INFLATION
Can Brazil control inflation?

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YOUNGER BRAZILIANS did not suffer through one of the worst scourges of economic national life: the dreaded hyperinflation that haunted the country until the mid-1990s, unscathed by various economic plans to curb it. In March 1990 monthly inflation reached 80% as measured by the Brazilian Institute of Economics IGP-DI price index—almost 3% a day. In 1993 inflation was a staggering 2,708% a year. But now, two decades after adoption in 1994 of the Real Plan, a set of economic measures that included the introduction of a new currency, the real, the memory of hyperinflation has begun to fade.

With this history, expressing concern about a single-digit inflation rate of about 5.5%, although it is above the official inflation target of 4.5%, may seem overzealous or even just plain odd. But Salomão Quadros, assistant superintendent, IBRE / FGV General Indices, warns that “Because we live in a much better situation today does not mean that we should stop pursuing lower inflation . . . . The issue is not just numbers. People become more flexible and accommodating with regard to inflation. It’s a tricky situation.”

In the 1980s Brazil carried out five economic plans to curb inflation, mostly based on freezing prices and wages: The cruzado currency (February 1986), the Bresser plan (July 1987), the Summer plan (January 1989), the Collor plan (March 1990), and finally the real currency (1994).

The first four initiatives were not able to contain the escalating inflation and stabilize the economy. Quadros believes, however, that all the plans helped in some way to forge the strategy that eventually succeeded. But not everything was resolved. “Although greatly reducing inflation, the insufficient fiscal consolidation in the Real Plan relied on an overvalued exchange rate. Between 1994 and 1998, the exchange rate anchor brought inflation down more than the fiscal stance would allow,” Quadros explains.

The overvalued exchange rate brought about a serious external balance of payments crisis in 1998, which caused heavy losses of international reserves. Those forced the central bank to let the exchange rate float and adopt targeting to keep inflation at acceptable levels. “Inflation targeting had already been used for some years in countries like England, Chile, and New Zealand. As these countries had not had a brilliant record in curbing inflation, they sought a framework to commit to permanent control of inflation,” Quadros said.

In Brazil, Quadros believes, the model was to some extent naive at first. In the first three years the authorities set the center of the target at 8%, 6%, and then 4%, with upper and lower limits within 2 percentage points, and the outcomes were 8.94%, 5.97%, and 7.67%. “They did not take into account the
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Now that more than 10 years have passed since inflation was first targeted, Quadros feels some disappointment with the results: “[They’re] not exactly what we wanted after 20 years of the Real Plan. We have a target of 4.5% that has not changed since 2006. We could have been more ambitious.”

The strategy did not curb inflation, the central bank raised its interest rate in the first half of 2011. In August, however, it suddenly reversed its policy, starting a loosening cycle that has reduced interest rates to the lowest levels in history. Quadros believes that given the still unfolding international crisis the central bank under President Rousseff is mainly concerned about economic growth.

Even if it is justified, Quadros believes that the current level of inflation generates uncertainty for the Brazilian economy. As he explained, “The problem is entrenching inflation expectations in sectors like services. Schools, for example, adopt annual contracts based on past inflation. The same goes for urban buses. Service inflation is little affected by the interest rate policy.” The future of inflation is unknown because inflation expectations depend to some extent on the central bank making its medium-term goals clearer.

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