

Asset Bubbles, Unemployment, and Capital Market Frictions

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Abstract

We construct a tractable infinitely agents model with capital and labor market frictions to demonstrate that relationships among asset bubbles, capital accumulation, and unemployment. Because of credit constraints, asset bubbles appear under mild parameter conditions despite the assumption of infinitely lived agents. The presence of asset bubbles corrects allocative inefficiency, re-locating investment resources from low productive agents to high productive agents. We show that asset bubbles promotes capital accumulation and reduces unemployment rates.

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