

Top Research Picks

- ➔ **India Strategy: GST – Rate, Structure & Rationale - Will it deliver in its current sub-ideal form?**

Other Research

- ➔ **India Economics: IIP zooms 9.8% YoY in October... - ...but number a statistical illusion**

14 December 2015



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GST – Rate, Structure & Rationale

Will it deliver in its current sub-ideal form?

With barely a week left for the Winter session of Parliament to end, hopes of the Constitutional Amendment Bill on GST getting the Rajya Sabha nod have remained fickle. Recommendations of the CEA panel on a Revenue Neutral Rate and the GST structure do hint of a possible meeting ground between the govt. and the opposition. Even in its current sub-ideal form, the tax reforms can deliver significant efficiency and productivity improvements by moving towards a single market across India. Among the beneficiaries, we like Maruti Suzuki, Eicher Motors, Hero MotoCorp, Ultratech Cement, HUL, GSPL, Asian Paints, Orient, Bata India, Symphony. Telcom and metal sectors are likely to be adversely affected.

- ➔ **GST – biggest indirect tax makeover post the VAT:** The Goods and Services Tax (GST), which has been adopted by 160+ countries in some form or the other, has been struggling to meet its fate in India for more than a decade now. The tax reform, which is the extension of the VAT that was implemented in the mid-2000s, is heralded as the great hope for simplifying the intricate web of indirect taxes in India.
- ➔ **So near and yet so far:** The Constitution Amendment Bill (CAB) has been passed by the Lok Sabha, but has been stuck in the Rajya Sabha, where NDA is in minority. There seems to be a meeting ground on all the three conditions put up by the Congress party. However, even if the bill receives the RS nod, it's a long way ahead. The CAB will need to be ratified by at least 15 state legislatures before becoming an Act post which the Centre and the States will have to pass their GST laws. The government is unlikely to meet its 1st April 2016 implementation timeline. The best case for implementation date is 1st Oct 2016.
- ➔ **A sub-ideal GST:** The CAB has many distortionary features that make the GST regime a sub-ideal one. These include the additional 1% levy, large exclusions from the GST base, the GST rate structure, and exemptions on petroleum products and other goods. Nevertheless, even in its second best avatar, the reform has the potential to deliver significant efficiency and productivity gains.
- ➔ **Positive for corporates:** GST implementation is expected to affect India Inc. in three broad ways:
 1. **Tax-rate differentials:** The effective indirect tax incidence is expected to decline post the implementation of GST due to removal of the tax-on-tax (cascading effect) arising from the non-availability of input tax credits (as in the current system) across the value chain.
 2. **Supply chain efficiencies:** Since the GST subsumes most of the state-level taxes, it would reduce the need for reconciliation at state borders. This could lead to a dismantling of the web of check-posts around the country, thereby speeding up the movement of goods and reducing logistics and inventory management costs, which are very high in India vis-à-vis other countries.



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IIP zooms 9.8% YoY in October...

...but number a statistical illusion

IIP growth climbed to a five-year high of 9.8% YoY in Oct'15 as manufacturing output surged by 10.6% YoY. We however believe the spike is an aberration led by a festive season shift to November this year (from October last year). This has helped IIP growth to average at 4.8% YoY during Apr-Oct'15 versus 2.2% in the year-ago period. We expect growth to slightly moderate in the remaining part of FY16 as an adverse base effect kicks in.

- ➔ **Oct IIP growth at five-year high:** Industrial production rose by 9.8% YoY in Oct'15 (our/consensus estimate: 6.1%/7.8%), its quickest pace in five years. The number for Sep'15 was revised up to 3.8% from 3.6% earlier.
- ➔ **Strong base effects at play, growth unsustainable:** While the IIP number looks good prima facie, it comes off a low base and is unlikely to sustain going forward. Manufacturing output usually spikes in the pre-festive month and declines during the festive season owing to lesser number of working days. Thus, the festive season shift to November largely explains the surge in IIP during Oct'15.
- ➔ **Broad-based growth in manufacturing:** Manufacturing output shot up by 10.6% in Oct'15 vis-à-vis a decline of 5.6% in the year-ago month. Output of 17 of the 22 industries in the manufacturing sector rose YoY, with as many as 10 industries recording double-digit growth. As against this, output of 16 of the 22 industries had declined in Oct'14.
- ➔ **Consumer durables lead the way:** Production of consumer durables spiraled up to 42.2% in Oct'15 off a low base (Oct'14 saw a 35.2% decline). Among durables, gems & jewellery production jumped 372.5% and was the top contributor to IIP growth. Production of passenger cars/scooters & mopeds rose by 21.4%/24.5%.
- ➔ **Capital goods continue to do well:** Capital goods output rose by 16.1% in Oct'15, thus growing by over 10% for the fifth consecutive month. Capital goods and consumer durables have been the key drivers of IIP growth during the last five months.
- ➔ **Electricity in line, mining surprises:** Electricity generation rose by 9% in Oct'15, in line with the eight-core estimates. Mining output however surprised on the upside, rising by 4.7% (vs. 4.5% in Oct'14). Crude oil and natural gas output, which account for ~50% of mined output, declined by 2% during the month.
- ➔ **Apr-Oct'15 growth at 4.8%:** IIP growth accelerated to 4.8% during Apr-Oct'15 YoY from 2.2% in the year-ago period, led by a pick-up in manufacturing activity (5.1% vs. 1%). Given that industrial growth had improved during Nov'14-Mar'15, we expect more moderate numbers in the remaining part of FY16. Our full-year estimate stands at 4.3%.

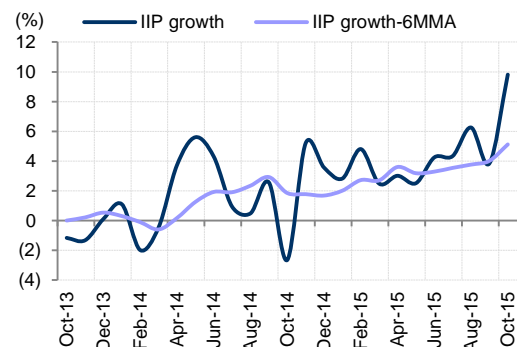


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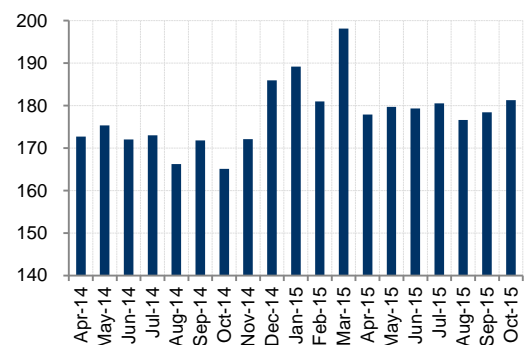
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IIP growth at 5-year high in Oct'15



Source: RCML Research, MOSPI

Favourable base pushed up growth in Oct'15



Source: RCML Research, MOSPI

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