

# The Impact of Monetary Policy on Stock Market Performance: Evidence from Sri Lanka

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## Abstract

**Introduction:** The study explores the pivotal role of monetary policy in shaping stock market performance, focusing on Sri Lanka's All Share Price Index (ASPI). It highlights the critical influence of monetary tools like Treasury Bill Rate (TBR), Money Supply (M2), Standing Lending Facility Rate (SLFR), and Statutory Reserve Ratio (SRR) alongside macroeconomic variables like the Exchange Rate and Inflation Rate. By addressing the gaps in existing literature, particularly during the post-COVID-19 economic crisis, the research emphasizes the dynamic interplay between monetary policy and market performance.

**Methodology:** This will be a quantitative test based on secondary data from July 2014 to August 2024, which was extracted from the Colombo Stock Exchange and Central Bank of Sri Lanka. Analyzing the research will draw upon econometric methods which include tests of unit roots, regression analysis, and diagnostic checks for multicollinearity, heteroskedasticity, and autocorrelation in order to draw conclusions about how monetary policy variables affect the ASPI. The model has been developed considering its robustness and reliability by incorporating all the required macroeconomic indicators as control variables.

**Findings:** The above analysis indicates that monetary policy variables such as money supply, treasury bill rate, and inflation rate are positively and significantly related to ASPI. Thereby, these variables prove to be the important contributors toward improving stock market performance in Sri Lanka. On the contrary, SLFR and ER negatively influence ASPI, reflecting the devastating effects of the tight monetary stance and currency depreciation on market dynamics. The contribution of the SRR, though positive, is insignificant to explain the trend in the stock market. All diagnostic tests prove that the estimated model is reliable and free from multicollinearity, heteroskedasticity, or autocorrelation. The findings emphasize that monetary policy does not have a one-way effect on the stock market in Sri Lanka.

**Conclusion:** Monetary policy significantly influences the performance of the stock market in Sri Lanka; therefore, proper monetary interventions are very important in creating a stable and prosperous market. Though the findings support theoretical expectations and prior literature on the subject, there are limitations to this present study, which include exclusion of some of the key

macroeconomic variables, such as fiscal policy, and also sector-specific analysis. Thus, future study could elaborate more on those dimensions and create more comprehensive insights. These are very important findings in terms of the policy implications for policymakers and investors in developing an appropriate view of how monetary policy affects stock performance in emerging economies.

**Keywords:** Monetary Policy, ASPI, Stock Market Performance, Sri Lanka