Capital Account

Prelims: *Current events of national and international importance | Economy*

Why in news?

India has a structural capital account deficit (CAD) problem in external balance of payments (BOP) transactions.

- **BOP (Balance of Payments) –** A record of all economic transactions (goods, services, investments, transfers) between a country and the rest of the world over a period.
- **3 components of BOP –** Current account, Capital account & Financial account.
    - **Current Account –** It records trade in goods (visible items) and services (invisible items), includes unilateral transfers like remittances, gifts, and donations.
    - **Capital Account –** It tracks capital transactions such as purchase/sale of land, property, and fixed assets, includes loans, borrowings, investments, and foreign exchange reserves. It helps to finance deficits in the current account.
    - **Financial Account –** It records cross-border investments in real estate, business ventures, FDI, and portfolio investments, it shows changes in ownership of assets between domestic and foreign entities.
- **Current Account Deficit (CAD)** – A situation where the value of goods, services, and transfers a country imports is greater than what it exports.
- **Impact –** A persistent CAD can signal a country's reliance on foreign capital, affecting exchange rates and economic stability.
- **Role of Capital Inflows –** Normally, India finances its CAD through capital inflows -
    - Foreign Portfolio Investment (FPI)
    - Foreign Direct Investment (FDI)
    - External Commercial Borrowings (ECBs)
- When these inflows dry up, the rupee faces pressure because the balance

of payments cannot be sustained.

- **Current Situation –** Foreign capital inflows have ***sharply declined***, especially FPIs, but ***this is contradictory*** because India's GDP growth remains strong, yet investors are pulling back.
- **Net Capital Inflows Plunged -** Net foreign capital inflows hit a 16-year low of **$18 billion in 2024-25**, falling below the CAD of **$23.1 billion** for the same fiscal year.
- **Continued Shortfall -** The trend continued in April-September 2025, with only **$8.6 billion** in net capital inflows against a CAD of **$15.1 billion**.
- **Pressure on Rupee -** This imbalance (inflows < CAD) means insufficient dollars are coming in to cover the deficit, creating downward pressure on the rupee.
- **Reasons include** – Global monetary tightening (higher US interest rates), risk aversion among investors, concerns about India's external vulnerabilities.

Difference between a Current Account and Capital Account

	Current Account	Capital Account
Meaning	Looks at the trade balance, net income, and direct payments of a nation.	Evaluation of capital expenditures and capital investments.
Components	Exports/imports, investment income, and transfers	Foreign direct investment, portfolio investment, and foreign loans
Measures	Exports and imports of a nations goods and services	Trading of foreign assets and liabilities
Balance of Payment	Negative balance equal to net borrower Positive balance equal to net lender	Surplus equal to inflow of money Deficit equal to outflow of money
Represents	Trade balance of a nation, direct payments, and net income.	Capital investments and expenditures

References

1. Indian Express | Why the rupee has a capital account problem
2. Investopedia | Current vs. Capital Accounts



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