

Short-term interest rate and stock market performance in Sri Lanka: Evidence from bi-variate and multivariate analysis

W.P.P.K. Weerakoon and A.L.M. Jameel

Department of Accountancy & Finance, Faculty of Management Studies,
Rajarata University of Sri Lanka, Mihintale, Sri Lanka.

Corresponding author: wppkweerakoon@gmail.com

Abstract

Stock market performance and interest rates are major economic indicators in an economy. Researchers have studied the relationship between interest rate and stock market performance under bi-variate and multivariate analysis. However, their findings are inconclusive. The purpose of this study is to examine the relationship between short-term interest rate and stock market performance in Sri Lanka using bi-variate and multivariate analysis. The study used three-month Treasury bill rate as the independent variable and it was used as the proxy for the short-term interest rate under the bi-variate analysis. In addition, the study used other three important macroeconomic variables namely money supply, consumer price index and exchange rate as control variables under the multivariate analysis. All Share Price Index was used as the dependent variable and it was used as proxy for the stock market performance. Data were collected for the period spanning from July 2005 to June 2015. Correlation analysis reveals that there is a negative and significant relationship between short-term interest rate and stock market performance. Multivariate analysis suggests that exchange rate and inflation rate have a negative effect on stock market performance while money supply has a positive effect. These findings have significant implications for various parties including policy makers, stock market regulators, investors, and stock market analysts.

Keywords: All Share Price Index, exchange rate, money supply, Treasury bill rate, stock market performance.