Revisiting the Current Account: Insights from Sectoral Balances

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- ◇Integrating sectoral flows into the analysis of global imbalances is essential for a better understanding
- ◇Results challenge the widespread view that household sector plays a key role
- ◇The drivers of the current account are mainly associated with the corporate and public sector
- ◇Post-crisis contraction of current account imbalances reflected in improvements in the corporate sector

New light on current account imbalances and their adjustment by analyzing their domestic counterpart

Traditionally:

$$CA = SAV - INV \tag{1}$$

But also,

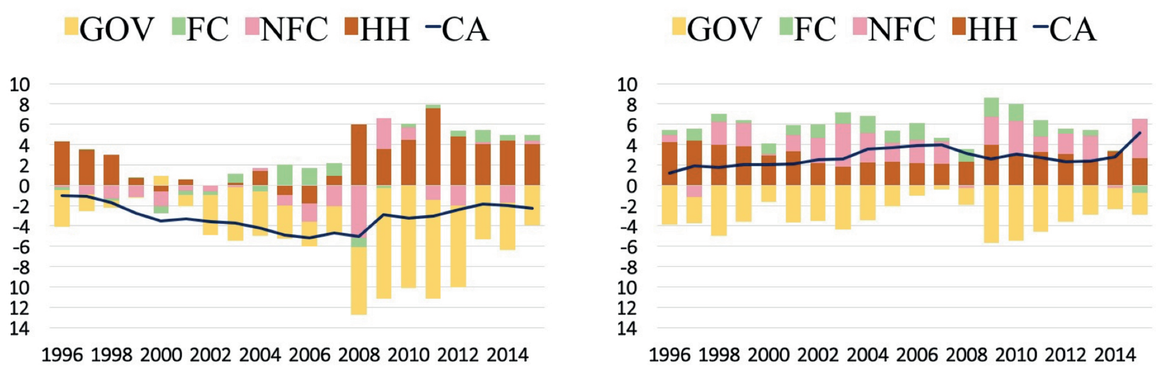
$$CA = NFB^{HH} + NFB^{GOVT} + NFB^{NFC} + NFB^{FC} \tag{2}$$

With the Net Financial Balance (**NFB**) of each sector: household (**HH**), government (**GOV**), non-financial corporation (**NFC**), and financial corporation (**FC**) sector

$$NFB^{sector} = SAV^{sector} - INV^{sector} \tag{3}$$

Typically, we expect the NFC sector to run a net deficit, i.e to borrow in order to fund investment, and the HH sector to run a net surplus, i.e to be a net saver, with FC intermediating the funds ⇒**less true today!**

Figure 1 : Sectoral Contribution to Current Account Balances (% GDP)



(a) Deficit Countries (b) Surplus Countries

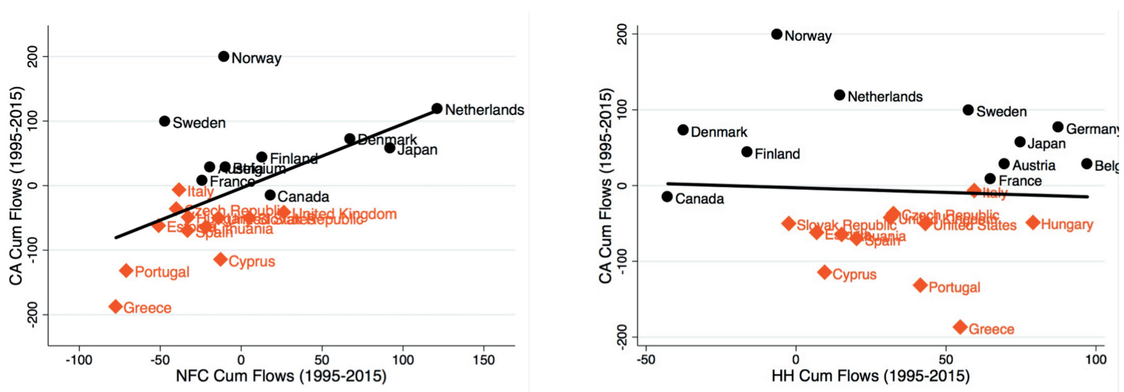
We re-examine through this lens:

① The standard medium-term covariates of the current account

② The current account adjustment since the crisis

③ Episodes of persistent current account deficits and surpluses

Strong correlation between Current Account & NFC sector, but surprisingly no relationship with Household sector



(c) NFC (d) HH

Note: Cumulative flows in % of GDP. Deficit countries in red, surplus countries in black

1 The standard covariates of the Current Account are associated with NFC & GOV sectors

Panel OLS estimation over the 1995-2015 period (3-year non-overlapping average + time fixed effects)

$$\begin{aligned} CA_{it} &= \alpha + \beta X_{it} + \epsilon_{it} && => R^2 = 60\% \\ NFB^{HH}_{it} &= \alpha + \beta X_{it} + \epsilon_{it} && => R^2 = 16\% \\ NFB^{GOV}_{it} &= \alpha + \beta X_{it} + \epsilon_{it} && => R^2 = 57\% \\ NFB^{NFC}_{it} &= \alpha + \beta X_{it} + \epsilon_{it} && => R^2 = 39\% \\ NFB^{FC}_{it} &= \alpha + \beta X_{it} + \epsilon_{it} && => R^2 = 04\% \end{aligned} \tag{4}$$

⇒ X_{it} is the standard set of current account fundamentals: terms of trade, credit, GDP growth, GDP per capita and demographics

2 The post-crisis external adjustment is mainly reflected in improvements in NFC sector

Positive GAP: pre-crisis current account balance in excess of values explained by underlying fundamentals

Negative GAP: pre-crisis current account balance lower than values explained by underlying fundamentals

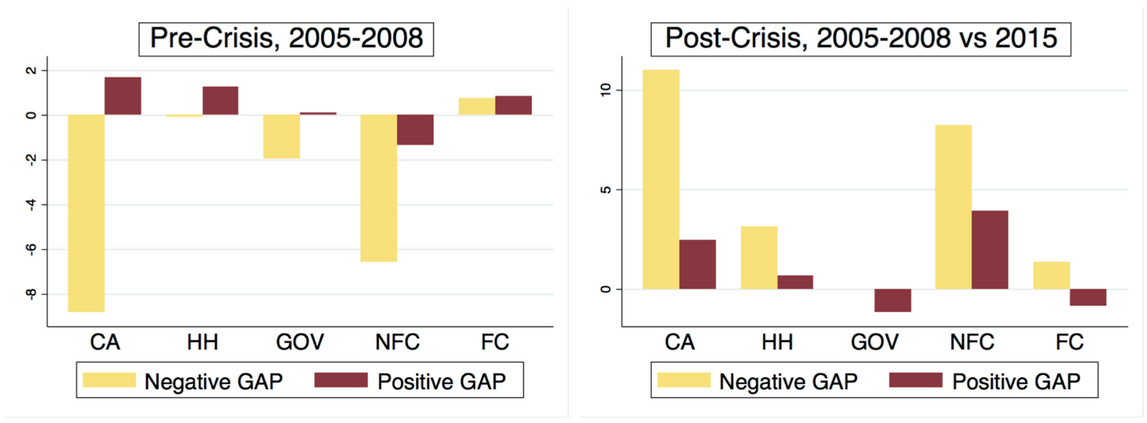


Figure 3 : Average Adjustment Conditional on Pre-Crisis Current Account Gap (% GDP)

3 During large Current Account episodes: no change in dynamics of HH sector

Average net sectoral balance during current account episodes ($> 3\%$ or $< -3\%$ of GDP):

	CA	HH	GOV	NFC	FC
Current Account Deficit	-7.0	2.0	-3.8	-4.9	-4.8
Current Account Surplus	7.0	3.2	0.6	0.5	1.3
No Current Account Episode	-0.2	3.0	-3.2	-0.2	0.8

Main References

- Lane, P. R. and Milesi-Ferretti, G. M. External adjustment and the global crisis. *Journal of International Economics*, 2012.
- Lane, P. R. Risk Exposures in International and Sectoral Balance Sheet Data. *World Economics*, October 2015.

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