

## PERSISTENT FISCAL DEFICIT AS A DETERMINANT OF INFLATION IN SRI LANKA: ARDL APPROACH

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Fiscal deficit is an important issue in developing countries as it can have impacts on macroeconomic variables such as inflation. The present study examined the persistence of fiscal deficit as a determinant of inflation and focused on long-run co-integration between inflation and fiscal deficits in Sri Lanka from 1977-2019. Inflation was taken as the dependent variable and the study was based on autoregressive distributed lag (ARDL) to investigate the long-run relationships among the variables and the error correction model (ECM) to examine short-run dynamics. The co-integration among the variables was indicated through the bound test approach when inflation was the dependent variable. The bound test suggested the presence of co-integration among the variables when inflation is taken as the dependent variable and hence the long-run relationship between inflation and fiscal deficit in Sri Lanka. The policymakers should think of increasing the revenue through taxes in order to bridge the fiscal deficit.

**Keywords:** ARDL, Co-integration, Error Correction, Fiscal deficit, Imports, Inflation, Nominal wage rates