

## **The causal relations among stock prices and the macro economic variables: Evidence from Sri Lanka**

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### **ABSTRACT**

**T**his study aims to investigate long term relations among Stock Market returns and the Macro Economic Variables in Sri Lanka. The behavior of the Colombo Stock Market returns presents a veritable problem to be reckoned with, which might not yet been addressed scientifically. The objective of the study is, therefore, to identify the effects of macro economic variables on the stock market. In achieving this, the study specially expected to identify the macro economic factors, the importance of those factors and identify the other factors, which affect to the stock market.

Out of the number of economic variables, more important variables have been selected for this study. Those are exchange rate, interest rate, lending rate, deposit rate, money supply, inflation and the treasury bills rate. The stock market behavior is explained by using two price indices. Those are All Share Price Index and Sensitive/Milanka Price Index, which are developed by Colombo Stock Exchange.

The secondary data is used for this purpose. It is gathered the monthly data from the Colombo Stock Exchange and the Central Bank of Sri Lanka. This research study covers a 12 years period from 1990 to 2001.

In data analysis, general statistics as means of standard deviation etc., econometric test and the vector error correction model are applied wherever necessary. The research findings indicate that three macro economic variables, lending rate, exchange rate and deposit rate affect the All Share Price Index and the Sensitive Price Index/ Milanka Price Index. All Share Price Index and the Sensitive/Milanka Price Index do not affect to any macro economic variables except interest rate.

Accordingly, it is certain that this study provides a valuable supplementary evidence to the existing literature of the financial management through imparting the knowledge of the stock market behavior in Sri Lanka.