

Festival comes early for Consumption

In a major reform of the indirect tax structure, second generation GST reforms have been announced. The rationalization and correction of anomalies such as inverted duty structure will play crucial role in stimulating domestic economy. Lower rates are expected to have long term positive impact, with a multiplier effect across sectors. The pass-through of these cuts will have a disinflationary effect. The rejig in rates is likely to boost both rural and urban demand, especially given the onset of festival season. This is indeed a big push moment for domestic growth. Easier compliance and access to cheaper raw material will enhance export competitiveness and catalyze growth in the MSME sector. The spillover effect will be felt in improved credit demand for banks, coinciding with festival splurge.

In this note, we tried to look at the boost to consumption from 1) inflation aspect 2) boost to production from disaggregated IIP data 3) Sectoral impact and 4) movement of major market variables post GST rate announcement.

Simplified two tier structure

Government has come up with a detailed list of tax structure under GST, 99% of the goods have been kept in the 0, 5% or 18% rate. Majority of the items of daily households, both FMCG and durables, are kept in the 5% bracket. Thus, bringing down the overall effective GST rate. Considering the entire consumption profile the rate translates to 10-11%, currently. We expect the taxable consumption group will translate to ~Rs 150-160 lakh crore. This amount may even be higher once we get the new proportion of GST collected under each head.

We estimate the net gain to consumption of ~ Rs 0.7-1 lakh crore which amounts to ~ 0.2-0.3% of GDP, (anticipated from Sep onwards). The impact might even be higher since the savings to consumers in terms of cess might also be translated into consumption demand.

As per Government estimate, the revenue impact due to GST is pegged at Rs 48,000 crore, which will be a direct benefit to private consumption. However, based on the assumption that lower indirect tax rates would translate to lower inflation, we expect a gain of around Rs 20,000-50,000 crore. For the same, we have assumed 100% transmission. This might not translate to the full extent.

Table 1: New Slab structure

Old Slab	New Slab	Effective GST rate on taxable consumption	Effective GST rate on overall consumption
5%	5%	14-15%	10-11%
12%			
18%	18%		
28%			
	40%		
Others	Others		

Source: Ministry of Finance, Bank of Baroda Research

The angle of inflation:

Here we tried to map the GST commodity wise list with disaggregated CPI. Food items where major rejigs of rates happened (migration from 12% slab to 5% rate) consists of ~9% in the overall CPI food basket. This is based on certain assumptions as the direct one to one mapping with the GST HSN list is not available. However, the next best proxy is assumed. The CPI weighted index is arrived at for those specific products accounting for the tax differential and taking FY25 as the base year. On average price change tantamount to -6.1% for these 9% food and beverage items of CPI. Thus, we may witness a 25-35bps drop in F&B inflation in the next 6 months.

- Among F&B, major price drop is expected for prepared meals and snacks, oils & fat due to drop-in rates of butter and vanaspati. For cereals & products, drop in prices of bread, noodles etc. have contributed to its decline. All these are daily consumables. Hence it will give a major thrust to real consumption demand and in turn to investment.

Table 2: Food items facing lower tax rates

Food & Beverages (F&B)	Weight	GST_OLD	GST_NEW	Difference in GST rates	Old Index	New Index	Price change, (%)
Cereals & products	1.0	-	-	-	165.6	149.0	-10.1
Sewai, noodles	0.0	12.0	5.0	-7.0	-	-	-
Bread (bakery)	0.1	5.0	0.0	-5.0	-	-	-
Biscuits, chocolates, etc.	0.9	18.0	5.0	-13.0	-	-	-
Milk and products	0.1				180.9	170.6	-5.7
Milk: condensed/ powder	0.0	12.0	5.0	-7.0	-	-	-
Other milk products	0.0	5.0	0.0	-5.0	-	-	-
Oils and fats	0.1	-	-	-	186.1	166.4	-10.5
Butter	0.0	12.0	5.0	-7.0	-	-	-
Vanaspati, margarine	0.1	18.0	5.0	-13.0	-	-	-
Fruits	0.5	-	-	-	177.8	166.7	-6.3
Groundnut	0.3	12.0	5.0	-7.0	-	-	-
Dates	0.0	12.0	5.0	-7.0	-	-	-
Cashewnut	0.1	12.0	5.0	-7.0	-	-	-
Walnut	0.0	12.0	5.0	-7.0	-	-	-
Other nuts	0.0	12.0	5.0	-7.0	-	-	-
Sugar and confectionary	1.1	-	-	-	127.1	119.2	-6.3
Sugar - other sources	1.1	12.0	5.0	-7.0	-	-	-
Candy, misri	0.0	18.0	5.0	-13.0	-	-	-
Honey	0.0	18.0	5.0	-13.0	-	-	-
Sauce, jam, jelly (gm)	0.0	12.0	5.0	-7.0	-	-	-
Ice-cream	0.0	18.0	5.0	-13.0	-	-	-
Non-alcoholic beverages	1.4	-	-	-	180.4	194.0	7.6
Tea: leaf (gm)	1.0	28.0	40.0	12.0	-	-	-
Coffee: powder (gm)	0.1	12.0	5.0	-7.0	-	-	-
Mineral water (litre)	0.0	18.0	5.0	-13.0	-	-	-
Cold beverages: bottled/canned (l)	0.1	28.0	40.0	12.0	-	-	-
Fruit juice and shake (litre)	0.1	12.0	5.0	-7.0	-	-	-
Other beverages: cocoa, chocolate,	0.1	18.0	40.0	22.0	-	-	-

Food & Beverages (F&B)	Weight	GST_OLD	GST_NEW	Difference in GST rates	Old Index	New Index	Price change, (%)
Prepared meals, snacks, sweets, etc.	4.8	-	-	-	208.3	184.9	-11.3
Cooked meals purchased (no.)	2.4	18.0	0.0	-18.0	-	-	-
Cooked snacks purchased	1.2	5.0	0.0	-5.0	-	-	-
Prepared sweets, cake, pastry	0.6	18.0	5.0	-13.0	-	-	-
Papad, bhujia, namkeen, mixture,	0.5	12.0	5.0	-7.0	-	-	-
Other packaged processed food	0.1	18.0	5.0	-13.0	-	-	-
Total	9.0	-	-	-	-	-	-

Source: CEIC, PIB, Bank of Baroda Research

- For core inflation we expect, ~ 10% of the bucket will benefit due to lower GST rates. On average, price drop is expected to be 7.4%. Thus, core will face downside pressure of ~30-40bps in the next 6 months. The majority will be felt in personal care and effects which will partly mitigate the volatility caused in this component due to higher gold prices.
- Other than personal care and effects, inflation in household goods and services and education will also come down. It is to be noted that these components of inflation have remained sticky in past episodes. Thus, government's move has carefully nudged the demand towards these sectors.
- Within household goods and services, household appliances got a significant push through lower rates for AC, stove, sewing machine, utensils and non-institutional medicines.
- For personal care and effects, toilet soap, toothpaste, hair oil, suitcase, umbrella got a significant relief.
- Thus core basket will be impacted more on the downside due to lower rates.

Thus, the overall impact on CPI is expected to be around 55-75bps. Thus, we revise downward our current estimate of headline CPI to 3.1% from our previous forecast of 3.5%.

Table 3: Majority of items of core inflation face lower tax rates

Core	Weight	GST_OL D	GST_NE W	Differenc e in GST rates	Old Inde x	New Inde x	Price change , (%)
Pan, tobacco and intoxicants	1.1				210.3	211.8	0.7
Pan: finished (no.)	0.2	28.0	40.0	12.0			
Ingredients for pan (gm)	0.1	18.0	5.0	-13.0			
Bidi (no.)	0.4	28.0	18.0	-10.0			
Cheroot (no.)	0.0	28.0	40.0	12.0			
Zarda, kimam, surti (gm)	0.0	28.0	40.0	12.0			
Other tobacco products	0.3	28.0	40.0	12.0			
Core excl. Pan, tobacco	Weight	GST_OL D	GST_NE W	Diff	Old Inde x	New Inde x	Price change , (%)
Clothing	0.1	-	-	-	201.4	188.8	
Footwear	0.4	-	-	-	183.5	172.0	
Household goods and services (Only major products shown)	5.5	-	-	0.0	189.7	172.0	-9.4
Air conditioner, air cooler	0.1	28.0	18.0	-10.0	-	-	-
Sewing machine	0.0	12.0	5.0	-7.0	-	-	-

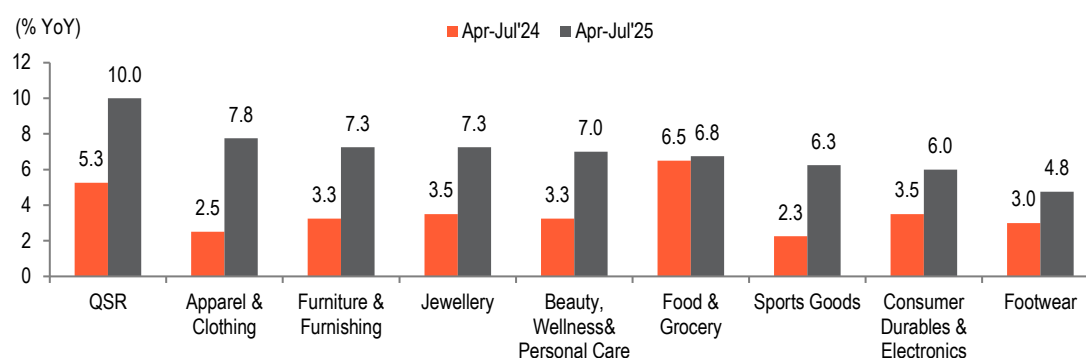
Core	Weight	GST_OL D	GST_NE W	Differenc e in GST rates	Old Inde x	New Inde x	Price change , (%)
Stove, gas burner	0.0	12.0	5.0	-7.0	-	-	-
Stainless steel utensils	0.2	12.0	5.0	-7.0	-	-	-
Bucket, water bottle/ feeding bottle	0.1	12.0	5.0	-7.0	-	-	-
Incense (agarbatti), room freshener	0.2	12.0	18.0	6.0	-	-	-
Candle (no.)	0.0	12.0	5.0	-7.0	-	-	-
Medicine (non-institutional)	4.0	12.0	0.0	-12.0	-	-	-
Spectacles	0.1	12.0	5.0	-7.0	-	-	-
X-ray, ECG, pathological test, etc. (non-institutional)	0.5	12.0	5.0	-7.0	-	-	-
Recreation and amusement	0.0			0.0	172.9	162.1	-6.3
Hotel lodging charges	0.0	12.0	5.0	-7.0	-	-	-
Transport and communication	1.0			0.0	163.7	150.9	-7.8
Motor car, jeep	0.5	28.0	18.0	-10.0	-	-	-
Tyres & tubes	0.1	18.0	5.0	-13.0	-	-	-
Railway fare	0.2	12.0	5.0	-7.0	-	-	-
Television	0.2	28.0	18.0	-10.0	-	-	-
Education	1.0			0.0	175.1	156.4	-10.7
Books, journals: first hand	0.6	12.0	0.0	-12.0	-	-	-
Stationery, photocopying charges	0.4	12.0	0.0	-12.0	-	-	-
Personal care and effects	2.4	-	-	0.0	175.2	156.2	-10.8
Toilet soap	0.6	18.0	5.0	-13.0	-	-	-
Toothpaste, toothbrush, comb, etc.	0.4	18.0	5.0	-13.0	-	-	-
Powder, snow, cream, lotion and perfume	0.4	18.0	5.0	-13.0	-	-	-
Hair oil, shampoo, hair cream	0.5	18.0	5.0	-13.0	-	-	-
Shaving cream, aftershave lotion	0.4	18.0	5.0	-13.0	-	-	-
Suitcase, trunk, box, handbag and other travel goods	0.0	12.0	5.0	-7.0	-	-	-
Umbrella, raincoat	0.1	12.0	5.0	-7	-	-	-
Total	10.4	-	-	-	-	-	-

Source: CEIC, PIB, Bank of Baroda Research

A digression:

Fig 1 below shows how retail sales have fared across different segments in FYTD25 (Apr-Jul). In all segments there has been revival. The lower prices through GST cut pass-through will further improve demand in these segments.

Fig 1: Improved demand visible in sales of consumer-oriented industries



Source: Retailers Association of India, Bank of Baroda Research

The angle of production:

If we look at the disaggregated IIP data, the pieces of the puzzle fit well. Majority of the non-durable goods where production was facing downside risk due to lower demand have been given support through lower GST rates. This will be helpful for production of Butter, jams, fruit jellies, honey, pastry, fruit juices etc. in the coming months. Thus, IIP growth, which was thought to be pressured from higher tariffs, might get significant support from domestic demand.

Table 4: On production side, majority of consumer non-durables were facing risk on production side

Consumer non durables	Wts in IIP	Index- FY24	Index- FY25
Consumer non-durables*	15.33	-1.5	4.1
Condensed milk	0.05	6.2	-2.9
Butter and other fats	0.04	21.3	-4.6
Jams, fruit jellies, marmalades, etc.	0.02	-4.8	-7.3
Ice cream and other edible ice, whether or not containing cocoa	0.04	-9	13.1
Artificial honey, whether or not mixed with natural honey etc.	0.01	66.7	-19.1
Cocoa butter, fat and oil	0.1	0.7	-3.7
Pastry, cakes, biscuits etc.	0.15	-3.1	-2.7
Fruit juices etc.	0.04	-11.3	-10.3
Pencil sharpeners	0.1	-13.1	8.8
Hair oil, shampoo	0.1	-2.3	-8
Dental floss, toothpaste	0.3	3.7	-1.6
Tooth powder	0.3	3.7	-1.6
Shaving cream, shaving lotion, aftershave lotion	0.1	-13	24.1
Toilet Soap	0.6	-0.4	-3
Concentrates of tea etc.	0.3	-0.2	-4.5
Drinking water	0.01	-8.4	1.8

Source: CMIE, Bank of Baroda Research, Note: Sectors where growth was trailing behind have been marked in red, * The weight may not add up to the subcomponents as only important items have been shown.

- **For durables**, specific focus of GST Council has been on items where production was trailing behind such as stove, Utensils, bags etc. However, we believe the non-durables part of IIP will get more assistance due to lower GST rates.

Table 5: ...Even for durables, it was trailing behind for certain commodities

Consumer durables, YoY	Wts in IIP	FY24	FY25
Consumer durables*	12.8	3.6	8.0
Furniture	0.1	-10.2	7.8
Carpets	0.1	0.3	13
Kerosene burners, stoves etc.	0	-54.8	-16.8
Utensils	0.2	19.1	-2.6
AC	0	12.1	18.8
Contact lenses; Spectacle lenses	0	19.9	22.8
TV	0.3	-4.2	16.7
Playing cards, chess board, carom board and other board games, like ludo, etc.	0	7.2	-2.8
Sports goods	0	25.6	11.7
Umbrellas	0	2.1	9
Human hair-articles thereof	0	-17.3	25.8
Handicraft- Handbags	0	-18.8	-10.7
Handbags and shopping bags, of cotton	0.1	5.8	-1.7
Tube for tractor tyres	0.1	1.7	5.1

Source: CMIE, Bank of Baroda Research, Note: Sectors where growth was trailing behind have been marked in red* The weight may not add up to the subcomponents as only important items have been shown.

GST boost to negate the tariff impact to an extent

The table shows a comprehensive list of commodities where share of US exports is higher in India's overall export profile. Thus, it is more susceptible to the higher tariff rate imposed by the US. However, we can clearly see that the current reforms of reduction in tax rates have been targeted towards those sectors. Textile, chemicals and products and poultry and dairy items, especially condensed milk, butter, ghee etc. would receive significant benefit from a lower tax rate.

Table 6: Sectors impacted due to tariff to get a boost through lower GST rates

Commodities	Share of US in total exports of India	Boost through GST
Readymade garments	33.4	Migrated to 5% from 12%
Chemicals & related products	24.3	Pharma goods (Note 4) migrated to 5% from 12%
Poultry and dairy products	23.1	Butter and other fats, condensed milk and cheese migrated to 5% from 12%
Machinery & instruments	19.6	Majority has been reduced to 5% and 18% rate from its notch higher slab
Misc. processed items	15	Migrated to 5% from 12%

Source: <https://cbic-gst.gov.in/>, CMIE, Bank of Baroda Research, Note 4: includes Sterile surgical items

Table 7: GST rationalization to benefit sector

Sector	Impact
Cement	<ul style="list-style-type: none"> - On a FYTD basis, cement production rose by 8.9% against 1.5% last year. - Sectoral growth expected to strengthen further, post monsoon. Boost demand for affordable housing. - Pick up is expected in construction activity and will be positive in the long term, especially in the second half.
Automobile	<ul style="list-style-type: none"> - Majority benefit to small cars and bikes with engines below 1200cc. On FYTD basis, PV and 2-wheeler sales have grown at a steady pace of 2.5% and 2.4% respectively. - Onset of festive demand is expected to boost sales. Auto companies have already started revising the prices to incorporate the newer rates. - Special efforts to remove inverted duty structure also expected to be positive for the industry.
Agriculture	<ul style="list-style-type: none"> - Focus on farm mechanization, lower dependency on imports. - Boost farm productivity, increase farmers income, supported by higher saving.
Household sector	<ul style="list-style-type: none"> - Growth in consumer durable output remains stable at 7.7% in Jul'25. FMCG output has also inched up for the same period. - Daily essential food items along with electronics to be cheaper and stimulate consumption. - Premiumization and formalization to gather pace - With GST rate rationalization, a pickup in the consumer good output is expected in near term.
Textile	<ul style="list-style-type: none"> - Lower rates will boost input competitiveness and positive for exports
Chemicals	<ul style="list-style-type: none"> - Positive for fertilizer, power and metallurgy sector that use this as part of raw material. - Expected to address the working capital challenge and key positive for MSME.
Hospitality	<ul style="list-style-type: none"> - Strong demand likely given lower rates for on hotel stays, boost tourism

Source: Bank of Baroda

Market Reaction to GST rate cut

- Broader market indices closed higher, as investors priced-in the revamping of the GST tax structure.
- Strong gains were noted in the auto, metal and consumer discretionary indices, since the announcement.
- Bond Yields eased at a much slower pace as revenue loss is expected to be much lower than anticipated, allaying concerns of fiscal slippages.

Table 8: Impact on financial market post the announcement

Sectoral indices	04-09-2025 (change from 03-09-2025)	05-09-2025 (change from 03-09-2025)
Auto	0.7	1.3
Capital goods	-0.6	-0.3
Metal	-0.6	0.7
Consumer durable	0	0.1
Consumer discretionary	0.2	0.6
Sensex	0.2	0
INR	-0.1	-0.1
10Y (bps)	-5	-3

Source: Bloomberg, Bank of Baroda Note: Green highlighted ones are the sectors which got support post announcement of GST rates

Conclusions:

In a major overhaul to the indirect tax structure, the current simplified GST rate structure had come in place. This has been a big push moment for overall consumption demand. The real gain to consumers through lower inflation is significant. This opens more scope to even re-route consumption to savings and investment. What has been interesting is the sector specific focus. GST rates have been lowered especially for certain non-durables segments which were facing downside risks to production. For durables, as well, those segments have received special attention whose share in exports to USA has been significantly higher. Thus, fine policy balancing is a welcome move.

- The taxable consumption group would be ~Rs 150-160 lakh crore. We estimate the net gain to consumption of ~ Rs 0.7-1 lakh crore which amounts to ~ 0.2-0.3% of GDP, from H2 onwards.
- Inflationary impact will be ~ 55-75bps. Thus, we revise downward our current estimate of headline CPI to 3.1% from our previous forecast of 3.5%.
- Tax reform is also expected to negate the higher tariff impact to certain extent.
- We retain our growth projection to 6.5% as our baseline forecast expected some underlying policy support.
- RBI will be watchful of evolution of inflation trajectory which is reeling under downside pressure before taking a call on rates.
- We expect at most 25bps cut remains in the current cycle since bond market has exhibited some pressure recently.
- The GST rate cut is expected to revive bank credit growth in H2FY26. Lending to MSMEs, auto, consumer durables, other personal loans and credit card receivables will improve. Our baseline forecast for credit growth for FY26 was ~ 10-11%. However, we expect the current move of lower indirect tax rates to stimulate the growth of credit by another 1% (net gain due to lower inflation) to our baseline projection. The second order effect will be more pronounced.
- As per government estimates, GST overhaul is expected to impact FY26 revenue by Rs 48,000 crore. This impact is minimal as accounts for only ~0.1-0.2% of the GDP. We continue to expect fiscal deficit target for FY26 to be met, as there remains a possibility that consumption improves significantly and the actual impact on revenues is even lower.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com