Factors Influencing Exchange Rate Volatilities in Sri Lanka; In Comparison to Peru

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Abstract

This study aims to identify the factors affecting the exchange rate volatilities in Sri Lanka compared to Peru. The country Peru was selected because it is the most comparable to Sri Lanka based on the GDP Per Capita (PPP), population and Human Development Index (HDI), and colonization. The main objective of this study is to identify the factors affecting exchange rate volatilities in Sri Lanka compared to Peru. The aim of the study is to investigate whether the external value of the Sri Lankan Rupee is influenced by issues, such as macroeconomic factors, sociocultural factors, institutional factors, and social factors and, if yes, how, and why. In other words, the study aims to find out the impact of macroeconomic factors on exchange rate volatilities in Sri Lanka, the impact of institutional factors on exchange rate volatilities in Sri Lanka, the impact of sociocultural factors on exchange rate volatilities of Sri Lanka and the impact of social factors on exchange rate volatilities on Sri Lanka. A quantitative regression analysis technique was employed on the data collected from secondary sources, such as the Central Bank of Sri Lanka, IMF databases, and World Bank databases for the period from 1997 to 2022. The discussion of the results was done from a critical perspective with the support of the literature. The findings of the study revealed that major elements that have an impact on a country's exchange rate volatility are GDP per capita, unemployment rate, social contributions, and human development index. Foreign Direct Investments also became significant when the social contribution factors moderated it. The regression statistics between the two countries show that Sri Lanka has a higher level of exchange rate volatility compared to Peru. It is evident that sociocultural and macroeconomic factors have the biggest effects on the currency rate volatility in Sri Lanka, while institutional factors, such as political stability, absence of violence, and rule-based governance index, have no discernible impact on Sri Lanka's exchange rate volatility. The findings will be helpful for the researchers to advance their research studies in this field and for policymakers to develop sustainable frameworks for exchange rate stability, which is identified as an essential factor for economic development.

***Keywords**: Exchange rate, Institutional factors, Gini index, Macroeconomic factors, Public debt*

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