

## **THE RELATIONSHIP BETWEEN INTEREST RATES AND INFLATION IN SRI LANKA S G**

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### **Abstract**

There is direct relationship between interest rate and inflation we can identify the above relationship according to this research. There can investigate the long-run and the short-run relationship between above interest rate and inflation in Sri Lanka. This paper will examine the long-run bivariate relationship between the short-term interest rates and the inflation rate in Sri Lanka. There have been numerous studies, which has looked into the Fisher effect in USA and Canada. Recently there has been research carried out on European Union countries and even some Latin American countries. The objective of this paper is to consider the relationship between short-term interest rates and inflation in the relatively small Indian sub-continent economy of Sri Lanka. There have been very little or no research carried out on Fisherman effect in Sri Lanka.

The first section the paper will look at similar research done (on the Fisher's effect) in other countries. Different methodologies adopted by the researchers will also be looked into. The second section will look at the methodology used; the relevant tests and the next section will concentrate on analyzing the Sri Lankan data. An appropriate model will be built based on the test results. The 3-month Government TB rate will be used as the short-term interest rate and the year-on-year movement in the consumer's price index (CPI) will be used to calculate the inflation rate.

There seems to be relatively little or no research done on the Fisher relationship in Sri Lanka. One of the key finding that I intend to make is to discover whether the Sri Lankan data point towards co-integration between Interest rates and Inflation. Since there is considerable amount of political influence over the governance of interest rates and since successive government policies have a larger impact on inflation, this would be an interesting finding.

**Key words:** Fisher Effect, consumer's Price index (CPI).