

# Price bubble

Business



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### Introduction

Perhaps, one of the biggest challenges that contemporary central banking system experiences is the asset price bubble. Despite a widely known belief that prices in equity markets increase steadily over a long term, these markets have been showing strong swings in price being most likely to be unable to be justified by changes in the underlying economic fundamentals. This piece of paper summarizes the views Arlington W William that he wrote in his paper ' price bubbles in large financial asset markets'.

### Major findings of the article

As Williams (p. 242) wrote in his article, many literatures have already emphasized that financial asset markets showed price bubble as an existing phenomenon that shorts selling opportunities, limits price change rules and margins buying opportunities etc. In laboratory marketing analysis, conducted as out-of-class computerized microeconomic theory markets, it has been observed that price is more likely to be bubbled above intrinsic value and then crashed back to intrinsic value too. Price in the third laboratory market also tended to be intrinsic more accurately that sought to have a common price expectation with an asset share.

The above mentioned market-laboratory experiment was very important because it has been able to address the potentially critical issues regarding the price bubble and how it is robust to various factors like, 1) substantial increase in group size, 2) inter-trader information existing outside laboratory privacy, 3) non-monetary reward structure etc. The market experiments have used a cash reward system whereby small markets with around fifteen traders watching the phenomenon in the market-laboratory.

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The price bubble phenomenon has resulted consistently with cash-reward, small group and strict privacy lab experiment for little experienced traders. The computerized market laboratory experiment highlighted that people are ready to buy assets at very high prices, though the accurate reason is quite unknown, it has been detailed that those who buy in such high prices perhaps gain profits from such doings by earning dividends or by selling to others.

An interesting result of the experiment

An interesting outcome of the experiment was the approximation of risk-neutral expectation market equilibrium, which was due to that traders in all three model markets began to learn that common market price expectation that is from their expected dividend earning with asset shares.

Discussion Question

The above mentioned market-laboratory experiment raises an important question regarding the price bubble mainly about why people buy assets when they are of huge prices. Despite all explanations, including the opportunities of earning increased profits, the answer may be quite unknown. Why still people buy assets for such very high prices?.

References

William, AW, Price bubbles in large financial asset markets, Handbook of Experimental

Economics Results, Volume 1, Elsevier B. V, 2008