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Dipanwita Mazumdar
Economist

Consumption cheer through GST reforms

Indian consumers are likely to get another leg up through the recently announced GST reforms where focus has been on rationalization and simplification of the existing tax structure. What is going to be the major sigh of relief for the consumers is migrating from the current four-tier structure towards a two-tier one. Most importantly, the higher slab of 12% rate is pushed towards the lower rate of 5% and the 28% rate to the 18% rate. Thus, majority of consumer goods which lie within this bracket, especially FMCG and durable goods, are likely to benefit under the baseline scenario. We estimate 11.4% composition of PFCE (private final consumption expenditure) will receive direct advantage. The second-round impact through further reduction in intermediate input cost will be higher.

In this note, we tried to look at the consumption side of the story which will get a boost through 1) reduction in indirect tax rates and 2) through the channel of moderation in inflation. A sectoral perspective is given for majority of the goods which might be migrated to a lower tax slab. A one-to-one mapping of these products from GST HSN list has been done with the national account statistics data of disaggregated private final consumption expenditure (PFCE) at current prices.

Simplified two tier structure proposed

Government has yet to announce officially the detailed structure of GST. WE have made some assumptions here:

- Using the proportion of GST collected under different slabs, we get a rough estimate of the impact of migration of higher to lower tax slabs.
- Overall, we estimate the taxable consumption group would translate to ~Rs 150-160 lakh crore.
    - This is computed using different iterations of proportion of GST collected under different slabs and accounting for the migration of 12% to 5% slab and the 28% to 18% slab.
    - For the 40% slab, where usually sin goods are expected to be placed; we assumed a 10-20% range of commodities of 28% bracket to fall in the purview of 40% slab.

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). However, we are yet to know the details of 40% slab. Hence the impact might even be higher.

The table below shows that the major rejigging is expected in the 18% and 28% bracket. On account of this, effective tax rate is expected to come off to 14-15% of taxable GST goods and services. This is estimated using our computed Rs 150-160 lakh crore taxable consumption group. The effective GST rate goes down even further if we consider the entire consumption profile.

Table 1: New Slab structure

<table>
<tr><th>Old Slab</th><th>Proportion of GST collected, FY24</th><th>New Slab</th><th>Effective GST rate on taxable consumption</th><th>Effective GST rate on overall consumption</th></tr>
<tr><td>5%</td><td>6-8 %</td><td>5%</td><td rowspan="6">14-15%</td><td rowspan="6">10-11%</td></tr>
<tr><td>12%</td><td>5-6 %</td><td></td></tr>
<tr><td>18%</td><td>70-75 %</td><td>18%</td></tr>
<tr><td>28%</td><td>13-15 %</td><td></td></tr>
<tr><td></td><td></td><td>40%</td></tr>
<tr><td>Others</td><td>1-2 %</td><td>Others</td></tr>
</table>

Source: Ministry of Finance, Bank of Baroda Research

Sectoral Impact of GST:

Next, we tried to assess the sectoral impact due to this major overhaul in indirect tax rates. Here we accounted for those sectors which have the major share in overall PFCE and have one-to-one correspondence with commodity-wise breakdown of GST list. However, since the PFCE list is not exhaustive, we expect the benefit to consumption from the tax differential to be on the higher side. We expect the major push will come from food products where majority of the items are proposed to be shifted from the 12% to 5% rate. Considering the popular items, the overall share of food in PFCE translates to 8.6% with milk and milk products, oils and fat and processed food items, accounting for a notable share.

Non-food items have been downplayed in the calculation as disaggregated PFCE list does not cover it in an exhaustive manner. Here we expect the number to be on the upside. Durable goods sector such as AC, LED/LCD TV, Motor vehicles, Motorcycles and its parts will be significantly benefitted. The special focus on reduction in GST rates for Chassis fitted with engines, will further bring down the vehicle prices in the near term. Here for consumption calculation, motor parts and vehicles have been discounted due to lack of information. It is worth mentioning here that consumer durables production has been under pressure in Q1FY26 at 2.6% compared to 10.7% of same period of previous year. Thus, this move of lower tax rate will provide a significant upward push to these numbers.

Table 2: Sectors in focus

PFCE Disaggregated Components	Wts in PFCE	Old GST Rate	New GST Rate
Food Products	**8.6**		
Milk & Cheese	6.1	12	5
Oils and fat	1.4	12	5
Sugar, Jam, Honey, Chocolate and Confectionery	0.8	12	5
Non Alcoholic Beverages	0.3	28	18
Non-Food	**2.8**		
Electrical appliances	0.1	28	18

PFCE Disaggregated Components	Wts in PFCE	Old GST Rate	New GST Rate
Footwear	0.7	12	5
Glass	0.1	12	5
Textile	2	12	5
Total	**11.4**	**-**	**-**

Source: MOSPI, Bank of Baroda Research

Majority of the items especially in the 28% list are intermediate inputs such as portland cement, aluminous cement, slag (items used in construction), new pneumatic tyres, pumps and different motor vehicle parts. Thus, reduction in rates for these items will help in weighing down the price of final product. The second-round effect through reduction in prices of intermediate input is significant.

GST boost to negate the tariff impact

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, chemical and products and poultry and dairy items, especially condensed milk, butter, ghee etc. would receive significant benefit from a lower tax rate.

Table 3: 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

The angle of inflation:

Here we tried to map the GST commodity wise list with disaggregated CPI. Food items where major rejigging of rates happened (migration from 12% slab to 5% rate) comprise of ~3.3% in the overall CPI basket. This is based on certain assumption taken for items such as processed items, non-alcoholic beverages, motorcycles and its parts, footwear and textile, since the entire basket is not covered under the lower rates. The share of non-food items is also expected to be higher at ~5.2%. Thus, core inflation has a higher downside risk.

Thus, we expect 8.5% of overall CPI basket to be impacted due to lower tax rate. Even WPI has a downside risk as majority of intermediate input cost is also expected to come down especially for machinery and construction related products. The exact impact on inflation can be evaluated once the full list of rates commodity wise is available.

However, what can be clearly said is that items of daily household consumption will have a downside risk. Thus, this reduction in tax rates comes at a very opportune time when due to higher tariff rates by the US on India some degree of risk might emanate on account of imported inflation. Hence, the reform in indirect tax is a fine balancing act amidst turmoil in the global policy space.

Table 4: Majority of food and non-food items face lower tax rates

Items in CPI	Wts in CPI	Old GST Rate	New GST Rate
Food	**3.32**		
Milk powder	0.04	12	5
Noodles	0.03	12	5
Oils and fat	0.56	12	5
Sugar, Jam, Honey, Chocolate and Confectionery	0.97	12	5
Processed Food	0.83	12	5
Non Alcoholic Beverages: Mineral Waters, Soft Drinks, Fruit and Vegetable Juices	0.88	28	18
Core	**5.21**		
AC	0.05	28	18
Dish washer	0.00	28	18
LED/LCD TV	0.82	28	18
Motor vehicles, Motorcycles and its parts	0.64	28	18
Tyres	0.07	28	18
Medicinal items	0.20	12	5
Spectacles	0.06	12	5
Wool and leather products	0.00	12	5
Footwear	0.48	12	5
Glass	0.00	12	5
Textile	2.79	12	5
Candles	0.03	12	5
Others	0.06	12	5

Source: CEIC, MOSPI, Bank of Baroda Research

From Bank's Perspective:

In terms of Bank lending, it opens more opportunities for vehicle loans, credit card outstanding and other personal loans targeted towards consumer durable segment. This comes at a time when monetary boost has already been provided by RBI through frontloading of 100bps repo rate cut by RBI. The correspondent reduction in fresh WALR in the current cycle by SCBs has been 71bps. CIBIL report stated that the balance level delinquencies of auto and personal loans have also improved. Thus, against this backdrop, it sets an ideal time for pick up in credit demand. NBFCs are also expected to see a pickup in their loan portfolio. This coinciding with festive month, will have a higher cumulative impact.

Conclusion:

India has already embarked on its path of reform amidst volatile global policy landscape. The first such move was visible in a major rationalization of GST rates by proposing a simplified two-tier structure. The migration of major essential items of consumption, especially food items, from the 12% to 5% bracket will provide a major breather for middle class consumers. The durable goods sector, such as AC, LED/LCD TV, Dishwasher, Motor vehicle and its parts which have been reeling under pressure for some time, will also get a significant boost as majority of them have migrated from the 28% slab to 10% slab. For motor vehicles, it will be a major fillip before the seasonal festive cheer. In terms of macro-impact, we assess:

- 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.
- We estimate 11.4% of PFCE will receive direct advantage.
- Tax reform is also expected to negate the higher tariff impact to limited extent.
- Inflation to face downside pressure as we expect at least 8.5% of overall CPI basket to be impacted due to lower tax rate. Lower intermediate input cost is also expected to bring down producer prices.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
dipanwita.mazumdar@bankofbaroda.com