

**European University Institute**  
**Department of Economics**  
Block I (Fall 2021)  
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## **Asset Pricing and Bubbles**

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### **Course objective**

This half-credit course covers the theory of rational bubbles in asset prices. It focuses on (i) the sources of asset bubbles, i.e., which frictions (dynamic inefficiency, financial frictions, agency problems...) may give rise to bubbly equilibria; (ii) their macroeconomic implications (for efficiency, growth, instability, capital flows, factor misallocation...); and (iii) their policy implications (for monetary, fiscal and macro-prudential policy).

### **Grading**

Grading will be based on a referee report (50%) and a 20-minute in-class presentation (50%).

### **Topics**

#### **General reading**

- Stephen F Le Roy. Rational exuberance. *Journal of Economic Literature*, 42(3):783–804, 2004
- Gadi Barlevy. Economic theory and asset bubbles. *Economic Perspectives*, 31(3), 2007
- Alberto Martin and Jaume Ventura. The macroeconomics of rational bubbles: a user’s guide. *Annual Review of Economics*, 10:505–539, 2018

#### **Review of bubbleless asset pricing**

- Robert E Lucas Jr. Asset prices in an exchange economy. *Econometrica*, pages 1429–1445, 1978
- John Y Campbell. Asset prices, consumption, and the business cycle. *Handbook of Macroeconomics*, 1:1231–1303, 1999
- John Y Campbell and Robert J Shiller. Stock prices, earnings, and expected dividends. *Journal of Finance*, 43(3):661–676, 1988
- John H Cochrane. Production-based asset pricing and the link between stock returns and economic fluctuations. *Journal of Finance*, 46(1):209–237, 1991

### **Partial-equilibrium models of asset bubbles**

- Olivier Jean Blanchard. Speculative bubbles, crashes and rational expectations. *Economics Letters*, 3(4):387–389, 1979
- Behzad T Diba and Herschel I Grossman. On the inception of rational bubbles. *The Quarterly Journal of Economics*, 102(3):697–700, 1987
- K.A. Froot and M. Obstfeld. Intrinsic bubbles: the case of stock prices. *American Economic Review*, 81(5):1189–1214, 1991

### **Dynamic (in)efficiency and rational asset bubbles**

- Andrew B Abel, N Gregory Mankiw, Lawrence H Summers, and Richard J Zeckhauser. Assessing dynamic efficiency: Theory and evidence. *The Review of Economic Studies*, 56(1):1–19, 1989
- François Geerolf. Reassessing dynamic efficiency. *manuscript*, 2018
- Jean Tirole. Asset bubbles and overlapping generations. *Econometrica*, pages 1499–1528, 1985
- Manuel S Santos and Michael Woodford. Rational asset pricing bubbles. *Econometrica*, pages 19–57, 1997
- Philippe Weil. Confidence and the real value of money in an overlapping generations economy. *Quarterly Journal of Economics*, 102(1):1–22, 1987
- Pierre Cahuc and Edouard Challe. Produce or speculate? asset bubbles, occupational choice, and efficiency. *International Economic Review*, 53(4):1105–1131, 2012

### **The role of financial frictions**

- Emmanuel Farhi and Jean Tirole. Bubbly liquidity. *Review of Economic Studies*, 79(2):678–706, 2012
- Jianjun Miao and Pengfei Wang. Asset bubbles and credit constraints. *American Economic Review*, 108(9):2590–2628, September 2018
- Jianjun Miao, Pengfei Wang, and Jing Zhou. Asset bubbles, collateral, and policy analysis. *Journal of Monetary Economics*, 76:S57–S70, 2015
- Narayana R Kocherlakota. Bubbles and constraints on debt accumulation. *Journal of Economic Theory*, 57(1):245–256, 1992
- Narayana Kocherlakota. Bursting bubbles: Consequences and cures. *Unpublished manuscript, Federal Reserve Bank of Minneapolis*, 2009
- Alberto Martin and Jaume Ventura. Managing credit bubbles. *Journal of the European Economic Association*, 14(3):753–789, 2016
- Vasco M Carvalho, Alberto Martin, and Jaume Ventura. Understanding bubbly episodes. *American Economic Review*, 102(3):95–100, 2012
- Benjamin Larin. Bubble-driven business cycles. *unpublished*, 2020

### **Asset bubbles and long-run growth**

- Tomohiro Hirano and Noriyuki Yanagawa. Asset bubbles, endogenous growth, and financial frictions. *Review of Economic Studies*, 84(1):406–443, 2016
- Gene M Grossman and Noriyuki Yanagawa. Asset bubbles and endogenous growth. *Journal of Monetary Economics*, 31(1):3–19, 1993
- Alberto Martin and Jaume Ventura. Economic growth with bubbles. *American Economic Review*, 102(6):3033–58, 2012
- Jacques Olivier. Growth-enhancing bubbles. *International Economic Review*, 41(1):133–152, 2000
- Pablo Guerrón-Quintana, Tomohiro Hirano, and Ryo Jinnai. Recurrent bubbles and economic growth. 2020

### **Asset bubbles as risk shifting**

- Franklin Allen and Douglas Gale. Bubbles and crises. *Economic Journal*, 110(460):236–255, 2000
- Edouard Challe and Xavier Ragot. Bubbles and self-fulfilling crises. *The BE Journal of Macroeconomics*, 11(1), 2011
- Gadi Barlevy. A leverage-based model of speculative bubbles. *Journal of Economic Theory*, 153:459–505, 2014

### **Asset bubbles and monetary policy**

- Jordi Galí. Monetary policy and rational asset price bubbles. *American Economic Review*, 104(3):721–52, 2014
- Jordi Galí. Monetary policy and bubbles in a new keynesian model with overlapping generations. *American Economic Journal: Macroeconomics*, 13(2):121–67, 2021
- Feng Dong, Jianjun Miao, and Pengfei Wang. Asset bubbles and monetary policy. *Review of Economic Dynamics*, 37:S68–S98, 2020
- Vladimir Asriyan, Luca Fornaro, Alberto Martin, and Jaume Ventura. Monetary policy for a bubbly world. *The Review of Economic Studies*, 88(3):1418–1456, 2021

### **Asset bubbles and capital flows**

- Ricardo J Caballero and Arvind Krishnamurthy. Bubbles and capital flow volatility: Causes and risk management. *Journal of Monetary Economics*, 53(1):35–53, 2006
- Jaume Ventura. Bubbles and capital flows. *Journal of Economic Theory*, 147(2):738–758, 2012
- Aart Kraay and Jaume Ventura. *11 The Dot-Com Bubble, the Bush Deficits, and the US Current Account*. University of Chicago Press, 2007