

## MONEY SUPPLY AND AGGREGATE FOOD PRICES IN SRI LANKA

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According to neo-classical theory, aggregate price level is positively related to the money supply. Further, it theorizes that the relationship between interest rate and investment and the relationship between interest rate and savings are negative and positive respectively. Samaranayake (1986) however, reveals that, the relationship between the interest rate and the investment or savings behaviour in Sri Lanka is not significant. The objective of this study is to investigate the influence of money supply on the aggregate food prices in Sri Lanka.

Quarterly data of eleven years (1975/85) were used for the study. In a bi-variate system, money supply was allowed to influence food prices in the system with lags (bi-variate Vector Auto Regression) and the effect examined. The result of the analysis shows that the influence of money supply on the aggregate food prices is not significant. Thus, the effectiveness of money supply as a stabilization policy is doubtful in Sri Lanka. Major reasons for this may be government intervention and other imperfections in money and commodity market in Sri Lanka.