

An Absorption Approach to Modeling the US Current Account

Juann H. Hung , Edward N. Gamber 

First published: 14 April 2010

<https://doi.org/10.1111/j.1467-9396.2010.00867.x>

Accessibility issue? [Request accessibility update.](#)



Abstract

This paper derives and estimates a current account model based on the absorption approach (which views the current account balance as the difference between domestic saving and investment). This approach provides a framework which allows drivers of cross-border financial flows and other determinants of saving and investment to be included in a current account model, an advantage not offered by the elasticity approach (which views the current account balance as the sum of net exports, net investment income, and net unilateral transfer). We estimate and compare vector error-correction models of the absorption and elasticity approaches, with the absorption model nesting the elasticity model. We find that (1) the restrictions imposed by the elasticity model are rejected; and (2) the mean-squared prediction errors of the absorption model are significantly smaller than those of the elasticity model.

References

Aizenman, Joshua and Yothin Jinjarak, "Current Account Patterns and National Real Estate Markets," NBER working paper 13921, July (2008).

[Google Scholar](#) 

Bertaut, Carol C., Steven B. Kamin, and Charles P. Thomas, "How Long Can the Unstable US Current

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

Cheung, Yin-Wong and Kon S. Lai, "Finite-Sample Sizes of Johansen's Likelihood Ratio Tests for Cointegration," *Oxford Bulletin of Economics and Statistics* 55 (1993): 313-28.

[Web of Science®](#) | [Google Scholar](#)

Chinn, Menzie D. and Eswar Prasad, "Medium-Term Determinants of Current Accounts in Industrial and Developing Countries: An Empirical Exploration," *Journal of International Economics* 59 (2003): 47-76.

[Web of Science®](#) | [Google Scholar](#)

Clark, Todd E. and Ken D. West, "Approximate Normal Tests for Equal Predictive Accuracy in Nested Models," *Journal of Econometrics* 138 (2007): 291-311.

[Web of Science®](#) | [Google Scholar](#)

EIEWS 6.0 User's Guide II, Quantitative Micro Software, Irvine, California, January (2007).

[Google Scholar](#)

Fratzcher, Marcel, Luciana Juvenal, and Lucio Sarno, "Asset Prices, Exchange Rates and the Current Account," ECB working paper 790, August (2007).

[Google Scholar](#)

Gagnon, Joseph E., "Long-Run Supply Effects and the Elasticities Approach to Trade," Federal Reserve Board, International Finance discussion paper 754, January (2003).

[Google Scholar](#)

Goldstein, Morris and Mohsin S. Khan, "Income and Price Effects in Foreign Trade," in Ronald R. Jones and Peter B. Kenen (eds), *Handbook of International Economics*, Vol. 2, Amsterdam and New York: North-Holland/Elsevier (1985): 1041-105.

[Web of Science®](#) | [Google Scholar](#)

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

Gruber, Joseph W. and Steven B. Kamin, "Explaining the Global Pattern of Current Account Balances," *Journal of International Money and Finance* 26 (2007): 500-22.

[Web of Science®](#) | [Google Scholar](#)

Harberger, Arnold C., "Currency Depreciation, Income, and the Balance of Trade," *Journal of Political Economy* 58 (1950): 47-60.

[Web of Science®](#) | [Google Scholar](#)

Hausmann, Ricardo, M. and Federico Sturzenegger, "US and Global Imbalances: Can Dark Matter Prevent a Big Bang?" available at http://www.cid.harvard.edu/cidpublications/darkmatter_051130.pdf, 13 November (2005).

[Google Scholar](#)

Hooper, Peter, Karen Johnson, and Jaime Marquez, "Trade Elasticities for the G-7 Countries," *Princeton Studies in International Economics*, No. 87, Princeton, NJ: Princeton University (2000).

[Google Scholar](#)

Hung, Juann H. and Angelo Mascaro, "Return on Cross-Border Investment: Why Does US Investment Abroad Do Better?" Congressional Budget Office Technical Paper No. 2004-17, Washington, DC: Congressional Budget Office (2004).

[Google Scholar](#)

Isard, Peter and Hamid Faruquee, "Exchange Rate Assessment: Extensions of Macroeconomic Balance Approach," IMF occasional paper 167 (1998).

[Google Scholar](#)

Isard, Peter, G. Russell Kincaid, and Martin J. Fetherston, "Methodology for Current Account and Exchange Rate Assessments," IMF occasional paper 209 (2001).

[Google Scholar](#)

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

[Google Scholar](#) 

Laursen, Svend and Lloyd A. Metzler, "Flexible Exchange Rates and the Theory of Employment," *Review of Economics and Statistics* 32 (1950): 281–99.

[Web of Science®](#)  | [Google Scholar](#) 

Lee, Jaewoo, Gian Maria Milesi-Ferretti, Jonathan David Ostry, Alessandro Prati, and Luca Antonio Ricci, "Exchange Rate Assessments: CGER," IMF occasional paper 261 (2008).

[Google Scholar](#) 

Mackinnon, James G., Alfred A. Haug, and Leo Michelis, "Numerical Distribution Functions of Likelihood Ratio Tests for Cointegration," *Journal of Applied Econometrics* 14 (1999): 563–77.

[Web of Science®](#)  | [Google Scholar](#) 

Marquez, Jaime, "Bilateral Trade Elasticities," *Review of Economics and Statistics* 72 (1990): 70–77.

[Web of Science®](#)  | [Google Scholar](#) 

Obstfeld, Maurice, "Aggregate Spending and the Terms of Trade: Is There a Laursen–Metzler Effect?" *Quarterly Journal of Economics* 97 (1982): 251–70.


[Web of Science®](#)  | [Google Scholar](#) 

Obstfeld, Maurice, "Capital Mobility in the World Economy: Theory and Measurement," *Carnegie-Rochester Conference Series on Public Policy* 24 (1986): 55–103.

[Google Scholar](#) 

Punzi, Maria Teresa, "The Link between Housing Prices and Current Account Deficit: A Study of 10 OECD Countries," manuscript, Boston College Department of Economics (2007).

[Google Scholar](#) 

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#) 

[Manage Preferences](#)

[Accept All](#)

[Reject Non-Essential](#)

ABOUT WILEY ONLINE LIBRARY

[Privacy Policy](#)

[Terms of Use](#)

[About Cookies](#)

[Manage Cookies](#)

[Accessibility](#)

[Wiley Research DE&I Statement and Publishing Policies](#)

HELP & SUPPORT

[Contact Us](#)

[Training and Support](#)

[DMCA & Reporting Piracy](#)

[Sitemap](#)

OPPORTUNITIES

[Subscription Agents](#)

[Advertisers & Corporate Partners](#)

CONNECT WITH WILEY

[The Wiley Network](#)

[Wiley Press Room](#)

Copyright © 1999-2026 John Wiley & Sons, Inc or related companies. All rights reserved, including rights for text and data mining and training of artificial intelligence technologies or similar technologies.

WILEY

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)



[Manage Preferences](#)

[Accept All](#)

[Reject Non-Essential](#)