Impact of inflation on Unemployment in Sri Lanka: Perspective of Phillips Curve

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Abstract

The aim of this study is to identify the impact of inflation on unemployment in Sri Lanka over the period 1990 - 2016 through the perspective of Phillips curve. For this purpose, the annual time series data for the above period were collected from central bank report in 2016. To achieve the objective, the inflation rate which represents by wage price index was considered as the dependent variable, and the unemployment rate was used as independent variable in the study. The collected data were analysed using simple linear regression model and reciprocal model which represents the Phillips curve. Results of the coefficient of correlation in linear regression model suggest that inflation and unemployment have 87.5% of negative correlations among them while the model reveals that rate of inflation has a negative impact on unemployment in the country. Results of reciprocal model confirmed the concept of Phillips curve, and it has found that even if the unemployment rate increases indefinitely, the percentage decrease in wage price index floor will not be more than 12.23 percent per year and the results are statistically significant at 1% level. Also, the above model proves that Sri Lanka has attained a 20.8% of the natural growth rate of unemployment which is higher than under linear model while adjusted R2 is 0.93 in reciprocal model shows that compared to the linear model, the reciprocal model is the best-fitted one to measure the strength of the above two variables. Findings of the study may help the policymakers in formulating the policies to minimize the harmful consequences of inflation and level of unemployment in Sri Lanka.