

**October 15<sup>th</sup>, 2018**  
**KAP 414**  
**2:00 P.M. – 3:00 P.M.**

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**“Circuit Breakers and Contagion”**

**Abstract:** Circuit breakers are commonly imposed in financial markets. We develop a dynamic equilibrium model with multiple stocks to study how circuit breakers affect price dynamics and market-wide contagion in bad times. We show that even when stock returns are independent in the absence of circuit breakers, circuit breakers can cause stock returns to become highly correlated, especially when the circuit breakers are close to be triggered in bad times. In addition, circuit breakers can cause a crash in one stock to trigger a crash in another stock, and can thus increase the market-wide crash risk. Our analysis suggests that circuit breakers may be a source of financial contagion, especially in bad times. Our analysis provides some rationale for the abandonment of the 2016 short-lived circuit breakers rule in Chinese stock markets.