Current Account Sustainability in Latin America Considering Nonlinearities

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We test current account sustainability based on the framework developed by Hakkio and Rush [1991] and Husted [1992] using a two-regime threshold vector error correction model. This methodology allows us to characterize short-run nonlinearities in the current account. We estimate the model for four Latin American economies: Chile, Brazil, Colombia, and Mexico. We find a long-run relationship between the current account components, which implies strong sustainability for Chile and Mexico and weak sustainability for Colombia and Brazil. For the first two countries, the predominant regime is associated with a current account surplus. In contrast, for Colombia and Brazil, the prevailing regime corresponds to a situation in which there is a long- run deficit. In general, the impulse response analysis shows that expenditure and income shocks have positive and significant responses in the predominant regime for both series.