Domestic Savings, Money Supply and Economic Growth In Sri Lanka

Rachmawati Rachman[1], Abazin Sok[2]
[1]STIE Jaya Negara Tamansiswa Malang, Indonesia
[2]University of Economics Ho Chi Minh City, Vietnam

Abstract
This study aims to investigate the impact of money supply, domestic savings and total debt ratio on economic growth.This study uses an annual research period of 48 years from 1972 to 2020 in Sri Lanka to estimate Sri Lanka's economic conditions and the impact of money supply, domestic savings, and debt-to-economy ratios in Sri Lanka. We use the second data in this study which is sourced from the world bank. This study uses the Error Correction Model (ECM) analysis. We found that the domestic saving ratio can encourage economic growth in Sri Lanka in terms of loanable supply where the increase in the amount of savings, the increased loanable supply which has an impact on lowering interest rates so that investment can increase and economic growth can be encouraged to grow.

Keywords: Domestic Savings, Money Supply, Economic Growth,Sri Lanka
JEL Classification: C01,C15,E01,E02

Received: January 16,2022 Accepted: April 1,2021
DOI : 10.54204/TMJI/Vol412022004

Background
The poverty circle or poverty trap cycle theory is a set of forces that influence each other in a certain way that causes a country to remain poor and is very slow to develop. This is the background of the birth of a balanced development strategy in developing countries (Eldridge, Rancourt, Langley, & Héroux, 2022). The cooperation between developed countries and developing countries has resulted in inequality in terms of economic development. Developed countries have a scattering effect that encourages the rate of economic development of their country. On the other hand, developing countries get the impact of this cooperative relationship which hinders their economic development. (Miller,2017). The factors that influence the growth of per capita income from implementing critical minimum efforts are the internal diseconomic scale and the external diseconomic scale. Internal diseconomic scale is the result of indivisible factors of production. (Arnold,2015). Entrepreneurship will emerge, increase in knowledge sources, develop community skills, increase the rate of savings and investment (Morris, Santos, & Neumeyer, 2020). A balanced development strategy or also known as the big push theory by building various interrelated industries on a large scale at the same time (Stoica, Roman, & Rusu, 2020).
The workforce increases as a result of population development, and work experience and education increase their skills. Inflation causes the prices of goods to increase so that people's purchasing power will decrease. This will reduce investors' interest in investing in a company. If investors' interest in investing in a company decreases, the company's stock prices will decrease. This will automatically cause the share price to decrease (Giri & Masanta, 2020). However, the

excess quantity of human resources encourages the government not only to direct the population to become workers or employees but also to become job providers (Widarni & Bawono,2020). The growth of interest in entrepreneurship is important in economic development given the contrasting conditions between labor demand and supply. The supply of labor is very high while the demand is relatively low. Meanwhile, the number of job providers. Through the spirit of entrepreneurship, new business units need to be built so that they are able to accommodate excess labor (Browder, Aldrich, & Bradley, 2019). Entrepreneurship can be a solution for post-covid 19 economic recoveries (Huynh, Truong, Duong, Nguyen, Dao, & Dao, 2021). Entrepreneurs can encourage production, which is indicated by GDP on a macro basis. Gross Domestic Product which is shortened to GDP or often referred to as Gross Domestic Product or abbreviated as GDP (Dallago & Tortia,2018).

Inflation is defined as price increases that occur continuously and price increases occur in all categories of goods and services. The rate of inflation is a description of prices. The soaring price is reflected in high inflation. Meanwhile, the relatively stable price is reflected in the low inflation rate. It can be concluded that if the price increases for only one good, it is not inflation, but if the increase causes the price of other goods and services to also rise, it is called inflation (Bassetto & Sargent, 2020).

The central bank can change the ratio of mandatory reserves to implement monetary policy. This is the portion of the savings they have to keep, either on their balance sheet or deposited with the central bank. When central banks increase, it means that they can lend less third party deposits as credit. As a result, the amount of money in the economy is shrinking. This policy is called a contractionary policy and is usually carried out to moderate the rate of inflation (Campiglio, Dafermos, Monnin, Ryan-Collins, Schotten, & Tanaka, 2018). Conversely, when the reserve requirement ratio falls, the growth in the money supply grows faster. Banks have more funds to lend. Due to abundant liquidity, loan interest rates will usually fall and encourage demand for credit. An increase in credit will boost the money supply through the money multiplier effect (Ayre, 2019). By knowing the rate of economic growth, the government can make plans regarding state revenue and development plans that will be carried out. Poor economic growth can be used as a basis for receiving financial assistance from international parties, such as the World Bank or other countries. Meanwhile, for business actors or companies, the level of economic growth can be used as the basis for making plans for the development of the company's products and resources (McDonald,2010). The existence of the Bank will open and expand employment and employment opportunities, so as to be able to absorb workers who are still unemployed in the community. Activities in providing services in payment traffic and circulation of money can help the smooth flow of goods and services in society (Suryanata, 2019).

Banks are very important in people's lives because they facilitate the exchange of goods and services, collect and channel public funds, provide information and knowledge, and provide financial guarantees. Banks as financial institutions act as public financial intermediaries between parties that have excess funds and those who need funds. The position of banking in the national economy is very strategic. The important role of banking in the national economy and the high level of public trust that must be maintained make banking an industry with the most stringent regulations (Mosteanu & Faccia, 2020). There is no absolute definition of money included in the calculation. Each country has a different classification and size of money. The most common classifications of money are the narrow money supply and the wide money supply (Wen, Min, Zhang, & Yang, 2019).

The application of monetary policy must be wise. Money is created every time the bank makes a new loan. A loan, when withdrawn and spent, mostly ends up as a deposit in the banking system, which is counted as part of the money supply. Financial deepening is a term that appears to emphasize that quality development in the financial sector does not only focus on the aspect of depth, but also on the affordability and efficiency of financial service providers (Luis, de la Fuente, & Perote, 2019). Although the role and success of the financial sector in growing the economy varies from time to time and from country to country, the need for an effective and efficient financial sector to grow the economy cannot be denied. Financial deepening is not only sufficient by increasing its size, but it is also necessary to prioritize the qualities that enable the financial sector to perform its functions, both as a motor as well as support for economic growth, without causing negative impacts that are not anticipated and overcome (Bawono, et al., 2019). The capital market plays a very important role in economic development, namely as a source of external financing for the business world and a vehicle for public investment so that the presence of the capital market can increase the choice of sources of funds (especially long-term company funds. The capital market can also be defined as a place with an organized system that is uniting fund owners or investors (buyers of securities) and users of funds (sellers of securities) which is done directly and or indirectly (Godke Veiga, & McCahery, 2019).
The capital market can be said to be one of the economic instruments that are highly influenced by various events that have information content for investors. investors, the capital market is a vehicle that can be used to invest their funds (in financial assets). The presence of the capital market will increase investment options so that the opportunity to optimize the utility function of each investor is even greater (Baret, Celner, O'Reilly, & Shilling, 2020). Events that can be used as information by investors can come from the internal and external conditions of the share issuer. Events originating from internal market conditions can be in the form of dividend distribution announcements, issuance of financial reports, stock split, and so on, while external events are generally economic and non-economic factors (Nagy, Oláh, Erdei, Máté, & Popp, 2018). One of the macroeconomic events that have various impacts on the fluctuation (volatility) of stock movements in the capital market is the fluctuation in the value of a country's currency which is measured or expressed in other currencies, which also affects the export and import trade of goods and services, related to the issuing company stocks were for companies that do international trade (Tan, Sadiq, Aldeehani, Ehsanullah, Mutira, & Vu, 2022). This study aims to investigate the impact of money supply, domestic savings and total debt ratio on economic growth.

Research Method

This study uses an annual research period of 48 years from 1972 to 2020 in Sri Lanka to estimate Sri Lanka's economic conditions and the impact of money supply, domestic savings, and debt-to-economy ratios in Sri Lanka. We use the second data in this study which is sourced from the world bank. This study uses the Error Correction Model (ECM) analysis with the following equation.

$$GDP_t = \alpha_0 + \alpha_1 M2_{t1} + \alpha_2 BC_{t2} + \alpha_3 DS_{t3} + e_t$$

GDP_t is the total national production in the period t. The money supply ratio, or $M2_t$, is measured during the time period t. The total credit ratios across the country in period t form BC_t. The total domestic saving across the country during the time period t is represented by the symbol DS_t. αo, α1, α2, α3 is the coefficient.

Results and Discussion

The results of the ECM test that we conducted are shown in table 1.

Table 1. Results of ECM Estimation

Variable	Coeff.	t-stat.	Prob.
C	0.004124	0.123441	0.8926
D(M2)	-0.817243	-8.927.221	0.0000
D(BC)	0.082142	1.981.522	0.0341
D(DS)	0.071112	8.112.115	0.0000
U(-1)	-0.691141	-3.212.334	0.0001
Adjusted R-squared	0.894231		
Prob. F-statistics	0.000000		

The money supply (M2) is significantly impacted inversely economic growth, which reflects that the increase in money supply in Sri Lanka has actually put pressure on the Sri Lankan economy. A healthy credit ratio has an impact on improving the economy, supported by domestic saving. This is indicated by the direction of the positive influence of the significant ratio of domestic debt and savings on economic growth.

Conclusion

The money supply in Sri Lanka has an impact on economic pressures that are getting worse in Sri Lanka after Covid 19. In Sri Lanka, the percentage of domestic savings, which determines the amount of loanable capital available, can promote economic growth. Then an increase in loanable supply has an impact on lowering interest rates so that investment can increase and economic growth can be encouraged to grow.

References

Arnold,R.A.(2015). Microeconomics. Boston : Cengage Learning

Ayre,P.C.I.(2019).Finance in Developing Countries. London,UK : Routledge

Baret, S., Celner, A., O’Reilly, M., & Shilling, M. (2020). COVID-19 potential implications for the banking and capital markets sector. Maintaining business and operational resilience. Deloitte Insights, 2(2), 96-108.

Bassetto, M., & Sargent, T. J. (2020). Shotgun wedding: Fiscal and monetary policy. Annual Review of Economics, 12(1), 659-690.

Bawono,S, Zainuri, Niken ,R.(2019).Dynamics Of Real Exchange Rate And Three Financial Crisis: Purchasing Power Parity Relative Approach In Indonesia And Thailand.INTERNATIONAL JOURNAL OF SCIENTIFIC & TECHNOLOGY RESEARCH, 5 (05), 58-62. https://www.ijstr.org/final-print/may2019/Dynamics-Of-Real-Exchange-Rate-And-Three-Financial-Crisis-Purchasing-Power-Parity-Relative-Approach-In-Indonesia-And-Thailand.pdf

Browder, R. E., Aldrich, H. E., & Bradley, S. W. (2019). The emergence of the maker movement: Implications for entrepreneurship research. Journal of Business Venturing, 34(3), 459-476.

Campiglio, E., Dafermos, Y., Monnin, P., Ryan-Collins, J., Schotten, G., & Tanaka, M. (2018). Climate change challenges for central banks and financial regulators. Nature climate change, 8(6), 462-468.

Dallago,B., Tortia,E.(2018). Entrepreneurship and Local EconomicDevelopment.London : Routledge

Eldridge, E., Rancourt, M. E., Langley, A., & Héroux, D. (2022). Expanding Perspectives on the Poverty Trap for Smallholder Farmers in Tanzania: The Role of Rural Input Supply Chains. Sustainability, 14(9), 4971-4981.

Giri, B. C., & Masanta, M. (2020). Developing a closed-loop supply chain model with price and quality dependent demand and learning in production in a stochastic environment. International Journal of Systems Science: Operations & Logistics, 7(2), 147-163.

Godke Veiga, M., & McCahery, J. A. (2019). The financing of small and medium-sized enterprises: an analysis of the financing gap in Brazil. European Business Organization Law Review, 20(4), 633-664.

Huynh, D. V., Truong, T. T. K., Duong, L. H., Nguyen, N. T., Dao, G. V. H., & Dao, C. N. (2021). The COVID-19 Pandemic and Its Impacts on Tourism Business in a Developing City: Insight from Vietnam. Economies, 9(4), 172-182.

Luis, P., de la Fuente, G., & Perote, J. (2019). The drivers of Bitcoin demand: A short and long-run analysis. International Review of Financial Analysis, 62(1), 21-34.

McDonald,P.F.(2010).Immigration, Labour Supply and Per Capita Gross Domestic Product.Canberra : Department of Immigration and Citizenship

Miller,M.M.(2017).Economic Development for Everyone: Creating Jobs, Growing Businesses, and Building Resilience in Low-Income Communities.London : Routledge

Morris, M. H., Santos, S. C., & Neumeyer, X. (2020). Entrepreneurship as a solution to poverty in developed economies. Business Horizons, 63(3), 377-390.

Mosteanu, N. R., & Faccia, A. (2020). Digital systems and new challenges of financial management–FinTech, XBRL, blockchain and cryptocurrencies. Quality-Access to Success Journal, 21(174), 159-166.

Nagy, J., Oláh, J., Erdei, E., Máté, D., & Popp, J. (2018). The role and impact of Industry 4.0 and the internet of things on the business strategy of the value chain—the case of Hungary. Sustainability, 10(10), 3491-3501.

Stoica, O., Roman, A., & Rusu, V. D. (2020). The nexus between entrepreneurship and economic growth: A comparative analysis on groups of countries. Sustainability, 12(3), 1186-1196.

Suryanata, I. G. N. P. (2019). Investment multiplier effect expands tourism destinations. International Research Journal of Management, IT and Social Sciences, 6(2), 44-51.

Tan, L. P., Sadiq, M., Aldeehani, T. M., Ehsanullah, S., Mutira, P., & Vu, H. M. (2022). How COVID-19 induced panic on stock price and green finance markets: global economic recovery nexus from volatility dynamics. Environmental Science and Pollution Research, 29(18), 26322-26335.

Wen, F., Min, F., Zhang, Y. J., & Yang, C. (2019). Crude oil price shocks, monetary policy, and China's economy. International Journal of Finance & Economics, 24(2), 812-827.

Widarni,E.L., Bawono,S.(2020).Human Capital Investment For Better Business Performance.Singapore : Triplenine Communication