Relationship between Inflation and Economic Growth in Sri Lanka

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This paper examines two policy views in economic literature on the relationship between inflation and economic growth in the context of Sri Lanka. It is widely believed that moderate and stable inflation rates promote the development process of a country, and hence economic growth. Moderate inflation supplements return to savers, enhances investment, and therefore, accelerates economic growth of the country. The main objective of this paper is to examine empirically this controversial issue for Sri Lanka. This is tested using a Regression Analysis technique, Unit Root Test and co-integration. The unit root test is initially performed to find the stationary properties of the each time series. To test the long run relationship F-test is used. Vector error correction is further employed and performed to investigate the short run dynamics of the relationship between inflation and economic growth. Annual data on GDP and Inflation Rate for the period of 1980 to 2013 is used in this research. Further, an assessment of empirical evidence has been used for driving the conclusion. The study proved that the interest rate has minor relationship with GDP. These results have important policy implications on inflation and economic growth of Sri Lanka.

Keywords: *Economic Growth, Inflation, Regression Analysis*