Current account

6.9 As a proportion of GDP, on BoP basis, exports, which had grown from 5.8 per cent in 1990-91 to 12.2 per cent in 2004-05, grew further to 13.1 per cent in 2005-06 (Table 6.3). The corresponding rise in imports was from 8.8 per cent in 1990-91 to 17.1 per cent in 2004-05 and further to 19.5 per cent in 2005-06. Trade deficit as a proportion of GDP, which had actually declined from 3.0 per cent in 1990-91 to 2.1 per cent in 2002-03, widened to 4.9 per cent in 2004-05 and further to 6.4 per cent in 2005-06. Imports grew rapidly and the trade deficit widened sharply, particularly in 2004-05 and 2005-06, because of higher outgo on import of petroleum, oil and lubricants (POL) with large increases in international POL prices.

6.10 According to an IMF and International Energy Agency (IEA) estimate, an oil price increase of US$10 per barrel results in a deterioration of the trade balance of oil importing developing countries by 1.2 per cent of GDP. Trade deficit in India ballooned from 2.3 per cent of GDP in 2003-04, when oil prices began their initial climb, to 4.9 per cent in 2004-05 and further 6.4 per cent in 2005-06. An estimate excluding the impact of the oil price rise, that is with the same headline price of Indian basket of crude as in 2002-03 but with the same quantities as actually imported in the relevant years, yields trade deficit of 3.4 per cent of GDP each in 2004-05 and 2005-06. The above estimate indicate an oil price impact of 1.47 per cent and 3.05 per cent in 2004-05 and 2005-06, respectively somewhat lower than the impact projected by the IMF-IEA estimate.

6.11 The invisibles (net), comprising of non-factor services (like travel, transportation, software services and business services), investment income, and transfers, have traditionally compensated to a large extent the trade deficit, and this trend continued in 2005-06 with a moderate current account deficit at 1.1 per cent of GDP. As a proportion of GDP, invisibles (receipts) at 11.5 per cent of GDP in 2005-06 exhibited steady growth from a

Table 6.3 : Selected indicators of external sector

								(April-Sept.)	
	1990-91	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2005-06	2006-07
1. Growth of exports - BOP (%)	9.0	21.1	-1.6	20.3	23.3	28.5	23.4	34.2	22.9
2. Growth of imports - BOP (%)	14.4	4.6	-2.8	14.5	24.1	48.6	32.0	48.2	25.3
3. Exports/imports - BOP (%)	66.2	78.5	79.4	83.4	82.9	71.7	67.0	64.5	63.3
4. Import cover of FER (No. of months)	2.5	8.8	11.5	14.2	16.9	14.3	11.6	11.2	10.4
5. External assistance (net)/TC (%)	26.2	4.8	13.4	-29.4	-16.5	6.7	6.9	3.0	1.8
6. ECB (net)/TC (%)	26.8	50.6	-19.0	-15.9	-16.9	18.1	11.2	21.4	25.1
7. NR deposits/TC (%)	18.3	27.2	33.0	28.0	21.0	-3.4	11.5	1.7	10.0
As per cent of GDP at current market prices									
8. Exports	5.8	9.9	9.4	10.6	11.0	12.2	13.1		
9. Imports	8.8	12.6	11.8	12.7	13.3	17.1	19.5		
10. Trade balance	-3.0	-2.7	-2.4	-2.1	-2.3	-4.9	-6.4		
11. Invisibles balance	-0.1	2.1	3.1	3.4	4.6	4.5	5.3		
12. Current account balance	-3.1	-0.6	0.7	1.2	2.3	-0.4	-1.1		
13. External debt	28.7	22.5	21.1	20.3	17.8	17.3	15.8		

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 hundred 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 volumes

Box 6.2 : Towards fuller capital account convertibility

With growing strength of the balance of payments in the post-1991 reform period, in August 1994, by accepting obligations under Article VIII of the articles of agreement of the IMF, India made the Rupee convertible for current account transactions. A Committee headed by Shri S.S.Tarapore in 1997 had chalked out a phased road map for making the capital account convertible. The East Asian crisis intervened soon thereafter, leading to lack of popular enthusiasm for capital account convertibility. With external sector remaining robust and gaining strength every year and the relative macro economic stability with high growth providing a conducive environment for relaxation in capital controls, RBI, in pursuance of the announcement by the Prime Minister, constituted a Committee (Chairman: S.S. Tarapore) on March 20, 2006 for setting out a roadmap towards fuller capital account convertibility. The Committee submitted its Report to the RBI on July 31, 2006.

Conscious of the risks in the movement towards fuller convertibility of the Rupee as emanating from cross country experiences in this regard, the Committee calibrated the liberalization roadmap to the specific contexts of preparedness – namely, a strong macroeconomic framework, sound financial systems and markets, and prudential regulatory and supervisory architecture. After reviewing the existing capital controls, it detailed a broad five-year time frame for movement towards fuller convertibility in three phases: Phase I (2006-07); Phase II (2007-08 to 2008-09); and Phase III (2009-10 to 2010-11). It recommended the meeting of certain indicators/targets as a concomitant to the movement in: meeting FRBM targets; shifting from the present measure of fiscal deficit to a measure of the Public Sector Borrowing Requirement (PSBR); segregating Government debt management and monetary policy operations through the setting up of the Office of Public Debt independent of the RBI; imparting greater autonomy and transparency in the conduct of monetary policy; and slew of reforms in banking sector including a single banking legislation and reduction in the share of Government/RBI in the capital of public sector banks; keeping the current account deficit to GDP ratio under 3 per cent; and evolving appropriate indicators of adequacy of reserves to cover not only import requirements, but also liquidity risks associated with present types of capital flows, short-term debt obligations and broader measures including solvency.

Some of the significant measures, to be implemented in a sequenced manner as per the given roadmap include: raising the overall external commercial borrowing (ECB) ceiling as also the ceiling for automatic approval gradually; keeping ECBs of over 10-year maturity in Phase I and over 7-year maturity in Phase II outside the ceiling and removing end-use restriction in Phase I; monitoring import-linked short-term loans in a comprehensive manner and reviewing the per transaction limit of US$20 million; raising the limits for outflows on account of corporate investment abroad in phases from 200 per cent of net worth to 400 per cent of net worth; providing Exchange Earners Foreign Currency Account holders access to foreign currency current/ savings accounts with cheque facility and interest bearing term deposits; prohibiting FIIs from investing fresh money raised through Participatory Notes (PN), after providing existing PN-holders an exit route so as to phase them out completely within one year; allowing non-resident corporates (and non-residents) to invest in the Indian stock markets through SEBI-registered entities including mutual funds and portfolio management schemes who will be individually responsible for fulfilling know your customer (KYC) and Financial Action Task Force (FATF) norms; allowing institutions/corporates other than multilateral ones to raise Rupee bonds (with an option to convert into foreign exchange) subject to an overall ceiling which should be gradually raised; linking the limits for borrowing overseas to paid-up capital and free reserves, and not to unimpaired Tier I capital, as at present, raising it substantially to 50 per cent in Phase-I, 75 per cent in Phase II and 100 per cent in Phase III; abolishing the various stipulations on individual fund limits and the proportion in relation to net asset value; raising the overall ceilings from the present level of US$2 billion to US$3 billion in Phase I, to US$4 billion in Phase II and to US$5 billion in Phase III; raising the annual limit of remittance abroad by individuals from existing US$25,000 per calendar year to US$50,000 in Phase I, US$100,000 in Phase II and US$200,000 in Phase III; allowing non-residents (other than NRIs) access to Foreign Currency Non-Resident (FCNR(B)) and Non-Resident (External) Rupee Account (NR(E)RA) schemes.

modest level of 2.4 per cent of GDP in 1990-91, with the most recent two years showing acceleration, particularly in software and business services. Simultaneously, invisible payments at 6.2 per cent of GDP in 2005-06 have grown, albeit at lower levels and somewhat unevenly, again with acceleration being noticed in the most recent two years.

6.12 The steady growth in invisibles (net) conceals divergent patterns and sharp changes in some of the components over a decade and half. For instance, annual growth in travel receipts (gross), after remaining mostly in single digit during the 1990s, has shown rapid growth in the range of 18-52 per cent in the last three years ending in 2005-

06. Nevertheless, with even faster growth in travel payments (gross), growth in travel receipts in net terms have been negative since 1997-98. Similarly growth in transportation receipts has varied in the range of (-) 11.3 per cent to 46.0 per cent between 1991-92 and 2005-06, with high growth in the latest 4 years. With growth in payments also varying from (-) 28.9 per cent to 95.0 per cent in the same period, and very high growth of 95.0 per cent and 72.8 per cent in the last two financial years (2004-05 and 2005-06), there were also outflows on a net basis under transportation. In the recent two years ending in 2005-06, with strong growth, miscellaneous (other than software services) payments have exceeded such receipts. Rapid growth of non-software miscellaneous services payments may indicate how business services payments have also risen in tandem with business services receipts in recent years, reflecting the ongoing technological transformation and modernization of the economy/industry.

6.13 Private transfers (net), which remained the single largest component of the invisibles (net) account till 2004-05, fell below miscellaneous (net) receipts in 2005-06. The ratio of net invisible receipts to private transfers (net) rose dramatically from 3/7 to more than 2 between 1991-92 and 2005-06. The growth in miscellaneous (net) receipts has been driven mostly by software services. On a net basis, in 2005-06, with rapid growth of 31.7 per cent and 209.8 per cent in receipts from software services and business services, respectively, non-factor services moved closer to private transfers in the invisibles account. In the invisible account, on a gross basis, both receipts and payments have grown at rapid rates of over 30 per cent in both 2004-05 and 2005-06.

6.14 The four other main components of non-factor services, namely, travel, transportation, insurance and Government transactions (not included elsewhere), have exhibited mixed trends. Transportation (net), which had yielded modest positive inflows only in 2003-04 and 2004-05 in the preceding decade and a half, slipped back with an outflow of US$1.6 billion in 2005-06. The pick up in international tourism observed in 2003-04 and 2004-05 continued in 2005-06 and resulted in a net inflow of US$1.4 billion in 2005-06. With insurance receipts and payments more or less balancing each other and Government account yielding a modest net outflow of US$197 million, the total invisibles (net) inflow amounted to US$23.9 billion in 2005-06 for non-factor services.

6.15 Investment income (net) continued to be negative reflecting the servicing costs of capital inflows. While receipts on this account have grown rapidly at an average rate of 20.1 per cent in the last six years to reach US$5.7 billion in 2005-06, payments on this account grew at a lower average rate of 13.6 per cent to reach US$11.2 billion in 2005-06. Official transfers, a very small component in the invisibles account, continued to decline in 2004-05 and 2005-06.

6.16 Overall, in 2005-06, current receipts (including grants) grew by 27.6 per cent to US$197.4 billion. But, such receipts fell short of current payments (including grants) which grew by 31.4 per cent to US$206.6 billion. Current receipts covered 95.6 per cent of current payments in 2005-06.

6.17 As per the quarterly data on BoP for 2006-07 released by the RBI on December 29, 2006, both imports and exports have decelerated in the first half of the current year. With revisions to the first quarter data, trade deficit at US$35.1 billion during April-September 2006 was considerably higher than US$27.1 billion observed in the corresponding period of 2005. As per the quarterly data, export growth, which was 23.7 per cent in the first quarter of 2006-07, continued to be robust at 22.9 per cent in the first six months (34.2 per cent in April-September 2005). Imports, which had grown by 23.6 per cent in the first quarter, also strengthened to 25.3 per cent growth in the first six months of the current year. There was, however, a deceleration of import growth from 48.4 per cent in the first half of 2005-06. However, as pointed out by the Economic Advisory Council to the Prime Minister in its outlook for BoP released on January 11, 2007, the provisional nature of the data, which can get revised sharply, needs to be taken into account in drawing any firm conclusions. The Council, in an earlier Report, had also expressed concern at the levels of divergence between customs (DGCI&S) trade data and RBI's trade data as per BoP accounts (Box 6.3).

6.18 In the first half of the current year, while invisibles receipts rose on account of growth in export of software and other professional and business services, invisible payments also rose sharply, particularly in travel and transportation. Net invisible receipts at US$23.5 billion, was up from US$19.9 billion in the first half of 2005-06, but not enough to offset the rising trade deficit. Consequently, during April-September, the current account deficit widened from US$7.2 billion in 2005 to US$11.7 billion in 2006.

Box 6.3 : Divergence in trade data

Periodically concerns have been expressed, since 1980s, as regards the divergence in the merchandise trade data compiled by the two agencies, namely, Reserve Bank of India (RBI) and Directorate General of Commercial Intelligence and Statistics (DGCI&S), Kolkata, Ministry of Commerce and Industry. This divergence is more pronounced in the case of imports. This divergence was examined by the High Level Committee on Balance of Payments (Chairman: Dr. C. Rangarajan, April 1993) and the Technical Group on Reconciling Balance of Payments and DGCI&S data on merchandise trade (Chairman: Shri O.P. Sodhani, September 1995). While the two agencies are recording the same transactions, the scope, time period, definition, method and coverage of items of trade differ considerably, besides inclusion and exclusion errors in trade items. While RBI relies on foreign exchange release/receipt returns, which are actual cash outgo and cover all flows, DGCI&S relies on customs data, which in turn are based on bills of entries (import document filed with the Customs), which might remain somewhat incomplete for a number of reasons in the short run. Defence imports are not reflected in the DGCI&S data. As such for a particular time period at any specific date, given the leads and lags in reporting, the two sets of data would never match.

The extent of the divergence has narrowed over the years, particularly for years prior to 2004-05 (Table below).

Divergence in import data

(in US$ million)

Year	RBI-BoP	DGCI&S-Customs	Difference
1990-91	27,915	24,075	3,840
1995-96	43,670	36,678	6,992
2000-01	57,912	50,536	7,376
2001-02	56,277	51,413	4,864
2002-03	64,464	61,412	3,052
2003-04	80,003	78,150	1,853
2004-05	118,908	111,518	7,390
2005-06	156,993	149,166	7,827
2006-07(April-September)	95,691	83,927	11,764

As per the extant revision policy of the RBI, data on exports and imports are revised every quarter up to 24 months while DGCI&S finalise their trade data after 8 months. However, the extent of this level of divergence in the current conjecture makes it arduous for calibrating the policy responses to external sector developments in the short-run.