

# History of Financial crises

## Introduction

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# Outline

1. Introduction: Conceptual Foundations
2. Historical Dynamics: Financial Cycles, Contagion, and Crisis Patterns
3. Frequency of financial crises: why so many??
4. Syllabus & logistics of this course

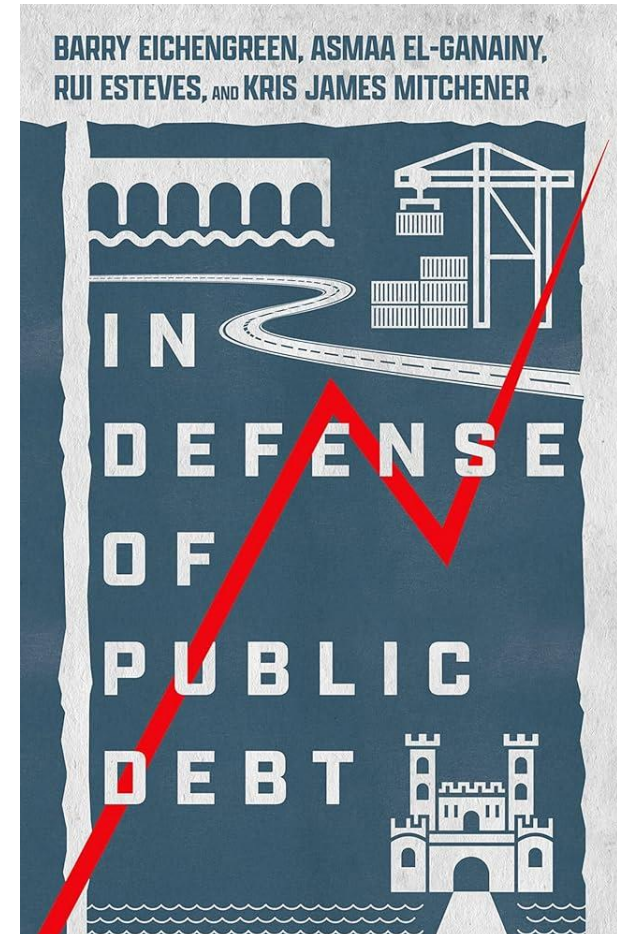
# INTRODUCTION

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- This lecture introduces the key concepts, mechanisms, and historical patterns that characterize financial crises. It provides the analytical and historical foundation necessary to understand why crises occur repeatedly and how they shape the evolution of financial systems and economic institutions.
- Class Objectives
  - Critically analyze financial crises by combining historical and economic perspectives.
  - Synthesize the multiple dimensions of financial instability through an interdisciplinary approach.
  - Conduct independent research using library databases and both printed and electronic academic sources.
  - Design and develop an independent research project using rigorous historical and economic research methods.

# Why Study Financial Crises?

- Financial crises are recurrent features of capitalist economies, not exceptional events. They have occurred from ancient debt crises in Greece and Rome to modern global crises such as the Great Depression and the 2008 financial crisis.
- Studying financial crises allows us to understand:
  - How financial systems function and become fragile
  - How credit expansion can generate instability
  - How governments and central banks respond to crises
  - How crises reshape financial institutions and regulations
- Major institutions such as the Federal Reserve (1913) and deposit insurance systems emerged directly from financial crises.
- Financial crises are therefore key moments of institutional transformation.



# What is a Financial Crisis?

- A financial crisis is a situation in which the financial system experiences severe disruption, affecting credit, asset prices, and economic activity.
- Typical characteristics include:
  - Sharp declines in asset prices
  - Disruptions in credit markets (credit crunch)
  - Failures of banks or financial institutions
  - Sovereign or private debt defaults
  - Major interventions by central banks and governments
- Financial crises often lead to recessions, rising unemployment, and long-lasting economic damage.
- They represent breakdowns in financial intermediation, which is essential for economic growth.



Credit Suisse – by Chappatte, june 2023

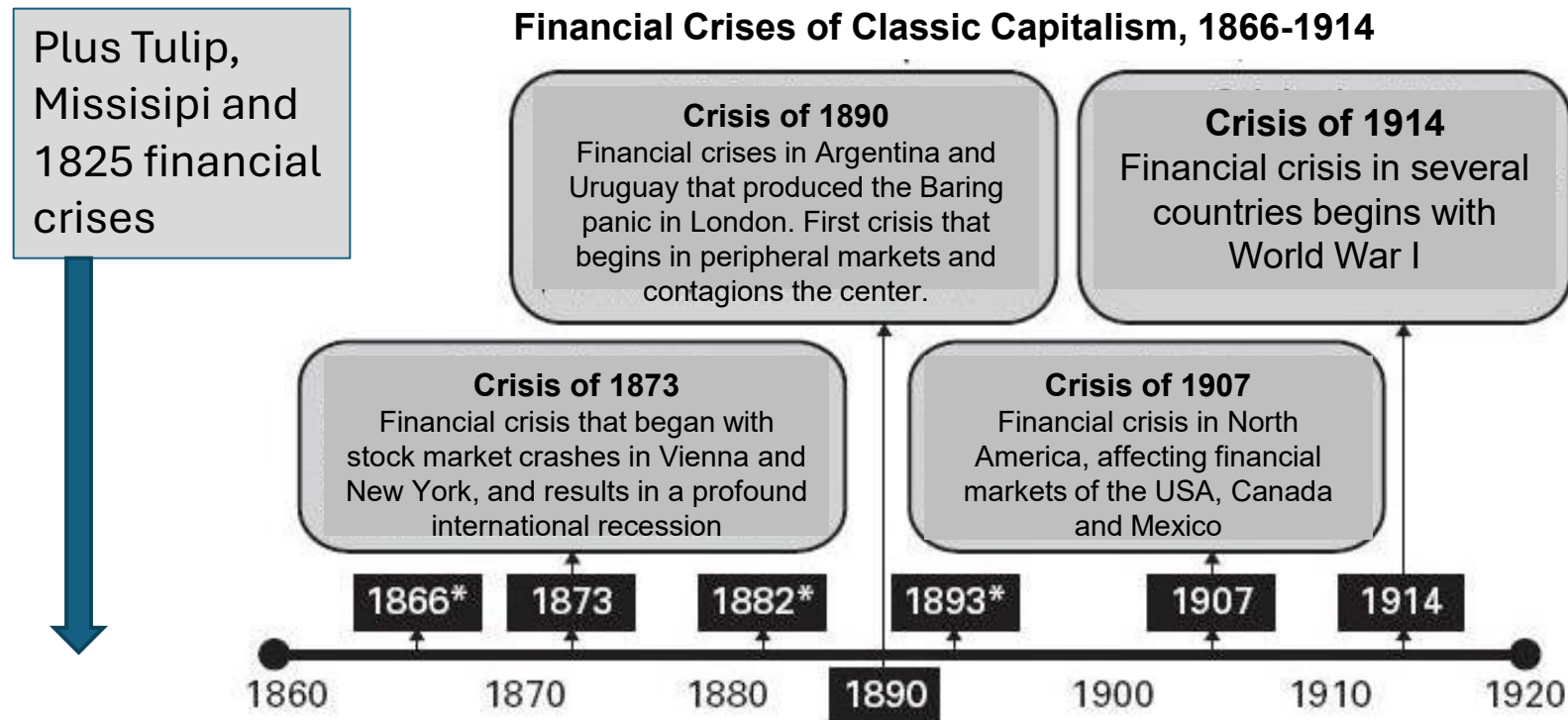


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# FINANCIAL CRISES IN HISTORY

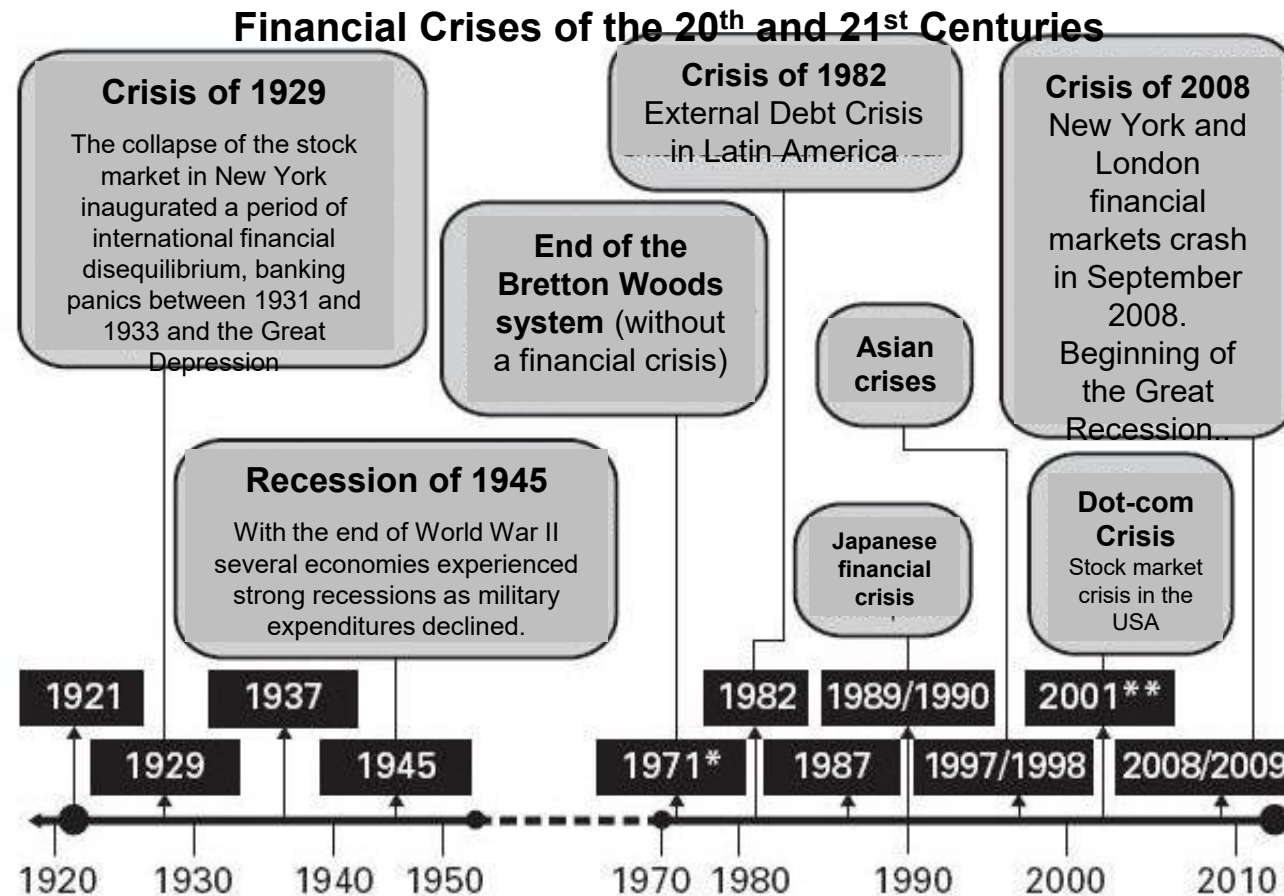
Diagram 1



\* The years marked with an asterisk correspond to minor financial crises, with epicenters in London (1866), Paris (1882) and New York (1893).

**Source:** Author's own elaboration based on Carlos Marichal, *Nueva historia de las grandes crisis financieras. Una perspectiva global, 1873-2008* (Madrid/Buenos Aires/México: Debate, 2010): 35, available at <http://www.historiadelascrisis.com.mx/attachments/DIAGRAMA1.JPG> (accessed on April 26th, 2012)

Diagram 2



**Source:** Author's own elaboration based on Carlos Marichal, *Nueva historia de las grandes crisis financieras. Una perspectiva global, 1873-2008* (Madrid/Buenos Aires/México: Debate, 2010): 35, available at <http://www.historiadelascrisis.com.mx/attachments/DIAGRAMA2.JPG> (accessed on April 26th, 2012)

# Main Types of Financial Crises

- **Banking crises**
  - These occur when banks face large losses, bank runs, or insolvency. They disrupt the credit system and can spread rapidly to the entire economy.
- **Currency crises**
  - These involve a collapse in the value of a currency due to speculative attacks, capital outflows, or macroeconomic imbalances. They often occur in fixed exchange rate systems.
- **Debt crises**
  - These occur when governments or private borrowers are unable to repay their debts. Sovereign defaults have been common throughout history.
- These three types of crises often interact and reinforce each other.

# TYPES OF CRISES, 1870-1997

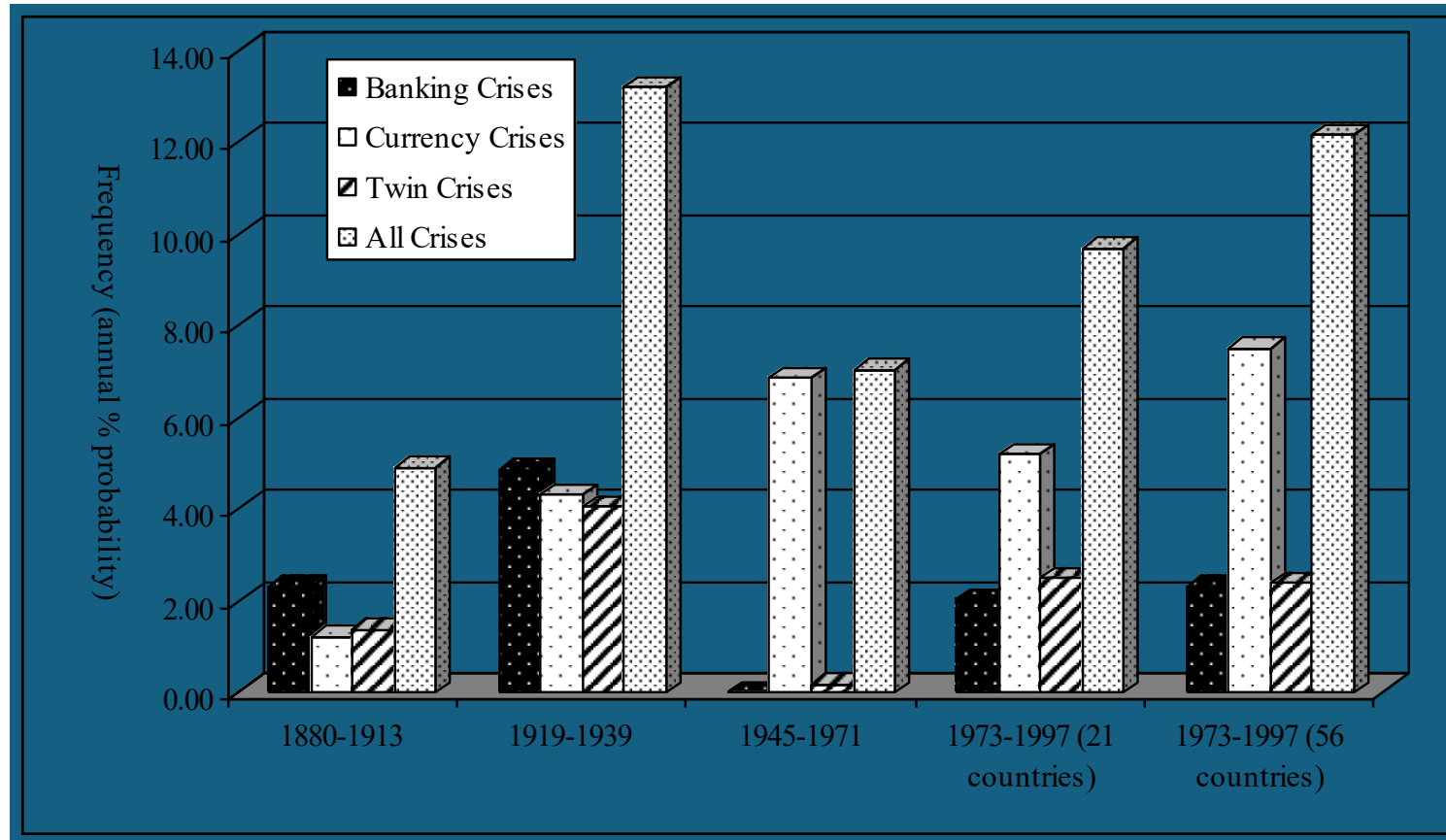
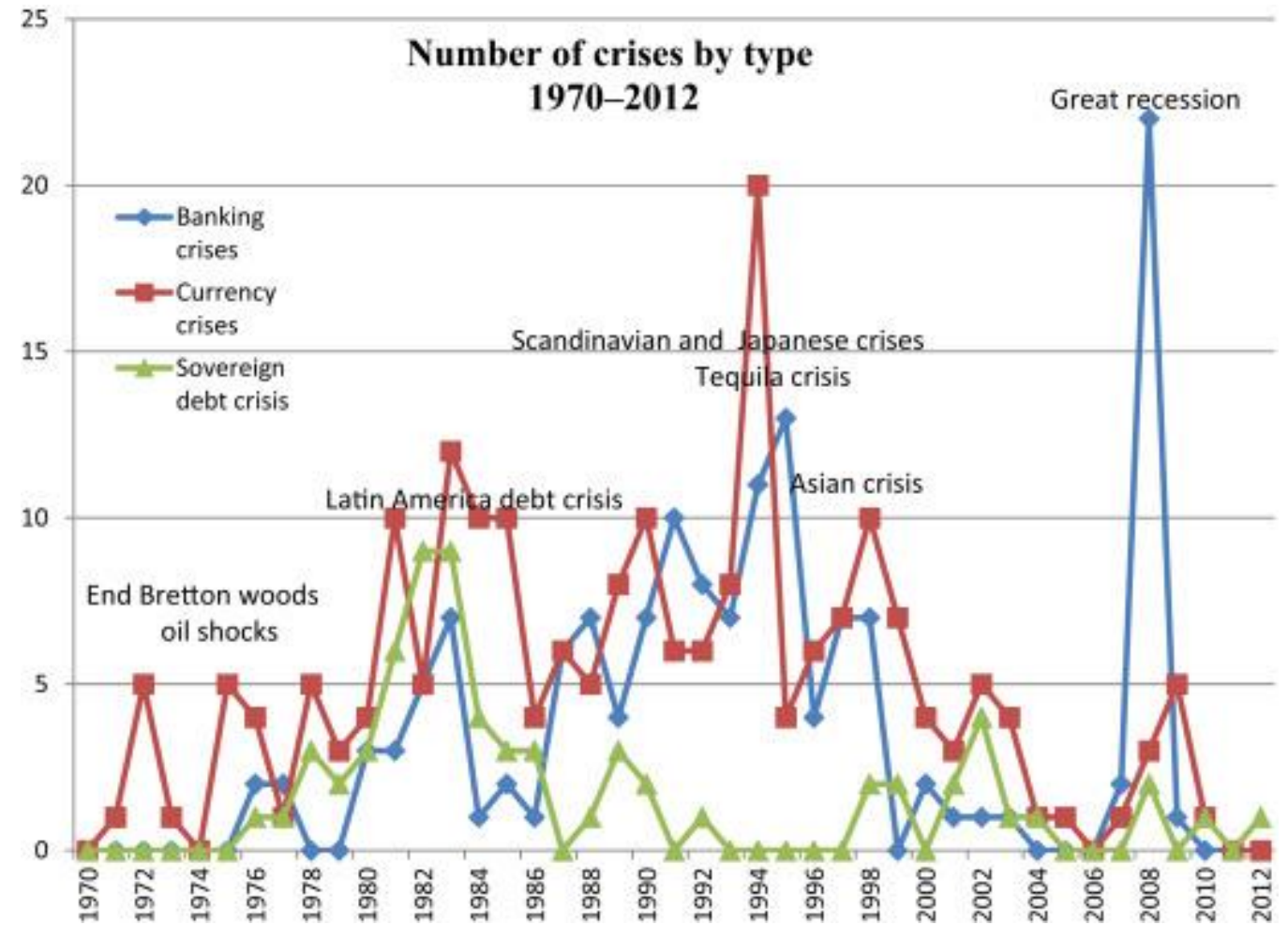


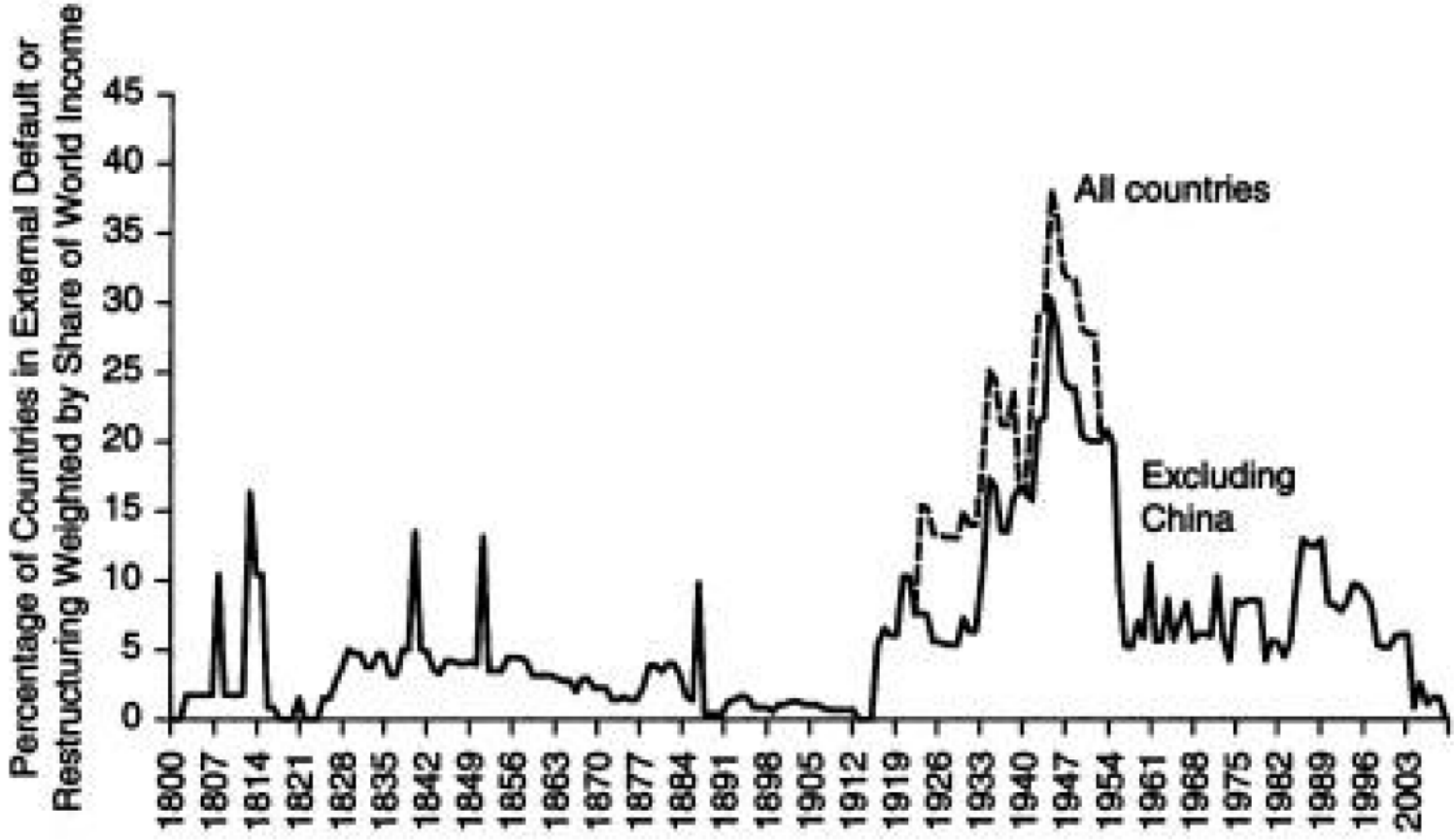
Figure from: Bordo et al. 2001

## Updated figure

- Source: Laeven and Valencia, 2013, Laeven and Valencia, 2014.



# External Defaults, from «This Time Is Different» (Reinhart And Rogoff, 2009)



# Contagion: How Crises Spread Internationally

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- Financial crises often spread across countries through contagion.
- This occurs through several mechanisms:
  - Financial linkages: Banks and investors operate internationally
  - Capital flows: Investors withdraw capital from multiple countries simultaneously
  - Trade linkages: Economic downturns reduce global demand
  - Expectations and panic: Fear spreads among investors
- Example:
  - The collapse of Lehman Brothers in 2008 triggered a global financial crisis affecting Europe, Asia, and Latin America.
  - Financial globalization increases both growth opportunities and systemic risks.

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# FINANCIAL INTEGRATION IN HISTORY – CAPITAL FLOWS

Sources: Obstfeld and Taylor, 2003 and Kisker, 2021.

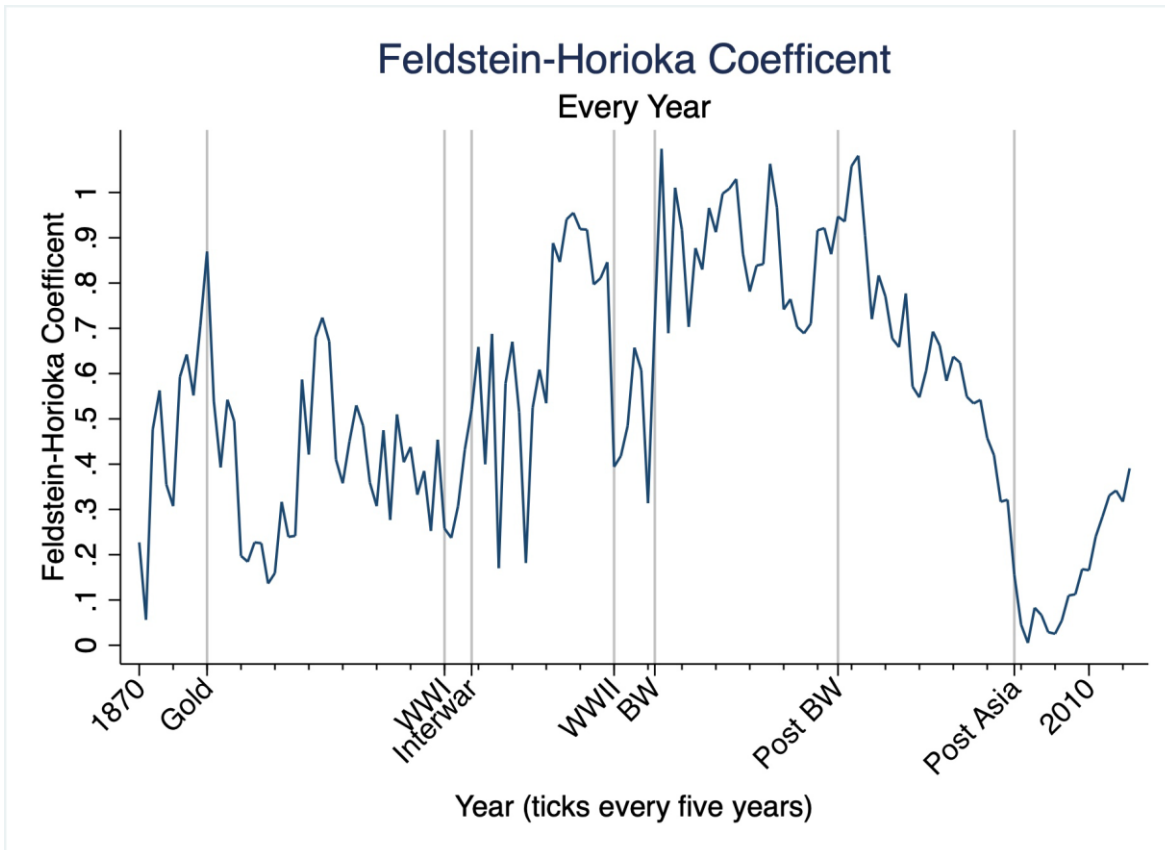
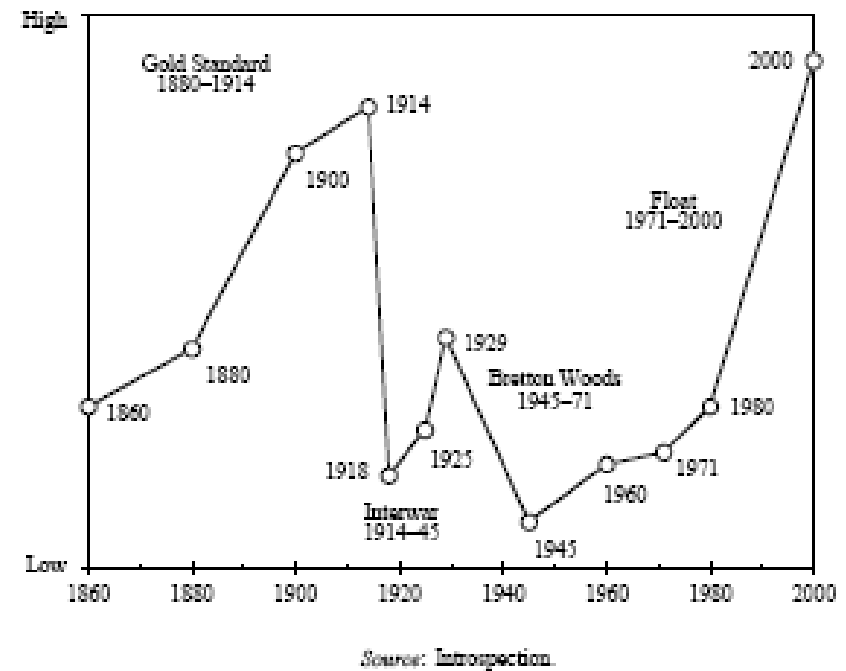


Figure 1: Conjecture? A Stylized View of Capital Mobility in Modern History



# Financial Crises and the Financial Cycle

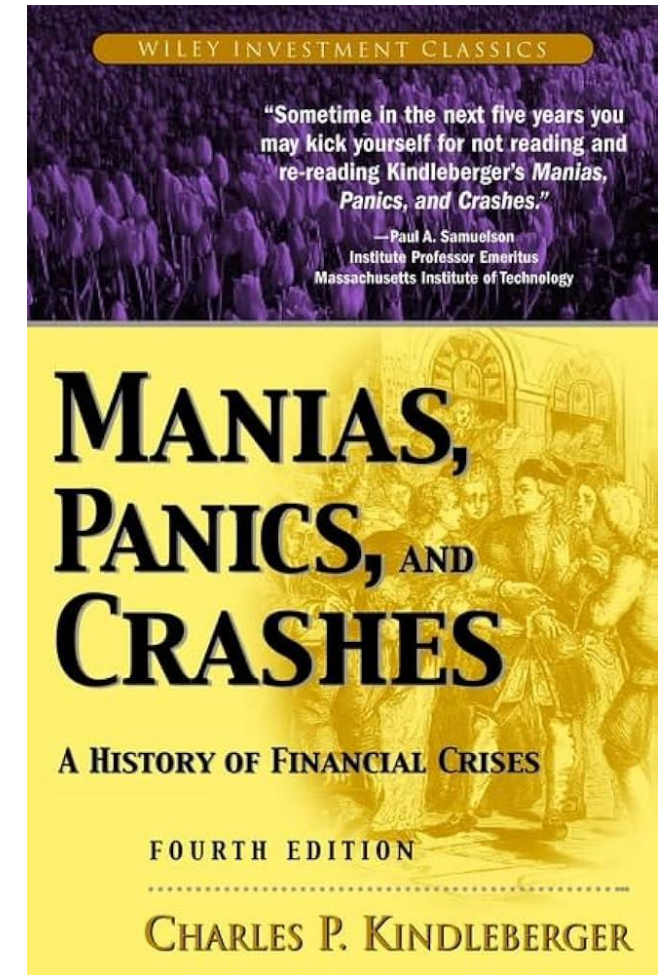
- Financial crises are closely linked to financial cycles.
- According to economists such as Wicksell, Fisher, Keynes, and Minsky, financial systems are inherently unstable.
- The key mechanism is credit expansion.
- When credit expands rapidly:
  - Asset prices increase
  - Investors take greater risks
  - Financial fragility increases
  - Eventually, this process generates bubbles that collapse.
- Financial crises are therefore endogenous to capitalist financial systems.

# The Minsky– Kindleberger Crisis Model

- Financial crises follow a predictable sequence:
- **Stage 1 – Displacement**
- A new opportunity emerges (technology, financial innovation, new markets)
- Example: railways in the 19th century, housing in the 2000s
- **Stage 2 – Euphoria**
- Asset prices increase rapidly
- Credit expands
- Optimism dominates markets
- **Stage 3 – Mania**
- Speculation intensifies
- Investors take excessive risks
- Asset prices detach from fundamentals
- **Stage 4 – Distress**
- Investors begin to doubt asset values
- Some investors sell
- Financial fragility becomes visible
- **Stage 5 – Revulsion (Crash)**
- Asset prices collapse
- Investors panic and sell massively
- Banks suffer losses
- Credit contracts sharply
- This leads to recession.
- This boom-bust cycle has characterized financial crises for centuries.

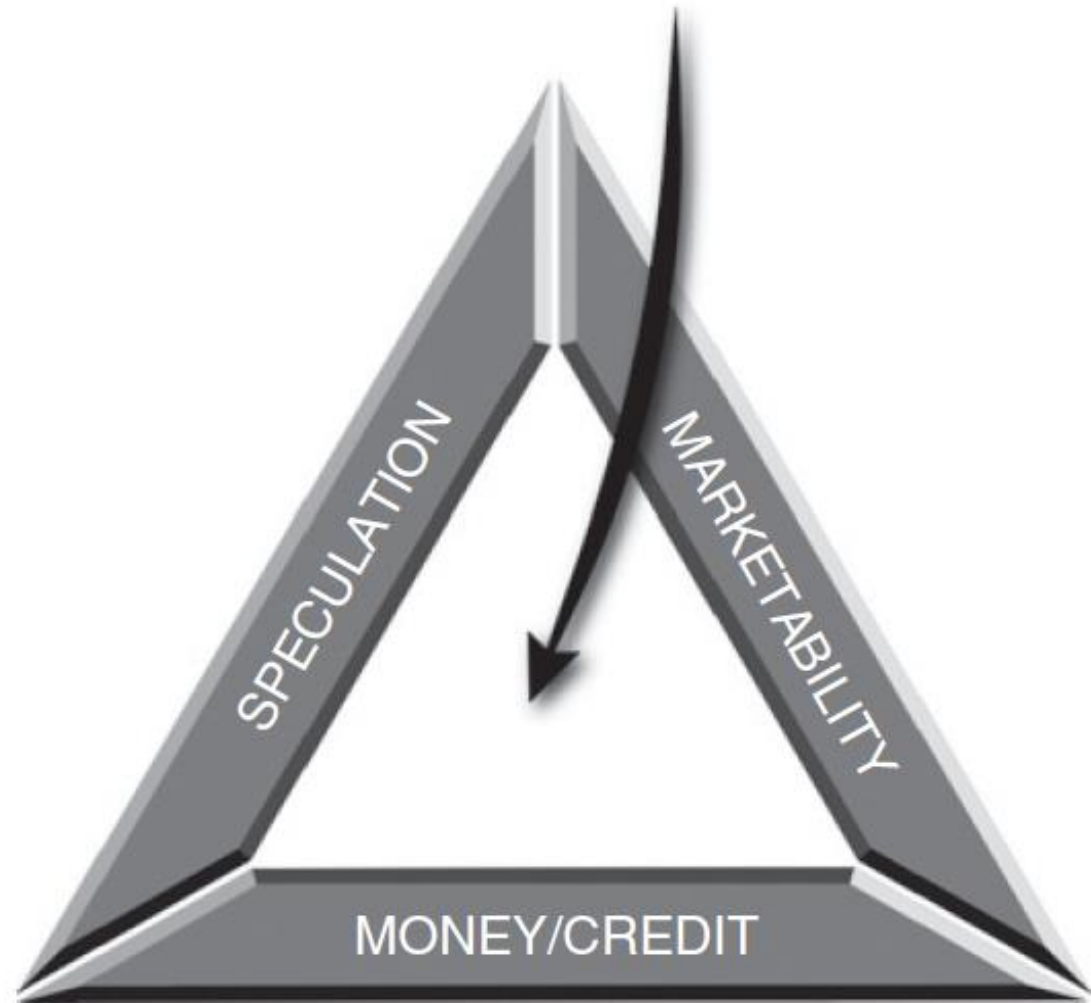
# Why Financial Crises Are Recurrent

- Financial crises occur repeatedly because of structural features of financial systems:
  - Credit expansion creates fragility
  - Speculative bubbles form regularly
  - Financial markets are influenced by expectations and psychology
  - Global integration facilitates contagion
- Financial stability itself can generate instability, as periods of stability encourage risk-taking.
- This is the central insight of Minsky's financial instability hypothesis.



The bubble triangle – Quinn & Turner, 2020.

**POLITICS AND/OR TECHNOLOGY**



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# Course evaluation

- *Blog posting and Discussion leadership (15%)*: This course is organized around a set of readings that will be used to prepare in-class discussion. Students are expected to complete all readings prior to the class. Each week a student (or group of students) will lead the class discussion. The student (or student team) leading the discussion will post a list of questions on the class' blog no later than at noon the day before class. Questions will help other students prepare comments related to the readings for that week.
- *Class discussion (15%)*: We will work in a seminar-like environment. Class participation is therefore a vital part of the course and a significant component in the final grade. There will be opportunities for students to engage often contentious debates and issues that surround the origins, magnitude, and consequences of the financial crisis. Remember that quality matters more than quantity.
- *Research paper (50%)*: Students will write a research paper (min 6'000 and max 8'000 words without bibliography) that examines a particular case of a financial crisis, integrating the knowledge acquired in this class. Papers must draw on empirical data collected during the course of the semester (more info below).
- *Research paper assignments (20%)*: In order to guide you through your research throughout the semester, you will be given a number of assignments that will help you meet deadlines and progress towards the completion of your final paper.
- *Second session*: students evaluated during the second session (*rattrapage*) will be graded according to the same structure (i.e. class discussion, blog posting, and research paper assignments). The research paper can be submitted one day before the start of the exam session at latest.