

The GST overhaul, effective 22-Sep, is a significant shift aimed at stimulating growth through consumption-led strategies, especially as indirect taxes are regressive in nature. The loss to the exchequer is estimated at ~0.14% of GDP, with states possibly taking a larger hit. However, with compensation cess ceasing to exist (nearly 0.5% of GDP), there is a de-facto demand boost for the economy (consumption sector), even as that revenue was not allowed to be used for fiscal math/budgetary flows. This move strengthens our longstanding sectoral rotation theme of '**consumption over capex**'. *Ceteris paribus*, such tax changes would add ~0.6% of GDP to domestic demand on an annualized basis and should boost (mass) consumption in FMCG, consumer durables, autos, and similar sectors.

GST overhaul comes into effect

The GST rationalization from 22-Sep will lead to a shift toward a dual-slab structure, ie: 5% and 18%, replacing the current 4-tier structure, along with a 40% slab for luxury and sin goods (mostly intoxicants). Compensation cess for most goods will cease to exist by 22-Sep and fully by end-CY25. Segments like i) **entry-level PVs (and even large SUVs)**, ii) most 2Ws, ii) a majority of consumer durables and consumer staples will see substantial benefits. Insurance and cement sector gains, however, will be constrained.

Limited estimated hit to the exchequer

The government estimates GST changes-led net revenue loss of Rs480bn (0.14% of GDP), with gross revenue loss at Rs930bn, while the new category of sin/luxury tax would provide additional revenue of Rs450bn. Static calculations have been made using FY24 consumption basket as the base. This would ease some of the fiscal slippage fear in the bond market.

We note that there is currently pressure on the Centre's gross tax revenue (GTR), already trailing budgeted growth (GTR growth for 4MFY26 is tracking ~0.8% vs 13% BE), making the BE tax buoyancy of 1.1x appear too ambitious. However, some buffers may be available in the form of higher non-tax revenue, helped by higher RBI and PSU dividends as well as possible divestment in IDBI/PSBs' stake sales (reducing the risk of divestment slippage). We will also keep an eye on i) the government's spending pattern to bridge taxation gaps in FY26 by cutting other expenditure (miscellaneous capex), and ii) whether fiscal support to tariff-affected sectors is largely in the form of credit guarantees (does not impact fiscal math directly) or direct fiscal support (subsidies).

Domestic demand impact, *ceteris paribus*, could be ~0.6% of GDP

The effective demand gain must be seen in light of simplifying the regressive indirect tax structure – India's indirect tax-to-revenue ratio is one of the highest among EMs. Technically speaking, the loss to the exchequer should be seen as a net gain to private economic agents. However, there are a few factors to note:

- 1) The annualized consolidated fiscal hit with the GST rejig appears to be contained under Rs500bn (0.14% of GDP), adjusting for the new luxury + sin tax, per the government's calculations. However, with compensation cess ceasing to exist (nearly 0.5% of GDP), there is a de-facto demand boost for the economy (consumption sector), even as that money was not allowed to be used for fiscal math/budgetary flows for either the Centre or states and was only to pay for redemption of/interest on Covid-related loans.
- 2) Notably, some items in the existing highest GST slab (28%) attract compensation cess, taking their effective rate to +45% (for instance, luxury cars effectively taxed earlier at 48-50% will now be subsumed within the lower GST tax of 40%).
- 3) The positive spill-over effect on consumption owing to reduction in indirect tax incidence, easier compliance, correction in the inverted duty structure in some key sectors, etc, would come into effect with a lag. The impact would be more concentrated in mass consumption items, contingent on demand elasticities.

'Consumption over capex' sectoral rotation theme gathers further steam

Overall, this implies a lower fiscal drag in FY26/27 and potentially a de-facto demand boost of ~Rs2trn (0.6% of GDP) to the consumption economy in CY27, with compensation cess getting dissolved. This reinstates our **sector rotation theme of consumption over capex**. All else being equal, such tax changes should boost (mass) consumption in FMCG, consumer durables, autos, and similar sectors. **Sectoral winners:** Autos, FMCG, durables, cement, footwear/apparel, QSRs, hospitals/insurers; **Sectoral losers/to watch:** Upstream oil & gas, coal-linked power, and select ancillaries (maybe metals, if cess on coal is not removed).

Key highlights:

- Loss of Rs480bn (0.14% of GDP) to the exchequer with GST 2.0, although fiscal buffers are available.
- Domestic demand may see a boost of ~0.6% of GDP as compensation cess is withdrawn.
- 'Consumption over capex' sectoral rotation theme gathers further steam.
- Autos, FMCG, Durables, Cement, Footwear/Apparel are the key sectoral winners.

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Exhibit 1: Slab-wise GST changes for key items in the new regime

Current GST rates	New GST rates	Category	Key items
0% (exempt)	0%	Goods	Fresh milk, Eggs, Fruits, Vegetables, Salt, Unpacked foodgrains, Sanitary napkins, Contraceptives, Books, Newspapers, Khadi fabrics, Agricultural implements, Hearing aids
0% (exempt)		Services	Educational services, Healthcare services, Public transportation, Government services, Agricultural services, Religious services, Library services, Health & Term Life Insurance (previously 18%)
5%	5%	Goods	Packaged milk products, Edible oils, Sugar, Tea, Coffee, Spices, LPG (domestic), Life-saving drugs, Electric vehicles, Readymade Garment below Rs2,500 (previously Rs1,000)
5%		Services	Economy air travel, Railway transport, Small restaurants (below Rs7,500), Goods transport services, Print media advertising
12%		Goods	Butter, Ghee, Cheese, Processed foods, Building materials, Footwear below Rs2,500 (previously Rs1,000)
12%		Services	Hotel accommodation up to Rs7,500
12%	18%	Services	Premium economy, business and first class air travel, Works contracts
18%		Goods	Mobile phones, Televisions, Electronic items, Cosmetics, Readymade garments & Footwear (above Rs1,000), Luxury watches, Steel products, Machinery, Furniture, Footwear & Readymade Garment above Rs2,500
18%		Services	Telecom services, IT services, Consulting, Legal services, Financial services, Hotel accommodation (above Rs7,500), Courier services, Entertainment services
28%		Goods	Air conditioners, Cement, High-end electronics, SUVs (sub-4mtrs- currently 28-31% including cess)
28%		Services	Luxury hotels (5-star)
Varied	40%	Goods	Aerated drinks, Tobacco products, Luxury cars, Large SUVs (currently 43-50% including cess)
		Services	Casino services, Online gaming, Betting and gambling services, Sports events

Source: CBIC, Emkay Research

Exhibit 2: Domestic demand to see ~Rs2trn boost (due to compensation cess' withdrawal)

(FY24 base)	Rs bn	% of GDP
Gross revenue loss to the exchequer owing to GST 2.0	930	0.3
Sin and luxury tax gains to the exchequer in GST 2.0	450	0.1
Net loss to the exchequer owing to GST 2.0	480	0.1
Gross gain to HHs owing to withdrawal of compensation cess	1,500	0.4
Net estimated gain to domestic demand	1,980	0.6

Source: Ministry of Finance, Emkay Research estimates

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Exhibit 3: Centre's tax revenue is tracking much lower growth than budgeted, while both revex and capex are higher

Centre's fiscal summary	FY26 budgeted growth vs FY25P (%)	4MFY26 growth (%)
Gross tax revenues	13	1
Direct taxes	17	-4
Corporate tax	10	8
Income tax	22	-10
Indirect taxes	11	6
Customs duty	3	-10
Excise duty	6	9
GST	15	9
Other taxes	77	-33
Net tax revenue	14	-7
Total expenditure	9	20
Revenue expenditure	9	17
Interest payments	14	36
Major subsidies	-1	-10
Capital expenditure	7	33
Defense	13	67
Railways	0	9
Roads and highways	-5	-15
Housing and urban affairs	19	-21
Transfers to states	3	103
Others	34	201

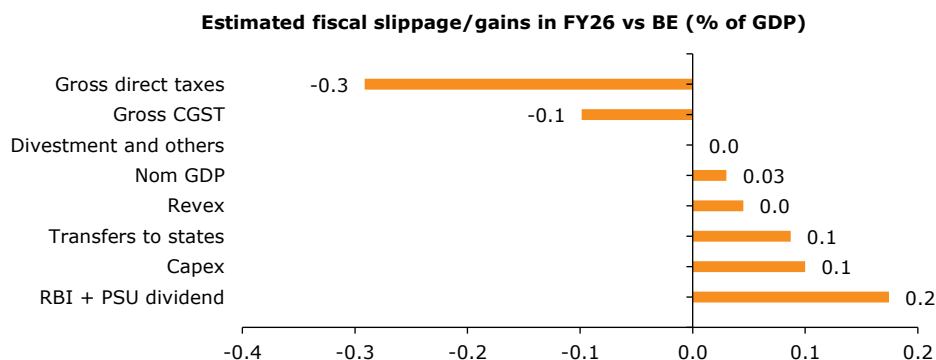
Source: CEIC, Emkay Research. Note: FY26BE growth is calculated on FY25P figures.

Exhibit 4: While states' tax revenue growth is tracking much lower than budgeted, they have curtailed expenditure as well

States' fiscal summary	FY26 budgeted growth vs FY25P (%)	4MFY26 growth (%)
Total Receipts	24	2
Revenue Receipts	24	1
Tax Revenue	13	2
OTR	19	7
SGST	18	11
Stamps and Registration Fees	25	7
Land Revenue	36	4
Sales Tax	18	2
State Excise	21	10
States' share of Union Taxes	3	-9
Other Taxes	12	-3
Total expenditure	20	8
Revenue expenditure	19	6
Interest payments	22	11
Subsidies	20	-12
Capital expenditure	30	11

Source: CEIC, state budget documents, Emkay Research; Note: FY26BE growth is calculated on FY25P figures. Data is for 18 major states.

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Exhibit 5: Centre's fiscal slippage may be partially countered by miscellaneous capex cut

Source: Union budget documents, Emkay Research estimates

Exhibit 6: The latest GST reforms lead to a ~10% cut in GST rates across auto segments

Category		Fuel Type	Tax Parameters	Earlier			Post Reforms	
				GST	Cess	Total	GST 2.0	Benefit
2Ws		Petrol	Under 350cc	28%	0%	28%	18%	▼ 10%
			Over 350cc	28%	3%	31%	40%	▲ 9%
4Ws	Sub 4 mtrs	Petrol	<1200cc	28%	1%	29%	18%	▼ 11%
		Diesel	<150cc	28%	3%	31%		▼ 13%
		SHEV/PHEV	Petrol <1.2L Diesel <1.5L	28%	0%	28%		▼ 10%
	PV	Petrol/Diesel	>1.2L and >1.5L <1.5L	28%	17%	45%	40%	▼ 5%
		Petrol/Diesel	>1.5L	28%	20%	48%		▼ 8%
		SHEV/PHEV	Petrol >1.2L Diesel >1.5L	28%	15%	43%		▼ 3%
		SUV	>4mtr; >1.5L; GC >170mm	28%	22%	50%		▼ 10%
	FCEV			12%	0%	12%	5%	▼ 7%
	Electric			5%	0%	5%		No change
3Ws			Passenger and Goods carriers	28%	0%	28%	18%	▼ 10%
CVs			Trucks, Buses, Ambulances	28%	0%	28%	18%	▼ 10%
Tractors and Agri Machinery				12%	0%	12%	5%	▼ 7%

Source: Company, Emkay Research

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