

Trade Fragmentation, Inflationary Pressures and Monetary Policy

Discussion of Ambrosino, Chan & Tenreyro (2025)

Simon Lloyd

Bank of England and Centre for Macroeconomics

November 2025

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

This Paper

Question du jour: How does trade fragmentation affect inflationary pressures? What monetary policy response is needed to sustain inflation at target?

This Paper

Question du jour: How does trade fragmentation affect inflationary pressures? What monetary policy response is needed to sustain inflation at target?

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

This Paper

Question du jour: How does trade fragmentation affect inflationary pressures? What monetary policy response is needed to sustain inflation at target?

Answers: challenge ‘conventional wisdom’

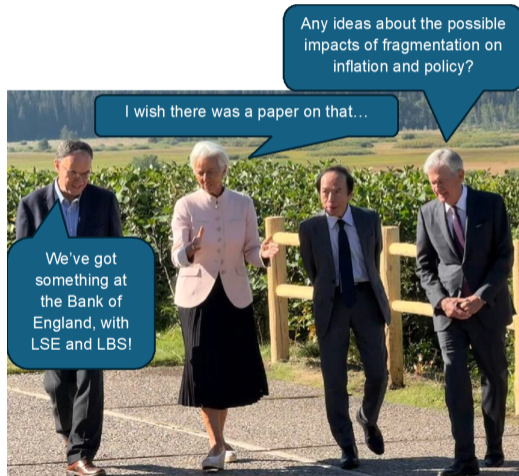
- ▶ Inflationary impacts, and associated policy responses, depend on:
 - *Supply*: effects of fragmentation on import prices
 - *Demand*: ‘income effects’ from lower real wages and productivity
- ▶ **Pace** is key: more prolonged fragmentation → stronger demand responses

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



Praise

Authors excellently tackle a question on everyone's lips

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-**R**ANK 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-**T**ANK *more* insightful

My Comments and Suggestions

#1 Learn a lot from the SOE-**R**ANK 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-**T**ANK *more* insightful

#2 Model setup 'hardwires' sectoral reallocation between T and NT

- NT uses imported intermediates, T doesn't
...so $\downarrow Y_{NT}$, while $\uparrow N_T \rightarrow \uparrow Y_T$, following fragmentation

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

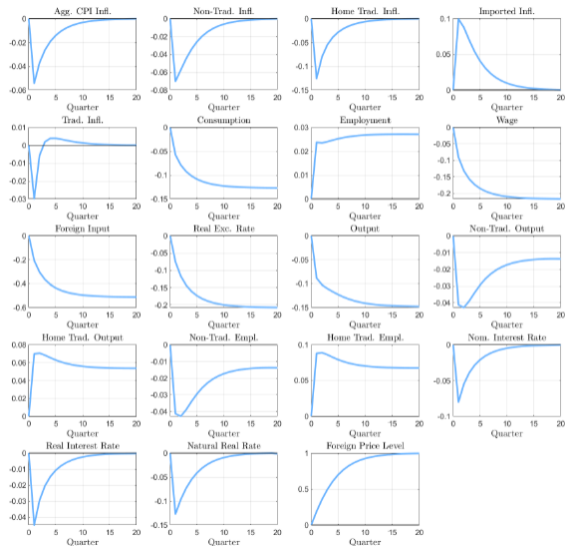
#2 Model setup 'hardwires' sectoral reallocation between T and NT

- NT uses imported intermediates, T doesn't
...so $\downarrow Y_{NT}$, while $\uparrow N_T \rightarrow \uparrow Y_T$, following fragmentation

#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]

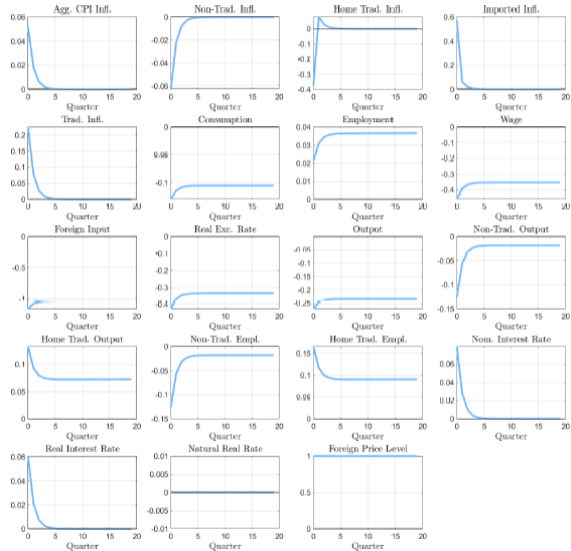
#1. Gradual $\uparrow P_F^*$ in RANK



- \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?]

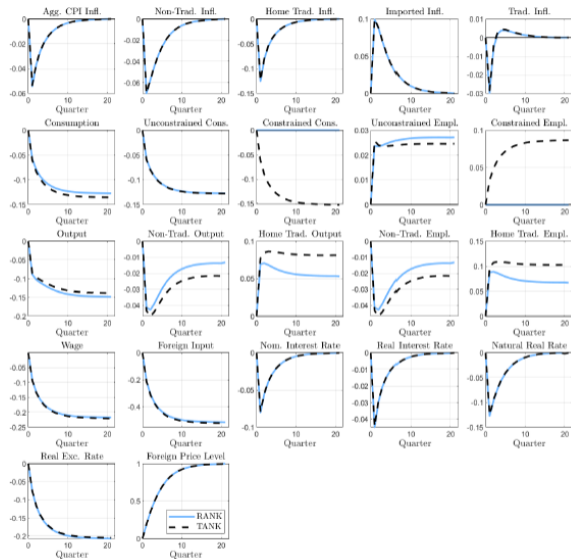
#1. One-Off $\uparrow P_F^*$ in RANK



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

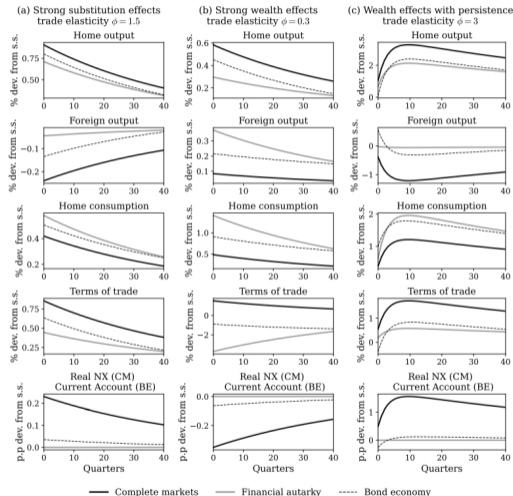
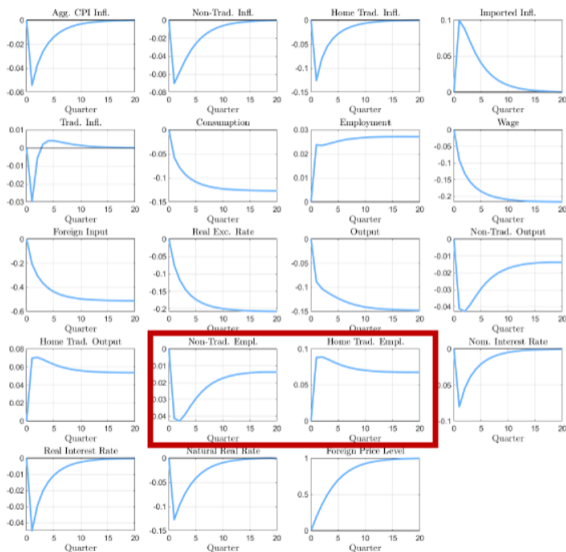


Figure 23.7: International transmission of positive home productivity shock

[Corsetti et al. 25, phdmacrobook.org]

#2. Enriching Sectoral Reallocation



‘Asymmetric’ setup:

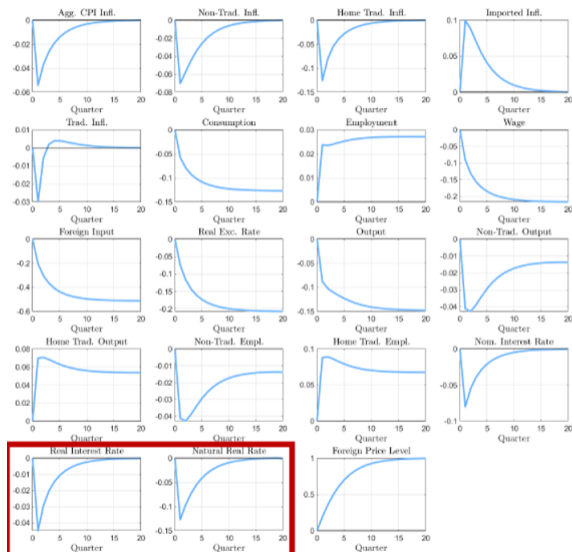
► NT: $Y_N(i) = A_N M_F^\kappa(i) N_N^{1-\kappa}(i)$

► 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 $\downarrow\downarrow r^*$

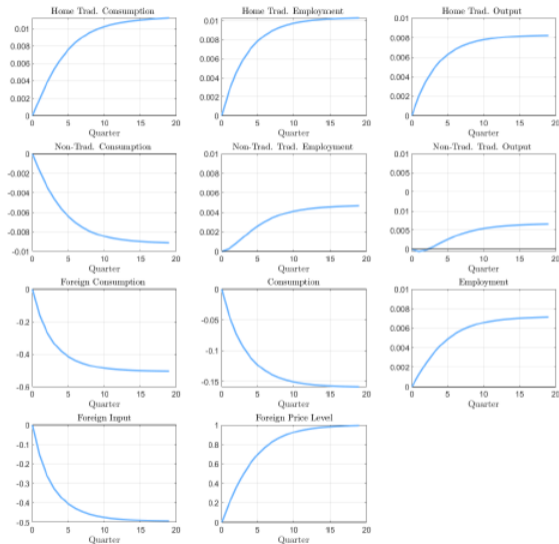
⇒ Rates lower, but policy 'more restrictive' ($r > r^*$)

'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