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EMERGING TRENDS IN POST- CONFLICT SOCIETIES: CHALLENGES AND THE WAY FORWARD

Impact of Interest Rate on Investment, in the Sri Lankan Context. A Study on the Effectiveness of Monetary Policy

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Abstract

The study investigates whether interest rate affect negatively on investment, leading economic growth. In the study, private and public corporation capital formation (PPCCF) is taken as dependent variable and Central Bank Rest (CBR) and real gross domestic income (RGDP) are taken as independent variables. The civil war, which experienced in the country, is used for the analysis as dummy variable. The data of the period from 1978 - 2013 is used for the study. Vector Error Correction test through Co-integration methodology is applied to estimate the long-run model and the short-run dynamics of investment. The variables; interest rate (CBR) and income (RGDP) are positively related with investment in the long-run, in the Sri Lankan context. The positive coefficient of income is significant and consistent with the hypothesis. Positive coefficient of interest rate is significant but inconsistent with the insights. The inverse relationship between investment and interest rate does not consist in the Sri Lankan context. According to short run dynamics represents in the Vector Error Correction Model 85% of the disequilibrium ($\mu 1_{t-1}$) in investment is adjusted towards equilibrium within one year period. Interest rate, income and the civil war environment jointly affect to investment expenditure in the Sri Lankan experience.

Keywords: Interest rate, private and public corporation capital formation, Real Income, Vector Error Correction methodology,

Co-integration methodology.