Capital Account

6.62 According to the projections of the latest WEO (September 2005) of the IMF, after robust growth in 2003 and 2004, private capital inflows were expected to moderate during 2005 and 2006 for emerging market and developing economies. While longer term direct investment inflows were expected to remain stable, portfolio flows of the shorter variety were expected to decline. Emerging Asia (comprising economies of developing Asia and the Newly Industrialised Asian economies, i.e. Indonesia, Malaysia, Philippines and Thailand) was also not an exception to the trend. According to the WEO, net private capital flows were expected to decline from US$132.9 billion in 2004 to US$84.6 billion in 2005 for emerging Asia, primarily on account of net portfolio outflows, while direct investment inflows (net) were expected to increase marginally to US$84.2 billion in 2005 from U$81.6 billion in 2004. The projected moderation in capital flows was mainly due to an expected tightening of global financial markets with enhanced inflationary expectations induced by higher energy prices.

6.63 So far, in India, however, there have not been any signs of dampening of portfolio flows. Between 2002-03 and 2004-05, the capital account surplus grew steadily from US$10.6 billion to US$31.6 billion (Table 6.2). The growth was driven mainly by foreign investment inflows, out of which portfolio flows, comprising chiefly foreign institutional investment (FII) inflows, were the leading contributors.

6.64. Since 1990-91, India's capital account has experienced several interesting changes in terms of the relative roles played by different varieties of capital flows in augmenting the overall balance. Between 1998-99 and 2001-02, the share of foreign investment in the overall capital account balance increased steadily from 29 per cent to 80 per cent. Thereafter, however, the proportion has followed an oscillating pattern within a band of 39 to 79 per cent. It appears that the importance of debt-creating flows in the overall balance of payments increased with the emergence of a current account deficit in 2004-05. Debt-creating flows comprising external assistance, commercial borrowings and non-resident deposits, after being negative for two successive years, were 19 per cent of the capital account surplus in 2004-05. This trend in debt-flows appears to have continued in 2005-06.