

## **Session 6: Theories of the current account**

### **The traditional approach to the current account**

1. Derive a relationship between national savings, investments and the current account in an open economy. Thereby, give possible sources of a current account deficits.
2. What is the “twin deficit hypothesis”?

### **The intertemporal approach to the current account**

3. Derive a transition from the traditional approach to the intertemporal approach to the current account as, for example, used in Obstfeld and Rogoff, “Foundations of International Macroeconomics”, p. 1-11.
4. Derive the two period model as shown in Obstfeld and Rogoff, “Foundations of International Macroeconomics”, p. 1-11.
5. Why is intertemporal trade a good thing? Can you show this “gains of trade” graphically? What is the role of the current account?
6. Reconsider the twin deficit hypothesis. Can you distinguish between cases when government budget deficits that are followed by CA deficits and cases when they are not?
7. Based on the knowledge you have from the previous questions, give the basic idea of the intertemporal approach to the current account.

### **On the sustainability of current account deficits**

8. When loses a country the creditworthiness of a current account imbalance?
9. List ‘soft’ sources of possibly unsustainable CA deficit.