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THE RELATIONSHIP AMONG INFLATION, EXCHANGE RATES AND SECTORAL STOCK PRICE INDEXES IN SRI LANKA

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The stock market plays a vital role in any country directing much needed capital into required sectors. The research on stock prices generates vital information for investors, stock market brokers, policy makers and the general public. Many studies have investigated the overall performance of the stock market indexes and the impact of associated macroeconomic variables. However, examining the aggregate price index does not generate sufficient information related to a particular industry or a sector. In this context, this study examines the behaviour of stock prices in three sectors, namely, the bank, finance and insurance sector; the hotel and travel sector; and the beverage, food and tobacco sector.

We used the Autoregressive Distributed Lag approach (ARDL) to estimate models for the above mentioned sectors. The monthly average Sectoral Share Price Index (SSPI) values, exchange rates, and inflation rate data for the period of January 1994 to March 2011 were used in the analysis.

Our results indicate that inflation and lagged stock price index shows some weak evidence of long run equilibrium relationships. This indicates that such variables may have influenced investor decisions in buying shares of the hotel sector. Given our methodology, the bank, finance and insurance sector and the beverage, food and tobacco sector do not indicate any equilibrium relationships.