IMPACT OF MACRO ECONOMIC DETERMINANTS ON INFLATION IN SRI LANKA - A STATISTICAL APPROACH

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DECLARATION OF THE CANDIDATE AND SUPERVISOR

I hereby declare this project report is the product of my own and is based on a research that I performed independently without the participation of any other person or authority. The references made to other researches here have been acknowledged appropriately with due appreciation. The sources of data and information external to the dissertation and the research have been acknowledged appropriately. Also the substance in this research has never been submitted for any other degree, anywhere else. I hereby give my consent to making this available by photocopy for inter-library loans, and for the title and summary of the dissertation to be made available for use by other institutions of learning.

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ABSTRACT

This study attempts to analyze the experience of inflation in Sri Lanka for the period 1960 to 2013 using the econometric framework of Johanson and Juselius cointegration approach, Granger causality analysis and vector error correction model (VECM). The data used are annual series of Colombo Consume Price Index as a proxy variable for inflation rate, gross national product, broad money supply, budget deficit and exchange rate. The empirical results of the study indicate the existence of long run dynamic relationships among the variables. However, VECM identified that broad money supply growth and exchange rate depreciation have significant positive effects on inflation. The errors of the VECM model was found as white noise. The results would be useful how business and industry play on the economy of the country. Furthermore, the results of this study emphasize the need to put in place a stable macroeconomic policy environment relating to these variables in an effort to maintain price stability, since low inflation would enhance economic growth.

Keywords: Budget deficit, Co-integration, Granger causality, Inflation, Money supply

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