



CAUSALITY RELATIONSHIP OF MONETARY POLICY ON INFLATION IN SRI LANKA

Sithy Hajara. M. M¹ & Fathima Rifka. M. U²

Correspondence: hajaraseusl@gmail.com

Abstract

Monetary policy plays an important role in stabilizing economic instabilities and especially, in controlling the rate of inflation in Sri Lankan economy. The main objective of this study is to identify the causality relationship of monetary policy on inflation in Sri Lanka. In order to reach this objective Granger causality test is used to examine the causality relationship between the variables. The inflation, Gross Domestic Product, money supply, exchange rate and trade balances are the variables used in this research. The analysis was carried out secondary data for the period from 1980 to 2019 and the software of E-views 10 is used to analyze the data. The results of the stationary test show that all variables are non-stationary at levels but stationary at the first differences. The Granger causality test indicates that there is a bi-directional relationship between money supply and inflation, economic growth and trade balance have a uni directional relationship on inflation in Sri Lanka. On the basis of estimated results, the study concludes that the monetary policy has the causality relationship on inflation in Sri Lanka.

Keywords: Inflation, Monetary policy, Granger causality

¹ Department of Economics and Statistics, South Eastern University of Sri Lanka.

² Department of Economics and Statistics, South Eastern University of Sri Lanka.