

Cyclical Reaction of Fiscal Policy and its Relationship with the Current Account Balance

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We investigate whether cyclicalities explain the heterogeneous response, reported in previous literature, of the current account to changes in government spending. This research is motivated by the growingly central role played by fiscal policy in macroeconomic stabilization. Thereby, understanding its effects has become essential to devise and implement efficient policies.

The analysis is based on the estimation of a modified version of the current account present value model for a sample of 51 countries, over the period 2002Q1-2018Q4. The model is used to analyze effects of shocks to both aggregate and disaggregate components of fiscal spending. To account for the heterogeneity within our sample, we adopt Pedroni (2013) heterogeneous structural panel VAR approach and complete our study with a Bayesian time series VAR by country.

We confirm the importance of cyclicalities in the response of the current account to aggregate spending shocks, but not to shocks in the underlying disaggregate spending categories. We also find that government spending is more likely to influence the current account through property income (interest payments) and subsidies rather than through wages and intermediate consumption.

JEL classification: E62, F32, F44

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