05 September 2025

India's Landmark GST Reform: Boosting Growth, Easing Inflation, Testing Fiscal Prudence

DMI FINANCE

- India's Goods and Services Tax (GST) Council has approved the most significant indirect tax reform since 2017, moving from a complex four-tier structure to a simplified two-tier regime.
- GST rates have been consolidated into 5% and 18% slabs, with tax reductions across essentials, agriculture, healthcare, and consumer durables.
- The reforms aim to ease the burden on middle-class households, support MSMEs and farmers, and reinvigorate key growth drivers.
- Strategically, the policy focus signals a shift away from government-led investment spending towards reviving private consumption demand, complementing income tax cuts and the RBI's repo rate reductions.
- The new GST rates will take effect from 22 September, earlier than the Diwali timeline suggested by the Prime Minister, to spur festive demand.
- Alongside tax rate cuts, the Council introduced business-friendly measures such as faster GST registration, expedited refunds, and correction of inverted duty structures to improve competitiveness and reduce litigation.
- Together, these reforms could potentially support a virtuous cycle of lower costs, stronger demand, wider compliance, and higher revenues. However, these benefits will play out over the medium term and hinge on effective implementation.
- The fiscal revenue implication of GST rate cuts is estimated at ~30 basis points (bps) of GDP in FY26, with the centre accounting for ~10 bps and states ~20 bps, requiring some expenditure rationalisation to avoid overshooting the budget deficit targets.
- While equities rallied briefly on the GST announcement, they pared gains amidst continued US tariff concerns. Bond markets remain cautious amid additional bond supply concerns; the RBI may need to support through measures such as Operation Twist and a reduction in duration bond supply in the H2-FY26 borrowing calendar.
- In FY26, the demand boost from the GST rationalisation and expected discontinuation of compensation cess by the end of Q3-FY26 is estimated at ~40 bps of GDP. This, combined with a better-than-expected Q1 economic growth, introduces an upside bias to our FY26 real GDP forecast of 6.2%.
- As a result of GST rate cuts, headline CPI inflation is also likely to ease by ~30–50 bps in FY26, supporting a softer inflation trajectory, widening the space for the RBI's policy rate cut.

Pramod Chowdhary
Chief Economist
pramod.chowdhary1@dmifinance.in

Bhawna Sachdeva
Economist
bhawna.sachdeva@dmifinance.in

Rajvinder Kaur
Economist
rajvinder.kaur@dmifinance.in

Shantanu Sharma
Economist
shantanu.sharma@dmifinance.in

www.dmifinance.in

+91 11 4120 4444

DMI Finance Private Limited
Express Building, 9-10, 3rd Floor,
Bahadur Shah Zafar Marg,
Delhi – 110002.

DMI FINANCE

GST Council Unveils Landmark Indirect Tax Reform

India's Goods and Services Tax (GST) Council has approved the most significant indirect tax reform since the system's inception in 2017, moving from a complex four-tier structure to a simplified two-tier regime. GST rates have been consolidated into 5% and 18% slabs, with substantial reductions across essential goods, agriculture, healthcare, and consumer durables. The reforms are aimed at easing the burden on middle-class households, supporting MSMEs and farmers, and reinvigorating key drivers of the economy. At the same time, a special 40% GST rate has been levied on a few demerit and luxury goods. The Council also unveiled procedural and institutional reforms designed to simplify compliance, reduce disputes, and enhance ease of doing business.

The new GST rates will take effect from 22 September (except for a few items), earlier than the Diwali timeline suggested by Prime Minister Narendra Modi in his Independence Day address. The timing appears deliberate: by advancing implementation ahead of the festive season, the Council aims to spur demand. The measures are estimated to boost economic growth by ~40 bps of GDP and reduce headline CPI inflation by ~30–50 bps (depending on pass-through) in FY26, with the impact concentrated in H2-FY26. However, the reforms carry fiscal risks, with potential revenue losses of ~10 bps of GDP for the Centre and ~20 bps for the states in FY26. Some of the shortfall could be offset through expenditure rationalisation, though this may dilute part of the growth impulse from the tax cuts. Some possible surpluses from the GST compensation fund could also help reduce the net fiscal impact.

Strategically, this reform signals a continued focus on a shift from a policy approach of government-led investment spending to a stronger emphasis on reviving private consumption demand, which had started with the income tax cuts announced in the budget. It complements other measures, including income tax rebates and the RBI's repo rate cuts, forming part of a broader stimulus package to boost domestic demand and support the economy amid global trade uncertainties and the adverse impact of US tariffs.

Wide Range of Tax Cuts to Lower Input Costs and Stimulate Demand

The GST reforms provide targeted relief to middle-class households through reduced tax rates on everyday essentials such as packaged foods, bicycles, textiles, education-related items, and hygiene products, all now taxed at 5% instead of 12%–18%. Ultra-high temperature milk, paneer, and Indian breads (roti, paratha, chapati) have been fully exempted. In consumer durables, GST on electronics such as televisions, monitors, and air conditioners has been cut from 28% to 18%, offering relief to households and potentially reviving demand in a sector that has faced subdued and uneven demand. Mobile phones, however, will likely continue to attract an 18% rate.

The healthcare sector has received notable relief, with 33 life-saving drugs now exempted from GST. Individual health and life insurance policies, previously taxed at 18%, are fully exempt, while group insurance remains at 18%. The GST rate on medical devices, including thermometers, glucometers, diagnostic kits, and oxygen equipment, has been reduced to 5%. This package is likely to ease the financial burden of healthcare and improve access for households.

The automobile sector benefits significantly, with GST on small cars, motorcycles below 350cc, three-wheelers, buses, trucks, and ambulances lowered from 28% to 18%. A uniform 18% GST on auto parts should resolve classification disputes and create supply chain efficiencies. Mid-sized and large cars, SUVs and sports cars will be subjected to the special 40% GST rate (without cess), down from an earlier effective tax (including cess) range of 45–50%. This could boost vehicle sales, particularly for small cars, during the festive season.

In services, essential categories such as budget hotels (tariffs under Rs 7,500) and wellness services will now be taxed at 5%. Economy-class air travel retains the concessional 5% rate, while GST on business and premium economy moves up to 18%. Luxury aircraft for personal use face the highest 40% GST slab, reflecting the government's intent to tax premium segments more heavily while protecting economy travellers.

Agriculture and housing have also been prioritised. GST on tractors, farm machinery, and certain pesticides has been reduced to 5% from 12%–18%, expected to support rural demand. GST on cement has been cut from 28% to 18%, while rates on marble, granite, bricks, bamboo flooring, and packing materials have been lowered from 12% to 5%. Developers are likely to pass on some of this benefit, making housing more affordable.

Pan Masala, gutkha, cigarettes, chewing tobacco products like zarda, unmanufactured tobacco and bidi will continue at the existing rates of GST and compensation cess where applicable, till loan and interest payment obligations under the compensation cess account are completely discharged, which the finance minister indicated should be within CY2025.

Reforms to Improve Ease of Doing Business and Create a Virtuous Cycle of Growth

Beyond GST rate changes, the Council introduced several business-friendly reforms. These include automatic GST

Commodity-wise Revised GST rates			
Sector	**Items**	**From**	**To**
Food	UHT Milk, pre-packaged paneer/roti/khakhra	5%	**Nil**
	Dairy products, dry fruits and nuts, animal fats & oils , coffee and beverages (excl. non-alcoholic),Instant & preserved foods and processed foods	12%	**5%**
	Chocolates, cocoa foods, sugar confectionery, ice cream, pastries, cakes	18%	**5%**
Daily Essentials	Hair Oil, shampoo, toothpaste, bicycles, utensils etc	12%-18%	**5%**
Textile & Footwear	Footwear of sale value not exceeding Rs. 2500 per pair	12%	**5%**
	All manmade fibres and yarn	12%-18%	**5%**
	Articles of apparel exceeding Rs. 2500	12%	**18%**
Electronics	TVs (above 32 inches), air-conditioners, dishwashers, batteries & storage devices (excluding lithium-ion)	28%	**18%**
	Renewable devices (solar heaters, windmills, biogas, waste-to-energy)	12%	**5%**
	Kitchenware & household stoves	12%-18%	**5%**
	Mobile phones	18%	**18%**
Automobile	Small cars, motorcycles ≤350cc, 3-wheelers, hybrid cars (≤1200cc petrol, ≤1500cc diesel)	28%	**18%**
	Mid size cars	28% + Cess	**40%**
	Commercial vehicles (buses, trucks, ambulances)	28%	**18%**
	Auto parts & accessories (tyres, brakes, gearboxes, etc.)	28%	**18%**
Healthcare	Individual Life & Health insurance	18%	**Nil**
	Lifesaving medicines	12%	**Nil**
	Other medicines (allopathy, ayurvedic, homoeopathic)	12%	**5%**
	Medical devices (diagnostic kits, bandages, instruments, thermometers, lab devices)	12%-18%	**5%**
Agriculture	Tractor tyres & tubes	18%	**5%**
	Tractors, hand-propelled & animal-drawn vehicles and irrigation equipment (drip systems, sprinklers)	12%	**5%**
Infrastructure and Construction Goods	Cement	28%	**18%**
	Marble and granite block, sand lime bricks or stone inlay work , woods	12%	**5%**
Education	Maps, globes, charts, notebooks and sharpeners	12%	**NIL**
	Mathematical boxes, geometry boxes and colour boxes	12%	**5%**
Luxury and Sin Goods	Aerated waters with added sugar (colas, soft drinks), carbonated beverages of fruit drink/with fruit juice, and caffeinated beverages	28%	**40%**
	Betting, casinos, gambling, horse racing, lottery, online money gaming	28%	**40%**
	High-end luxury automobiles, SUVs, yachts, and personal-use aircrafts	28%	**40%**
	Tobacco, pan masala, gutkha, cigarettes, nicotine products	28%	**40%**
Services	Hotel accommodation, services <= Rs. 7,500 per unit per day	12%	**5%**
	Beauty and physical well-being services like gym, salons ,yoga centres	18%	**5%**
	Air passenger transport (non economy class)	12%	**18%**
	Passenger Transport by Motor Vehicle (fuel included, other than same line of business)	12%	**18%**

Source: PIB, GoI

registration within three working days for small and low-risk applicants, expedited export refunds, and changes to post-sale discount rules to reduce litigation. Provisional refunds of 90% of claims under inverted duty structures will now be fast-tracked, helping ease cash flow pressures for businesses. The Council also corrected inverted duty structures by reducing GST on man-made fibres from 18% to 5% and yarn from 12% to 5%, alongside a cut to 5% on fertiliser inputs such as sulphuric acid, nitric acid, and ammonia. These measures should improve competitiveness, reduce import dependence, and lower litigation risks.

Together with GST rate cuts, these reforms are intended to create a virtuous cycle of growth. By making goods and services cheaper, they are likely to lift household savings and stimulate consumption. Lower input costs should enhance MSME competitiveness, support domestic manufacturing, and promote value addition. The government expects that lower tax rates combined with better compliance could ultimately increase tax collections, reinforcing a cycle of lower costs, higher demand, stronger revenues, and sustainable growth. However, these benefits will likely play out in the medium to long term and will depend on effective implementation.

Policy Stimulus vs. Fiscal Risks

Wide-ranging GST cuts will weigh on fiscal math. According to the Revenue Secretary, the net fiscal implication of the reforms is Rs 48,000 crore (based on the FY24 consumption base), though details remain unclear. Factoring in GST revenue loss in H2-FY26, the end of GST compensation cess by December 2025, and second-round tax gains from a likely stronger demand, our estimates put the net fiscal revenue loss at ~30 bps of GDP in FY26, with the Centre accounting for around 10 bps and states the rest. With a GST multiplier of 1.08, the demand boost is estimated to improve GDP by ~40 bps in FY26 (with impact concentrated in H2), broadly offsetting the negative impact of US tariffs (potential adverse direct estimated impact of ~25–35 bps of GDP, assuming partial tariff rollback in Q4). This, combined with the stronger-than-expected Q1 GDP, introduces an upside bias to our FY26 real GDP growth forecast of 6.2%. Depending on the pass-through by producers, inflation should also benefit, with headline CPI likely to be ~30–50 bps lower in FY26 (with the impact concentrated in H2-FY26) due to GST rate cuts, widening the space for the RBI's policy repo rate cut.

Stock markets have responded positively, but the bond market continues to remain concerned about the possibility of increased bond supply. The NIFTY50 opened 1.1% higher on 4th September (the day following the GST announcement), boosted by the breadth of GST reforms; however, the concerns over the US tariffs overshadowed throughout the day, and the index closed with moderate gains of 0.1%. The 10-year G-Sec yield moderated to close at 6.49% on 4th September from 6.54% in the previous session but remained higher than the low of ~6.25% in June. Concerns persist about higher market borrowing requirements, while demand for long-term bonds from insurers and pension funds has softened. This has already steepened the G-Sec yield curve in recent months, weighing on transmission through the bond market. The underlying challenge lies in demand-supply mismatches, which require a coordinated response from both the RBI and the government.

Looking ahead, the RBI is expected to announce the H2-FY26 borrowing calendar in September. The market expects the central bank to shorten the average duration of borrowings to ease pressure on long-end yields. While the RBI may also signal discomfort with current yield levels through auction cancellations or by rejecting aggressive bids, such interventions are usually short-lived in impact. One option the RBI might consider is Operation Twist (buying long-term government securities while selling short-term ones), especially since outright OMOs are constrained by the 100-bps CRR cut.

DISCLAIMER

This research report/material (the “Report”) is for the personal information of the authorised recipient(s) and is not for public distribution and should not be reproduced or redistributed to any other person or in any form without DMI’s prior permission.

In the preparation of this Report, DMI has used information that is publicly available as well as data gathered from third party sources. Information gathered and material used in this Report is believed to have been obtained from reliable sources. DMI, however makes no warranty, representation or undertaking, whether expressed or implied, that such information is accurate, complete or up to date or current as of the date of reading of the Report, nor does it assume any legal liability, whether direct or indirect or responsibility for the accuracy, completeness, currency or usefulness of any information in this Report. Additionally, no third party will assume any direct or indirect liability. It is the responsibility of the user or recipient of this Report to make its/his/her own decisions or enquiries about the accuracy, currency, reliability and correctness of information found in this Report.

Any statement expressed as recommendation in this Report is general in nature and should be construed strictly as current opinion of DMI as of the date of the Report and may be subject to change from time to time without prior intimation or notice. The readers of this Report should carefully read, understand and investigate or enquire (either with or without professional advisors) into the risks arising out of or attached to taking any decisions based on the information or opinions contained in this Report. DMI or its officers, directors, personnel and employees, including persons involved in the preparation or issuance of this Report may have potential conflict of interest with respect to any recommendation and related information and opinions.

Neither DMI nor any of its officers, directors, personnel and employees shall be liable for any loss, claim, damage of whatsoever any nature, including but not limited to, direct, indirect, punitive, special, exemplary, consequential, as also any loss of profit in any way arising from the use of this Report or the information therein or reliance of opinions contained in this Report, in any manner.

No part of this Report may be duplicated or copied in whole or in part in any form and or redistributed without the prior written consent of DMI. Any reproduction, adaptation, distribution or dissemination of the information available in this Report for commercial purpose or use is strictly prohibited unless prior written authorization is obtained from DMI. The Report has been prepared in India and the Report shall be subject only to Indian laws. Any foreign reader(s) or foreign recipient(s) of this Report are requested to kindly take note of this fact. Any disputes relating to the Report shall be subject to jurisdiction of Republic of India only.