

JEL Classification Numbers
C32, E21, F32

Summary of
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"Macroeconomic Uncertainty, Precautionary Savings, and the
Current Account" by Atish R. Ghosh and Jonathan D. Ostry

The relationship between external current account developments and changes in the macroeconomic environment remains a key issue in open-economy macroeconomics. Modern theories of current account determination have viewed the current account as a buffer to smooth consumption in the face of shocks to output, investment, and government expenditure. For the most part, models of the current account have assumed perfect foresight, implying that there is no ex ante uncertainty regarding the future values of various macroeconomic variables (income, government spending) that affect consumption and saving decisions today. Indeed, the term "shock" in these models merely refers to a onetime change in the exogenous variables--events to which agents are assumed to have assigned a zero probability.

This paper examines whether the insights afforded by existing intertemporal models of the current account remain valid once uncertainty is explicitly incorporated. The intertemporal model of the current account is extended to include the effects of precautionary savings and is tested empirically. It is shown that the greater the uncertainty in national cash flow--defined as output less investment less government expenditure--the greater is the precautionary demand for savings and, other things being equal, the larger will be the current account surplus. Empirical support for the model is found using quarterly data from four large industrial countries.