In July 1914, as it became clear that a European war was on the cards, London, the world’s foremost international financial centre, suffered an acute financial crisis. The financial markets froze, shares crashed and depositors were unable to access their funds for days. The London Stock Exchange shut and stayed shut for five months. It was feared that a run on the banks had begun, threatening the country’s payments and credit mechanisms – and all as Britain teetered on the verge of war and then plunged into the Armageddon.

Despite its unrivalled severity, the financial crisis of 1914 is virtually unknown. The reason is straightforward – it is simply absent not only from general texts but also from most of the specialist literature. Several journalistic accounts appeared in 1915, but ever since it has been overlooked – until now, the 100th anniversary.

Why? Well, presumably because the financial crisis was overshadowed by the diplomatic crisis and then the military conflict. The life and death struggle was more important and dramatic than the financial disintegration. Every political, social, cultural and economic dimension of life was in crisis in summer 1914: there was nothing especially notable about the financial sector being in trouble. Moreover, the crisis was effectively managed and, as it turned out, there was no headline-making casualty. There was no Barings or Lehman Brothers.

Nevertheless, it was the most severe systemic financial crisis that London has ever experienced. And not just London. Some 50 countries around the world had financial crises with runs on banks and stock market slumps. It was the most extensive and acute global financial crisis ever.

Breakdown

The countdown to war began with the assassination of Austrian Archduke Franz Ferdinand in Sarajevo on 28 June. The markets took the murder in their stride. After all, there had been Balkan crises in each of the previous three summers and all had been defused.

Market perceptions of the risk of war were transformed by Austria’s belligerent ultimatum to Serbia on the evening of Thursday 23 July. This was the ‘Minsky moment’ when greed turned to fear – collateral damage from the diplomatic crisis before a shot had been fired. There was an immediate international scramble for liquidity – meaning the dumping of assets and the withdrawal of credit. Continental bourses crashed and there were runs on savings banks.

In London, the foreign exchange and money markets broke down early in the week beginning Monday 27 July. Then on Friday 31 July, the London Stock Exchange, for the first time in its 117-year history, shut its doors. Displaced brokers and jobbers milled around in Throgmorton Street like “swarming ants around the destroyed heap”. (See main photo above)
the bank rate from 3% to 4% and then to 8%. The Governor also asked the Prime Minister and Chancellor to suspend the Bank Act, which would allow the Bank to print more notes to relieve the pressure for liquidity from banks and businesses. The political authorities’ condition, based on past precedent, was a 10% bank rate. This was duly implemented – the highest rate in the world. The Governor was furious with the joint-stock banks for pulling their call loans to City firms, contrary to his request, to boost their liquidity. The central bank retaliated by limiting lending to the banks. As Europe went to war, the City went to war with itself.

**Crisis Containment**

With the City at loggerheads and the banking system in danger, management of the crisis moved to the Treasury. Saturday 1 August saw the start of the summer holiday weekend. Monday’s bank holiday was extended by a further three days, providing a breathing space for the formulation of crisis management measures. In the middle of the unprecedented four-day public holiday, at 11 p.m. on Tuesday 4 August, Britain declared war. These were days of innumerable and interminable meetings in the City, with the Treasury making preparations for the reopening of the banks and money market on Friday 7 August. “These are exciting if interesting times,” wrote the Deputy Chairman of Lloyds Bank. “I never thought I should have so many Bank Holidays together or that there should be so much Bank about them and so little holiday! I have spent them from morning till late at night in meetings and conferences.”

The principal crisis containment measures, devised and introduced during the long bank holiday, were the issuance of Treasury currency notes and a ‘general moratorium’. The Treasury notes were small denomination notes that were paper substitutes for the sovereign (£1) and half sovereign (50p) gold coins. Bearing the signature of Sir John Bradbury, the Permanent Secretary, they became known popularly known as ‘Bradburys’. (See photos on pages 5 and 6)

The general moratorium was a legalised suspension of contracts aimed to protect debtors until commercial conditions calmed down, but also as a further safeguard for the banks against a run on deposits. Such a measure was unknown in Britain and newspapers offered guidance to bewildered readers. *Punch* magazine expressed the public puzzlement with a satirical array of vox pops suggestions as to the meaning of the word ‘moratorium’: “It’s a big ship…one of the Cunaders”; “Sister ship to the Lusitania”; “A place for burying people – a sort of big tomb where they put dead kings. There’s one at Windsor.”

In the run-up to the reopening of the banks on Friday 7 August, ministers vociferously denounced the hoarding of gold in speeches in the House of Commons. “In the run-up to the reopening of the banks on Friday 7 August, ministers vociferously denounced the hoarding of gold in speeches in the House of Commons. The press joined in with enthusiasm. ‘The Folly of Hoarding’ was the headline to a thundering editorial in *The Times*. “Everyone should understand the simple position. All the gold should be in the banks and available for the state as a whole,” exorted the *Evening News*. “In the same way as people are sending their sons to fight in case it should be necessary, so they should pay their gold into the banks, in case the state should require it.”

“The Duty of Every Good Britisher”. “Today when the £1 notes are ready at the banks it is the duty of every good Britisher to take all the sovereigns that he or any of his family possess to the nearest bank and change them for £5 or £1 notes,” stated the *Evening News*. “Do not let your friends alone to this, do it also yourself. It is a duty, a small one it is true, but in the aggregate the result will be helpful to the country, and your country must be your first care today. All the gold coin we possess is required for the use of our forces in the field and for the purchases required by the country abroad.” The campaign was successful; not only was there no run, but gold coin was paid into the banks in return for new Treasury notes.

The photo above shows the queue at the Bank of England of people seeking to change £5 notes for gold.
Suspension of the Bank Act, which prescribed a fixed ratio between the Bank of England’s gold reserves and the volume of notes in circulation, meant the suspension of sterling’s adherence to the gold standard, since it would not be possible to redeem the expanded note issue for gold. Suspension of the gold standard was urged by the banks to prevent internal and external drains of gold, but this was strongly opposed by Bradbury because it would undermine sterling’s position as the lynchpin of the international financial system, and since devaluation was likely, would harm Britain’s ability to borrow abroad should it become necessary (as it did). John Maynard Keynes, a young Cambridge don who was an unofficial helper to the Treasury team during the crisis, penned a vital memorandum that persuaded the Chancellor, David Lloyd George, against suspension of the gold standard. Keynes argued that as a huge creditor to the world, London would be the recipient of gold flows once the crisis abated, as proved the case. Prior to the crisis, the Bank’s gold reserve was £38 million. By December, it was a record £73 million. In the event, the suspension of the Bank Act was never implemented. Although Britain remained on the gold standard throughout the war, regulations made impossible in practice for private citizens to obtain gold.

The re-opening of the banks on Friday 7 July was anxiously awaited. It featured in a novel by H G Wells, Mr Britling Sees It Through: “When the public went to the banks for the new paper money, the banks tendered gold – apologetically. The supply of new notes was very insufficient, and there was plenty of gold.”

Revival

With the banking system secured, the authorities turned their attention to the revival of the City’s moribund financial markets and the removal of the emergency measures when it was safe to do so.

Revival efforts focused on the money market. The perceived problem was the £350 million of ‘derelict’ pre-war bills of exchange that were clogging banks’ balance sheets. Many were on account of foreign firms that would not remit funds at maturity. It was believed that this ‘incubus’, as Lloyd George put it, was preventing the creation of new bills and inhibiting the banks from lending to business.

On Wednesday 12 August, the Chancellor announced what he called the ‘Cold Storage Scheme’. By this ‘heroic intervention’, as a leading commentator put it, the Bank of England, under Treasury guarantee, offered to buy almost any pre-war bill. This would concentrate problem bills at the Bank of England and boost the liquidity of the banks. Banks rushed to offload bills. By early September, the Bank of England held £133 million of bills, almost 40% of the money market.

A key stimulus to the revival process was the beginning of usage by the state of the mechanisms of the City to finance the war. On 19 August, there was an auction of £15 million of Treasury bills. By the end of the year, there was £100 million outstanding and, in 1919, there was £1.2 billion outstanding. November 1914, while the Stock Exchange was still closed, saw the first War Loan bond issue. At £350 million, it was, Lloyd George proudly told the House of Commons, the world’s biggest ever fund-raising. However, due to various miscalculations, the issue was a fiasco, though this was kept from the public. Despite much arm-twisting of the banks, only £237 million of the loan was subscribed for, leaving a shortfall of £113 million – no less than £38 billion in today’s money. To disguise the failure, the Bank of England’s Chief Cashier and his deputy personally subscribed for the missing millions, being secretly provided with funds. It was, observed a senior official, “the Treasury’s blackest secret”.

The final normalisation step was the re-opening of the Stock Exchange. This eventually took place, with strict restrictions on dealings, on Monday 4 January 1915. The Great Financial Crisis was over.

Perspectives

Overall, the management of the financial crisis of 1914 has to be judged a success. The emergency measures “Saved the City”, as Lloyd George boasted in his memoirs. First, the measures forestalled the dreaded run on the banks and the potential collapse of the country’s payments and credit mechanisms. Second, they preserved the institutional structure of the City’s markets, both as regards functions and firms.

No major bank or financial firm failed in 1914. This was an important achievement since such failures can have serious contagion effects. It was the outcome of massive and unprecedented state intervention in the financial system. The City survived the crisis more or less intact, but its business was transformed from financing the global economy schemes. This was 9% of GDP. It was state intervention in the financial system on a hitherto unimaginable scale.

Remittance to London was facilitated by the opening of Bank of England gold depositories across the Empire. Depositors received a credit at the Bank that could be used to meet obligations in London. Over the autumn, the foreign exchanges returned to pre-war levels.

The general moratorium was scheduled to run for a month. But removing it proved problematic because fears of a run on the banks revived every time there was a reversal on the battlefield. It was judged that to remove it and then have to re-impose it would be economically chaotic. Hence, the moratorium was twice extended. It was eventually lifted, without incident, on 4 November.
The bank support schemes of 1914 injected The Bank of England’s Funding for Lending Both crises featured bank illiquidity, systemic Major international financial crises are uncommon events. 1914 saw one. So did 2007/08 and we are still living with the fallout. The causes of the two crises were plainly very different, but there are echoes in their unfolding and management by the authorities. Both crises featured bank illiquidity, systemic illiquidity and a credit crunch. And both crises saw measures to address these problems. The objective of the Bank of England’s Special Liquidity Scheme of 2008 was to improve the liquidity of the banking system. It aimed to do so by helping banks to finance illiquid ‘troubled assets’ on their balance sheets, notably their investments in mortgage-based securities. It was the same purpose as Lloyd George’s Cold Storage Scheme of 1914, which aimed to remove the ‘derelict’ bills from their balance sheets. The Bank of England’s Funding for Lending Scheme was introduced in 2012 to incentivise banks to boost their lending to the real economy by providing them with funding. It has a distinct resemblance in purpose to 1914’s ‘Expanded Scheme’, which provided loans to specialist banks to help them resume their role in credit provision. Such parallels illustrate the relevance of past precedents for current policymakers. The bank support schemes of 1914 injected substantial liquidity into the banking system. The Treasury’s intention was that the funds would help the banks to resume lending to business. But instead, the banks placed much of the funds on deposit with the Bank of England for safe-keeping. Between August and December, bankers’ deposits at the Bank of England more than trebled from £30 million to £105 million. This was not the outcome that the Chancellor expected from the array of measures that had been taken to support the banks. He was infuriated by the complaints he received from business about the banks’ refusals to lend and gave the bankers’ leaders a sharp dressing down at the Treasury. He even hinted at state control if they did not fulfil their side of the bargain. Reporting on the meeting to the Commons, he stated that: “I think we have done for the banks as much as ever they could have expected of us. We did not do it in order to strengthen their position or to increase the dividends. We did it in order to enable them to finance the trade of the country during a difficult period. If the government is prepared to take risks, they must take risks as well...” They were sentiments that might well have been expressed by Alastair Darling or Mervyn King, Indeed, the Governor told the Treasury Committee that the support provided by the Bank of England was designed “not to protect the banks, but to protect the economy from the banks”.

City economist Brian Reading has observed that the 1914 Treasury currency notes “smack of Quantitative Easing”. Both measures provided additional liquidity to the financial system. Later in the war, the Treasury notes significantly boosted inflation. Many predict a similar eventual outturn to QE. But, of course, there are notable differences. One is the post-crisis economic recession that typically follows a banking crisis. There was no such recession in 1914 – there was the Great War.