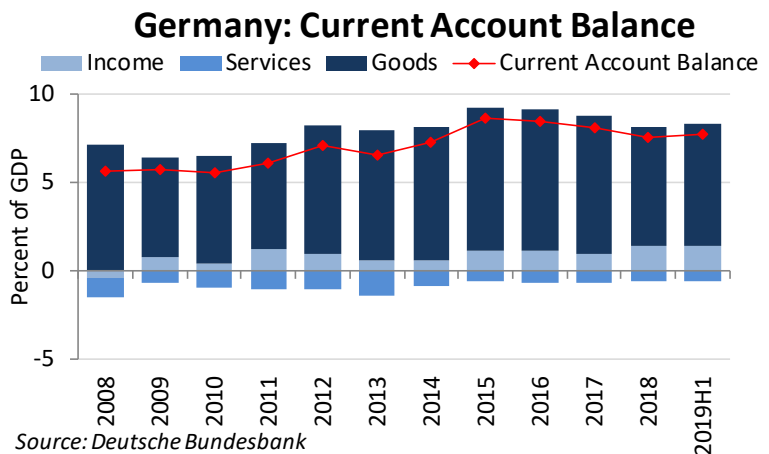
The euro weakened in 2019, both on a bilateral basis against the U.S. dollar and in broad nominal and real effective terms. The weakness of the euro is a multi-year phenomenon, spurred initially by concerns about the resilience of the monetary union in the midst of the regional crisis and sustained more recently by weaker growth prospects, chronically low inflation, and, in response, monetary policy accommodation. The ECB's quantitative easing and negative interest rate policy generated a sizable shift in bond market yield differentials between the euro area and other major economies, which has contributed to the euro's weakness versus its historical level in recent years. 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's current account surplus as a share of GDP stood at 7.3 percent over the four quarters through June 2019 and remains the largest in the world in nominal terms at \$283 billion. While German domestic demand contributed substantially to growth from 2015-2018, helping stall the growth in the current account surplus, it was not sufficient to appreciably reduce external imbalances. The



persistence of Germany's external imbalances is even more concerning amid recent signs of slowing growth. Second quarter GDP data highlight that the weakness in German growth that began in Q3 2018 is being driven by more than transitory factors. This further underscores the clear need for economic policies to address the structural factors that contribute to high domestic saving and low consumption and investment.

Germany's economic policies — notably excessively tight fiscal policy emanating from high tax levels — have restrained domestic consumption and investment. Overly conservative

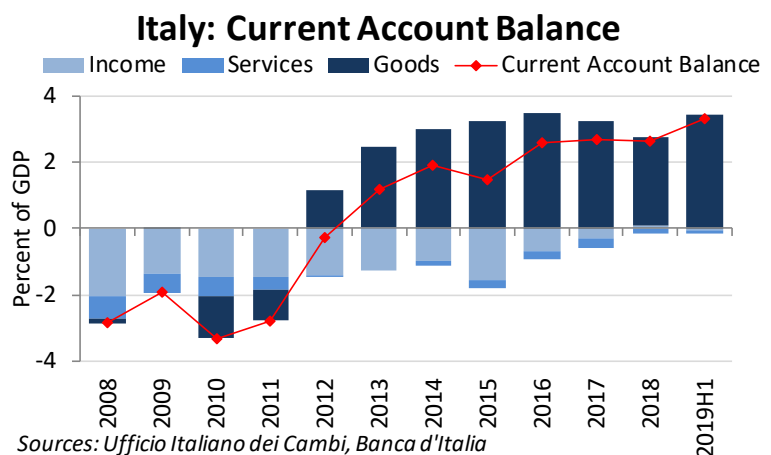
budget processes and national fiscal rules restricting new debt have played a role in Germany’s excessively tight fiscal stance: Since 2014, Germany’s approved budgets have called for fiscal balance, but stronger-than-forecast revenues and under-execution of spending plans have meant that in fact fiscal surpluses have averaged 1 percent of GDP over this time period, while reaching historic records of 1.1 percent of GDP and 1.7 percent of GDP in 2017 and 2018, respectively. Germany’s substantial fiscal space should be deployed to bolster current activity, reduce the burden of taxation — particularly through tax cuts that would lower the labor tax wedge — and enact other growth-friendly policy reforms, which would help external rebalancing proceed at a reasonable pace.

Over the long run, there has been a meaningful divergence between German domestic inflation and wage growth and (faster) average euro area inflation and wage growth (though German wage growth has recently accelerated to above the euro area average). This long-run divergence has contributed to a general rise in Germany’s competitiveness vis-à-vis its euro area neighbors. However, given the wide dispersion of economic performance across the euro area, the euro’s nominal exchange rate has not tracked this rise in German competitiveness. Consistent with this, the IMF estimates that in 2018 Germany’s external position remained substantially stronger than implied by economic fundamentals, and that Germany’s real effective exchange rate was undervalued by 8-18 percent.

Germany’s bilateral trade surplus with the United States has more than doubled since the creation of the euro and remains a matter of significant concern. Treasury recognizes that Germany does not exercise its own monetary policy and that the German economy continues to experience strong gains in employment. Nevertheless, Germany is now at risk of slipping into recession and — as the fourth-largest economy globally — has a responsibility to contribute to more balanced demand growth and to more balanced trade flows. The persistence of record surpluses suggests that Germany could do more to support domestic demand and, in turn, demand for imports. This would contribute to both global and euro area rebalancing.

Italy

A growing trade surplus pushed Italy’s current account into surplus from 2013 onwards, though both the trade and current account surplus have moderated slightly since 2017 as higher energy costs and weaker external demand have weighed on the external position. Over the four quarters through June 2019, Italy’s current account stood at 2.8 percent of GDP.



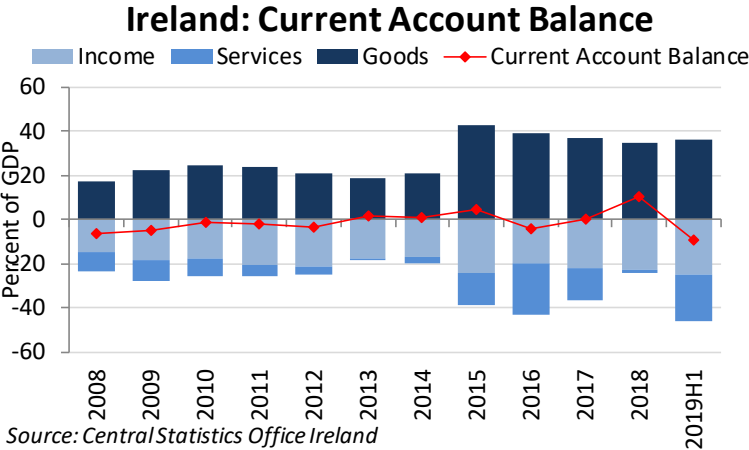
The United States is Italy’s third-highest export destination, and Italy’s goods trade surplus with the United States rose to \$33 billion in the first half of 2019. Italy also runs a modest services trade surplus with the United States, at \$4 billion over the same period.

The IMF’s most recent assessment describes Italy’s external position as broadly in line with medium-term economic fundamentals. However, Italy faces longstanding structural weaknesses that have contributed to low growth and weak social outcomes. Simultaneously, the high public debt level is a key source of vulnerability, which combined with political uncertainty has raised concerns about the long-term sustainability of its public finances.

Italy’s growth marginally rebounded in the first half of 2019 after emerging from a technical recession during the second half of last year. In order to escape a low-growth, high-debt equilibrium, it is critical that Italy undertake fundamental structural reforms to tackle deep-rooted rigidities and boost competitiveness and potential growth. Italy should adhere to prudent fiscal management over the next several years, including a shift in the composition of fiscal policy toward more growth-friendly and better-targeted spending, to help reduce external vulnerabilities and bolster investor confidence. The government should also focus on reforms to address barriers to stronger growth in Italy, such as labor market reforms to tackle the sizable unit labor cost gap between Italy and the rest of the euro area and other supply-side reforms that will help reinvigorate investment.

Ireland

Over the past decade, Ireland’s external position has been transformed, with the current account balance moving from a deficit above 6 percent of GDP pre-crisis to a surplus above 10 percent of GDP in 2018. Gross current account flows have risen notably, with much larger goods trade surpluses alongside significant income and services trade deficits. The current account simultaneously has



become more volatile and subject to significant data revisions: while Ireland has typically run surpluses in recent years, the services deficit widened substantially in the second quarter of 2019, pushing the current account into deficit by more than 0.8 percent of GDP over the first half of this year. The significant and growing presence of large-scale foreign multinational enterprises (MNEs) with headquarters in Ireland has contributed notably to the average rise and increased volatility of the current account balance.

Indeed, the growing role of foreign MNEs in Ireland has created challenges with accurately measuring economic activity that is rooted in domestic residents’ versus MNEs’ activities.

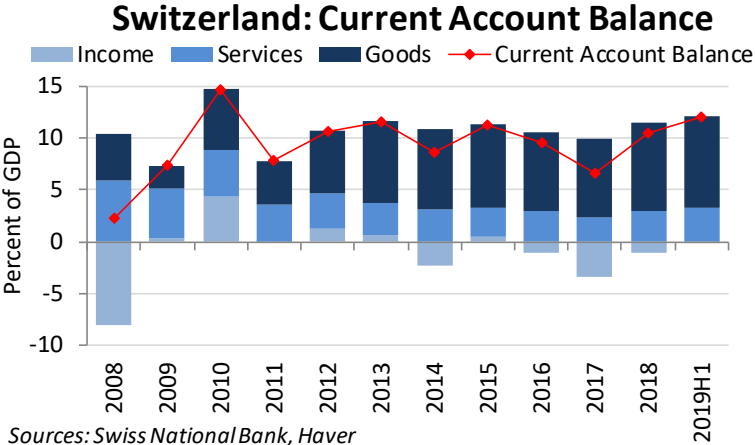
Since 2017, Ireland’s Central Statistics Office has produced complementary metrics for economic activity and the balance of payments which exclude the profits of re-domiciled companies, the depreciation of intellectual property products, and aircraft leasing. The modified economic measure — the Modified Gross National Income or GNI* — indicates that in 2018 the Irish domestic economy was roughly 22 percent smaller than measured by GDP. Similarly, the modified current account balance metric that filters out the volatile activities of MNEs with limited impact on the domestic economy suggests that the current account balance that is attributable to Irish (domestic) residents was in the range of 1-3 percent of GNI* from 2015-2017. A similar modified measure from the IMF calculated Ireland’s 2018 adjusted current account surplus to be 3.4 percent of GDP, with the IMF assessing Ireland’s external position to be broadly consistent with medium-term fundamentals and desirable policy settings.

The United States is Ireland’s top export destination, with U.S. goods imports from Ireland reaching \$57 billion in 2018. Ireland has maintained a goods trade surplus with the United States for 23 consecutive years, growing its surplus from just over \$1 billion in 1996 to a record high of roughly \$49.7 billion in the four quarters to June 2019. On the other hand, Ireland runs a significant services trade deficit with the United States; in 2018, the United States’ services trade surplus with Ireland stood at \$29 billion.

Switzerland

Switzerland’s GDP growth reached 2.8 percent in 2018, supported by strong external demand in early 2018 despite a slowdown in the second half of the year. The Swiss National Bank (SNB) expects growth to weaken to between 0.5 and 1.0 percent in 2019, but rebound modestly to trend over the medium term. Inflation remains subdued despite a tightening labor market. Higher imported energy prices and depreciation of the franc temporarily increased Switzerland’s headline inflation above 1 percent in mid-2018, but subsequent reversals have caused inflation to decline to 0.6 percent in June 2019 (below the mid-point of the SNB’s 0-2 percent price stability target).

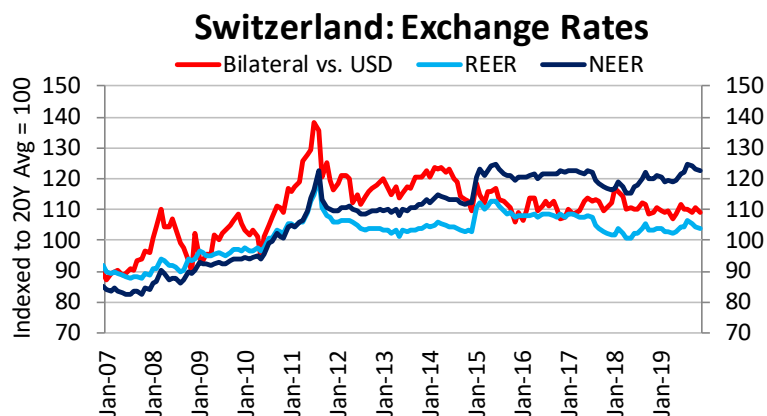
Switzerland’s current account surplus remains large and persistent at 10.7 percent of GDP over the four quarters through June 2019. The United States’ goods trade deficit with Switzerland was \$22 billion over the four quarters through June 2019, up from \$17 billion compared to the same period a year earlier.



Over 2019, movements in the Swiss franc largely mirrored changes in risk sentiment. The nominal effective exchange rate (NEER) appreciated slightly over the first 11 months of

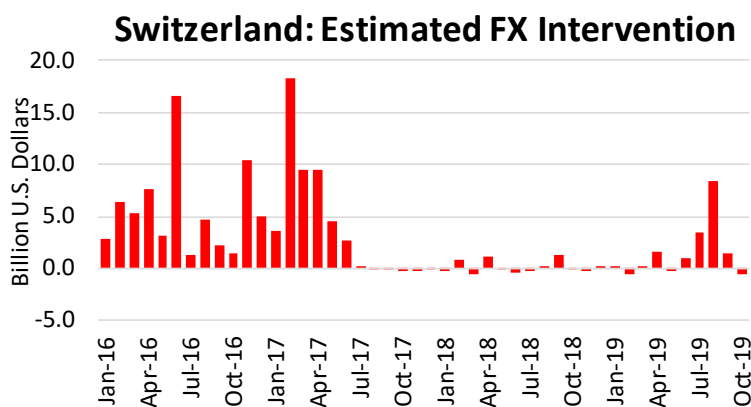
2019 period by 1.6 percent, while the real effective exchange rate (REER) depreciated slightly by 0.2 percent. The SNB maintains the assessment that the franc is “highly valued.”

The SNB does not report foreign exchange intervention outside of a yearly total in its annual report. Based on sight deposit data, Treasury estimates that the SNB’s net foreign currency purchases totaled \$3 billion (0.5 percent of GDP) over the 12 months ending in June 2019. As a result of interventions and valuation changes, the SNB’s foreign reserves had grown to \$778 billion by the end of the second quarter of 2019 (up from \$738 billion at end-2018). More recently, foreign exchange purchases by the SNB increased markedly over July and August as global risk appetite deteriorated. While recent purchases come amidst disinflationary pressures, they have been undertaken even as inflation remains positive. Treasury continues to encourage the Swiss authorities to transparently publish all intervention data on a higher frequency basis.



Sources: FRB, Bank for International Settlements

Given the current dip in economic growth and substantial external surplus, Treasury urges Switzerland to adjust its macroeconomic policies to more forcefully support domestic economic activity. Despite borrowing costs for the Swiss government being among the lowest in the world, fiscal policy remains underutilized, even within the constraints of Switzerland’s existing fiscal rules.



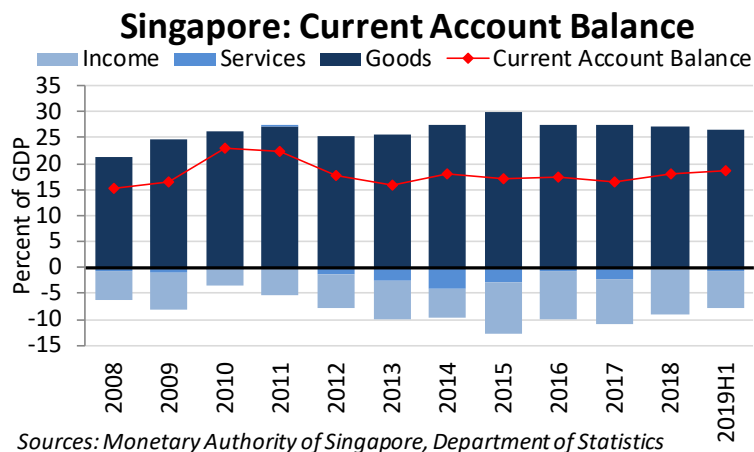
Sources: Swiss National Bank, U.S. Treasury estimates

As monetary policy approaches its limits, Treasury urges Switzerland to use its ample fiscal space — with the budget in surplus and public debt around 40 percent of GDP — to cut taxes and pursue structural reforms to spur investment. In particular, Switzerland could increase expenditures to deal with high savings related to population aging as the high level of household savings would seem to point to a need for improved public policies to help with population aging and retirement needs.

Singapore

Singapore has a large and persistent current account surplus that stood at 17.9 percent of GDP over the four quarters through June 2019. The outsized current account surplus is

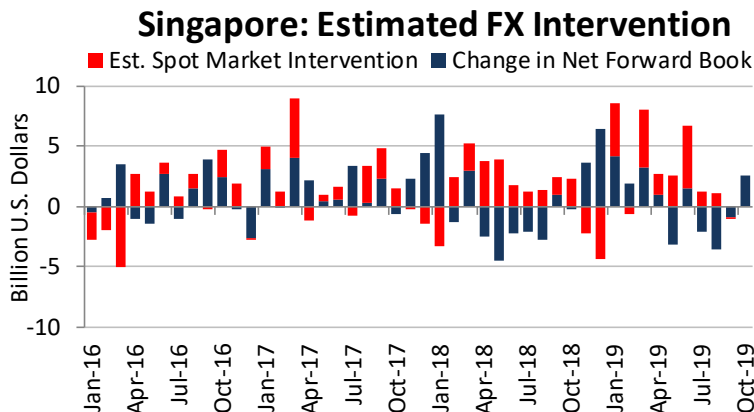
driven by an extremely large goods trade surplus, partly offset by deficits in the services trade and income balances. The current account surplus has remained above 14 percent of GDP since 2003. Over that same period, Singapore's national saving rate has exceeded 40 percent of GDP, well above most regional peers. The high saving imbalance reflects, in part, high forced saving and relatively modest social safety net spending, which in concert depress consumption and push up both public and private saving. Structural factors like a rapidly aging population and Singapore's status as a financial center and an oil exporter all contribute to the external imbalance. However, these structural factors are insufficient to fully explain Singapore's large surpluses. The IMF's most recent assessment found Singapore's external position to be substantially stronger than warranted by medium-term fundamentals and desirable policies.



The United States has run a steady bilateral goods trade surplus with Singapore, which totaled \$4 billion in the four quarters ending June 2019. Last year, the top U.S. exports to Singapore included machinery, aircraft, medical instruments, mineral fuels, and agricultural products. 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.

The Monetary Authority of Singapore (MAS) tightly manages the Singaporean dollar against a basket of trading partner currencies. Like other central banks MAS aims to achieve price stability in the domestic economy. However, MAS is uncommon in that it uses the nominal effective exchange rate of the Singapore dollar (the S\$NEER) as its primary tool for monetary policy rather than using interest rates because external price pressures are more acutely felt in Singapore, where gross trade flows total roughly 400 percent of GDP. MAS manages the value of the Singapore dollar within an undisclosed trading band and executes changes to its monetary policy stance by making adjustments to the degree of appreciation or depreciation (i.e. the rate of change of the S\$NEER) and the width of the trading band. Within this framework, greater appreciation has the effect of monetary tightening (analogous to an increase in the policy interest rate), while depreciation has the opposite effect, through the pass-through of changes in the exchange rate to the price of tradable goods. MAS executes its policy by purchasing and selling currency in the foreign exchange market, which augments or subtracts from its stock of official foreign reserves. When MAS believes it has an excess of reserves, it transfers assets to Singapore's sovereign wealth fund, GIC, for long-term investment.

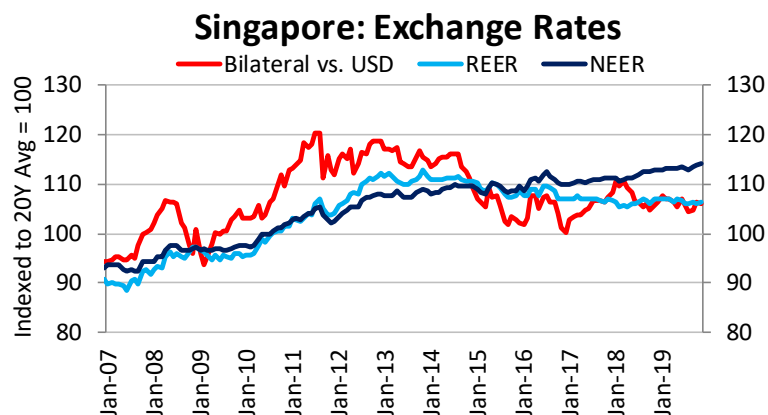
MAS does not yet disclose its intervention in foreign exchange markets. However, MAS announced on May 8, 2019 that it would begin disclosing data on foreign exchange intervention operations, comprising MAS's net purchases of foreign exchange on a six-month aggregated basis, and with a six-month lag from the end of the period, beginning with the data for the second half of 2019.



Sources: Monetary Authority of Singapore, U.S. Treasury estimates

Treasury welcomes this development. Over the four quarters through June 2019, Treasury estimates that Singapore made large net purchases of foreign exchange of at least \$32 billion (9.0 percent of GDP), with purchases picking up notably in the first half of 2019 compared to 2018 levels. MAS intervention accelerated as several of Singapore's significant trading partners shifted towards more accommodative monetary policy, and MAS leaned against attendant appreciation pressures.

The Singapore dollar appreciated by 1.3 percent against the U.S. dollar over 2019. Over the first 11 months of 2019, the S\$NEER appreciated by 1.0 percent while the real effective exchange rate depreciated by 0.8 percent. The IMF's most recent assessment noted that Singapore's exchange rate is 2.2-14.2 percent weaker than warranted by fundamentals. A number of reforms would help reduce external imbalances.



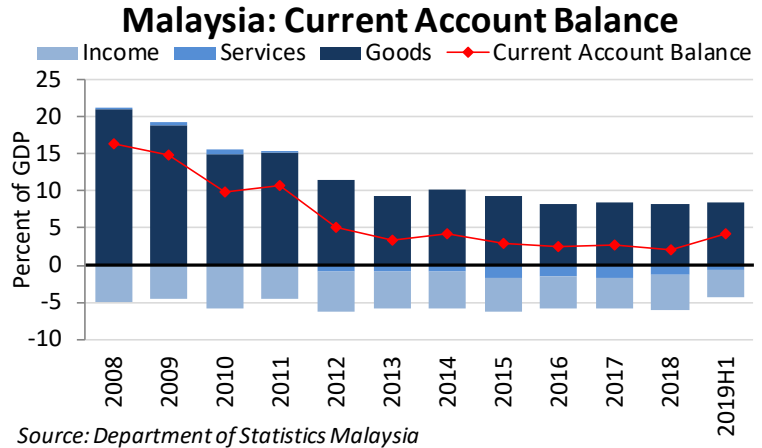
Sources: FRB, Bank for International Settlements

Expanding the social safety net 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 real effective exchange rate should play a role in facilitating external rebalancing.

Malaysia

Malaysia's current account surplus declined from a high of 16.3 percent of GDP in 2008 to 2.1 percent of GDP in 2018 but rising investment income and a temporary decline in capital imports pushed the current account surplus up to 3.0 percent of GDP over the four quarters ending June 2019. This trend of external rebalancing has been facilitated by higher levels

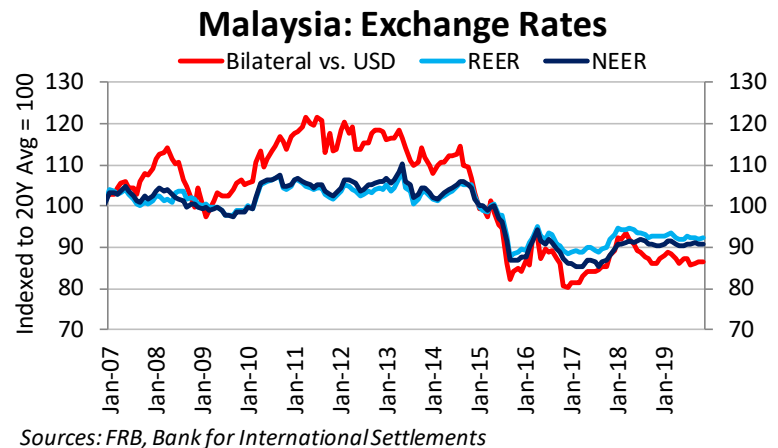
of both consumption and investment, following years of elevated national savings. In 2008, gross national saving was 39 percent of GDP; by 2018, it had fallen to 26 percent of GDP. As of June, 2019, gross national savings edged higher to 27 percent.



A significant decline in Malaysia’s overall goods trade surplus has been a key factor in the general narrowing of the current account surplus over the last decade; nonetheless, the goods trade surplus remains large, and steadily exceeded 8 percent of GDP in recent years. Malaysia’s key exports include electronics and petroleum products. The goods trade surplus has been partly counterbalanced by a large income deficit.

Over the four quarters through June 2019, Malaysia’s goods trade surplus with the United States stood at \$26 billion, roughly unchanged from the same period in 2018. Malaysia’s largest goods exports to the United States were electrical machinery, optical and medical instruments, rubber, and furniture. The largest U.S. goods exports to Malaysia were electrical machinery, aircraft, optical and medical instruments, and plastics.

Bank Negara Malaysia (BNM) maintains a floating exchange rate regime, although BNM often intervenes in the foreign exchange market. Over the first 11 months of 2019, the ringgit depreciated 1.1 percent against the dollar and 0.6 percent on a real effective basis, while the nominal effective exchange rate appreciated by 0.6 percent. The IMF’s most recent assessment estimated the ringgit to be 3-7 percent weaker in real effective terms than what is warranted by fundamentals and desirable policies.

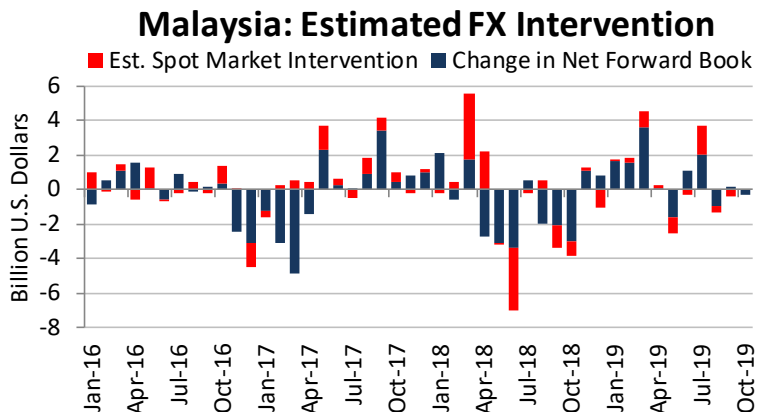


Malaysia does not publish intervention data, but based on Treasury estimates of BNM intervention activity, BNM has demonstrated a pattern over time of intervening on both sides of the market, as illustrated by alternating periods of significant net sales and net purchases of foreign exchange over the last few years. Treasury estimates that over the four quarters through June 2019 on net BNM sold about \$1 billion in foreign exchange

(equivalent to 0.3 percent of GDP) in support of the ringgit in the midst of depreciation pressures.

Malaysia's substantial external rebalancing over the last decade is welcome, and the authorities should pursue appropriate policies to firmly entrench it. Continuing to promote efficient and well-targeted social spending will help avoid

excessive levels of precautionary saving. The authorities should seek to foster more high-quality and transparent investment, particularly from the private sector. 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.



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

Vietnam

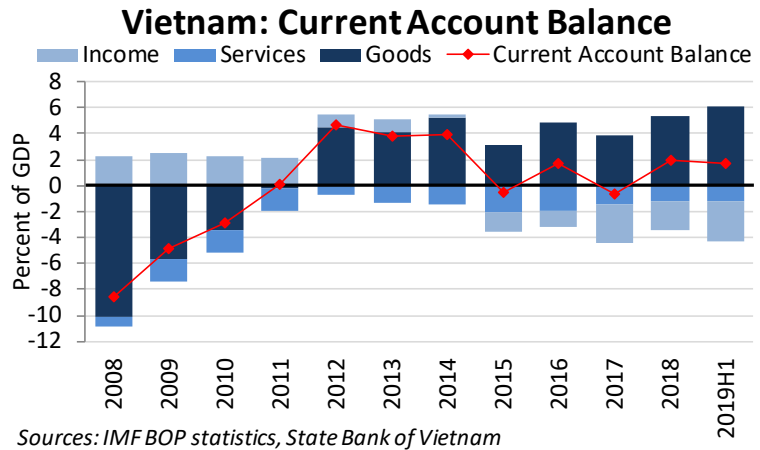
Over the last decade, Vietnam's large and skilled labor force, competitive wages, and young and well-educated population have drawn large numbers of foreign invested enterprises (FIEs) to operate in Vietnam. As a result, Vietnam's inbound foreign direct investment, the majority of which is concentrated in export sectors, has steadily increased, reaching a record \$16 billion (6 percent of GDP) over the four quarters through June 2019.

The rapid growth of the FIE sector has transformed Vietnam's external position. The large trade and current account deficits that persisted throughout the 2000s were eliminated, and from 2012 onwards a large goods trade surplus emanating from electronics and other manufacturing help raise the current account balance. In recent years, there has been a growing gap between the trade surplus in the FIE sector (15 percent of GDP) and a trade deficit in the domestic sector (8.3 percent of GDP). The IMF assesses Vietnam's external position to be substantially stronger than warranted by fundamentals and desirable policies, and reflects the relatively unproductive domestic economy and constraints on private investment.

The large goods trade surplus has been offset in recent years by deficits in both services trade and primary income, and the current account surplus stood at 1.7 percent of GDP over the four quarters through June 2019.¹⁵ The IMF expects the current account to continue declining in the medium term, based on a smaller trade surplus as economic duality diminishes.

¹⁵ Vietnam continues to revise its balance of payments statistics in consultation with the IMF. The results of recent revisions improved the estimation of primary income, subsequently shrinking recent current account deficits.

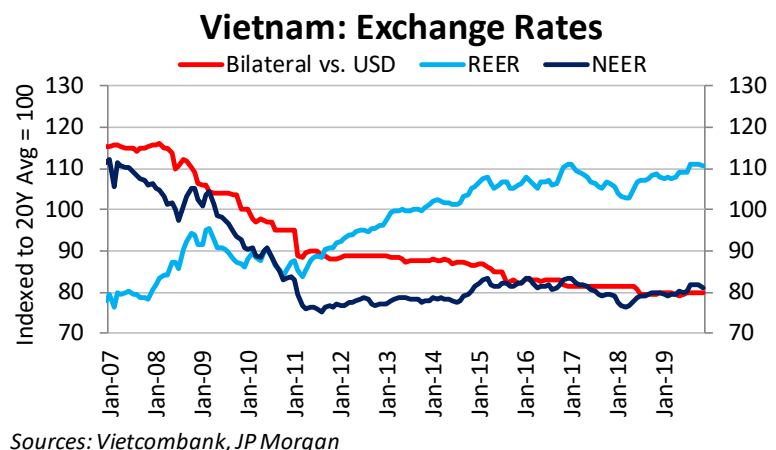
In the four quarters through June 2019, Vietnam's goods trade surplus with the United States reached \$47 billion, the sixth largest among the United States' trading partners and a 18 percent increase over the annual surplus in 2018. The growing trade surplus with the United States reflects a large expansion of Vietnam's export capacity in apparel and technology, and its growing global supply chain integration, but also tariff and non-tariff barriers that have impeded U.S. companies' and agricultural producers' access to the Vietnamese market in automobiles, agriculture, digital trade, electronic payments, and other areas.



There has been a particular rise this year in certain imported goods from Vietnam, which tracks the fall in imports of similar goods from China. This partly reflects the movement of supply chains, as well as increasing production in existing factories, in both lower value added products (apparel, shoes, and bags) and higher valued added electronics and electrical equipment. However, some of this supply chain migration effect could be overstated because of transshipment to avoid tariffs on Chinese imports. Vietnamese authorities have acknowledged this problem and claim to have prosecuted over 1,300 cases of trade-related fraud in the first six months of 2019. In addition, Vietnam issued draft regulations regarding country-of-origin labeling. Vietnam should continue to strengthen its legal framework for combatting trade-related fraud, and to strengthen enforcement measures to reduce transshipment.

Vietnam's authorities tightly manage the value of the dong. Since January 2016, the State Bank of Vietnam (SBV) has allowed the dong to float +/- 3 percent 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, the SBV still appears to manage the dong far more closely to the U.S. dollar than to any other reference, and in very few instances has the dong reached the edge of the band during trading.

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, together with



bouts of much higher inflation than its trading partners, the REER appreciated notably from end-2010 to end-2015, rising by 22 percent, and was broadly stable from 2015 to present. The dong remained virtually flat against the dollar in 2019, while the NEER and REER appreciated 1.7 and 2.2 percent over the first 11 months of 2019, respectively. The most recent IMF assessment indicated that the dong was 8.4 percent undervalued on a real effective basis as of 2018.

Vietnam does not publish data on foreign exchange intervention. However, the Vietnamese authorities have credibly conveyed to Treasury that net purchases of foreign exchange were 0.8 percent of GDP over the four quarters through June 2019.¹⁶ Vietnam intervened in both directions over the course of these four quarters: The authorities sold foreign exchange over the second half of 2018 as financial turbulence in a few large emerging markets led to a pullback from other smaller emerging markets and created downward pressure on many emerging market currencies, including the dong. As global financial conditions eased and holiday-related remittances increased in early 2019, the authorities shifted to purchasing foreign exchange, with net purchases over the first half of 2019 modestly outweighing net foreign exchange sales over the prior six months. Treasury urges the authorities to enhance the timeliness and transparency of data on foreign exchange reserves, intervention, and external balances.

Vietnam's foreign exchange reserves have been below standard adequacy metrics for several years. For example, during the period of currency market stress in 2015, reserves declined to \$29 billion, equivalent to only 1.9 months of import coverage. Since that time, the central bank has gradually rebuilt its reserves, though the IMF continues to assess that Vietnam's reserves remain below adequate levels, standing at 76 percent of the IMF's reserve adequacy metric (for fixed exchange rate regimes) as of end-2018.

Further structural reforms are crucial for building greater resilience and stability into this dynamic economy. A stronger, modernized monetary policy framework will allow the SBV to transition to an inflation-targeting monetary policy regime. 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 contribute to financial sector risks, will enable financial institutions to better allocate capital and manage risks. As Vietnam strengthens its monetary policy framework, and reserves reach adequate levels, Vietnam should reduce its intervention and allow for movement in the exchange rate in line with economic fundamentals, including gradual appreciation of the real effective exchange rate, which will help reduce external imbalances, including the bilateral trade surplus with the United States.

¹⁶ Forward intervention is included on a trade date basis.

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 most recent four-quarter period (July 2018 to June 2019, unless otherwise noted) are provided in Table 1 (p. 19) and Table 2 (p. 40).

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 account for more than 80 percent of U.S. trade in goods over the four quarters through June 2019. This includes all U.S. trading partners whose bilateral goods surplus with the United States in 2018 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 ending June 2019.¹⁷ 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 percent of U.S. GDP) have a “significant” surplus. Highlighted in red in column 1 are the 12 major trading partners that have a bilateral surplus that meets this threshold over the most recent four quarters. Table 3 provides additional contextual information on bilateral trade, including services trade, with these trading partners.

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 2019						
China	401	3.9	617	-37	-0.4	75
Mexico	93	10.0	620	-7	-0.8	59
Japan	69	1.8	221	-10	-0.3	82
Germany	67	2.3	184	0	0.0	69
Italy	33	2.2	79	4	0.2	24
Canada	21	1.7	613	-28	-2.2	101
India	21	1.0	93	4	0.2	55
Korea	20	1.6	136	-9	-0.7	34
France	19	0.9	94	-3	-0.1	40
Taiwan	18	4.0	82	-2	-0.4	18
United Kingdom	-4	-0.2	129	-13	-0.6	136
Singapore	-4	-1.6	58	-13	-4.8	32
Brazil	-9	-0.7	73	-21	-1.5	33
Netherlands	-24	-3.5	79	-6	-0.9	32
Hong Kong	-29	-10.3	39	-3	-0.9	24
<i>Memo</i> : Euro Area	156	1.6	638	-34	-0.3	292
Economies with annual services trade data through 2018						
Ireland	50	17.4	69	-29	-7.7	68
Vietnam	47	24.6	67	-1	-0.5	4
Malaysia	26	9.5	51	-1	-0.4	5
Switzerland	22	4.2	62	-18	-2.5	61
Thailand	19	4.9	45	1	0.2	7
Belgium	-14	-3.5	52	-1	-0.1	11

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

*Quarterly services data is through Q2 2019. For trading partners where quarterly bilateral services trade data are not available, annual services data through 2018 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).

¹⁷ 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 Monthst (3d)
China	401	1.2	-1.2	166	-0.3	-40	-1	No
Mexico	93	-1.0	1.7	-13	0.0	0	0	No
Japan	69	3.4	-0.2	168	0.0	0	0	No
Germany	67	7.3	-1.5	283	..	..	..	..
Ireland	50	-0.8	0.4	-3	..	..	..	..
Vietnam	47	1.7	1.2	4	0.8	2	9	No
Italy	33	2.8	0.7	56	..	..	..	..
Malaysia	26	3.0	0.9	11	-0.3	-1	6	Yes
Switzerland	22	10.7	0.9	74	0.5	3	2	Yes
Canada	21	-2.2	1.3	-37	0.0	0	..	No
India	21	-2.0	-1.3	-56	-0.6	-15	9	Yes
Korea	20	4.0	-3.5	67	-0.5	-8	-7	No
Thailand	19	5.3	-4.4	27	1.5	8	9	Yes
France	19	-0.7	-0.2	-18	..	..	..	..
Taiwan	18	11.0	-2.8	66	0.1	1	1	Yes
United Kingdom	-4	-5.0	0.4	-141	0.0	0	..	No
Singapore	-4	17.9	0.3	65	9.0	32	27	Yes
Brazil	-9	-2.4	-0.8	-44	-0.5	-10	1	No
Belgium	-14	-1.3	-2.2	-7	..	..	..	..
Netherlands	-24	10.3	2.2	93	..	..	..	..
<i>Memo</i> : Euro Area	156	2.7	-0.4	362	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.

Criterion (2) – Material current account surplus:

Treasury assesses current account surpluses in excess of 2 percent of GDP to be “material” for the purposes of enhanced analysis. Highlighted in red in column 2a of Table 2 are the 10 economies that had a current account surplus in excess of 2 percent of GDP for the four quarters ending June 2019. In the aggregate, these 10 economies accounted for around two-thirds of the value of global current account surpluses in 2018. 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 percent of an economy’s GDP to be persistent, one-sided intervention.¹⁸ Columns 3a and 3d in Table 2 provide Treasury’s assessment of this criterion.¹⁹ In economies where foreign exchange interventions are not published, Treasury uses estimates of net purchases of foreign currency to proxy for intervention. Singapore met this criterion for the four quarters ending June 2019, per Treasury estimates.

Summary of Findings

Pursuant to the 2015 Act, Treasury finds that no major trading partner met all three criteria in the current reporting period based on the most recent available data. Nine major trading partners, however, met two of the three criteria for enhanced analysis under the 2015 Act in this Report or in the May 2019 Report. Additionally, one major trading partner, China, constitutes a disproportionate share of the overall U.S. trade deficit. **These 10 economies — China, Japan, Korea, Germany, Italy, Ireland, Switzerland, Singapore, Malaysia, and Vietnam — 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.

¹⁸ 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.

¹⁹ 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.

- 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 has since risen back above the threshold.
- 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.
- Ireland and 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. Ireland and Vietnam met one of the three criteria in this Report, having a significant bilateral trade surplus with the United States.
- Switzerland 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. Switzerland previously was included on the Monitoring List in every Report between October 2016 and October 2018, having a material current account surplus and engaged in persistent, one-sided intervention in the foreign exchange market.

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

Further, based on the analysis in this Report, Treasury has concluded that China should no longer be designated as a currency manipulator at this time. Additionally, no other major trading partner of the United States met this 1988 Act standard during the period covered in this Report.

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.