

The Optimal Monetary Policy Response to Tariffs

Discussion of Bianchi and Coulibaly (2025)

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

Topical



This Paper (In My Own Words)

- ▶ Optimal response to (dom. import) tariffs is **more expansionary** than price stability
- ▶ **Policy mix matters** for the efficacy of trade policy in achieving domestic objectives
- ▶ Headline results apply to **range of extensions**:
temp. vs. perm., other distortions, endogenous TOT, imported intermediates

This Paper (In My Own Words) & My Questions

- ▶ Optimal response to (dom. import) tariffs is **more expansionary** than price stability
 - More expansionary or less contractionary?
 - **Is strict price stability really the 'best', or only relevant, benchmark?**
- ▶ **Policy mix matters** for the efficacy of trade policy in achieving domestic objectives
 - Mechanism centers on fiscal externality
 - **Does it have to be monetary policy that implements this?**
- ▶ Headline results apply to **range of extensions**:
temp. vs. perm., other distortions, endogenous TOT, imported intermediates
 - Certainly true for baseline calibration
 - **How robust to alternative parametrizations?**

Broader Literature

Lots of recent work on tariff policies in open-macro frameworks

[Barattieri et al. '21; Comin & Johnson '21; Jeanne '21; Auray et al. '22 '24; Erceg et al. '23; Lloyd & Marin '24]

Much smaller literature studying tariffs in monetary models

- ▶ **Bergin & Corsetti '23:** endo. TOT, synchronized/unilateral tariffs, global coop. alloc.
 - 'Headline' conclusion consistent: optimal policy *expansionary*
 - But differences in most relevant case: unilateral tariffs
- + **New Work:** Bergin & Corsetti '25 assessing opt. pol. and sectoral allocation with tariffs
- ▶ **Monacelli '25:** exo. TOT, unilateral tariffs, emphasis on implementable mon. pol.
 - Optimal policy expansionary; implementation with FX target
- ▶ **This Paper:** exo. TOT, unilateral tariffs, domestic optimal allocation
 - Many closed-form solutions
 - Transparent focus on domestic policy objectives

The Mechanism

Key Result: Optimal monetary policy response to tariffs expansionary

Fiscal Externality:

- ▶ Tariffs reduce imports: $\uparrow \tau \longrightarrow \downarrow c^f$
- ▶ But they also increase govt. revenue, which is rebated to households T

$$P^h c^h + P^f (1 + \tau) c^f + \frac{eb'}{R^*} = eb + W\ell + T + D$$

- ▶ Marginal private cost of imports $>$ social cost \longrightarrow imports fall by *too much*
- ▶ Ramsey planner corrects this by expanding (vs. price-stability)

Implication: Tariffs shocks \neq TOT shocks (or Canadian surcharge on US-bound electricity!)

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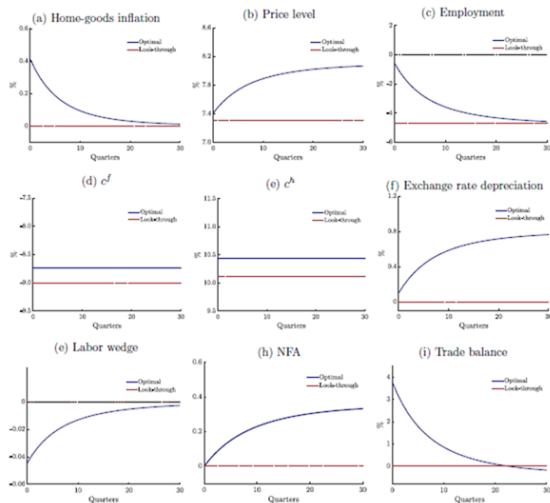
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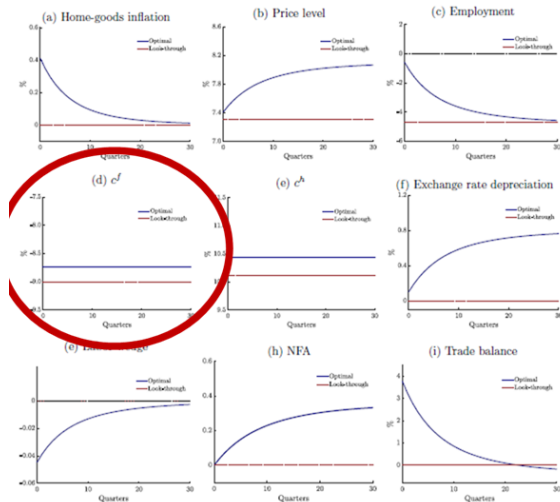
Qn: Does this reflect mon. pol. incentives? Other policies to implement allocation?

Is Look-Through (Price Stability) Best Benchmark?

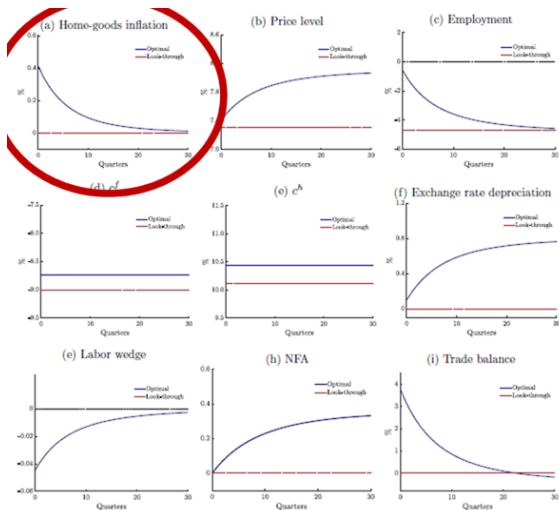


Is Look-Through (Price Stability) Best Benchmark?

Import decline larger under look-through...

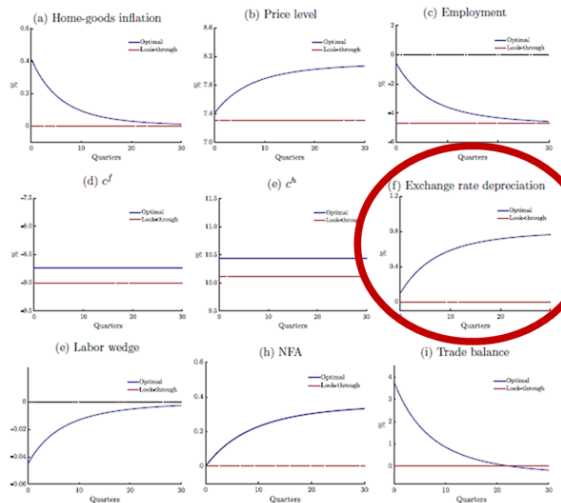


Is Look-Through (Price Stability) Best Benchmark?



Import decline larger
under look-through...
...where home-goods
inflation held fixed

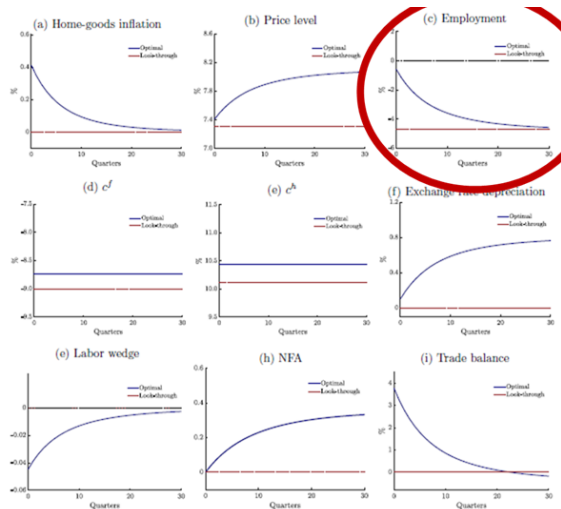
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Optimal policy accepts
inflation and FX
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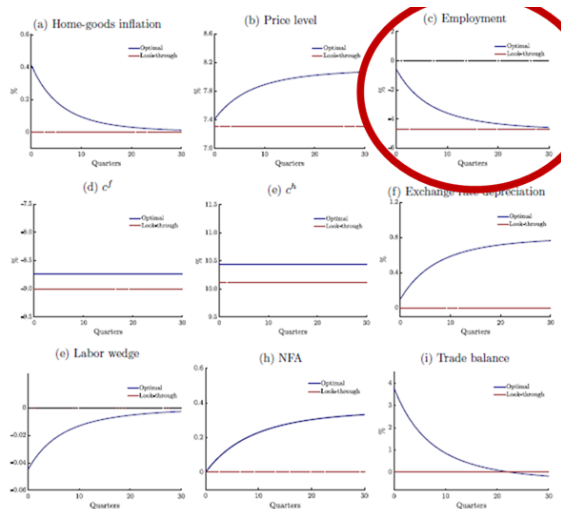


Import decline larger
under look-through...
...where home-goods
inflation held fixed

Optimal policy accepts
inflation and FX
depreciation...

...with more gradual
employment decline to
flex-price

Is Look-Through (Price Stability) Best Benchmark?

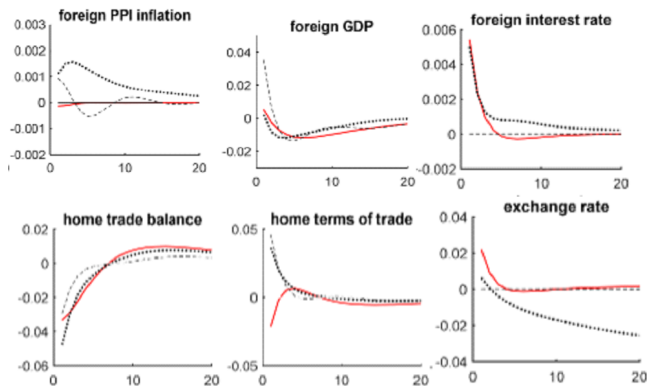


↓ ~ 4.5% employment
large for 10% tariff where
imports 15.5% GDP

Qn: How contractionary is
look-through policy?

Suggestion: Consider
other policy benchmarks

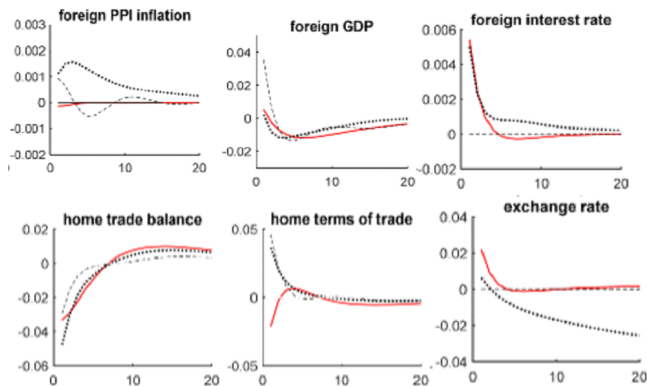
Other Benchmarks



Bergin & Corsetti '24, Fig 4 (adapted). **Foreign tariff on home imports.**

Optimal (red solid), no policy (thin black dash), Taylor rule (thick black dot)

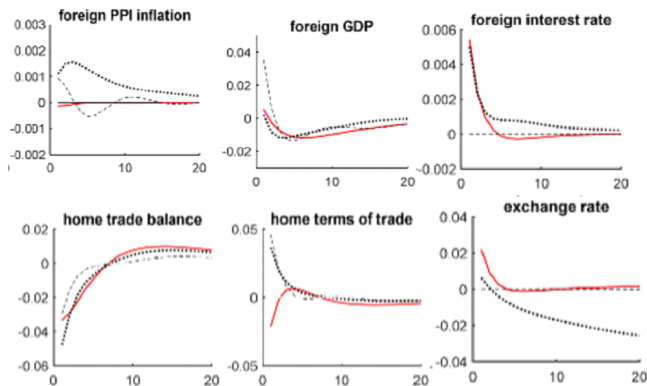
Vs. Look Through, No Policy Looks Very Expansionary...



Bergin & Corsetti '24, Fig 4 (adapted). Foreign tariff on home imports.

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...While Taylor Rule Doesn't Appear Far Off Domestic Optimum



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In Sum

- ▶ Topical paper
- ▶ Clear implications for optimal policy mix in a domestic economy setting tariffs

Would be great to see:

- ▶ Comparison with other policy benchmarks
- ▶ More discussion of policy implementation
- ▶ Further discussion of generalizability of results in extensions