27

Macroeconomic Determinants of Current Account Balance: An Investigation from Sri Lanka

Tharindu Udayanga Kamburawala
Temporary Assistant Lecturer
Department of Economics
University of Kelaniya

Abstract

Current Account deficit has been negatively influencing the Balance of Payment imbalance in Sri Lanka. Alternatively, a high volume of external debt and the exchange rate depreciation are being considered as the factors that affect the external economic stability of the country. This study is designed to focus on macroeconomic determinants influencing current account balance (CAB) in comparison to External Debt (EXD), Exchange Rate (EXR) and Reserve Assets (RA). It covers the period from 1990 to 2017 and uses secondary time series data. Data were extracted from the World Economic Outlook Database of International Monetary Fund and the International Debt Statistics of World Bank. Augmented Dickey Fuller (ADF) unit root method has been used to test the order of integration of time series variables. Akaike Information Criterion (AIC) has been used to determine the optimal lag length of each series. The Johansen Cointegration method has been adopted to investigate the relationship between variables. Vector Error Correction Model (VECM) has been

adopted to determine the short run dynamics and long run adjustment of variables. These tests were conducted using STATA econometric software. The findings of the study revealed the long-term basis causality running from reserve assets, external debt and exchange rate to current account balance. However, there is no significant impact of exogenous variables on determining the current account balance in short term basis. Based on the findings, certain recommendations are made for policy makers and monetary authorities to increase foreign reserve assets of the country while decreasing the high volume of external debt and controlling the exchange rate depreciation.

Keywords: Current Account Balance, External Debt, Exchange Rate, Balance of Payments