Challenges in current account deficit

Why in news?

\n\n

IMF recently forecasted India's current account deficit (CAD) to widen to 2.6 percent of GDP in 2018/19 from 1.9 percent in the previous year.

\n\n

What are the recent developments that affected CAD?

\n\n

\n
- Value of oil imports has risen, even though these have been offset by increases in net factor incomes from abroad.
\n
- This lead to a balance between balance of trade and balance of invisibles in the current account.
\n
- Stronger dollar growth and the negative events in Argentina and Turkey impacted many such emerging markets due to **deteriorating emerging-market sentiment** among investors.
\n

\n\n

What are the structural factors surrounding CAD in India?

\n\n

\n
- India's GDP growth is largely driven by consumption that are largely import-intensive.
\n
- A depreciating rupee should result in a fall in import demand and a rise in export demand through the price effect.
\n
- The situation gets different altogether in India, wherein exports respond mainly to improvements in productivity and to changes in global demand.
\n
- This made our exports highly **inelastic to exchange rate depreciation**.

\n
- Since 1991, import intensity of the Indian economy has risen steadily.
\n
- It has been fuelled by increased elite prosperity and their luxury consumption needs instead of importing food and other items of mass consumption.
\n
- Key growing sectors like defence, aviation, and electronics have failed to secure significant import substitution in recent times.
\n
- New import-intensive sectors have emerged as in cheap clothing from Bangladesh and Vietnam and solar panels from Japan and China.
\n
- India also raised its **import of non-tradeables** wherein forex spent on education and recreational travel abroad raised from $176 million in 2013 to $5.4 billion in 2017.
\n

\n\n

What does the recent Nomura Damocles Index say?

\n\n

\n
- It assesses the risk of exchange rate crisis for 30 emerging market economies.
\n
- A score above 100 suggests a country is vulnerable to an exchange rate crisis in the next 12 months.
\n
- With moderation in CPI inflation and the CAD, alongside sufficient forex reserve buffer, **India scored 25** and was well **within the safety threshold**.
\n
- Yet, higher oil prices, portfolio outflows and a sharper-than-expected domestic growth slowdown still remains as its key vulnerabilities.
\n

\n\n

How should India proceed?

\n\n

\n
- Encouraging FDI and FPI inflows could be the immediate strategy to arrest the rising CAD.
\n

- That would make CAD to stabilise at levels which our growing mega-economy would easily finance by attracting **stable capital inflows**.
  \n
- But in the long term, India should moderate the CAD by orienting her **domestically driven growth** to foster substitution in imports.
  \n
- Hence, India’s external account challenge is structural and it requires a **continuing, orderly depreciation of the rupee**, which would eventually reduce the pace of import growth and encourage export growth.
  \n

\n\n

Source: Business Standard

\n\n

\n\n

\n\n

\n\n

\n

