How the world's stock exchanges could close for five months

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The idea that almost overnight of all the world's stock exchanges closing for five months, long bank holidays, government restrictions on all business payments for over two months, government money printing, restrictions on gold, enormous bailouts of finance houses. It all sounds like some bad economic thriller... but could it happen in a modern, financially connected world? Perhaps it already has... read the story from the article below and see if you recognise the situation?

> *London, August 4*
> *It was looking like a good year until that last week of July. The stock market crash of seven years before had almost faded from memory. Inflation was under control and interest rates had stabilized. Emerging markets were booming. Commodity prices were up, on the back of sustained global growth. Best of all, volatility was as low as most investors could remember. True, returns even on high-risk assets were being driven down so low that you needed yet more leverage to make serious money. But, thanks to unprecedented international capital mobility and a spurt of financial innovation, the world economy was swimming in credit.*
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> *It was an act of terrorism on June 28 that began the Great Drain. At first it seemed like just another assassination in just another Muslim country—and not the only one to have suffered the trauma of Western occupation in recent years. And although the terrorists scored a big hit (the vice president was not a popular figure, but a powerful one) the financial markets took it in their stride. Stocks barely moved.*
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> *It was not until the ultimatum [to the Muslim country] more than three weeks later, on the evening of July 23, that investors began to feel nervous. For its terms were truly formidable, particularly the demand that [foreign] officials be allowed into the country to investigate alleged sponsorship of the terrorists. The government immediately dismissed the ultimatum as "impossible." With the declaration of the Russian [leader] that Moscow would not tolerate an attack, those who had been warning of an imminent [world crisis] suddenly seemed prescient. Unfortunately, their warnings had gone unheeded on Wall Street.*
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> *Within days of the ultimatum, the delicate web of international credit had been torn to shreds. Foreign investors rushed to withdraw their money from New York. Russia suspended payments to all foreign institutions. As hedge funds rushed to cover their positions, panic selling swept the world's financial markets. But the further asset prices fell, the worse the crisis became. Securities that had been the collateral for immense pyramids of debt were suddenly unsellable.*
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> *As prime brokers—the principal providers of credit to the markets—the big investment banks were exposed like naked swimmers when the tide suddenly goes out. The central banks lacked the means to stem the outflow; the decline in liquidity was orders of magnitude larger than their entire balance sheets. The only way to avoid a complete financial implosion was to literally close the world's stock exchanges. The first to go were the smaller European exchanges. By July 31, however, even New York and London had shut their doors. The world's principal stock markets would remain closed until January.*
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> Fantasy? Not entirely. An almost identical sequence of events brought the last great age of globalization to a shuddering halt in the summer of 1914. Buoyant financial markets had initially shrugged off the assassination of Archduke Franz Ferdinand, the heir to the Austrian throne, in the Bosnian capital, Sarajevo. But Austria's tough ultimatum to Serbia sparked both a geopolitical and a financial chain reaction. As traders and investors suddenly grasped the likelihood of a full-scale European war, with Russia taking the Serbs' side, liquidity was sucked out of the world economy. [That would lead to financial changes unprecedented in scope: **temporary closure of markets, moratoria on debts, emergency money issued by governments, bailouts for the most vulnerable institutions.]**

The first danger signs were rising insurance premiums in the wake of the Austrian ultimatum. Bond and stock prices began to slip as prudent investors sought to increase the liquidity of their positions. European investors were especially quick to start selling their Russian securities, followed by Americans. Exchange rates went haywire as a result of efforts by cross-border creditors to repatriate their money: sterling and the franc surged, while the ruble and dollar slumped. By July 30, panic reigned on most financial markets. The first firms to come under pressure in London were the jobbers on the Stock Exchange, who relied heavily on borrowed money to finance their holdings of equities. As sell orders flooded in, the value of stocks plunged below the value of their debts, forcing a number (notably Derenberg & Co.) into bankruptcy. Also under pressure were the commercial bill brokers in London, many of whom were owed substantial sums by continental counterparties that now were unable or unwilling to remit funds. (To put it mildly, these firms' strategies were highly correlated.) Their difficulties in turn had an impact on the acceptance houses (the elite merchant banks), who were first in line if foreigners defaulted, since they had "accepted" the bills. If the acceptance houses went bust, the bill brokers would go down with them, and possibly also the larger joint-stock banks, which lent millions every day on call to the discount market. Their decision to call in loans notoriously deepened the crisis.

Just because top traders have never seen a massive liquidity crisis doesn't mean those crises never happen. Traders' memories are simply too short.

As all concerned scrambled to sell assets and increase their liquidity, stock prices slumped, compromising brokers and others who had borrowed money against shares. Domestic customers began to fear a banking crisis. Queues formed as people sought to exchange banknotes for gold coins at the Bank of England. At the same time, the effective suspension of London's role as the hub of international credit helped spread the crisis from Europe to the rest of the world.

Perhaps the most remarkable feature of the crisis of 1914 was the **closure of the world's major stock markets for up to five months** . The Vienna market was the first to close, on July 27. By July 30 all the continental European exchanges had shut their doors. The next day, London and New York felt compelled to follow suit. Although a belated settlement day went smoothly on November 18, the London Stock Exchange did not reopen until January 4. Nothing like this had happened since its foundation in 1773. The New York market reopened for limited trading (bonds for cash only) on November 28, but unrestricted trading did not resume until April 1, 1915. Nor were stock markets the only ones to close in the crisis. Most U.S. commodity markets had to suspend trading, as did most European foreign-exchange markets. The London Royal Exchange, for example, remained closed until September 17. It seems likely that, had the markets not closed, the collapse in prices would have been as extreme as it would be in 1929, if not worse.

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a number of countries, beginning with Russia, simply suspended the gold convertibility of their currencies. ...

In London the Bank Holiday of Monday, August 3, was extended through Thursday, August 6. Payments due on bills of exchange were **postponed for a month** by royal proclamation. A one-month moratorium on all other payments due (except wages, taxes, pensions, and the like) was rushed onto the statute books. (These moratoria were later extended until, respectively, October 19 and November 4.) On August 13, the chancellor of the exchequer gave the Bank of England a guarantee that if the bank discounted all approved bills accepted before August 4 "without recourse against the holders," the Treasury would bear the cost of any loss the bank might incur. This amounted to a **government rescue of the discount houses** ; it opened the door for a massive expansion of the monetary base, as bills poured into the bank to be discounted. On September 5, assistance was also extended to the acceptance houses. Arrangements varied from country to country, but the expedients were broadly similar and unprecedented in scope: **temporary closure of markets, moratoria on debts, emergency money issued by governments, bailouts for the most vulnerable institutions.**

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The closure of the New York Stock Exchange and federal bailouts for the likes of Goldman Sachs may seem unimaginable to us now. But financial history reminds us that ten-sigma events do happen. And, when they do, liquidity can ebb much more quickly than it previously flowed.

From Niall Ferguson's article " Chill Wind from 1914 "

Perhaps it is wise to have "financial crisis insurance" prepared before "a total unexpected crisis" happens again...

"History doesn't repeat itself, but it does rhyme,said Mark Twain." - John Robert Colombo