

Impact of Stock Market Performance on Economic Growth of Sri Lanka: An Econometric Analysis

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Capital markets long played an important role in economic development. Recently, attention was grabbed by the stock market performance and economic growth. The objective of this study was to explore the causal relationship between stock market performance and economic growth. The study used time-series data throughout 1990 - 2018. Data were collected from the Colombo Stock Exchange, World Bank data, and Central Bank annual reports. Market capitalization was used as the proxy for stock market performance and Gross Domestic Production (GDP) was used as the proxy for economic growth. The macroeconomic variables such as export, Foreign Direct Investment (FDI), inflation, and capital formation were used as the control variables in this study. According to the Augmented Dickey Fuller (ADF) test, the data set was stationary at the first difference form. Johanson co-integration test, Vector Error Correction Model, and Impulse Response Functions were used to check the short-run dynamics and long-run relationship between the stock market performance and economic growth. The co-integration test results confirmed that there is a long-run relationship between stock market performance and economic growth. The Impulse Response Function suggested that shocks from the stock market did not make an immediate effect on economic growth but in the long run there existed a positive relationship. Other macroeconomic variables showed fluctuated negative impacts on economic growth while Foreign Direct Investment managed to create a positive relationship in the long run. Therefore, the study recommends the policymakers to increase the concern towards the stock market performance to boost economic growth.

Keywords: Economic growth, long-run relationship, Macroeconomic variables, Market capitalization, Stock market performance