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**RBI Working Paper Series 16 / 2012****India's Sustainable CAD Level**

The sustainable level of India's Current Account Deficit (CAD) would be in the range of 2.4 to 2.8 per cent of GDP over the medium term. This will be on the assumptions that GDP growth ranges between 6.0 and 8.0 per cent, inflation is around 5.0 per cent and interest rate and size of capital flows broadly follow their trends in the recent past. This was the major finding of a working paper published on the Reserve Bank website today. The Working Paper titled '[Sustainable Level of India's Current Account Deficit](#)' has been authored by Shri Rajan Goyal.

The paper argues that excessive current account deficit (CAD) tends to make an economy vulnerable to external debt or currency crisis which in turn leads to financial instability and causes substantial output and welfare losses. The paper observes that in the Indian context, although CAD averaging around 2.7 per cent of GDP during 2008-09 to 2010-11 did not cause any stress on the economy, CAD exceeding 4.0 per cent of GDP caused net drawdown of reserves of US\$ 12.8 billion in 2011-12. Noting that the sustainable level of CAD in India is historically believed to be below 2 per cent of GDP, the paper examines whether this level has moved up and if so what is the likely sustainable level of CAD in the current scenario.

The paper then goes on to estimate sustainable level of CAD for India by applying a statistical model to the threshold level of net external liabilities that the economy should not breach to ensure stability of the external sector. *Probit* analysis based on a panel of select economies has also been used to arrive at the threshold level.

*Note : The Reserve Bank of India introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of RBI and are disseminated to elicit comments and further debate. The views expressed in these papers are those of authors and not that of the Reserve Bank of India. Comments and observations may kindly be forwarded to authors. Citation and use of such papers should take into account its provisional character.*

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