What is wrong with securities markets?
&
What is right with Peru?

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“Low interest rates contributed to the gradual build-up of financial vulnerabilities in the past….It doesn’t take a genius to see that similar risks exist today.”
Christine Lagarde
Managing Director IMF

“There is too little economic risk-taking, and too much financial risk-taking.”
“And when he woke up, the dinosaur was still there”

Augusto Monterroso
Interest rates: historical aberration!
(Yield of 10-year US Treasuries)
No deleveraging, debts have risen ...
Assets are overvalued
Shiller’s CAPE of the S&P 500
Why CAPE?
Derivatives risks

Global OTC derivatives markets

Notional principal\(^1\)  USD trn

Gross market value\(^1\)  USD trn

Gross credit exposure\(^1\)  Per cent  USD trn

08  09  10  11  12  13  14  15

Interest rate  Commodities  FX  CDS  Equity  Unallocated

08  09  10  11  12  13  14  15

Interest rate  Commodities  FX  CDS  Equity  Unallocated

08  09  10  11  12  13  14  15

Share of gross market value (lhs)  Amounts (rhs)
Problem
Many traders believe that zero interest rates are the normal state of nature!

**Bloomberg Survey**

- One third of traders never experienced anything other than zero interest rates
- Two thirds have no adult memory of the dotcom crash of 2000.

**Cognitive bias**

- Behavior responds more to individual construction based on recent experience than to objective input.
Poor growth outlook
Declining dividend of integration into the world economy of China, India, Eastern Europe…
We know that only diamonds are for ever
Monetary normalization
Move on, do not procrastinate

Models are to be used, not believed.

— Henri Theil —
So central banks should normalize policy, not procrastinate …

As a youth I prayed, Give me chastity and continence, but not yet.

(Saint Augustine)
And what is right with

Average for period 5%

Subperiod
Emerging market crisis 2.3%

Rest of the years 7.0%
GDP still growing at 3% despite export shock

\[ y = 5940.3e^{0.1918x} \]
Vale un Perú ( Worth a Peru )

Spanish language phrase that has come to symbolize a matter of great value

Cities in the book The Wealth of Nations (1776)

Number of paragraphs in The Wealth of Nations

- London: 82 paragraphs
- Lima or Peru: 27 paragraphs
- Boston or NY or Philadelphia: 12 paragraphs