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The Latest REM Working Papers

The center of **Research in Economics and Mathematics** (REM) circulates research, notably by its affiliated members, as working papers intended for professional and public discussion and comment. The papers have not been peer reviewed.

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Events

For your 2021 calendar:

9th UECE Conference on Economic and Financial Adjustments, ISEG/UL – Lisbon School of Economics and Management/University of Lisbon, **July 30, 2021**. Submissions until **15 June 2021**, to rem@iseg.ulisboa.pt

INFER 2021, 23rd Annual Conference, ISEG/UL – Lisbon School of Economics and Management/University of Lisbon, **September 8-10, 2021.** Submissions until **14 June 2021**, via Conference Maker: https://editorialexpress.com/conference/INFER2021.

REM Working Papers

Current Account Targeting Hypothesis versus Twin Deficit Hypothesis: the EMU experience of Portugal, António Afonso, José Carlos Coelho, *Working Paper 0182-2021*

We study the relationship between the government budget balance and the current account balance for Portugal, using quarterly data from 1999 to 2019. On the one hand, the causality tests find a unidirectional relation running from the current account balance to the government budget balance. On the other hand, IV estimations show a bi-directional relationship between these variables, and the existence of a bilateral relationship between the structural components of both balances. Even so, the policy implication is that the use of fiscal policy to correct the external imbalance, especially in an economic crisis, is not substantial, due to the small size of the estimated impact. In addition, with an ARDL model, we find a negative long run relationship between the share of public consumption on GDP and the current account balance. As expected, the variation of real public consumption produces an adverse accumulated response on the current account balance. Finally, the investment rate negatively affects the cyclical component of the current account balance and contributes to the structural improvement of the budget balance.

Is Macroprudential Policy Driving Savings?, André Teixeira, Zoë Venter, *Working Paper 0181-2021*

This paper shows that the recent surge in savings is a result of tighter macroprudential policy. Using a difference-in-differences approach with staggered treatment adoption, we find that households in EU countries that adopted macroprudential policy between 2000 and 2019 increased their savings up to one third more than households in countries without macroprudential policy. Furthermore, our results indicate that the loan-to-value ratio explains most of the variation on savings. Finally, we find that a longer exposure to macroprudential policy exacerbates savings with searing consequences on growth.

Uncertainty and Effectiveness of Public Consumption, Eduardo de Sá Fortes Leitão Rodrigues, *Working Paper 0180-2021*

This article investigates how increased uncertainty affects the effectiveness of public consumption on economic activity. The paper examines three main issues: first, the influence of uncertainty on output and macroeconomic aggregates. Second, the effects of public consumption on the economy. Third, the impact of a simultaneous shock of uncertainty and government consumption on economic activity. We use Vector Autoregression (VAR) models for the United States, Brazil and a panel VAR with six European countries. The empirical results indicate a disruptive effect of uncertainty on GDP, private consumption, investment and hours worked. The fiscal effects point to slightly different results for the two countries. For Brazil and the United States, the increase in public spending has positive and significant effects on GDP. Regarding the effects of government consumption (high uncertainty), the fiscal effects are not statistically significant, while in times of low uncertainty the effects are positive and significant. Subsequently, we designed a Dynamic Stochastic General Equilibrium (DSGE) model akin to Basu and Bundick (2017), and added three features: tax on labor income, the relationship between private consumption and government consumption and a simultaneous shock of uncertainty and government consumption. The model highlights four main conclusions. First, the negative influence of uncertainty on economic activity. Second, risk aversion magnifies the impact of the macroeconomic response. Third, public consumption has positive effects on economic activity. Finally, we examine the sensitivity of the economy's responses to different configurations of the relationship between public and private consumption, under normal conditions or uncertainty shocks. The findings suggest that, when the economy is hit by a simultaneous shock of uncertainty and public consumption, it obscures the effectiveness of the fiscal stimulus on the economy, corroborating the empirical results.