Nexus between Economic Growth, Unemployment and Inflation in Ethiopia - ARDL Bounds Testing for Cointegration

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by

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Abstract

The current fast and increasing economic growth in Ethiopia is influenced by inflationary pressure and huge unemployment surge. The objectives of the study are to estimate the short-run and long run relationships and causalities among the variables in Ethiopia by using a time series data for the period 1991 to 2016, that are triangulated from domestic and international sources such as EEA and WB: WDI database. VAR, ARDL, VECM models and Granger Causality and Wald tests are used for analysis. The bounds test for cointegration results indicate the existence of long run relationship among the variables. Real GDP and inflation are negatively and significantly related to unemployment. The result is in line with Okun’s law of inverse relationship between unemployment and GDP growth. Granger Causality tests divulge a short run causality running from inflation to real GDP while real GDP does not have predicting power about economic growth. All the causalities found in this estimates are unidirectional. The short run, long run and ECM estimates of inflation, unemployment and GDP, all agree about significance and causation. First, the estimates shows that inflation and unemployment have significant inverse relations. Second, inflation and GDP have significant positive relations. It has been largely reported that, the Ethiopian economy has been growing by close to 10 percent for more than a decade. Therefore, the growth and the consecutive high demand in the economy leads to a moderate demand pull inflation. The speed, at which inflation returns to equilibrium after changes in unemployment and real GDP, as measured by ECM, is 112 percent, which indicates the vigor of the domestic economy. Policy makers might have something to learn about the relationship and direction of causality among macroeconomic indicators for future action.

Key Words: Real GDP, Inflation, Unemployment, Ethiopia, ARDL, VECM