

Short-Term Interest Rates and Expected Stock Returns: Evidence from Sri Lanka

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Abstract

The relationship of Sri Lankan short term interest rate and expected stock return was different from and foreign market. The theories and prior foreign studies results were negative relationship among the variables. This study examines the relationship between short term interest rates, as measured by Treasury bill yields of 91 days, 182 days and 364 days Treasury bill rates and stock returns in Sri Lanka. Regression analysis is employed to analyze the short term interest rate and stock return for the period of 2005 to 2015. It is employed on monthly, quarterly and annual time horizon. Stock returns based on All Share Price Index (ASPI) and S&P SL 20 index are used in the study and Treasury bill yields of 91 days, 182 days and 364 days are considered as the short term interest rates in this study. Furthermore analyze the periodically to identify the effect of after end the war in to the Sri Lankan economy in relating to the current research. The result of current research shows that negative relationship between interest rate and stock return in Sri Lanka. Furthermore, the Treasury bill rates effect on Stock return, becomes lager and more significant with longer maturity Treasury bill yield. Treasury bill yields explain up to 13%, 17%, and 13% in monthly, quarterly and annual returns respectively. Further it reveals that the explanatory power increases with the longer time horizon.

Keywords: *Colombo Stock Exchange, Short term Interest rates, Stock Return, Treasury bill yields*