

## Globalization and Financial Markets (II): Asset Bubbles

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This course examines the effects of globalization on the workings of financial markets, focusing on theoretical results, empirical evidence and policy implications. The first part of the course analyzes the problems associated with sovereign risk, while the second part studies the origins and effects of asset bubbles. Both parts are self-contained and students can either enroll for the entire course or for only one part.

This is the syllabus for the second part. Lecture notes will be distributed during the course. There is also a reading list below that contains papers of related interest.

*Lecture 1.* Basic theory. Empirical tests of bubbles

Basic concepts and stylized facts. The Samuelson-Tirole model. Rational vs. irrational bubbles. Empirical tests of bubbles. Application to the US stock market in the late 1990s.

*Lecture 2.* Frictions in financial markets

New models of bubbles with financial frictions: non-capitalized rents, agency costs and illiquidity. Fluctuations in investment and productivity growth. Financial reforms and stability.

*Lecture 3.* The effects of globalization revisited

The effects of globalization: theory and evidence. Capital account liberalization and emerging-market crises. Bubbles, the international transmission of shocks and contagion.

*Lecture 4.* Fiscal policy and crowding-out

A crowding-out theory of bubbles, investment and government debt. Application to global imbalances. Is the US current account deficit sustainable? The adjustment process.

*Lecture 5.* Asset prices and monetary policy

Asset bubbles, aggregate demand and monetary policy. Should central banks react to the emergence and/or the collapse of an asset bubble?

*Reading list:*

- Abel, A.B., N.G. Mankiw, L.H. Summers and R.J. Zeckhauser, "Assessing dynamic efficiency: theory and evidence," *Review of Economic Studies*, 1989.
- Abreu, D. and M. Brunnermeier, "Bubbles and crashes," *Econometrica*, 2003.
- Adam, K. and A. Marcet, "Stock market volatility and learning," mimeo, IAE, UPF and CREI, 2006.
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- Allen, F. and G. Gorton, "Churning bubbles", *Review of Economic Studies*, 1993.
- Allen, F. and D. Gale, "Limited market participation and volatility of asset prices," *American Economic Review*, 1994.
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- Bordo, M., and O. Jeanne, "Booms-busts in asset prices, economic policy and monetary policy," CEPR DP3398, 2002.
- Caballero, R., E. Farhi and M. Hammour, "Speculative growth: hints from the us economy," *American Economic Review*, forthcoming.

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- Campbell, J. “Asset pricing at the Millenium,” *Journal of Finance*, 2000.
- Cass, D. and K. Shell, “Do sunspots matter?,” *Journal of Political Economy*, 1983.
- Cechetti, S., H. Genberg, J. Lipsky, and S Wadhvani, Asset Prices and Central Bank Policy, Geneva Report on the World Economy, No. 2, ICMB, Geneva and CEPR, London.
- Curt Hunter, W., Kaufman, G. and M. Pomerleano, Asset Price Bubbles: The Implications for Monetary, Regulatory and International Policies, MIT Press, 2003.
- DeLong, B., A. Shleifer, L. Summers and R. Waldman, “Noise trader risk in financial markets,” *Journal of Political Economy*, 1990.
- Detken, C. and F. Smets, “Asset price booms and monetary policy,” ECB working paper No. 364, 2004.
- Froot, K. and M. Obstfeld, “Intrinsic bubbles: the case of stock prices,” *American Economic Review*, 1991.
- Gourinchas, P. and H. Rey (2005). “From world banker to world venture capitalist: the US external adjustment and the exorbitant privilege,” in R. Clarida, ed. G7 Current Account Imbalances: Sustainability and Adjustment, NBER, forthcoming.
- Grossman, G. and N. Yanagawa, “Asset bubbles and endogenous growth,” *Journal of Monetary Economics*, 1993.
- Jermann, U. and V. Quadrini, “Stock market boom and the productivity gains of the 1990s”, mimeo, Univeristy of Pennsylvannia and New York University, 2003.
- King, I. and D. Ferguson, “Dynamic inefficiency, endogenous growth and ponzi games,” *Journal of Monetary Economics*, 32, 1993.
- Kraay, A., and J. Ventura, “The dot-com bubble, the Bush deficits, and the US current account,” in R. Clarida, ed. G7 Current Account Imbalances: Sustainability and Adjustment, NBER, forthcoming.
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Ofek, E. and M. Richardson, "Dotcom mania: the rise and fall of internet stock prices," *Journal of Finance*, 2003.

Pastor, L. and P. Veronesi, "Was there a Nasdaq bubble in the late 1990s," *Journal of Financial Economics*, forthcoming.

Prasad, E., K. Rogoff, S. Wei, and M. Kose, "Effects of financial globalization on developing countries: Some Empirical Evidence," *IMF Occasional Paper* No. 220, 2003.

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Samuelson, P.A., "An exact consumption-loan model of interest with or without the social contrivance of money," *Journal of Political Economy*, 1958.

Shell, K., "Notes on the economics of infinity," *Journal of Political Economy*, 1971.

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Ventura, J., "Bubbles and capital flows," NBER WP9304 and CEPR DP3657, 2002.

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