



# 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](#)

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