Secular Stagnation, Liquidity Trap and Rational Asset Price Bubbles

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Resumo/Abstract:
We build a model of liquidity traps and secular stagnation of arbitrary duration caused by local shortages of assets and propose a new mechanism through which rational bubbles sustain investment and output. As opposed to a global shortage of assets or a safe asset shortage, local shortages of assets emphasize the macroeconomic importance of microeconomic portfolio constraints and liquidity differentials across markets. Financial frictions that hamper the well-functioning of financial markets prevent some agents to invest in capital and introduce a premium between the interest rate and the stock markets returns. A negative shock on the supply of assets available to those constrained agents rises the liquidity premium, decreases the interest rate and moves the economy toward the liquidity trap. Once at the ZLB, such a shock cannot be accommodated anymore by a drop in the interest rate, output falls under its potential to restore equilibrium between the supply and demand for liquidity. Bubbles that increase the supply of assets available to the constrained agents, prevent such a bad outcome and restore eciency of the equilibrium, at the possible cost of a drop in potential output.