Current Account

6.14 Under current account of the BoP, transactions are classified into merchandise (exports and imports) and Invisibles. Invisible transactions are further classified into three categories, viz. (a) Group of Services–Travel, Transportation, Insurance, Government Not Included Elsewhere (GNIE) and Miscellaneous Services, which encompass communication services, construction services, financial services, software services, news agency services, royalties, management services and business services, (b) Income, and (c) Transfers (grants, gifts, remittances, etc) which do not have any *quid pro quo.*

6.15 The current account, after being in surplus during 2001-02 to 2003-04, reverted to a deficit from the year 2004-05. This was despite a robust growth in net invisibles account fuelled by software exports and private transfers. Thus, large merchandise trade deficit coexisted with a lower deficit on the goods and services account because of the surplus on non-factor services (Figure 6.1). The current account therefore has been characterised by persistence of high trade deficit and buoyant invisibles surplus, which have provided support to current account position.

Merchandise

6.16 A widening of merchandise trade was one way to absorb foreign savings and the increase in exports and imports was a key component of the growth process. Exports rose from 11.0 per cent of GDP in 2003-04 to 14.1 per cent in 2007-08 and 15.2 per cent during 2008-09 (April-December) (Table 6.4). The average annual growth rate of exports during 2005-06 to 2007-08 was 25.0 per cent. Imports, however, grew even faster at an annual average rate of 29.5 per cent during 2005-06 to 2007-08. As a proportion of GDP, imports were 22.0 per cent of GDP in 2007-08 while exports were at 14.2 per cent. Thus, trade deficit widened to 7.8 per cent of GDP in 2007-08. The higher trade deficit could be attributed to a rise in imports of petroleum, oil and lubricants (POL) as well as non-POL imports.

6.17 In the year 2008-09 (April-December), India's merchandise exports (on BoP basis) at US$ 133.5 billion posted a growth of 17.5 per cent as compared with 23.0 per cent in the corresponding period of 2007-08. As per the data available for April-November 2008 from the DGCI&S, the exports of engineering goods and petroleum products showed higher growth, while growth in exports of textile products, ores and minerals, and gems and jewellery registered sharp deceleration.

Figure 6.1 (i) : Current account deficit, goods & services, trade and invisibles balance as a per cent of GDP

Figure 6.1 (ii) : Current account deficit, goods & services, trade and invisibles balance as a per cent of GDP

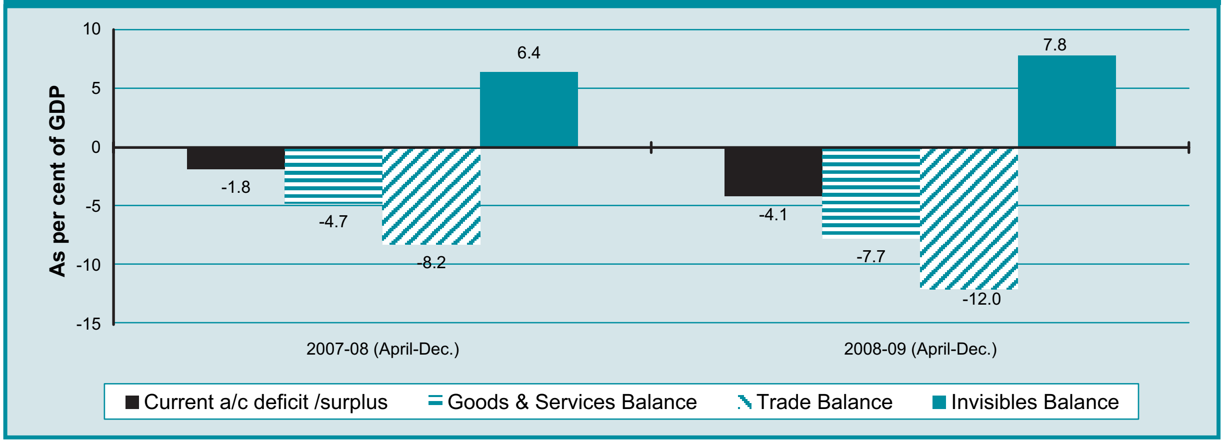

Table 6.4 : Selected indicators of the external sector

Sl. No.	Items	Years 2003-04	2004-05	2005-06	2006-07	2007-08	April-Dec. 2007-08	April-Dec. 2008-09
1.	Growth of exports - BOP (%)	23.3	28.5	23.4	22.6	28.9	21.9	17.5
2.	Growth of imports - BOP (%)	24.1	48.6	32.1	21.4	35.2	28.3	30.6
3.	Growth of Non-factor Service (credit)	29.4	61.0	33.3	28.0	22.1	25.9	16.3
4.	Growth of Non-factor Service (debit)	-2.3	66.4	24.0	28.5	18.5	10.7	9.7
5.	Exports/imports - BOP (%)	82.9	71.7	67.0	67.6	64.5	62.1	55.9
6.	Exports/imports of goods and services(%)	96.3	87.5	85.0	86.3	82.6	81.9	75.3
7.	Import cover of FER (No. of months)	16.9	14.3	11.6	12.5	14.4	14.3	9.8
8.	External assistance (net) /TC (%)	-17.1	6.9	6.7	3.9	2.0	1.6	12.2
9.	ECBs (net)/TC (%)	-17.5	18.5	9.8	35.6	21.0	21.2	46.5
10.	NR deposits(net)/TC (%)	21.8	-3.4	11.0	9.6	0.2	-1.1	13.8
		(As per cent of GDP mp)						
11.	Exports	11.1	12.2	13.0	14.1	14.1	13.5	15.2
12.	Imports	13.3	16.9	19.4	20.9	21.9	21.8	27.1
13.	Trade balance	-2.3	-4.8	-6.4	-6.8	-7.8	-8.2	-12.0
14.	Invisibles balance	4.6	4.5	5.2	5.7	6.3	6.4	7.8
15.	Goods and services balance	-0.6	-2.6	-3.6	-3.6	-4.6	-4.7	-7.7
16.	Current account balance	2.3	-0.4	-1.2	-1.1	-1.5	-1.8	-4.1
17.	ECBs	-0.5	0.7	0.3	1.8	1.9	2.1	0.8
18.	Foreign Direct Investment (net)	0.4	0.5	0.4	0.8	1.3	0.8	1.7
19.	Portfolio Investment	1.9	1.3	1.5	0.8	2.5	4.0	-1.3
20.	Total capital Account (net)	2.9	4.1	3.1	5.1	9.3	9.8	1.8
21.	External debt	17.8	18.5	17.2	17.9	18.9	24.5	26.2

Source : RBI
Note: (i) TC: Total Capital flows (net).
(ii) ECBs: External Commercial Borrowings.
(iii) FER: Foreign exchange reserves, including gold, SDRs and IMF reserve tranche.
(iv) GDPmp: Gross Domestic Product at current market prices.

6.18 Imports (on BoP basis) at US$ 238.9 billion recorded a growth of 30.6 per cent during April-December 2008 (28.2 per cent during April-December 2007). The higher growth rate was mainly due to a sharp rise of 43.3 per cent in oil imports during April-December 2008, as against 24 per cent growth in oil imports in April-December 2007.

6.19 Reflecting the impact of higher growth in imports coupled with the slowdown in export growth, merchandise trade deficit (exports minus imports) widened significantly to US$ 105.3 billion during April-December 2008 from US$ 69.3 billion in April-December 2007 (52.1 per cent increase). As per cent of GDP, exports were 15.2 per cent and imports 27.1 per cent in 2008-09 (April-December) vis-à-vis 13.5 per cent and 21.8 per cent respectively during the corresponding period of 2007-08. Trade deficit increased from 8.2 per cent of GDP in 2007-08 (up to Q3) to 12.0 per cent in 2008-09 (up to Q3).

6.20 The notable feature during 2008-09 was a decline of 10.4 per cent in merchandise exports on BoP basis in the third quarter of 2008-09 as against an increase of 33.0 per cent in Q3 of the year 2007-08. All commodities, particularly rice, raw cotton, sugar and molasses, iron ore, iron and steel, gems and jewellery showed decline with an exception of engineering goods. Import payments also registered lower growth of 8.9 per cent in Q3 of 2008-09 as compared to a high growth of 41.9 per cent in Q3 of 2007-08. The deceleration in import payments is attributed mainly to a sharp fall in oil prices to an average of US$ 53.55 per barrel during October-December 2008. Trade deficit was placed at a much higher level of US$ 36.3 billion during Q3 of 2008-09 (12.6 per cent of GDP) as compared to US$ 26.1 billion in Q3 of 2007-08 (8.4 per cent of GDP). Hence, the shrinkage in international demand because of global economic slowdown has a negative impact on Indian exports; while a sharp fall in international prices of oil has a positive impact on Indian imports during the third quarter of 2008-09.

6.21 As per the information available for 2008-09, exports at US$ 168.7 billion recorded a rise of 3.4 per cent over that of US$ 163.1 billion during 2007-08 (Ministry of Commerce and Industry estimates). Imports are placed at US$ 287.8 billion during 2008-09 indicating an increase of 14.3 per cent over 2007-08. Trade deficit is estimated at US$ 119.0 billion during 2008-09 as against US$ 88.5 billion in 2007-08.

6.22 The share of POL in the total imports has increased over the years since 2003-04, with a corresponding decline in the share of non-POL items. In the year 2003-04, the share of POL in total imports was 26.3 per cent, which has gradually increased to 26.8 per cent in 2004-05, 29.5 per cent in 2005-06, 30.8 per cent during 2006-07, 31.7 per cent in 2007-09 and 32.4 per cent in the fiscal 2008-09.

Invisibles

6.23 The surplus on the invisible account has played a key role in balancing the high trade deficit and lowering the current account deficit. The net invisibles (services, transfers and investment income) surplus was US$ 74.6 billion in 2007-08 and US$ 68.9 billion during April-December 2008. Software services, comprising information technology (IT) and IT-enabled services (ITES) was the main driver of the surpluses generated from non-factor services. The remaining components of non-factor services in the invisibles account of BoP, viz., travel, transportation, insurance, financial services, communication services and business services contributed only 8 per cent of the surplus in services trade in 2007-08 and 11 per cent in April-December 2008. Travel receipts (net) grew at an average rate of growth of 24 per cent during 2005-06 to 2007-08 reflecting the attractiveness of India as a tourist destination. During April-December 2008, travel receipts (net) was US$ 1.4 billion as against US$ 1.3 billion in the corresponding period of 2007-08 reflecting 7.8 per cent growth.

6.24 Growth in software services receipts (both IT and ITES) was phenomenal at an annual average of 30.1 per cent during 2005-06 to 2007-08. The software services (net), recorded a rise of 28.3 per cent in 2007-08 on top of an increase of 31.7 per cent during 2005-06 and 30.4 per cent during 2006-07. This trend has continued in fiscal 2008-09 (April-December), following a growth of 28.2 per cent in receipts from software services (net). The non-software services (communication services, construction services, financial services, news agency services, royalties, management services and business services) also registered a growth of 26.7 per cent during fiscal 2008-09 (up to Q3) (Box 6.1).

6.25 Private transfers, mainly workers' remittances continued its traditional role of being a major source of the invisibles account surplus with an annual average growth of 27 per cent during 2005-06 to 2007-08 and were around 3 per cent of GDP during the same period. During April-December 2008, private transfers were placed higher at US$ 34.9 billion as against US$ 28.3 billion during April-December 2007, recording a rise of 23.2 per cent (Box 6.2).

6.26 Investment income outflows are in the form of interest, dividend, profit, etc. for servicing debt and non-debt liabilities in the capital account. The net investment income was placed at US$ (-) 2.9 billion in 2002-03. With the rapid build up of foreign

Box 6.1 : Performance of Indian IT software and services sectors

As per RBI data, software exports registered 28.2 per cent growth (US$ 32.3 billion) during 2008-09 (April-December) vis-à-vis US$ 25.2 billion during the corresponding period in 2007-08. During the third quarter (October-December) of 2008-09, when many sectors were reeling under the effect of global financial crisis, the software exports increased to US$ 10.2 billion as against US$ 8.8 billion during the same quarter of 2007-08, indicated 16.1 per cent growth over the year.

As per the National Association of Software and Services Company (NASSCOM), software and services export revenues are expected to reach US$ 47 billion by the end of fiscal 2008-09 at the growth rate of 16-17 per cent. Total IT–Business Process Outsourcing (BPO) industry is expected to reach US$ 71.7 billion, accounting for 5.8 per cent of India's GDP, software and services revenues (exports plus domestic) aggregated to about US$ 60 billion. Industry will continue to remain a net hirer and focus on value creation, direct employment at 2.23 million, indirect employment estimated at more than 8 million.

Industry is also diversifying geographically with Continental Europe registering the highest growth rate though United States remains the dominant market. Over a four-year period (2004-05 to 2007-08) Continental Europe is estimated to grow at 51.4 per cent as against an industry growth rate of 33.3 per cent, while the U.S. share is expected to come down from 68.2 per cent to 60 per cent of the industry share.

NASSCOM has taken a two-year view to factor in the volatile economic environment under which world growth is projected to fall 0.5 per cent in 2009, but recovers to 3 per cent in 2010 and estimates the Indian IT industry to grow at 15 per cent compound annual growth rate (CAGR) to achieve export revenues of US$ 60-62 billion by fiscal 2010-11.

Reference: NASSCOM Press Release on Performance of Indian IT Software and Services.

Box 6.2 : Global crisis and workers' remittances

Workers' remittances have been a major source of balance of payments support in many emerging economies. The flows also help in poverty alleviation, as a significant part of the remittances are in the nature of transfers for family maintenance. According to the World Bank estimates, remittances to developing countries were of the order of US$ 305 billion in 2008, which far exceed the flow of official assistance.

India has been a top recipient of private transfers in recent years. As per the Reserve Bank of India estimate, the magnitude of such transfers was US$ 30.8 billion 2006-07 and US$ 43.5 billion 2007-08. During 2008-09 (April-December), such transfers were US$ 36.9 billion. The third quarter of 2008-09 (October-December) however witnessed marginal deceleration in remittance flows to US$ 10.5 billion as against US$ 10.9 billion in the corresponding quarter last year due to global financial crisis.

According to a World Bank study, remittances are likely to decline by 5-8 per cent in 2009, which may cause hardship in many poor countries. However, the decline in nominal dollar terms would be smaller relative to the projected fall in private capital flows or official aid. The study identifies several reasons for the resilience of remittances in the face of economic downturns:

- Remittances are sent by the cumulated flows of migrants over the years and not by the recent migrants alone. This makes remittances flows to show robustness over time.
- Remittances are a small part of migrants' incomes, and migrants continue to send remittances even when hit by income shocks.
- Because of a rise in anti immigration sentiments and tighter border controls, especially in the U.S. and also in Europe, the duration of migration appears to have increased. Those staying back are likely to continue to send remittances.
- If migrants do indeed return, they are likely to take back accumulated savings. This may have been the case in India during the Gulf War of 1990 91, which forced a large number of Indian workers in the Gulf to return home. Also the "safe haven" factor or "home bias" can cause remittances for investment purposes to return home during an economic downturn in the host country.
- Several high income OECD countries are likely to undertake large fiscal stimulus packages in response to the financial crisis. This increase in public expenditure, if directed to public infrastructure projects, will increase demand for both native and migrant workers. Taylor (2000) found that public income transfer schemes in the United States resulted in increased remittances to Mexico.

Reference : World Bank

currency assets, investment income receipts grew rapidly. However, investment income payments grew even faster, with the result that net investment income remained negative at US$ (-) 6.7 billion in 2006-07, US$ (-) 4.3 billion in 2007-08 and US$ (-) 4.2 billion in 2008-09 (up to Q3).

6.27 The net invisible surplus grew by 42.9 per cent to reach US$ 74.6 billion in 2007-08 (6.4 per cent of GDP). Net invisibles (receipts minus payments) at US$ 68.9 billion during April-December 2008 were up by 28.1 per cent over US$ 53.8 billion during April-December 2007. The invisibles surplus financed about 65.4 per cent of trade deficit during April-December 2008 as against 77.6 per cent during April-December 2007.

6.28 Despite higher invisibles surplus, the trade deficit widened mainly on account of higher growth in imports coupled with slowdown in export growth in the third quarter of 2008-09. The current account deficit (CAD) therefore was higher at US$ 36.5 billion in April-December 2008 (135.1 per cent increase, over US$ 15.5 billion during April-December 2007). The ratio of CAD to GDP also increased from 1.8 per cent in 2007-08 (up to Q3) to 4.1 per cent in 2008-09 (up to Q3).

6.29 During the third quarter of the year 2008-09 (October-December), there was a nominal negative growth for both invisible receipts and payments reflecting the adverse impact of global economic slowdown. Invisible receipts declined on account of fall in travel, transportation and insurance receipts in the services category and private transfers and investment income receipts. Overall services exports, however, witnessed a marginal increase of 0.5 per cent during the third quarter (compared with a higher growth of 33.4 per cent in Q3 of 2007-08) due to increase in software exports. Private transfer receipts declined marginally during Q3 of 2008-09. Software services receipts, on the other hand, increased by 11.8 per cent during the quarter. Invisible payments also recorded a marginal negative growth of 2.1 per cent during Q3 of 2008-09, led mainly by sharp decline in payments under travel, software and business services account. There was also a marginal decline in payments under investment income in the form of interest payments and dividends. The net invisibles (receipts minus payments) rose marginally to US$ 21.7 billion in Q3 of 2008-09 (US$ 21.5 billion during Q3 of 2007-08). At this level, net invisibles surplus financed 59.7 per cent of trade deficit in Q3 of 2008-09 (82.6 per cent in Q3 of 2007-08). Accordingly, the current account deficit rose sharply to US$ 14.6 billion (5.1 per cent of GDP) during Q3 of 2008-09, as compared to US$ 4.5 billion (1.5 per cent of GDP) in Q3 of 2007-08. This was mainly on account of large trade deficit and marginal increase in net invisibles during the third quarter of 2008-09