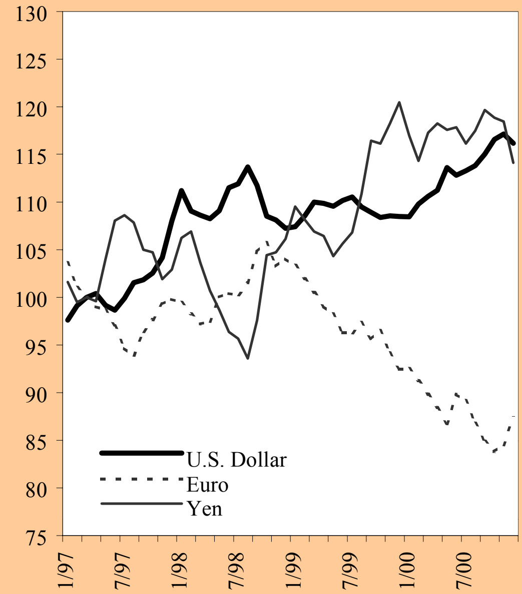
U.S. Department of the Treasury

Report to Congress on International Economic and Exchange Rate Policies

For the Period July 1, 2000 through December 31, 2000

Real Value of the Dollar, Euro, and Yen

Trade-weighted currencies, 1997-2000 (3/97=100)



Source: FRB (Broad Real Index), ECB (Broad Real CPI-weighted Euro), JP Morgan (Yen Broad Real)

THIS REPORT REVIEWS DEVELOPMENTS IN U.S. INTERNATIONAL ECONOMIC POLICY, INCLUDING EXCHANGE RATE POLICY, DURING THE PERIOD OF JULY 1, 2000 THROUGH DECEMBER 31, 2000. THIS REPORT IS REQUIRED UNDER SECTION 3005 OF THE OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988 (THE "ACT").

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Summary

Major Findings

- **The pace of U.S. economic growth slowed markedly over the period of July 1, 2000 through December 31, 2000.** While inflation and unemployment remained low, private investment, especially in inventories, fell off sharply.
- **Global growth also slowed, leading to an export contraction in the fourth quarter of 2000. U.S. import growth declined as well, but not as much as exports.**
- **Strong capital inflows continued in the second half of 2000.** The strong capital inflows exceeded the financing needs of the U.S. current account deficit, reflecting the attractiveness of investment in the United States.
- **Treasury determined that no major trading partners of the United States manipulated exchange rates under the terms of Section 3004 of the Act during the period under consideration. We continue to monitor the exchange rate practices of major U.S. trading partners and encourage their taking further steps toward more flexible exchange rate regimes where appropriate.**

Policy Priorities

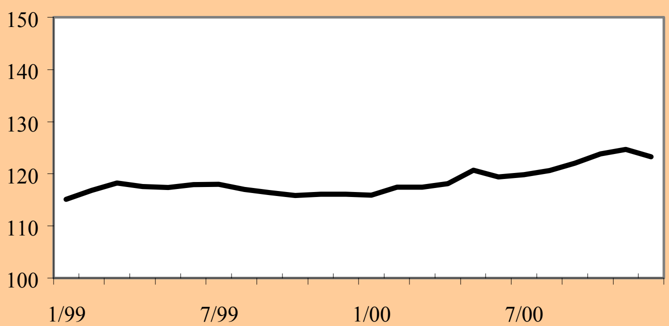
- **Pursue sound economic and financial policies in the United States. The slowing U.S. economy reinforces the need for immediate and permanent tax relief to undergird more vigorous economic growth.**
- **Encourage policies abroad that promote strong global growth. A healthy global economy requires that economies raise productivity and perform to their full potential.**
- **Pursue efforts to expand world trade, notably opening foreign markets to U.S. exports, and support free trade that has been critical to U.S. economic success.**
- **Encourage closer monitoring of economic and financial developments, and prompt policy action to prevent financial crises.**
- **Combat money laundering. Effective efforts are critical to the integrity of the international monetary system.**
- **Continue to monitor the policies and practices of major U.S. trading partners for evidence of currency manipulation.**

Economic and Currency Market Developments in Key Economies

United States

The Federal Reserve Board staff's broad nominal dollar index indicated that the dollar appreciated 3.2% on a trade-weighted basis during the period covered by this report, after a 2.9% appreciation in the first half of 2000. The real dollar appreciated 3.0% during the second half of 2000, after a 4.0% appreciation during the first half. Dollar movements have reflected the record-setting U.S. expansion, continuing growth differences between the United States and Japan, and renewed uncertainty about emerging market economies. During the reporting period, the Federal Reserve left its target for the Federal Funds rate unchanged.

Currency Movements: United States
Federal Reserve Board Staff Nominal Broad Dollar Index, 1/97=100



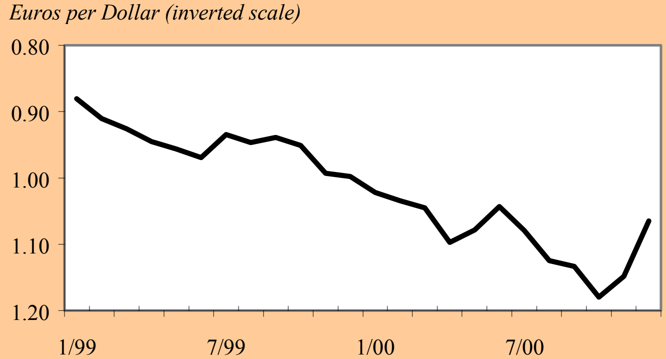
Euro Zone Countries

The euro depreciated further during the second half of 2000, with a net decline of 2.6% against the dollar and 2.3% on a nominal trade-weighted basis. At year-end, with reports of a rapidly slowing U.S. economy, the euro rallied to $0.94 from a low in late October just above $0.82. Rising domestic demand and increasing oil prices offset the effect of a decline in the trade-weighted value of the euro, and the Euro Zone's current account deficit stabilized at about 0.5% of GDP in the second half.

Euro Zone economic growth in 2000 was 3.4%, the best in 10 years. In most countries, growth slowed slightly in the second half of the year, to an aggregate 2.9% saar (seasonally adjusted annualized rate), although some countries had surprisingly strong fourth quarters: France, Italy, and the Netherlands grew 4.0%, 3.4%, and 3.6% (saar) respectively. The exception was Germany's sharp second half growth slowdown to 2.0% (0.8% saar in the fourth quarter). The unemployment rate fell during the period to 8.7%, the lowest level in over 8 years. Last year's sharp increase in oil prices maintained inflation rates above the ECB's 2.0% medium-term target rate during the second half of the year. The core inflation rate (excluding food and energy prices) remained below 2% and was 1.6% y/y at the end of 2000.

In response to concerns about inflation, (and to a lesser extent, concerns about the exchange rate), the ECB steadily tightened monetary conditions with two 25 basis point interest rate increases in the second half of 2000. Although monetary growth remained above the ECB's desired 4.5% y/y "reference rate" throughout the year, the rate of growth had slowed to 5.1% by December. During the second half of 2000, the spread between the yield on U.S. and German benchmark 10-year government bonds decreased 52 basis points. Most of the Euro Zone stock markets followed U.S. markets down at the end of the year and ended slightly down on the whole year (the German DAX index was down 6.5% from end-June to end-December).

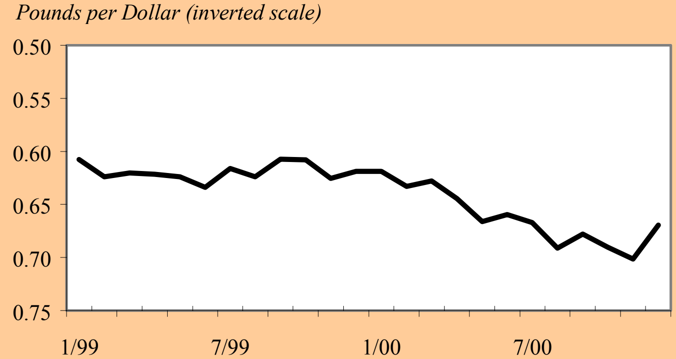
Currency Movements: Euro-zone
Euros per Dollar (inverted scale)



United Kingdom

In the second half of 2000, sterling appreciated on a real trade-weighted basis by 1%. The changes in sterling relative to the UK's major trading partners were driven by the difference in growth rates and investment climates. Sterling fell by 3% against the dollar, but rose by 2.6% against the Euro. Sterling had appreciated sharply in 1997, and the real trade-weighted exchange rate in December 2000 was 17.7% above its 1996 level (though it was lower, by 6.4%, against the dollar).

Currency Movements: United Kingdom
Pounds per Dollar (inverted scale)



In the second half of 2000, the goods trade deficit was 3.2% of GDP, up from 3% in the first half of 2000. The current account deficit for the second half totaled $11.3 billion or 1.6% of GDP, down from a deficit of $13.2 billion or 1.8% of GDP in the first half. This was due to improvement of the invisibles balance.

The UK's real GDP grew at an annualized rate of 3.0% during the second half, above its 10-year average growth rate of 2.4%. Parallel to global slowing, the economy slowed to 1.6% (saar) in the 4Q/2000. Although the economy slowed, labor market conditions remained generally tight, particularly for skilled workers. The unemployment rate, at 3.6%, reached a 25-year low.

The UK has benefited from a low inflation environment for some time. The benchmark inflation rate (retail prices excluding mortgage interest rates) was 2.1% for all of 2000, below the Bank of England's 2.5% target rate. The BOE's Monetary Policy Committee held its benchmark interest rate at 6% during the second half of 2000.

Japan

The yen depreciated 5.4% against the dollar and was essentially unchanged against the euro over the six-month period ending in December 2000. The yen depreciated 6.7% against the dollar in real terms and 3.1% in real trade-weighted terms from June to December. Japan's current account surplus fell from a seasonally adjusted ¥6.9 trillion ($63 billion, or 2.7% of GDP) in the first half of 2000 to ¥6.0 trillion ($55 billion, or 2.5% of GDP) in the second half of 2000. Japanese investors increased their holdings of foreign assets in the July-December period, recording net outflows of ¥10.8 trillion ($99.3 billion), while foreign investors increased their holdings of Japanese assets by ¥7.5 trillion ($68.9 billion). Net foreign exchange reserve accumulation totaled ¥2.1 trillion ($19 billion) in the last six months of 2000, vs. ¥1.9 trillion ($18 billion) in the first six months of 2000.

Japan's gradual economic recovery from the 1997-1998 recession began to slow in late 2000 on still-sluggish consumer demand and weakening export markets. Industrial production growth slowed to 2.8% q/q in the last three months of 2000, compared to 5.3% growth in the first nine months of the year vs. the same period of 1999. Japan needs to continue to make progress in market-opening deregulation and other structural and financial market reforms to raise its potential growth rate. A shrinking labor force due to Japan's rapidly aging population implies that strong productivity growth will be needed if Japan is to achieve stronger growth than the 1.2% GDP growth rate recorded on average over the past 9 years.

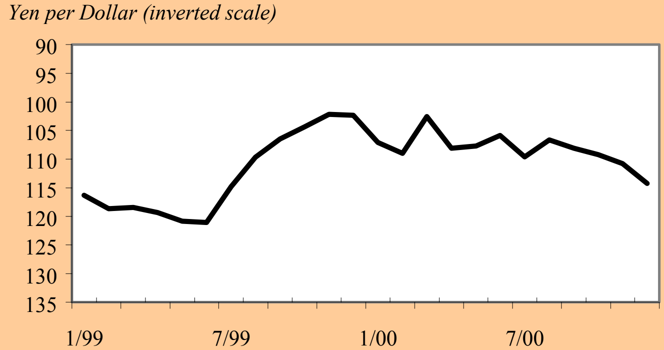
Canada

During the second half of 2000, the Canadian dollar experienced relative strength against all currencies except the U.S. dollar, rising 2.6% against the yen and 2.7% against the euro, but falling 2.9% against the U.S. dollar. Because of the importance of U.S. trade to Canada, the Canadian dollar fell 1.2% on a real trade-weighted basis during the reporting period. However, Canadian terms of trade with all trading partners improved 0.5% over the second half, partly on the strength of energy prices.

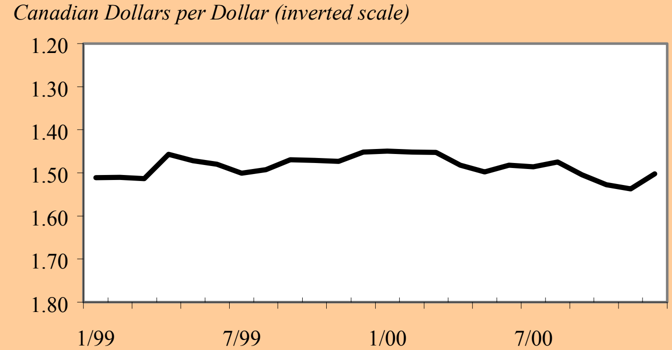
Energy and other goods exports played an important role in increasing Canada's overall current account surplus to $6.9 billion (2% of GDP) in the second half, up from $5.8 billion in the first half. The goods surplus increased to 5.6% of GDP in the second half, as net exports of energy increased 29% over the first half. Natural gas prices doubled between June and December, while non-energy commodity prices rose 1.8%. Goods exports to the United States were particularly important, rising 5% during the reporting period.

Real GDP grew 4.0% (saar) during the last six months of 2000, slowing from the 4.7% pace set in the first half. The unemployment rate averaged 6.9%, up slightly from the 6.7% in the first half but still around a 24-year low. Inflation remained low and within the 1-3% target of the Bank of Canada. Consumer prices were up 3.2% in the year to December 2000. Excluding energy prices, the increase was 2.2%. The Bank of Canada held its benchmark policy rate, the Bank Rate, steady during the second half of 2000. Long-term government bond rates fell slightly toward the end of the year.

Currency Movements: Japan
Yen per Dollar (inverted scale)



Currency Movements: Canada
Canadian Dollars per Dollar (inverted scale)



Overview of Emerging Market Finances

Credit and liquidity spreads in emerging financial markets rose considerably in the second half of 2000, on renewed concerns about the sustainability of the rapid growth experienced in the first half of 2000. The yield spread over U.S. Treasuries of JP Morgan's Emerging Market Bond Index+ (EMBI+), **after remaining largely unchanged in the first half, widened by 52 basis points in the second half of 2000.** This increase was due, in part, to the increasing spreads of Argentine debt, which increased sharply between October and November of 2000. At one point, Argentina EMBI+ spreads increased to 987 bps, but spreads declined throughout December with the successful conclusion of an IMF package. In contrast, spreads on Mexico's EMBI+ index widened only 6 bps in the second half of 2000.

Additional weakness manifested itself in the declines in most emerging market stock indices in the second half. The South Korean stock market index experienced a continual decline in value between end-2Q/2000 and end-4Q/2000 (falling to just under half of 1999 levels). In Latin America, losses were concentrated in the fourth quarter; Brazilian and Mexican markets continued to gain value throughout 3Q/2000, but then retreated sharply.

Another indication of tightening conditions was the dramatic reduction in bond offerings in 4Q/2000. Only $9 billion in new bonds were issued, less than one-quarter the volume of the first quarter of 2000. For the year as a whole, bond issuance remained essentially flat (over 1999 levels).

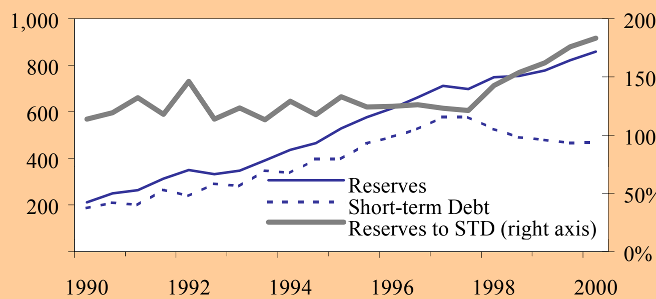
However, the emerging market economies made progress in reducing their vulnerability to external shocks in 2000. Short-term debt declined to $469 billion in 2000, down slightly from 1999 levels. Meanwhile, reserves continued to increase, and the ratio of reserves to short-term debt climbed to nearly 200% by 2Q/2000 (latest available data). As the accompanying graph ("Emerging Markets Reserves to Short-Term Debt") indicates, however, this increase was concentrated in the East Asian emerging markets and not matched elsewhere. Indeed, the ratio of reserves to short-term debt decreased in Sub-Saharan Africa and the Middle East although in the former case, the ratio remained above 100%. Eastern European and Central Asian emerging markets managed to increase the ratio slightly (from 140% in 1999 to 150% in 2000). Latin American economies experienced a decline in the ratio to 85%.

Financial Market Developments in Emerging Markets
(issuances in bil. of U.S. dollars, and percent increases in an index)

	1999	2000	1Q/00	2Q/00	3Q/00	4Q/00
Issuances	163.7	216.9	60.3	55.4	52.2	48.8
Bonds	82.4	82.0	33.8	16.1	23.0	9.0
Equities	23.2	41.7	8.9	11.6	8.8	12.3
Loans	58.1	93.2	17.6	27.7	20.4	27.5
Returns (EOP; % inc. over prev. year)						
EMBI+	26%	16%	29%	23%	28%	16%
Argentina	13%	8%	15%	15%	12%	8%
Brazil	41%	13%	31%	25%	29%	13%
Mexico	15%	18%	18%	20%	25%	18%
Poland	1%	16%	4%	8%	11%	16%
Russia	166%	55%	248%	97%	146%	55%
Stock Markets						
Brazil	152%	-11%	67%	44%	43%	-11%
Mexico	80%	-21%	52%	19%	25%	-21%
Shanghai-A	19%	51%	55%	14%	21%	51%
S. Korea	83%	-51%	39%	-7%	-27%	-51%

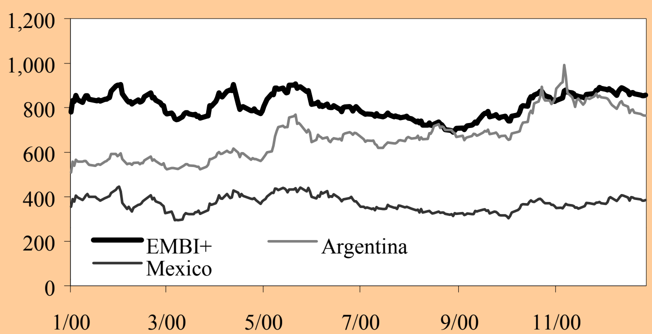
Source: IMF Em. Mkt. Financing (Q. Rep. on Developments & Prospects)

Reserves to Short-Term Debt, 1990-2000
For developing and emerging markets (bil.U.S. $ and % of S-T debt)

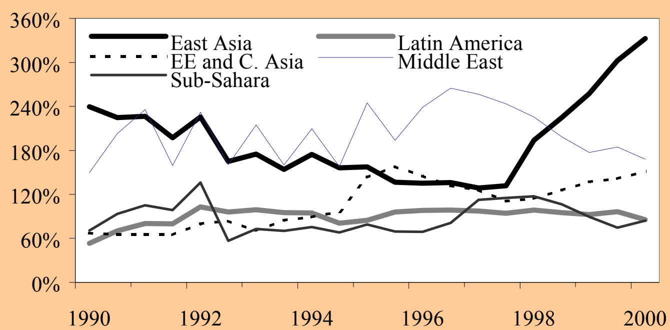


Source: IMF, World Bank, OECD, BIS External Debt Tables

Tale of Two EMBI+ Spreads, 2000
Basis point spreads over U.S. bonds (Source: Bloomberg)



Emerging Markets Reserves to Short-Term Debt
By region (usable reserves as a percent of S-T debt, inc. trade credit)



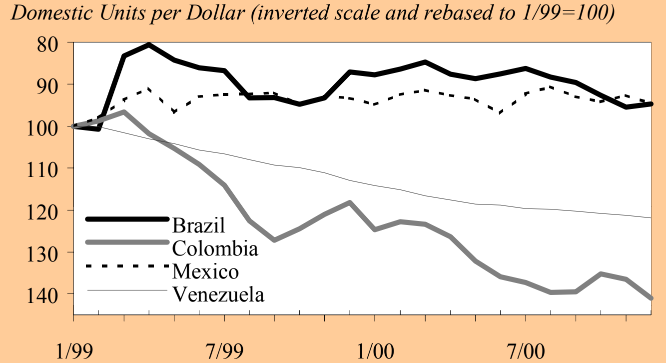
Latin America: Overview of Selected Countries

Year-on-year growth accelerated for the Latin American region during the reporting period. For 2000, regional growth was about 4%, vs. no growth in 1999. Argentina was the notable exception. Its economy contracted 0.5% in 2000. At the other end of the spectrum, Mexico experienced 7% GDP growth. External bond spreads, as measured by the Latin America EMBI+ index, widened 27 basis points in the second half of the year and 109 basis points for the year. Nonetheless, the larger Latin sovereigns issued $12 billion in new bonds in the second half of 2000, after placing $21 billion in the first half of the year.

Argentina. The Argentine economy contracted over 1% y/y in the second half of 2000 after disappointing first half growth and a 3.4% contraction in 1999. Weak aggregate demand continued to feed a deflationary environment, with the CPI falling 0.5% during the second half. The resignation of Vice President Alvarez in early October and poor fiscal results for the first nine months sparked market concern that Argentina was facing an imminent economic and financial crisis. Argentina's access to international bond markets closed, and it had difficulty rolling over its domestic debt. The spread on Argentina's component of the EMBI+ index widened 300 bps between June 30 and November 8 to 987 bps over U.S. Treasuries, though it narrowed to 773 bps by end-December following agreement with the IMF on a $39.7 billion IMF-led support package. Despite stagnation and 9.7% improvement in the terms-of-trade for the year, the 2000 current account deficit totaled 3.3% of GDP, only marginally lower than the 3.5% current account deficit in 1999.

Brazil. In the second half of 2000, the Brazilian economy continued to rebound from its weak performance in 1999. Real GDP growth reached 5.1% y/y and 4.4% y/y in the 3rd and 4th quarters of 2000, and was 4.2% for the full year. At the same time, CPI inflation slowed to just under 6.0% in December, vs. 6.5% in June – below the Central Bank's (BCB) 2000 inflation target of 6%. In addition, Brazil met or exceeded the key targets under its three-year $18 billion IMF program. During 2H/2000, the BCB lowered its target overnight interest rate 175 bps (375 bps for the year) to 15.75%, bringing the real interest rate below 10%. After relative stability in 1H/2000, the Brazilian real depreciated 7.4% against the dollar in 2H/2000 amid limited progress on structural reforms and higher borrowing costs due to external uncertainties. For the year, Brazil's EMBI+ spread over Treasuries widened 113 basis points to 749 at end-December.

Currency Movements: Latin America
Domestic Units per Dollar (inverted scale and rebased to 1/99=100)



The current account deficit rose to $13.4 billion in 2H/2000, vs. $11.2 billion in 1H/2000 and $12.8 billion 2H/1999, but for the full year narrowed slightly to $24.6 billion (4.2% of GDP) from $25.1 billion (4.7% of GDP) in 1999. Net FDI inflows financed 134% of the 2000 current account deficit ($18.1 billion in FDI in 2H/2000 alone).

Colombia. Colombia's economy outperformed expectations in 2000. GDP grew 2.8%, vs. a contraction of 4.3% in 1999, and inflation was 8.7%, well under the 10% inflation target. Likewise, the 2000 fiscal deficit narrowed to 3.4% of GDP, from 5.5% in 1999 and under the IMF target of 3.6%. On the external front, strong export demand led to a current account surplus of $178 million in 2H/2000, vs. a deficit of $82 million in 2H/1999. Nonetheless, Colombia's EMBI+ spread widened to 755 basis points on December 31, 2000, from 722 basis points on June 30, 2000, reflecting investor concerns over the internal security situation and, to a lesser degree, discord between the Pastrana government and the Congress.

Ecuador. Ecuador has made considerable progress since the exchange rate crisis and debt default in 1999. It implemented a number of fiscal and structural reform measures throughout 2000, completing dollarization in September, normalizing relations with most Brady/Euro bondholders via a bond exchange in August, and completing negotiations to reschedule Paris Club arrears in September. These actions, along with higher-than-expected oil prices, allowed Ecuador to post a 1.3% of GDP fiscal surplus in 2000, compared with a 7.0% of GDP deficit in 1999. Though CPI inflation was 91% during 2000, it

Currency Values: Selected Latin American Countries
Domestic currency units per Dollar (end-of-month levels, 2000)

	1/00	6/00	12/00	Change 6/00-12/00
Brazil (Reais/$)	1.81	1.80	1.95	8.1%
Mexico (Pesos/$)	9.63	9.84	9.61	-2.4%
Venezuela (Bolivares/	655.51	682.00	699.75	2.6%
Ecuador (Sucres/$)	24,975	25,000	25,000	0.0%
Colombia (Pesos/$)	1,977.50	2,155.50	2,236.00	3.7%

Real GDP Growth: Selected Latin American Countries
Percent change from one year ago

	Mexico	Brazil	Venezuela	Argentina
3Q/99	4.4%	0.5%	-4.3%	-5.1%
4Q/99	5.4%	3.4%	-4.1%	-0.5%
1Q/00	7.7%	3.8%	1.1%	0.5%
2Q/00	7.6%	3.5%	2.7%	0.2%
3Q/00	7.3%	5.1%	3.4%	0.0%
4Q/00	5.1%	4.4%	5.6%	n.a.

Source: Haver Database

slowed in 2H/2000 and is generally expected to be 25-30% in 2001. Reserves above those legally required to back central bank liabilities, ended 2000 at $770 million, well above the IMF's target. Despite these positive developments, political divisions stalled many of Ecuador's promised bank and fiscal reforms (including tax reform), leading to delays in scheduled bimonthly reviews of its one-year $305m IMF program.

Mexico. Mexico's economic momentum dissipated slightly in the second half as GDP growth tapered to 6.2% y/y from 7.7% y/y in the first half. Despite the rapid expansion, inflation continued its downward trajectory. Inflation for 2000 was 8.9% y/y, below end-June's 9.4% y/y pace and the central bank's inflation target of 10%. A strong peso helped. The peso appreciated 3.4% in the second half of 2000 to 9.62/dollar on December 31, but depreciated 1.2% for the full year.

Rapid growth caused some deterioration in the current account, which widened to $18 billion (3.1% of GDP) in 2000 from $14 billion (2.9% of GDP) in 1999. Nonetheless, capital inflows boosted net international reserves by $6 billion in the second half of the year to $35.6 billion on December 31 and enabled Mexico to repay early all its outstanding loans from the IMF.

Emerging Asia

Growth in Emerging Asia (outside of China) reached 6.9% in 2000, up from 6.5% in 1999. All the major economies in the region posted positive growth, ranging from 3.9% in the Philippines to 9.9% in Singapore. During the first three quarters of the year, Asian economies continued to benefit from strong global demand, especially for electronics and telecommunications equipment. Intra-regional trade also continued to expand at a rapid pace. A resurgence in import demand resulted in a decline in current account surpluses for all major economies during 2000 with the exception of Indonesia, Singapore, and Taiwan. The slowdown in growth in the United States and Europe, and Japan's faltering recovery, led to a sharp slowdown in export growth during the fourth quarter. The export falloff was most pronounced in high technology goods, with Singapore, Korea and Malaysia the most affected countries.

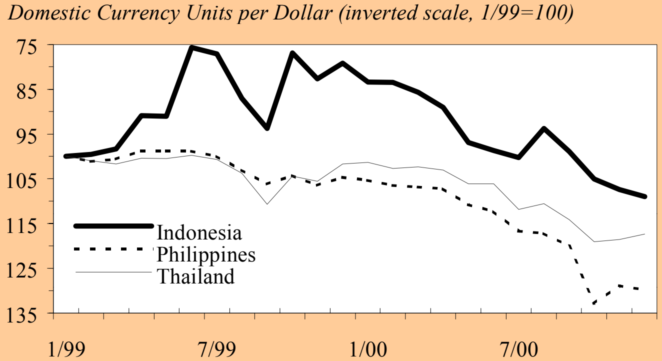
With the exception of China, Hong Kong, and Malaysia, most of the large economies in the region maintained managed floating exchange rate regimes. Central bank reserve accumulation was much more moderate during 2000, compared to 1999 when most central banks intervened in the foreign exchange markets to build up their reserves in the wake of the Asian financial crisis. During 2H/2000 foreign exchange reserves actually declined for Malaysia, Taiwan and the Philippines as export growth slowed and capital markets became increasingly concerned over the disappointing progress made in addressing structural constraints on growth as well as growing political turmoil in the Philippines.

Indonesia. Indonesia's economy finally began to rebound, growing nearly 5% in 2000 compared to zero in 1999. However, this was from a low post-crisis base; Indonesia has yet to experience the robust recovery of other Asian crisis countries. Factors supporting growth included high oil prices and relatively strong demand from Indonesia's largest trading partners. Investor confidence remained weak due to political uncertainty and enduring concerns about the government's willingness and capacity to follow through with its IMF-supported economic program. Concerns about the possibility of new fiscal and banking crises also put downward pressure on the rupiah and upward pressure on short-term interest rates.

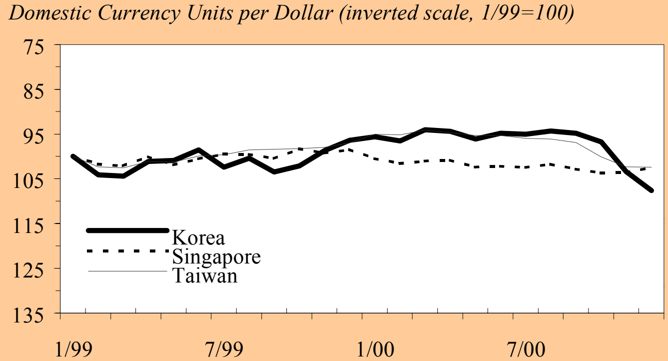
Indonesia maintains a floating exchange rate regime. The central bank intervened sporadically, and was able to rebuild reserves, particularly during periods of high oil prices. During the second half of 2000, net international reserves increased from $16.2 billion to $17.8 billion, equivalent to about 50% of total short-term external debt on a residual maturity basis. Nevertheless, the rupiah depreciated 1.2% in real effective terms (and 8.2% against the dollar in nominal terms) over the reporting period. The weak rupiah continued to support Indonesian exports, which grew 27% in 2000. Growth of non-oil exports was slower at 17% in 2000. The U.S. bilateral trade deficit with Indonesia grew from $3.5 billion in 1H/2000 to $4.3 billion in 2H/2000.

Philippines. The Philippines' real GDP growth in 2000 was the lowest in Emerging Asia at 3.9%. Fiscal overruns, slow progress on structural reforms, and a political crisis undermined

Currency Movements: Selected ASEAN Countries
Domestic Currency Units per Dollar (inverted scale, 1/99=100)



Currency Movements: NIEs (ex. Hong Kong)
Domestic Currency Units per Dollar (inverted scale, 1/99=100)



investor confidence late in the year, triggering intense downward pressure on the peso. The current account surplus increased to an estimated 10% of GNP in 2000 (from 9% in 1999), despite slowing export growth, as import growth declined even more sharply. The bilateral trade surplus with the United States in 2000 was $6.0 billion compared to $5.2 billion in 1999.

The Philippines maintains a managed floating exchange rate regime. During the height of the political crisis, the Philippine monetary authorities intervened intermittently and raised interest rates by a total of 400 basis points to support the peso and stem inflationary pressures. Nevertheless, the peso fell 14% against the dollar and 11% on a real effective basis during the reporting period. Gross international reserves fluctuated over the period but ended roughly unchanged at $15 billion for the year, or 110% of short-term debt (on a residual maturity basis). As a percent of M2, gross reserves rose to 51% at end-2000 from 44% at end-1999.

Thailand. Thailand's economic recovery continued in 2000, with GDP growing 4.2%, supported mainly by accommodative fiscal policies and strong growth in export-oriented industries. Monetary policy, in the absence of inflationary pressure, was also broadly accommodative and supportive of the conomic recovery. During the second half of 2000, the current account surplus remained largely unchanged from the first half at 7% of GDP. Thailand's bilateral trade surplus with the United States was $9.7 billion in 2000. Thailand maintains a floating exchange rate regime. Thailand experienced a steady outflow of private capital during the year due to amortization payments to foreign banks and growing market concerns over the disappointing progress made in addressing structural problems in the banking and corporate sectors. During the reporting period, the Thai baht depreciated 10% against dollar and 5% in real effective terms. Net international reserves were largely unchanged, rising by $556 million to $29 billion, equivalent to 209% of short-term external debt on a residual maturity basis. As a percent of M2, reserves rose from 28% to 30%.

Singapore. Singapore's GDP growth rebounded strongly in 2000 to 9.9% and was largely export led, especially in electronics and chemicals. The current account surplus in 2000 was $21.8 billion (22% of GDP), unchanged from 1999. Singapore's bilateral trade surplus with the United States grew from $1.3 billion in the first half of 2000 to $2.4 billion in the second half. Official foreign reserves increased by $3 billion to $80 billion in 2000, primarily as a result of interest earnings. As a percent of M2, reserves grew from 74% at end-1999 to 82% at end-2000.

Given the importance of imports in household consumption, Singapore's monetary policy is heavily influenced by movements in its exchange rate. Given the strong growth during the second half of 2000, the Monetary Authority of Singapore adopted a "tightening" stance, by targeting a slight appreciation in the Singapore dollar on a nominal trade-weighted basis. The Singapore dollar was broadly stable against the U.S. dollar and there was a slight appreciation on a real, trade-weighted basis.

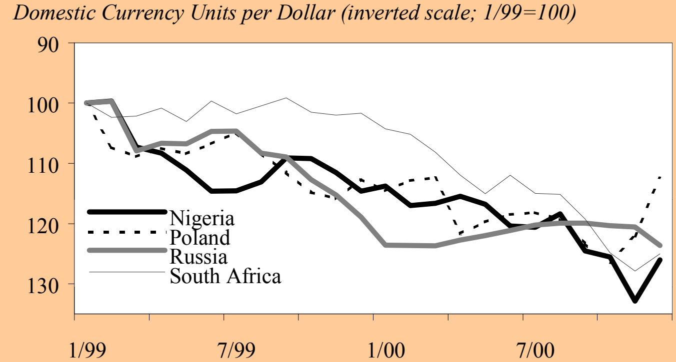
Developments in other Economies

Nigeria. Nigeria reached agreement with the IMF on a one-year $1 billion precautionary Standby Arrangement in August 2000, clearing the way for a Paris Club rescheduling of $23 billion of Nigeria's external debt (of which $21 billion were arrears) in December 2000. This resumption of relations with the international community as well as the continued increase in oil prices – which averaged $29.8 per barrel in 2H/2000 compared to $27.1 per barrel in 1H/2000 – further boosted prospects for an overdue economic recovery in Nigeria. However, so far expectations have failed to translate into broad-based GDP growth (2.8% in 2000 compared to 1% in 1999), and performance under the IMF program was poor. Excessive fiscal spending (roughly 45% of GDP) destabilized macroeconomic fundamentals, with year-on-year inflation and reserve money growth reaching 14.5% and 40%, respectively, in December 2000.

The government attempted to rein in the excess liquidity through open market operations, but they were under-subscribed and thus only moderately successful. The government responded to increased pressure in the foreign exchange market with greater-than-envisioned sales of foreign exchange reserves and enforcement of existing capital controls. (Note: foreign exchange reserves nonetheless increased in 2000 by $4 billion to $9.4 billion or 6.7 months of imports). In 2H/2000, restrictions on foreign exchange trading segmented the recently liberalized interbank market into "official" and "open" markets, with a 10% gap emerging between them. In December 2000, the Government merged the two markets (resulting in an 8% depreciation of the official rate) by restoring the transferability of funds. However, the premium between this interbank rate and the tolerated parallel market rate continued, widening from 5% in 1H/2000 to 13% at end-2000. Performance on broader structural issues, such as privatization, is essential to the continuation of the IMF program but progress to date has been slow.

Poland. Poland's economy slowed in the second half of the 2000, as the effects of the authorities' tight monetary stance worked their way through the system. In August 2000, the

Currency Movements in Other Emerging Markets
Domestic Currency Units per Dollar (inverted scale; 1/99=100)



Monetary Policy Council increased its benchmark rates by 150 bps, completing a rate-hiking cycle that pushed borrowing costs up by 600 bps in less than a year. Real GDP grew 3.3% in 3Q/2000 and 2.4% in 4Q/2000, compared to 5.2% for the first half of the year, and the unemployment rate rose to 15%, up from 13.8% in July. At the same time, inflation fell from a two-year high of 11.6% y/y in July to 8.5% y/y in December. The current account deficit also improved, falling from 7.4% of GDP in July to approximately 6.2% in December.

The zloty/USD and zloty/euro rates experienced wide swings during the reporting period. The zloty depreciated from 4.30 zloty per USD on July 1st to 4.71 in mid-October, before appreciating roughly 12% to 4.13 by the end of the year. Against the euro, the zloty appreciated from 4.09 at the beginning of July to 3.86 by the end of 2000 – an appreciation of approximately 6%. The zloty's strength in the fourth quarter of 2000 reflected high real interest rates and positive investor sentiment in light of improvements in the inflation and current account picture.

South Africa. Real GDP in South Africa grew a stronger-than-expected 3.5% in the second half of 2000 (after 2.4% in the first half) primarily because of sharp increases in private investment and exports. Real GDP is expected to grow 3.8% in 2001. The South African Reserve Bank's (SARB) targeted inflation measure fell to 6.9% in the second half (from 8.8% in the first half) in the wake of a slower money supply growth and subdued increases in labor costs. The rate of inflation is generally expected to fall to 6.5% in 2001. Despite the falling rate of inflation, the SARB did not loosen monetary policy because the rand depreciated significantly against the dollar. As a result of higher-than-expected revenues, the budget deficit for FY1999/2000 of 2.4% of GDP was lower than expected. The budget deficit is projected to rise slightly to 2.5% of GDP in 2002.

The rand depreciated a further 12% against the dollar in the second half of 2000 after depreciating 10% against the dollar in the first half. South Africa's terms of trade remained stable in the second half of 2000 after rising 0.5% in the first half. A surge in exports, led by the depreciating rand, caused the current account balance to improve from -0.5% of GDP for the first half of 2000 to -0.2% of GDP in the second half. A large increase in portfolio investment and FDI in the third quarter caused the balance on the financial account to narrow from -1.5% of GDP in the first half of 2000 to -0.6% in the second half. However, because capital flows were still negative, the SARB had difficulty accumulating foreign exchange reserves. The SARB reduced its net open forward position (NOFP) from $10.1 billion in June 2000 to $9.5 billion in December 2000, and net reserves remained at $4.9 billion.

Turkey. Turkey's GNP grew rapidly in 2000 at 5.9% y/y (after contracting 6.1% in 1999), reflecting a recovery from earthquakes in 1999 and the positive effects of Turkey's disinflation and economic reform program. The Turkish government launched the program in December 1999, supported by a 3-year $3.9 billion Stand-By Arrangement (SBA) agreed with the International Monetary Fund. The program was founded on: fiscal adjustment; a tight monetary policy; and structural reform, especially banking sector reform and privatization. A central feature of the program was a "crawling peg" mechanism for the exchange rate, with the pegged exchange rate depreciating in line with targeted inflation so it served as an anchor for disinflation. The crawling peg was scheduled to shift gradually to an expanding band later in mid-2001, before moving to a flexible exchange rate in 2003.

Results were positive, if not entirely on target, for most of the reporting period. Growth was strong, reaching 6.6% in the second half of 2000. All fiscal targets were met or exceeded. Inflation dropped sharply, especially in the second half. Consumer price inflation was 39% y/y in December 2000, down from 57% in June 2000 and 69% in December 1999, but still above the target of 25%.

However, circumstances changed by late November 2000. A number of factors – delays in structural reform (especially for the banking sector and privatization), higher interest rates (rising from a low of 31% for T-bills in April to 87% in early December), a growing current account deficit (reaching 5% of GNP in 2000), and serious weaknesses in the banking sector (including a serious maturity mismatch and large open foreign exchange position) – prompted a financial crisis and liquidity crunch in late November and early December, 2000. The Central Bank responded by injecting liquidity beyond the agreed levels in the IMF program. A medium-sized bank failed, and heavy foreign exchange outflows of $7.5 billion over two weeks threatened the foreign exchange peg. In reaction, the government and IMF agreed to strengthened economic policies, and a $7.5 billion Supplemental Reserve Facility was approved December 21, 2000. These actions stabilized financial markets, although residual effects could be seen in the banking sector and market confidence, including in the exchange rate peg, and the economy remained fragile.

U.S. Economy

Overview of the U.S. Economy

The U.S. economy downshifted to a lower growth rate in the second half of 2000. Even with this slower rate of growth, the United States is enjoying the longest period of uninterrupted growth in its history. After growing 5.2% in the first half of 2000, growth slowed to 1.6% in the second half. Reduced business investment in equipment and software, and an inventory correction accounted for much of the decline. The lower equipment and software investment mostly reflected a reduction in aircraft and truck production. A downturn in motor vehicle production accounted for 0.8 percentage point reduction in real GDP growth in 4Q. By the end of the year, factory output was falling. However, U.S. nonfarm productivity growth remained robust, growing 2.2% in 4Q/2000, slower than the 1995 to 2000 average of 2.8%, but still higher than the 1973 to 1995 average of 1.3%.

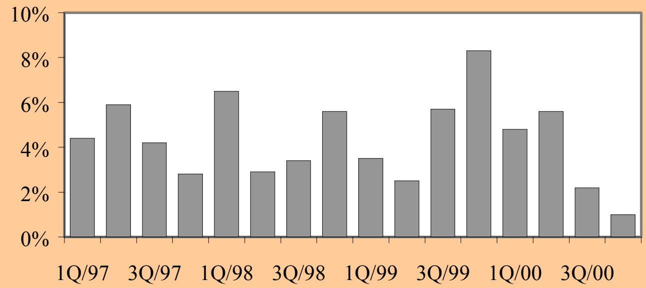
The U.S. unemployment rate reached a low of 3.9% in September and October but ended the year slightly higher, at 4%. The CPI inflation rate reached 3.4% y/y in December, down from 3.7% in June, largely due to easing oil prices. The "core" rate of inflation (excluding food and energy) was essentially unchanged (2.5% in June; 2.6% in December). The interest rate on the benchmark 10-year U.S. Treasury note, after peaking in January at 6.7%, declined throughout 2000 to 5.2% in December. Gross national saving as a share of GDP declined 0.5 percentage point in the second half to 18% of GDP (compared to end-1H/2000).

IMF Article IV Consultation

The conduct of economic policy by the U.S. Administration and the Federal Reserve was highly commended by the IMF staff at the conclusion of the IMF staff's 2000 consultation with the United States on July 12, 2000 (in accordance with Article IV of the IMF's Articles of Agreement). The IMF staff said that "[s]ound monetary and fiscal policies have contributed to making the current U.S. economic expansion the longest on record." The IMF staff also notes the importance of the U.S. expansion to the global economy. "The strength of the U.S. economic expansion played a critical role in supporting world economic growth during the period of turbulence in 1997-98."

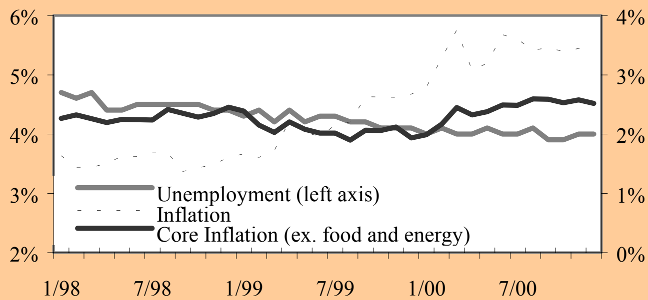
However, the IMF staff also took the view that the growth in U.S. domestic demand in excess of supply and the perceived attractiveness of the investment environment have been reflected in a large and growing current account deficit. In the view of the IMF staff, appropriate policies in major U.S. trading partners to promote sustained expansion of their economies as well as U.S. policies aimed at sustaining noninflationary growth are necessary to produce a smooth rebalancing of global demand. Consistent with a broad effort by the United States to enhance the transparency of the IMF, the United States is part of a pilot project established by the IMF's Executive Board to allow countries to release to the public the staff reports on their Article IV reviews. The staff report on the U.S. economy was released on July 28, 2000 on the IMF's web site.

U.S. Real Gross Domestic Product. 1997-2000
% change over previous quarter, SAAR



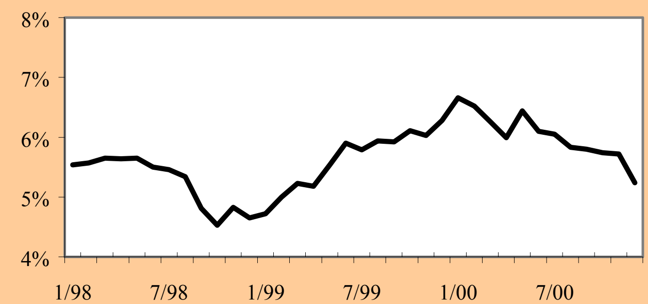
Source: Bureau of Economic Analysis (BEA)

U.S. Civilan Unemployment Rate and Inflation Rate
Unemployment (left axis); Inflation (y/y % change in prices, right axis)



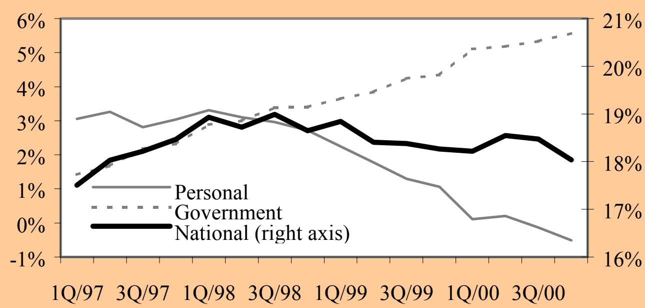
Source: Bureau of Labor Statistics

U.S. Interest Rates
% (10 year Treasury, constant maturity)



Source: U.S. Treasury

U.S. National Saving and Selected Components
% of GDP (personal/gov't on left axis; national on right axis)



Source: BEA

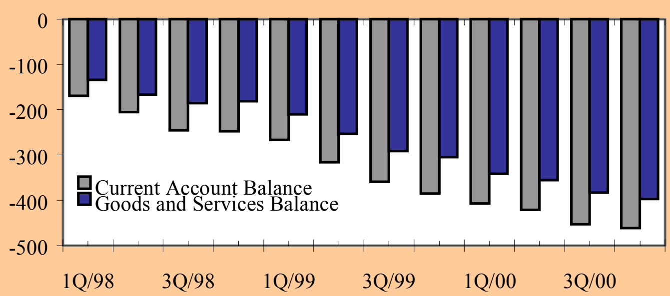
Trade Flows

The downshift in U.S. growth helped to moderate U.S. import consumption in the second half of 2000. However, a combination of slowing global growth that reduced U.S. exports and continued high energy prices led to an increase in both the trade and current account deficits. In the fourth quarter of 2000, U.S. imports fell for the first time in five years, and U.S. exports declined sharply after six quarters of strong growth.

During 2000, the current account deficit rose every quarter to new, record levels, from $421 billion (saar) in the second quarter of 2000 to $461 billion (saar) in the fourth quarter of 2000 (at 4.6% of GDP). Over the same period, the goods and services deficit increased from $355 billion (saar) to $397 billion (saar).

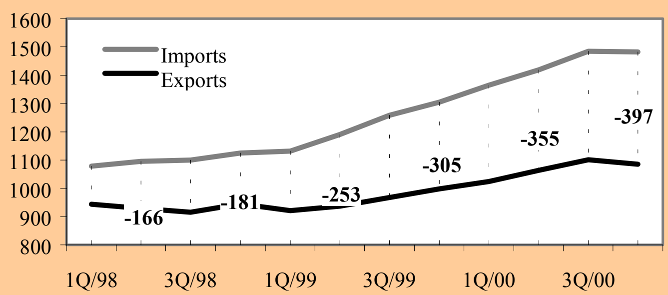
U.S. exports of goods and services increased 11.2% in the second half of 2000 over the same period in 1999. However, goods exports declined sharply, resulting in a 5.6% decline in fourth quarter exports (annualized). **An important component of the U.S. current account includes the growing "trade in invisibles"** (services exports and imports, and income receipts and outflow payments). Invisibles exports (services plus income receipts) reached an all-time high in 2000, finishing the year at 83% (or nearly equaling) merchandise exports. Invisibles imports (services plus outflow payments for foreign employees and past foreign investments) are still less than half of merchandise imports (46% in the fourth quarter of 2000).

U.S. External Balances
Billions of U.S. $, SAAR (Balance of Payments, BOP, Basis)



Source: Bureau of Economic Analysis, Bureau of the Census

U.S. Trade in Goods and Services
Billion of U.S. $, SAAR (BOP Basis, trade balances in bold)



Source: Bureau of Economic Analysis, Bureau of the Census

U.S. Trade in Goods and Services
Billions of U.S. $ (BOP basis, SAAR)

	Exports		Imports	
	Level	Change	Level	Change
1Q/99	921.3	-9.3%	1,132.0	2.3%
2Q/99	937.2	7.1%	1,190.4	22.3%
3Q/99	967.9	13.8%	1,258.7	25.0%
4Q/99	998.6	13.3%	1,303.7	15.1%
1Q/00	1,023.8	10.5%	1,364.8	20.1%
2Q/00	1,063.7	16.5%	1,418.7	16.8%
3Q/00	1,101.7	15.1%	1,484.2	19.8%
4Q/00	1,085.8	-5.6%	1,482.8	-0.4%

Source: Bureau of the Census

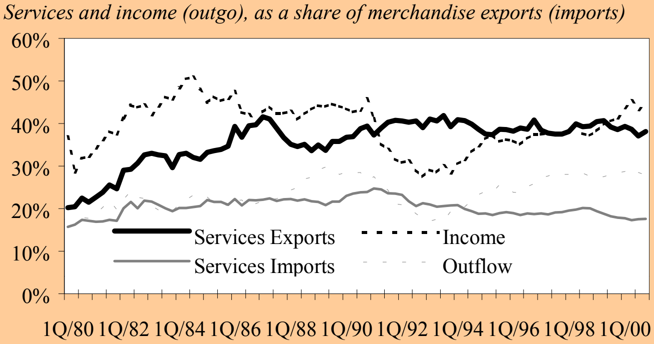
U.S. Bilateral Merchandise Trade Balances
Billions of U.S. $ (nsa, Census basis)

	China	Japan	Canada	Mexico	South America	EU
1Q/99	-13.6	-16.3	-6.8	-5.7	1.1	-5.6
2Q/99	-15.7	-17.2	-6.8	-6.5	-0.3	-10.6
3Q/99	-20.1	-19.4	-9.4	-6.3	-2.5	-13.8
4Q/99	-19.3	-20.4	-9.4	-4.2	-1.7	-13.3
1Q/00	-16.7	-19.1	-10.8	-5.7	-4.1	-13.1
2Q/00	-19.4	-20.6	-11.5	-6.2	-3.4	-13.4
3Q/00	-25.0	-20.4	-13.3	-6.7	-3.6	-14.9
4Q/00	-22.7	-21.2	-14.8	-6.3	-3.0	-14.2

Source: Bureau of Economic Analysis, Bureau of the Census
Quarterly non-seaonsally adjusted (nsa) data can be volatile.

The rising current account deficit tends to lead to a larger negative U.S. net international investment position (NIIP). While the 2000 NIIP data will not be available until June 2001, outflow payments have increased sharply since 1993 (when the level of net foreign indebtedness was approximately one-quarter the -$1.1 trillion position at current cost in 1999). Outflow payments were $353 billion (saar) in 4Q/2000. Despite an appreciated dollar, which tends to reduce foreign income receipts, this category has also increased sharply and is now greater than services exports. Income receipts (at $356 billion, saar) nearly equaled outflow payments in 4Q/2000, resulting in no significant net effect on the current account balance.

U.S. Trade in Services and Income Receipts, 1980-2000
Services and income (outgo), as a share of merchandise exports (imports)



Financial Flows

Financial inflows continued to increase during the period covered by this report, reflecting the attractiveness of the United States as a destination for business investment. Capital inflows help maintain lower interest rates than would likely be possible otherwise. Funds generated by investments made at suitable rates of return can be used to service any debt that is created through the trade deficit. However, increased capital flows and trade deficits increase the potential vulnerability of the United States to changes in global financial markets' perceptions of investment opportunities in the United States.

The annual return on foreign direct investment has helped support past flows. As the table ("Annual Return on FDI, 1993-1999") indicates, there is significant variation in the return on foreign direct investment by country.

In the fourth quarter of 2000, outflow payments (at $353 billion saar) on foreign investments were sizable, nearly one quarter (24%) of the total imports of goods and services. While part of the current account balance, outflows represent payments on past, accumulated current account deficits.

There is also significant variation in the dependence of other nations on income flows from the United States. For Canada, income flows have declined in importance since 1993, and are now only 4% of Canadian receipts on exports of goods and services to the United States. On the other hand, for six of the twelve Euro Zone countries, U.S. outflow payments have risen from 15% of their exports to the United States in 1993 to 26% in the fourth quarter of 2000.

Annual Return on FDI, 1993-1999

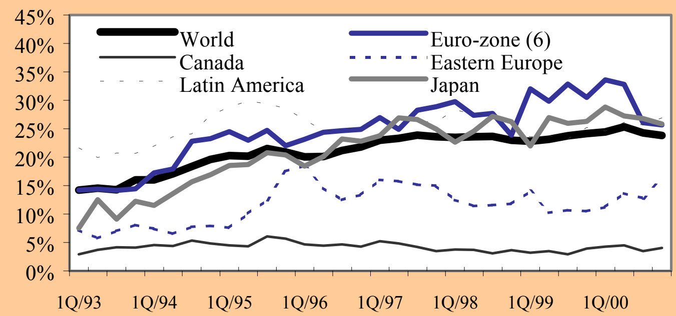
ROA measured by the ratio of FDI income to stock of FDI at historical cost (per year) in current U.S. Dollars

	1993	1994	1995	1996	1997	1998	1999	1993-99
World	1.5%	4.3%	5.8%	5.1%	5.9%	4.1%	5.2%	4.5%
Canada	3.4%	7.0%	8.0%	5.8%	4.4%	2.1%	1.9%	4.6%
Euro-zone	1.5%	4.5%	5.7%	5.9%	6.2%	4.9%	5.7%	4.9%
U.K.	5.7%	7.3%	9.1%	8.5%	8.3%	4.8%	6.7%	7.2%
LA*	7.4%	5.2%	7.3%	7.6%	10.0%	12.6%	9.9%	8.5%
Mexico	4.3%	-1.6%	1.2%	0.1%	6.1%	10.1%	7.2%	3.8%
Mid.East	-3.2%	0.9%	2.4%	2.0%	8.7%	5.8%	2.3%	2.7%
Japan	-2.1%	0.8%	3.4%	2.5%	4.4%	3.8%	4.0%	2.4%
NIE-3	1.2%	2.9%	4.7%	3.3%	2.9%	-1.1%	0.5%	2.1%

Note: **LA=Latin America, excluding Mexico. NIE-3= Hong Kong, Singapore, Taiwan. Korea had several years of poor returns and negative recorded inflows (i.e., outflows) of FDI.*

U.S. Outflow Payments as a Share of Imports, 1993-2000

By economy, as % of imports of goods and services from that economy



Source: BEA; Euro (6): Germany, France, Italy, BelNeLux

U.S. Financial Flows

Billions of U.S. $, s.a., details might not equal totals due to rounding

	Q1/99	Q2/99	Q3/99	Q4/99	Q1/00	Q2/00	Q3/00	Q4/00	1999	2000
Net Financial Flows	**77**	**100**	**70**	**64**	**58**	**151**	**102**	**88**	**312**	**400**
Net Portfolio Flows	**77**	**-6**	**45**	**74**	**117**	**23**	**73**	**63**	**190**	**276**
U.S. acquisition of foreign assets*	-13	-97	-69	-42	-80	-75	-51	-75	-221	-281
Foreign acquisition of U.S. assets	90	91	114	116	196	98	124	138	411	556
Foreign Official	4	-1	12	27	22	6	12	-4	43	36
Private**	86	92	102	88	174	92	112	142	368	521
Net Banking Flows	**15**	**-5**	**13**	**-26**	**-64**	**65**	**-7**	**-24**	**-2**	**-31**
Assets	28	-42	-11	-45	-56	18	-6	-67	-70	-110
Liabilties	-14	37	25	20	-9	47	-1	43	67	79
Net Direct Investment	**-14**	**111**	**12**	**16**	**6**	**63**	**37**	**49**	**125**	**155**
U.S. direct investment abroad	-41	-33	-44	-33	-43	-37	-36	-45	-151	-162
Foreign direct investment in the United States	27	144	56	49	49	100	73	94	276	317

Source: Bureau of Economic Analysis

* Net private claims on foreigners by nonbanks plus net private U.S. purchases of foreign securities.

**Net purchases of U.S. Treasury securities, net nonbank liabilities to foreigners, net purchases of gov't non-Treasury securities, and net U.S. currency flows.

U.S. Exchange Rate Policies

During the reporting period, July 1 through December 31, 2000, the dollar traded in a range of ¥104.22 to ¥114.39. The period was characterized by downward pressure on the euro. Toward the end of October, the euro reached a record low of $0.8225. In December, the euro rebounded to end the year just above $0.94.

There were two episodes of exchange rate intervention to support the euro. The first, in September, was a coordinated effort among the G-7 monetary authorities. The second episode was a unilateral effort by the European Central Bank (ECB) undertaken in early November.

G-7 Statements on Exchange Rate Policies

In September 2000, G-7 Finance Ministers and Central Bank Governors issued the following statement.

- "We discussed developments in our exchange and financial markets. We have a shared interest in a strong and stable international monetary system. At the initiative of the European Central Bank, the monetary authorities of the United States, Japan, United Kingdom and Canada joined with the European Central Bank on Friday, September 22, in concerted intervention in exchange markets, because of the shared concern of Finance Ministers and Governors about the potential implications of recent movements in the euro for the world economy. In light of recent developments, we will continue to monitor developments closely and to cooperate in exchange markets as appropriate."

Exchange Rate Regimes Assessed

Elements of Manipulation

Section 3004 of the Omnibus Trade and Competitiveness Act of 1988 requires the Treasury to analyze annually the exchange rate policies of foreign countries, in consultation with the IMF, and to consider whether countries manipulate the rate of exchange between their currency and the dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. The Secretary of the Treasury is required to undertake negotiations with those manipulating countries that have material global current account surpluses and significant bilateral trade surpluses with the United States, unless there would be a serious detrimental impact on vital national economic and security interests.

- **Treasury undertook a broad review of the performance of major trading partners of the United Stated and concluded that no major trading partners of the United States manipulated exchange rates under the terms of Section 3004 of the Act during the period under consideration.**

- **Treasury officials have urged the Malaysian and Chinese authorities to move, over time, to more flexible exchange rate regimes.**

In evaluating evidence of currency manipulation, Treasury looks at the following five factors:

- **External Balances.** Persistent global current account surpluses are fundamentally a reflection of an excess of national savings over national investment, but in some cases may also reflect efforts to maintain an exchange rate level that would prevent external adjustment.

- **Exchange Restrictions and Capital Controls.** Restrictive exchange regimes and capital controls can be a concern, particularly where the restrictions are designed to maintain a consistently undervalued exchange rate.

- **Exchange Rate Movements.** Large depreciations of exchange rates, if induced artificially rather than by market forces responding to fundamentals, could suggest an attempt to gain a competitive advantage in trade. Manipulation could also be reflected in the absence of a significant appreciation of the exchange rate when justified by fundamentals. Equilibrium real exchange rates, however, are determined by a number of factors and are therefore difficult to define.

- **Changes in International Reserves.** Significant and persistent accumulation of foreign exchange reserves could be a source of concern if it reflects efforts to maintain an excessively competitive exchange rate.

- **Macroeconomic Trends.** When analyzing these economies, Treasury looks at the macroeconomic policy stance and other conditions that are important determinants of exchange rates.

Assessment

As the law requires, economies were examined as potential exchange rate manipulators if they had significant global current account surpluses and bilateral surpluses with the United States and maintained a fixed or actively managed exchange rate system during the reporting period. Detailed assessments are not provided for those economies where oil exports, with prices customarily denominated in dollars, clearly dominate total exports, and fluctuations in world oil prices produce at times wide swings in the trade and current account balances.

Five emerging market economies were reviewed in detail: Taiwan, China, Korea, Russia, and Malaysia.

Taiwan. Taiwan's economy expanded by 6% in 2000. However, a noticeable deceleration in growth occurred in the second half of the year with both private consumption and investment contracting. Disputes between the ruling and opposition parties, uncertainty over the government's economic policies, tight credit conditions due to the weakness in its domestic financial sector and rising unemployment weighed heavily on investor and consumer confidence. The slowdown in global demand for Taiwan's predominantly high-technology exports, which began in the last quarter of 2000, is expected to contribute to a further weakening of aggregate growth going forward. The current account surplus widened in the 2H/2000 to 4.6% of GDP up from 1.6% of GDP in the first half. Over the same period, Taiwan's bilateral trade surplus with the U.S. increased to $8.6 billion, up from $7.6 billion.

Taiwan maintains a heavily managed exchange rate policy. Nevertheless, the New Taiwan Dollar depreciated 7% against the dollar and and 3% on a real effective basis over the reporting period as the authorities allowed the currency to move largely in line with market forces. Taiwan's monetary authorities exert a strong influence on the foreign exchange market through heavy and frequent intervention, the use of various capital controls and close monitoring of trading. Over the second half of 2000, net foreign exchange reserves decreased by $7.1 billion to $107 billion as the authorities leaned against a weakening of the Taiwanese dollar. As a percentage of M2, reserves declined to 18.7% from 19.3%. U.S. Treasury officials have urged the authorities to reduce their role in the foreign exchange market, and allow market forces and participants greater freedom to engage in private foreign exchange transactions.

China. China's real GDP growth was relatively unchanged at about 7.8% y/y in 2H/2000 compared to 8.2% y/y in 1H/2000, as recovery in domestic demand (fueled by fiscal and monetary stimulus) offset slowing global demand and the impact of a weakening yen and other Asian currencies on China's external competitiveness. As a result, China's current account surplus declined slightly to an estimated 1.5% of GDP in 2000 (official statistics, available only on an annual basis, had not been released at the time this report was prepared) compared to 1.6% in 1999. China's merchandise trade surplus measured $12 billion in 2H/2000, similar to 1H/2000 but only about half of the $21 billion trade surplus in 2H/1999, as export growth continued to be outpaced by even stronger import growth. China's bilateral trade surplus with the United States rose to $47 billion in 2H/2000, from $36 billion in 1H/2000 and $39 billion in 2H/1999 due to robust U.S. demand and the competitiveness of Chinese products relative to other low cost producers.

China implements a de facto currency peg to the dollar, which it has maintained unchanged within a tight band since 1995. During the Asia crisis, at a time when many Asian currencies depreciated sharply, China maintained the renminbi peg against the U.S. dollar. The real effective exchange rate of the RMB appreciated about 5% between July and October 2000, as Asian currencies depreciated against the dollar. Gross foreign exchange reserves reached $166 billion by end-2000, about 10 times short-term external debt on a residual maturity basis, virtually unchanged from end-1999. Reserves as a percent of M2 declined slightly to just over 10% at end-2000, from 11% at end-1999. Reserve growth during 2H/2000 can be accounted for largely by estimated interest earnings. China also continues to maintain wide-ranging controls on capital account transactions. In bilateral discussions, U.S. Treasury officials have urged China to move, over time, to a more flexible exchange rate regime to give monetary policy greater scope to address domestic economic conditions.

Korea. Korea's real GDP grew 8.8% in 2000. However, real GDP fell during the fourth quarter compared to the third (on a seasonally adjusted basis) due to weakening exports, particularly in the electronics sector. This, along with a recovery in domestic demand, led to a significant decline in Korea's current account surplus during 2000 to the equivalent of 2½% of GDP compared to 6% in 1999. However, Korea's bilateral trade surplus with the United States rose to $7.8 billion in the second half of 2000, compared to $5 billion during the same period in 1999. The increase reflected a surge in electronics goods exports during the third quarter of 2000.

Korea maintains a managed floating exchange rate regime. Net foreign exchange reserves rose by about $12 billion in the reporting period to $96 billion. At the end of 2000, reserves stood at 218% of short-term external liabilities compared to 189% in 1999. As a percent of M2, reserves were modestly higher at 28½% compared to 26½% at end-June and 25½% at end-1999. During the reporting period, the won depreciated 13% against the dollar and 4% on a real effective basis. In bilateral discussions, Treasury officials continued to stress to Korean officials the importance of allowing market forces to determine the exchange rate.

Russia. Russia's GDP rose 7.6% in the second half of 2000 compared to the second half of 1999 and 3.4% compared to the first half of 2000, reflecting robust industrial output growth and a recovery in domestic demand. Federal revenue collections slipped slightly in the second half, falling to 16% of GDP from 17% of GDP in the first half, and caused the primary surplus to fall to 4% of GDP from 6% of GDP. The current account surplus remained steady at 18% of GDP in the second half, primarily due to stable energy prices and rising non-energy exports. Imports recovered strongly in the second half of 2000, rising 17% compared to the second half of 1999, reflecting increases in household income and some real appreciation of the ruble during 2000. Russia's bilateral trade surplus with the United States reached $5 billion in 2000.

Russia operates a managed floating exchange rate. The ruble was under strong pressure to appreciate in the second half of 2000, but the Central Bank of Russia intervened to keep the ruble around 27.7-28.0 R/$. The ruble appreciated 7% (in real terms) in the 2H/2000 due to Russian inflation. By intervening, the CBR took advantage of Russia's favorable balance-of-payments position to rebuild reserves from their low levels following the 1998 financial crisis. The favorable balance-of-payments position also enabled the Russian government to pay its external debt. In 2000, Russia's foreign exchange reserves more than doubled from $12.5 billion to $28 billion, while the ratio of Russia's reserves to short-term debt increased from 128% to 321%. Accumulation of reserves fueled growth of base money, which increased 60% in 2000, while inflation was 20%.

Malaysia. Malaysia's real GDP grew 8.5% in 2000, largely on strong export performance. However, the economy slowed appreciably in the fourth quarter, in line with slowing external demand. A surge in government spending in the fourth quarter prevented a more dramatic deceleration. The current account surplus for 2000 is estimated to have declined to 10% of GDP compared to 16% in 1999. Nevertheless, the bilateral surplus with the United States increased from $9 billion to $11 billion on strong U.S. demand for electronics goods.

Malaysia has maintained a fixed peg to the dollar since September 1998, when it also imposed capital controls. Malaysia has since relaxed these controls, largely limited as of end-2000 to a capital gains tax on investments held less than a year, restrictions on foreign investment by residents, and a prohibition on offshore trading in the ringgit. As regional currencies depreciated over the period, the ringgit appreciated 4.8% on a real trade-weighted basis. Despite a sizable current account surplus, capital outflows led to a $4 billion decrease in net international reserves in 2H/2000 to $30 billion. As a percent of M2, reserves fell from 35% at end-1999 to 32% at end-2000. Nevertheless, reserves as a percent of short-term debt rose to 374% at end-2000, up from 355% at end-1999. In bilateral discussions, U.S. Treasury officials continued to urge Malaysian authorities to move, over time, to a more flexible exchange rate regime.

Policy Priorities

- **Pursue sound economic and financial policies in the United States.** Economic fundamentals – productivity growth, the flexibility of labor and capital markets, and low inflation – remain strong.

- **In particular, the slowing U.S. economy reinforces the need for immediate and permanent tax relief to undergird more vigorous economic growth.**

- **Encourage policies abroad that promote strong global growth.** A healthy global economy requires that economies raise productivity and perform to their full potential.

- **In particular, encourage Japan and Europe to undertake appropriate macroeconomic policies and intensify structural reforms necessary for strong and balanced global growth.** Encourage developing countries to cultivate a good policy environment and work to raise productivity, which is the ultimate driver of higher incomes per capita and reduced poverty.

- **Pursue efforts to expand world trade, notably opening foreign markets to U.S. exports, and support free trade that has been critical to U.S. economic success.**

- **Encourage closer monitoring of economic and financial developments, and prompt policy action to prevent financial crises.**

- **Combat money laundering.** Effective efforts are critical to the integrity of the international monetary system.

- **Continue monitoring major U.S. trading partners for evidence of currency manipulation as countries balance the goals of reserve accumulation to cover foreign liabilities and appropriate exchange rate adjustment.** In economies with a significant amount of debt denominated in foreign currencies, or where the currency is fixed to another currency, a sufficient level of foreign reserves is important. However, in the context of a floating exchange rate regime, a country can accumulate an excessive level of reserves in an attempt to prevent a currency appreciation. This appreciation can serve an important element in the adjustment of both trade and financial flows. Excessive intervention can, in the long run, build pressures in an economy.

Appendix

OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988 (H.R. 3)

SEC. 3004. INTERNATIONAL NEGOTIATIONS ON EXCHANGE RATE AND ECONOMIC POLICIES.

(a) Multilateral Negotiations.-The President shall seek to confer and negotiate with other countries-

(1) to achieve-

(A) better coordination of macroeconomic policies of the major industrialized nations; and

(B) more appropriate and sustainable levels of trade and current account balances, and exchange rates of the dollar and other currencies consistent with such balances; and

(2) to develop a program for improving existing mechanisms for coordination and improving the functioning of the exchange rate system to provide for long-term exchange rate stability consistent with more appropriate and sustainable current account balances.

(b) Bilateral Negotiations.-The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and 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. If the Secretary considers that such manipulation is occurring with respect to countries that (1) have material global current account surpluses; and (2) have significant bilateral trade surpluses with the United States, the Secretary of the Treasury shall take action to initiate negotiations with such foreign countries on an expedited basis, in the International Monetary Fund or bilaterally, for the purpose of ensuring that such countries regularly and promptly adjust the rate of exchange between their currencies and the United States dollar to permit effective balance of payments adjustments and to eliminate the unfair advantage. The Secretary shall not be required to initiate negotiations in cases where such negotiations would have a serious detrimental impact on vital national economic and security interests; in such cases, the Secretary shall inform the chairman and the ranking minority member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of the Committee on Banking, Finance and Urban Affairs of Representatives of his determination.

SEC.3005. REPORTING REQUIREMENTS.

(a) Reports Required.-In furtherance of the purpose of this title, the Secretary, after consultation with the Chairman of the Board, shall submit to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, on or before October 15 each year, a written report on international economic policy, including exchange rate policy. The Secretary shall provide a written update of developments six months after the initial report. In addition, the Secretary shall appear, if requested, before both committees to provide testimony on these reports.

(b) Contents of Report.-Each report submitted under subsection (a) shall contain-

(1) an analysis of currency market developments and the relationship between the United States dollar and the currencies of our major trade competitors;

(2) an evaluation of the factors in the United States and other economies that underline conditions in the currency markets, including developments in bilateral trade and capital flows;

(3) a description of currency intervention or other actions undertaken to adjust the actual exchange rate of the dollar;

(4) an assessment of the impact of the exchange rate of the United States dollar on

(A) the ability of the United States to maintain a more appropriate and sustainable balance in its current account and merchandise trade account;

(B) production, employment, and noninflationary growth in the United States;

(C) the international competitive performance of United States industries and the external indebtedness of the United States;

(5) recommendations for any changes necessary in United States economic policy to attain a more appropriate and sustainable balance in the current account;

(6) the results of negotiations conducted pursuant to section 3004;

(7) key issues in United States policies arising from the most recent consultation requested by the International Monetary Fund under article IV of the Fund's Articles of Agreement; and

(8) a report on the size and composition of international capital flows, and the factors contributing to such flows, including, where possible, an assessment of the impact of such flows on exchange rates and trade flows.

(c) Report by Board of Governors.-Section 2A(1) of the Federal Reserve Act (12 U.S.C. 225a(1)) is amended by inserting after "the Nation" the following:", including an analysis of the impact of the exchange rate of the dollar on those trends".

SEC. 3006. DEFINITIONS.

As used in this subtitle:

(1) Secretary.-The term "Secretary" means the Secretary of the Treasury.

(2) Board.-The term "Board" means the Board of Governors of the Federal Reserve System.