Balancing the Balance of Payment

What is the issue?

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- New RBI data on India's Balance of Payments for 2017-18 was released recently.
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- With CAD expected to widen, it is essential to assess the overall Balance of Payments (BoP) position of India.
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What does the data reveal?

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- **CAD** - The RBI data show current account deficit (CAD) at around $48 bn.
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- This is the highest since the record $88 bn of 2012-13.
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- CAD is expected to widen to $75 bn during this fiscal.
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- **Forex** - India's forex reserves stands at around $424 billion as on March 2018.
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- This is actually the eighth largest in the world.
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What does it imply?

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- The current reserves can finance 10.9 months of imports.
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- This is better when compared to 7.8 months in March 2014.
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- The RBI’s current forex war chest is clearly sufficient.
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- This can meet the immediate import needs.
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- It could also keep away currency value fluctuations.
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- Given these, any anticipation of a “crisis” position is highly misplaced.
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What then is the concern?

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- **Countries generally** accumulate reserves by exporting more than importing.
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- IMF data on the current account balances reveals this nature.
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- Top 10 forex reserves holders have been running surpluses year after year.
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- This is however barring India and Brazil.
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- **India** has always had deficits on its merchandise trade account.
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- Its value of imports of goods is far in excess of that of exports.
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- However, India has traditionally enjoyed a surplus on its ‘invisibles’ account.
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- Invisibles basically cover receipts from export of software services.
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- Inward remittances by migrant workers, and tourism also form part of this.
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- On the other side, it includes payments towards interest, dividend and royalty on foreign loans, investments and technology/brands.
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- Besides it includes payments on banking, insurance and shipping services.
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- However, invisibles surpluses have not largely exceeded trade deficits.
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- This has resulted in the country consistently registering CADs.
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How has India been managing this deficit?

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- India and Brazil represent unique cases of economies that have built reserves.
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- This was largely on the strength of the capital rather than current account of the BoP.
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- Thus, India has been managing these years with CADs, and still accumulating reserves.
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- This is because foreign exchange comes not only from exporting but also from capital flows.
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- It could be by way of foreign investment, commercial borrowings or external assistance.
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- For most years, net capital flows into India have been more than CADs.
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- The **surplus capital flows** have, then, gone into building reserves.
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Is this a sustainable model?

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- It is to be noted that there have also been years with reserves depletion.
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- This was due to net capital inflows not being adequate to fund even the CAD.
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- Expecting foreign capital to bridge the gap between exports and imports would not be ideal.
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How does the future look?

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- **CAD** - The CAD fell sharply from 2012-13 to 2016-17.
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- This was mainly because of India’s oil import bill nearly halving.
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- However, in 2017-18, the CAD has risen due to resurgent global crude prices.
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- Furthermore, CAD is expected to cross $75 billion this fiscal.
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- **Inflows** - There are signs of capital flows slowing down as well.
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- Foreign portfolio investment in India also reflects the larger sell-off pattern across emerging market economies.
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- This is primarily in response to profitable rising interest rates in the US.
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- The Swiss investment bank Credit Suisse's has forecasted on net capital flows to India for 2018-19.
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- Being $55 bn, it is far lower than the projected CAD of $75 bn.
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- **Reserves** - Eventually, forex reserves may decline for the first time since 2011-12.
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- The RBI’s data already show the total official reserves as in June at $413.11 bn.
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- This is a dip of around $ 11 bn over the level of end-March 2018.
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How to deal with it?

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- Favourable growth prospects are essential to attract capital flows to fund CADs.
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- The investment environment of the country should also be conducive.
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- Notably, it is better if these investments go towards augmenting the economy’s manufacturing and services export capacities.
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- This, instead of simply producing or even importing for the domestic market, would be better.
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- In the long run, this can help narrow the CAD to more sustainable levels.
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Source: Indian Express

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