

Rational Bubble on Interest-Bearing Assets

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Abstract

This paper compares fiat money and a Lucas' tree in an overlapping generations model. A Lucas' tree with a positive dividend has a unique competitive equilibrium price. Moreover, the price converges to the monetary equilibrium value of fiat money as the dividend goes to zero in the limit. Thus, the value of liquidity represented by a rational bubble is part of the fundamental price of a standard interest-bearing asset. A Lucas' tree has multiple equilibrium prices if the dividend vanishes permanently with some probability. This case may be applicable to public debt, but not to stock or urban real estate.

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