GST rationalisation to strengthen demand for consumer discretionary

Positive for domestic manufacturing particularly MSMEs, risks to core inflation and fiscal deficit

Acuité believes that the reduction of GST on over 50 items, largely consumer durables will boost consumption in the economy and is likely to have a positive impact on capacity utilisation of the domestic manufacturing ecosystem. Some of the products where the reduction has been proposed relate to the indigenous handicraft sector which is expected to regain its competitiveness vis-à-vis cheaper imports. This also moves the GST structure towards a narrower and simpler taxation band. However, such rationalisation would lead to revenue losses for the Government and would present risks to fiscal deficit and core inflation.

Since the implementation of the GST in July 2017, the GST Council has adopted a phase wise rationalisation of the tax structure to provide relief to certain industry sectors and address any potential anomalies. In the 28th GST Council recently, the Government has reduced the applicable tax to over 50 items which is expected to boost demand in the consumer discretionary segment and give a fillip to the domestic manufacturing setup particularly MSMEs which are involved in the value addition chain. The GST rates for over 17 consumer durable goods including televisions (of over 27" size), washing machines, refrigerators, etc. and paints have been reduced from the highest slab of 28% to 18% which is expected to make these goods more affordable and increase their penetration in the semi-urban and rural areas. Furthermore, the reduction in rates on some of the handicraft products such as handbags and leather items including low priced footwear is also expected to strengthen domestic manufacturing of these items and enhance their competitiveness against cheap imports. Higher demand and increased capacity utilisation thereof in some of these sectors may also lead a renewal of the much-awaited capex cycle in the private sector. The proposed measure to apply GST on actual tariff basis instead of the standard tariff rates will benefit the domestic hotel and tourism sector particularly the mid to premium category of hotels where there is significant divergence between the above rates. The decision to reduce the GST on ethanol from 18% to 5% will also spur oil companies to go for higher offtake from the sugar industry, thereby improving their cash flows. The details of such rate revisions and their impact is enclosed in Table-I below.

Says **Suman Chowdhury, President – Ratings, Acuité Ratings and Research, "In our opinion, these measures are positive for corporates and MSMEs who are either involved in manufacturing, wholly or partly or trading of products such as electronics items, chemicals, leather, handicraft etc. MSMEs have also been provided relief through a simpler tax filing mechanism and quarterly returns for businesses with turnover up to Rs. 5 Cr. Overall, this is a move towards a GST structure which has fewer tax slabs and is simpler in administration."**

Notwithstanding the positive impact of such GST rationalisation, Acuité also believes that it builds inflationary pressures. In the opinion of **Karan Mehrishi**, **Lead Economist, Acuité Ratings and Research** "**Core inflation, which has seen significant divergence from headline inflation since January 2018 has been steadily approaching the 6% target range; as of June 2018, the differential is recorded at near 250 bps. We believe that this is primarily driven by the revised minimum support price (MSP) and the implementation of the 7th Pay Commission recommendation. While the lower tax structure will add to the consumption growth, it can also lead to the rural markets witnessing a faster acceleration in inflation. This has the potential to expedite the rate hike cycle of RBI, with a 25 bps hike in the near term and may contribute to higher borrowing costs over the next 2-3 quarters."** Acuité also estimates that the potential revenue loss for the Government on account of such reductions stand at Rs. 14,800 Cr. per annum which may increase the fiscal deficit slightly by around 12 bps. Higher fiscal deficit than estimates coupled with higher public spending can have a further impact by pushing up interest rates.

Table 1: Key Changes- GST Structure & Impact

Category	Previous GST	Revised GST	Impact
Electric Appliances, TV, Washing Machines, Refrigerators, Mixers, Water Coolers etc.	28%	18%	Consumer Durables: Positive
Paints & Varnish	28%	18%	Paints Sector: Positive Real Estate Sector: Positive
Leather Products Footwear (<Rs. 1000)	28% 18%	18% 5%	Leather Goods: Positive
Lithium-Iron Batteries	28%	18%	Electronics Sector: Positive
Ethanol	18%	5%	Sugar Sector: Positive
Handloom, handmade carpets, lace, handbags, iron, brass and copper ware, mineral carving	12%	5%	Handicrafts Sector: Positive
Sanitary Napkins	12%	0%	
Retail loans, home loans, NBFCs	NA	NA	Financial Services: Negative
Hotel Charges (applicable on)	Standard Tariff	Actual Tariff	Hotel Sector: Positive

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