Box 1 Market upheavals following terrorist attacks

The terrorist attacks on the USA on September 11 caused great upheavals in markets around the world. The attacks were made just before markets opened in the USA and it was immediately decided not to open New York Stock Exchange for trading. Many other markets were open, however. The initial impact reflected great uncertainty, both about what exactly had happened and not least about the conceivable effect on market infrastructure and the financial system as a whole. Major financial institutions had facilities at the World Trade Center and it was unclear whether important hardware or data were housed there which could be vital for normal trading.

In the markets, the first discernible signs were sharp rises in the prices of oil and gold, and bond prices rose at once, a classical response to uncertainties. The US dollar fell immediately against most other currencies, but given the uncertainty that prevailed, the drop was regarded as a fairly small one. One contributing factor was the Federal Reserve's immediate announcement that access to its discount window, which normally is discouraged, would be unrestricted for the time being. Work also began on setting up emergency facilities for the Federal Reserve in London. The European Central Bank and other major central banks soon announced that measures would be taken to ensure smooth settlement of currency trading.

Hiccups were noticed on foreign exchange markets but most of them were kept open, although trading contracted sharply. A few banks temporarily suspended bid quotations in dollars and others announced qualifications about being uncertain whether settlements could be made at specific times. Trading shrank substantially in most markets. Calm was restored in the course of time and intervention by central banks in Europe and Japan, together with swaps made by the Federal Reserve with several central banks, dispelled uncertainties about payments settlements.

In Iceland, the most noticeable impact for foreign exchange market participants was the difficulties they encountered in obtaining quotes in dollars from established international credit institutions, and when such quotes were made they typically included qualifications about delivery and settlement. ACI – the Financial Markets Association – suggested to its members not to make any aggressive quotes in financial markets for the time being. At 14:00 GMT on September 11 Iceland's interbank foreign exchange market makers made a gentlemen's agreement not to trade for an unspecified period. Early on the morning of September 12 the Central Bank met the market makers and Financial Supervisory Authority to appraise the foreign exchange market situation. It was decided that the market would open as normal but that market makers would refrain from trading as far as possible for the time being. The Central Bank cited the clause in its joint declaration with the government of Iceland from March 27 authorising it to intervene in the foreign exchange market if large swings posed a threat to financial stability. As the day wore on it became clear that foreign exchange trading ought to be able to continue as usual and gradually the situation normalised.