

## TEMPOS DIFÍCEIS: reações às crises de 1857 e 1864 no Brasil

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As duas primeiras décadas da segunda metade do século XIX se caracterizaram por grandes mudanças institucionais no terreno das políticas monetária e bancária no Brasil. Por trás destas mudanças, duas crises de vulto: uma, de origem internacional, alcançou o país em novembro de 1857; a segunda, em 1864, teve caráter doméstico e conseqüências mais graves. O artigo compara as reações a ambos os episódios e conclui que houve um processo de aprendizado que, ao final, permitiu que a resposta à crise de 1864 tenha sido mais consistente do que a que se tentou em 1857.

### 1 - Introduction

The so-called apogee of the Brazilian Empire, between 1850 and 1870, witnessed tremendous change in the conduct of monetary and banking policy. Behind these changes were two opposing forces: on the demand side, resources unleashed by the end on the trans-Atlantic slave trade sought alternative investment opportunities, while from the supply side, the government attempted to check monetary expansion, in an effort to ensure Brazil's adherence to the gold standard. The history of crisis and institutional change in the monetary and banking spheres can be explained partly by these two conflicting forces.

The article will contrast the reactions to the two major financial crises to hit the Brazilian Empire at the time: the 1857 crisis and the Souto crisis of 1864. It will be shown that failure to agree on the necessary measures prevented the government and the Bank of Brazil from addressing the consequences of the international crisis which hit the country in November 1857. By contrast, the reaction to the Souto crisis proved much more successful, as both Bank and government appeared to have learned from past mistakes, and undertook adequate counter-cyclical measures to restore calm to the market.

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## 2 - The 1857 and 1864 Crises: antecedents and developments

### 2.1 - The 1857 Crisis

In the early 1850s the banking system in Brazil consisted of a host of institutions dedicated mostly to bill discounting. These institutions were responsible, thus, for providing short-term capital to commercial activities, prominent among which were the coffee and sugar trade. When discounting bills of exchange, private banks (*casas bancárias*) made use of *vales*, or short-term promissory notes. The same instrument was preferred by the few joint-stock banks then in existence. Deeming the unchecked issue of *vales* incompatible with macroeconomic stability, the government decided to charter a semi-official note-issuing bank in 1853, the Bank of Brazil. This bank came into being as a result of the amalgamation of two existing *vale*-issuing banks, the Mauá-owned Bank of Brazil and the Banco Comercial do Rio de Janeiro. Amongst the responsibilities of the new institution were the yearly withdrawal of 2,000 *contos*' worth of Treasury notes from circulation, which would comprise an interest-free loan to the government. Moreover, the Bank was expected to help the latter in maintaining the exchange rate at close to its gold parity of 27 pence to the *milréis*. To that end, notes issued by the Bank of Brazil were to be redeemed by gold or government paper, at the Bank's discretion. Furthermore, total issues were limited to twice the amount of gold and Treasury notes held in its reserve fund. In short, by granting a monopoly of issue of convertible notes to the Bank of Brazil, the government sought to ensure macroeconomic stability, while meeting growing demands for monetary growth.

In mid-1857, as the coffee sector started to experience a shortage of labour, wages and the price level also increased, leading to demands for an expansion of the money supply.<sup>2</sup> The accompanying requests for authorisation to incorporate new banks of issue were met with sympathetic ears by Minister of Finance Bernardo de Souza Franco. From late August Souza Franco gave permission for the establishment of six new banks of issue (out of a total of 50 requests), thus breaking the monopoly hitherto held by the Bank of Brazil. The rules governing the issue of notes were similar for all six banks, and broadly in line with those that applied to the Bank of Brazil. They could issue notes to bearer, redeemable on sight in gold or Treasury

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<sup>2</sup> *Relatório do Ministério da Fazenda* 1858, p. 4. Hereafter, *RMF*.

notes, to an amount equal to their respective paid-in capital. Notes were to be backed by consolidated government debt (*apólices*), and shares of railways and other companies benefiting from government profit guarantees.

Crucially, creation of the new banks of issue was not done by means of a law, as had been the case in 1853 with the third Bank of Brazil. Instead, it was an act of the Executive, taken during the parliamentary recess. In doing so, Souza Franco was moving into a legal “grey area”. In fact, banking legislation fell into the broader rules governing incorporation, as laid down in the 1850 Commercial Code. Article 295 of the said legislation determined that corporations could only start operations after obtaining authorisation from the government and, when these operations entailed a special privilege, pending legislative approval.<sup>3</sup> Clearly, the issue of banknotes was a privilege and recognised as such when the Bank of Brazil was incorporated. Moreover, Art. 15, para 17, of the imperial Constitution delegated to the General Assembly the task of ‘determining the weight, value, inscription, type and denomination of coins (...)’.<sup>4</sup> This further suggested the need for legislative sanction when allowing banks of issue to be established. None of this deterred Souza Franco from his objective of meeting, even if only partially, the demands for an expansion of the volume of credit.

Be that as it may, misfortune had it that the bold policy shift promoted by Souza Franco coincided with a major crisis at the international level. It was triggered by the dramatic drop in some commodity prices, following bumper cereal and wool production in the United States and Eastern Europe, after the end of the Crimean War. The failure of the Ohio Life Insurance and Trust Company, in August 1857, led to a panic in the American market, requiring the shipment of gold from Britain. In order to stem the drain on its reserves and ensure the functioning of the gold standard, the Bank of England increased its discount rate to 10%, causing a re-diversion of capital to London, and the spread of panic to continental markets. News of the crisis in the United States arrived in Rio on 13 November, soon followed by packets from Europe bringing

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<sup>3</sup> Law 556, 25 July 1850.

<sup>4</sup> See *Constituições do Brasil*, p. 19.

accounts of interest rate rises in London.<sup>5</sup> This came barely three months after the first of the governmental decrees was promulgated and, it must be stressed, before any of the new banks started issuing notes.<sup>6</sup> Foreign trade was badly hurt in Rio and in some of the major ports in the provinces, as creditors in Hamburg demanded immediate settlement of commercial debts. At the same time, the practice of purchasing goods on consignment was suspended, as orders placed in Europe were required to be accompanied by the corresponding payments in hard currency.<sup>7</sup> Business in Rio came to a virtual standstill.

**Table 1**  
**Bank of Brazil, Head Office: selected indicators, June 1857-June 1858**  
(in *contos*)

Month/Year	<i>Fundo Disponível</i>	Notes in Circulation	Value of Portfolio
June 1857	13,125.7	32,804.9	40,193.7
July	13,049.8	33,366.8	38,895.4
August	13,467.1	32,983.5	38,404.6
September	12,872.1	29,312.9	39,009.9
October	12,848.2	30,208.4	41,426.4
November	11,322.7	30,522.3	46,424.5
December	10,859.3	33,175.0	51,836.6
January 1858	11,105.8	31,084.8	49,538.5
February	10,994.1	28,858.1	47,668.3
March	9,978.8	27,131.6	46,210.5
April	8,877.3	24,545.9	43,843.4
May	8,829.6	23,418.4	42,965.2
June	8,753.0	25,607.0	45,780.0

Source: Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas pelo Presidente do Banco*, 1857 and 1858.

At first, the Bank of Brazil suffered a run for redemption of its notes in gold. The Bank obliged, in an attempt to calm the market. Yet, it was aware of the limits to

<sup>5</sup> For details, see *Relatorio da Comissão de Inquérito Nomeada por Aviso do Ministério da Fazenda, de 10 de Outubro de 1859*, undated.

<sup>6</sup> There is the possibility, of course, that the simple news of the imminence of new banks entering the market could have provoked a run for sterling and corresponding depreciation of the *milréis*, even before the banks actually started their operations. Nevertheless, quotations in the Rio Bolsa show a stable *milréis*, at above par, until early December, when news of the crisis finally reached the city and provoked a run for sterling. Exchange-rate quotations are in Junta de Corretores de Fundos Públicos da Cidade do Rio de Janeiro, “Livro de Registro Oficial de Cotações de Títulos e Valores”, various issues, Arquivo Nacional, P8 13203.

<sup>7</sup> See M. B. Levy and A. M. R. de Andrade, “El Sector Financiero y El Desarrollo Bancario en Río de Janeiro (1850-1888)”, in C. Marichal and P. Tedde (eds.) *La Economía Financiera y la Formación de la Banca Central en España y Latinoamérica*. Madrid, Banco de España, 1993.

its efforts. The difficult balancing act that it was forced to perform was clearly perceived by its directors. At the same time that the Bank had an interest in (and felt a duty to) meeting demands from the market, on the other it had to maintain the level of its reserves. As tension increased, businesses brought an increasing amount of bills to be discounted at the Bank. From an average of 42,000 *contos* in September-November, the Bank's portfolio increased to just under 52,000 *contos* in December.<sup>8</sup>

In his 1858 report, the president of the Bank of Brazil stated that in late December 1857-early January 1858 the Bank was following what became known as "Bagehot's rule" in the case of financial distress. This meant lending liberally - and dearly. Its (inter-bank) rates of discount were increased from 8% to 10% on 15 December, and to 11% on the 23<sup>rd</sup>. For other businesses, the rates, when discounts were available, were as high as 15%.

As the drain on its reserve fund continued, the Bank felt that its potential note issues - and, hence, the volume of discounts it was able to carry out - was being compromised. As a result, on 27 November the Bank unilaterally decided to suspend convertibility of its notes into gold. Shortly afterwards, the government let it be known that it was willing to help the Bank reinforce its reserve fund by means of a guarantee on a loan of the equivalent of 3,000 *contos* (£340,000), to be arranged in London.<sup>9</sup> On 1 December, the first of a series of memoranda was exchanged between Bank and government. The Bank indicated that 3,000 *contos* were insufficient to restore calm to the market, and that until it could gauge the actual extent of demand for bills of exchange, some £600,000 would be needed. The second Bank memorandum, in turn, called attention to the extent of the drain in its reserve fund and the effect this was having on its ability to pursue regular discounting activities. The Bank then asked the government to be allowed to increase the limit of its note issue from three to four times the reserve. Three days later the government replied in the affirmative to these requests, although the wording of its two memoranda was vague. Briefly, the government stated that it was conscious of the need to maintain both

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<sup>8</sup> This increase should not be considered a seasonal phenomenon, as in previous years there had been little change in the Bank's portfolio at the end of the year.

<sup>9</sup> These 3,000 *contos* represented the amount of Treasury notes that the Bank had already withdrawn from circulation, and which, according to Article 60 of its statutes, served as a ceiling to the guarantees that the government could provide on such occasions.

internal (i.e., discounts) and external (exchange rate) stability and would do its utmost to help the Bank. Nevertheless, Souza Franco did not commit himself to a specific amount for the guarantees.<sup>10</sup> Soon afterwards, an operation to prop up the rate of exchange began.

The strategy consisted of selling drafts on London (guaranteed by the Treasury) at a relatively appreciated rate of exchange. The first draft, totalling £100,000, was made on the Union Bank of London, on account of a credit which that bank had offered to the Bank of Brazil earlier in the year. One month into the operation, the exchange rate continued to fall. Since the arrival of news of the panic overseas, the *milréis* had dropped by about 15%, being quoted at 23½d and 24d on 31 December. On 9 January, Souza Franco sent a new memorandum to José Pedro Dias de Carvalho, acting president of the Bank, enquiring about his plans to sustain the rate of exchange. On the same day, Dias de Carvalho replied that the Bank was willing to continue selling drafts on London, so long as the government would furnish it with the necessary Treasury notes to compensate for the loss of gold from its reserve fund. The government obliged, putting 1,000 *contos* at the disposal of the Bank, which went on to sell £200,000 worth of drafts in the market, at the rate of 25d. With this operation the government sought to force the rate of exchange up by increasing the supply of sterling.

By late January 1858, when the packets brought news of a worsening of the crisis in Europe, the Bank found difficulty in finding bills of exchange locally for purchase. This ultimately forced it to dip into its own reserves, leading to further losses of gold. In light of this, and in an effort to safeguard the fund, it once again took unilateral action. This time by deciding to shift its efforts from defence of the rate of exchange to concentrating on providing discount facilities to the domestic market. In a reversal of the previous trend, its discount rate for the best private paper was lowered from 11% to 10% on 27 January, and then to 9% on 10 February.

Meanwhile, the decline in the value of the *milréis* would persist - the exchange rate reached 22¾ on 4 March 1858. On 10 March, as the deadline for the handing-in of the semi-annual instalment of 1,000 *contos* in Treasury notes to the Caixa de

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<sup>10</sup> See “Reserved Memorandum” from Souza Franco to José Pedro Dias de Carvalho (acting president of the Bank of Brazil), 4 December 1857, in *RMF* 1857, Annex, p. 6.

Amortização drew near, the directors of the Bank decided to bring 700 *contos* from the offices in Bahia and Pernambuco to reinforce the reserve fund at the head office. Two days later, the Bank again turned to the government, calling its attention to the problems caused by the export of the silver coins still in circulation, and used as small change. The Bank believed this could only be stopped if additional efforts were employed to force up the rate of exchange. It would be willing to draw on London at the rate of 25d, provided that the Treasury gave the usual guarantees and exempted the Bank from any obligation concerning a timetable for the shipment of bills to London.

Souza Franco's reply came on the same day, 12 March. He made it clear that he found the Bank's proposal too vague, for no specific figure was attached to the amount of guarantees sought from the government. Moreover, and as a sign that he was losing patience with what he perceived as foot-dragging on the part of the Bank, Souza Franco affirmed that the government had decided to undertake the defence of the rate of exchange directly through the Treasury, without the Bank's help. Nevertheless, Souza Franco kept the door open. He was willing to extend the same guarantees as before should the Bank publicly announce that it would be drawing up to £400,000 at a rate not lower than 25½ by the March packet and up to £200,000 (at a rate of at least 26d) by the April packet. The Minister demanded a prompt reply from the Bank to what turned out to be his last offer.<sup>11</sup>

According to the *Relatório da Fazenda* of 1857 the Bank of Brazil refused this last offer from the government, dated 12 March. As a result, the Minister of Finance immediately turned elsewhere for help.<sup>12</sup> At 2:00 p.m., soon after the messenger arrived at Souza Franco's office with news of the Bank's position, the Minister had Mauá summoned.<sup>13</sup> On the very same day, the Barão, through the Mauá, MacGregor Bank, announced he would be selling 90-day bills of exchange at the rate of 25½d on the packet boat about to depart, a rate which was followed by other institutions. The total planned amount put at the service of his scheme to prop up the exchange rate would be as follows: £400,000 in March, £200,000 in April, £150,000 in May and, finally, £60,000 in June. This declining scale of drafts attests to Mauá's confidence in

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<sup>11</sup> Ibid, p. 12.

<sup>12</sup> Ibid., p. 9.

<sup>13</sup> See J. Caldeira, *Mauá: empresário do Império* (Rio de Janeiro, Cia. das Letras, 1995), p. 338.

the success of measures to re-establish the value of the *milréis*. In practice, Mauá would sell bills of exchange from the Brazilian office of his bank, drawn on its London branch, and guaranteed (up to £750,000) by the Treasury's reserves in that city. After being bought in Rio, the bills still had to be shipped to London, to be presented in 90 days. The bills would then be paid for in London with the Treasury's money and then sent back to Brazil, where the final settlement between the Mauá Bank and the Treasury would occur. In all, the process would take some 150 days.<sup>14</sup>

Fundamentally, the Barão was placing a bet against the market, by selling large amounts of the commodity perceived as most valuable at the time (sterling), in exchange for the discredited domestic currency. His reasoning for embarking on such an operation was as follows. The extent of the devaluation of the *milréis* since the outbreak of the commercial crisis, he estimated, was not warranted by any indicator of the "fundamentals" of the Brazilian economy, to use a modern term. The balance of payments was momentarily in deficit, largely as a result of a drop in the international demand for commodities exported by Brazil, specially coffee, the price of which, however, was hardly affected. Mauá thought he knew by what amount the balance of payments was in the red and, also, what the supply of bills of exchange would be in the near future. If his estimates were right, there was room for (in this case stabilising) speculation on his part. Also, given the existence of a mass of other speculators ready to bet against him (and ultimately the domestic currency), the opportunity to make a fortune - and prove them wrong in the process - was all too real.

In June 1858, as the time to settle accounts with the Treasury drew near, the players would finally have to show their hands. Winners and losers would soon be known. In England, business had returned to normal, and interest rates were lowered to 2.5%. In the meantime, the Brazilian market was about to become awash with sterling, as the government finalised details in London of a loan of approximately £1.4 million, directed towards the nationalisation and extension of the D. Pedro II railway. When news of this deal reached Rio, in June, the rate of exchange - which had been quoted at 25½ since the beginning of Mauá's rescue operation in mid-March - rose to 27d (18 June), only to fall back to 25½d five days later. The pressure for appreciation of the currency, however, had made itself felt. In early July the government withdrew

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<sup>14</sup> Ibid., p. 346.



its guarantees on the drafts on London. Meanwhile, holders of bills of exchange became increasingly nervous at the prospect of having to sell sterling at a lower price than they had paid earlier, in order to meet pressing expenses in local currency. As August approached, so did the peak period in coffee shipments from the interior in Rio.<sup>15</sup> Accordingly, demand for the hitherto shunned *milréis* increased, adding pressure for the appreciation of the exchange rate, and allowing Mauá to settle his debts with the Treasury, with considerable gain for his bank.

In mid-August, judging that the worst was over, the government demanded that the Bank of Brazil resume the exchange of its notes for gold, on demand. On 25 August, convertibility was restored at the Bank of Brazil and the rate of exchange reached near par, at 265/8d. The crisis was officially over, but it would leave a lasting legacy on both policy and debate on monetary matters in Brazil. There were 90 bankruptcies across the country and in Rio alone losses amounted to 20,000 *contos* (£1.7 million).

## **2.2 - The 1864 Crisis**

One of the major consequences of the 1857 crisis was the strengthening of the position of opponents of Souza Franco's liberal views on money and banking. Led by Minister Ângelo Muniz da Silva Ferraz, advocates of monetary orthodoxy succeeded in approving the infamous Law of Impediments (Law 1083 of 22 August 1860) and Decree 2685, of 10 November 1860. In an effort to prevent what was deemed irresponsible monetary growth, both pieces of legislation imposed controls on the expansion of issues of unbacked banknotes. Essentially, the existing banks of issue were given a timetable to restore convertibility, under penalty of being forced to contract their outstanding issues. As a result, the Bank of Brazil agreed to take over the issuing rights of its two competitors in Rio, the Rural & Hipotecário and the Comercial & Agrícola.

Despite the Bank's efforts to meet the demands of the market for credit, in September 1862 the city of Rio experienced a dress rehearsal of what would later turn

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<sup>15</sup> Coffee shipments to Rio occurred throughout the year, but peaked between August and November. See J. Sweigart, *Coffee Factorage and the Emergence of a Brazilian Capital Market, 1850-1888* (New York, Garland Publishing, 1987), p. 111.

out to be the major commercial crisis in the history of the Empire. A seasonal drain of specie, once again, was credited with causing illiquidity in the capital. Resources were being channelled to finance the booming cotton sector in the province of Maranhão, which had benefited from the outbreak of the American Civil War.<sup>16</sup> Several private banks (*casas bancárias*) in Rio went under, and those that survived required the assistance of more liquid institutions in the market.

On 18 May 1863, additional signs of what would be a major financial crisis were looming on the horizon. The *casa bancária* of Antonio José Alves Souto & Cia. (Casa Souto), Rio's largest non-corporate private bank, sent an urgent request to the Bank of Brazil. It asked for the 'necessary amount (of money) to satisfy the commitments of that day, given that the resources with which it was counting were not forthcoming'.<sup>17</sup> In spite of the reluctance of some directors, who pointed to Souto's virtual insolvency, the Bank raised their credit limit from 14 thousand to 20 thousand *contos* (£2.3 million).<sup>18</sup>

For much of the remainder of 1863 and well into 1864 the minutes of the meetings of the directors of the Bank of Brazil reveal little but discussions over the day-to-day operations of the Bank, the exception being allegations of mismanagement in the operation of some of its *caixas filiais*. Until at around 10 a.m. on 10 September, and without prior notice, José Antônio Alves de Souto suspended operations at his bank, in the centre of town. The news soon spread to the rest of the city, leading to a run on other *casas bancárias*. At 3:00 p.m. a mass of people had gathered in the financial district of Rio de Janeiro, at the Rua Direita, demanding prompt redemption of paper issued by the main banks. Police were called to ensure the safety of bankers and prevent disturbances. The Bank of Brazil, unlike most of its competitors, was not subject to a run. Gold withdrawals from its reserve fund on 10 September amounted to just over five *contos*. On that day it did, however, act as a lender of last resort, helping *casas bancárias* to the tune of 2,870 *contos*, most of which was taken-up by

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<sup>16</sup> See J. Schulz, *A Crise Financeira da Abolição* (São Paulo, Edusp, 1996), pp. 41-2.

<sup>17</sup> Meeting of the Board of Directors of the Bank of Brazil on 18 May 1863, cited in C. Pacheco, *História do Banco do Brasil* (Banco do Brasil, 1973, 4 vols.), Vol. IV, p. 7.

<sup>18</sup> *Ibid.*, p. 8.

the house of Montenegro, Lima & Co.<sup>19</sup> Unlike the events of 1857, the Bank of Brazil was keenly aware of its crucial position in the Rio money market. Accordingly, it spared no efforts in providing discounting facilities for institutions experiencing hardship. At the same time, it sought support from the government in allowing a relaxation of the limits on note issues, and the suspension of convertibility.<sup>20</sup>

Contemporaries initially claimed that the Bank of Brazil precipitated the crisis, by refusing to advance Souto a “mere 900 *contos*” to help it settle its commitments on that fateful September day.<sup>21</sup> This is not an accurate description of events. The minutes of the extraordinary meeting of the board of directors of the Bank of Brazil, convened on 10 September at 2:00 p.m., reveal that the house of Souto had never asked the Bank to advance that amount. Instead, they show that Souto had simply approached an inspector of the Bank (Coelho de Castro) and sought his advice on how to proceed in face of its adversities, to which Castro replied with the recommendation that Souto suspend operations.<sup>22</sup> The extraordinary board meeting decided that the Bank suggest to the government the liquidation of the Casa Souto, under the supervision of its main creditors. The Bank felt that small investors should have priority in receiving their money, after which the remaining creditors would attempt to agree on conditions for the final liquidation. To that end, the Bank would be willing to receive on deposit the outstanding bills of small investors, paying interest at 5% p.a. Should the investors instead prefer prompt payment, it would advance them the money, so long as the government guaranteed the Bank the corresponding 5% interest. Finally, the Bank said that it was only awaiting a signal from the government before proceeding to help smaller creditors.<sup>23</sup>

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<sup>19</sup> *Ibid.*, p. 29.

<sup>20</sup> Banco do Brasil, *Relatorio* 1865, pp. 5-12.

<sup>21</sup> See *Relatorio da Comissao Encarregada pelo Governo Imperial por Aviso do Primeiro de Outubro e 28 de Dezembro de 1864, de Proceder a um Inquerito Sobre as Causas Principais e Accidentaes da Crise do Mez de Setembro de 1864* (1865). Rio de Janeiro, Typographia Nacional, Annex, p. 52.

<sup>22</sup> See Banco do Brasil, “Actas”, session No. 811, 10 September 1864, AD 007/11-A. Contemporary estimates put Souto’s debts with the Bank of Brazil alone at the outbreak of the crisis at 14,000 *contos* (£ 1.6 million). See Soares, *Esboço*, p. 51.

<sup>23</sup> Pacheco, *Banco do Brasil*, Vol. IV, p. 31.

The next day, the president of the Bank of Brazil presented this proposition to the recently-appointed Prime Minister, Francisco José Furtado. After hearing the joint session of the Finance and Justice standing committees of the Council of State, the government stated that it was in principle sympathetic to the idea and would do its utmost to help the Bank. However, it alleged that it could not go ahead with the liquidation, for this would give rise to a conflict between the ‘constituted powers’.<sup>24</sup> Later that night, the Ministers of Finance and Agriculture went over to the headquarters of the Bank of Brazil. Although acknowledging the gravity of the situation, they argued that the government could not commit itself to any “extralegal” rescue operation unless the Bank could assure them of the final success. Obviously, it could not guarantee anything, and the meeting ended at 2:00 a.m. on 12 September without any decision being taken.<sup>25</sup> During the course of that day renewed appeals were made to the imperial government to take action to quell the panic. Once again the official position was one of indecision. The next day crowds gathered at the doors of the Bank of Brazil and demanded prompt redemption of its notes in gold. Several *casas bancárias* decided to shut that day, signalling their incapacity to honour payments any further. At the sight of the throng outside, which prevented the entrance of its president, and in the face of a clamour for gold that threatened its reserves, the Bank once again turned to the government. This time it requested the ‘suspension of all payments in this market for 30 days, in view of the extraordinary and abnormal circumstances, so as to allow for, in the meantime, the adoption of the necessary measures demanded by commerce (...)’.<sup>26</sup>

The Bank of Brazil claimed that the sheer amount of discounts it had performed over the previous two days (close to 13,000 *contos*) could not be kept up for long without a severe loss of gold.<sup>27</sup> Furthermore, and in order to allow it to carry on its rediscounting activities with the *casas bancárias*, the Bank also sought an

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<sup>24</sup> Banco do Brasil, “Actas”, session No. 812, 12 September 1864, AD 007/11-A.

<sup>25</sup> Ibid.

<sup>26</sup> Memorandum sent by the Bank of Brazil to the imperial government on 13 September, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 34. At the time the Bank had clearly broken the limits on its issues, its reserve fund amounting to 10.9 thousand *contos*, while outstanding issues exceeded 35.9 thousand *contos*. Ibid., pp. 34-5.

<sup>27</sup> Between 12 and 14 September the *fundo disponível* lost almost 3,000 *contos*. “Banco do Brasil: Quadro do Troco Realizado em Moeda Metálica em Setembro de 1864”, in the Annex to *Comissão de 1864*.

extension of its issuing limit to three times the value in the reserve fund. The government allowed an increase in the Bank's leverage, through Decree 3306, 13 September. On the 14<sup>th</sup> suspension of convertibility was also decreed 'for the time being', and Bank of Brazil notes were made legal tender in the provinces where they had been issued (Decree 3307).

On 15 September, the Bank and the Rural & Hipotecário sent a joint petition to the Emperor. They proposed that while the Legislative did not convene extraordinarily, the government supervise the process of liquidating banks with liabilities in excess of 10,000 *contos* and that had closed their doors.<sup>28</sup> In other words, both banks were urging the government to take an administrative act in order to tackle the crisis of confidence in the market.<sup>29</sup> On the same day, the views of the Justice and Finance standing committees of the Council of State were heard informally by the Emperor.<sup>30</sup> On the occasion, commissioners refused to sanction a step that would have implied going against commercial law, which established that it was up to the courts to decide on similar issues.

As tension in the market (and on the streets of Rio) rose, the Emperor decided to turn once again to his councillors in search of guidance. This time, the Justice and Finance Committee agreed with the suggestions put forth by the Bank of Brazil and the Rural & Hipotecário. The Conselho Pleno was held on the same day (16 September) at 21:00 and endorsed the opinion of the Committee. They consisted, basically, of enacting provisional rules for the liquidation of private banks, the appointment of inspectors to oversee liquidations, and the adoption of a 30 to 60-day moratorium on both bankruptcies and the payment of bills, *vales* and other commercial paper.<sup>31</sup> Accordingly, on 17 September the government issued Decree 3308, mandating a 60-day moratorium on all payments in the Court and province of Rio de Janeiro. Also, the discount rate at the Bank was increased from 8% to 9% on

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<sup>28</sup> *Comissão de 1864*, Annex, p. 36.

<sup>29</sup> As already noted, the Bank of Brazil had made a similar proposal the day after Souto & Cia. shut its doors, on 11 September, to no avail.

<sup>30</sup> J. Nabuco, *Um Estadista do Império* (Rio de Janeiro, Topbooks, 1997, 5<sup>th</sup> edn.), Vol. I, p. 468.

<sup>31</sup> J. H. Rodrigues (ed.), *Atas do Conselho de Estado* (Brasília, Senado Federal, 1978, 14 vols), Vol. V, pp. 393-7. Hereafter, *ACE*.

26 September, then to 10% on 8 October, where it remained until 12 April 1865.<sup>32</sup> Monetary expansion was unequivocally pursued this time. Between August and September the total amount of Bank of Brazil notes in circulation increased by 30%, to 62.7 thousand *contos*.

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<sup>32</sup> Figures are from the statistical Annex to *Comissão de 1864*.

**Table 2**  
**Bank of Brazil: Notes in Circulation and Portfolio**  
**Balances, July 1864 - June 1865**

(in *contos*)

Date	Head Office		<i>Caixas Filiais</i>		Total	
	Notes in Circulation	Portfolio Balances	Notes in Circulation	Portfolio Balances	Notes in Circulation	Portfolio Balances
31 Jul 1864	25,260.5	37,831.3	23,785.1	4,447.3	49,045.6	42,278.6
31 Aug	25,167.3	38,310.4	23,152.8	4,326.3	48,320.1	42,636.7
30 Sep	42,333.4	67,082.3	20,394.4	4,450.8	62,727.8	71,533.1
31 Oct	45,790.9	68,430.7	20,866.2	5,028.3	66,657.1	73,513.0
30 Nov	45,035.5	68,408.6	22,042.2	5,341.2	67,077.7	73,749.8
31 Dec	43,168.0	63,975.6	23,270.5	6,025.0	66,438.5	70,000.6
31 Jan 1865	40,126.2	59,536.0	25,443.2	5,876.4	65,569.4	65,412.4
28 Feb	39,605.6	62,232.9	26,216.1	5,772.7	65,821.7	68,005.6
31 Mar	41,636.6	65,722.1	26,913.4	6,483.2	68,550.0	72,205.3
30 Apr	44,523.2	69,158.0	27,424.2	5,819.0	71,947.4	74,977.0
31 May	44,437.4	69,260.7	27,753.6	5,554.3	72,191.0	74,815.0
30 Jun	45,139.4	74,237.6	n.a.	n.a.	n.a.	n.a.

Notes: n.a. = data not available.

Source: Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas*, 1865 and 1866.

Most of this increase in outstanding note issues was accounted for by the operations of the head office of the Bank, which also discounted the bulk of commercial paper.<sup>33</sup> The private bank of Bahia & Irmãos, for example, discounted approximately 10,000 *contos* with the Bank. The Rural & Hipotecário, Mauá, MacGregor, and Gomes & Filhos received, each, more than 5,000 *contos* from the Bank in order to meet the run on their own tills.<sup>34</sup> The Bank's portfolio, as a result, increased nearly 70% between August and September 1864, from 42.6 thousand *contos* to 71.5 thousand *contos*. According to an observer, the massive increase in its discounting operations forced the Bank's directors to spend the night of 14 September signing fresh notes to be put in circulation the following morning.<sup>35</sup>

Contemporaries disputed the impact of the government measures. For some, they succeeded in 'helping dissipate considerably the panic, while things got slowly

<sup>33</sup> Provincial offices played a less prominent role in the provision of liquidity to the market, reflecting the marginal impact of the crisis outside Rio de Janeiro.

<sup>34</sup> *Comissão de 1864*, p. 73. The house of Bahia & Irmãos, and the Rural & Hipotecário endured the largest withdrawal of deposits during the crisis, 16,000 and 15,000 *contos*, respectively. *Ibid.*

<sup>35</sup> See *Banker's Magazine*, Vol. 24, November 1864, p. 1006.

back to normal'.<sup>36</sup> Others argued that 'the government's arbitrary measures provided a temporary truce', which in the end only benefited poorly managed banks.<sup>37</sup> Finally, it was claimed that 'the increased issues of the Bank and suspension of convertibility made the panic go away, and the crisis died from exhaustion (...)'.<sup>38</sup> These conflicting appraisals of the effectiveness of the measures adopted to deal with the crisis were to be expected. In essence, they reflected *a priori* views on the role of the market in "punishing" malpractice, against the opinion of those who deemed government intervention necessary in such cases. With hindsight, it appears that concerted action by Bank and government did indeed provide an environment where solvent, but illiquid, institutions could survive the turmoil. Be it as it may, the toll from the crisis was substantial, claiming some of the largest private banks in Rio.<sup>39</sup>

### 3 - The Reactions Compared

As seen in Section 2.1, in 1857 the government initially sought the assistance of the Bank of Brazil in staving off what amounted to a momentary balance of payments crisis. In this regard, it asked the Bank to intervene in the foreign exchange market, in order to prop up the value of the *milréis*. The Bank initially complied with the government's request but, a few weeks later, decided to retreat from the operation. The loss of gold from its reserves added to fears that its core business - bill discounting - would be affected, given the obligation to remain within the assigned ratio between reserves and note issue. The government, then, resorted to the services of the Mauá, MacGregor Bank, which succeeded in re-establishing the value of the currency at close to par. Mutual recrimination between government, Bank and members of the opposition in Parliament soon followed. The nature of the operation conducted by Mauá was challenged on both technical and ethical grounds. Many were

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<sup>36</sup> *Jornal do Commercio*, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 39.

<sup>37</sup> *Ibid.*

<sup>38</sup> Testimony collected by the enquiry into the crisis of 1864, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 40.

<sup>39</sup> It is worth remarking that the liabilities of A. J. Souto & Cia. amounted to about £4 million, not far from the £5 million of Overend, Gurney, which failed in London two years later. This illustrates the extent of the damage caused to a market that was infinitely smaller than London. See M. de P. Abreu and L. A. C. do Lago, "Property Rights and the Fiscal and Financial Systems in Brazil: colonial heritage and the imperial period", *Texto para Discussão*, Department of Economics, PUC-Rio, No. 370, August 1997, p. 49.



unconvinced about the desirability of artificially sustaining the rate of exchange. Still others attacked Souza Franco for relying on Mauá, a personal friend, and not the Bank, to stave off the panic.

From then on, relations between the Bank of Brazil and the government would be soured. At the root of this lay the failure to agree on a “proto-central-bank” role for the institution.<sup>40</sup> Although the expression was seldom used at the time,<sup>41</sup> contemporaries were aware of the Bank’s position as an agency at least partly responsible for seeing to the soundness of the currency. This was its “macro” function, to be achieved via convertibility and a rule that bound its note issues to gold reserves. An interrelated, “micro”, function for this proto-central bank existed as well. It concerned the role of the Bank as a lender of last resort in times of crisis.<sup>42</sup> In practice, this meant abiding by what later came to be known as “Bagehot’s rule” in case of market distress: (i) to lend freely; (ii) to banks that are distressed, but solvent; (iii) against collateral; and (iv) at a penal rate of interest. Insolvent banks should be allowed to fail, and help should be confined to banks facing a temporary lack of liquidity.

Though muddled by conflicting legislation, the Bank of Brazil was still expected to perform proto-central-bank functions. In part this was due to the sheer weight of the Bank in the banking sector and the size of its gold reserves. Nevertheless, years after its creation, it was still not clear how exactly the Bank was to exercise both its micro and macro functions. This was borne out by the events that followed the 1857 crisis. Still, there was a degree of learning by doing in action, as seen when the Souto crisis broke out, on 10 September 1864. On the occasion, the Bank clearly perceived its role as a lender of last resort to the market:

The retraction that many banks make, and the safety measures taken in moments of danger, render the situation even worse, just when, on the contrary, the expansion of (note) issues would be the only healthy and efficacious remedy. The most notable

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<sup>40</sup> The prefix “proto” is used to distinguish institutions such as the Bank of Brazil from modern-day central banks, which, amongst other things, regulate the money supply via control over commercial banks’ reserve levels, and open market operations.

<sup>41</sup> A major exception was the discussion by Souza Franco of the desirability of a “central bank”, in his 1848 book. See B. de S. Franco, *Os Bancos do Brasil* (Brasília, Ed. da Universidade de Brasília, 1984), p. 84.

<sup>42</sup> See C. Goodhart, *The Evolution of Central Banks* (Cambridge, Mass., MIT Press, 1988), “Introduction”.

crises can only be dominated, and overcome, when banks facilitate their resources, for in these circumstances the sole element of life is the circulating medium, which momentarily fills the void left by vanishing capital. The Bank of Brazil understood this and, in order to provide the necessary assistance to commerce, had to increase its issues considerably.<sup>43</sup>

In 1864, unlike 1857, the institutions needed to deal with the crisis were partly present, in the shape of a Bank of Brazil that was much more aware of its potential role as a lender of last resort and, accordingly, acted swiftly. True, on the part of the government there was vacillation, as evidenced by the Council of State's initial dismissal of the need for extraordinary measures to deal with the crisis. However, after just a few days the government reconsidered its initial position and issued Decrees 3306 and 3307 granting the Bank, respectively, permission to increase its issues and suspend convertibility. Between 10 and 20 September the Bank of Brazil provided advances in the order of 30,000 *contos* (£3.3 million) to the banking system, both to domestic and foreign institutions.<sup>44</sup> For its part, the government finally enacted legislation mandating a moratorium on the initiation of bankruptcy procedures, as well as on the payment of bills, *vales* and obligations in general. However arbitrary (and illegal), these measures - in conjunction with the lender of last resort role of the Bank - helped shelter the market from even more dire consequences. A summary table reveals the different underlying behaviour of agents and the contrasting effects of the 1857 and 1864 crises.

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<sup>43</sup> Cf. "Representação da Directoria do Banco do Brasil", in *Proposta do Poder Executivo sobre o Meio Circulante e Documentos Relativos Mandados Publicar para Serem Presentes á Assembléa Geral Legislativa* (Rio de Janeiro, Typ. Nacional, 1866), p. 31.

<sup>44</sup> Figures presented by the president of the Bank, Cândido Batista de Oliveira, in a meeting of the Council of State, on 9 November 1864. See *ACE*, Vol. V, p. 401.

**Table 3**  
**Brazil: the 1857 and 1864 crises compared**

<b>1857</b>					<b>1864</b>				
<b>Origin:</b> “imported”					<b>Origin:</b> domestic				
<b>Start:</b> 13 November (arrival of news of the crisis in the United States)					<b>Start:</b> 10 September (Souto & Cia. shuts its doors)				
<b>Treasury Notes in Circulation:</b> approx. 43,000 <i>contos</i> and declining					<b>Treasury Notes in Circulation:</b> approx. 28,000 <i>contos</i> and stable				
<b>Bank of Brazil</b>  <b>Outstanding Note Issues:</b> averaged 50,000 <i>contos</i> in the six months prior to the crisis; reduced to 40,000 <i>contos</i> at the end, in August 1858 <b>Issuing Limit:</b> at three times the reserve fund since April 1855 <b>Suspension of Convertibility:</b> 27 November 1857 (at the initiative of the Bank, not the government) <b>Rate of Discount:</b> raised from 8% to 10% on 15/12/57 increased to 11% on 23/12/57 lowered to 10% on 27/1/58 lowered to 9% on 19/2/58					<b>Bank of Brazil</b>  <b>Outstanding Note Issues:</b> averaged 47,000 <i>contos</i> in the six months prior to the crisis; increased to more than 72,000 <i>contos</i> by April 1865 <b>Issuing Limit:</b> increased to three times the reserve fund on 13 September 1864 <b>Suspension of Convertibility:</b> 14 September 1864 (by government decree) <b>Rate of Discount:</b> raised from 8% to 9% on 20/9/64 increased to 10% on 8/10/64				
<b>Monetary Indicators</b> (% change on previous quarter)					<b>Monetary Indicators</b> (% change on previous quarter)				
period	H	M1	R/D	C/M1	period	H	M1	R/D	C/M1
1857 I	6.4	8.1	-1.1	1.1	1864 I	2.7	1.2	-9.7	8.8
1857 II	3.1	6.6	-34.2	-0.9	1864 II	0.0	1.9	1.9	-4.9
1857 III	2.3	7.9	-50.6	-4.4	1864 III	15.2	11.0	21.2	0.0
1857 IV	2.0	2.3	-28.1	-3.7	1864 IV	3.4	3.6	-14.6	7.5
1858 I	-10.1	-11.6	25.3	-1.6	1865 I	2.0	4.3	-23.4	2.3
1858 II	9.4	11.3	-12.4	-0.1	1865 II	3.3	-0.6	21.3	3.4
1858 III	-6.8	-3.5	-8.4	-7.0	1865 III	0.6	4.1	-10.8	-4.2
1858 IV	6.2	1.0	28.8	4.1	1865 IV	4.1	4.5	-21.3	3.7
<b>Rate of Exchange</b> (in pence per <i>milréis</i> ) Oct-Nov 1857: above par (27d) Dec 1857: 26 ¼ (high) 23 ½ (low) Jan 1858: 25 ¼ (high) 24 (low) Feb 1858: 25 (high) 24 (low) Mar 1858: 25 ½ (high) 22 ¾ (low) Apr-May 1858: 25 ½ June 1858: 27 (high) 25 ½ (low) July 1858: 27 (high) 25 ½ (low)					<b>Rate of Exchange</b> (in pence per <i>milréis</i> ) Jul-Sep 1864: above par (27d) Oct 1864: 27 ¼ (high) 26 (low) Nov 1864: 26 ¾ (high) 25 7/8 (low) Dec 1864: 26 ½ (high) 26 (low) Jan 1865: 26 1/8 (high) 25 ¾ (low) Feb 1865: 26 (high) 25 5/8 (low) Mar 1865: 26 (high) 25 ¾ (low) April 1865: 26 (high) 25 (low)				

Notes: Monetary indicators are as follows: H = high-powered money (monetary base); M1 = currency held by the public + demand deposits; R/D = bank reserves as a proportion of demand deposits; and C/M1 = currency held by the public as a proportion of money supply.

Sources: Monetary data from IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987). Bank of Brazil figures from Banco do Brasil, *Relatório Apresentado à Assembléa Geral dos Accionistas pelo Presidente do Banco* - 1858 and 1865. Exchange rates from Junta de Corretores de Fundos Públicos da Cidade do Rio de Janeiro, “Livro de Registro Oficial de Cotações de Títulos e Valores”, various volumes.

Reactions to the 1857 and 1864 crises were clearly different, not only on the part of the government, but also of the Bank of Brazil and the public at large. To begin with, suspension of convertibility in 1857 was decided unilaterally by the Bank of Brazil, and implemented a full two weeks after the initial run on banks in Rio. Continued depletion of its reserve fund, in an attempt to defend the (now floating) rate of exchange by selling drafts in the market, forced the Bank (specially its head office) to

contract its note issue sharply. This serves to highlight one of the peculiarities of the rules that governed note issues in Brazil. The statutes of the Bank of Brazil stipulated a ratio between its note issues and the amount of gold and Treasury paper in its reserve fund. The ratio itself varied over time, from 2:1 to 4:1, depending on the desire to increase or decrease liquidity in the market. Yet, the requirement that issues of the Bank maintain some proportion to its reserves was never abandoned altogether. Not even during times of crisis, as the 3:1 limit was not relaxed in 1857. Consequently, the Bank was constrained in its efforts to tackle the crisis. Indeed, although loss of gold from redemption was precluded via suspension of convertibility, it would continue to occur as a result of the sale of drafts, used to defend the rate of exchange. Therefore, the rules under which the Bank was forced to operate placed it in an awkward position. If it used its gold reserves to defend the currency - as the government expected it to do - it would necessarily have to reduce its issues, which were a proportion of these (dwindling) reserves. Bill discounting would therefore suffer, damaging the Bank's core business. Macroeconomic considerations (defence of the *milréis*) and its private interests (note issues) were clearly at odds.

Meanwhile, withdrawal of Treasury notes from circulation proceeded as usual, reducing liquidity even further. As a result, both the monetary base and M1 declined sharply in the first quarter of 1858. Throughout, the Bank's discount policy was erratic. In November and December 1857, it initially increased both discounting operations and interest rates, which rose from 8% to 11%. Nevertheless, soon after negotiations with the government collapsed, the Bank changed policy, charging a lower rate of interest on a shrinking volume of discounts. The reserve/deposits ratio increased in the first quarter of 1858, reflecting the cautious mood on the part of the banking system as a whole. The parallel decrease in the public's liquid holdings - as captured by the drop in the C/M1 ratio - was not enough to compensate the actions of the banking system, rendering the monetary contraction inevitable. Finally, it was only after the rescue operation undertaken by Mauá bore fruit, in mid-1858, that the rate of exchange returned to par.

In September 1864, meanwhile, after the initial indecision as to the powers to be allowed the Bank, the government raised the Bank's issuing limit. Suspension of convertibility followed almost immediately, as decreed by the government. Contrary

to its course of action in 1857, this time the Bank of Brazil increased its discounting activities massively. It provided much-needed liquidity to the market, at high interest rates, thus acting as a true lender of last resort. Increases in high-powered money in the wake of the Souto crisis were sufficient not to be annulled by both the greater reserve ratio at the banks and the public's preference for holding cash, which could have dampened the monetary expansion. Also, the extent of the assistance furnished by the Bank, combined with the extraordinary bankruptcy legislation enacted by the government, helped to calm the market. The reaction was seen to be unequivocally counter-cyclical, and consistent, unlike the mixed signals sent out by both government and Bank in 1857. The fall in the exchange was correspondingly much milder than in the previous crisis<sup>45</sup> and exchange-rate volatility was also reduced. In spite of this, losses due to the Souto Crisis at the end of March 1865 were put at 65 to 70 thousand *contos* (£7.5 million) in the city of Rio, where twenty-five businesses went bankrupt.

As seen above, in both 1857 and 1864 suspension of convertibility was opted for. This has been portrayed as amounting to an exercise in conscious counter-cyclical policies.<sup>46</sup> Yet, it was shown that in 1857 the decision to discontinue redemption of notes for gold was taken unilaterally by the Bank of Brazil, not the government. The latter actually blamed this move for the subsequent depreciation of the *milréis*. Suspension was strictly a protective measure employed to safeguard the Bank's reserve fund, not a deliberate effort to shelter the domestic economy from deflation, as often happened in similar circumstances in Europe and the United States. In 1864, by contrast, Bank and government worked closely to fight the crisis. Suspension of convertibility and extension of the Bank's issuing limits were clearly seen as essential components of a set of measures designed to provide *casas bancárias* with the funds they needed to honour deposits.<sup>47</sup> In a sense, by assisting the market policymakers were indeed pursuing a counter-cyclical policy. Had they failed to enact extraordinary bankruptcy legislation, and maintained convertibility of Bank of

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<sup>45</sup> Subsequent deterioration of the rate of exchange can be imputed to the continuing monetary expansion that accompanied the escalation of the Paraguayan War.

<sup>46</sup> See C. M. Peláez, "The Theory and Reality of Imperialism in the Coffee Economy of Nineteenth-Century Brazil", *Economic History Review* (2<sup>nd</sup> series), Vol. 29, No. 2, May 1976, pp. 276-90.; and, less emphatically, Schulz, *A Crise*, Chapter 2.

<sup>47</sup> Banco do Brasil, "Actas", sessions of 12, 13, and 14 of September 1864, AD 007/11-A.

Brazil notes, assistance to the market would have been greatly impaired, and losses been even greater.

#### 4 - Conclusions

Overall, then, reaction to the 1857 and 1864 crises were undoubtedly different. As a matter of fact, the nature of the two episodes was distinct. The first crisis, as noted, had been “imported”. It consisted of a momentary balance of payments crisis, caused by falling export revenues and the drying-up of international commercial credit. The ensuing panic led to massive purchases of sterling, which triggered a speculative attack on the *milréis*. With hindsight, the government’s reaction, by trying to defend the rate of exchange, appears to have been correct. Unlike, say, a crisis resulting from a permanent shock in the country’s terms of trade, the events of 1857 were transitory. Mauá perceived this at the time, hence his success in restoring the value of the exchange rate after conditions in the international economy resumed their natural state. The decision by the Bank of Brazil to abandon its part in the defence of the currency is also understandable. Apart from legal aspects surrounding its duties as a guarantor of currency stability, which had not yet been cleared up, the Bank’s position was greatly limited by the rule that bound its note issues to the reserve fund. The Mauá, MacGregor Bank did not suffer from a similar constraint. In the end, therefore, despite the failure of Bank and government to operate in tandem, both domestic and external balances were restored. Had there been more co-ordination, and were the Bank free from constraints on its note issues, perhaps the international crisis would not have lasted so long in Brazil.

In 1864, on the other hand, the crisis was largely of a domestic nature. It amounted to a commercial crisis, basically resulting from unsound operations carried out by *casas bancárias*.<sup>48</sup> Response to the crisis from both the government and the Bank of Brazil was far superior to that in 1857. The government, by adopting extraordinary bankruptcy legislation and by relaxing the rules that constrained the operations of the Bank; in particular, the requirement of convertibility and issuing limits. At the same time, the Bank’s role as lender of last resort was readily acknowledged. Convertibility was suspended, and Bagehot’s rule followed.

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<sup>48</sup> This point is explored in detail in Chapters 4 and 7 of my doctoral thesis.

Consequently, the exchange rate recovered rapidly, unhealthy banks were liquidated, and confidence restored. In the end, it can be argued that the government had learned from its mistakes in 1857, and acted accordingly.