Source : www.livemint.com Date : 2021-07-02

A WIDENING CURRENT ACCOUNT DEFICIT IS BOTH GOOD NEWS AND BAD

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

The CAD stood at $8.2 billion for the March quarter, or 1% of gross domestic product (GDP), according to the latest data. The key factor was the 19% growth in imports.

India’s widening current account deficit (CAD) brings relief on the economic growth front, especially since it was led by imports growth. But the increase in imports comes along with a global commodity price surge, a sure path towards inflationary pressures.

The CAD stood at $8.2 billion for the March quarter, or 1% of gross domestic product (GDP), according to the latest data. The key factor was the 19% growth in imports. An increase in imports, especially non-oil and non-gold, points to a pick-up in domestic economic growth. Indeed, the fourth quarter numbers indicate that recovery has gained strength after restrictions imposed in the wake of the pandemic were eased.

Analysts at IDFC First Bank said imports, excluding oil and gold, were higher at $5.5 billion. “This is reflective of improvement in domestic demand conditions as restriction had eased and covid-19 cases had reduced," they wrote in a note.

Analysts are hopeful that with faster vaccination, growth recovery would gain traction and this would reflect in the CAD through increase in imports. “Going forward, with vaccinations gaining critical mass in H2 (we expect 60% of the population to get inoculated with a single dose before the end of 21 December), the pace of normalization in economic activity would gather momentum," wrote analysts at QuantEco Ltd, an independent economic research firm.

Rising imports may mean recovery, but they also spell trouble on the inflation front. The increase in imports comes along with a broad-based surge in key global commodity prices. From crude oil to steel, prices of most commodities have galloped in the past few months. This would only add to domestic inflationary pressures through the import route.

The situation complicates the Reserve Bank of India’s (RBI’s) policy response to growth. As such, retail inflation has surged to over 6% in April. Input cost pressures are already visible and producers may soon begin to pass this on once they see demand coming back. Analysts at HSBC said the faster increase in retail inflation compared to wholesale prices shows that producers have begun to pass on their costs to consumers.

“A closer look revealed a faster rise in the consumer price index (CPI) inflation momentum compared to wholesale price index (WPI) inflation, likely led by more pass-through of higher input costs, higher oil prices and logistical disruptions due to the lockdowns," they wrote in a note.

This will challenge an already complicated situation for the Reserve Bank. The central bank’s forex policy would perhaps be at the centre stage, as it manages imported inflation with a desired CAD. In all probability, RBI will tone down its forex interventions given the widening of CAD. The exchange rate’s gains would somewhat dull the inflation stemming from imports.

END