

**"An Econometric model
For inflation and unemployment
In Sri Lanka since 1963".**



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ABSTRACT

This study investigates the relationship between inflation and unemployment in Sri Lanka using annual data for the period 1963- 2003.

Simple scatter plots, scatter with regression, and reciprocal model are use to explore the above relationship (Phillips curve). According to the simple scatter, the functional relationship was not identified, but the advanced techniques used the reciprocal model showed that there was weak and downward sloping and non linear relationship between inflation and unemployment in srilanka.

Linear and non-linear regression model are also applied in this study to test the relationship statistically. Linear models are estimated using ordinary least square estimation. Non-linear model are using the reciprocal method. In the linear models variables are using in the form of log, first difference, and original level. Among the explanatory variable unemployment was statistically 5 per cent significant level.

The study found that there was negative and unstable relationship between inflation and unemployment during the overall sample period. But there seems to have been no fixed relationship between inflation and unemployment as Phillips argued. A closer look at the data shows that there has been trade off between inflation and unemployment

Another interesting point to note is the change in the gradient of the curve along with time. It implies that the slope of the Phillips curve is a function of macroeconomic status and the relationship is asymmetric. Thus is some evidence that the elasticity of CCPI inflation with respect to unemployment has fallen recently. Empirical evidence for Sri Lanka shows that the Phillips curve has a concave shape. Sacrifice ratio between those two variables also change over the period.