Discussion - Trade Fragmentation, Inflationary Pressures and Monetary Policy

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An important paper!

- New Keynesian model
  - Small open economy, non-tradable/tradable sectors use domestic intermediate goods
  - Intermediates s.t. Rotemberg-type nominal frictions, export goods have flex price
  - TANK, portfolio frictions to foreign investments
- Investigate impact of trade fragmentation on inflation
  - Highlight race between shift in demand vs. shift in supply
  - Gradual increase in imported goods price: inflation $\downarrow$
  - One-time permanent increase in imported goods price: inflation $\uparrow$
  - Gradual decrease in exporting sector productivity: inflation $\uparrow$
- Robustness analysis: RANK/TANK; openness; wage rigidities

Comment 1: Discuss Partial Equilibrium Channels

Setup: 2 periods, 2 countries (foreign M, domestic D)

$$\pi_t^{\text{CPI}} \approx \alpha_t \pi_t^M + (1-\alpha_t) \pi_t^D$$

- **Imported goods** (PCP): $p_t^M = s_t + p_t^{*M}$, so π_t^M moves with tariffs + exchange rate s_t
- **Domestic goods:** π_t^D depends on domestic goods market equilibrium

Intratemporal decision: imported vs. domestic goods

- *Substitution effect (exp. switching):* shift consumption to $D \Rightarrow$ inflationary for π_t^D
- *Income effect :* HH feel poorer $\Rightarrow$ lower consumption $\Rightarrow$ deflationary for π_t^D
- *Elasticity of substitution = 1:* substitution and income effects exactly offset

Comment 1: Discuss Partial Equilibrium Channels (2)

Setup: 2 periods, 2 countries (foreign M, domestic D)

$$\pi_t^{\text{CPI}} \approx \alpha_t \pi_t^M + (1-\alpha_t) \pi_t^D$$

Intertemporal decision: consuming today vs. tomorrow?

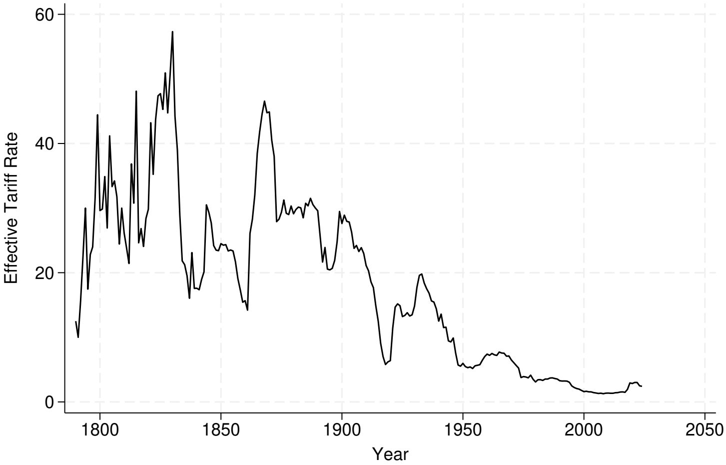
- *Substitution effect:* depends on shock
  1. **Gradual increase in** p^{*M} : shift to today $\Rightarrow$ inflationary
  2. **Permanent increase in** p^{*M}: no relative price change in PE
  3. **Mean-reverting increase in** p^{*M}: shift future consumption $\Rightarrow$ deflationary
- *Income effect:* poorer $\Rightarrow$ lower consumption path $\Rightarrow$ deflationary for π_t^D
- *Low IES* $\Rightarrow$ weak substitution effect $\Rightarrow$ increase savings

Comment 2: Clarify Contribution to the Literature

- Early literature: Mundell (1961), Krugman (1982)
- NKOE: Barattieri et al (2021), Auclert et al. (2025), Bergin and Corsetti (2023), Monacelli (2025), Werning et al. (2025), Pablo Cuba-Borda et al. (2025), Kalemli-Özcan et al. (2025)
- Rise in tariffs has
  - ambiguous effect on domestic output
  - more or less inflationary consequences
- **This paper:**
  - importance of the full path of trade restrictions
  - tariffs can lead to decline in CPI if gradual increase + low IES

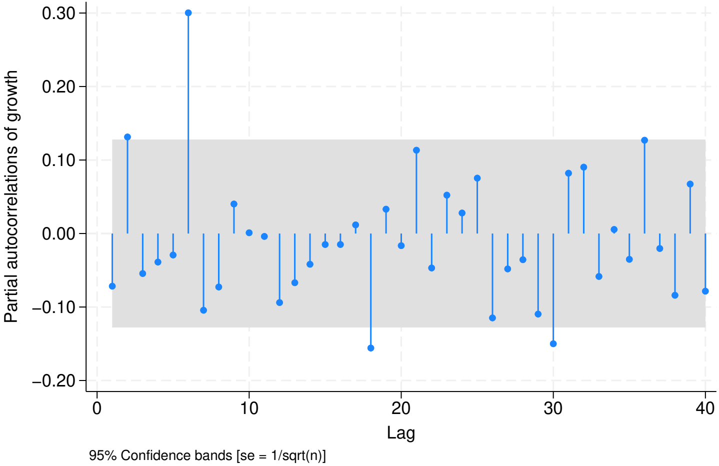
Comment 3: Stress the Empirical Relevance of the Gradual Tariffs Increase

- Impossible to read into the future. At best history rhymes.



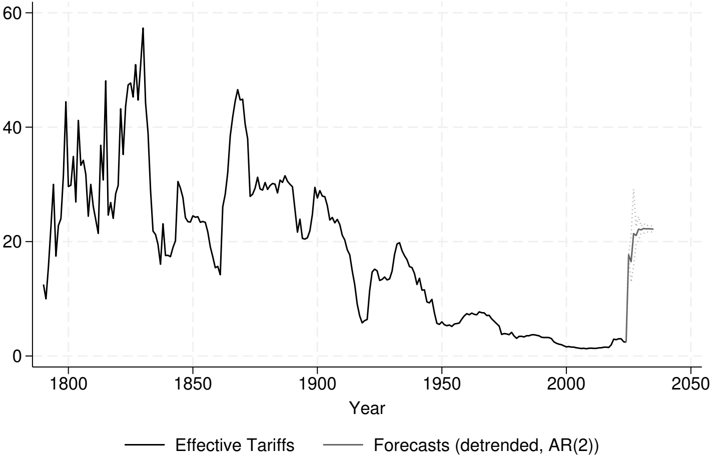
Comment 3: Stress the Empirical Relevance of the Gradual Tariffs Increase

- Compute the partial autocorrelations



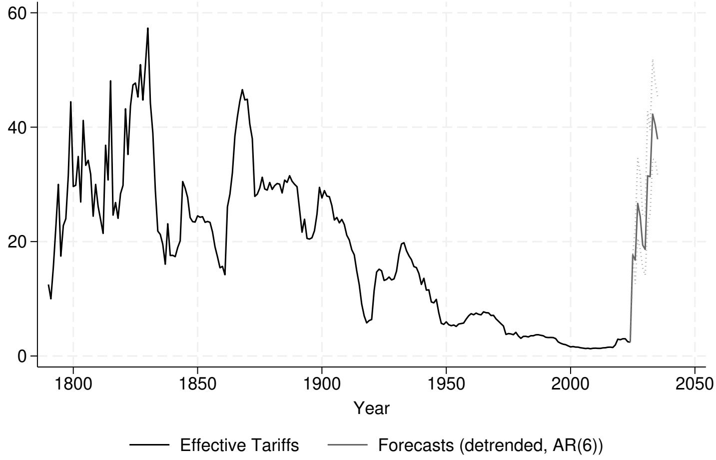
Comment 3: Stress the Empirical Relevance of the Gradual Tariffs Increase

- Forecasts using an AR(2) are consistent with gradual increase



Comment 3: Stress the Empirical Relevance of the Gradual Tariffs Increase

- Forecasts using an AR(6) are consistent with gradual increase



Comment 4: Add Sensitivity Analysis to Connect with Literature

Previous literature highlights importance of

1. Elasticity of import substitution and intertemporal substitution
   Auclert et al. (2025), Bergin and Corsetti (2023)
2. General equilibrium effects: reaction of monetary policy and exchange rate
   Mundell (1961), Krugman (1982), Monacelli (2025)

Suggestions:

- Sensitivity analysis with respect to elasticities (σ, μ)
- Sensitivity analysis with respect to MP rule: target PPI instead of CPI
- Clarify impact of exchange rate in GE

Comment 5: Assumptions about Pricing of Imports and Exports

- Paper assumes full pass-through of tariffs to import prices
  - Evidence that pass-through to retail prices<border prices: Amiti et al. (2019), Fajgelbaum et al. (2020); Cavallo et al. (2021); Flaaen et al., 2019.
- Paper assumes producer currency pricing of imports
  - Evidence of local currency pricing of imports into U.S. (Gopinath & Rigobon, 2008)
  - Matters for the pass-through of exchange rate and transmission of MP
- Paper assumes local currency pricing of exports
  - Evidence of producer currency pricing of U.S. exports (Gopinath & Rigobon, 2008)
  - How do these assumptions affect results?

Comment 6: Incorporate Heterogeneous Incidence and Revenues of Tariffs

HANK literature emphasizes:

- Importance of distribution of marginal propensity to consume
  - Individuals will react differently to change in tariffs
  - based on their basket of consumption
  - based on their sources of earnings (sectors,factors)
- Importance of how revenues from taxation are recycled
  - Paper assumes no revenues from tariffs

Suggestions: extend analysis in future work

Conclusion

A very important paper

Empirically-relevant insights for policy-makers!