Impact of Inflation Targeting Monetary Policy on Economic Growth in Sri Lanka

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Abstract

This paper investigates the impact of inflation-targeting monetary policy on economic growth in Sri Lanka. The objective of this paper is to assess the effects of monetary policy on key macroeconomic variables in the small open developing economy of Sri Lanka. To this end, this paper is organized as follows: Section I introduces the established evidence on the effects of monetary policy in the long and short run as well as a brief introduction to monetary policy in Sri Lanka. Section II reviews the existing literature about the methods of assessing the effects of monetary policy on macroeconomic variables. Section III explains the methodology and data used in the analysis. Section IV analyses the results obtained while Section V summarizes and concludes the discussion. To assess the impact of inflation-targeting monetary policy on key macroeconomic variables in Sri Lanka, such as inflation, Output, and unemployment, to identify the channels through which inflation-targeting monetary policy affects economic growth in Sri Lanka, to examine the impact of inflation on economic growth in Sri Lanka over the period 2000-2022, To measure the degree of responsiveness of economic growth (GDP) to changes in the general price levels (Inflation rate). The research design, conceptual framework, formulation of hypotheses, details of the research design, population, and sample selection justification are all covered in the methodology chapter. The study uses time series data from 2002 to 2022 to quantitatively analyze the effect of Sri Lanka's inflation-targeting monetary policy on economic growth. It supports the duration, sample, and data-gathering techniques selected, and emphasizes statistical analysis for validation with E-Views 12 SV software. The analysis concludes that there is no discernible difference between the treatment and control groups regarding the rate of inflation and the growth of the gross domestic product throughout the study. However, the result indicates that when the economy must deal with exogenous uncertainties, emerging economies can manage the rate of inflation increase.

Keywords: Inflation Targeting, Monetary Policy, Gross Domestic Growth, Vector Error Correction, Central Bank of Sri Lanka.