

Trade Fragmentation, Inflationary Pressures and Monetary Policy

Discussion of Ambrosino, Chan & Tenreyro (2025)

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The views expressed here do not necessarily reflect the position of the Bank of England.

This Paper

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Answers: challenge ‘conventional wisdom’

- ▶ Inflationary impacts, and associated policy responses, depend on:
 - *Supply*: effects of fragmentation on import prices
 - *Demand*: ‘**income effects**’ from lower real wages and productivity
- ▶ **Pace** is key: more prolonged fragmentation → stronger demand responses

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Recipe: SOE-R/TANK model + T and NT sectors + **Imperfect international risk sharing**

- ▶ ‘Fragmentation’ = $\uparrow P_F^*$ or $\downarrow A_T$
- ▶ Policy = Taylor-type monetary rule, then optimal commitment(?)

Praise

Authors excellently tackle a question on everyone's lips



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Framework easily extended to consider numerous other fragmentation-type scenarios:

- ▶ Higher *variance* of supply-side shocks
- ▶ Trade policy
- ▶ Diversification
- ▶ ...

Clear bottom line for policymakers: fragmentation need not imply *higher* rates

My Comments and Suggestions

#1 Learn a lot from the SOE-**RANK** model...but keen to learn more

- Pace matters with imperfect international risk sharing [Corsetti et al. 08, ReStud]
- But substitutability / complementarity of goods should matter too
...and possibly in ways that make SOE-**TANK** *more* insightful

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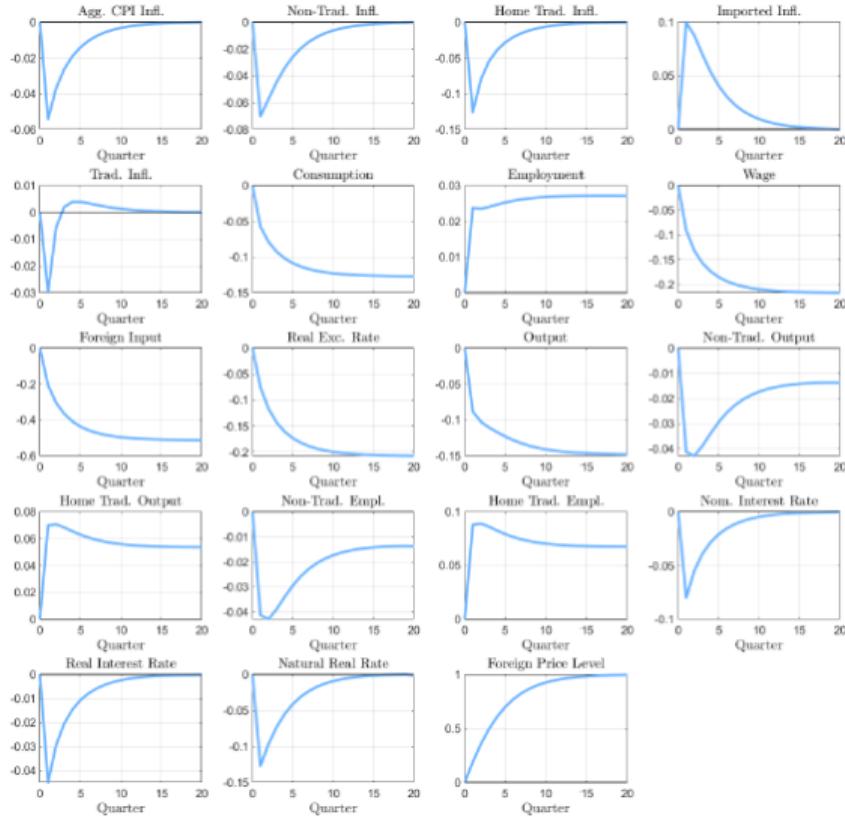
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#3 (Even) more to learn from policy responses

- Taylor-type rule: monetary policy still appears ‘restrictive’ ($r > r^*$) post-fragmentation
- Optimal policy: implement with capital controls and trade policy? [Lloyd & Marin 24, JIE]

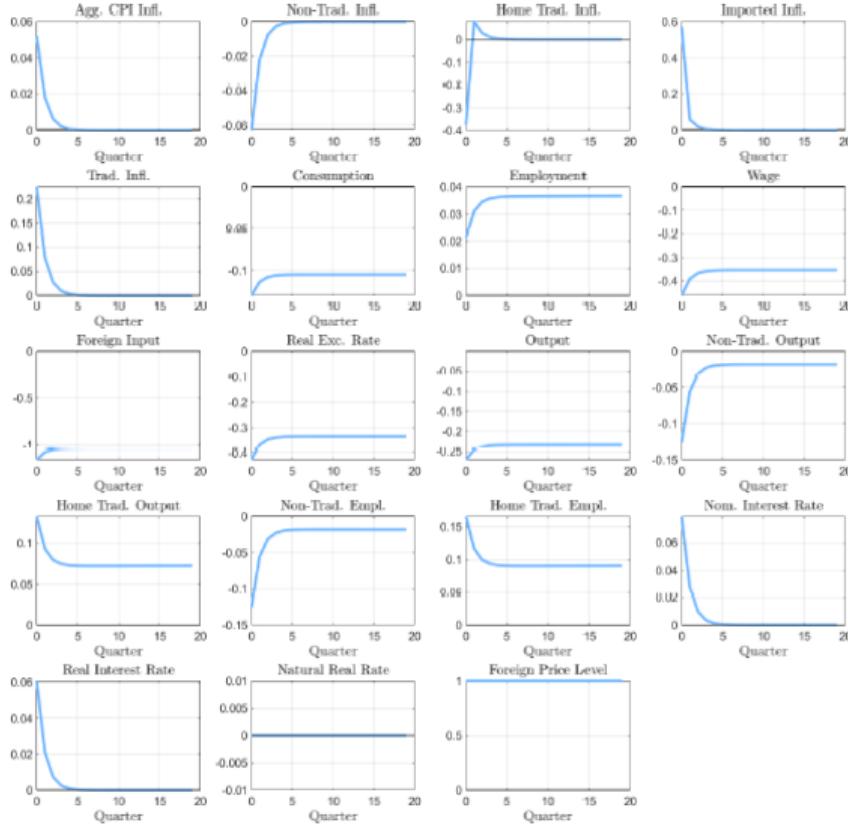
#1. Gradual $\uparrow P_F^*$ in RANK



- \uparrow imp. inflation, but gradual $\downarrow W/P$
- Some $\uparrow N_T$, but does not prevent $\downarrow \Pi_t$
- Taylor rule $\downarrow r$
- Weaker demand (intertemporally) $\downarrow r^*$

[Small Suggestion: vs. complete-markets?]

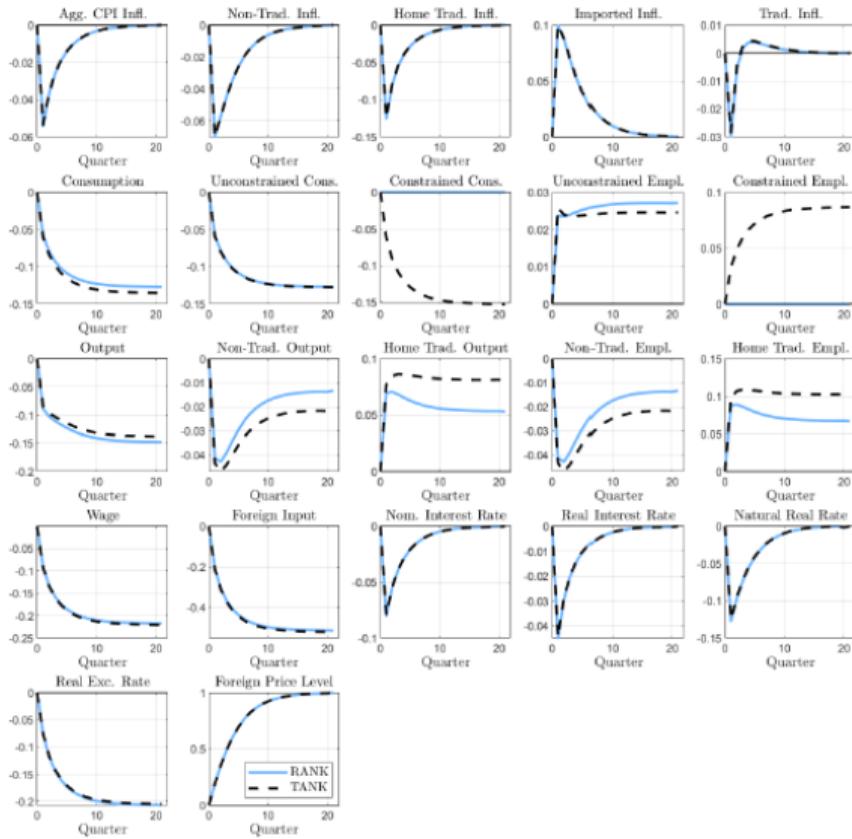
#1. One-Off $\uparrow P_F^*$ in RANK



Inflation and real-rate responses different!

- ▶ Temporary stagflation
- ▶ Taylor rule $\uparrow r$, while $\leftrightarrow r^*$

#1. Being FRANK About Differences Between RANK and TANK



Differences modest...

...but Cobb-Douglas assumptions

Suggestion: embrace the CES aggregator!

- Stronger IE with complementarity?
- Explore where SOE-TANK differs most

#1. Deviating from Cobb-Douglas to Explore Income Effects

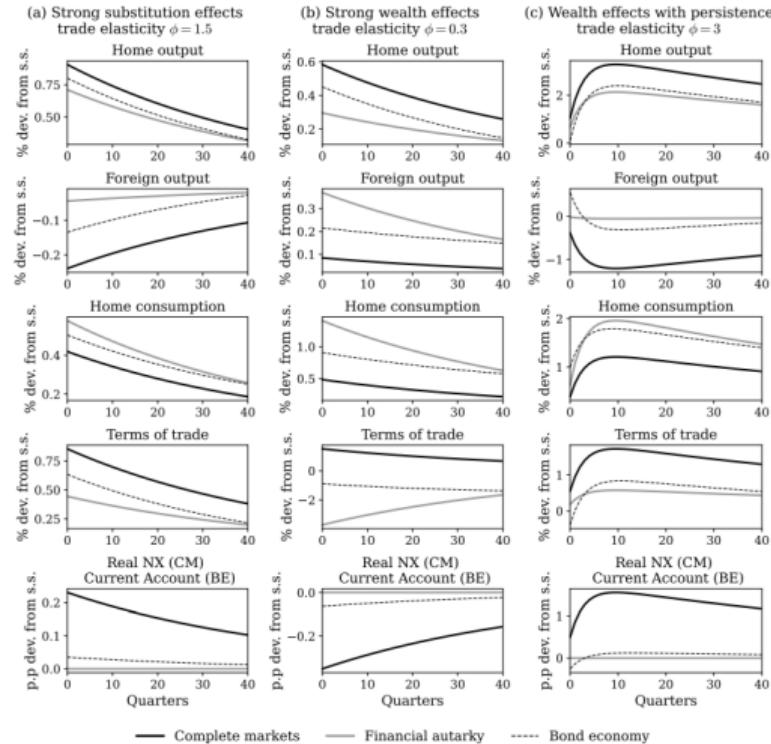
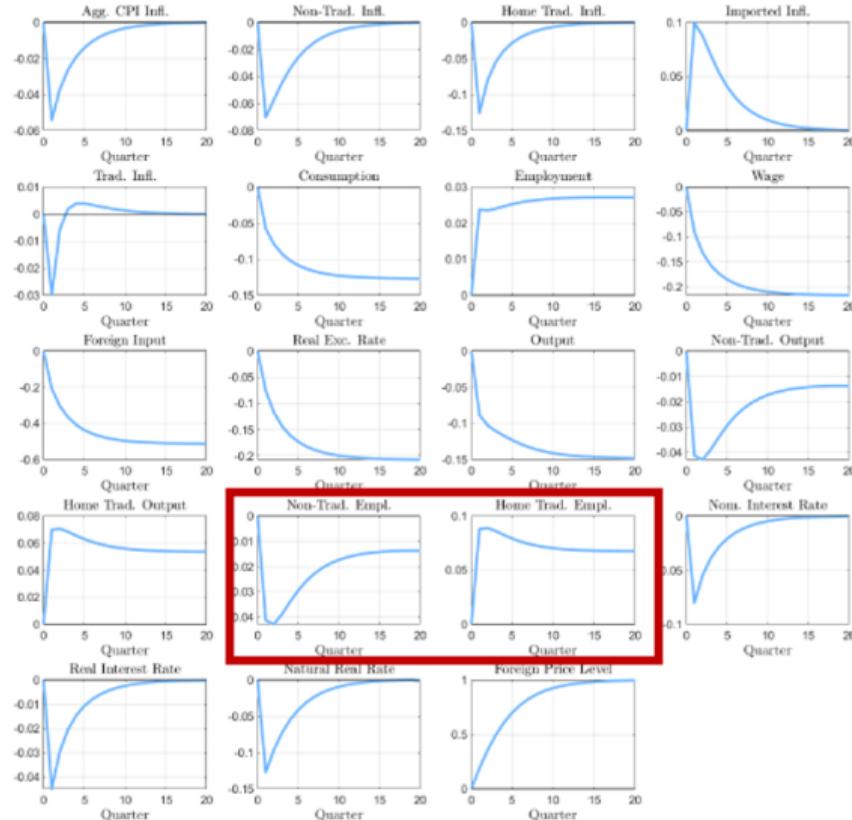


Figure 23.7: International transmission of positive home productivity shock

[Corsetti et al. 25, phdmacrobook.org]

#2. Enriching Sectoral Reallocation



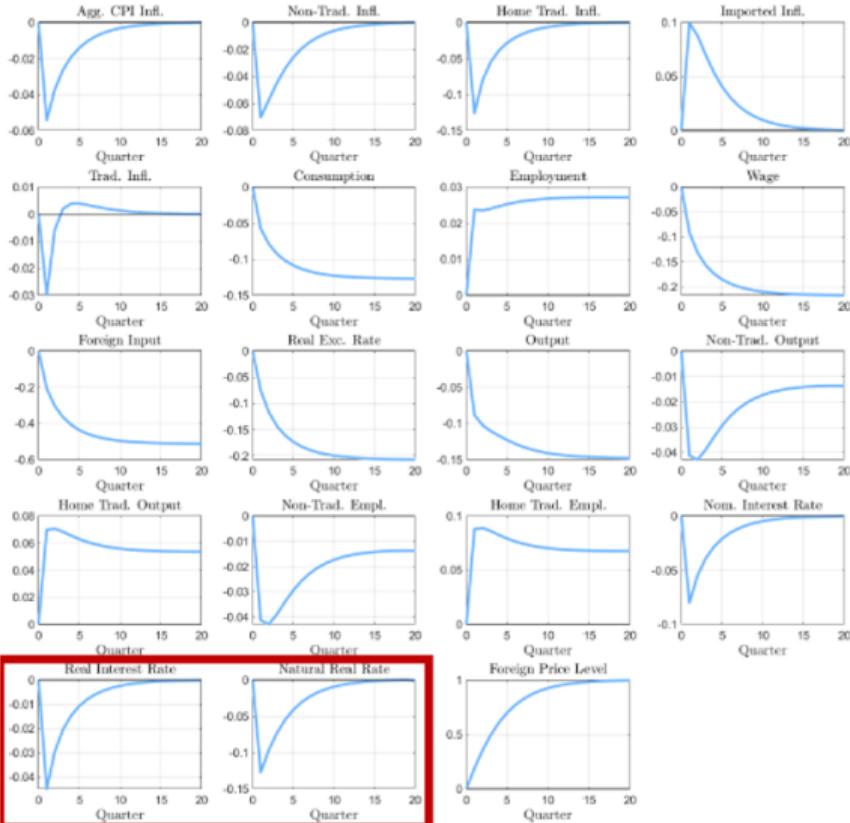
'Asymmetric' setup:

- NT: $Y_N(i) = A_N M_F^\kappa(i) N_N^{1-\kappa}(i)$
- T: $Y_H = A_H N_H^{1-\zeta}$

Plays important role in sectoral reallocation

Suggestion: more 'symmetric' treatment

#3. Policy Response is Nuanced

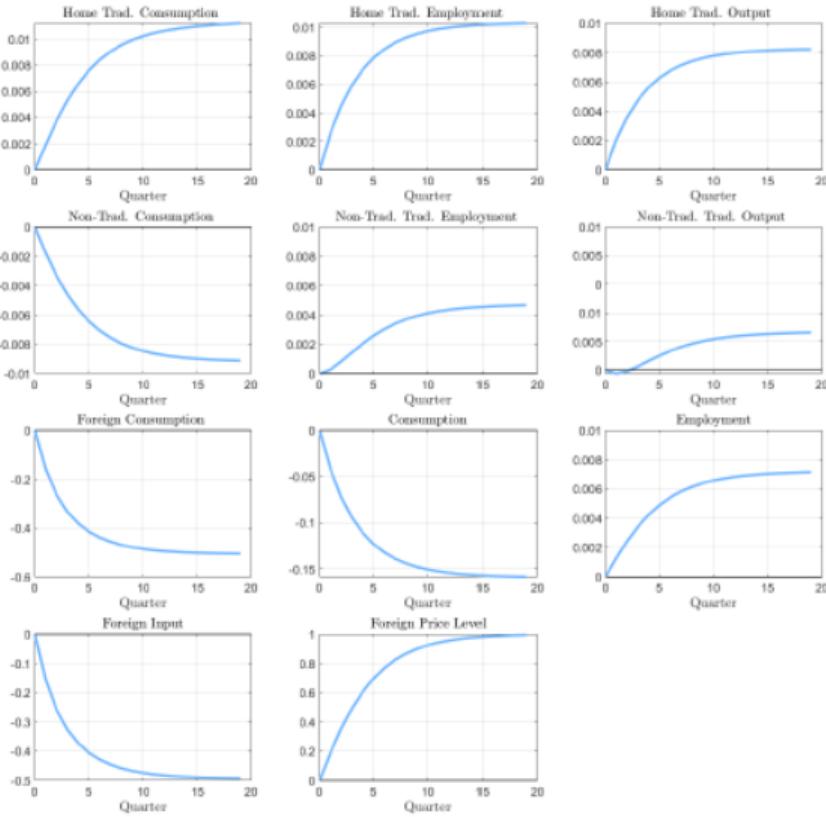


- Gradual $\uparrow P_F^* \rightarrow \downarrow r$ and $\downarrow\downarrow r^*$
- ⇒ Rates lower, but policy ‘more restrictive’ ($r > r^*$)
- ‘Conventional wisdom’ redux?

Suggestion: explore alternative parametrisations of Taylor-type rule (i.e. $\phi_\pi = 0$ or $\phi_y = 0$ extremes)

$$\frac{I_t}{I} = \left(\frac{\Pi_t}{\Pi}\right)^{\phi_\pi} \left(\frac{Y_t}{Y}\right)^{\phi_y}$$

#3. Connecting Taylor Rules with Optimal Policy Exercises



Optimal allocations different to those under Taylor rule

- E.g., small expansion in NT

Suggestion: explore monetary policy implementation of optimal allocation

- Alternative: optimised simple rules?

#3. Exploring Implementation via Other Means

- ▶ Gradual fragmentation generates incentives to borrow/save between periods
- ⇒ Scope for unilateral **capital controls** to improve welfare [Costinot et al. 14, JPE]
- ▶ Since small-open economy is ‘large’ in ‘own’ goods market, incentives remain
- ▶ And especially so when there are deviations from **free trade**
- ⇒ Additional scope for unilateral **trade policy** [Lloyd & Marin 24, JIE]

Suggestion: Explore these incentives in further work

? In gradual $\uparrow P_F^*$ case: subsidise M to prevent reallocation to T?

In Sum

- ▶ Important paper in light of ongoing policy debates
- ▶ Clear message for policymakers
- ▶ Flexible laboratory to explore numerous dimensions of fragmentation

My comments:

- #1 Leverage underutilised aspects of SOE-RANK
- #2 More agnostic sectoral split
- #3a Bridge gap between rule- and planner-implied allocations to say more on **monetary policy**
- #3b Scope to explore implementation of optimal allocation with other policies in future