Money Supply and Economic Growth in Sri Lanka
(An Empirical Re-Examination of the Monetarist Concept)

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The purpose of this study was to empirically re-examine the causal relationship between money supply and economic growth in Sri Lanka. The time series data used in this study were collected from the sample period from 1959 to 2013. An Augmented Dickey Fuller (ADF) test was used for verifying the unit (stationary) root of the time series variables such as money supply and economic growth, and then a simple regression model was employed in this study to test the long-term relationship between the variables. Based on the regression result, the coefficient of money supply was positive. Therefore, there is a direct relationship between money supply and the Gross Domestic Product (GDP). The P Value was less than five percent and the value of R-squared of this model was higher than the Durbin Watson statistics (R^2>DW). The residual of this model was stationary at a five percent significance level. Therefore, the conclusion was that money supply and the GDP are co-integrated at I(0) level form. The short-term behaviours of these variables were explained by the Error Correction Mechanism (ECM) at a significance level of five percent. Therefore, these variables were co-integrated in the short term and a two-way causal relationship based on the Granger Causality test statistics was also established.

Keywords: Money supply, Economic growth, Co-integration, Error Correction Mechanism, Augmented Dickey Fuller test