The Impact of Inflation on the Development of the Financial Sector in Sri Lanka

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ABSTRACT

Introduction: This study examines the impact of inflation on the development of the financial sector (financial institutions, financial markets) as a whole in Sri Lanka.

Design/ Methodology/ Approach: The sample period is from 1980 to 2019. And the investigates the impact of inflation on the development of the financial sector in the short run and long run. Regression and correlation approaches were utilized to accomplish this. The idea of financial development has been measured using the financial development index provided by IMF, Inflation, according to the study's conclusions, can have a negative influence on the financial sector in the short and long run. Government spending, trade openness, external stability, and the degree of economic activity were used as control variables in the model's development. The ARDL model is used to determine whether there is a relationship between inflation and financial sector development because of it can be used to evaluate both stationarity in level I and stationarity in 1st deference I variables. And Various diagnostic tests will be run to determine the created model's goodness of fit.

Findings: In the short run, the magnitude of the influence is large for the dependent variable. In long term, Inflation will not affect the development of the financial sector.

Conclusion: The final result emphasized that the short-term relationship between inflation and financial sector development is negative and statistically significant. And the long-term relationship between inflation and financial sector development is negative but not statistically significant.

Keywords: *Financial sector development, Inflation, Sri Lanka, ARDL Model (Auto Regressive Distributed Lag)*