

Causes of bank distress during the Austro-Hungarian “Gründerkrach”

(working title)

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Abstract

Following in the footsteps of Gorton and Metrick (2012), recent contributions to the field of financial economics have concentrated on explaining the advent of borrower demise in the repo (repurchase agreements) market. Inspired by the failure of Lehman Brothers, a US investment bank which was forced to suspend payments and face bankruptcy when its short-term repo funding suddenly dried up in autumn 2008, economists have attempted to pin down necessary and/or sufficient conditions for repo runs to occur (c.f. inter alia Acharya et al. (2011), Gorton and Ordoñez (2014), Martin et al. (2014)). Less attention has been paid to both, possible causes of financial distress on the lending side of repo markets, and policy responses to repo crises (see, however, Acharya and Öncü (2011), Oehmke (2014) and Antinolfi et al. (2015) for work pointing in this direction). The present paper partly addresses these questions from a historical perspective by focusing on the Austro-Hungarian “Gründerkrach” of 1873, an episode of financial turmoil which entailed both a severe stock market crash and a fully-blown banking crisis. Contemporary sources on the “Gründerkrach” accord a decisive role in establishing the link between stock market crash and banking sector distress to an early version of repo loans, which credit institutions granted to each other and in particular to stock-market agents. Building on these historical accounts and bringing to bear a large array of new data, the main goal of the present study is to provide a theoretically and empirically grounded explanation for the wave of bank failures in the months following Black Friday on May 9th 1873. For this purpose, the study will situate repos in the wider context of banks’ business models during the stock market boom leading up to the crisis of 1873 to examine the impact these loan contracts had on lenders’ demise. The merely anecdotal and mostly qualitative accounts in the earlier literature on the “Gründerkrach” banking crisis turn this investigation into a primer.

Literature (abstract)

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