External Sector Turbulence

What is the issue?

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- India’s external sector is becoming more vulnerable and less resilient due to various issues.
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- Government need to take long term measures to address the rising concerns.
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What are the external sector related concerns faced by India?

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- Current account deficit of India stands at $15.8 billion or 2.4 per cent of GDP.
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- In the case of portfolio investments the net inflows stood at $5.3 billion but substantial net capital outflow is around $8.1 billion.
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- This resulted in a depletion of $11.3 billion of the foreign exchange reserves (on a BoP basis) as against an accretion of $11.4 billion in Q1 of 2017-18.
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- In aggregate, the outflows from the outstanding forex reserves over end-March 2018 till date September 2018 were $25.26 billion.
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- Income elasticity of demand for India’s export has remained stagnant and, therefore, the share of India’s export remained constant at 1.7 per cent in the world export.
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What are the reasons behind such concerns?

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- The slide in the value of the rupee has led to rise in the current account deficit and a substantial net capital outflow.
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- Persistent rise in crude price and the pressure of rising protectionism in world trade is severely affecting India's trade.
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- Protracted stagnation in competitiveness is another important factor is the movement in the Real Effective Exchange Rate (REER).
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- Apart from this the firming up of the US growth rate and appreciation of the US dollar against major currencies has also brought a host of trouble to India.
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- All such interlinked and collective factors have resulted in India's external sector becoming more vulnerable and less resilient.
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What measures were taken in this regard?

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- Government had taken non-monetary measures like restrictions on non-essential imports like finished electronics, certain textiles, automobiles, high-end consumer products.
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- Government has also removed 5 per cent withholding tax on masala bonds, removal of the foreign portfolio investor exposure limits in corporate bonds and a freer ECB regime.
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- The measures taken together are expected to garner $8-10 billion.
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- There are also plans to adjust the Real Effective Exchange Rate by the RBI.
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What are the issues with government's measure?

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- Essentially, the measures are of two types: restriction on imports; and

encouragement of debt inflows.
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- Import restrictions are fine as tools for crisis management but they go against the spirit of reform.
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- Further, measures like the relaxation on “masala” bonds and ECBs amount to a quick fix just to postpone the problem.
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- The burgeoning CAD could not be financed in a non–disruptive manner as the net capital inflows were not adequate.
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- The rise in REER in India is lower than in many economies, however those economies are not seeing such a crash in their currency value as India because they do not suffer from a high CAD.
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- At a conceptual level, increase in the REER index reflects diminishing competitiveness.
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- Thus, the recent measures announced by the authorities may provide some short-term relief.
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What measures need to be considered?

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- The sustainable solution to India’s problem is encouraging Greenfield FDI and non-oil exports such as iron and steel, non-ferrous metal, and automobiles.
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- Efforts should also be made to further strengthen exports of marine products and chemicals, It is important in this regard to enhance quality-control measures.
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- The trend of the direction of exports is required to be shifted towards the Middle East and North Africa, apart from the US, China and the EU.
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- This is the long haul, and this requires clear policies and prioritisation at India’s end.
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Source: Business Line

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