

**THE IMPACT OF USD EXCHANGE RATE
FLUCTUATIONS AND MACROECONOMIC
FACTORS ON FOREIGN DIRECT INVESTMENT
INFLOWS IN SRI LANKA**

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Master of Science in Business Statistics

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Dissertation submitted in partial fulfillment of the requirements for the
degree
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DECLARATION

I declare that this is my own work and this Dissertation does not incorporate without acknowledgement any material previously submitted for a Degree or Diploma in any other University or Institute of higher learning and to the best of my knowledge and belief it does not contain any material previously published or written by another person except where the acknowledgement is made in the text. I retain the right to use this content in whole or part in future works (such as articles or books).

Signature:

Date: 16-Dec-2024

The supervisor should certify the Dissertation with the following declaration.

The above candidate has carried out research for the Master of Science in Business Statistics Dissertation under my supervision. I confirm that the declaration made above by the student is true and correct.

Name of Supervisor: Dr. H. A. S. G. Dharmarathne

Signature of the Supervisor:

Date: 16-Dec-2024

DEDICATION

This thesis is dedicated to my family especially to my husband M.B.C.M Bandara and loving daughter M.B. Hetheshi Giaana. Lastly to my loving parents; mother P.V. Disna, father J.S.Rathnasiri for their support and encouragement throughout the period.

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ABSTRACT

The primary aim of this research is to investigate the impact of fluctuations in the USD exchange rate (as the U.S. dollar (USD) holds a dominant position in global trade and financial markets) on foreign direct investment inflows into Sri Lanka, placing exchange rate stability as a critical factor in attracting investment. Furthermore, the research will consider how the fluctuations of other important factors like GDP growth, inflation, and trade openness influence the FDI inflows in Sri Lanka. These variables were chosen based on their theoretical and empirical importance in FDI literature and their relevance to the Sri Lankan economic context. By understanding these factors, this study aims to provide comprehensive insights into the economic factors that influence FDI inflows especially during times of currency fluctuation.

The analysis establishes both long- and short-run relationships between the identified variables using the Autoregressive Distributed Lag Model (ARDL). ARDL is particularly suitable for this research as it accommodates variables of different levels of integration (i.e., $I(0)$ and $I(1)$). The test results indicate a presence of the long-run relationship between FDI inflows and the selected other variables. In addition, Error Correction Model (ECM) is applied to observe short-run dynamics and the adjustment mechanism toward the equilibrium in the long run. Results from this study show that GDP growth has a positive and significant impact on FDI inflow, both in the short and long run. The error correction term is highly significant with a negative coefficient signifying that the speed of adjustment toward the long-run equilibrium is high. In this respect, it is found that almost 86% of disequilibrium is corrected in short-run periods. The data have been analyzed on the statistical software Eviews. These insights hold significant implications for policymakers, as they highlight the need to stabilize key economic indicators to enhance Sri Lanka's attractiveness as a destination for foreign investment.

Keywords: Foreign Direct Investment Inflow, Exchange Rate, GDP Growth, Inflation, Trade Openness, ARDL Model, ECM

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LIST OF ABBREVIATIONS

Abbreviation	Description
ADF	Augmented Dickey Fuller
AIC	Akaike information criterion
ARDL	Autoregressive Distributed Lag
BG	Breusch Godfrey
BP	Breusch Pagan
CUSUM	Cumulative Sum
CUSUMSQ	Cumulative Sum of Squared
DW	Durbin Watson
ECM	Error Correction Model
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
JB	Jarque Bera

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