Impact of Macroeconomic Factors on Stock Market Performance of Sri Lanka: A Sectoral Approach

Dumindu Senanayake and A. N. Wijayanayake
Department of Industrial Management, University of Kelaniya
ssedumindu@yahoo.com* & *anni@kln.ac.lk

Colombo Stock Exchange *(CSE)*, Sri Lanka was considered to be one of the top performing stock markets in the world in recent past (until Dec 2010). After the end of the civil war in the country it has attracted a lot of investors and firms during a time period where all the uncontrollable factors like political stability and security concerns were rapidly changing.

The main purpose of this study is empirically investigating the impact of macroeconomic factors on emerging stock market of Sri Lanka. Relationships between macroeconomic factors such as Inflation (measured by Colombo Consumer Price index), Interest rates, Exchange rates, Gross Domestic Product (GDP), and Money Supply and stock market performance have been tested using All share Price index *(ASPI)*, Milanka index and five major sector indexes for the period from 2003 to 2010. Relationship between *CSE* indexes and macroeconomic factors was tested using natural logarithm values of monthly data and quarterly data. Regression analysis was the highly used statistical method in this research to find the relationships.

Influence of the macroeconomic factors to the *CSE* was determined by the coefficient of correlation **r** values between *CSE* index/Milanka index/Sectoral index and each macroeconomic factor given above. The results of the analysis revealed that the Money supply and Colombo Consumer Price Index have a major impact over the stock market performance. It is further revealed that the *GDP* and Interest rate also have significant impacts, though it is anticipated, that the Exchange rates do not have any significant influences over the *CSE*. Influences of the macroeconomic factors have been ranked according to the strength of the coefficients and their collective influences have also been considered under the multiple regression analysis.

***Key words**: Macroeconomic factors, Stock market indexes, Linear regression, Multiple regression*