

Draghi on the dance floor

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Mario Draghi, the iconic central banker, faces new challenges amid a rapidly-changing backdrop. It takes a lot of *sang froid* and agility for anyone to change one's assumptions - let alone for longtime civil servants. Mario Draghi has only recently morphed into a Prime Minister, but of course a very large chunk of his career was spent wearing a central banker hat. So **how does Draghi's past experience underpin his government agenda? How much of it can actually serve as guidance for the present? Not much, we suspect. Here is why.**

As we write this note, the social consequences of the pandemic have been vastly greater than the public health consequences and that's because, for the first time in history, a decision was made to deal with an infectious pathogen by shutting down significant parts of the economy and indeed of social life, and this is what differentiates 2020/2021 from previous public health crises. This would hardly have been an option in the past. In fact, one of the paradoxes of the past 12 months is that states have been able to endure great economic harm – and thus wreak havoc in the social sphere - by measures that in almost any previous era would simply have been impossible.

The effects on political ecosystems have been intense. For instance, **when he was sworn in, Draghi could safely assume that Merkel-exit would occur at the end of Q3 this year, and that until then he could rely on a robust EU framework. What we are witnessing instead is a Merkel- Dämmerung in Q1, already sending shockwaves across the entire EU**, due to Merkel's perceived inconsistencies and apparent inability to tackle the Covid emergency effectively. The myth of Mutti Merkel, long hailed as the pragmatic and wise leading force in the EU, is gone.

The first cracks to the mould have appeared already – Draghi can see all this but [there's a lot of fog over Germany's established euro-role on the horizon, as witnessed by a court stay on approving the European Commission issuing debt on its own.](#)

The disrupted political ecosystem has also affected global supply chains and the nexus between fiscal and monetary policies, as the current surge in debate on inflation shows. Now, one thing that typically gives the creeps to political risk analysts is that **policy markers tend to underestimate tail risk. That's a type of myopia that comes of only studying the history of your own career.** But what *general history* teaches us is that **moves in inflation expectations are nearly always linked to wars, especially big wars, and to geopolitical drivers. If that's the case, then the thing to watch from here is not so much what Lagarde and Powell say, but**

actually what Anthony Blinken says, because that is the thing that is most likely to cause inflation expectations to move - just on the basis of history - a geopolitical shock rather than simply a big increase in the deficit or big expansion of the central bank balance sheet. Draghi is a very bright person and this is the arena in which he is an acclaimed expert. So he has realized all this already, although **his new job will require some policy gymnastics as he finds himself contemplating more urgent imperatives and harder constraints than in the past**. Imperatives are the things that must be done in order for a community to survive and prosper. Constraints are the things that cannot be done. Imperatives and constraints are rarely aligned. There are things that must be done that *can't* be done. **Draghi, too, is struggling to align the things that must happen with the things that are impossible, to the extent reality permits them to.**

Draghi's plate is already very full and his choices signal a strong reluctance to embrace any geopolitical exuberance. His stated focus remains on Italy's near abroad, and a trip to Libya is imminent. **Relations with Russia and Turkey are generally good, and Draghi wants to keep it this way. Russia was not demonized in Draghi's commencement speech, and Turkey was labelled a 'partner'**. The recent ['airing of grievances' with Erdogan](#), and [Draghi's desire not to have Russian mercenaries in Libya](#) belies Draghi's intention to keep things as they are. As for Draghi's reluctance to inch any closer to the UK, it doesn't have much to do with the contemporary Franco-German Anglophobia. Draghi is no fan of Jeanne d'Arc, nor of Kaiser Wilhelm II. Rather, **Draghi does not wish to undermine Italy's relations with Moscow**, which the UK Integrated Review categorizes as an 'active threat' as opposed to China, which is only a 'systemic challenge'. In other words, **Draghi cannot go full Boris, because this would inevitably entail the Salisbury general doctrine, too**. In other words, Draghi is happy to selectively [reprimand the Lazio and Campania governors who hastily placed massive orders of Sputnik vaccines](#), but he will not take it any further than that.

Draghi has proven very creative in the past, using the power of words and symbols to tame panicking capital markets. He will need to be as creative these days.

Stay tuned!