

# **Title: Interpreting Brazilian Inflation: Monetarists, inertialists and Keynesians**

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## **ABSTRACT**

The purpose of the paper is to make a critical review of the main interpretations of the Brazilian high (or chronic) inflation in the 1980s, many of them irreconcilable. One may detect three main approaches: monetarists (Lemgruber), inertialists (Arida, Bresser, Lara-Resende, Lopes, Simonsen) and Keynesians (Belluzzo, Kandir, Tavares).

In particular, the inertial inflation hypothesis (IIH) – according to which current inflation is mainly explained by past inflation, that is, prices rise today because they rose yesterday - has at least four strands which seek to explain why the Brazilian inflation was at the time rigid downwards. The IIH was formulated by Brazilian economists who were dissatisfied with the conventional wisdom, which diagnosed inflation in a country like Brazil, that is, with historical and institutional peculiarities, as if it were the same phenomenon observed in more developed or mature economies. One might say that this hypothesis is one important theoretical contribution from Latin American economists to the correct understanding of inflationary processes.

In high inflation regimes, agents adopt some commonly known practices in order to cope with the fact that their real incomes erode over time and uncertainty tends to increase. They follow a sort of conventional behaviour based on (formal or informal) indexation of contracts grounded on a widely accepted and reliable price index. The consequence, in terms of policies, is that deflationary aggregate demand management can be useless and damaging, for the output-employment costs of reducing inflation are unbearably high. Consequently, some sort of unorthodox approach is needed (say, income policies, deindexation, prices freezing etc.).

It is important to note that the Real Plan – a successful stabilisation plan launched in 1994 after many failed attempts at fighting inflation during the 1980s and first half of the 1990s – owes its success to the accumulated knowledge on inflation stabilisation in Brazil propitiated by the fierce debates among those different interpretations.

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