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THE LOWDOWN ON CURRENT ACCOUNT DEFICIT

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Foreign capital, Foreign Trade & BoP

The current account measures the flow of goods, services and investments into and out of the country. We run into a deficit if the value of the goods and services we import exceeds the value of those we export. The current account includes net income, including interest and dividends, and transfers, like foreign aid.

India’s current account deficit (CAD) is pegged at $13 billion or 1.9% of the GDP in Q4 of 2017-18, which increased from $2.6 billion or 0.4% of the GDP in Q4 of 2016-17. However, the CAD moderated marginally from $13.7 billion (2.1% of GDP) in the preceding quarter.

For the quarter, the Reserve Bank of India attributed the widening of the CAD to a higher trade deficit ($41.6 billion) brought about by a larger increase in merchandise imports related to exports. For the full financial year, the CAD increased to 1.9% of the GDP in 2017-18 from 0.6% in 2016-17 on the back of a widening of the trade deficit. India’s trade deficit increased to $160 billion in 2017-18 from $112.4 billion in 2016-17.

The central bank wants to see the current account gap within 2.5% of the GDP, which is seen as crucial for currency stability. For example, the CAD touched a high of 4.8% of the GDP in 2012-13 on rising gold and oil imports, which also impacted the rupee that depreciated rapidly. High current account deficit forced the government to impose import restrictions on non-essential items like gold.

As the rupee is under pressure — it hit the 71-mark against the dollar on Friday — and oil prices are inching up, it will impact the current account. While the present depreciation is mainly due to external factors with the dollar strengthening against all emerging market currencies, the rising trade deficit is adding to the worry about the currency. The rupee is the worst performing currency among the emerging market economies in Asia, and depreciated over 9% against the dollar in the current financial year. The central bank is also not seen intervening aggressively, according to currency dealers. As a result, the rupee, in a short span of time, travelled from the mid-68 levels to 71 a dollar. The foreign exchange reserves, also seen as an important factor for currency stability, have depleted by $26 billion since April, due to sporadic interventions by the central bank to control the pace of fall in the currency.

The July trade deficit numbers have had an impact on the currency. According to data released by the government, a sharp surge in imports led to worsening of the trade deficit to $18.02 billion against a deficit of $11.45 billion during July 2017. Imports during July were $43.79 billion, representing a growth of 28.81%, compared to $33.99 billion a year ago.

The government attributed the increase to a sharp increase in crude oil prices — global Brent crude prices increased 53.16% in July, compared to the same period the previous year. The oil import bill, which saw a 57% increase, and a 41% jump in gold imports to $2.96 billion in July are seen as the main reasons for the high trade deficit.

Since a higher trade deficit will widen the current account deficit, the rupee could be under pressure from domestic factors also, economists have said. A huge current account gap could make the rupee depreciate further in the absence of meaningful intervention from the central bank.

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