

AN ECONOMETRIC ANALYSIS OF MONEY SUPPLY AND BALANCE OF PAYMENT IN SRI LANKA (1977-2019)

This study examines the relationship between the balance of payments and the money supply in the context of Sri Lanka, using annual data from Sri Lanka over the period of 1977 to 2019. The data of the balance of payments (BOP), money supply (MS), gross domestic product (GDP), inflation (INF), and government expenditure (GE) was collected from the world development indicators of the World Bank and the Annual Reports of the Central Bank of Sri Lanka. The ADF and PP unit root test methods were employed to test the stationarity of the series. The ARDL bound test was applied to identify the co-integrating relationship and long-run relationship between the variables. The error correction model (ECM) was adopted to investigate the short-run relationship as well as the long-run adjustment of the model. Finally, the Granger Causality Test was adopted to examine the causality relationship between variables. All unit-root test methods confirmed that all variables are stationary at their first difference. The ARDL Bound Testing results confirmed that, there is a cointegrating relationship between the variables. Further, this test suggests that BOP has a positive and significant impact on MS in the long run. The Error Correction Model found that there is no short-run relationship between BOP and MS. The Granger causality test reveals that uni-directional causality exists from MS to BOP. Finally, the empirical results of this study show that there are long-run positive relationships between MS and BOP in Sri Lanka. Meanwhile, there is uni-directional causation between MS and BOP. This conclusion emphasizes that, in order to reduce the deficit of BOP in Sri Lanka, MS could be used as a policy instrument in the long run.

Keywords: Balance of payment, Money supply, Gross Domestic Product, Inflation

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REGISTRATION NO: SEU/IS/15/AT/053