

[Recurrent Bubbles and Economic Growth](#)

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A decade after the worst crisis since the Great Depression, economic observers seem to agree on a few points. First, an asset price bubble emerged in the years leading up to the crisis. Second, the implosion of this bubble triggered a financial crisis, resulting in the Great Recession. Third, the recovery has been lackluster, with GDP growing about 1 percentage point slower after the crisis. Interestingly, recent empirical studies find that these features are common to other financial crises, and moreover, these bubble-driven financial crises are not extremely rare but recurring over time with an interval of a few decades in many cases. Motivated by these empirical findings, this paper studies the economic implications of recurrent bubbles and their crashes.

We study a regime-switching recurrent bubble model with endogenous growth. The economy experiences both bubbly and bubbleless regimes recurrently. Infinitely-lived households expect future bubbles, which crowds out investment and reduces economic growth. Because realized bubbles crowd in investment, their overall impact on economic growth and welfare crucially depends on both the level of financial development and the frequency of bubbles. We examine U.S. economic growth performance through the lens of our model, finding evidence of recurrent bubbles. Furthermore, counterfactual simulations suggest that 1) the IT and housing bubbles together lifted the U.S. GDP by almost 2 percentage points permanently; and 2) the U.S. economy could have grown faster if people had believed that asset bubbles were impossible to arise. Finally, we compute the welfare cost of asset bubbles based on the counter-factual simulation.