

## **Policy Brief**

# **Devaluation & Inflation<sup>1</sup>** (Financial Market and Goods & Services)

**Do we really have an Inflationary pressure in Puntland?**

**Garowe, October 2020**

### **Key Policy Messages**

The Key Policy Messages are summarised below based on the results of our enquiry on the existence of inflationary pressures and/or local currency appreciation in Puntland:

- (i) On the money (or financial) market there is a strong need to establish a committee composed by the government and the business community to have regular meetings for a fistful control on this situation
- (ii) On the market of goods and services all government institution and the business community should have regularly keep an eye on the monthly publication of the Puntland Statistics Department for inflation rates
- (iii) For the future of the local currency the Puntland Government should put some pressure to the Federal Government to introduce a new reliable paper money to substitute the already shrink market of the local currency

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<sup>1</sup>Professor Mohamed S. Samantar, Executive Director of SIDRA, Abdifatah M Abdullahi, Director of Puntland Statistics Department and Awil M. Ahmed, Deputy Director, Puntland Statistics Department

## Do we really have an Inflationary pressure in Puntland?

### *Introduction*

After scrutinising at the actual situation in Puntland we seem to have come to the conclusion that the simple answer is NO for the claimed Puntland inflationary predicament.

Let us draw our facts from some reliable sources a few key lines to answer this big question at this point in time.

Before we do that, we will attempt in this Policy Briefing to make some inherent definitional confusions between inflation and devaluation (depreciation) in Puntland as well as deflation and revaluation (appreciation). It is not clear that these phenomena occur in two distinct markets (**Financial Market and Goods & Services**).

We will begin to make some clarification on these definitional transcriptions:

#### 1. *Devaluation (Depreciation)*

An increase in the Exchange rate (SoSh/US\$) is NOT inflation but can cause or influence inflation rates provided that all people in Puntland use the SoSh;

Revaluation refers to an upward adjustment to the country's official exchange rate relative to price of the foreign currency (US\$). In the same vein appreciation of a currency **associated with a floating or managed floating exchange rate system**. Whereas revaluation of a currency is associated with the fixed exchange rate regime. Impacts of appreciation and revaluation of a currency. Exports: Appreciation and revaluation of currency make the exports less competitive in the international market. In other words, both appreciation and revaluation have similar impacts but they have some differences.

Revaluation increases the value of the domestic currency with respect to the foreign currency. Revaluation is a feature of the fixed exchange rate regime, where the exchange rate is determined by the central bank or the government. Revaluation is opposite to devaluation, (or depreciation) which is a downward adjustment.

With regard to the **foreign exchange regime** a liberal financial system operates in Puntland, with a dual exchange rate subsystem that uses market rates for private transactions but a usually overvalued rate for government transactions. In Puntland we

have observed that for the first time in the history of Puntland, and indeed in Somalia in general, there is a declining trend in the market exchange rates and since August 2011 it is below the level (around SoSh20.99 in December 2012 per US\$) of the official exchange rate of SoSh30, 000 per US\$

A report by an economic committee set for this purpose by the Government have come to a sensible proposal to collect import-export duties in solely US \$'s.

## 2. *Legal tender of the currency*

The SoSh in use in Puntland is NOT used in any part of Somalia as a legal tender outside Puntland, while US\$ is a legal tender throughout Somalia;

This fact divides Somalia into three areas of local currencies, as legal tenders. against the US\$: Puntland, Somaliland and South-Central.

## 3. *Inflation rate*

In economics, inflation or price inflation is a general rise in price level relative to available goods & services resulting in a substantial and continuing drop in purchasing power in an economy over a period of time. The inflation rate is most widely used by calculating the movement or change in a price index, typically the consumer price index (cpi). The inflation rate is the percentage change of a price index over time. This is what the Puntland Statistics Department (PSD) does on a monthly basis nowadays.

## 4. *Dollarisation of Puntland economy*

As explained by Mohamed Dalmar<sup>2</sup> in one of his articles on monetary policies in Somalia we can reiterate that:

The foreign exchange market operated by money-changers grew bigger and more vibrant as it benefited from the absence of government controls and the sizeable inflow of remittances from the Somali diaspora. These remittances are channelled through the money transfer companies, the Hawala which built, over the years, a very elaborate network of offices and agents capable of transferring funds not only to Somalia but also to any part of the world instantly

On a survey carried out by the World Bank<sup>3</sup> can be seen that the penetration of mobile money (expressed in US\$) reached 82.1%. This means that only 17.9% of Puntlander's use the SoSh. The effect of the rise of SoSh against the US\$ does NOT necessarily cause inflation as we have explained in paragraph 1 above and as a consequence its effect on the economy is negligible

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<sup>2</sup> <https://wardheernews.com/wp-content/uploads/2015/02/Somalia-Monetary-policy-By-Dalmar.pdf>

<sup>3</sup> [https://www.alticonsulting.com/wp-content/uploads/2017/11/WB-MME\\_Final-Short-Version\\_20170608.pdf](https://www.alticonsulting.com/wp-content/uploads/2017/11/WB-MME_Final-Short-Version_20170608.pdf) (page 11)

## 5. *PSD calculation of Inflation*

As mention in paragraph 4, during the peak of the depreciation of SoSh against the US\$, the monthly change of September 2020 recorded an increase of 0.09 percent compared to an increase of -0.75 percent in the previous month of August 2020<sup>4</sup>.

This fact of no real inflationary pressures taking place but a depreciated Local currency was confirmed by the results of the survey, on the biggest market of goods in Garoowe, carried out by the First deputy Governor of Nugaal region<sup>5</sup>.

In this survey Deputy Governor Mr Qassim Mohamed Abdi assured his interviews and the public at large that a special Government committee has been appointed to take the necessary measures to deal with the depreciation.

An earlier government intervention by devaluing the SoSh against the US\$, as mentioned above in paragraph 1, was NOT effective in its purpose to translate itself into an inflationary pressure. On the contrary it had a negative consequence as deflationary state of affairs. In fact, The Annual Inflation Rates (2005=100) in % fell from 112.325 in 2011 to 61.83 in 2012<sup>6</sup>,

## 6. *Stakeholders*

The current depreciation is generated by small business communities, especially the money-changers, still using the SoSh paper money as legal tender causing havoc to the poor categories of the society.

On the contrary in 2011 the devaluation of the purposely generated by the Ministry of Finance in order to boost solely Government revenues by raising the So.Sh against the US\$ even above the free-market exchange rate causing havoc to the major business community and the society as large in fear of inflationary pressures as this can easily get transferred to the poor consumers. The business community challenged the Government to settle the crisis with the help of an economic committee as mentioned above in paragraph 2.

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<sup>4</sup> <http://pl.statistics.so/consumer-price-index-cpi-september-2020/>

<sup>5</sup> <https://www.bing.com/videos/search?q=Puntland+TV+guddomiye+xigeenka+1aad+Nugaal&&view=detail&mid=66DB713024C9CFA6884566DB713024C9CFA68845&&FORM=VRDGAR&ru=%2Fvideos%2Fsearch%3Fq%3DPuntland%2520TV%2520guddomiye%2520xigeenka%25201aad%2520Nugaal%26gs%3Dn%26form%3DQBVDH%26sp%3D-1%26pq%3Dpuntland%2520tv%2520guddomiye%2520xigeenka%25201aad%2520nugaal%26sc%3D0-42%26sk%3D%26cvid%3D9E7E8DA8961A499EAC4A2A6387FFCA09>

<sup>6</sup> [https://www.researchgate.net/publication/290974318\\_Puntland\\_Consumer\\_Price\\_Index\\_and\\_Exchange\\_Rate](https://www.researchgate.net/publication/290974318_Puntland_Consumer_Price_Index_and_Exchange_Rate) (page 9)

### *Conclusions*

We now know that Puntland has two tier exchange rates. The official and the free market exchange rates are practiced in Puntland. Under normal conditions the Puntland State Bank should play the role of fixing the official exchange rate from the Government side for the purpose of monetary market stability. This role is played in practice by the Ministry of Finance for its taxation purposes.

The free-floating exchange rate is established by the money-changers and the business community.

Under these facts the Government will play the role of devaluing or revaluing the local currency against the foreign currencies while the money-changers will appreciate or depreciate the local currency

We now know that the Puntland Statistics Department makes regular estimations on the inflation rates through the Consumer Price Index on a monthly basis.

Due to the strong dollarisation of the economy facilitated by the introduction of the mobile money and considering the fact that a small portion of Puntland consumers use local currency changes in the money market doesn't affect much the market of goods and services in Puntland.

### *Recommendations*

Having seen the above concluding remarks we can make the following recommendations:

- (a) On the money (or financial) market there is a strong need to establish a committee composed by the government and the business community to have regular meetings for a fistful control on this situation
- (b) On the market of goods and services all government institution and the business community should have regularly keep an eye on the monthly publication of the Puntland Statistics Department for inflation rates
- (c) For the future of the local currency the Puntland Government should put some pressure to the Federal Government to introduce a new reliable paper money to substitute the already shrink market of the local currency