

Panel “Goeconomic Fragmentation: Drivers, Dynamics, and Global Consequences”

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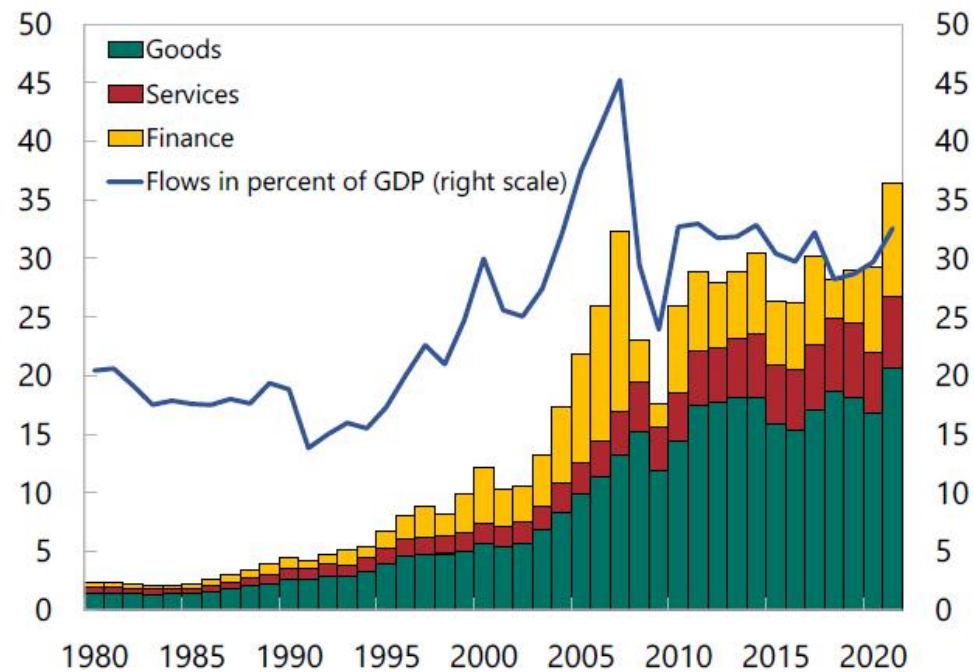
(*): The views expressed here are my own and not necessarily those of other members of the Board of the Central Bank of Chile.

The current state of global economic integration (IMF (2023))

- The network of linkages across countries has become highly complex.
- Supply chains have become highly internationalized.
- The production of many critical commodities has become highly concentrated.
- Some emerging market economies have been playing an increasingly important role in the global economic system.

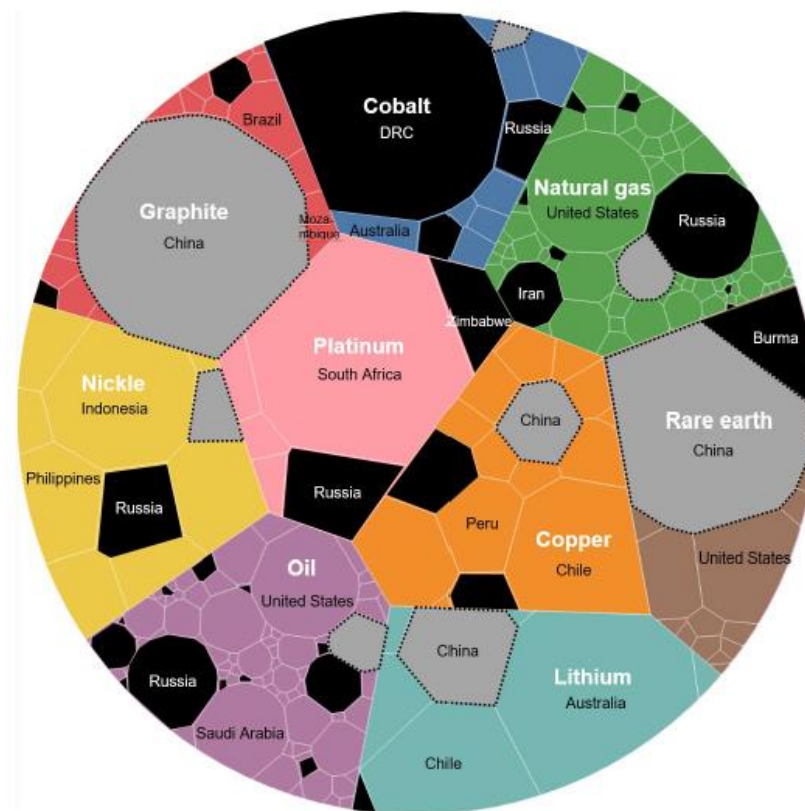
The current state of global economic integration

Figure 2: Global Flows of Goods, Services and Finance (\$ trillion, unless indicated otherwise)



Sources: IMF Balance of Payments, World Bank and IMF staff calculations
Note: The figure shows exports only.

Figure 3: Global Production Structure: Selected Commodities, 2020



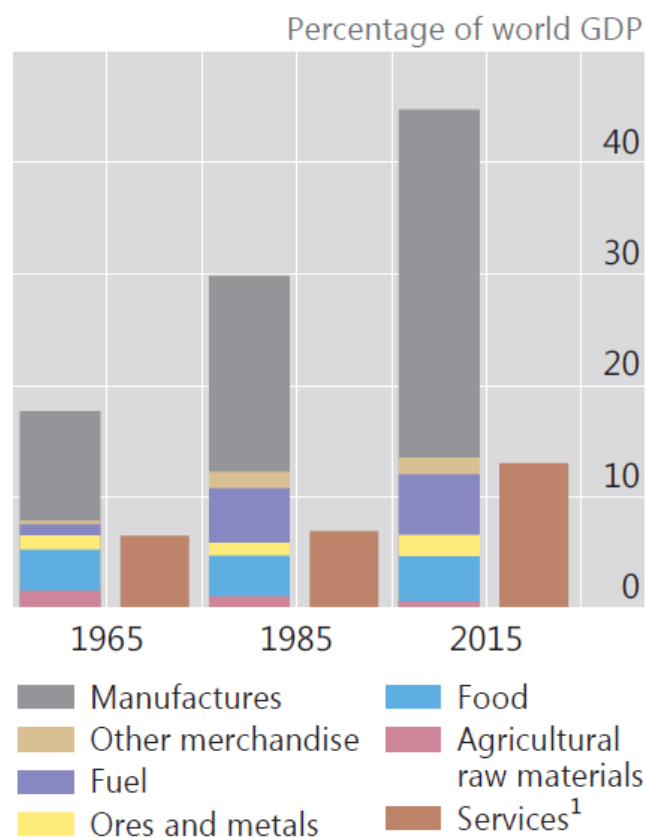
Sources: IEA, USGS, and IMF staff calculations.
Note: Countries shaded in black are under sanctions; China is denoted in gray.

The current state of global economic integration

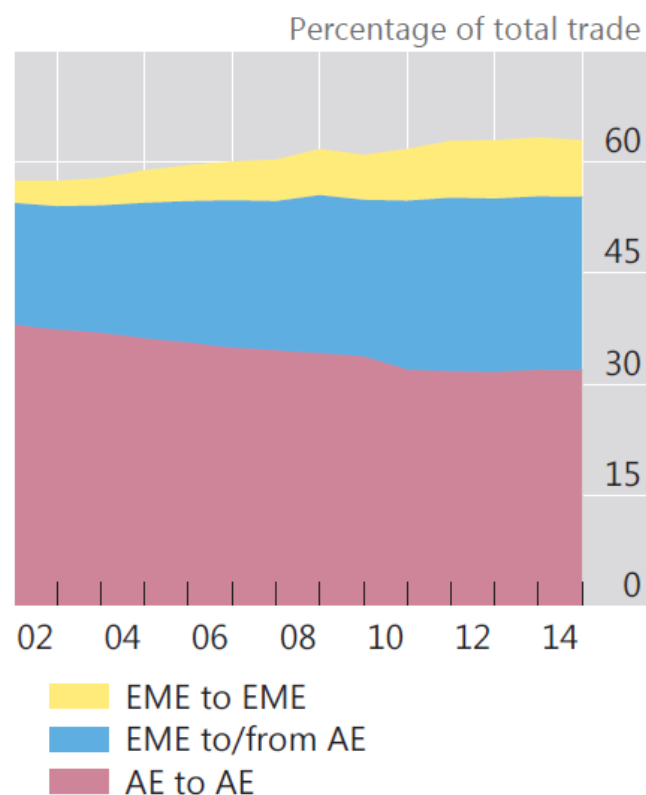
Trade has become more complex as EME involvement has grown

Graph VI.3

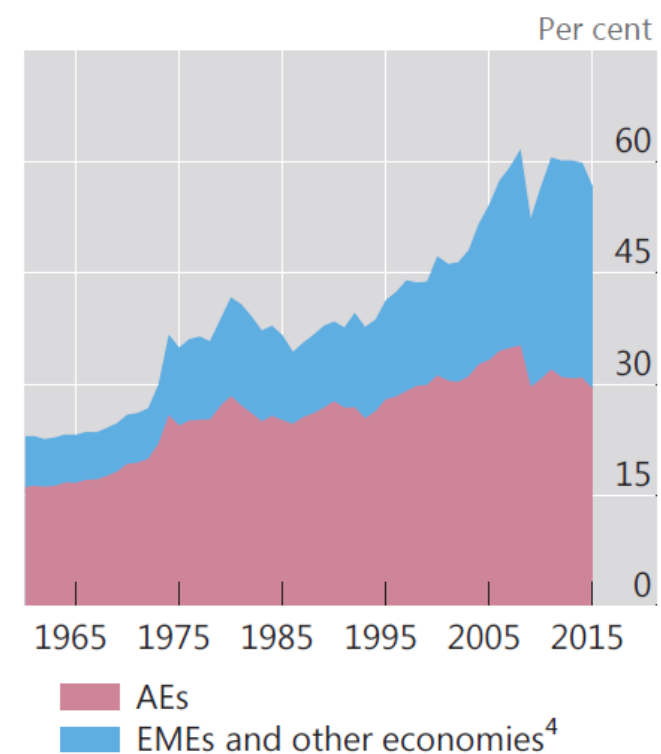
Composition of trade



Country links in GVCs²



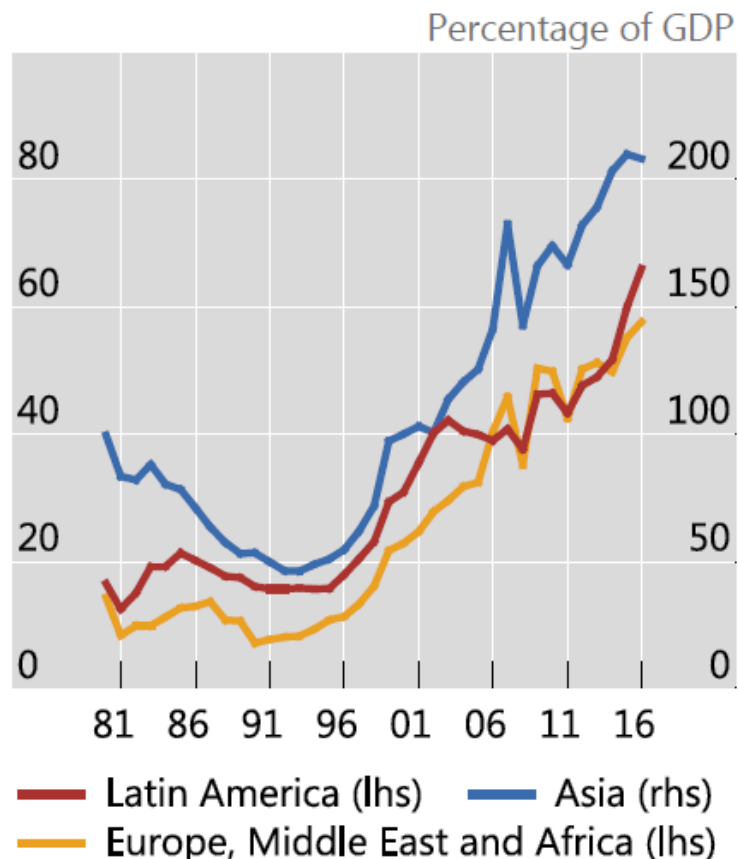
Contributions to world trade openness³



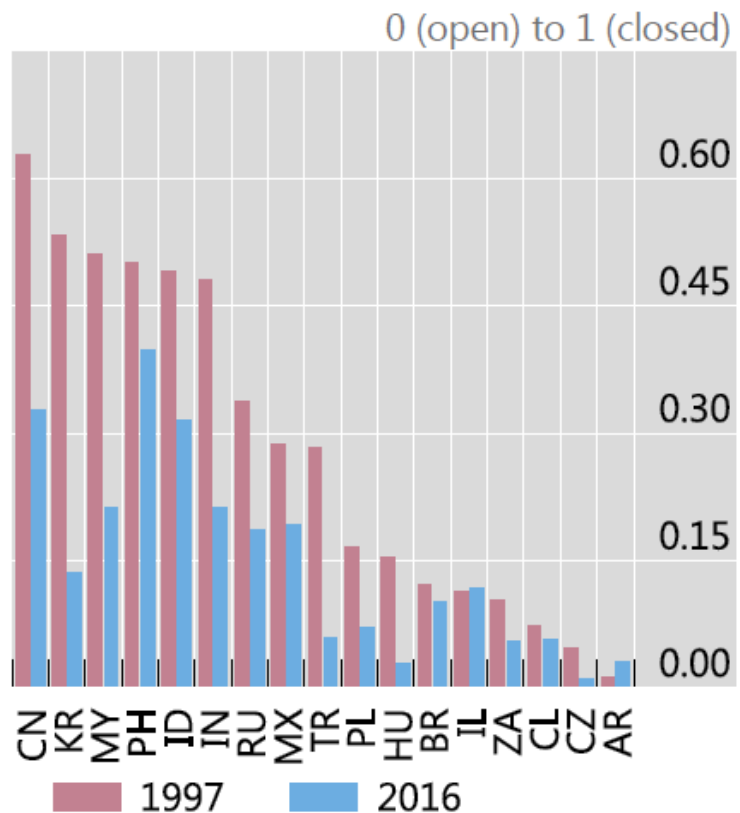
Source: BIS Annual Economic Report (2017).

The current state of global economic integration: FDI in EME

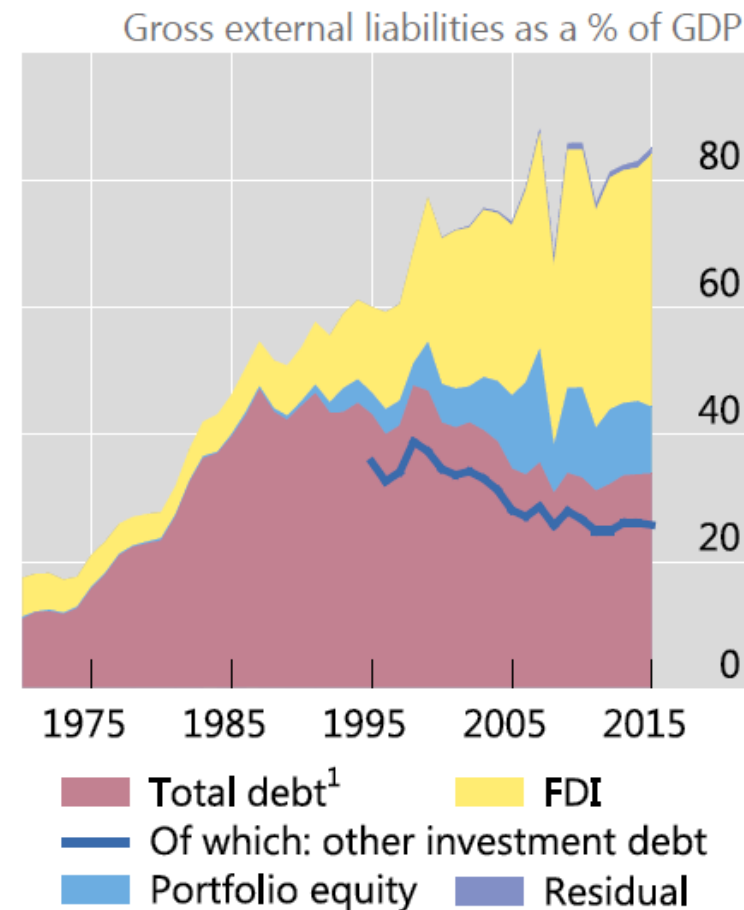
Regional FDI dynamics



FDI restrictiveness



Evolution of external positions



Source: Yavuz Arslan & Juan Contreras & Nikhil Patel & Chang Shu, 2018. BIS (ed.)

The current state of global economic integration

- Interdependence...

Geopolitical factors influenced the global economic and financial landscape we observed in recent decades...

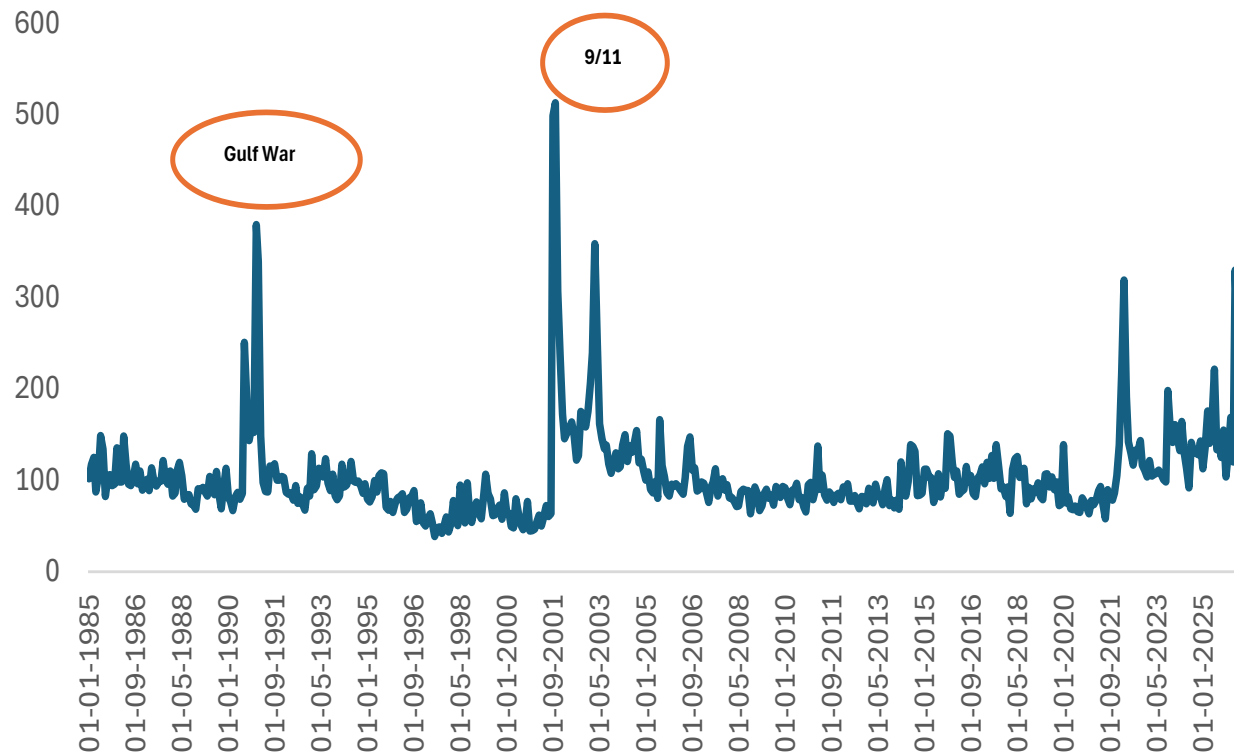
- Obstfeld (2023):
 - The end of the foreign official convertibility of U.S. dollars into gold.
 - Floating exchange rate system.
 - The European Union and the Euro.
 - USA's China policy in the seventies (the demise of Soviet bloc).
 - Globalization in trade and FDI/The rise of China.
 - Flexible exchange rate, independent monetary policy and capital mobility
 - Global financialization.
 - Dollar-centered global finance (dollar dominance).
 - Ascendancy of free market economics.
 - Political influence.

Geopolitical factors influenced the global economic and financial landscape we observed in recent decades...

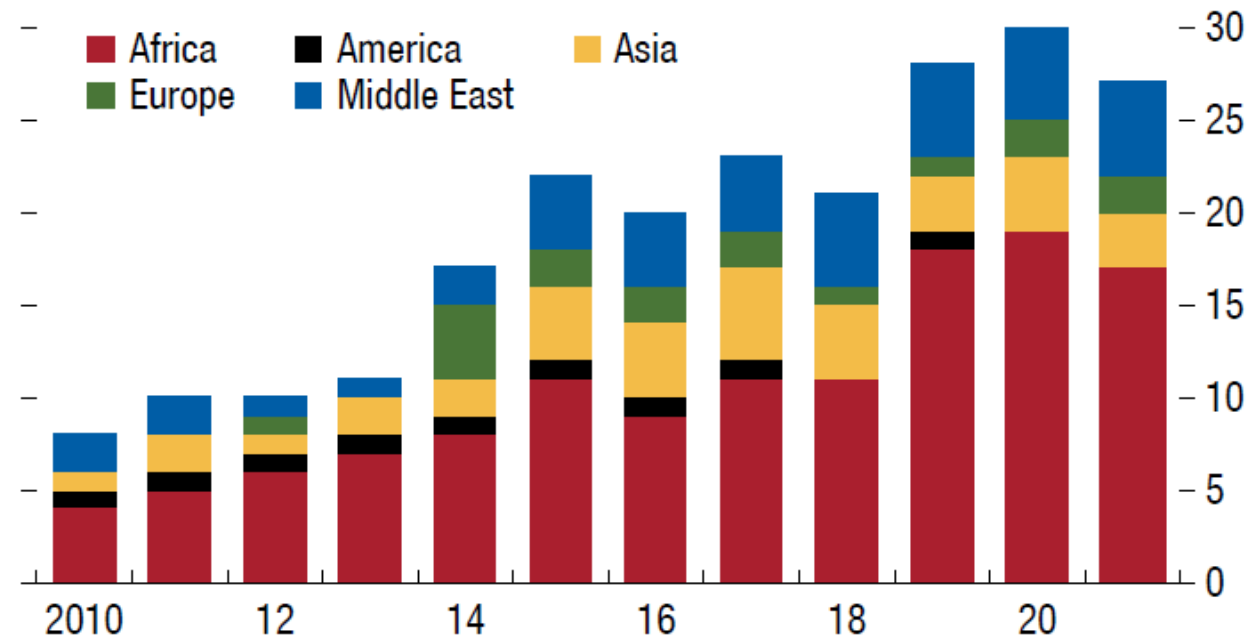
- Clayton, Maggiori and Schreger (2025): “Hegemonic powers can increase their own welfare by voluntarily and credibly constraining their use of coercion. A hegemon that commits to limiting its demands can dissuade other countries from pursuing costly anti-coercion policies.” ...international institutions as commitment devices...
 - Free trade agreements (NAFTA, WTO accession for China).
 - Multilateral institutions (IMF, World Bank, WTO) built on US-friendly rules.

Geopolitical tensions have increase...

Geopolitical Risk Index, January 1990 to May 2026



2. International Military Conflicts, 2010–21
(Number of disputes)

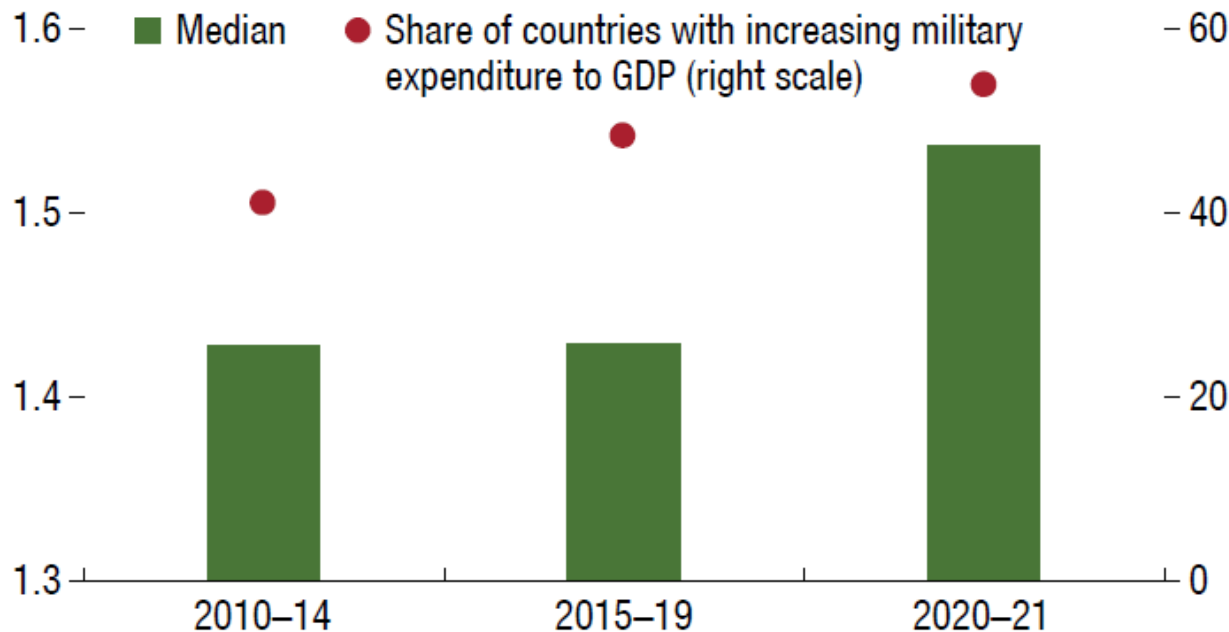


Source: Global Financial Stability Report (2023), IMF. Caldara and Iacoviello (2022).

Geopolitical tensions have increase...

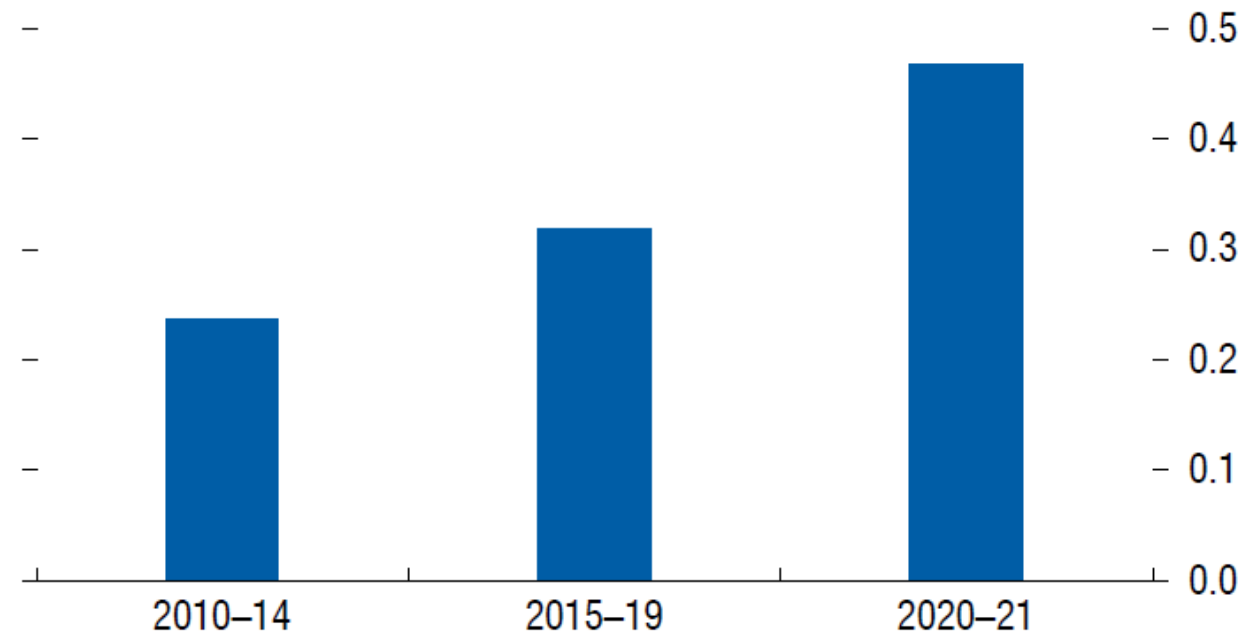
3. Ratio of Military Expenditure to GDP, 2010–21

(Percent)



4. Foreign Policy Distance, 2010–21

(Index)



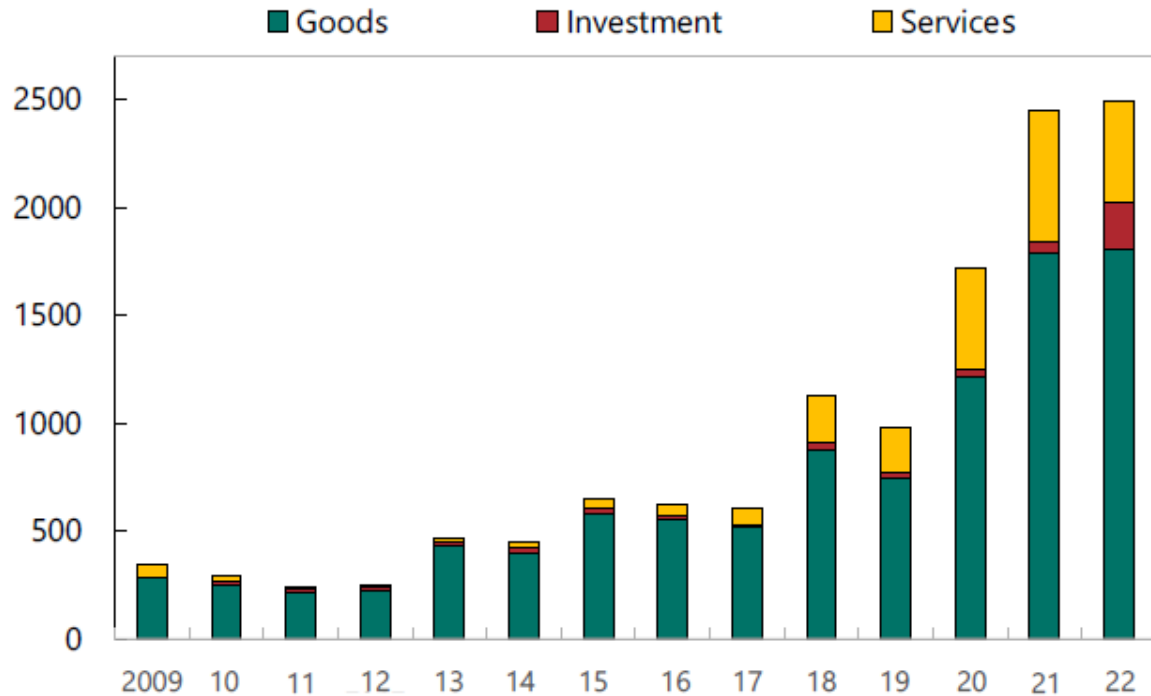
Source: Global Financial Stability Report (2023), IMF.

Geopolitical tensions

- Moving to a new equilibrium?
 - If countries with significant geoeconomic power are perceived as willing to exert significant degrees of that power, other countries will respond.
 - Derisking (reducing impact to financial and trade sanctions; economic decoupling and friend-shoring)
 - Block formation.
 - Industrial policy.
 - Fragmentation could be the equilibrium in this case.

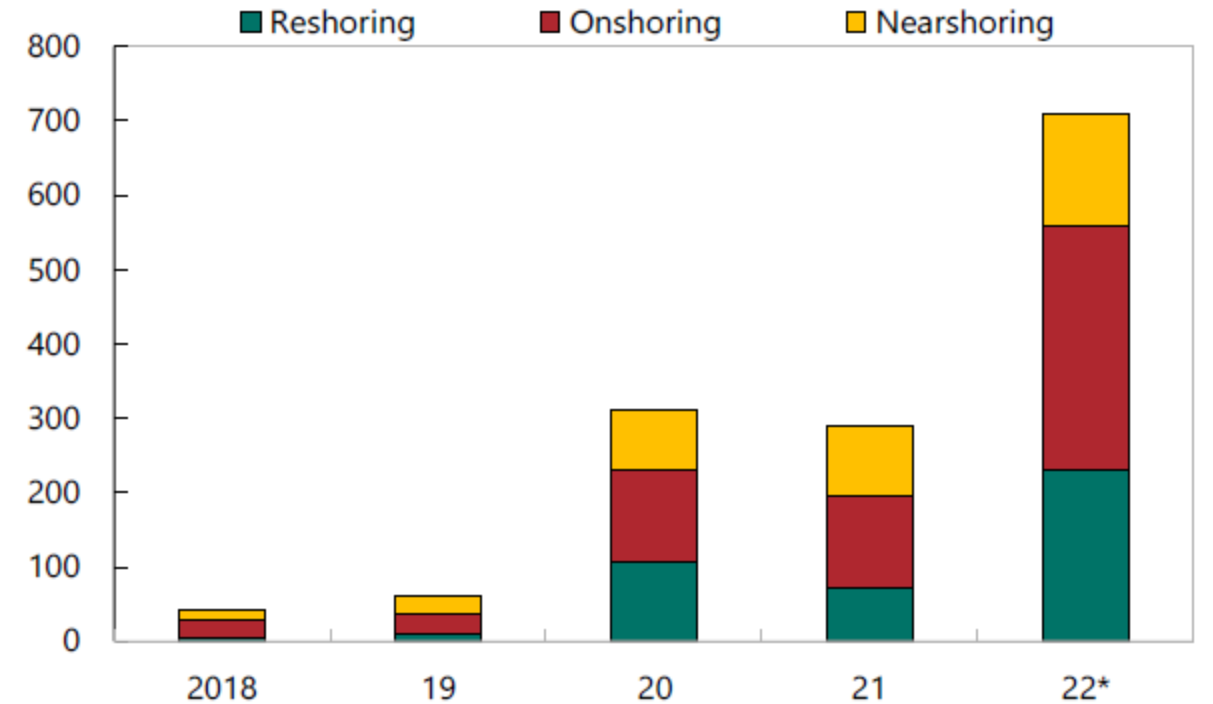
Signs of fragmentation?

Figure 7. Trade Restrictions Imposed (Number)



Sources: Global Trade Alert (2022), updated as of December 7, 2022

Figure 9. Mentions of Key Terms in Corporate Presentations (Number)



Sources: 2022 IMF, Regional Economic Outlook: Asia and Pacific.

Source: Geoeconomic Fragmentation and the Future of Multilateralism, IMF Staff Discussion Notes, 2023.

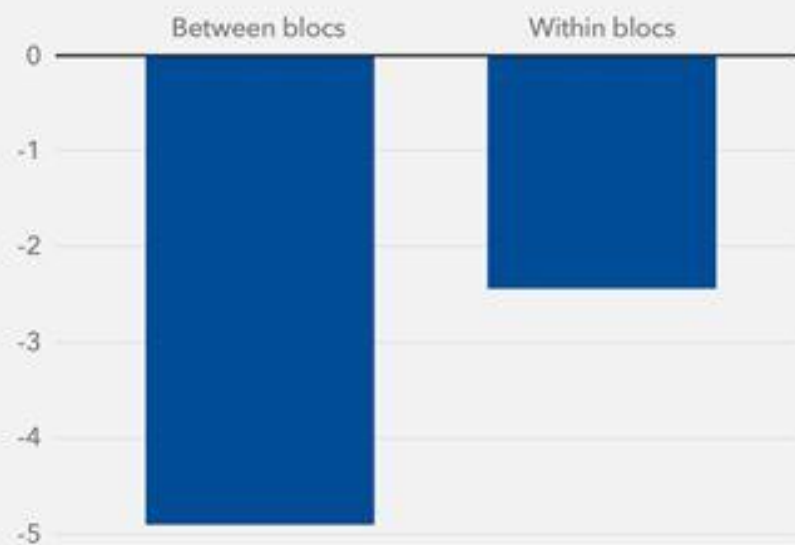
Signs of fragmentation?

EMERGING FAULT LINES

GEOPOLITICAL CONSIDERATIONS ARE ALREADY AFFECTING TRADE FLOWS

CHANGE IN TRADE GROWTH POST WAR

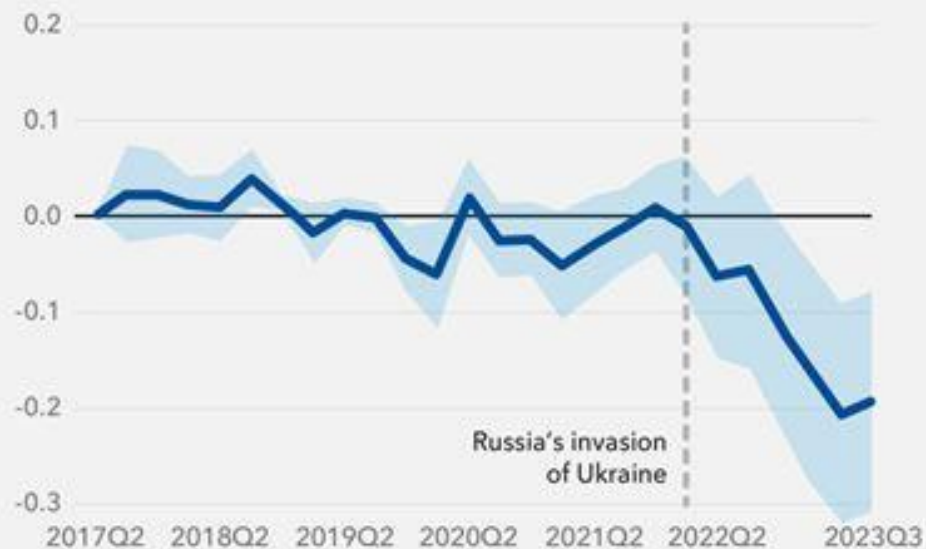
(PERCENTAGE POINTS)



Source: Gopinath et al. (2024), Trade Data Monitor and IMF staff calculations
Note: The chart shows the weighted quarterly trade growth averaged over quarters during 2022Q2 - 2023Q3 minus the equivalent for the period 2017Q1 - 2022Q1 within blocs, and between blocs.

TIMING OF TRADE FRAGMENTATION, BETWEEN BLOCS

(SEMI-ELASTICITY)



Source: Gopinath et al. (2024), Trade Data Monitor and IMF staff calculations.
Note: Plots the semi-elasticity of trade for flows between blocs, and associated 90 percent confidence bands, estimated with PPML and a fully saturated gravity model. Bloc definition based on Ideal Point Distance (a measure based on voting pattern in the United Nation General Assembly computed by Bailey et al. (2017)).

Economic fragmentation costs

- Trade fragmentation and financial fragmentation costs could be significant (recent IMF-CEPR report).
 - **Trade fragmentation:** ECB report indicates that global GDP could drop from nearly 6% in a selective decoupling scenario to 9% in a severe decoupling scenario where all products are affected. GDP losses would be heterogeneous across countries, and trade flows would shift towards neutral countries. In the severe-decoupling scenario, inflation is up to 4 percentage points higher in the first year after the shock. As economies adjust only gradually, fragmentation still entails a higher inflation rate five years after the shock.
 - **Financial fragmentation** induced by geopolitical tensions can increase banks' funding costs, reduce their profitability, and prompt them to decrease lending, with potentially adverse effects on economic activity.
 - **Reduced risk diversification.** Geopolitical tensions increase the frequency of real and financial shocks and raise the cost of external finance, particularly for more financially vulnerable countries. (macroeconomic volatility)
 - **Technology absorption**, especially important for EMEs (FDI).

Fragmentation and global payment system

- On dollar dominance and current technology irruption in payment systems.
 - Krugman (1980, 1984): what determines the structure of exchange is the distribution of transaction costs across currencies. If one currency has particularly low transaction costs – due to cheaper conversion, deeper financial markets, stronger infrastructure – it will tend to dominate the system, even if it doesn't reflect the underlying trade flows. This is an explanation for the global role of the US dollar.

Perspectives for EMEs

- To have into account: some EMEs are critical in supply of some critical minerals/commodities.
- Fragmentation fuels larger and more frequent supply shocks.
 - Empirical evidence indicates that spikes in geopolitical risk are associated with higher inflation in the years surrounding the event.
- Identification of transmission channels (input-output, trading partners, choke points).
 - Enhanced monitoring of supply chains.
 - Macro models with supply-chain interlinkages.
 - Choke points.
 - Targeted de-risking.
 - Critical for look-through approach/second round effects.

Perspectives for EMEs

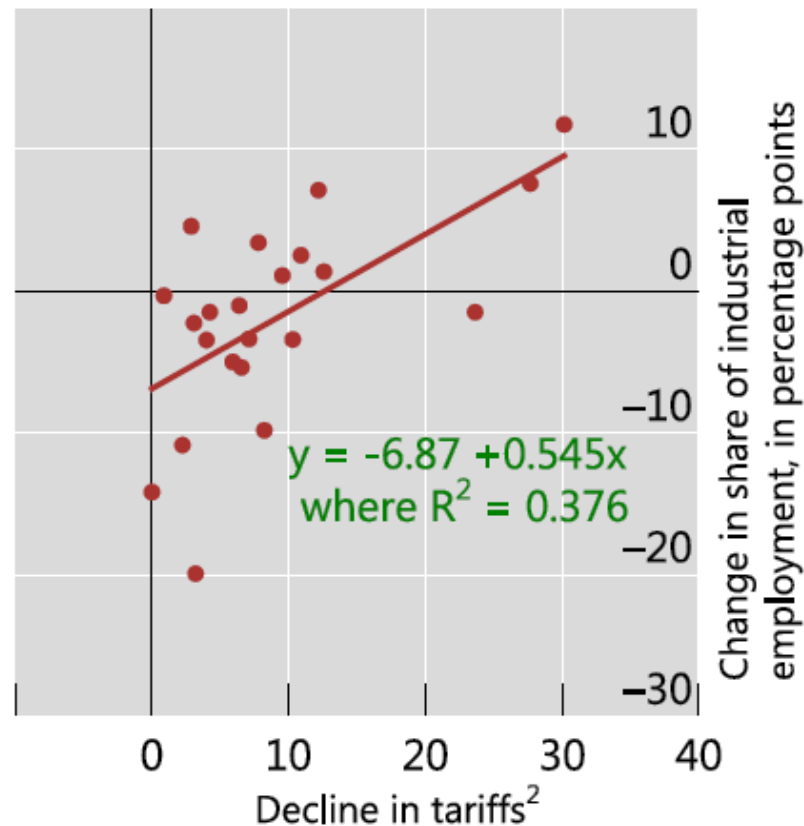
- A sound macroeconomic/financial stability policy framework is key (monetary/fiscal).
 - Credible IT.
 - Critical: symmetric response of monetary policy.
 - International liquidity/Build adequate buffers.
 - Financial stability regulation.
- Critical identification of vulnerabilities and (potential) structural changes (microdata agendas at central banks, to continue developing economic models with network effects and microstructure of goods markets dimensions).

Perspectives for EMEs

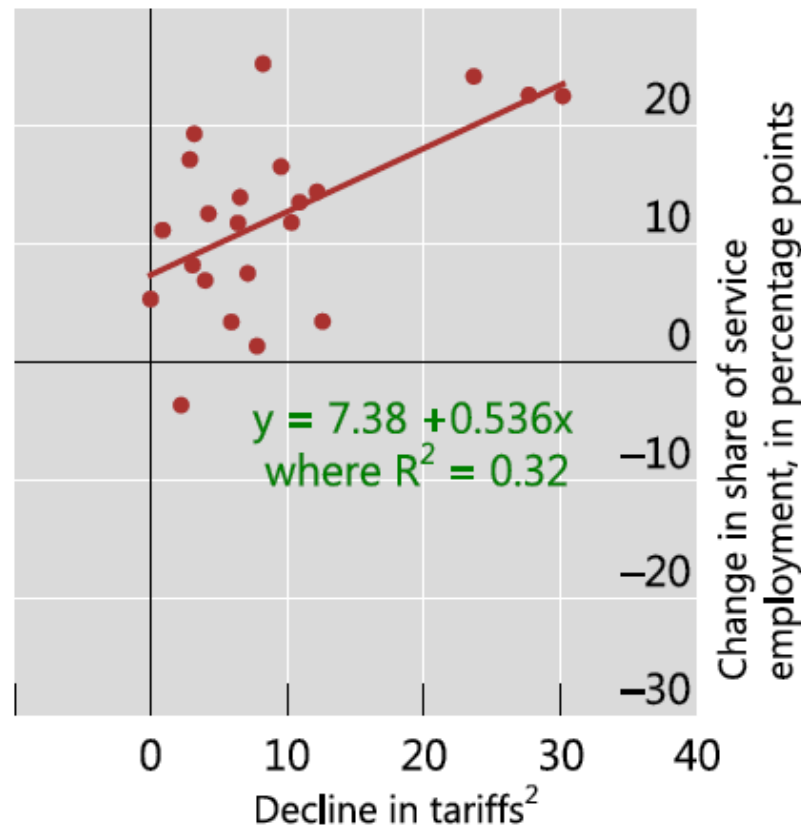
- The role of technology: automation and AI.
- Labor markets.

Perspectives for EMEs: labor markets

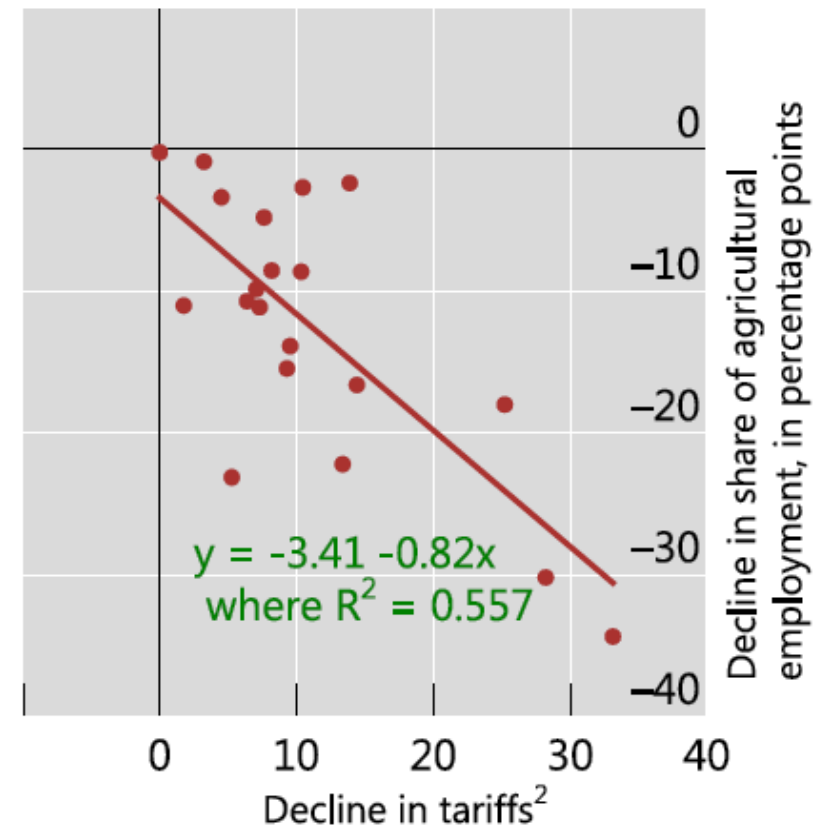
Lower trade barriers, higher industry employment share¹



Lower trade barriers, higher services employment share¹



Lower trade barriers, lower agricultural employment share¹



Countries included: AR, BR, CL, CN, CO, CZ, HK, HU, ID, IN, KR, MX, MY, PE, PH, PL, RU, SG, TH, TR and ZA (see footnote in Graph 2 for country codes).

Source: Yavuz Arslan & Juan Contreras & Nikhil Patel & Chang Shu, 2018. BIS (ed.)

Perspectives for EMEs

- The role of technology: automation and AI.
- Labor markets.
- Political challenge is enormous, in times of (domestic) political fragmentation.
- Transition costs (towards a new equilibrium?) may be large.

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