Issues with external account

What is the issue?

\n\n

India’s external account faces several structural issues that needs to be addressed.

\n\n

What are the recent happenings?

\n\n

\n
- The rupee became the worst performing Asian currency recently.
\n
- This was attributed to the rising interest rates of the developed countries from near-zero levels, which led the exit of portfolio investors from emerging markets.
\n
- Also, emerging market currencies have been declining relative to the dollar with increased demand for dollars to finance oil imports.
\n
- India has been placed among the group of countries whose currencies were particularly vulnerable.
\n
- India’s current account deficit(CAD) has been widened from $14.4 billion in 2016-17 to $48.7 billion in 2017-18.
\n
- There are also projections that CAD will at 2.6 per cent of GDP in 2018-19.
\n

\n\n

What are the structural weaknesses?

\n\n

\n
- **Oil Imports** - India’s net petroleum products import bill which stood at $83 billion in 2015-16, has risen to touch $109 billion with the rise in international price of Brent crude.

\n
- This made the trade deficit has risen by around 50% in 2017-18 to touch $162.2 billion.
\n
- But, given the multiple, technological and geopolitical factors affecting oil prices, such volatility will always prevail.
\n
- So, ensuring balance of payments resilience requires an ability to ride through periods of high oil prices, without further fall in rupee value.
\n
- **Balance of trade** - India was the largest recipient among developing countries of remittances from abroad and a highly successful exporter of software and IT-enabled services.
\n
- This should have boosted the receipts and enabled India to have a strong and resilient current account.
\n
- But the total of receipts from private transfers and from net exports of Telecom, Computer and Information Services either stagnated or declined since 2014-15.
\n
- Hence neutralising the increase in revenue outflow in the trade balance through additional forex is getting difficult.
\n
- **Revenue neutralisation** - Imports of IT and electronics goods is now matching or exceeding receipts from software and IT-enabled exports.
\n
- This is reflected in the fact that the value of imports of Electronic Goods within the Capital Goods Category **stands at 70%** in 2017-18 of the receipts from net exports of Telecom, Computer and Information Services.
\n
- Moreover, demand from both the government and the private sectors has arisen for such products with India holding less leverage in the domestic production of such products.
\n
- This has undermined the role of IT-enabled services exports as a source of forex earnings that can make the balance of payments more resilient.
\n
- **Capital outflow** – The RBI says that the net outflow of portfolio capital amounted to $8.1 billion in the first quarter of 2018-19, as compared with an inflow of $12.5 billion in the corresponding quarter of the previous year.
\n
- RBI’s open market operations, designed to provide some backing to the rupee, drained India’s forex reserves, which fell by $25 billion from its recent

peak of around $425 billion.
\n

\n\n

What lies ahead?

\n\n

\n
- Given these structural weaknesses in the current account, India is deeply vulnerable when faced with outflows of investment on the capital account.
\n
- The rupee’s recent depreciation had initially been dismissed as reflecting global developments that affected all emerging markets, and not just India.
\n
- Thus, rather than just attributing shifts in monetary policy in the advanced nations as a reason, India should also focus on the structural weaknesses in its external account to address rupee volatility.
\n

\n\n

Source: Business Line

\n

