Monetary Policy and Asset Price Bubbles in a New Keynesian Model

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Abstract

I generalize the New Keynesian model by introducing overlapping generations of finite-lived consumers and a life-cycle savings motive. The proposed framework is suitable for the analysis of a number of macroeconomic phenomena that can be ruled out in the standard New Keynesian model, while preserving the simplicity of the latter (and having it as a limiting case). Such phenomena include the emergence of asset price bubbles, a permanent negative natural rate of interest ("secular stagnation"), and deviations from Ricardian equivalence. In the present paper I focus on the possibility of bubbly equilibria and its implications for economic fluctuations and the design of monetary policy.

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