International Monetary Monitor

Date: 17/11/2026
Newsletter No. 57

Indian M3 Surges: Inflation Risk Ahead

By John Greenwood

Introduction

- In IMM Newsletter#32 ("Monetary Stability Helps India to Weather Financial Shocks") I described how the Reserve Bank of India (RBI) had successfully navigated the Covid pandemic, not allowing broad money (M3) to accelerate and thereby avoided any upswing of inflation from its on-going rate of around 5%. https://internationalmonetarymonitor.co.uk/monetary-stability-helps-india-to-weather-financial-shocks/
- Following a period of excess money growth when M3 growth had peaked at 25.4%, the RBI under three successive Governors – Subbarao, Rajan, and Patel - had brought money growth down to an average of about 10% p.a. between 2010 and 2016.
- This period of steady growth of M3 produced a CPI inflation rate of just under 5% p.a., close to the RBI's 4% target.
- Regrettably, however, the situation has now changed for the worse. Since the start of 2026 M3 has surged from a stable 10% growth rate to 17.6% in October 2026.
- Unavoidably, if continued, the upsurge in M3 growth will produce an upswing of India's CPI inflation rate over the next year or two (2027-28), potentially pushing up inflation from 5% towards 8-10%.
- This sudden surge of money growth needs to be curtailed soon, and the causes of it extinguished.
- This IMM Newsletter #57 looks at the surge in Indian broad money growth (Section 1), its immediate and underlying sources (Section 2), and spells out some of the likely consequences of continuing with the policy (Section 3).

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The IMM Newsletter contains economic research written by John Greenwood, founder and Chief Economist of International Monetary Monitor. A pioneer of monetary research in Asia, John was also the publisher, editor and lead author of Asian Monetary Monitor, a bi-monthly publication that he operated for 20 years from Hong Kong between 1977 and 1996. (See Archives section of the IMM website.) From 1999 to 2021 John was Chief Economist at Invesco, based in London.

Section 1. The Surge in Indian Broad Money Growth (M3)

After a decade during which Indian broad money growth (M3) has averaged just over 10% p.a., there has been an abrupt surge in this key economic indicator (Figure 1).

Figure 1. Indian Broad Money Growth Rate Surges to 17.6% in October

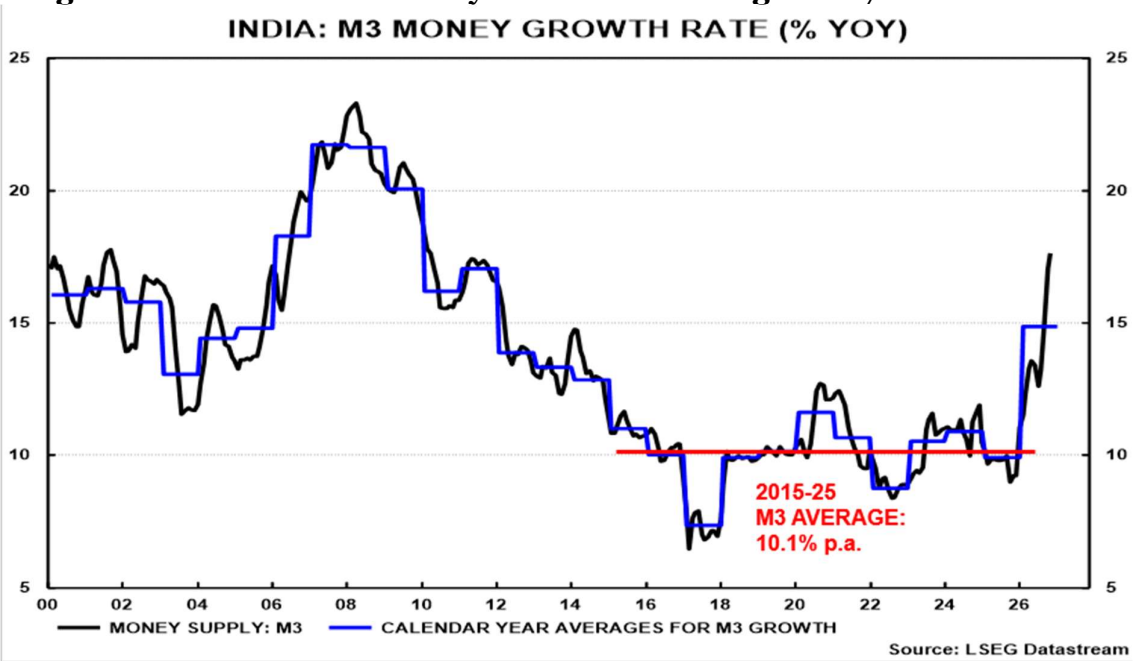
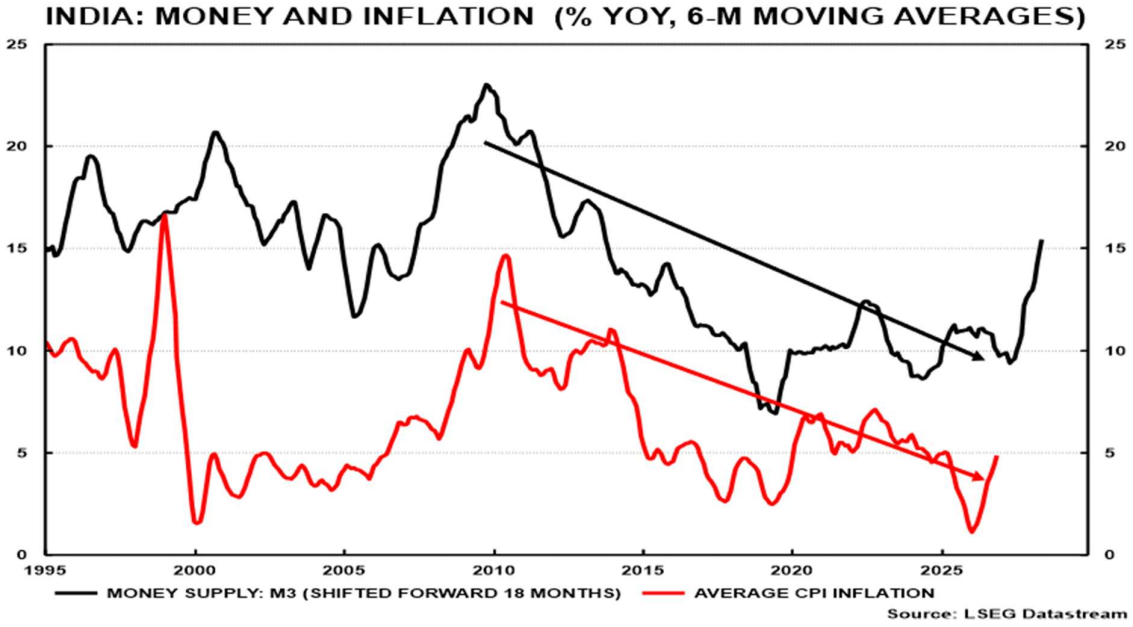


Figure 2. Slowing M3 Growth since 2008 Reduced Inflation, but the Recent Surge Risks Renewed Inflation



As shown in Figure 2, between 2008 and 2016, broad money growth progressively slowed, bringing down Indian CPI inflation from around 15% in 2010 to below 5% on recent readings of the CPI (% year-on-year and averaged over 6 months). [Note also that M3 growth in Figure 2 is shifted forward by 18 months to take account of the typical lag between changes money growth and changes in goods and service prices.]

Since 2016, CPI inflation has averaged just 4.7%, only slightly above the Reserve Bank of India's central target of 4% (which has a +/- 2% tolerance band).

By my calculations, the optimal broad money (M3) growth rate for the RBI to achieve its 4% CPI target is about 10-12% p.a. This is based on a simple Quantity Theory of Money calculation. (For details, see pp. 4-5 of IMM Newsletter #32, February 2024 https://internationalmonetarymonitor.co.uk/monetary-stability-helps-india-to-weather-financial-shocks) . On this basis the recent surge in M3 growth to 17.6% sends warning signals about the future of numerous economic indicators (see Section 3 below) and especially about inflation.

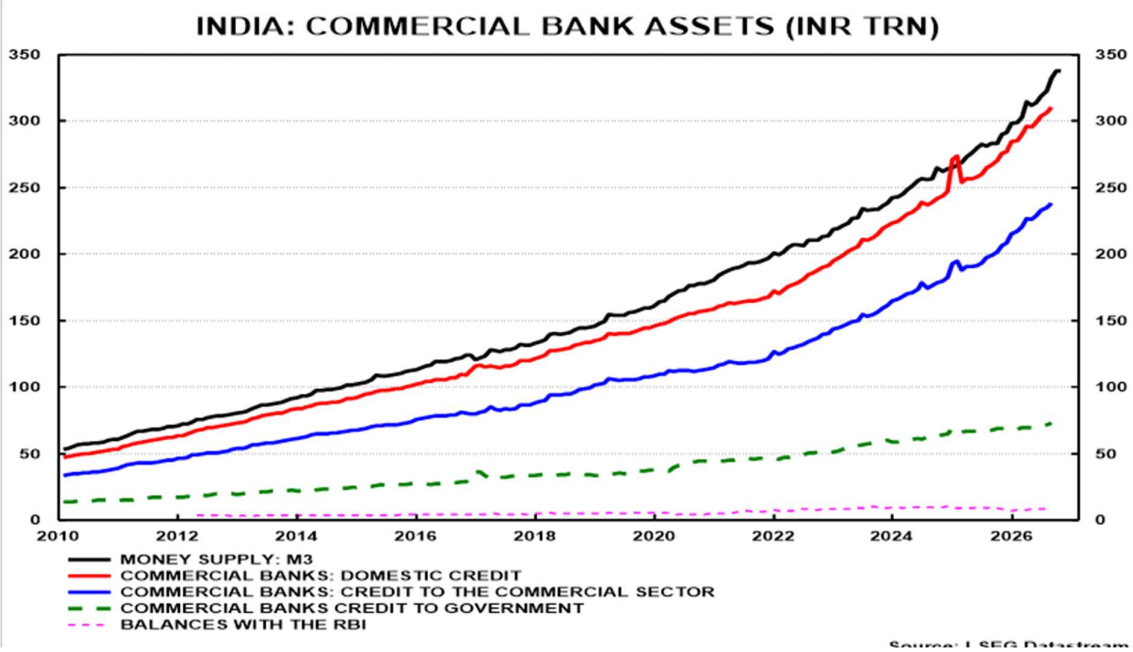
So what has gone wrong?

Why has Indian broad money growth surged since the start of 2026?

Section 2. The Counterparts of Indian M3 Growth

M3 in India consists of the deposits of the non-bank public at Indian banks plus the cash currency held by the non-bank public. As shown in Figure 2, the main counterpart asset on the books of the banks is lending to the commercial sector.

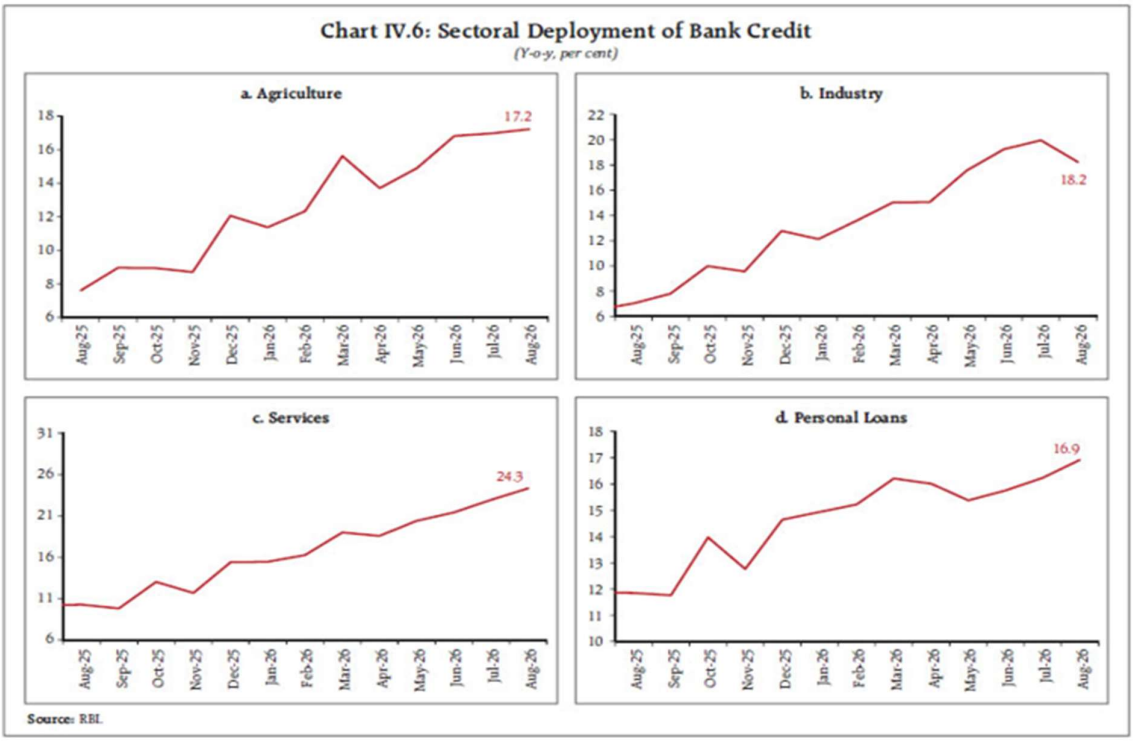
Figure 3. The Assets of Indian Banks are Mainly Loans to the Private Sector



Credit to the commercial sector plus lending to the government sector is known as Domestic Credit. Bonds issued by firms or the government are included in these totals. As Figure 3 shows, the bulk of Domestic Credit (in red) consists of loans to the commercial sector (in blue). The other component, lending to the government (green dashed line), has not been growing rapidly recently.

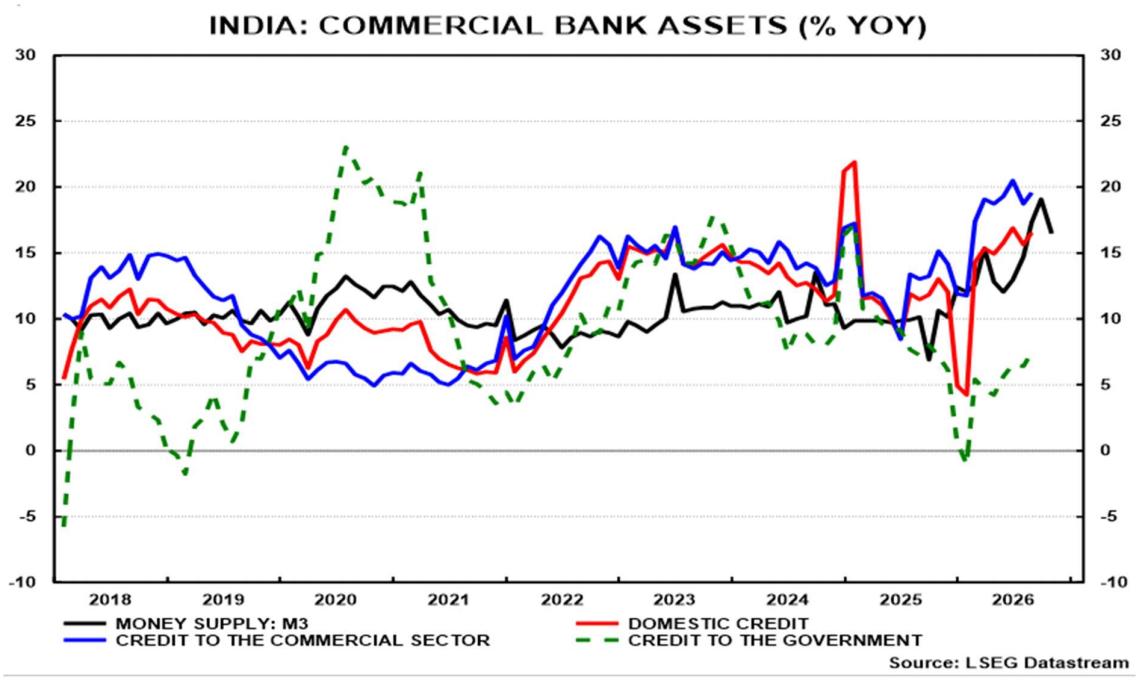
In turn, credit to the commercial sector is comprised of loans to agriculture, industry, services and personal loans. The surge in the volume of lending to each of these sectors is shown In Figure 4, which is a chart from the RBI's Monthly Bulletin for October 2026. This confirms that the acceleration of lending growth has been across the board, not limited to any particular sector.

Figure 4. The Credit Surge has been Across All Sectors



For completeness I show the growth rate of Domestic Credit, commercial credit, and credit to the government in Figure 5 below. As shown in the chart, as of August 2026 credit to the commercial sector (blue line) had risen to 19.6%, while credit to the government sector, which includes bank holdings of Indian government bonds, had increased by only 7.5%. Since the surge in broad money growth is therefore mainly explained by the surge in bank credit to the commercial sector, we must examine the motives of the banks and/or the policies of the RBI to understand the underlying drivers which have prompted these upswings.

Figure 5. Rapid M3 Growth has been Underpinned by Growth in Lending to the Commercial Sector.



The key drivers of the upsurge in credit growth appear to be the following:

1. The RBI's policy easing cycle that began in February 2025.

- The RBI cut policy rates by a cumulative 125 bp and cut the cash reserve ratio by 100 bp.
- It also injected about ₹8.8 lakh crore (or 8.8 trillion Indian Rupees, equivalent to about US$100 billion at 85 INR per USD) of liquidity through government bond purchases.
- Bank lending rates fell about 87 bp, from 9.87% to 9.0% by February 2026.

2. A rebound from a weak base. Credit growth had slowed to about 9–10% in early 2025. Total formal credit ***flows*** (change in credit in the period compared with the change in credit a year earlier) jumped 38% in FY26 after contracting 8% in FY25, so 2026 is partly a recovery.

3. Strong demand from the economy and firms. Real GDP grew about 7.7% in FY26. Private capex was reviving, and manufacturing, construction and services were all borrowing more.

4. Banks had the balance sheet capacity to lend. The Cash Reserve Ratio (CRR) cut and the liquidity injections let banks lend more. Banks were also well capitalised,

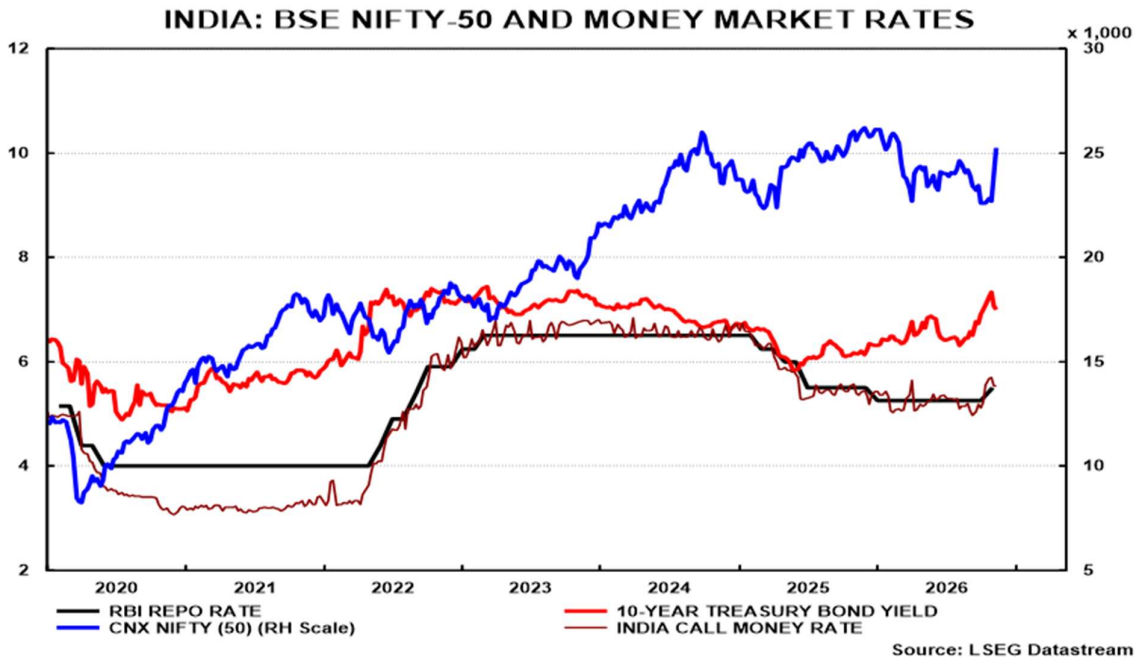
with low non-performing assets and public-sector banks had recently achieved record profits.

Section 3. Likely Consequences of Continued Rapid Money Growth

The surge in broad money growth has so far persisted for just over half a year. This means that it is probably not too late to reverse the policy before it starts to have serious consequences.

Normally one would expect the first effects of faster money growth to show up in the asset markets – the money markets, the equity and bond markets, as well as the property market. However, as Figure 6 shows there has been little impact so far on the equity market (represented by the CNX Nifty Index shown in blue). It is possible that adverse sentiment due to energy price rises or perceived weakness in the external exchange rate and the 25 b.p. October repo rate hike by the RBI to 5.5% could be behind the failure of the stock market to react more to the surge in broad money growth. But a response may yet be seen if rapid M3 growth persists.

Figure 6. Little Impact so far of M3 Acceleration



The next impact to be expected would be on the real economy, which has already been showing strong growth. Despite global headwinds, real GDP grew by 7.8% year-on-year in both the January-March and April-June quarters. Growth was led by private consumption and strong investment activity while the contribution of net exports also remained positive. High frequency indicators available so far suggest that economic activity was maintaining momentum in the latest (July-September)

quarter, albeit with some moderation compared to the preceding quarter. Despite a deficient and uneven southwest monsoon, crop planting has only been marginally lower than last year. Manufacturing activity, despite cost pressures, is holding up well, as indicated by IIP and PMI indicators. Services sector activity remained steady and broad-based, owing to buoyant domestic and external demand. Both manufacturing PMI and services PMI remained in expansionary zone in the April-June quarter.

Given these already strong growth rates it is probably unreasonable to expect any further upturn. All we can expect is a continuation of vigorous growth for a few more quarters.

Finally, the impact on inflation from the 2026 surge in M3 growth cannot reasonably be expected until sometime in 2027. However, if broad money growth continues at close to 18%, this could easily increase the inflation rate from 4-5% to somewhere in the 5-10% range. The RBI therefore needs to act now, raising its repo rate further, sufficient to slow broad M3 money growth back to the 10-12% range.

Conclusion

- After several years of successful monetary management when the RBI kept India's M3 growth around 10% p.a., there has been an unfortunate spurt in money growth to 17.6% year-on-year in October.
- The previous steady 10% broad money growth had brought inflation under control and maintained it at a fairly steady 4-5%.
- That achievement is now being put at risk.
- In response the RBI needs to act firmly and steadily to raise rates sufficiently to slow M3 growth from 17% to about 10-12%. If the RBI can achieve this over the next 3-6 months there should be no severe consequences.
- The momentum of economic growth and the state of private sector balance sheets should enable real GDP growth to continue at 6% or more, while inflation would be prevented from rising by more than a couple of percentage points in 2027.
- Already the RBI has raised interest rates by 25 basis points (on 7th October 2026) to 5.50%. Also, the RBI noted that rate cuts are off the table in the near term, with future moves likely to be either a pause or another hike depending on inflation trends. These are welcome steps in the right direction.