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FEASIBILITY OF ADOPTING INFLATION TARGETING IN SRI LANKA

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ABSTRACT

Monetary targeting framework has served well for decades in monetary management in Sri Lanka, however several researchers have articulated the need for adopting inflation targeting in view of several reasons, particularly to develop a new anchor for monetary policy conduct. The Central Bank of Sri Lanka has also expressed its interest in moving towards inflation targeting in the medium term, and hence a greater need exists of examining and exploring the issues and prospects in adopting inflation targeting in Sri Lanka as there are several prerequisites and conditions to be fulfilled for a successful inflation targeting regime. Amongst many other prerequisites for inflation targeting, the controllability of operating targets and its impact on the ultimate target of inflation is considered as one of the important.

This study attempts to examine the statistical relationships between operating targets and inflation rates in Sri Lanka, which is considered as one of the important prerequisites in inflation targeting. At the same time, it is intended to provide a framework for institutional, legislative and operational arrangements with a view to facilitate adopting inflation targeting in Sri Lanka. This study finds that statistical relationships between operating and final targets are not sufficiently strong, persistent and significant in the Sri Lankan context; however there are signs of emerging relationships. Those would persist with matured economic structure and developed financial markets, enabling adopting inflation targeting in Sri Lanka in future.