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As Inflation Creeps Up, Brazilians Grow More Nervous

By TONY SMITH

SÃO PAULO, Brazil, Nov. 18 — A black and red banner reading "Say No to This Product" greets suppliers arriving at the purchasing department of Pão de Açúcar, Brazil's leading supermarket chain.

The suppliers are told that the banner may soon be hanging over an empty shelf where their products used to be displayed in the chain's stores. "We are out of this product because we don't accept the supplier's price hike," the smaller type on the banner says. "Please choose another product. Respect the consumer, respect Brazil."

Prices are an extremely touchy subject in Brazil. The country was plagued by hyperinflation in the 1980's, then enjoyed eight years of relative stability after adopting a new currency, the real, in 1994.

Now Brazilians are watching nervously as the annual inflation rate creeps back up toward double digits again, in large part because the real has fallen sharply against the dollar this year.

Much of what Brazil exports is priced globally in dollars, so the economy as a whole is benefiting from the exchange-rate shift. But for consumers, it can be very bad news, felt directly in higher prices for imported goods and indirectly in domestic goods because producers can charge higher prices in reais and still be competitive internationally in dollar terms.

As a result, wholesale prices in the country have shot up 17 percent over the last 12 months, according to the National Association of Open Market Institutions, a nonprofit umbrella group of financial institutions. Consumer prices have risen only 8.5 percent, suggesting that retailers are absorbing some of the increases.

"Some suppliers have raised their prices by 25 percent, and sugar has gone up 75 percent," said Hugo Bethlem, commercial director at Pão de Açúcar. "That's simply unacceptable, and there's no way we can pass on such increases to the customer when Brazilians' income is shrinking in real terms."

The Brazilian currency has lost 30 percent of its value against the dollar since January, largely because investors have been worried by the rise of Luiz Inácio Lula da Silva of the left-leaning Workers' Party. Mr. da Silva won the

presidency last month; he takes office on Jan. 1.

Despite repeated public promises from Mr. da Silva and his aides that the new government will honor Brazil's debts and keep a lid on the budget deficit, some economists say they expect his government to emphasize economic growth over fighting inflation. In fact, they fear that the government may be tempted to allow inflation to accelerate as a way of easing the country's fiscal constraints, at least cosmetically.

By printing money, the argument goes, the new government could inflate its revenue and pay off local-currency debt more easily. A more liquid money supply could also help jump-start consumer spending or finance ambitious social programs, like a food stamp program for 10 million poor families that Mr. da Silva announced in his first postelection address to the nation.

But such a policy would fly in the face of the commitments the country made to the International Monetary Fund when the fund arranged a $30 billion emergency aid package for Brazil earlier this year. It would also make life harder for millions of low-income Brazilians.

There are signs that the Workers' Party prefers to err on the side of caution. It is already backing away from campaign pledges to raise the monthly minimum wage by $10, to $63. "The raise we grant will be feasible, allowing us to keep inflation under control," said José Dirceu, the party's president.

Nevertheless, Guido Mantega, an economic aide to Mr. da Silva, has criticized the Brazilian central bank's current leadership, saying it has been overzealous in raising interest rates in hopes of keeping Brazilian inflation "at Swiss levels" — at the cost of stifling growth.

Economists are divided on the inflation outlook for next year.

Hugo Penteado of Banco Real ABN Amro predicts that the inflation rate will peak at 7.8 percent this year and ease to 6.5 percent in 2003. "It's a blip," Mr. Penteado said. "There is no demand inflation at the moment because the economy is so slow."

But John Welch, Latin American economist at WestLB, expects inflation to hit 12 percent next year. "We're not talking hyperinflation, just higher inflation," he said.

The central bank now forecasts 8.2 percent inflation for 2003, well above its target of 6.5 percent. Last month, it surprised investors by raising its benchmark interest rate three percentage points, to 21 percent.

Judging by sales of inflation-indexed government bonds, investors are hedging their bets. Demand for the bonds has been so high that the central bank sold $1.8 billion worth in October, double the amount of the month before. The heavy demand has even pushed yields on the bonds below that available on short-term fixed-rate notes, suggesting that investors are betting on a rapid run-up in consumer prices.

Some economists say the way Brazil calculates its price indexes exaggerates inflation a bit compared with the methods used in other countries, and the Workers' Party is discussing technical changes for the index. But at Pão de Açúcar, Mr. Bethlem is convinced that the new government will not let inflation rip.

"One thing is sure in this country: hyperinflation, never again," he said. "I don't believe the new government would risk our stability by allowing it to go into double digits."

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