Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about the current account deficit and its significance; reasons for its contraction; about balance of payments; OPEC

News: Data released by the Reserve Bank of India (RBI) shows India’s current account deficit (CAD) reduced to 0.9% of GDP in the second quarter of 2019-20 from 2% in the first, primarily due to a lower trade deficit.

Is it a reason to cheer?

India’s CAD shrunk in the second quarter as imports contracted, while exports posted a modest growth. Given the current slowdown, lower imports point to weak demand rather than a better trade position.

What makes up current account?

Current account is essentially a record of all trade, net transfers and earning transactions of a country with the rest of the world. Therefore, current account has four essential components.

1. The first is trade, the net value of goods and services.
2. The second is net income, defined as income earned by residents from the rest of the world minus the income paid to foreigners.
3. The third is direct transfers, which record net remittances, and
4. the fourth is asset income.

Current account is said to be in surplus when the value of exports is greater than that of imports; it is in deficit when the value of imports is higher.

Why is it bad if the trade deficit is high?

International trade has become an important political economy issue in advanced economies such as the US and the UK. Developed economies have become concerned with the extent of their CADs and have used trade policies to reduce
them. This isn’t new as mercantilism was widely practiced in the 16-18th centuries when countries focused on using state regulations to maximize exports to increase the wealth of a nation. Most countries want to export more goods than they import, implying that a country will get more income than it spends. India, maintains a high current account deficit along with a fiscal deficit.

What’s the reason for a contraction in India’s CAD?

India’s CAD contracted from $19 billion in the second quarter of 2018-19 to $6.3 billion during the corresponding period of 2019-20. The data shows that this contraction is primarily because of a lower trade deficit. Also, net services receipts have increased by 0.9%. So, while imports have shrunk, exports have posted a modest growth, leading to a contraction in CAD.

What about concerns regarding oil prices?

A major component of our import bill is crude. The value of our imports is sensitive to movements in global oil prices, which are contingent on geopolitical factors, besides economic considerations of the Organization of the Petroleum Exporting Countries (OPEC), an important player in the global oil market. Oil from Canada, Brazil and the US also plays an important role in determining overall supply and, thus, prices. Despite tensions in West Asia, prices have been subdued and are likely to remain comfortable due to the supply glut.

Is a contraction in CAD not a good thing?

A contraction in CAD may be good during a normal growth year, but it is a cause of concern during a slowdown. The bulk of India’s imports is for self-consumption, so their contraction is a sign of weak demand rather than of a better trade position. Low growth has led to lower imports. Once growth picks up, imports will rise. RBI should look at the value of the rupee and intervene to avoid its appreciation due to a lower CAD and net positive capital flows.