

On 3 September 2025, India's Goods and Services Tax (GST) Council approved significant GST simplifications and reductions for a range of categories. This has come at the right juncture given the country faces a potential slowdown from higher-than-expected US tariffs on Indian goods exports. In this investment note, Rana Gupta, Senior Portfolio Manager, Indian Equities, and Koushik Pal, Senior Director, Indian Equities, examine

the impact of this "structural rate cut" on the country's economic trajectory and equity investment opportunities in the background of the US tariff situation and its impact when US-India trade relations were to normalise.

Indian Equities: GST 2.0 — A Structural Tax Cut at the Right Time

GST 2.0 – a simplified indirect tax regime with structurally lower tax rates – has come at the right juncture given the country faces a potential slowdown from higher-than-expected US tariffs on Indian goods exports.

Its introduction should cushion external headwinds while addressing broader domestic needs. By simplifying the tax slabs from four to two (5% and 18% plus a demerit rate of 40%), and retiring the GST compensation cess, policymakers have delivered a stimulus worth 0.6% of gross domestic product (GDP) to households at a direct fiscal cost of only 0.15% of GDP. The balance comes from eliminating a cess that had served its purpose — effectively a structural tax cut.

This reform of GST, along with measures like income tax and interest rate cuts, has nearly offset the slowdown from tariff risks in the short to medium term.

It re-anchors growth toward domestic consumption, simplifies the tax system, and boosts household purchasing power. Taken together with the Union Budget's income tax relief – around 0.3% of GDP – and the 100 basis points (bps) – around 0.3% of GDP – of monetary policy easing by the Reserve Bank of India (RBI), India now has a combined domestic impulse of roughly 1.2% of GDP.

With below-target inflation and a moderating current account deficit, policymakers have used their hard-earned fiscal discipline to lean in — turning stability into stimulus when it is most needed.

We believe GST 2.0, along with other measures, could largely offset the direct slowdown from exports due to the tariff drag by supporting domestic demand.

From Complexity to Simplification

India's GST system, once burdened by four tax slabs, has been complex with an outdated categorisation of goods. Consumption growth had also been slowing due to lower fiscal impulse in earlier years, despite deeper formalisation of the economy.

Against this backdrop, GST 2.0 simplifies the system into two functional slabs — merit (5%) and standard (18%), plus a demerit rate (40%). This reorientation lowers friction for businesses and provides clarity for households. This was reached by slashing rates from 12% to 5% and 28% to 18% for most mass consumption items, while putting select luxury and "sin" goods at 40%. Even the goods at the 40% slab, like SUVs, benefit from an effective tax rate cut due to the removal of the cess.

The following chart shows the current and new GST rates (effective from 22 September 2025).

Chart 1: Current and new GST rates¹

Sector	Eff. GST rate (%)	
	Current	New
Automobiles		
2W ICE	28	18
3W	28	18
PVs - Hatchbacks + Sedans	29	18
PVs - Micro/Compact SUVs (< 1.2L engine)	29	18
PVs - Micro/Compact SUVs (> 1.2L engine)	45	40
Mid-size SUVs	48	40
Large SUVs/MPVs	50	40
Commercial vehicles	28	18
Tractors	12	5
Cement	28	18
Air-conditioner	28	18
Non-life insurance	18	0
Consumer staples		
Butter and others fats (ghee, butter oil etc.)	12	5
Fruit pulp or fruit juice-based drinks	12	5
Namkeens	12	5
Sanitary napkins	12	5
Oral care	18	5
Skin cleansing, soaps, shampoos	18	5
Sugar, Biscuits, chocolates	18	5
Total		

From Simplification to Stimulus

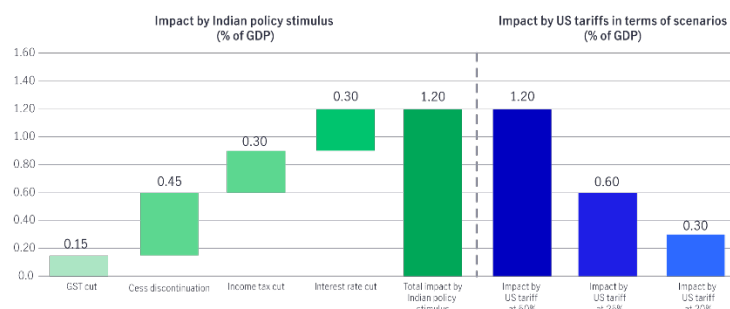
The centrepiece of the new policy is the removal of the cess, a levy that had been introduced to fund transition debt.

With those obligations largely met, eliminating the cess creates immediate relief. As a result, households receive a domestic stimulus of approximately 0.6% of GDP (around Indian Rupee (INR) 2.0 trillion or USD 24 billion), while the direct fiscal impact is only around 0.15% of GDP (approximately INR 0.6 trillion or USD 7.5 billion).

The remainder at 0.45% of GDP is effectively a tax cut through discontinuation of the cess, which was estimated at around INR 1.4 trillion or USD 16.5 billion. Importantly, discontinuation of the cess will not amount to fiscal revenue loss, as it was never accounted as part of the revenue and was collected to fund a transition debt, which has now been repaid.

The following chart shows the GDP impact of the policy stimulus versus the GDP impact of the US reciprocal tariffs.

Chart 2: Comparative impact on India's GDP of policy stimulus versus US reciprocal tariffs²



From Stimulus to Macro Impact

This fiscal stimulus translates into a meaningful macro impact. On its own, GST 2.0 provides consumers with a transfer of approximately 0.6% of GDP. Combining this with the Union Budget's direct income tax relief (around 0.3% of GDP) and the RBI's 100 bps easing on consumer loans (around 0.3% of GDP), the total domestic fiscal and monetary impulse is estimated at 1%-1.2% of GDP.

In a recent note "Impact of U.S. Tariffs on Indian Exports", we estimated that US tariffs at 50% could negatively impact at most 1.2% of GDP via export channels.

GST 2.0 provides a domestic counterweight of almost the same scale, while also improving structural efficiency in the tax system. From a direct impact perspective, GST 2.0, alongside other measures, are expected to provide a strong buffer for the domestic consumption channel against potential goods export slowdown due to the 50% tariff imposed by the US. That said, some uncertainty could still linger, as indirect impacts begin to take hold over the next few months.

While stronger domestic demand and weaker exports may widen the current account deficit modestly, this only implies a manageable Rupee depreciation within the bounds of India's external resilience.

¹ Source: GST Council. The computation of "current" GST rates includes cess.

² Source: The Ministry of Statistics and Programme Implementation, Government of India. The graph is based on projected FY2026 GDP. US tariff calculations assume current exemptions to continue.

Given the lingering uncertainty on the trade side, if the Indian government continues to pursue its fiscal deficit targets aggressively, that will be a risk in our view. On the other hand, if the US rolls back the tariff rate from 50% to 25% and further resets it lower in the range of 15%-20% (which is in line with other Asian countries), that will be a crucial positive.

On the backdrop of domestic reforms, a normalisation of US-India trade relations could be a positive turning point for growth and India's corporate earnings trajectory.

Sector Views

The sectoral footprint is uneven. The following sectors are expected to be the biggest beneficiaries.

- **Autos:** Areas where affordability matters the most are the key beneficiaries, such as two-wheelers, entry-level cars, commercial vehicles, and tractors. SUVs are also expected to benefit from the discontinuation of the cess.
- **Consumer durables:** White goods, such as air-conditioners, refrigerators, and washing machines, could see a direct affordability boost.
- **Consumer staples:** While most items in personal care and packaged food categories will see prices drop due to the GST rate cut, we expect savings on essentials will be spent on other discretionary items like quick commerce, durables, jewellery, and travel.

Among other major categories, GST was also reduced for cement, as well as affordable apparel and footwear.

While we may see a near-term lull in demand in anticipation of the price drop effective from 22 September 2025, we expect a significant demand rebound going into the second half of FY2026 (fourth quarter of 2025 and first quarter of 2026).

Portfolio Positioning

GST 2.0 strengthens the case for overweighting domestic consumer cyclicals, electronics and white goods. Besides, we also like domestic infrastructure plays. We continue to stay true to our 5D structural framework for sector preferences.

Consumer cyclicals: The segment is expected to benefit from GST cuts, income tax relief, and lower interest rates, mainly due to its price elasticity of

demand. Structurally, sectors like consumer tech, travel, auto, and white goods should continue to see growth. This is part of our “**Digitization**” and “**Demographic**” themes.

- **Domestic manufacturing of electronics and white goods:** Growing consumption of white goods and electronic items, like mobile phones and laptops, has boosted domestic manufacturing. GST cuts will sustain such demand. Moreover, we expect better value addition in those sectors due to component manufacturing, supported by policy-driven import substitution via PLI (Production Linked Incentives) schemes. This is a part of our “**Deglobalization**” theme, in which import substitution benefits companies in such sectors.
- **Domestic infrastructure:** Positive infrastructure spending and domestic growth should support segments, such as telecom, hospitals, renewable power, and real estate. In addition, growth in these segments is also boosted by market consolidation, asset completion, and cashflow improvements. This is part of our “**Decarbonization**” and “**Deficit Reduction**” themes.

Apart from the domestic sectors, we continue to like the area below from a bottom-up perspective.

- **Pharmaceuticals** (CRDMO – Contract Research, Development, and Manufacturing Organisation): Outside of China, India remains a key geography of CRDMO of small molecules for global pharmaceutical companies, thanks to its scale and technology. This is part of our “**Deglobalization**” theme, in which Indian exporters could potentially gain market share due to supply chain diversification out of China.

Conclusion

Through GST 2.0, India is leveraging its macro stability to support its economy by tilting the growth engine towards households and domestic consumption, amid potential export headwinds.

The costs – a modest fiscal deficit, a manageable widening in current account, and a moderate Rupee depreciation – are affordable given the country's

discipline in its fiscal balances, inflation and external accounts. The policy mix now offers a cushion against tariffs.

If the 50% tariff for goods exported to the US remains in effect, we expect more policy support to affected sectors, like textiles and jewellery, in the form of credit guarantee schemes for small and medium enterprises, which could contain the impact on the asset quality of lenders.

If the 50% tariff is rolled back to 25% or reset lower to a range of 15%-20% amid ongoing negotiations, that will be a significant positive for economic and earnings growth.

Overall, we believe this policy combination reaffirms India's position as one of the few large economies that can deliver economic growth while maintaining macro stability.

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