

The Effect of Monetary Policy on Stock Market in Sri Lanka

Thishanthi G. T.¹ and Silva N. K. L.²

¹thakshulathishanthi@gmail.com, ²nklsilva90@gmail.com

Department of Accountancy, University of Kelaniya, Sri Lanka

Researchers provide evidence on the effect of monetary policy changes on dynamic response of stock prices (Galiy and Gambettiz, 2013). This paper aims to investigate the relationship between changes of monetary policy and stock market performance of Colombo Stock Exchange (CSE). Publicly available data of Colombo Stock Exchange and Central bank of Sri Lanka is used for this research. Monetary policy changes would be derived from Money Supply, Interest Rate and Exchange Rate Changes and the Stock Market Performance from movements of All Share Price Index. Accordingly, all share price index is considered to be the dependent variable and monetary policy variables as independent variables. This study covers the period from January 2005 to December 2012 and monthly data would represent the movements of variables. Following Manike (2002), a multiple regression model is used to find the intended outcomes of this study. Further correlation analysis is used to identify relationships between variables to provide meaningful results. It is hypothesized to have a strong relationship between the variables (Bernanke and Kuttner, 2005) and a positive effect of Monetary Policy on Stock Market in Sri Lanka. Findings of this study may highly beneficial for existing and potential investors in the stock market, and for future researchers.

Keywords: *Monetary Policy, Money Supply, Interest Rate, Exchange Rate, Stock Market Performance, All Share Price Index, Colombo Stock Exchange*