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A Vehicle Currency Country's Welfare under Optimal Monetary Policy*

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Abstract

This paper addresses the welfare consequences for a country issuing vehicle currency, in a standard two-country dynamic general equilibrium model with price stickiness. Deriving optimal monetary policy rules and evaluating welfare under various assumptions regarding currencies for invoicing exports, this paper obtains analytical conditions under which use of vehicle currency in pricing exports actually benefits the vehicle currency country compared with a situation in which each country prices its exports in its own currency. Moreover, this paper numerically illustrates that there is a fairly broad parametrical range that leads to a case in which use of vehicle currency is preferred not only by the vehicle currency country, but also by the non-vehicle currency country.

Keywords: vehicle currency; optimal monetary policy; tradable and non-tradable goods

JEL Classification Codes: F40, F41

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