Harry's Take

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Bubbles Stoked by Governments Are the Worst, Starting With the South Seas Bubble of 1720

The first, and perhaps craziest, recorded bubble was the infamous tulip bubble of 1637. It followed the first futures markets and involved speculation by small numbers of wealthy people in the early stages of the Dutch Golden Age, 1600–1720. The market went up 60 times in 2.2 years, and at the top, a single tulip bubble sold for over 10 times the annual wages of a skilled craftsman. But this bubble had little consequence due to its limited size and scope. It did reveal the propensity for human delusion and greed in a short period of time!

The Dutch East India Company was the first joint-stock company: it sold shares to the public to finance long-distance trade in 1602. By the early 1700s, a number of such companies had formed. Then came a new twist: the first public-private partnership venture, in 1711 in England.

At the end of that golden age for both the Dutch and English came the first bubble of real consequence: The South Seas bubble. Why? It was a dubious scheme by the British government to pay off its debts from the War of Spanish Succession (1701–1714).

The Treaty of Utrecht (in The Netherlands) in 1713 gave Spain a monopoly on trade with South America, and England got in on that monopoly for helping Spain win. The Bank of England formed the South Seas Company in 1711, first granting its monopoly on South American slave trade in exchange for taking over part of its massive war debt. The more lucrative slave trade fizzled out after the war, but England then got a monopoly on all trade in South America. However, the first broader trade voyages did not occur until 1717 and had little success.

Undeterred, the English government kept promoting these voyages to the public in exchange for taking over more of its failing debt. In the later stages, politicians were bribed to promote the stock. Low-interest loans were made to larger speculators. And get this: The South Seas Company used its own money to buy its own shares both to promote the price and to reduce the float. **These were likely the first stock buybacks!**

Other joint-stock ventures were getting popular because of this, and the French government came up with a similar scheme with the Mississippi Land Company. France's **first central bank** lent money at low rates with easy credit policies to public investors and used the proceeds to pay off its government debt.

To make a long story short, the South Seas bubble went from 128 pounds (about $167 today) in January 1719 up to $1,050 in July 1720—an 8.2-times' gain in 1.5 years—before it collapsed back near its origin, to 175 pounds, by September, in just 2 months. The Mississippi Land Company and other private stocks also collapsed.

This bubble impacted the English, French and other European economies substantially, as there was much more public speculation and loss. It actually marked a long-term peak in joint-stock prices—a 67-year bear market into 1787 before broader stock exchanges emerged and a “roaring” 233-year bull market since—which is about to crash more than ever by my forecasts.

And we wonder why we are witnessing the greatest single bubble in modern history from 2009–2020… with central banks directly goosing stock and financial assets with direct QE purchases and zero-to-negative real interest rates… and with companies using such money and artificial profits for massive stock buybacks.

Yes, history does repeat itself… and the worst bubbles are the ones supported by governments.

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Got a question or comment? You can reach us at info@hsdent.com.