

## THE EFFECT OF MACROECONOMIC FACTORS ON STOCK MARKET PERFORMANCE: EVIDENCE FROM THE COLOMBO STOCK EXCHANGE

S.D.S.L. Gunawardhana<sup>1,\*</sup> and K.V.A. Shantha<sup>2</sup>

<sup>1</sup>*Department of Accountancy & Finance, Faculty of Management Studies, Rajarata University of Sri Lanka.*

<sup>2</sup>*Department of Accounting & Finance, Faculty of Management Studies, The Open University of Sri Lanka.*

\*Corresponding author (Email: sahirulakshan26@gmail.com)

### ABSTRACT

Financial stability is vital for a country's economic prosperity and societal well-being. Recent evidence from Sri Lanka indicates a significant impairment in its financial strength, as characterized by severe fluctuations in crucial economic indicators such as inflation, exchange, and interest rates. Theoretically, these fluctuations are expected to affect stock market performance, which is a vital reflection of a country's financial stability. Despite their significance, the influence of macroeconomic factors on stock market performance has not been sufficiently explored in the Sri Lankan context. The objective of this study is to empirically examine the impact of key macroeconomic variables, specifically inflation rates, exchange rates, and interest rates, on the performance of the Colombo Stock Exchange. Using a quantitative approach, secondary data from the Central Bank's annual reports and the CSE database were analyzed over the six years from 2017 to 2022. The results of the correlation analysis indicate strong positive correlations between the exchange rate, inflation rate, and interest rate, highlighting the interconnected dynamics among currency movements, inflation, and interest rates. The regression analysis reveals that the inflation rate and exchange rate positively impact stock market performance, whereas the interest rate has a negative effect. These findings contribute to the literature on the macroeconomic determinants of stock market performance and provide valuable insights for investors, policymakers, and financial institutions. By incorporating these economic indicators into their decision-making processes, stakeholders can enhance their financial strategies and foster economic stability.

**Keywords:** Colombo stock exchange, exchange rate, financial stability, inflation rate, interest rate.