Trade Fragmentation, Inflation, and Monetary Policy

Discussion of Ambrosino, Chan, and Tenreyro (2025)

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CEPR ESSIM

Globalization and Monetary Policy

From the perspective of monetary policy, globalization does matter. Shocks and persistent economic trends associated with America's involvement in the global economy must be factored into the design of an appropriate monetary policy...

We still have a lot to learn about the mechanisms through which globalization is impacting the U.S. economy. As the globalization trend unfolds, we policymakers will turn to you, our colleagues in the economics profession, for the best in theory and evidence to guide us.

Janet L. Yellen “Monetary Policy in a Global Environment", May 27, 2006

Overview

- Open-economy TANK model + international market incompleteness
- Tradable and nontradable sectors with imported intermediates
- Monetary Policy: Taylor rule targeting CPI inflation & output
- Focus: trade fragmentation shocks (gradual, immediate, productivity)

Main result: anticipation effects can be strong

Scenario	Inflation	Consumption
Gradual Import Price Rise	$\downarrow$	$\downarrow$
Immediate & Permanent Import Price Rise	$\uparrow$	$\downarrow$
Negative Tradables TFP Shock	–	$\downarrow$

- **Key Insight:** Anticipation significantly affects current demand.

Study the role of hand to mouth agents, trade openness, and labor market rigidities.

Comments

1. Fragmentation $\approx$ reverse of “trade integration"
2. Suggest: combined tradables TFP shock + Import price shock
3. The GE mechanisms that can induce deflation depend strongly on a news shock type mechanism.
4. Imported inputs are used only in the non-tradable sector.
5. Fragmentation is not interpreted as tariffs
6. Monetary policy is set to target CPI inflation

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3.
4.
5.
6.

Globalization and [dis]Inflation?

in an open economy, prices of imports affect domestic inflation both directly – through the final goods and services bought by households – and indirectly – through the prices of imported intermediates used in the production of final goods and services in the consumption basket. For years the direct effect has imparted a steady disinflationary bias. The integration of lower-cost producers into the global economy acts like an increase in potential supply for advanced economies.

Mark Carney “[De]Globalisation and inflation", 18 September 2017

Globalization and Inflation?

we argue that trade integration is best thought of as a long-lived (arguably permanent) shock, with long phase-in dynamics. With forward-looking consumers, anticipated increases in trade raise aggregate demand prior to their realization, which drives equilibrium inflation up in standard New Keynesian models.

Comin & Johnson (2022) “Offshoring and inflation", NBER WP

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focus here on HtM hhs +portfolio adjustment costs.

Natural rate dynamics in a RANK economy

Consumption and Production side forces:

1. Future growth in import prices $\implies$ future income $\downarrow$. PIH postpone consumption.
2. High import prices in future $\implies$ "productivity" of future production $\downarrow$. PIH postpone consumption

$\longrightarrow$ Both $\downarrow R^*$. (Gradual det of ToT important.)

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unanticipated permanent shock has no effect on R^*

HtM households

- Exchange rate depreciations/trade fragmentation raise import prices $\implies$ reduce households' real income and consumption.
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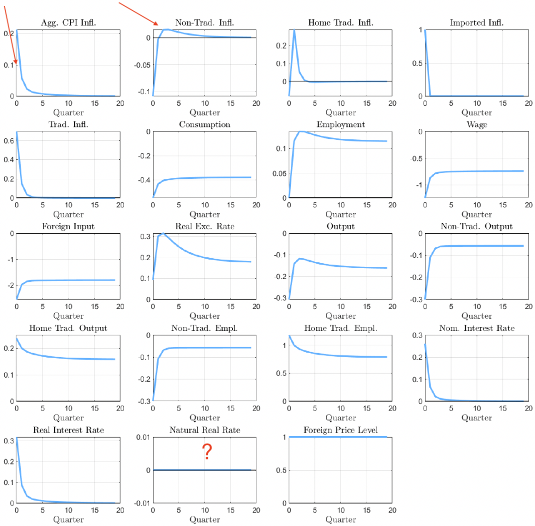
What do HtM bring to this exercise?

1. Presence of HtM hhs dampens the forward looking "news shock" effects
2. HtM amplify real income channel from contemporaneous shock

Overall: can get sizable real income effect on R^*

ROLE OF PORTFOLIO ADJUSTMENT COSTS

Figure 5: IRFs to a Front-loaded Increase in Foreign Price Level.



Dynamics due to portfolio adjustment costs

What is a natural rate allocation?

Philosophical

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Philosophical *natural* question

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Two definitions of flexible price allocations in their environment

1. Woodford (2003): *time-t flexible*
2. Neiss and Nelson (2003): *time-0 flexible*

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with endogenous state variable, these differ

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   Covid supply shocks lit: complementarities in consumption/production, extrapolative expectations, etc can get $\frac{\partial R^*}{\partial TFP} < 0$
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SUMMARY OF DISCUSSION

- Authors provide clear insights into fragmentation's macro effects
- Partial equilibrium insights of inflationary effects of supply shocks can be overturned
- Monetary policy response is not same across all kinds of supply shocks

Main suggestion: embrace quantitative analysis
(perhaps with endogenous tradables productivity)

Trade policy uncertainty

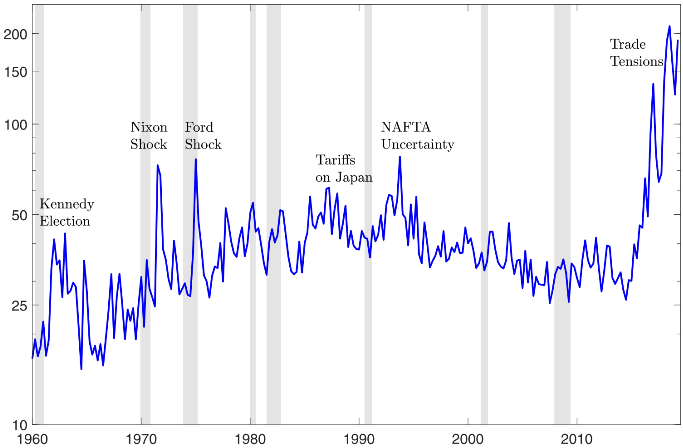
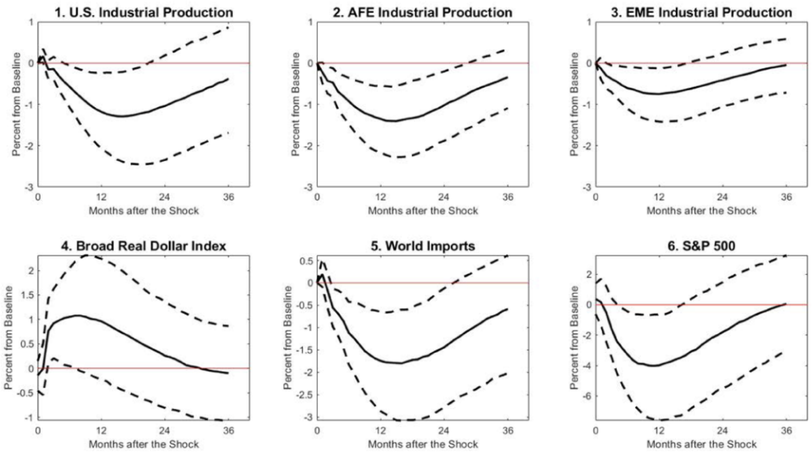


Fig. 3. News-Based Index of Aggregate Trade Policy Uncertainty. *Note:* Quarterly news-based trade policy uncertainty index extending through 2019Q2. A value of 100 indicates that one percent of all newspaper articles discuss trade policy uncertainty. The vertical gray areas represent NBER recession dates. The y-axis uses a log scale.

Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2020), "The Economic Effects of Trade Policy Uncertainty," Journal of Monetary Economics, 109, pp.38-59.

EFFECTS OF TRADE POLICY UNCERTAINTY

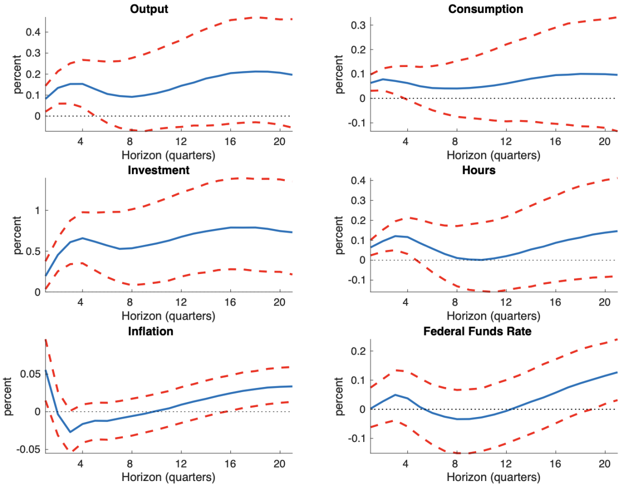


Note: Impulse responses to a TPU shock of 150 points (dashed lines: 1 standard deviation confidence interval). Sample from 1985M1 through 2019M5. The size of the shock matches the increase in TPU in March 2018.

Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2019). "Does Trade Policy Uncertainty Affect Global Economic Activity?," FEDS Notes.

Are News shocks inflationary?

Figure 6 Responses to a Patent-Based News Shock



Cascaldi-Garcia, Danilo and Vukotic (2020). Patent- Based News Shocks.