

2025 SBA-GSIM Colloquium

Rational Bubbles and Their Implications for Cryptocurrencies

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Abstract

We analyze a model of heterogeneous rational bubbles that compete and complement each other. When some bubbles burst, surviving ones gain value, offsetting losses from collapsed bubbles. This “compensation effect,” combined with diversification, enhances welfare. A portfolio of fragile bubbles may rival a single, stable bubble. The stationary equilibrium imposes a tight upper bound on bubble size, considering covariance structures, price fluctuations, and the emergence of new bubbles. These results have important policy implications, particularly for managing crypto ETFs and issuing CBDCs, highlighting the potential benefits of a diversified approach to fragile financial systems.

JEL Classifications: D53, E44, E51, E58, G01

Keywords: Rational bubbles, Bubble bursting, Diversification, Crypto ETF, Nonstationary equilibrium

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