Widening Current Account Deficit

Why in news?

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A recent data has revealed that India's Current Account Deficit (CAD) has widened to 2.4 % of GDP in the first quarter of 2017-18, which is the highest in the last four years.

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What is CAD?

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- CAD refers to the deficit arising out of the difference between inflow and outflow of foreign exchange as a result of imports and exports.
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- CAD stood at $14.3 billion in the first quarter of the current financial year.
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- This was valued at 2.4% of gross domestic product, compared to 0.1% last year.
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What are the reasons for its increase?

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- **Trade -** Imports overall rose by over 20% year-on-year in August.
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- On the other hand, exports rose by only 10% in the same period.
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- The resultant higher trade deficit has translated into higher CAD.
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- Half of the rise in this import is contributed by the spike in gold imports prior to the introduction of GST.
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- **Exchange Rate** - Rupee has appreciated by over 6% against the dollar this year.

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- An over-valued currency has resulted in reduced margins and made exports uncompetitive; thus an imbalance in trade in favour of imports.

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How did India manage inspite of higher CAD?

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- **Capital Account Surplus -** India was able to pay its import bills easily due to a strong capital account surplus.
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- Foreign investors have pumped huge sums into India as it remains one of the few places offering higher yields.
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- Net FDI almost doubled in the first quarter this year.
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- Also, net FPI jumped about six times to $12.5 billion.
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- **External Debt -** India's total external debt also declined by 2.7% during the financial year 2016-17.
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- However, this is not a sustainable solution to the problem.
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What are the risks of this trend?

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- A large CAD to GDP is viewed as making a country more vulnerable to sudden stops or reversals in foreign capital inflows.
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- There are signs that the U.S.Federal reserves & some other western central banks are considering a monetary policy tightening.
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- This will impact the foreign investment flows to India.
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- This might also push the Rupee into a downward spiral.
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What should be done?

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- The imbalance in trade is now to be resolved by boosting exports.
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- The blockage of funds under GST and uncertainties has left little or no working capital at the disposal of exporters.
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- Focussing on manufacturing in the labour-intensive sectors would bring the double benefits of boosting exports and generating employment.
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- Efforts are needed to reduce paperwork and costly over-regulation so as to make exporting easier.
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- Besides, RBI should keep a check on the external commercial borrowings to keep debt under control.
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Source: Business Standard

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