Stewart Investors
St Andrews Partners

1825

The panic of 1825

History is full of bubbles, booms and busts, corporate collapses and crises, which illuminate the present financial world.

At Stewart Investors we believe that an appreciation of financial history can make us more effective investors today.

The financial panic of 1825 has been described as the 'first modern financial crisis.'[2] It resulted in a major banking crash across Britain, economic recession and multiple bank failures, with ripples reaching as far away as Latin America. There were many associated bankruptcies, including the world's best-selling novelist.

> The country was… within twenty-four hours of a state of barter.

War & Peace

Britain was at war with France for most of the years from 1793 until 1815, a long period of conflict which required a huge increase in government spending. This was funded by debt and new taxes, such as income tax.

Some areas of the economy grew strongly during the war, particularly the coal, iron and lead industries, as well as production of items such as beer, candles and glass.[3] The period following the peace in 1815, however, was deflationary with lower government spending and renewed European competition, resulting in falling prices, profits and wages.[4]

1820s boom

The economy rebounded in the early 1820s as good harvests caused food prices to fall, boosting consumption and investment. Exports to new markets in Latin America expanded and investment surged in domestic infrastructure projects, such as gas lighting and steam shipping, and other businesses, including brewing, distilling, paper and textiles.[5]

Escalating risk

Significant monetary and credit expansion occurred between 1822 and early 1825,[6] with the smaller country banks very active outside London.[7] Much of the lending found its way into stock market speculation. Some of the country banks were poorly capitalised and not able to diversify risk, because of the prohibition on joint-stock banking outside London, which limited ownership to six partners, making them particularly vulnerable to shocks.[8]

Bubble

The stock market entered bubble territory in 1825, propelled by a surge in new company flotations. A contemporary stockbroker listed 624 companies floated on the London stock market in 1824 and 1825.[9] These were spread across a variety of industries, indicating the 'hot' sectors of the time, including insurance, ports, railways, roads, shipping and gas lighting, all associated with the industrialisation of Britain in the early 19th century, as well as South American mining schemes and Latin American government bonds.

As the boom proceeded, the quality of investments declined, as is usually the case. One company stated its aim was to drain the Red Sea to recover treasure left by the Ancient Egyptians after it was parted by Moses![10] Quality hit rock-bottom in a scam launched by fraudster Gregor MacGregor based on investment in a fictional Central American country called Poyais, perhaps the ultimate swindle in financial history.[11]

1825 collapse

The inevitable crash came in 1825 when a poor harvest resulted in a huge increase in food imports, draining liquidity from the financial system. Share prices plummeted; they would fall by almost 70% between January 1825 and September 1826.[12] 80% of the 624 new joint-stock companies listed in the years 1824-25, no longer existed by 1827.[13]

The Bank of England contributed to the crisis, tightening monetary conditions early in the year before loosening them. At the time, the Bank was not a 'central bank' in the modern sense with a remit to act as lender of last resort, but a listed company pursuing its own financial interests, although its banknotes were legally privileged.[14] The Bank itself began to run low on reserves and had to rely on gold shipped across the English Channel from the Banque de France, an early example of international financial cooperation.

Monetary tightening had an immediate impact on the country banks. By September 1825, banks in Cornwall and Devon were in difficulties, and by December there were failures: Wentworth, Chaloner & Rishworth in York and Pole, Thornton & Co in London, which caused runs on other country banks. Ultimately 73 out of 770 banks in England and 3 out of 36 in Scotland failed during the panic.[15] The economy crashed in 1826.

The credit crunch was a very severe one. Walter Bagehot described the panic as: 'a period of frantic and almost inconceivable violence; scarcely anyone knew whom to trust; credit was almost suspended; the country was... within twenty-four hours of a state of barter'.[16] The problems spread overseas, precipitating sovereign debt defaults across the new republics of Latin America.

A famous casualty – Walter Scott
Many businesses went bust in 1826, but the most famous casualty was best-selling historical novelist Sir Walter Scott, then at the peak of his fame. As part-owner of the Ballantyne publishing business, he faced debts of more than £120,000 when the business collapsed. Unprotected by limited liability, he refused a bail-out offer from the Duke of Buccleuch, and tried, literally, to write himself out of debt, by selling his books.

Between 1826 and his death, Scott completed six novels and eleven works of non-fiction, including a 9-volume Life of Napoleon. It was a rare example of a financial panic resulting in the creation of literature, although novels such as Woodstock (1826) and The Surgeon's Daughter (1827), written during these years, are not regarded as Scott's best work.

Lessons for investors

The panic of 1825 was an early example of a global financial crisis which radiated out from London to impact markets around the world. It indicated the high degree of integration of the global economy by the early 19th century.

The panic highlights the risk of investing in banks, as financial contagion impacts the whole banking system, with potentially huge losses for shareholders in any bank. As a result, we are cautious about having any exposure to banks in our portfolios.

We believe that banks are fundamentally risky investments. In order for us to invest in one, we must have confidence in the quality of stewardship and integrity of the management team.

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1 Bagehot, Lombard Street, 155-158.

2 Alexander J. Dick, On the Financial Crisis, 1825-26. (2012)

3 R. C. Michie, Money, Mania and Markets, 18.

4 Michie, 20.

5 Michie, 34.

6 George Pickering, The role of the Bank of England note issues amongst the causes of the Panic of 1825, 2. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208923, 15.

7 Larry Neal, The Financial Crisis of 1825 and the Restructuring of the British Financial System, Federal Reserve Bank of St Louis, 61.

8 Michael D. Bordo, Federal Reserve Bank of St Louis Review https://files.stlouisfed.org/files/htdocs/publications/review/98/05/9805mb.pdf, 78.

9 Neal, 64.

10 Pickering, 23.

11 https://www.stewartinvestors.com/en-gb/education/lessons-from-the-past-the-gregor-macgregor-scam/

12 Pickering, 2.

13 Pickering, 10.

14 Pickering, 4.

15 Charles P. Kindleberger, Manias, Panics and Crashes, 83.

16 Bagehot, Lombard Street, 155-158, quoted in Pickering, 6.

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