A MODEL OF CYCLICAL INTERNATIONAL CAPITAL MOVEMENTS

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Abstract This paper introduces fiscal increasing returns to domestic capital into a standard optimizing model of international portfolio selection. The resulting system displays surprising dynamic behavior. Endogenous cycles of any length may occur around the steady state equilibrium, with both capital flows and asset prices displaying regular fluctuations. Initial conditions and expectations both matter in selecting the cycle on which the economy converges. Hence, "animal spirits" may determine the course of asset prices and capital flows.

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