

## **6.1 Empirical Investigation of Determinants of Trade Balance in Sri Lanka**

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### **ABSTRACT**

The balance of trade is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports. There was a continuous increasing negative trade balance (TB) in Sri Lanka over the past few decades which adversely affect to the Sri Lankan Economy. Therefore it is high right time to investigate the Macro Economic Variables which are likely to affect the TB as suggested by the literature. Hence, the objective of this paper is to provide some insights on the links between trade balance and a broad set of economic variables proposed by the literature such as Exchange Rates, Gross Domestic Products (GDP), Interest Rate and Inflation Rate.

This study was conducted using secondary data extracted from the Central Bank Annual Report, pronouncement of Securities and Exchange Commission in Sri Lanka for the period 1999 to 2008. This paper adopts quantitative approach on secondary date collected from the above sources. Correlation, regression, t test and ANOVA are the statistical techniques used to analyze the data. Stepwise regression was run to find out the best model which describes the variation of the TB.

The results of this research shown that, GDP and the Exchange Rate are significant variables in determining the TB and has a negative relationship with trade deficit. Inflation Rate and Interest Rate have a marginal positive relationship with Trade Deficit and are not significant. There were two models which adequately explain the variation of TB, but the model 2 which comprise of GDP and Exchange Rate is the best model selected based on the adjusted R squared technique. This finding is compatible with literature finding in the other counties.

**Key words** – Trade Balance, Exchange Rate, GDP, Inflation Rate, Interest Rate