

The Transmission of the Financial Crisis in 1907: An Empirical Investigation

Jon Moen, Mississippi, and Ellis Tallman, Oberlin

Similarities Between 1907 and 2008

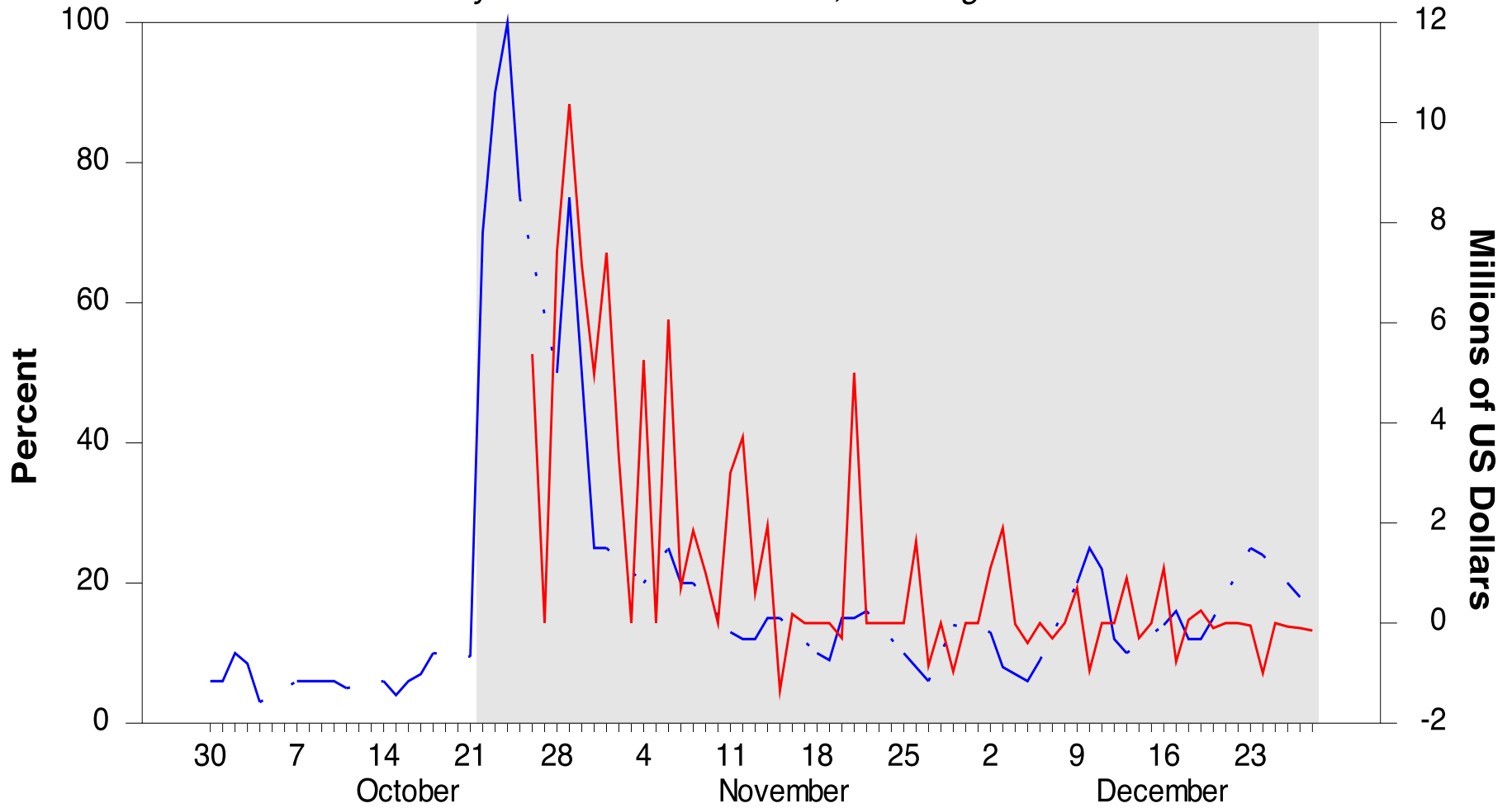
- ▶ Heinze national banks => Bear Stearns: *aided by LOLR.*
- ▶ Trust Companies => Investment Banks: *outside traditional LOLR arrangements.*
- ▶ Knickerbocker => Lehman Brothers: *both received no aid.*

When Did the Panic Spill over to other Markets?

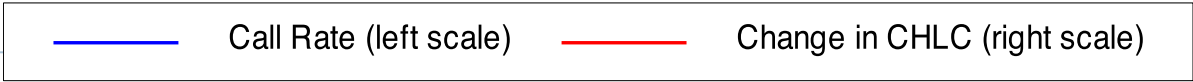
- ▶ Crisis at the Heinze National Banks—
 - ▶ No panic (but rumblings)
- ▶ National Bank of Commerce Announcement on Oct. 21.
- ▶ Knickerbocker Run.
 - ▶ Call loan rate spikes

Chart 3a: Call Loan Rate (Max) versus Change in CHLC Issues

Daily Observations in 1907; Shading for Panic



Source: New York Times, Clearing House Loan Committee Reports



So Far Panic Confined to New York

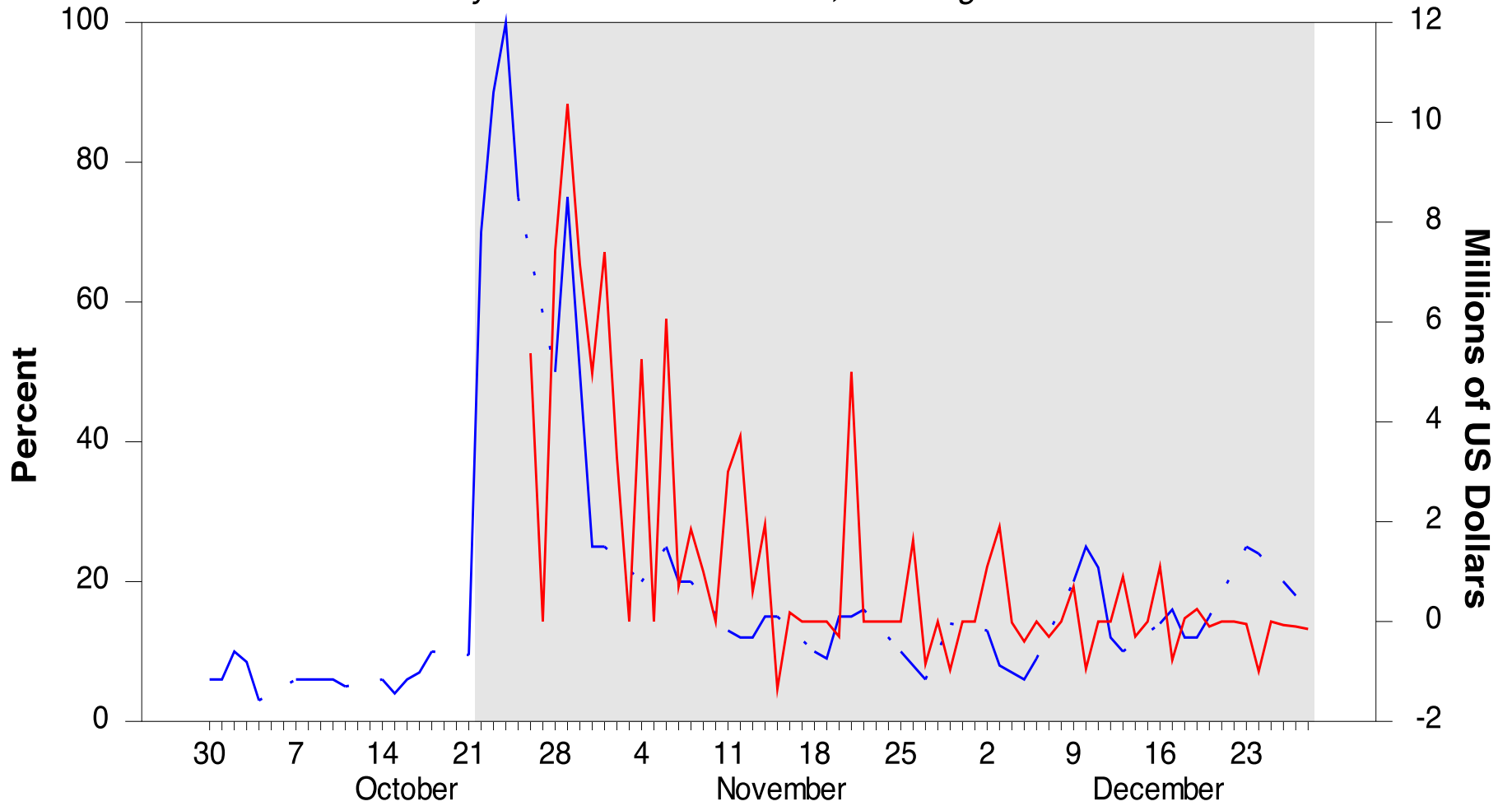
- ▶ Knickerbocker trust suspends on Tuesday, October 22.
- ▶ Runs on deposits spread to other New York Trusts
 - ▶ Trust Company of America, for example, October 23.
- ▶ Credit Tightens on the Stock Market, October 24.
 - ▶ Money pools formed by JP Morgan.
 - ▶ Call rate remains around 50%.

Suspension and Loan Certificates

- ▶ On October 26 The New York Clearing House Acts.
 - ▶ Authorizes issuance of clearing house loan certificates.
 - ▶ Announces suspension of convertibility of deposits.
 - ▶ Call rate falls, but not back to normal yet.
- ▶ *Unusual in that unlike in earlier panics, both actions are taken at the same time.*

Chart 3a: Call Loan Rate (Max) versus Change in CHLC Issues

Daily Observations in 1907; Shading for Panic



Source: New York Times, Clearing House Loan Committee Reports

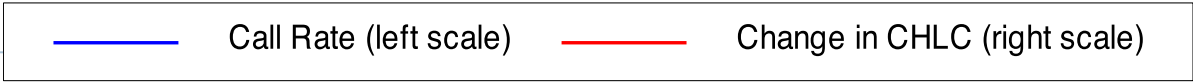
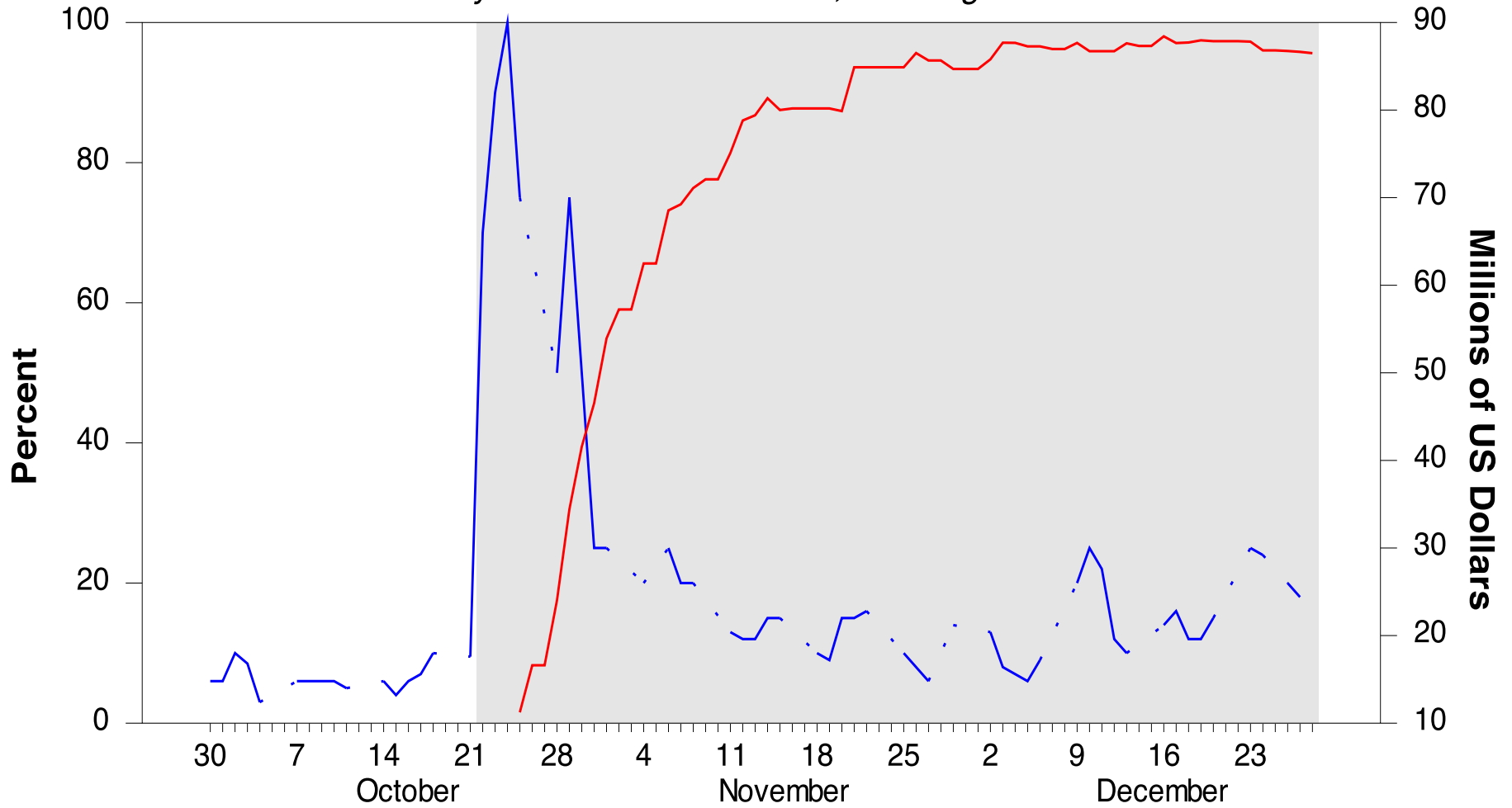


Chart 5a: Call Loan Rate (Max) versus NYCH Loan Certificates

Daily Observations in 1907; Shading for Panic



Source: New York Times, Clearing House Loan Committee Reports

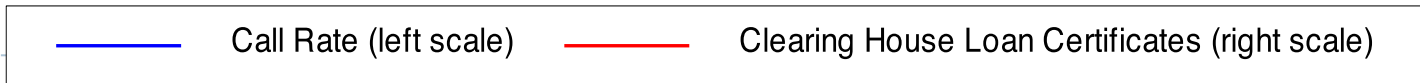
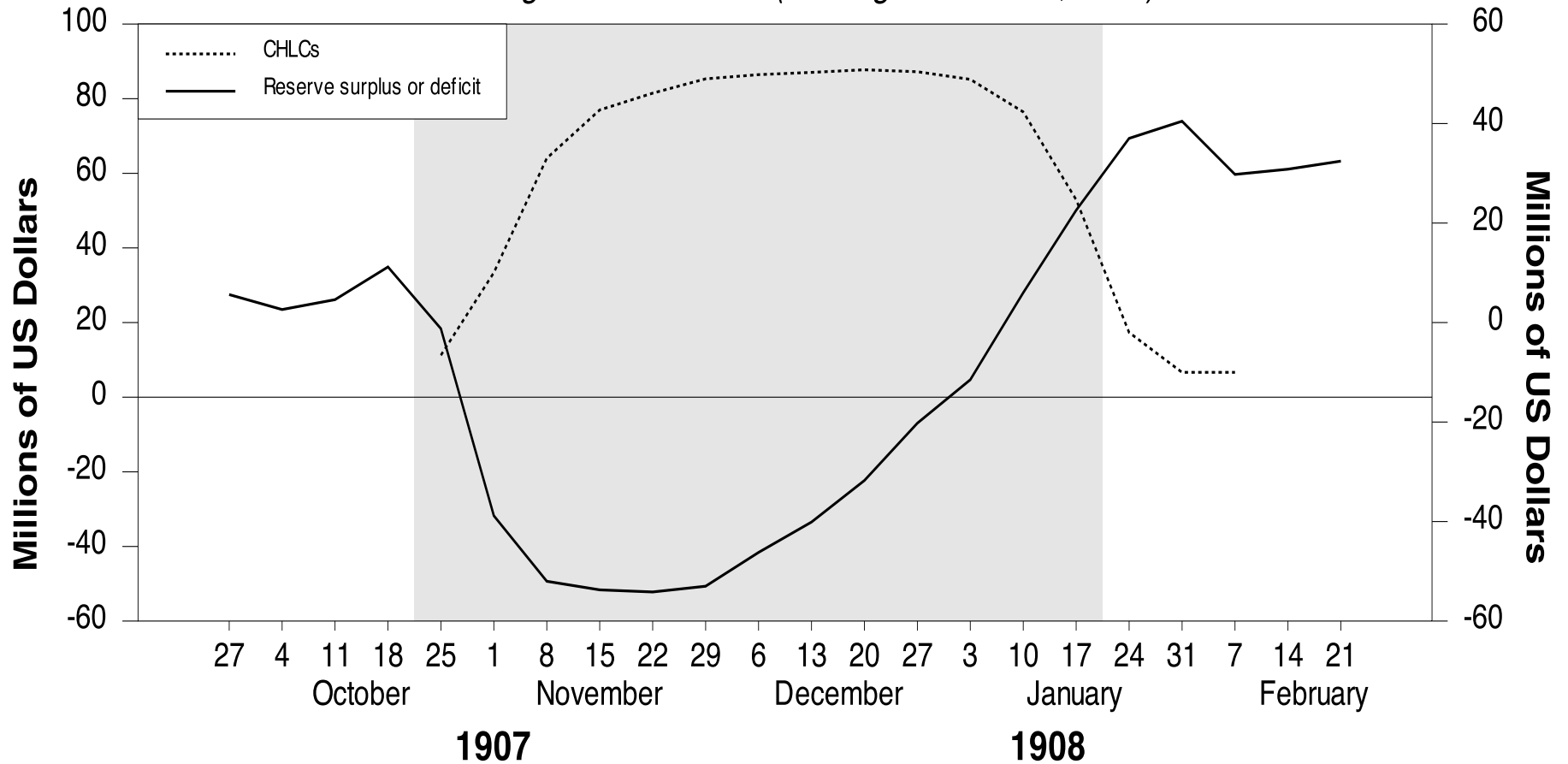


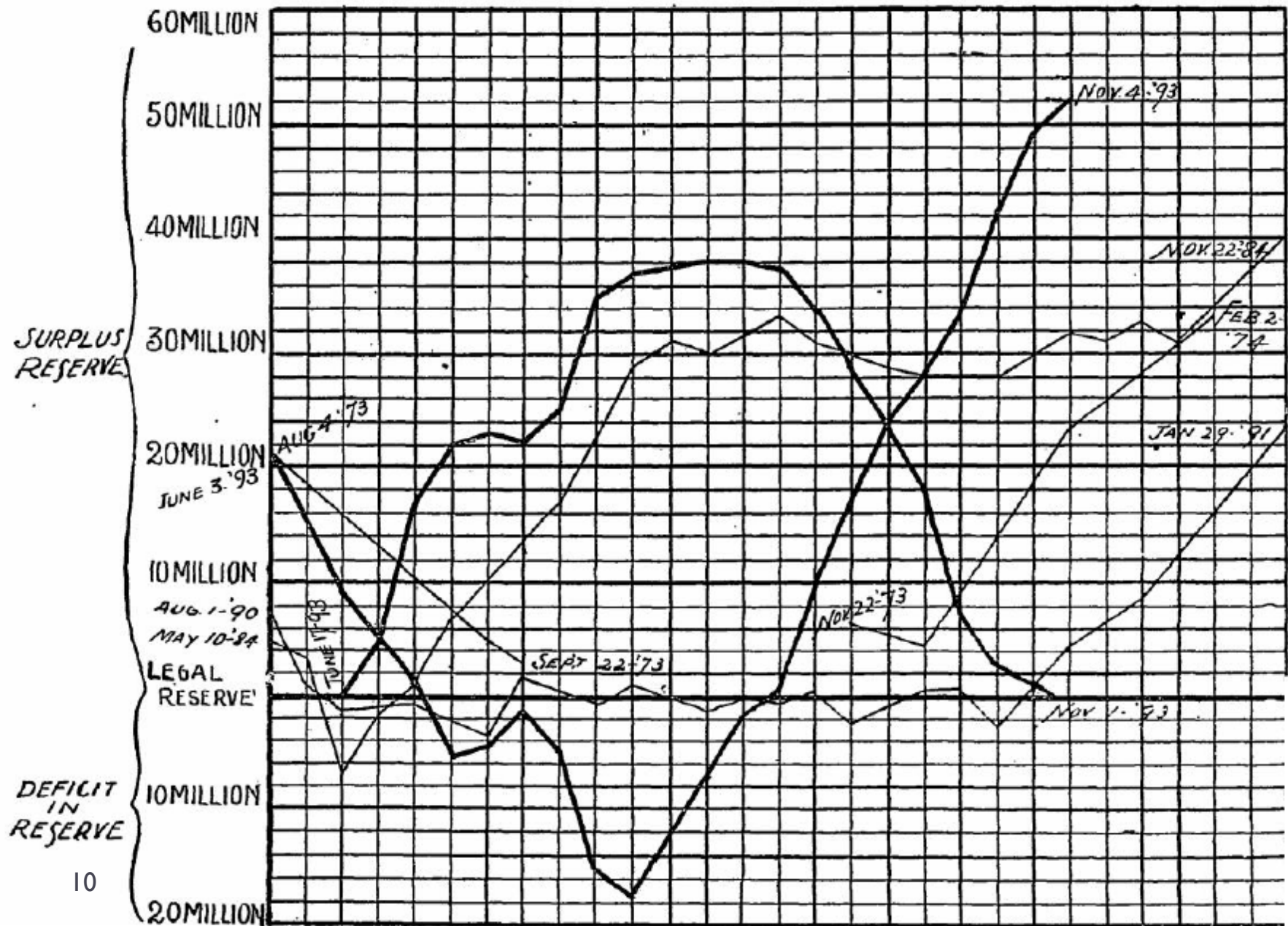
Chart 4: NYCH Bank Reserve Balance vs CHLCs

Shading indicates Panic (starting October 22, 1907)



Sources: Clearing House Loan Committee Reports and Kemmerer (1910)

BANK RESERVES AND CLEARING HOUSE LOAN CERTIFICATES.



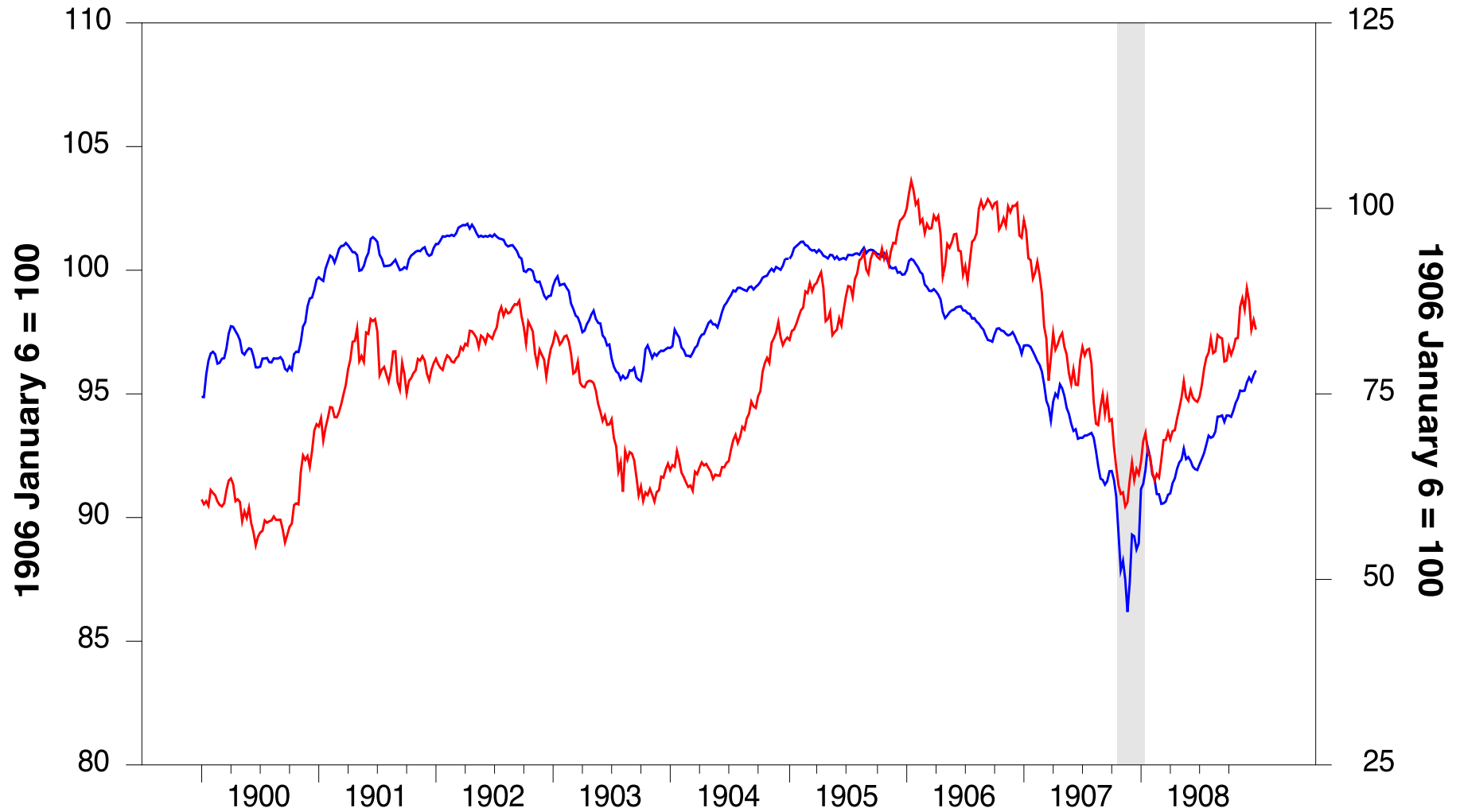
Currency Premium and Gold Flows

- ▶ The announcement of suspension raised the premium on cash over deposits in New York.
- ▶ Spurs gold imports according to Muhleman and Cannon, although Sprague (1910) and Wicker (2000) disagree.
- ▶ Spread panic overseas through exchange rates, outflows of gold to the US.

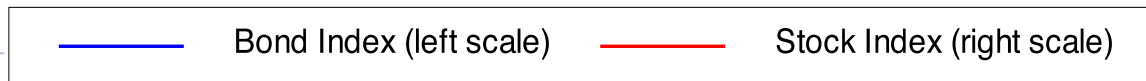
Stock and Bond Markets

- ▶ No immediately obvious reason why panic should have spread beyond the trusts.
- ▶ Stock market had been in a long decline throughout 1907.
 - ▶ “Rich Men’s Panic” in March.
- ▶ Bank of England, Earthquakes in 1906 had tightened credit.
- ▶ Correlation between stock and bond returns increases in mid-November.

Chart 8: Equal-Weight Bond Index versus Stock Index, 1900-1908



Source: Kemmerer (1910), Schwert (1990)



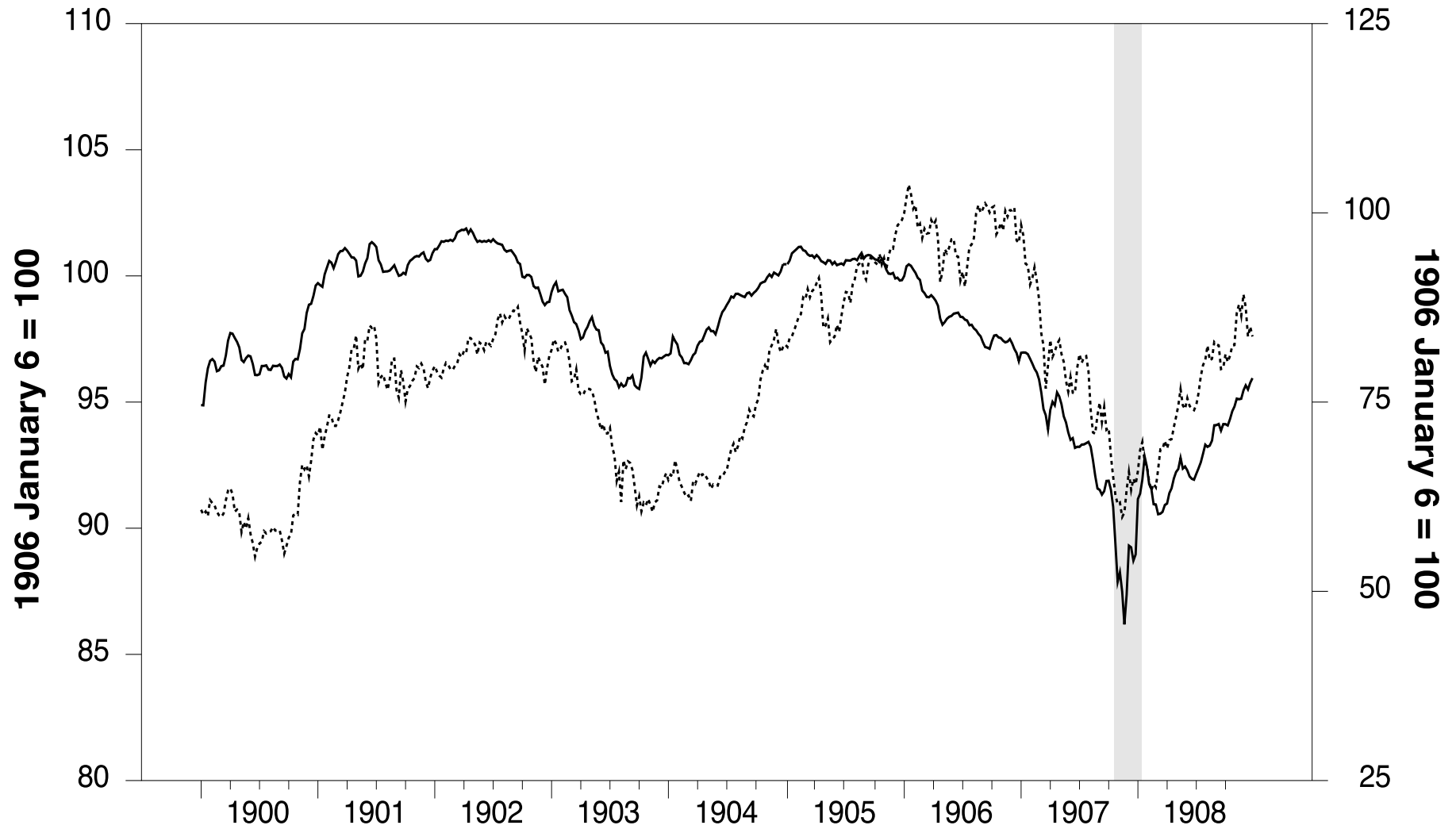
How 1907 Changed the Present

- ▶ More Aware of Intermediaries Removed from the Usual Sources of Liquidity.
- ▶ Role of different types of intermediaries operating in the same financial market.

How the Present Has Changed 1907

- ▶ Focusing on dramatic runs on deposits can be misleading.
- ▶ Disruptions to short-term lending important.
- ▶ Unintended links between financial markets.
- ▶ Alignment of private and collective interests.

Chart 8: Equal-Weight Bond Index versus Stock Index, 1900-1908

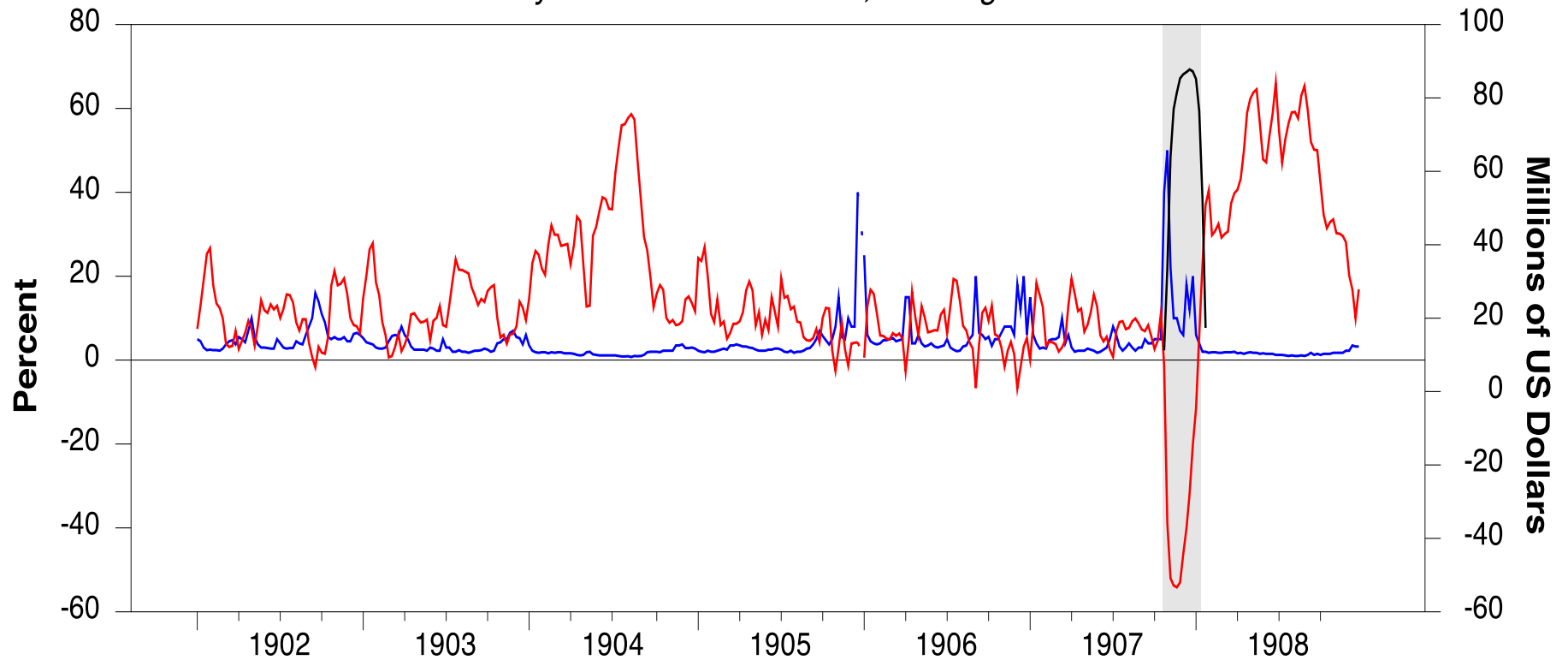


Source: Kemmerer (1910), Schwert (1990)



Chart 4c: Call Loan Rate, NYCH Aggregate Reserve Deficit, and CHLCs

Weekly Observations in 1907; Shading for Panic



Source: Kemmerer (1910), Clearing House Loan Committee Reports

