

The Determinants of the Balance of Payments Imbalance of Sri Lanka

K. K. T. Udayanga¹

ABSTRACT

Balance of Payment imbalance negatively affects to the external economic stability of Sri Lanka. Although the government has employed several strategies to manage the imbalance, those intentions have not been enough to sustain the Balance of Payment properly. This study is designed to focus on macroeconomic determinants influencing balance of payment imbalance (BOP) in comparison to Reserve Assets (RA) and Money Supply (MS). There are several types of theoretical approaches to be based on when doing academic studies on balance of payments. Theoretically, this research is based on the monetary approach for balance of payments. Searching the applicability of basic concepts of the monetary approach of BOP on Sri Lankan context was another objective of this research. This study covers the period from 1990 to 2017 and uses secondary time series data from the Central Bank of Sri Lanka. This study has adopted the Augmented Dickey Fuller (ADF) unit root method to test the order of integration of variables. Akaike Information Criterion has been used to determine the optimal lag length of each series. The Johansen Cointegration method is adopted to investigate the relationship between the variables and the effect of macroeconomic determinants on BOP imbalance. 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. Findings of the study reveal the long run causality running from Reserve Assets and Money Supply to BOP imbalance. Further, Reserve Assets affects positively when determining the BOP imbalance in short run as well. Research recommends policy makers and monetary authorities to maintain reserve assets effectively and to implement efficient reserve management framework for Sri Lanka. Further, this research suggests future researchers to analyse the impact of qualitative variables like political stability on BOP imbalance.

Key words: *Balance of Payments, Imbalance, Reserve Assets*

¹ Department of Economoics, University of Kelaniya, kktudayanga@gmail.com