

## **From CAB to CAAB? Correcting Indicators of Structural Fiscal Positions for Current Account Imbalances**

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A series of EU countries, most notably New Member States but also some euro-area countries, experienced in the past decade absorption booms (phases of buoyant domestic demand) that were coupled with widening current account deficits. Strong growth in absorption during the boom phase had a positive effect on fiscal revenue, which contributed to very sizeable improvements in the fiscal accounts. In some cases, however, the increase in absorption was "excessive", and reflected a deviation from fundamentals. With hindsight, there is also growing awareness that current account imbalances were, in many instances, aggravated by fiscal policy ineffectively leaning against the wind during good times. Moreover, it was also observed that, when the external imbalances underwent a sharp correction following the global crisis of 2008, the fiscal position abruptly shifted from apparently sound to large deficits and, in some cases, distressed situations.

Building on the above considerations, this paper discusses ways to construct indicators for the conduct of fiscal policy that permit to take into account not only the impact of the output cycle but also phases where absorption, and therefore the current account, deviate from prudent paths. Building on previous work by Jaeger and Klemm (2007), the paper shows that compared with the conventional cyclically-adjusted budget balance (CAB), correcting budgetary indicators also for absorption booms and busts permits to dispose of a better gauge of the structural fiscal position in countries experiencing large swings in their current account, and that the difference between this alternative cyclically and absorption-adjusted budget balance (CAAB) and the CAB was in some instances large among EU countries in the past decade. The paper also shows by means of DSGE model simulations that disposing of an appropriate calibration of the fiscal impulse would have mattered considerably for some countries undergoing boom-bust cycles: this would have implied a more prudent fiscal stance, smoother output dynamics, and contained macroeconomic imbalances.