THE IMPACT OF STOCK MARKET DEVELOPMENT ON ECONOMIC GROWTH IN SRI LANKA

Jayathilaka J.A.M.G. [1] and Gunasekara U.L.T.P. [2]

[1]menujayathilaka98@gmail.com; [2]thamarag@kln.ac.lk

Abstract

A country's economic vitality has traditionally depended heavily on the financial markets. This study's goal is to investigate the empirical relationship between Sri Lanka's stock market development and economic growth. Economic growth is assessed by GDP growth, while the stock market development is assessed by the market capitalization ratio, stock value traded ratio, and foreign direct investment ratio. It was assumed that Inflation can play the role of a control variable. This study used annual time series data for the period from 2001 to 2020. The study collects secondary data from the annual reports of the Colombo Stock Exchange (CSE) and the Central Bank of Sri Lanka. Multiple regression analysis with a cointegration test and vector error correction model (VECM) were used to analyze the data. The study identified important aspects of long-term relationships between these variables from 2001-2020. Cointegration tests show there is a strong positive relationship between stock market development and economic growth in the short run. The results of VECM show a significant effect on economic growth in the long run. The result of this study concludes that stock market development is driving economic growth in Sri Lanka. The study would fill the conceptual gap in this field by finding that Stock market development aids economic long-term growth. There are significant implications for Sri Lanka's economic policymakers and government.

Keywords: *Stock Market, Economic Growth, Sri Lanka*