Widening of Current Account Deficit

What is the issue?

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- RBI's preliminary data on India's balance of payments (BoP) for July-September 2018-19 was released recently.
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- It highlights the damage caused by high global oil prices and thus calls for appropriate policy response from the government.
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What is the CAD state?

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- Current Account Deficit (CAD) is the difference between outflow and inflow of foreign exchange in the country's current account.
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- India’s CAD widened to 2.9% of gross domestic product (GDP) in the July-September quarter, a four-year high.
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- This is in contrast to the same quarter a year ago when the CAD was only 1.1% of GDP.
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- The widening of the CAD was due to an increase in the trade deficit.
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- Trade deficit jumped to $50 billion in the September quarter as compared to $32.5 billion a year ago.
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- This is due to a higher import bill, largely under the increasing pressure from the oil bill.
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Is it a cause for concern?

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- The major factor that was behind the Current Account Deficit phenomenon is the global oil prices.
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- This has declined now as the global oil prices have dropped sharply since early October.
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- Brent crude is down almost 30% from the high it reached in early October.
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- The size of the deficit is thus likely to come down in the quarter ending December.
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- So, the government may not be too worried about the widening CAD figures.
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What is the need for caution?

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- Despite the above, as usual, medium to long-term risks to the external sector remain, with widening CAD.
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- There is the threat of price volatility faced by heavy importers of oil, a perennial threat to economic stability.
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- India, thus, has to diversify its energy base by tapping into local sources of energy.
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- **Inflows** - As long as foreign capital inflows into the economy are brisk enough to fund the huge import needs, widening CAD is not a worry.
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- But the trouble arises when foreign inflows dry up and restrict the ability to purchase essential imports.
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- So as liquidity conditions continue to tighten across the world, India's heavy import dependence is a cause for concern.
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- Also, if Western central banks tighten their monetary policy, the RBI will be forced to tighten its own policy stance.
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- On the one hand, this would be essential to retain investment capital and defend the rupee.
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- But on the other, this will impact domestic economic growth negatively.
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What should be done?

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- Each time the external account has come under pressure, the government has simply tried to bring in piecemeal emergency measures.
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- These include a little opening up of the capital account or restrictions on imports.
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- But such a policy is less likely to bring a permanent solution to the problem.
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- In order to bring about any meaningful change, the government should also try implementing proper structural reforms.
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- This would boost exports and help fund imports through means other than capital inflows, and end the over-reliance on imported oil.
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Source: The Hindu

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