

A Study of Purchasing Power Parity in South Asian Countries

Karunawardhana, S.S.¹ and Weerasinghe, W.D.J.D.²

Department of Finance, University of Kelaniya, Sri Lanka^{1,2}

shamikasanduni98@gmail.com¹, damindaj@kln.ac.lk²

ABSTRACT

Purpose: This primary objective of this study is to investigate the existence of the Purchasing Power Parity (PPP) condition in South Asian countries.

Design/Methodology/Approach: This research explores the validity of the purchasing power parity (PPP) hypothesis utilizing monthly data of South Asian countries throughout the period of 2015 to 2022. This research study is conducted based on secondary quantitative data. Out of the 8 South Asian countries 5 countries were selected as the sample (i.e., Bangladesh, Bhutan, India, Maldives, and Sri Lanka) based on the data availability. In the study, data analysis for short run purchasing power parity is done using the Vector Error Correction Method (VECM). Data analysis for long-run purchasing power parity is done using the co-integration method.

Findings: PPP appears to be supported in a panel of South Asian regions, according to panel results. This study also discovered that there is a long-term relationship between price and exchange rate, even while VECM analysis reveals a short-term correlation between exchange rate and price differential as well as a bidirectional causal relationship between price and exchange rate.

Originality: Investigations of the validity of purchasing power parity in the South Asian context are relatively limited. Therefore, this study contributed to the dearth of study by adding new knowledge to existing knowledge and filling the empirical gap in the South Asian context.

Keywords: *Purchasing Power Parity, Absolute PPP, Relative PPP, Price Differential, Exchange Rate Differential*