

Abstract

The three major economic indicators such as inflation, unemployment and interest rate play an important role in an economy of any country in terms of sustainable economic development. Economic policy makers should be taken into consideration of the relationship among these variables in order to maintain a healthy economic progress. But, the long term progress of the Sri Lankan economy is destabilized. The linkage among these variables and the impact on each other are very important for developing countries such as Sri Lanka to overcome the destabilized hurdles.

Hence, the study intends to investigate the impact of unemployment and interest rate on inflation in Sri Lanka. This study also analyses the short and the long run relationship among these three variables. Phillip's relationship between the variables inflation and unemployment also is discussed in details.

Fifty three years of annual data for the period of 1953- 2015 of the variable inflation, unemployment, interest rate, money supply (M_2) and government expenditure used for the analysis. Parametric and non parametric approaches have been employed in this study. The Autoregressive Distributed Lag (ARDL) model with co-integration technique has been employed to find the short and the long run relationship of the variable. The statistical package e-views 9.0 and Microsoft excel have been used for the analysis.

The study reveals that unemployment negatively impacts on inflation in short and long run in Sri Lanka, which is statistically significant. Further, the study revealed that the Phillip's relationship between inflation and unemployment exists in Sri Lankan economy. The interest rate is also negatively impacts on inflation in the short run and positively impacts in the long run. The results are statistically significant at five percentage confidence level and it shows theoretically same scenario in Sri Lanka too.

This study recommends that the relationship between the variables should be noted and utilized in optimum level in order to achieve sustainable economic development in Sri Lanka.

Key words: Inflation, Unemployment, Interest rate, Money supply, Government Expenditure