Q&A...

with Daniel Sanches, an economic advisor and economist here at the Philadelphia Fed.

Daniel Sanches

Economic advisor and economist Daniel Sanches joined our Research Department in 2010 after earning his master's degree and doctorate in economics from Washington University in St. Louis. His interest in the history of private monies led him to become one of the first academics to study the role of cryptocurrencies in the global economy. More recently, he cofounded the Bank's *Digital Currency Center*, a one-stop shop for insights into digital currency's effect on the broader economy.

Where did you grow up?

I grew up in Sao Paulo, the largest city in Brazil, in the 1980s and '90s. It was an interesting time. Everybody knew a little bit about economics because inflation was very high. You had to be smart with your money or else it would become worthless.

How did the high inflation affect your family?

Before 1994, the government would occasionally announce surprise plans to tackle inflation. Retired people like my grandparents were very anxious because these plans could change their pension overnight. Things were a little easier for my mother. After my father passed away in 1980, she went back to work. Eventually she owned her own small advertising company. It didn't grow much, but it paid for our education.

How did the Brazilian government finally tame inflation?

The 1994 plan wasn't a surprise. They created a virtual currency linked to the U.S. dollar, but they kept the old currency, too. For a few months, everything had two prices. Then, in July 1994, the government made the virtual currency the Brazilian real and phased out the old currency. This transition was very clear for everyone, and that's why it worked. If you communicate what you're going to do and do what you say you're going to do, there are very few surprises. And then people stop thinking that inflation will come back.

It sounds like you're talking about the self-fulfilling power of inflation expectations?

Yes, it's all about inflation expectations. We got inflation because the country grew very fast in the 1960s and '70s, and the government thought, OK, this growth will continue, let's spend the money. But after the economy decelerated in the late 1970s, the government just kept printing more money to keep up with its spending. We wouldn't find out how much money the government was printing until the prices went up. It was a very uncertain environment.

Brazil began its transition from a military dictatorship to a democracy in the second half of the 1980s. Is that why the government stopped printing so much money?

Yes. Brazil's economy was very cash-intensive. The informal sector was enormous. People were paid in cash. My family, like most middle-class families, had a bit more money and education, so we had a checking account that paid interest. Even if the interest rate was below the inflation rate, we were getting something for our money. But the majority of the population was unbanked. The new democratically elected government made combatting inflation its No. 1 priority, even more than fiscal stability. The two things go together, of course, but you need a shock to move inflation expectations. Only then do you adjust the fiscal situation. And that was done under democracy. It was the biggest achievement in Brazil during my lifetime. After 1994, I could see the economy grow again, people begin to invest again.

Why did you leave for the United States after graduating from college in Brazil?

One of my favorite teachers in college taught his class as "Keynes versus Friedman," with half the class being the Keynesian camp, which advocated for government spending, and the other half the Friedman camp, which argued for control of the money supply. He made us debate economic arguments and then switch camps. That's when I fell in love with economics. Because Friedman and so many other prominent economists were from the United States, I decided to go there for grad school.

Your article for this issue focuses on just two dominant international currencies. Isn't there a risk of doing a study based on such a small sample?

But that's what makes it interesting. When I started studying international currencies, I learned about network effects. The more people who use the dollar, the bigger the payoff if I use it too. That helps explain why there have been so few dominant currencies. I see presidents come and go. I see a financial crisis. But always, there's the dollar. After the Great Financial Crisis, people were saying, that's the end of the dollar. But they were wrong because of network effects.