

## THE RELATIONSHIP BETWEEN STOCK RETURNS AND INTEREST RATES IN SRI LANKA\*

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### ABSTRACT

This paper investigates the relationship between stock returns and interest rates in Sri Lanka using weekly and monthly data for the period January 1990 to December 1995. The results indicate that stock returns have a significant positive relationship with contemporaneous and lagged one-year Treasury bill yield, and both contemporaneous and lagged yield spreads. The spread between twelve and three-month yields is most important in forecasting stock returns. The changes in the interest rate structure trigger delayed reactions from investors and, seem to indicate inefficiency in the process of dissemination of market information.

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