

The Effects of Currency Depreciation on Consumer Buying Behavior in Somalia

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Abstract

This study analyzed the effects of currency depreciation on consumer buying behavior in Somalia. The study used a qualitative research method to assess the effects of local currency depreciation on consumer buying behavior. The study employed documentary review tool to collect data on the effects local currency depreciation on consumer buying behavior in Somalia. The study reviewed several books, articles and journals in relation to the effects local currency depreciation on consumer buying behavior in Somalia. The key findings of the study on the effects of currency depreciation on consumer buying behavior in Somalia include: currency depreciation increases the price of imported goods and services that makes it impossible for the consumers to buy them with local currency, currency depreciation increases the consumers' buying power to purchase domestic goods, currency depreciation leads to aggravated inflation that hinders the buying power of the consumers and manufacturers move imported cost like the cost of raw materials to the consumer who they bear the burden and they become so poor with little capacity to purchase goods and services. Therefore, the study recommended that the Federal Government to come with clear and effective monetary policy and regulations to allow the use of financial control and the use of local currency in the economy to increase consumer purchasing power to promote rapid economic growth in the economy.

Keywords: *Currency, depreciation, customer, consumer buying behavior, exchange rate*

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1. INTRODUCTION

Globally, many consumers face various financial challenges that influence their buying behavior due to diverse effects of currency depreciation (Tully et al., 2015). Though, there are many factors of financial constraints which can affect consumers buying behavior, it is crucial to identify how depreciation of a currency can influence consumer buying behavior. Somalia is largely dependent on imports of goods and services. For instance, many businesses and people import their supplies of raw materials and finished commodities for use in manufacturing and consumption respectively. Through its effect on aggregate consumption and its effects on consumer prices of imports, this has made the economy subject to exchange rate volatility. The exchange rate of the Somali Shilling to the dollar and other major currencies has extremely declined due to the lack of printed Somali Shillings, lack of currency regulations and unstable political situations in the country.

The loss of value of currency of any country with respect to foreign currencies like US \$ is called Currency depreciation. In simple words, it is unofficial increase of exchange rate due to demand and supply of currency. According to Michael & Norrbin (2017), “A devaluation of the domestic currency raises the price of foreign goods relative to the domestic goods”. This happens when country is following floating exchange rate system. Now days, the currency depreciation is one of main and important issue in Somalia. This issue has created many severe problems for the economy of Somalia. For example, if the Somali Shilling depreciates as comparative to the US dollar the exchange rate (the Somali shilling price to US dollar) rises, it means that it will take more Somali Shilling to buy 1 US dollar. Meanwhile the collapse of former Somali regime in 1991, the country’s political stability which is proved to be one of the key drivers of economic growth has changed into anarchy and chaos and this instability played a major role in how much the currency depreciation affects general price level and eventually purchasing power of households. Since then Somali Shilling depreciated extensively (currently at SoSh. 26/US 1\$) which created many problems to the consumers and affects their buying behaviors.

The main reason behind this sharp depreciation of Somali Shilling is poor economic conditions, terrorism, political instability, law and order situation and decrease in foreign portfolio

investment and in the country. The currency depreciation increases cost of doing business which reduces corporate competitiveness on the global market. Another important aspect is that currency depreciation increase exports. The fact that currency depreciation boosts exports is another crucial factor. However, as Somalia imports raw materials, machinery, food, oil, fertilizers, and other things due to the country's weak global competitiveness, this will undoubtedly increase import costs and inflation. In the short term, it might be favorable, but in the long run, the entire economy might suffer (Zia & Mahmood, 2013).

Consumers' social lives and consumption patterns have evolved during this depreciation of currency. People's social lives and standards of living have changed as a result of the currency crisis, which has affected businesses, the economy, and society as a whole over a lengthy period of time. Both the social habits and purchase decisions of consumers have been impacted by this transformation. Consumers are one of the pillars that determine the business sustainability and the existence of national economies. No study, to our knowledge has been conducted yet to the effect of currency depreciation on consumer buying behavior in Somalia. Most of the studies in Somalia related to currency depreciation analyzed the causes and effects of Somali Shilling depreciation (SIDRA, 2020); while a few studies analyzed the devastating local currency and the unofficial dollarization in Somalia (Yusuf & Abdurrahman, 2019).

However, this paper will examine the effect of currency depreciation on consumer buying behavior in Somalia. Considering the significance of psychological and behavioral factors of individuals during currency depreciation, it is of utmost importance to evaluate their psychological and behavioral responses to the changes resulting from the currency depreciation, and to determine the association between currency depreciation and consumer purchasing behavior. The second part of the study included the methodology of the research, and followed by the analysis of the data and the research findings. Lastly, the paper proposed some suggestions by evaluating the general results of the study.

2. THE PURPOSE OF THE STUDY

The main purpose of this study was to investigate the effects currency depreciation on *consumer* buying behaviour in Somalia.

3. LITERATURE REVIEW

3.1. Concept of currency depreciation

According to (Krugman et al., 2017), “Depreciation is a decrease in the value of a currency relative to another currency”. A depreciated currency is less valuable (less expensive) and therefore can be exchanged for (can buy) a smaller amount of foreign currency. For instance, So. Sh.26/\$1 means that the Somali Shilling has depreciated against the US dollar. It now takes 26 Somali Shilling to buy one US dollar, so that the Somali Shilling is extremely less valuable than dollar. Currency devaluation will increase the cost of imports, which could therefore increase domestic retail prices and lower the purchasing power of households, particularly the weaker ones. According to (WFP, 2021), Currency devaluation is expected to result into an increase in prices of imported goods. Increased import costs will be channeled to traders, wholesalers, and will eventually lead to an increase in the retail price of imported goods. Being an essential commodity, food has an inelastic demand curve. However, sharp depreciations can help local businesses by cutting production costs in comparison to foreign rivals, giving them a cost advantage in export markets, and increasing the price of imports, which encourages customers to switch to locally produced goods (Goldberg, P., and M. Knetter, 1997). As a result, households (the final consumers) would eventually incur the cost of the devaluation because they will have to spend higher prices in order to get the same amount of food as they did before the devaluation.

3.2. Consumer buying behavior

Consumer behavior was defined as the study of numerous behaviors involving individual's or groups' choices of purchase, use of, and disposal of goods, services, ideas, and experiences to gratify their irrational needs, wants, and desires (Solomon, 2010). Kotler et al., (2019) defined Consumer behaviour as “the study of how individuals or groups buy, use and dispose of goods, services, ideas or experiences to satisfy their needs and wants”. He also noted that the consumers' needs and wants vary according to their differences in cultures, situations and their individual differences. Culture is the main influencer of the consumer purchasing behavior.

Though there are many factors that impede on consumer buying behavior (like sociological, socio-cultural, demographic, and situational), exchange rate volatility is of the key macroeconomic variables that affects the consumption expenditure of consumers. As explained by Ezeji & Ajudua (2015), exchange rate is the value of one currency expressed as regards to

other currencies. Therefore, it becomes challenging for domestic consumers to purchase either foreign currencies or products and services from abroad when the domestic currency loses its value or rather depreciates. In contrast, domestic consumers pay less for goods and services when the domestic currency appreciates against foreign currencies. Simply said, as domestic currencies depreciate, domestic purchasing power increases (imports become more affordable), but as domestic currency appreciate, domestic purchasing power decreases (expensive imports and inexpensive exports). This implies a close association between household consumption spending and the currency exchange rate (Choi & Devereux, 2006).

Major changes in consumer behavior in the event of an economic crisis are related to the following aspects (Nie et al., 2010): With the decrease in consumer confidence due to economic uncertainty, expenditure budgets are significantly reduced as well. Consumers regulate their future consumption by shopping less and reducing their purchasing frequency (Shao Changbin, 2009). Consumers tend to be more rational and more sensitive to the prices of products or services. Consumers change their current purchasing habits and they worry about price and quality as they buy more goods. A study conducted by Bakri et al., (2012) found that currency and social are among the main factors affecting customer buying behavior during currency depreciation. They also recommended for international companies to consider social and currency differences while designing their marketing strategies and also conducting market segmentation prior to launching new products or plan.

4. METHODOLOGY

The study used a qualitative research method. The study used descriptive research design to assess the effects of local currency depreciation on consumers buying behaviour. The study used documentary review too to collect data on the effects local currency depreciation on consumer buying behaviour in Somalia. The study reviewed several books, articles and journals in relation to the effects local currency depreciation on consumer buying behaviour in Somalia.

5. THE FINDINGS OF THE STUDY

The findings of the study on the effects of currency depreciation on consumer buying behaviour entail the following:

5.1. Increase the price of imported goods and services

The currency depreciation in the country increases the price of imported goods whereby the local population that uses local currency end up buying the imported goods at higher price because of the depreciation of the local currency. According to Atlas Consulting & World Bank (2017), the estimated mobile money penetration estimation that used dollar currency was at the rate of “73% (rural areas 55%, urban areas 83% and IDP camps at 72%)”. Hence, this analysis clearly indicated that 45 % of the rural population, 17% of the urban population and 28 of the people in various IDP camps in Somalia used and relied on Somali Shillings. Furthermore, the findings of the study conducted by Atlai Consulting & World Bank (2017) through interview data collection tool revealed that Somali Shillings is the major currency being used in Somalia. The findings indicated that 31% (39 out 128) of the participants interviewed their salaries being paid in Somali shilling, not dollar; and 35% of the participants interviewed disclosed that they both use both Somali Shilling and United States dollar. Whereas, 49% (63 out of 128) of the participants interviewed revealed that around 20% to 30% of the total population in Somalia used Somali Shillings. Therefore, the 30% of the total population who use Somali Shillings are buying imported goods such as rice and cooking oil at expensive price owing to the fact that use Somali Shilling to buy those goods, not United States dollar. The main categories of these consumers are buying expensive imported goods are consumers living in IDP camps in Somalia and in rural areas of the country.

5.2. Decrease customer buying power of domestic goods

Due to local currency depreciation that resulted into increase prices of imported goods, this has stimulated demand for domestic products since consumers substitute expensive foreign goods with domestic goods. The customer will assess and contrast the pricing offered with comparable goods and with other standards (Wertenbroch et al., 2007). This demonstrates how the value of the currency affects how much a consumer could spend and how they shop while making decisions about what to buy (Raghubir & Srivastava, 2002). When currency is depreciated, consumers expenditure shifts from purchasing foreign goods to domestic goods (Kandil et al., 2007).

However, the local currency depreciation leads to high exchange rate in the country. Hence, this enables the people who earns their salaries or wages in local currency to receive less payment when they exchange their currency and it leads to increase in the prices of goods and services. Hence, it reduces their buying power and the rate of consumption of goods. According to the study conducted Atlai Consulting & World Bank (2017), the findings indicates that many employees in Somalia such as construction workers, cleaners, farmworkers, small scale business workers and fruit and vegetable sellers who are being paid in Somali Shillings have experienced rapid reduction of their earning that have affected their ability to buy basic goods because the prices of goods and services are too high and being charge in dollar, not in Somali Shillings which has depreciated against the dollar.

According to the assessment conducted by OCHA (2020), the prices of imported have increased in Somalia. For instance, the prices of imported goods also increased by 23% mainly Southern region of Somalia between December 2018 and January 2019. The areas facing high increase of prices due to the depreciation of Somali shillings (Sosh) entail: central Somalia, Northeast regions. Again, the prices of imported goods such as vegetable oil, sugar, rice and wheat flour increased due to deprecation of local currency by 10% between December 2019 and then January 2020.

5.3. Aggravate inflation

Currency depreciation increases the rate of inflation in the economy. This hinders the potential of consumers to purchase goods and services due to high prices of goods and services. According to a study by Bahmani-Oskooee et al. (2015), fluctuations in the exchange rate lead to excessive inflation, which reduces the purchasing power of consumers. These conclusions are supported by a study conducted in South Africa by Muzindutsi and Thandiwe (2018), which found that South African households raise their consumption level as a result of the appreciation of domestic currency. Exchange rate uncertainty and Inflation uncertainty coexist, which may in turn have an impact on household consumption decisions (Sin-Yu & Iyke, 2017).

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depreciation of Somali shillings (Sosh) entail: central Somalia, Northeast regions. Again, the prices of imported goods such as vegetable oil, sugar, rice and wheat flour increased due to depreciation of local currency by 10% between December 2019 and then January 2020. Similarly, based on the study conducted by SIDRA Institute (2020) on the causes and effects of the Somali Shilling Depreciation and Currency Crisis in Puntland, Somalia, the study disclosed that in September 2020 the Somali shilling to US dollar exchange rate rose from 34,000 to 42,000 SoSh per US dollar, an increase of 24 percent. At the end of November 2020, it reached a record high of 46,000 SoSh per US dollar. Hence, the high exchange rate of Somali shilling against the US dollar has caused serious concern and anxiety among the people in Somalia. The high inflation rate has hit the hardest poor Somalis and low-income earners in Somalia whom their salaries are being paid in Somali Shillings which have depreciated against the United States dollars. Hence, high inflation has diminished the purchasing power of the consumers in Somalia and has pushed them into deep poverty and hunger.

According to Somalia National Development Plan 2020-2024 assessment, food consumption poverty arises in Somalia when household consumption falls below average expenditure on food items across regions due to aggravated inflation. The national incidence of food consumption poverty (i.e. people reporting to have not been able to buy food in the past week due to lack of financial resources) is 49 percent. This means that one in every two Somalis is unable to meet their food needs. In absolute terms, over 6.2 million³⁵ people are food poor using the 2014 population estimates. The incidence of food consumption poverty in Mogadishu and nomadic populations is close to the national average. Rural agro-pastoralist and IDP settlements experience a significantly higher incidence of food consumption poverty (close to 60 percent in both cases), while incidence in urban centers other than Mogadishu is considerably lower (40 percent). These findings are presented graphically in Figure 2, below.

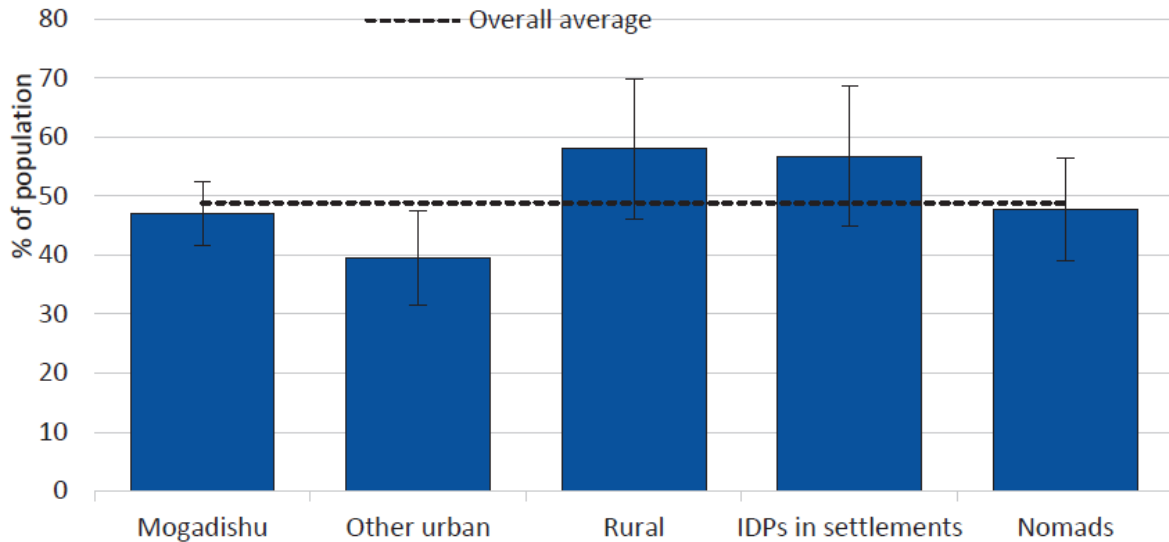


Figure 19: Food consumption poverty incidence

(Source: Somalia Poverty and Vulnerability Assessment)

5.4. Manufacturers move imported cost like the cost of raw materials to the consumer.

Due to increase inflation and local currency depreciation business owners especially, entrepreneur have shifted the burden of high inflation rate where the prices of goods are so high to the final consumers. Hence, this has affected consumers' ability to buy enough basic goods for consumption in Somalia. According to the study conducted SIDRA (2020), revealed that currency depreciation reduces the purchasing power and drives them to serious poverty and hunger due to high local currency against the United States dollars exchange rate.

6. CONCLUSION

From the findings of the study through documentary review of books, articles and journals in relation to the effects of currency depreciation on consumer buying behaviour in Somalia, the findings disclosed the following effects of currency depreciation on consumer buying behaviour in Somalia: increase the price of imported goods and services, decrease consumer buying power of domestic goods, aggravated inflation and manufacturers move imported cost like the cost of raw materials to the consumer. These findings indicate the value of the currency has an impact on the amount that could be paid by the consumer and consumer buying behavior in making

purchasing decisions. Therefore, the study recommended that the Federal Government to come with clear and effective monetary policy and regulations to allow the use financial control and the use of local currency in the economy to increase consumer purchasing power to promote rapid economic growth in the economy. Therefore, policies which focus on inflation reduction and currency rate stability will serve to increase consumer's welfare as well as consumer spending.

7. RECOMMENDATIONS

The various recommendations of the study derived from the findings of the study entail the following:

7.1. Implementation of new policy on currency reform

The Federal Government should implement new policy that encourages and promote the use of local currency in the economy and replace the United States dollars. Somali policymakers and government authorities should implement measures to raise household income and the exchange rate. These strategies can include strengthening the national currency, enhancing production, lowering the inflation rate, and creating new job possibilities.

7.2. Print new currency

Most of employees in Somalia who do white color jobs in both private and non-for-profit organizations are paid their salaries in US dollar and also these days various other employees who used to be paid in Somalia Shilling such as construction workers, cleaners, farmworkers, small scale business workers and fruit and vegetable sellers now get their payments, wages and salaries in dollar and they even prefer to be paid in dollar. However, the government should publish a new currency for the country and force public, private and non-for-profit organizations to pay their staff in Somalia Shilling.

7.3. Making of new and effective regulations

The Federal Government of Somalia through the Parliament should pass a regulation that allow the use of local currency buying goods and services in the economy as well as pass regulations

that change the use of mobile money from US dollar to Somali Shilling to control the inflow and outflow of foreign currency.

7.4. Introduction of loose fiscal policy.

The Federal Government of Somalia should introduce loose fiscal policy where the government should reduce the tax rate and increase spending to increase the purchasing power of the consumers.

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