

## POLITICS REGAINS POWER CENTRAL BANKS IN TOW

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As the editorialist of the geopolitical magazine *Limes* correctly writes, "Thirty years ago we mistook the end of peace for the end of war".<sup>1</sup> And this happened because it was decided to call the long truce based on the balance of terror the "cold war". The fear of a planetary nuclear explosion was accompanied by the rational conviction that neither of the two main antagonists, the Soviet Union and the United States, had the slightest interest in unleashing it. This solid, if dangerous, existential framework functioned for forty-five years, from the end of World War II to the fall of the Berlin Wall in 1989. The balance of power that characterized this era was a true system of conflict management. But, in that year, the United States and NATO did not win the confrontation by force of arms. They didn't even need to fire a gun to scratch that barrier that separated the two Germanies. The losers, the Soviets, had in fact committed suicide. Perhaps it was this

context that fed the illusion that there was no need to negotiate a new world system of conflict management. All that was needed was the power of the United States, so strong as to appear generous, and, above all, the liberalist ideology, well represented by Milton Friedman, which brought the market back into the center of the village that had become global: "The wider the range of activities affected by the market - Friedman wrote - the fewer the number of issues that require explicitly political decisions and, consequently, on which it is necessary to reach an agreement binding on all".<sup>2</sup> The State, in its most centralized application, that of the Soviet Union, had failed in front of the country, the United States, which better embodied the individual's aspirations of freedom, nurtured by the free market. The individual freedom to chase profit was to be the engine of a new overwhelming development. And so it was for the world as a whole. Delocalization has made it

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<sup>1</sup> *Limes*, Editoriale, "L'ultima parola ai popoli", March 2022, p.7.

<sup>2</sup> Milton Friedman, *Capitalismo e libertà*, IBL Libri, Turin 2010, p. 63.

possible to lower production costs. Technology has come out of the exclusivity of historically leading countries. This has allowed prices of services and products to fall, making the progression of globalization worthwhile. The role of the state and its power has continued to weaken, unable to position itself in transnational dynamics, fertile ground for multinational companies and their leadership. However, this prodigious path has produced winners, losers and consequent imbalances.

The first loser, as an institution and sprout of political power necessary to sustain economic power, was the European Union. Its becoming was based on the idea that the integration of the economies of member countries would inevitably lead to the birth of a true supranational state. However, the process had to be led by the states, within a Keynesian framework that envisaged their intervention. But the forces of the free market, already opened up by the revolution of Ronald Reagan and Margaret Thatcher in the 1980s, made the role of politics superfluous. The consequence has been institutional decadence, while the improved international allocation of resources has

led to a decrease in the prices of products and services, but contracting the purchasing power of large segments of the population.

The winners have been some emerging countries, with China at the center. The country of Mao and Deng Xiao Ping was able to welcome, with a prudent but controlled political profile, the *know-how* that Western entrepreneurs brought to them, taking advantage of lower production costs. What did it matter if political freedoms were reduced. The West was firmly convinced that free trade and economic growth, almost automatically, would force the government to hand over its power to free market forces. But this was not the case. Market forces became instrumental in strengthening the Chinese empire.

The system has held up because the general lowering of prices has allowed the central banks, especially the American, British, Japanese and European ones, to overcome all the crises that the free circulation of products and above all liquidity produced. With the 2008 financial crisis and the Pandemic, rates were brought down to zero and even into negative territory by continuing to inject

liquidity into the markets (*Quantitative Easing*). This was possible within a framework that tended to be deflationary. This financial approach was the instrument, only partly conscious, to finance the transition from an oil-based economy to an electrified and digitized one capable of containing the overheating of the earth necessary to ensure its survival. This evolution came to a halt on February 24, 2022.

The invasion of Ukraine by Russia has awakened the world, especially the Western one, from the ideologized idea that states must be weak and essential because it is only market forces that decide the optimal allocation of resources. It is now clear that wars are led by states with a logic of power that does not always go hand in hand with that of the economy. This new context also forces market operators to review their models. Financial flows will no longer move only in function of immediate profit. They must first be filtered through the lens of political interests.

In this new approach, which will become a new paradigm, many productions of strategic goods will be brought back to their respective territories of control.

Globalization is not dead: the interconnections are too important to be completely interrupted. But it will be greatly scaled back. Inflation will come down from the levels of the current emergency, but it will no longer mimic deflation. The new process, outlined by states, by inherently inflationary forces, will inevitably result in a more complicated and costly allocation of resources. The role of central banks is partly diminished. They are no longer able to finance the transition to a green economy on their own: with inflation, their activity becomes counterproductive, because fighting it means raising interest rates and slowing growth. States will have to intervene to stimulate growth, which must be higher than inflation. They will therefore seek to contain increases in the cost of energy and raw materials and encourage productive investments capable of expanding the economy and accelerating decarbonization. Putin's war has already become an expression of this new paradigm. The United States wants Russia to remain the important supplier of raw materials, but it cannot accept its excessive power. That is why now the goal is not only to help Ukraine retain its territory, but to weaken Russia by

diminishing its ability to influence the price of raw materials.

In any case, the United States will remain a privileged place for investment flows: it has a large domestic market and is independent from an energy point of view. Europe could come out of this less worse than one might think, because sooner or later Washington will have to work to revise its international institutions and will need the support of a united Europe. Switzerland and England are already obliged to review their relations with Brussels. They could come out of this positively if in the new realignment they manage to maintain sufficient room for maneuver. China will suffer from the outflow of liquidity, even if its central bank increases support for the economy.

The dangerous ongoing war is the first determining element of the new paradigm being constructed. Having to focus on growth, equity investments are inescapable, especially in stocks with very solid fundamentals and capable of dealing with the energy transition. The United States and the dollar will remain at the center of the system. Europe will experience a consolidation phase and stocks that can be the subject of mergers

or acquisitions will have to be selected. Cybersecurity stocks will rise, as warfare, hopefully sooner rather than later, will cease to use guns, but will not extinguish attacks on adversaries' digital devices. The bond market will remain difficult. But, perhaps most importantly, the Federal Reserve wanted to stoke fears of inflation and a powerful rate hike to push the economy to brake on its own and thus diminish the power of its future interventions.

In assessing how and where to invest, one must follow policy efforts to increase growth and contain inflation: central banks, in the new paradigm, will follow.

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