

Balancing the Balance of Payment

What is the issue?

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• New RBI data on India's Balance of Payments for 2017-18 was released recently.

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 With CAD expected to widen, it is essential to assess the overall Balance of Payments (BoP) position of India.

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What does the data reveal?

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- ${\bf CAD}$ The RBI data show current account deficit (CAD) at around \$48 bn.
- This is the highest since the record \$88 bn of 2012-13.
- \bullet CAD is expected to widen to \$75 bn during this fiscal. $\ensuremath{\backslash n}$

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• **Forex** - India's forex reserves stands at around \$424 billion as on March 2018.

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• This is actually the eighth largest in the world.

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What does it imply?

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 \bullet The current reserves can finance 10.9 months of imports. $\ensuremath{^{\text{h}}}$

- This is better when compared to 7.8 months in March 2014.
- The RBI's current forex war chest is clearly sufficient.
- This can meet the immediate import needs.
- It could also keep away currency value fluctuations.
- Given these, any anticipation of a "crisis" position is highly misplaced.

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What then is the concern?

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• Countries generally accumulate reserves by exporting more than importing.

- IMF data on the current account balances reveals this nature.
- Top 10 forex reserves holders have been running surpluses year after year.
- This is however barring India and Brazil.
- **India** has always had deficits on its merchandise trade account.
- Its value of imports of goods is far in excess of that of exports.
- However, India has traditionally enjoyed a <u>surplus on its 'invisibles' account.</u>
- \bullet Invisibles basically cover receipts from export of software services. $\ensuremath{\backslash n}$
- \bullet Inward remittances by migrant workers, and tourism also form part of this. $\mbox{\ensuremath{^{\mbox{\sc h}}}}$
- On the other side, it includes payments towards interest, dividend and royalty on foreign loans, investments and technology/brands.
- Besides it includes payments on banking, insurance and shipping services.
- \bullet However, invisibles surpluses have not largely exceeded trade deficits. $\ensuremath{\backslash} n$
- This has resulted in the country <u>consistently registering CADs</u>.

How has India been managing this deficit?

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• India and Brazil represent unique cases of economies that have built reserves.

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• This was largely on the <u>strength of the capital rather than current account</u> of the BoP.

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• Thus, India has been managing these years with CADs, and still accumulating reserves.

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• This is because foreign exchange comes not only from exporting but also from <u>capital flows</u>.

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• It could be by way of foreign investment, commercial borrowings or external assistance.

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- For most years, net capital flows into India have been more than CADs.
- The **surplus capital flows** have, then, gone into building reserves.

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Is this a sustainable model?

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- \bullet It is to be noted that there have also been years with reserves depletion. $\ensuremath{^{\backslash n}}$
- This was due to net capital inflows not being adequate to fund even the CAD.
- Expecting foreign capital to bridge the gap between exports and imports would not be ideal.

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How does the future look?

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• **CAD** - The CAD fell sharply from 2012-13 to 2016-17.

- This was mainly because of India's oil import bill nearly halving.
- However, in 2017-18, the CAD has risen due to resurgent global crude prices.

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- Furthermore, CAD is expected to cross \$75 billion this fiscal.
- Inflows There are signs of capital flows slowing down as well. \n
- Foreign portfolio investment in India also reflects the larger sell-off pattern across emerging market economies.

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- This is primarily in response to profitable rising interest rates in the US.
- The Swiss investment bank Credit Suisse's has forecasted on net capital flows to India for 2018-19.

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- Being \$55 bn, it is far lower than the projected CAD of \$75 bn.
- **Reserves** Eventually, forex reserves may decline for the first time since 2011-12.

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• The RBI's data already show the total official reserves as in June at \$413.11 bn.

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This is a dip of around \$ 11 bn over the level of end-March 2018.

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How to deal with it?

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• Favourable <u>growth prospects</u> are essential to attract capital flows to fund CADs.

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- The <u>investment environment</u> of the country should also be conducive.
- \bullet Notably, it is better if these investments go towards augmenting the economy's manufacturing and services export capacities. \n
- This, instead of simply producing or even importing for the domestic market, would be better.

 \bullet In the long run, this can help $\underline{\text{narrow the CAD}}$ to more sustainable levels. $\ensuremath{\backslash n}$

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Source: Indian Express

