

THE IMPACT OF MACROECONOMIC VARIABLES ON STOCK PRICES IN SRI LANKA: A BOUNDS TESTING APPROACH

Francis, S.J.^a, Ravinthirakumaran, N.^b, Ganeshamoorthy, M.^a

^a*University of Colombo, Sri Lanka*

^b*University of Queensland, Australia*

A vibrant stock market is of critical importance if a developing economy is to attain a high growth trajectory. In Sri Lanka stock market performance has been considered a key indicator of its economic as well as business health. This paper intends to examine the causal relationship between stock prices and macroeconomic variables and investigate the effects of macroeconomic variables on the dynamics of stock price movements in the Sri Lankan stock market. To empirically examine the long-run relationships and short-run dynamic interactions among the variables of interest, this study employs the autoregressive distributed lag bound test approach. The study uses monthly statistical data of macroeconomic and political stability variables such as industrial production, inflation rate, money supply, real exchange rate, trade openness, the average weighted prime lending rate, all share price index and war data from January 2007 to December 2019. The results reveal a significant relationship between stock market returns and macroeconomic and political stability variables except all share price index.

Keywords: *Macroeconomics; Stock prices; Bounds test*
