

The Macroeconomic Factors Affecting Exchange Rate: Analysis of the ARDL Model

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Abstract

This research project, titled "The Macroeconomic Factors Affecting Exchange Rate - Analysis of the ARDL Model," presents a comprehensive review exploring the intricate relationships between macroeconomic variables and exchange rates in the context of Sri Lanka. The investigation covers key independent variables, including interest rates, inflation rates, budget deficits, earnings from tourism, and capital flows. The Auto Regressive Distributed Lag (ARDL) model serves as the analytical framework. The research meticulously examines the dynamics of interest rate changes, inflation, and budget deficits in Sri Lanka. It analyzes the impacts of unconventional monetary policies and suggests the need for a deeper understanding of the influence of technology on tourism-related dynamics. The study also calls for a more nuanced examination of government spending's diverse effects on exchange rates and proposes a thorough analysis of geopolitical issues affecting capital flows. Research papers related to interest rates delve into the effects of low and negative interest rates on Sri Lanka's economy and the determinants of interest rates in the country. Papers exploring inflation scrutinize its impact on economic growth, while another investigates the relationship between monetary policy and inflation. Studies on budget deficits examine their connection with economic growth and inflation. Papers on earnings from tourism elucidate the sector's contribution to economic growth, emphasizing political stability as a vital factor. The research on capital flows, particularly foreign direct investment (FDI), examines their role in economic growth and exports. While highlighting the project's contributions, the literature review identifies critical research gaps. It suggests exploring the effects of unconventional monetary policies, technological advancements in tourism, diverse government spending, and geopolitical uncertainties on exchange rates. Addressing these gaps will enhance the project's depth and relevance, providing valuable insights for businesses, investors, and policymakers navigating the complex global economic landscape.

Keywords: Interest Rates, Inflation Rates, Budget Deficits, Earnings from Tourism, and Capital Flows, The Auto Regressive Distributed Lag (ARDL) Model.