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Lectures on Rational Price Bubbles

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Price bubble arises when the price of an asset exceeds the asset's fundamental value which is usually understood as the present value of future dividend payments. In times of instability in financial markets, news of bubbles arising and bursting are frequent. Most of the time they are quickly forgotten when prices return to normal levels. However, the "dot-com" bubble of 1999-2000 is, in popular opinion, an example of a genuine bubble (which burst).

Basic dynamic asset pricing theory says that price bubbles are rare and unlikely. The objective of these lectures is to re-examine this finding. Are bubbles really so unlikely?

Asset price bubbles in dynamic asset market models are intimately related to constraints on agents' debt. We will explore the possibility of asset price bubbles for a broad class of debt constraints including endogenous constraints induced by limited enforcement of market transactions. The issues of speculative trade and speculative bubbles will also be discussed. Here, the focus will be on heterogeneity of agents' beliefs.

Lecture 1. Rational Asset Price Bubbles.

Lecture 2. Self-Enforcing Debt and Price Bubbles.

Lecture 3. Heterogeneous Beliefs and Speculative Bubbles.

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