Balance of Payments (BOP)

6.6 The year 2004-05 marked a significant departure in the structural composition of India's balance of payments (BOP), with the current account, after three consecutive years of surplus, turning into a deficit (Table 6.2). In a significant transformation, the current account deficit, observed for 24 years since 1977-78, had started shrinking from 1999-00. The contraction gave way to a surplus in 2001-02, which continued until 2003-04. However, from a surplus of US$14.1 billion in 2003-04, the current account turned into a deficit of US$5.4 billion in 2004-05. The deficit was caused by a burgeoning excess of merchandise imports over exports, which was left uncompensated by the net surplus in invisibles. While the magnitude of the deficit is one of the highest in recent times, it underscored the rising investment demand in the economy. As a proportion of GDP, the turnaround in the current account balance was from a surplus equivalent to 2.3 per cent in 2003-04 to a deficit of 0.8 per cent in 2004-05 (Table 6.3).

6.7 The turnaround in the current account during 2004-05 was accompanied by a significant strengthening of more than 80 per cent in the capital account resulting in continued reserve accretion (Table 6.2). Compared with 2003-04, when loan inflows had turned into net outflows, such inflows shot up rapidly during 2004-05 and bolstered the size of the capital account surplus with good support from robust foreign investment inflows. Reserve accumulation during 2004-05, at around four-fifths of such accumulation during 2003-04, maintained India's status as one of the largest reserve-holding economies in the world.

Table 6.2 : Balance of Payments : Summary#

(in US $ million)

	1990-91	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	(April-Sept.)	
									2004-05	2005-06
1. Exports	18477	34298	37542	45452	44703	53774	66285	82150	36715	44761
2. Imports	27915	47544	55383	57912	56277	64464	80003	118779	51483	76396
Of which : POL	6028	6399	12611	15650	14000	17640	20569	29844	14578	20834
3. Trade balance	**-9438**	**-13246**	**-17841**	**-12460**	**-11574**	**-10690**	**-13718**	**-36629**	**-14768**	**-31635**
4. Invisibles (net)	-242	9208	13143	9794	14974	17035	27801	31229	14283	18679
Non-factor services	980	2165	4064	1692	3324	3643	10144	14199	5980	9512
Income	-3752	-3544	-3559	-5004	-4206	-3446	-4505	-3814	-1917	-3078
Pvt. transfers	2069	10280	12256	12854	15398	16387	21608	20253	9968	12043
Official transfers	461	307	382	252	458	451	554	591	252	202
5. Current Account Balance	**-9680**	**-4038**	**-4698**	**-2666**	**3400**	**6345**	**14083**	**-5400**	**-485**	**-12956**
6. External assistance (net)	2204	799	891	410	1117	-3128	-2858	1923	346	436
7. Commercial borrowing (net)@	2254	4367	333	4303	-1585	-1692	-2925	5040	1526	2752
8. IMF (net)	1214	-393	-260	-26	0	0	0	0	0	0
9. NR deposits (net)	1536	961	1540	2316	2754	2978	3642	-964	-1334	174
10. Rupee debt service	-1192	-802	-711	-617	-519	-474	-376	-417	-279	-142
11. Foreign investment (net)	101	2312	5117	5862	6686	4161	13744	12147	2490	7411
of which :										
(i) FDI (net)	96	2380	2093	3272	4734	3217	2388	3240	1979	2304
(ii) FIIs	0	-390	2135	1847	1505	377	10918	8280	339	4227
(iii) Euro equities & others	5	322	889	743	447	567	438	627	172	880
12. Other flows (net)+	2284	623	3930	-3739	-96	8795	6111	13830	4672	8827
13. Capital account total (net)	**8401**	**7867**	**10840**	**8509**	**8357**	**10640**	**17338**	**31559**	**7421**	**19458**
14. Reserve use (- increase)	**1279**	**-3829**	**-6142**	**-5842**	**-11757**	**-16985**	**-31421**	**-26159**	**-6936**	**-6502**

 # Actuals.
@ Figures include receipts on account of India Development Bonds in 1991-92, Resurgent India Bonds in 1998-99 and India Millennium Deposits in 2000-01 and related repayments, if any, in the subsequent years.
+ Include, among others, delayed export receipts and errors & omissions.
Source : Reserve Bank of India.

6.8 The broad trends observed in the current and capital accounts in 2004-05 have been maintained during 2005-06. The current account continues to be in deficit with the size of the deficit during the first half of the current year (April-September 2005) almost twenty seven times that of the deficit in the corresponding previous period (Table 6.2). Indeed, the current account deficit of US$5.3 billion during the first quarter (April-June 2005) itself was almost equivalent to the deficit for the whole of 2004-05. During the second quarter (July-September 2005), the deficit became even larger (US$7.7 billion) after growing at almost 45 per cent over and above that of the previous quarter. The rapidly enlarging trade deficit, buoyed by remarkable import growth, has been pushing the current account deficit. During the period 2001-02 to 2003-04, the invisibles (net) always overcame the trade deficit to maintain the current account in surplus. However, the trend was reversed in 2004-05 and appears to be continuing in 2005-06 (Table 6.3). At present, India is one of the few leading economies in the South East Asian region to have a fairly large current account deficit (Box 6.2).

6.9 The widening of the current account deficit has been accompanied by a similar widening of the capital account surplus. The capital account surplus during the first half of the current year has been more than one and a half times the surplus in the corresponding period of the previous year (Table 6.2). Moreover, between the first and second quarters, while the current account deficit increased by 45 per cent, the capital account surplus almost doubled in size (US$12.9 billion in July-September 2005 vis-à-vis US$6.5 billion in April-June 2005). Since 2002-03, much of the strengthening of India's capital account has emanated from augmentation of non-debt creating foreign investment (net) inflows, particularly Foreign Institutional Investor (FII) inflows. During the current year,

Table 6.3 : Selected indicators of external sector

								(April-Sept.)	
	1990-91	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2004-05	2005-06
1. Growth of Exports - BOP (%)	9.0	9.5	21.1	-1.6	20.3	23.3	23.9	29.5	21.9
2. Growth of Imports - BOP (%)	14.4	16.5	4.6	-2.8	14.5	24.1	48.5	38.3	48.4
Of which, POL (%)	60.0	97.1	24.1	-10.5	26.0	16.6	45.1	58.2	42.9
3. Exports/Imports - BOP (%)	66.2	67.8	78.5	79.4	83.4	82.9	69.2	71.3	58.6
4. Import cover of FER (No. of months)	2.5	8.2	8.8	11.5	14.2	16.9	14.3	13.9	11.2
5. External assistance (net)/TC (%)	26.2	8.2	4.8	13.4	-29.4	-16.5	6.1	4.7	2.2
6. ECB (net)/TC (%)	26.8	3.1	50.6	-19.0	-15.9	-16.9	16.0	20.6	14.1
7. NR deposits/TC (%)	18.3	14.2	27.2	33.0	28.0	21.0	-3.1	-18.0	0.9
As % of GDP at current market price									
8. Exports	5.8	8.3	9.9	9.4	10.6	11.0	11.8		
9. Imports	8.8	12.3	12.6	11.8	12.7	13.3	17.1		
10. Trade balance	-3.0	-3.9	-2.7	-2.4	-2.1	-2.3	-5.3		
11. Invisibles balance	-0.1	2.9	2.1	3.1	3.4	4.6	4.5		
12. Current account balance	-3.1	-1.0	-0.6	0.7	1.3	2.3	-0.8		
13. External debt	28.7	21.9	22.4	21.1	20.4	17.8	17.3		

Notes :

(i) TC : Total capital flows (net).
(ii) ECB : External Commercial Borrowing.
(iii) FER : Foreign Exchange Reserves, including gold, SDRs, and IMF reserve tranche.
(iv) As total capital flows are netted after taking into account some capital outflows, the ratios against item no. 5, 6 and 7 may, in some years, add up to more than 100 per cent.
(v) Rupee equivalents of BOP components are used to arrive at GDP ratios. All other percentages shown in the upper panel of the table are based on US dollar values.

Box 6.2 : India's Current Account Deficit vis-à-vis leading South East Asian Economies

The emergence of a widening deficit in India's current account has drawn attention to whether such a deficit is consistent with the BOP trends observed elsewhere in developing Asia. The table below shows the current account deficits, as per cent of GDP, for some select Asian economies:

Current Account Balances as per cent of GDP for Select Asian Economies

Country	1990	1997	2005*
China	3.1	3.8	6.1
India	-2.5	-0.7	-1.8
Indonesia	-2.5	-1.6	-0.4
Japan	1.4	2.2	3.3
Korea	-0.8	-1.6	2.0
Malaysia	-2.1	-5.9	13.5
Philippines	-6.1	-5.2	2.1
Singapore	8.4	15.6	25.7
Thailand	-8.3	-2.1	-2.5
Vietnam	-4.0	-6.2	-4.7

Source : World Economic Outlook (WEO), Database, IMF.

*** : Estimates for 2005 are projections**

In their current accounts, China, Japan, and Singapore have had, not only consistent surpluses but also surpluses that were increasing over time. As far as the other economies are concerned, since the 1997 East Asian crisis, barring India and Thailand, current account balances have either turned positive (e.g. Korea, Malaysia and the Philippines) or in deficit, gone down as a proportion of GDP (e.g. Indonesia and Vietnam). Current account deficits have widened only in India and Thailand.

There is a major difference between the East Asian crisis affected countries pre-1997 and India in recent years. Pre-1997, the crisis-affected countries financed their large current account deficits by short-term debt capital. Under liberal capital account regimes, banks and financial institutions in these economies had mobilized large resources through short term portfolio flows and invested them in high-risk assets. These investments became non-performing after sharp drops in exchange rates and withdrawal of capital flows, triggering financial system collapses. The potential disruptive consequences of the sharp expansion in the capital account appear limited in the case of India because of the calibrated policy followed in liberalizing the capital account and the non-debt nature of the capital flows. Nevertheless, given the marked difference in the current account performance between India and most other economies in the region, there may be a continuing need to maintain a close watch on the quality of the capital flows financing the current account deficit.

robust FII inflows were more than eleven times higher than such inflows during April-September 2004 (Table 6.2). The bulk of this increase occurred during July-September 2005, in response to the rising buoyancy in the stock markets. The period also witnessed an increase in inflows of commercial borrowings and short term credits on account of lower interest rate spreads on external borrowings and higher import financing requirements. The cumulative impact of higher debt and non-debt creating flows was a notable expansion in the size of the capital account surplus. The expansion succeeded in retaining an overall surplus in the balance of payments and resulted in a net reserve accretion of US$6.5 billion during April-September 2005 (Table 6.2), which was only marginally lower than the accretion of US$6.9 billion during April-September 2004.