



Current Account Deficit

For Prelims: Current Account Deficit, Balance of Payments, Forex Reserve.

For Mains: Factors on which Current Account Deficit depends and measures to deal with it.

Why in News?

Recently, an American financial services company Morgan Stanley has predicted that the **Current Account Deficit** will widen to a 10-year high of 3% of GDP in FY23.

What are the Key Points?

- In the wake of continued **geopolitical tensions**, the **surge in oil prices** is likely to be sustained, which would lead to deterioration in the current account deficit from a higher oil import bill.
- The **Balance of Payments (BoP)** to be in deficit of approximately 0.5-1% of **GDP (Gross Domestic Product)** because capital flows are likely to be lower than the current account deficit.
- The extent of vulnerability to funding risks **will be cushioned by the large forex reserves**, which stand at USD 681 billion.
- The company expects the April 2022 policy to mark the process of **policy normalization** with a reverse repo rate hike. However, if the RBI were to delay its normalization process, the risk of disruptive policy rate hikes would rise.
- There is **less room for fiscal policy stimulus to support growth** given high deficit and debt levels - it is seen that there is a possibility **of a modest fuel tax cut and reliance on the national rural employment program** as an automatic stabilizer.

PYQ

Consider the following actions which the Government can take: (2011)

1. Devaluing the domestic currency.
2. Reduction in the export subsidy.
3. Adopting suitable policies which attract greater FDI and more funds from FII's.

Which of the above action/actions can help in reducing the current account deficit?

- (a) 1 and 2
- (b) 2 and 3
- (c) 3 only
- (d) 1 and 3

Ans: (d)

What is the Current Account Deficit?

- A current account deficit occurs **when the total value of goods and services a country imports exceeds** the total value of goods and services it exports.
 - The balance of exports and imports of goods is referred to as the trade balance. Trade Balance is a part of 'Current Account Balance'.
- According to an earlier report of 2021, **High Oil Imports, High Gold Imports are the** major driving force, widening the CAD.

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With reference to Balance of Payments, which of the following constitutes/constitute the Current Account? (2014)

1. Balance of trade
2. Foreign assets
3. Balance of invisibles
4. Special Drawing Rights

Select the correct answer using the code given below:

- (a) 1 only
- (b) 2 and 3
- (c) 1 and 3
- (d) 1, 2 and 4

Ans: (c)

What is Balance of Payments?

- **About:**
 - BoP of a country can be defined as **a systematic statement of all economic transactions of a country with the rest of the world** during a specific period, usually one year.
- **Purposes of Calculation of BoP:**
 - Reveals the financial and economic status of a country.
 - Can be used as an indicator to determine whether the country's currency value is **appreciating or depreciating**.
 - Helps the Government to decide on fiscal and trade policies.
 - Provides important information to analyze and understand the economic dealings of a country with other countries.
- **Components of BoP:**
 - For preparing BoP accounts, economic transactions between a country and the rest of the world are grouped under - Current account, Capital account and Errors and Omissions. It also shows changes in Foreign Exchange Reserves.
 - **Current Account:** It shows export and import of visibles (also called merchandise or goods - represent trade balance) and invisibles (also called non-merchandise).
 - Invisibles include services, transfers and income.
 - **Capital Account:** It shows a capital expenditure and income for a country.
 - It gives a summary of the net flow of both private and public investment into an economy.
 - **External Commercial Borrowing (ECB), Foreign Direct Investment, Foreign Portfolio Investment**, etc form a part of capital account.
 - **Errors and Omissions:** Sometimes the balance of payments does not balance. This imbalance is shown in the BoP as errors and omissions. It reflects the country's inability to record all international transactions accurately.

- **Changes in Foreign Exchange Reserves:** Movements in the reserves comprises changes in the foreign currency assets held by the **Reserve Bank of India (RBI)** and also in **Special Drawing Rights (SDR)** balances.
- Overall the BoP account **can be a surplus or a deficit**. If there is a deficit then it can be bridged by taking money from the Foreign Exchange (Forex) Account.
 - If the reserves in the forex account are falling short then this scenario is **referred to as BoP crisis**.

PYQ

Which of the following constitute a Capital Account? (2013)

1. Foreign Loans
2. Foreign Direct Investment
3. Private Remittances
4. Portfolio Investment

Select the correct answer using the codes given below:

- (a) 1, 2 and 3
- (b) 1, 2 and 4
- (c) 2, 3 and 4
- (d) 1, 3 and 4

Ans: (b)

Source: TH

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