



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

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ABSTRACT

Capital markets long played an important role in economic history. Recently the focus has shifted towards the stock market performance and economic growth. The purpose of this study is to explore the presence of the causal relationship between these two variables. The study employed twenty-eight years of time series data from 1990 to 2018. Sample data collected from Colombo stock exchange, World bank data and central bank annual reports. Market capitalization is the stock market proxy and macroeconomic variables are control variables where GDP become proxy for economic growth. Data set is proven to be stationary at the 1st difference of the ADF test. Johanson co-integration test, vector error correction model and impulse response test used to check the short run dynamics as well as the long run relationship between the stock market and economic growth. The co-integration test results confirm that there exists a long-run relationship between stock market performance and economic growth. The Impulse Response Function suggests that shocks from the stock market do not make an immediate effect on the economic growth but in the long run there exist a positive relationship. Other macroeconomic variables show fluctuated negative impacts on economic growth while FDI manages to create a positive relationship in the long run. Hence the study revealed a positive impact regarding the stock market performance and economic growth, policymakers concern should increase towards the stock market in order to boost the economic growth.

Keywords: *Stock market performance, Market capitalization, Economic Growth, long run relationship, macroeconomic variables.*