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Issues with external account

What is the issue?

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India’s external account faces several structural issues that needs to be addressed.

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What are the recent happenings?

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- The rupee became the worst performing Asian currency recently.
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- This was attributed to the rising interest rates of the developed countries from near-zero levels, which led the exit of portfolio investors from emerging markets.
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- Also, emerging market currencies have been declining relative to the dollar with increased demand for dollars to finance oil imports.
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- India has been placed among the group of countries whose currencies were particularly vulnerable.
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- India’s current account deficit(CAD) has been widened from $14.4 billion in 2016-17 to $48.7 billion in 2017-18.
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- There are also projections that CAD will at 2.6 per cent of GDP in 2018-19.
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What are the structural weaknesses?

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- **Oil Imports** - India's net petroleum products import bill which stood at $83 billion in 2015-16, has risen to touch $109 billion with the rise in international price of Brent crude.
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- This made the trade deficit has risen by around 50% in 2017-18 to touch $162.2 billion.
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- But, given the multiple, technological and geopolitical factors affecting oil prices, such volatility will always prevail.
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- So, ensuring balance of payments resilience requires an ability to ride through periods of high oil prices, without further fall in rupee value.
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- **Balance of trade** - India was the largest recipient among developing countries of remittances from abroad and a highly successful exporter of software and IT-enabled services.
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- This should have boosted the receipts and enabled India to have a strong and resilient current account.
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- But the total of receipts from private transfers and from net exports of Telecom, Computer and Information Services either stagnated or declined since 2014-15.
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- Hence neutralising the increase in revenue outflow in the trade balance through additional forex is getting difficult.
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- **Revenue neutralisation** - Imports of IT and electronics goods is now matching or exceeding receipts from software and IT-enabled exports.
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- This is reflected in the fact that the value of imports of Electronic Goods within the Capital Goods Category **stands at 70%** in 2017-18 of the receipts from net exports of Telecom, Computer and Information Services.
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- Moreover, demand from both the government and the private sectors has arisen for such products with India holding less leverage in the domestic production of such products.
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- This has undermined the role of IT-enabled services exports as a source of forex earnings that can make the balance of payments more resilient.
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- **Capital outflow** – The RBI says that the net outflow of portfolio capital amounted to $8.1 billion in the first quarter of 2018-19, as compared with an inflow of $12.5 billion in the corresponding quarter of the previous year.

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- RBI's open market operations, designed to provide some backing to the rupee, drained India's forex reserves, which fell by $25 billion from its recent peak of around $425 billion.
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What lies ahead?

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- Given these structural weaknesses in the current account, India is deeply vulnerable when faced with outflows of investment on the capital account.
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- The rupee's recent depreciation had initially been dismissed as reflecting global developments that affected all emerging markets, and not just India.
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- Thus, rather than just attributing shifts in monetary policy in the advanced nations as a reason, India should also focus on the structural weaknesses in its external account to address rupee volatility.
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Source: Business Line

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