Factors behind moderating CAD

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What's in today's article?

Why in news?

- There are indications that the current account deficit (CAD) will moderate despite the global slowdown triggered by the rising inflation and interest rates.

What is Current Account Deficit (CAD)?

- The current account deficit is a measurement of a country's trade where the value of the goods and services it imports exceeds the value of the products it exports.

- The current account includes net income, including interest and dividends, and transfers, like foreign aid.
- It represents a country's foreign transactions and, like the capital account, is a component of a country's balance of payments (BOP).

What is the significance of CAD?

- CAD and the fiscal deficit together make up the twin deficits – the enemies of the stock market and investors.
- If the current account shows surplus, that indicates money is flowing into the country, boosting the foreign exchange reserves and the value of rupee against the dollar.
- While an existing deficit can imply that a country is spending beyond its means, having a current account deficit is not inherently disadvantageous.
  - If a country uses external debt to finance investments that have higher returns than the interest rate on the debt, the country can remain solvent while running a current account deficit.
  - If a country is unlikely to cover current debt levels with future revenue streams, however, it may become insolvent.

What are the causes of Current Account Deficit (CAD)?

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Image Caption: Causes of CAD

What is the level of CAD in India?

- According to the RBI, the CAD was at $36.4 billion for the quarter ending September 2022 and is expected to moderate in the second half of 2022-23.
  - CAD for the first half of 2022-23 stood at 3.3% of GDP.
- The situation has shown improvement in Q3:2022-23 as imports moderated in the wake of lower commodity prices, resulting in narrowing of the merchandise trade deficit.

What are the factors responsible for moderating CAD?

- The moderation in CAD was aided by:
  - the fall in commodity prices,
  - rising workers remittances and services exports, and
  - abatement of selling pressure by foreign investors.

- Recently, there has been sharp drop in imports which also led to the moderation of CAD. This sharp decline in imports was due to:
    - Non-oil imports falling, mainly due to a price impact;
    - Softening in domestic demand post the festive season;
    - Seasonal impact of the Chinese New Year holidays.

How will moderating CAD impact the market?

- While rising CAD raises concerns among investors as it hurts the currency and thereby the inflow of funds into the markets, a notable decline in CAD in January has improved market sentiments.
- Experts say that CAD is very important for the currency.
    - The value of an economy hinges a lot on the value of its currency and thereby, it also supports the equity markets by keeping the fund flow intact.

What is the growth outlook of Indian economy?

- **Capital inflows are expected to increase**
    - There is a perception in the markets that capital flows could come under some pressure with China's reopening.
    - However, inflows are expected to increase to the economy on the whole as India is expected to witness one of the highest growth rates among large economies.
    - At a time when the economies of many developed markets are expected to take a hit, the RBI has projected the GDP growth for the next fiscal (FY2024) at 6.4%.
    - The Union Budget has indicated a capital expenditure of Rs 10 lakh crore (over $ 120 billion).
    - Moreover, with the rise in interest rates in India after the RBI hiked the repo rate by 250 basis points to 6.50%, non-resident Indian deposits, remittances, and FPI investment in debt are expected to rise further.
    - NRI deposits had increased by $3.62 billion to $134.49 billion in the April-November period of 2022.
- **There is optimism among global investors about India**
    - The fundamentals around growth are significant – young population, 100s of millions of people speaking English and India has more engineers than anywhere else in the world.
    - India has a government now that is oriented towards growth. As more infrastructure comes into the country, it will continue to grow at a much faster rate than the rest of the world.
    - Hence, global investors see tremendous opportunity in India.

Q1) What is Fiscal Deficit?

When the government spends more than its total income, such a situation is called a fiscal deficit. It is calculated by subtracting the total income from the total expenditure and is either expressed in absolute terms or as a percentage of the GDP (Gross Domestic Product).

Q2) What Is the Balance of Payments?

The balance of payments (BOP) is a statement of all transactions made between entities in one country and the rest of the world over a defined period of time.

Source: Factors behind moderating CAD, how it will impact markets | Investopedia | Business Standard