DECISION CASE

The index that ate indexation: Brazil's 1994 Plano Real

Brazil / Economic policy · 2 November 2026 · macrolens.lk/research/case-brazil-plano-real.pdf

Abstract

In 1994, after six failed stabilization plans in nine years - most built on price freezes - Brazilian inflation ran near 50 percent a month. The Plano Real chose the opposite: no freeze, no surprises, and a four-month bridge unit, the URV, that let wages and contracts reprice in stable terms before the real launched on 1 July 1994. Monthly INPC inflation fell from 48 percent in June to 1.4 percent by September. Its central bank and the IMF credit de-indexation, monetary tightening and fiscal groundwork; poverty in six metropolitan areas fell from 42 percent in July 1994 to 27 percent in December 1995. The anchor wobbled - an overvalued peg broke in January 1999 - but Brazil's pivot to inflation targeting still held annual inflation at 8.9 percent that year. The case asks what sequencing buys, and what Sri Lanka's new October 2026 target can conditionally borrow from it.

Context: a decade of prices chasing themselves

Brazil's hyperinflation was an institution before it was a number. Through the 1980s the economy ran on backward-looking indexation: wages, rents, contracts and financial balances were adjusted automatically to the inflation just recorded, so each month's price rise became the floor of the next. In that setting a freeze could only repress, not cure. The record proved it six times over between 1985 and 1993 (Banco Central do Brasil). Most of the failed plans reached for a freeze: the Cruzado Plan's price and wage freeze in 1986, the Bresser Plan in 1987, the Verao Plan in 1989, and the Collor Plans of 1990-91, the first of which went further than prices and froze most financial assets outright. The 1986, 1987 and 1989 freezes were each followed by higher inflation than before; the Collor freezes of 1990-91 brought inflation down only temporarily before it reaccelerated (World Bank research). By 1993 the IPCA consumer price index closed the year up 2,477 percent; by June 1994 prices were rising roughly 45-50 percent a month (BCB series).

Two men inherited this in 1993. President Itamar Franco, elevated after Collor's impeachment, appointed Fernando Henrique Cardoso finance minister in May 1993. Cardoso's economists - among them Persio Arida and Andre Lara Resende, the theorists of inertial inflation - drew the lesson of the failures: the enemy was the indexation mechanism itself, and a plan that relied on freezing would be read by every Brazilian as the seventh version of the same trick (attributed accounts).

The decisions

The first decision was fiscal and deliberately unglamorous. In 1993 the government launched an Immediate Action Program and created the Emergency Social Fund (FSE), which freed roughly a fifth of federal revenues from earmarking so the budget could actually be balanced; the central bank's own history names this as the plan's phase one (BCB).

The second decision was rhetorical discipline: every step was announced in advance. The government explicitly denied itself surprises, contract breaches and any freeze of prices, wages or assets - the three devices that had destroyed public trust in the earlier plans (BCB).

The third decision was the plan's invention. On 1 March 1994 Brazil introduced the URV - Unidade Real de Valor - a unit of account with no banknotes, indexed daily by the central bank and pegged to the US dollar at CR$647.50 (BCB). Wages, social security benefits and public contracts were converted first; elsewhere adoption was voluntary, so relative prices could renegotiate themselves while everyone learned to think in a stable unit. For four months the economy ran on two measures of value: cruzeiros reais to pay with, URVs to price in. By the time the real arrived, the conversion had already happened in people's heads.

The fourth decision was the launch itself. On 1 July 1994, under Law 8,880 of 27 May, one URV became one real; 940 million banknotes and 688 million coins were already in bank vaults (BCB). Monetary policy tightened hard, public-sector prices were held initially, the new currency floated with a floor against the dollar, and trade was opened so imports could discipline domestic pricing (IMF).

The fifth decision came four and a half years later and was the plan's hardest: letting go. The real's peg had become an overvalued anchor defended with 39 percent interest rates; when Russia's August 1998 default cut off capital flows, Brazil floated in January 1999 rather than spend its reserves on a losing defense. Arminio Fraga, who took office in March, then executed a two-step pivot - a March 1999 promise of single-digit inflation by year-end, followed in June by a full inflation-targeting regime with published targets of 8, 6 and 4 percent for 1999-2001 (Fraga, IMF).

Decision chain

1986	Cruzado Plan freezes prices and wages; inflation returns higher within a year (attributed record)
1990	Collor Plan freezes most financial assets; recession follows, inflation survives (attributed record)
1993	Immediate Action Program and FSE fiscal fund; Cardoso becomes finance minister (BCB)
1993	IPCA inflation closes the year at 2,477 percent (BCB series)
1 Mar 1994	URV introduced at CR$647.50, indexed daily to the dollar; wages and public contracts convert first (BCB)
27 May 1994	Law 8,880 frames the changeover from the cruzeiro real to the real
1 Jul 1994	The real launches at one URV = R$1.00; 940 million new banknotes already distributed (BCB)
Sep 1994	Monthly INPC inflation, 48.2 percent in June, prints 1.4 percent (IBGE series)
Dec 1995	Metropolitan poverty, 42 percent in July 1994, reaches 27 percent (IPEA data via IMF)
Jan 1999	The overvalued peg is abandoned; the real slides from 1.20 to 2.15 per dollar by February (Fraga)
Jun 1999	Inflation targeting adopted with 8, 6 and 4 percent targets; the year ends at 8.9, inside the band (Fraga)

Measured outcomes I: what the bridge delivered

The disinflation was among the fastest ever recorded without a general freeze. The twelve-month IPCA rate fell from 4,922 percent in June 1994 to 916 percent in December 1994 and 22 percent in 1995 (BCB). The monthly series tells it better: INPC inflation of 48.2 percent in June 1994 printed 7.75 percent in July - the real's first month, inflated by last-minute re-marking - and 1.4 percent by September (IBGE series). By 1996 monthly inflation averaged under 1 percent (IMF).

The dividend went disproportionately to the poor, because inflation itself had been a regressive tax. Between September 1994 and September 1995, labor income per capita in six major metropolitan areas grew roughly 30 percent in the bottom half of the distribution against 10 percent in the top decile, and the metropolitan poverty rate fell from 42 percent in July 1994 to 27 percent in December 1995 (IPEA data via the IMF). An OECD assessment credits the plan's first twelve months with lifting 3.7 million people across the poverty line in the areas studied. Growth accompanied the stabilization: 6.0 percent in 1994, 4.2 in 1995, 2.9 in 1996 (IMF).

And the framework survived its own crisis. The January 1999 float produced none of the predicted catastrophe - forecasters had feared 30-80 percent inflation and a contraction of 3-6 percent of GDP - and the year closed with inflation of 8.9 percent, inside the new target band, with growth roughly flat (Fraga, IMF). Price stability then held for the following decades under the targeting regime the crisis had forced into being (BCB).

Measured outcomes II: what the anchor cost

The fiscal foundation eroded fast. The public sector's primary balance went from a 4.3 percent of GDP surplus in 1994 to 0.4 percent in 1995 and a 0.1 percent deficit in 1996 (IMF) - the FSE's discipline proved temporary, and the plan's political dividend was spent partly on spending.

The peg became the new vulnerability. Defending an appreciating real through the Mexican, Asian and Russian shocks required interest rates that reached 39 percent, swelled short-term domestic debt to about 40 percent of GDP, and let the current account deficit approach 5 percent of GDP (Fraga, IMF). When the peg broke in January 1999, the bill for the defense arrived all at once. Stabilization had been won twice - first against indexation, then against the anchor that replaced it.

The poverty record also carries a warning about windows. The same metropolitan data behind the celebrated 1994-95 improvement show, in a World Bank decomposition, extreme urban poverty higher in 1996 than it had been in 1976: the disinflation dividend was real but it operated inside a longer deterioration in labor markets and informality that stabilization alone did not reverse (World Bank research). The plan repaired the monetary institution; it did not repair the structure.

Transfer limits

Brazil's indexation was near-universal and legally embedded; Sri Lanka's inflation inertia runs through expectations, imported energy and administered prices rather than a mandatory monthly wage escalator, so a URV-style bridge has no direct analog - the mechanism to break is different. Brazil could defend its experiment with a large domestic debt market and, in 1999, an IMF-led financing package and voluntary bank rollovers; Sri Lanka enters its framework with debt restructuring only largely complete (IMF, October 2026) and far thinner buffers. And Brazil's import liberalization worked as price discipline partly because of continental scale; a small island's trade opening transmits to the exchange rate and government revenue faster (desk interpretation).

Lessons for Sri Lanka (conditional)

1. Kill the inertia, not the prices. Brazil's freeze-based plans failed repeatedly from 1986 to 1991; the Plano Real succeeded without a freeze by removing the backward-looking mechanism. Sri Lanka's disinflation from the 2022 peak likewise came without a general freeze, and as CCPI inflation ticks up to 8.3 percent in October 2026, the temptation of administered-price suppression is the Brazilian mistake in waiting (desk interpretation).

2. Fiscal first is sequencing, not rhetoric. The FSE preceded the real; the 1999 pivot worked because the primary balance had swung from a 1 percent of GDP deficit in 1997 to a 3 percent surplus by late 1998 - "that was key," in Governor Fraga's own account. Sri Lanka's doubled revenue ratio under its program is the same foundation stone (IMF, October 2026; desk interpretation).

3. Design the target as a bridge, not a cliff. The URV gave Brazil four months to reprice before the anchor bit. Sri Lanka's October 2026 framework agreement - 5 percent with a two-point accountability margin on the quarterly-average CCPI reading - offers a limited analogy: it tests the quarterly average rather than any single month, and unlike the URV it changes no contracts and reprices nothing on its own (desk analogy, with limits).

4. Pre-announce everything. Brazil's authority came from denying itself surprises; Sri Lanka's gazetted agreement, signed by the President and the Governor on 1 October 2026 under the CBSL Act's triennial review, is credibility by the same technology (desk interpretation).

5. Plan the exit from any anchor before markets choose it. Brazil defended its peg a year too long; what saved 1999 was that the replacement anchor - targets plus a primary surplus - was operational within six months. Any future Sri Lankan exchange-rate or program anchor deserves the same pre-built successor (desk interpretation).

6. Count the stabilization dividend honestly. Brazil's 42-to-27 metropolitan poverty fall and the 3.7 million lifted across the line are real and dated; so is the finding that extreme urban poverty was higher in 1996 than 1976. Disinflation buys the poor time and purchasing power; it does not substitute for labor-market and growth policy (desk interpretation).

Conclusion

The Plano Real worked because it treated hyperinflation as an institution to be dismantled rather than a number to be suppressed: fiscal room first, a bridge unit to unwind indexation, every step pre-announced, and no freeze. Its deeper proof came in 1999, when the framework survived the destruction of its own exchange-rate anchor because a successor - published targets on a primary-surplus foundation - was built in six months under fire (desk interpretation). Sri Lanka now runs the successor regime Brazil invented in that crisis, with a 5 percent target reset in October 2026, an October inflation reading of 8.3 percent that is not itself the quarterly-average accountability test, and its IMF program expiring in March 2027. The Brazilian lesson is that an anchor's credibility is manufactured in the fiscal groundwork and the honesty of the transition - never in the force of its defense (desk interpretation).

Sources

Banco Central do Brasil, "The Real Plan" (official program history, retrieved 1 November 2026): https://www.bcb.gov.br/en/monetarypolicy/realplan - six ineffective stabilization plans 1985-1993; the plan's three phases (FSE fiscal fund under the 1993 Immediate Action Program; URV transition from 1 March 1994 at CR$647.50 pegged daily to the dollar; real launched 1 July 1994 at 1 URV = R$1.00); pre-announced steps with no freezes of prices, wages or assets; IPCA twelve-month inflation 4,922% in June 1994 falling to 916% in December 1994 and 22% in 1995; 940 million banknotes and 688 million coins distributed; inflation-targeting regime adopted mid-1999

Benedict Clements, "The Real Plan, Poverty, and Income Distribution in Brazil", IMF Finance & Development, September 1997: https://www.imf.org/external/pubs/ft/fandd/1997/09/pdf/clements.pdf - plan elements (deindexation, monetary tightening, initial public-sector price freeze, managed float with a floor); monthly inflation from 45% in Q2 1994 to under 1% average in 1996; GDP growth 6.0% (1994), 4.2% (1995), 2.9% (1996); primary balance +4.3% of GDP (1994), +0.4% (1995), -0.1% (1996); six-metropolitan-area poverty 42% in July 1994 to 27% in December 1995 (Rocha/IPEA); bottom-50% labor income +30% vs top decile +10%, September 1994 to September 1995

Arminio Fraga (BCB governor from March 1999), "Monetary Policy During the Transition to a Floating Exchange Rate: Brazil's Recent Experience", IMF Finance & Development, March 2000: https://www.imf.org/external/pubs/ft/fandd/2000/03/fraga.htm - January 1999 float after Russia's August 1998 default; real from 1.20 to 2.15 per dollar by February 1999; forecasts feared 30-80% inflation and -3 to -6% GDP; primary balance from -1% of GDP (1997) to +3% (late 1998-99, "that was key"); policy rate 39% to 45% then downward bias; two-step adoption of inflation targeting (March 1999 announcement, June 1999 targets of 8%, 6%, 4% for 1999-2001 with a 2-point band on the IPCA); 1999 inflation 8.9% inside the band

Monthly price series, Banco Central SGS / IBGE: INPC 1994 monthly rates - June 48.24%, July 7.75%, September 1.40% (https://www.aasp.org.br/produtos-servicos/indices-economicos/mensal/inpc-ibge/); IPCA 1993 = 2,477.15%, peak month June 1994 = 47.43%, 1994 year = 916.43% (BCB SGS series 433)

OECD, "Fighting Extreme Poverty in Brazil" (1998): https://www.oecd.org/content/dam/oecd/en/publications/reports/1998/11/fighting-extreme-poverty-in-brazil_g17a1602/864833155654.pdf - 3.7 million people crossed the poverty line in the areas studied in the plan's first twelve months

Contested window: Sonia Rocha, World Bank Policy Research Working Paper 2210, "The Slippery Slope: Explaining the Increase in Extreme Poverty in Urban Brazil, 1976-96" (1999): https://doi.org/10.1596/1813-9450-2210 - extreme urban poverty higher in 1996 than in 1976 despite the stabilization; the 1986, 1987 and 1989 freezes each followed by higher inflation; 1990 asset freeze

Legal instrument: Law No. 8,880 of 27 May 1994, Presidencia da Republica (monetary changeover framework, URV averaging rules across three price indices): https://www.planalto.gov.br/ccivil_03/leis/l8880.htm

Sri Lanka anchors (Daily Mirror, retrieved 1 November 2026): 3 October 2026 - Monetary Policy Framework Agreement signed 1 October 2026 by the President (as Finance Minister) and the CBSL Governor under the Central Bank of Sri Lanka Act's triennial review: 5% inflation target for three years with a 2-point accountability margin (3% and 7% thresholds) on quarterly-average CCPI; initial agreement October 2023 (https://www.dailymirror.lk/business-main/Sri-Lanka-sets-5-inflation-target-for-next-3-years/245-351686); 30 October 2026 - CCPI inflation 8.3% in October 2026, up from 8.0% in September; food 8.8%, non-food 8.0% (https://www.dailymirror.lk/breaking-news/Sri-Lankas-inflation-climbs-to-8-3/108-353813); 17 October 2026 - IMF ready to support Sri Lanka beyond the EFF expiring March 2027; seventh-review staff-level agreement early October 2026; growth positive for eleven consecutive quarters; revenue ratio doubled; debt restructuring largely complete; October Regional Economic Outlook places Sri Lanka among economies where headline inflation has risen fastest after the energy shock and names it among FX interveners (https://www.dailymirror.lk/business-main/IMF-ready-to-support-Sri-Lanka-beyond-current-programme/245-352755)