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ACTION ARA-20

INFO OCT-01 CIAE-00 DODE-00 PM-05 H-02 INR-08 L604 NSAE-00  
NSC-10 P-03 RSC-01 PRS-01 SS-20 USIA-12 AID-28 E-15  
COM-08 TRSY-11 FRB-02 CEA-02 AGR-20 INT-06 OMB-01  
SIL-01 LAB-06 IGA-02 RSR-01 /190 W  
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113201

Pal 7586  
10/20/70

R 202130Z OCT 70  
FM AMEMBASSY RIO DE JANEIRO  
TO SECSTATE WASHDC 7453  
INFO AMEMBASSY BRASILIA  
AMCONSUL RECIFE  
AMCONSUL SAO PAULO

C O N F I D E N T I A L RIO DE JANEIRO 7586

SUBJECT: FINANCE MINISTER ON THE DEFENSIVE

1. FOR THE FIRST TIME IN HIS SUCCESSFUL FOUR-YEAR TENURE AS MINISTER OF FINANCE, DELFIM NETO FINDS HIMSELF ON THE DEFENSIVE REGARDING HIS POLICIES. AT ISSUE IS THE RATE OF INFLATION, WHICH FOR THE FIRST NINE MONTHS IS RUNNING AT ABOUT THE SAME RATE AS IN 1969. IF, AS NOW SEEMS LIKELY, RIO COST OF LIVING INDEX FOR 1970 RISES BY 23-25 PERCENT, THIS WILL BE FOURTH STRAIGHT YEAR THAT THERE HAS BEEN NO REDUCTION IN INFLATION RATE. SO FAR, THE PUBLIC ATTACKS ON DELFIM'S INFLATION PERFORMANCE HAVE BEEN MUTED AND OBLIQUE. NEVERTHELESS, THERE HAS BEEN SUFFICIENT CRITICISM TO HAVE CAUSED DELFIM TO SALLY FORTH IN THE PAST TWO WEEKS WITH A NUMBER OF PUBLIC STATEMENTS, INCLUDING ONE SIGNED NEWSPAPER ARTICLE, DEFENDING THE GOVERNMENT'S ANTI-INFLATION RECORD. WHILE HIS ENEMIES, BOTH WITHIN AND WITHOUT THE GOVERNMENT, CAN BE COUNTED ON TO MAKE AS MUCH OF THE INFLATION PROBLEM AS POSSIBLE, THE ODDS SEEM TO FAVOR DELFIM'S WEATHERING THIS FLURRY.

2. AS WAS THE CASE LAST YEAR, THE RECORD ON INFLATION DURING THE FIRST SEMESTER WAS GOOD, WITH THE VARIOUS PRICE

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INDICES RISING AT ABOUT 9 PERCENT FOR THE SIX MONTHS. AGAIN AS IN 1969, THE INFLATION ACCELERATED DURING THE THIRD QUARTER AND BY END SEPTEMBER, STOOD AT 16-17 PERCENT, DEPENDING ON WHICH INDEX IS USED. DELFIM, IN HIS PUBLIC UTTERANCES, ATTRIBUTES THE PICK-UP IN THE INFLATION RATE TO CORRECTIVE MEASURES TAKEN BY THE GOVERNMENT TO FREE PRICES OF CERTAIN COMMODITIES IN WHICH INFLATION HERETOFORE HAS BEEN SUPPRESSED. HE POINTS PARTICULARLY TO BEEF AND STEEL. AFTER THE GOVERNMENT SUPPLY AGENCY, SUNAB, GOT OUT OF THE BEEF BUSINESS EARLY THIS YEAR, BEEF PRICES ROSE SHARPLY (30 PERCENT THRU AUGUST). THE GOVERNMENT HAS ADJUSTED STEEL PRICES UPWARD BY 28 PERCENT DURING 1970 IN AN EFFORT TO GIVE STEEL INDUSTRY SUFFICIENT INTERNAL FUNDS TO HELP FINANCE BADLY-NEEDED EXPANSION OF CAPACITY. THE BEEF SITUATION HAS BECOME PARTICULARLY CRITICAL DURING THE LAST MONTH WITH SUPPLIES TO THE RIO MARKET OF NUMBER OF ITEMS BEING 50 PERCENT OF NORMAL. MEAT HAS VERY HEAVY WEIGHT IN THE COST OF LIVING INDEX, SO THAT RISE IN INDEX IN OCTOBER COULD BE DRAMATIC. IN EFFORT TO REMEDY THE SUPPLY SITUATION, GOB HAS BEGUN IMPORTING MEAT FROM ARGENTINA FOR THE RIO MARKET, THE FIRST

SHIPMENT OF WHICH ARRIVED BY AIR THIS WEEK. DELFIM ASSERTS THAT THE RISE IN PRICES WOULD HAVE BEEN ABOUT 4 POINTS LESS SO FAR THIS YEAR HAD IT NOT BEEN FOR THOSE TWO COMMODITIES ALONE, AND POINTS TO VERY LOW BUDGET DEFICIT AND CONTINUING STRENGTH OF BRAZIL'S BALANCE OF PAYMENTS AS EVIDENCE THAT GOVERNMENT HAS THE DEMAND SIDE WELL UNDER CONTROL.

3. DELFIM'S OPPONENTS ON THE INFLATION ISSUE POINT TO TWO MAIN FACTORS AS ALLEGED WEAKNESSES IN THE GOVERNMENT'S POLICIES: (1) THE WHOLE SYSTEM OF DEVICES, SUCH AS MONETARY CORRECTION OF DEBT INSTRUMENTS, WAGE INCREASES TIED TO PAST INFLATION,

AND THE FLEXIBLE EXCHANGE RATE POLICY, ALL OF WHICH, THEY SAY, PROVIDE A CONSTANT INFLATIONARY FEED-BACK INTO THE ECONOMY, AND (2) THE EXPANSION OF BANK CREDIT WHICH CONTINUES TO BE ATSD REE#IN EXCESS OF 30 PERCENT PER YEAR. THESE CRITICS BELIEVE THAT INFLATION COULD NOW BE ENDED IF THE GOVERNMENT TOOK A FIRM DECISION TO REMOVE THE "FEED-BACK" FACTORS AND BACKED UP THIS DECISION WITH A TIGHT CREDIT POLICY. A LEADING SPOKESMAN FOR THIS POINT OF VIEW IS JAYME MAGRASSI DE SA, PRESIDENT OF THE NATIONAL BANK FOR ECONOMIC

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DEVELOPMENT (BNDE). IT IS SAID THAT MAGRASSI ASPIRES TO BE DELFIM'S SUCCESSOR IN A FUTURE, "MORE NATIONALISTIC" CABINET. DELFIM'S REJOINDER TO THE MAGRASSI LINE IS THAT SUCH "SHOCK TREATMENT" WOULD REDUCE BRAZIL'S CURRENT HIGH GROWTH OF OUTPUT. DELFIM IS FRANK TO SAY THAT HE WOULD RATHER SACRIFICE FOUR OR FIVE POINTS IN THE INFLATION INDEX IN ORDER TO PRESERVE TWO PERCENTAGE POINTS OF GNP GROWTH.

\* COMMENT: BOTH SIDES IN THIS CONTROVERSY APPEAR TO HAVE SOME MERIT. IT SEEMS OBVIOUS THAT MONETARY CORRECTION AND WAGE POLICY PROVIDE SOME BUILT-IN IMPETUS TO CONTINUING PRICE INCREASES. AT THE SAME TIME, DELFIM IS CERTAINLY CORRECT THAT THE GOVERNMENT'S POLICY OF FREEING THE PRICE OF KEY COMMODITIES LIKE BEEF HAS HAD AN IMPACT ON THE PRICE LEVEL THIS YEAR. IN ADDITION, IT WOULD BE RISKY TO ATTEMPT TO DISMANTLE THE ELABORATE ADJUSTMENT MECHANISMS WHICH HAVE BEEN BUILT UP OVER THE PAST SIX YEARS AND TO WHICH THE FINANCIAL SYSTEM HAS GROWN ACCUSTOMED. NEVERTHELESS ONE OF THE REVOLUTION'S MAIN COMMITMENTS WAS TO END INFLATION AND PRESIDENT MEDICI HAS REAFFIRMED THAT COMMITMENT. WITH HIS ENEMIES APPARENTLY ATTACKING HIM BEHIND THE SCENES ON OTHER GROUNDS (SEE ARMA 804 OF OCTOBER 16), THERE IS PERHAPS EVEN MORE PRESSURE ON DELFIM THAN THERE NORMALLY MIGHT BE TO BEGIN TO SHOW SOME IMPROVEMENT ON THE PRICE FRONT.

BOONSTRA

NOTE: AS RECEIVED.

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