



## GST 2.0 – How good will be the feel good?

GST 2.0 is here. Rate reductions should result in price relief for consumers. The case will be built up for economic growth getting a fillip. The underlying obvious argument is that the price reduction will lead to a demand surge. This in turn will accelerate the wheels of production and the virtuous cycle will help in negating or mitigating the GST revenue gap being created in the first place. This is good economics and no doubting that. The rationalisation of rates is a great step. The income transfer from the government to the consumer is constructive. This is a logical progression from the effort to push up government capex spending post-Covid. The baton is being passed on to the consumers for the heavy lifting of growth.

Is this the only or main factor affecting consumption? Will consumption turn around and meaningfully? The price relief for consumers will no doubt be growth positive. The extent is an unknown. The time taken for the pass-through effect to show up is another imponderable.

More importantly for us as investors, the rhetorical question in the title to this piece is directed at investors and the market. The market tradition over the last decade and particularly after Covid is to celebrate any development as market positive. It is either positive immediately or if it is too much of an ask, it is positive in the long run.

Our thesis is this:

GST reduction is consumer positive. The impact will be divergent. It pays to parse the flurry of incoming data.

We are not sure that this is producer positive. The data presented below provides some food for thought.

We have said this, and we repeat. The market is on a treadmill of valuations, and it is hellbent of steepening the slope for itself. Implications are obvious. Feel good is ending up being an end in itself. GST 2.0 is a great structural reform just as GST1.0 was. The benefits from GST 1.0 came about over 5-7 years. GST 2.0 is one in many steps that can make India grow faster than other countries. Over time.

India has not been able to get out of the low-income trap. The fight is on to qualify for a middle-income trap. This is at the aggregate level for the country. Capital markets have marched ahead, and no government can keep feeding this cavernous beast. The most recent case in point is the income tax cut in February. Quite obviously, we have to agree that the salary earners would have got the higher salary from April. If there was such a dramatic a boost to disposable income and spending, where is it showing up? The only visible change is in flows into the market through MFs.

### These numbers call it out aloud

Country	Median Central GST / VAT rates on goods (%)	Median Central GST / VAT rates on services(%)
India	18	18
China	13	6
US	6-7 (State-level)	5.5-6.0 (State-level)
EU	21	21
Japan	10	10
UK	20	20
South Korea	10	10
Thailand	7	7
Singapore	9	9
Indonesia	11	11

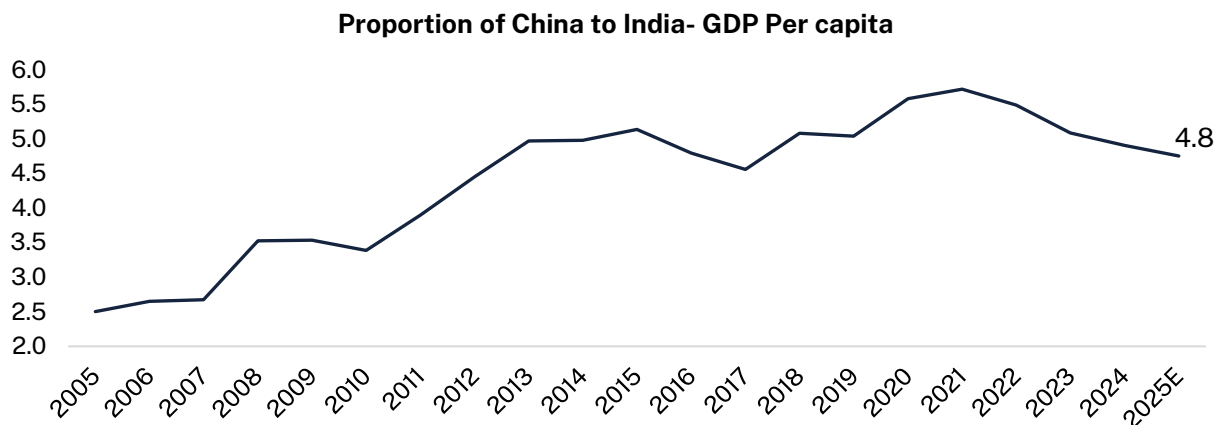
Source: Media Articles, Spark Fund Research



Country	Tax revenue % of GDP ( CY2023)
India	18.1*
China	20.4
USA	25.2
UK	35.3
Japan	34.4
South Korea	28.9
Indonesia	12.0

Note: \* For India - FY24.

Source: OECD, Reserve Bank of India, Spark Fund Research



Source: International Monetary Fund, Spark Fund Research

It is clear that we are on a tenuous tightrope walk. When taxes are cut, tax to GDP ratio will take a hit even as the same has been a nagging challenge for India. But then, growth is sagging without the thrust from a tax cut. Our GST rates are not very low even after the cut. On services, we are way higher. The data gives a reality check on how difficult it is for a country like India to break out of the low-middle income trap. The GST reforms are coming about at a time when the compensation cess to the states is ending. As the benefit is sought to be passed on to consumers, the state government finances will take a hit. There is no free lunch on the table.

At the same time, the income and wealth disparity in India present a sobering picture.

Countries	2023 Wealth Concentration (%)		2024 GDP Per Capita (USD)
	Top 1% of population	Top 10% of population	
India	40.1	65.0	2,711
China	30.3	67.9	13,313
USA	34.8	69.6	85,812
UK	21.3	57.1	52,648
Japan	24.8	59.3	32,498
Singapore	29.3	62.1	90,674
Indonesia	20.0	59.4	4,958
Thailand	32.9	65.3	7,492
EU	25.0	59.5	43,050

Source: World Inequality Database, International Monetary Fund, Spark Fund Research



The reforms come at a time when white collar employment is facing headwinds, and the going will get even tougher. Tax cuts may not be enough to counter the drag from many quarters. Added to this is the most formidable global backdrop we have seen after the oil shock of 1970s. There is a road uphill right ahead and these reforms may at best smoothen the climb.

**Unmistakable Implication:** The thrust of government policy at this juncture will not be to foster bull markets. The capital market developments are concomitant with the K-shaped recovery and income/wealth disparity in India. Capital markets are not the cause for these anomalies. These anomalies are in part manifesting through capital market distortions.

When China pump-primed its economy after the GFC, the distortions created cracks in the property market. After nearly two decades, the aftershocks are still reverberating. In India, imbalances have tended to show up through capital markets. Investors should take note.

### GST 2.0 and pricing power?

Average EBITDA Margin (%)	FY17 - FY18	FY21 - FY25
Mahindra & Mahindra	11.5	13.4
ITC	37.1	35.2
Hindustan Unilever	20.0	23.8
Titan Company	9.5	10.3
Bajaj Auto	19.4	18.3
TVS Motor Company	7.4	10.2
Asian Paints	20.8	20.6
Havells India	13.5	11.5
Nestle	20.7	23.7
Varun Beverages	23.6	21.1
Britannia Industries	14.7	17.7
Dabur India	20.4	19.6
Marico	18.8	19.3

Note: Varun Beverages data on CY basis.

Source: Ace Equity, Spark Fund Research

The above data by itself is not very conclusive as revenue growth has been underwhelming in the post-Covid years. In general, most of the consumer companies have tended to retain the margins that accrued as a result of avoiding the cascading impact of taxes which the GST regime brought about. In other words, margins improved after GST1.0. The drag in recent years is due to the abysmal growth in topline. The margins of consumer companies in India are in stark contrast to a jurisdiction like China where the scale and purchasing power are way higher. The margins in China are lower even though we are talking about products that are equivalent or better in terms of product quality, consumer salience and benefits. It is hard to make a case for margin improvement. On the contrary, there is every reason to believe that the competition could drive margins lower.

Against the reality of this backdrop, the focus may shift to pricing pressure. Quite obviously, the government will expect lower prices on everything where a GST cut is in the offing. Given the data, the government has a case. While consumers should benefit, this can be a case where someone may end up losing – which could be the companies. The interplay of input tax credits and rate cuts needs to be looked into for a better picture to emerge here.

GST 2.0 can turn into one more wake-up call after the usual euphoria. There have been many such wake-up calls for the market ringing over the last 12-18 months. To be fair, the market returns in the last 18 months have begun to reflect this.

The list of wake-up calls

1. Relentless FPI selling – Has been brushed aside. It helps to pay attention.
2. Consumer slowdown – Are tax cuts a panacea?



3. Earnings and growth slowdown – The market started to price it in during H2 of FY25. There may be more to come.
4. Tariff tantrum and global turmoil – Ongoing saga. The country is focussed on who is right and who is unfair. The focus should also be on who will bear the brunt.
5. Elevated valuations – Investors are supposed to get used to it. This will not end well but it is impossible to time a valuation reset

GST 2.0 comes as a positive reform amidst all this. The sectoral and intra-sectoral impact will be of essence in the short to medium term. There is going to be churn. We have already seen the producers complaining that the consumers are postponing decisions due to expected rate cuts.

GST 2.0 can be a growth enabler in the longer run. It could be disruptive in the short run. Our preference is to stay with companies which are not just dependent on such reforms but have autonomous tailwinds. To borrow from the Fed Chairman, when you are in a dark room with furniture, you stand still and take stock. At least until you know better.

Warm regards,

**P Krishnan (CIO) and Team Spark Fund**