

Widening Current Account Deficit

Why in news?

\n\n

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.

\n\n

What is CAD?

\n\n

\n

- CAD refers to the deficit arising out of the difference between inflow and outflow of foreign exchange as a result of imports and exports.

\n

- CAD stood at \$14.3 billion in the first quarter of the current financial year.

\n

- This was valued at 2.4% of gross domestic product, compared to 0.1% last year.

\n

\n\n

What are the reasons for its increase?

\n\n

\n

- **Trade** - Imports overall rose by over 20% year-on-year in August.

\n

- On the other hand, exports rose by only 10% in the same period.

\n

- The resultant higher trade deficit has translated into higher CAD.

\n

- Half of the rise in this import is contributed by the spike in gold imports prior to the introduction of GST.

\n

- **Exchange Rate** - Rupee has appreciated by over 6% against the dollar this year.

\n

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

\n

\n\n

How did India manage inspite of higher CAD?

\n\n

\n

- **Capital Account Surplus** - India was able to pay its import bills easily due to a strong capital account surplus.

\n

- Foreign investors have pumped huge sums into India as it remains one of the few places offering higher yields.

\n

- Net FDI almost doubled in the first quarter this year.

\n

- Also, net FPI jumped about six times to \$12.5 billion.

\n

- **External Debt** - India's total external debt also declined by 2.7% during the financial year 2016-17.

\n

- However, this is not a sustainable solution to the problem.

\n

\n\n

What are the risks of this trend?

\n\n

\n

- A large CAD to GDP is viewed as making a country more vulnerable to sudden stops or reversals in foreign capital inflows.

\n

- There are signs that the U.S. Federal reserves & some other western central banks are considering a monetary policy tightening.

\n

- This will impact the foreign investment flows to India.

\n

- This might also push the Rupee into a downward spiral.

\n

\n\n

What should be done?

\n\n

\n

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

\n

\n\n

\n\n

Source: Business Standard

\n

