LIQRISK / Liquidity and Risk in Macroeconomic Models
Research area: FP7 - European Research Council/Individuals, Institutions and Markets (SH1)
Beneficiary: Prof. Philippe Bacchetta
Host institution: University of Lausanne (UNIL)

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Type of contract: ERC Advanced Grant

PHILIPPE BACCHETTA

ANALYSING THE EFFECTS OF UNCERTAINTY ON PRODUCTIVITY AND EMPLOYMENT

Prof. Philippe Bacchetta, whose LIQRISK project has received € 2 million from the European Research Council (ERC), wants to explain the mechanisms behind liquidity and risk in financial markets, with the aim of understanding and thereby avoiding crises.

How did you become an economics professor at the University of Lausanne?

Even when I was young, I preferred the abstract world of ideas to that which is material and tangible, an inclination that found fertile ground in the field of economics research. I was fascinated by this subject. I felt that it fundamentally applied to society as a whole. In my doctoral studies, for example, I studied restrictions on capital flows in times of crisis.

How did you come to take an interest in risk dynamics, the topic of your European research project?

This was in response to the financial crisis in 2008 and the way in which it has undermined received economic wisdom. Explanations were coming from all quarters but I remained sceptical and refused to take the evidence at face value. It became clear to me that macroeconomic models were too simplistic. There are several ways of accounting for risk: the first is behavioural reactions such as panic effects, the second suggests that agents are not properly aware of their economic surroundings and are forced to alter their viewpoints radically whenever crises hit home, and the third upholds that theoretical modelling can cope with periods of high and low volatility. In other words, we can provide a model for shifts in risk levels. Capital flows and trade can be used to explain away the economic crisis but, in my opinion, it was panic driven. I wanted to investigate my hunch.

What are the main benefits of an ERC grant?

Generally speaking, macroeconomic research had been sidelined. This grant places it back centre stage. It also represents an accolade for the University of Lausanne. It makes me happy that I can put something back into an institution that has given me so much.

Our project aims to understand how panicking affects the economy, financial markets and society as a whole.

ABOUT THE PROJECT

In 2011, Professor Philippe Bacchetta was the only macroeconomics expert in Europe to receive an ERC grant, amounting to € 2 million. LIQRISK aims to elucidate the workings of financial crises so that their effects on productivity and employment, both nationally and globally, can be anticipated. This will be carried out by introducing risk and liquidity parameters into dynamic stochastic general equilibrium models and analysing their influence on the economy. The research will be two tiered.

The first part will deal with market risk and liquidity in developed financial economies, while the second will examine demand for liquid assets from emerging economies and the overall impact thereof.

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