Rising Current Account Deficit

Why in News

According to **a recent report by British brokerage Barclays, India's trade deficit has been jumping continuously since July 2021.** The **widening** [Current Account Deficit (CAD)] is driven by the **massive spike in commodity prices led by crude oil.**

- The CAD is **expected to reach $45 billion or 1.4% of GDP by March 2021.** This will put **pressure on the fragile economic recovery.**

Key Points

- **Definition:** 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'.**
- **Factor involved in India's Current Account Deficit:**
    - **High Oil Imports:** In India, close to 85% of the oil demand is met through imports.
        - Due to this it is estimated that every $10 per barrel rise in global crude prices will widen the trade deficit by $12 billion or 35 bps of **Gross Domestic Product (GDP)**.
    - **High Gold Imports:** Another force driving down the foreign exchange is gold imports.
        - Recovering domestic demand and the ongoing festive season are boosting Gold imports.
        - The **World Gold Council** expects gold demand this year to surpass the 2020 levels and it expects the demand for gold to remain high given the rising wealth effects and incomes.
    - **Services, the Positive side:** The report held that the monthly services surplus has improved from an average of $6.6 billion in 2019 to $7 billion in 2020, and to $8 billion in the first nine months of 2021.
- **Overall Impact**: The report ruled out an alarming situation and said that **with** record high foreign reserves**, there are no major risks to macro stability or balance of payments conditions.**
    - However, the widening deficit trend may continue for some time as a combination of demand recovery and rising commodity prices will continue to widen the trade deficit sharply.

Balance of Payments

- **Definition:**
    - Balance of Payments (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**.

Source: TH