Current account deficit narrows to 1.3% of GDP in fiscal third quarter

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India's current account deficit (CAD) narrowed to 1.3% of the gross domestic product (GDP) in the fiscal third quarter from 1.5% in the year-earlier period, as the country's trade deficit contracted.

Data released by the Reserve Bank of India (RBI) showed trade deficit in the October-December quarter narrowed to $34 billion from $38.6 billion in the same period in 2014-15.

CAD mirrors the difference between domestic savings and domestic investment, and conveys the extent of this gap that needs to be bridged by foreign savings.

CAD narrowed to 1.4% of GDP in the nine months ended 31 December from 1.7% in the corresponding period of 2014-15.

India's merchandise exports have been declining continuously since December 2014 because of sluggish global demand and low commodity prices, particularly that of oil.

The Economic Survey released before the 29 February budget said India's external sector outcome continues to be strong and sustainable because of strong macroeconomic fundamentals and low commodity prices. "As such, while the export slowdown may continue for a while before picking up in the next fiscal, the continuance of low global commodity prices augurs well for sustaining low trade and current account deficits," the survey added.

It said that while global concerns over China's economic growth and normalization of the monetary policy in the US may affect global financial flows, with policy reform initiatives and a strong macroeconomic outcome, the deficit in the current account is likely to be more than fully financed through stable flows, and the volatility in global financial markets may affect the exchange rate less than in other emerging economies.

Merchandise exports during the December quarter contracted 23.4% to $64.9 billion, while imports shrank 16.7% to $99 billion. Services exports during the December quarter fell 5% to $37.9 billion while services imports remained flat at $19.8 billion, leading to net services exports of $18.1 billion, a 9.5% drop due mostly to a fall in export receipts in transport and financial services. Net services exports act as a cushion to moderate the impact of the trade deficit.

Private transfer receipts, mainly representing remittances by Indians employed overseas, amounted to $15.8 billion, a decline from their level in the preceding quarter as well as from a year ago.

Devendra Pant, chief economist at India Ratings Ltd, said the slower growth of net services exports, and a decline in remittances over the second quarter of 2015-16 and the third quarter of 2014-15 are cause for concern.

“Remittances are largely affected by the subdued performance in the Middle East due to the collapse of oil prices. We expect full-year current account to remain benign at around the same level as in the third quarter in relation to GDP,” he added.

After moderating in the second quarter to $6.6 billion, net foreign direct investment (FDI) again picked up and stood at $10.1 billion in the third quarter. Against a sharp drop in net outflow in portfolio investments at $3.5 billion in the preceding quarter, net outflow was just $0.2 billion in the December quarter.

Non-resident Indian (NRI) deposits improved significantly in the third quarter of 2015-16 to $5.9 billion over the preceding quarter’s $4.2 billion.

Madan Sabnavis, chief economist at Care Ratings, said the balance of payments data looks very positive for the economy. “Exports continue to be an issue and in case commodity prices harden, there can be challenges in balance of trade in 2016-17. However, we would still be less than 2% in a worst case situation. Support from FDI will be important in 2016-17, too, as portfolio investment will be volatile, given the possible Fed action on rates,” he added.

However, Sabnavis said the rupee will remain stable and move down only gradually based on global disturbances in FY17.