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MACROECONOMIC DETERMINANTS OF CURRENT ACCOUNT DEFICIT IN ETHIOPIA

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ABSTRACT

Current account balance is typically used as one of the main leading indicators for future behavior of an economy and is part of the everyday decision process of policy makers. This study aims at examining the empirical links between current account deficit and macroeconomic variables in Ethiopia. To accomplish this, data on gross national savings, national income variables, fiscal deficit, exports, real effective exchange rate, and black market premium have been collected on annual time series data for the period 1973/74-2008/09. We have adopted econometric techniques to separate the long-run and short-run effects of the selected variables. The major findings include current account deficit in Ethiopia is moderately persistent in the long run. A rise in real domestic output growth generates a larger current account deficit. On the other hand, increases in national savings rates have a significant negative effect on the current account both in the long and short run. Budget deficit affects current account deficit positively or there is “Twin Deficit” in Ethiopia. The increase in exports is associated with significant reduction in the current account only in the short run. Nevertheless, shocks that increase (cause to appreciate) the real exchange rate are linked with significant higher current account deficit both in the long and short run. The findings of the study imply that there is a need for sound macroeconomic policies and strategies that improve the competitiveness of Ethiopia’s exports; reduce budget deficit; and results in the depreciation of real exchange rate in the long run.

KEYWORDS: Current account deficit, ECM, Ethiopia, Single dynamic modeling, Twin Deficit

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