

Consumption Smoothing and Precautionary Saving for Norway and Canada

Felix Fosu

Exporters of crude oil commonly experience high income and consumption fluctuation due to non-renewability of the resource and volatility in the resource revenue. As a way of overcoming these challenges, these countries accumulate large external asset by periodically holding surplus current account balance; partly to smooth consumption across generations and partly to cushion income and consumption against unexpected revenue shocks. This study employs an open and oil dependent economy-based model to estimate the optimal current account balance for two oil exporting countries under two different oil price models - A Markov switching and non-Markov price frameworks. We further investigate the role of consumption smoothing motive and precautionary saving motive in the current account path. We find that consumption smoothing component explains much of the variations in net foreign assets position of the two countries, especially Norway. Precautionary savings on the other hand is small relative to the former, but adding it improves the overall fit of the model under the non-Markov price framework.