

What are the general causes of financial crises?

Financial crises tend to look very different on the surface, but when you strip them down, the **causes are surprisingly recurrent**. Economists usually group them into a few broad categories:

1. Excessive Debt and Leverage

- **Private debt:** Households, firms, or banks borrow too much. When they can't repay, defaults cascade through the system.
 - **Public debt:** Governments borrowing beyond sustainability can spark sovereign debt crises.
 - Example: 1980s Latin American debt crisis, 2008 subprime crisis.
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2. Asset Price Bubbles

- When real estate, stocks, or other assets rise far beyond their fundamental value due to speculation and easy credit.
 - When bubbles burst, collateral loses value, borrowers default, and banks collapse.
 - Example: 1929 Wall Street Crash, 1990s Japan, 2007–08 US housing market.
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3. Weak or Risky Banking Systems

- Poor regulation, inadequate capital buffers, and risky lending practices make banks fragile.
 - Contagion spreads quickly through interbank linkages and runs.
 - Example: 1931 Creditanstalt failure, 2023 US regional banks.
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4. Currency and Balance-of-Payments Crises

- When countries can't maintain fixed exchange rates, or when capital flight drains reserves.
 - Often triggered by sudden loss of investor confidence.
 - Example: 1997 Asian financial crisis, 1994 Mexican peso crisis.
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5. External Shocks

- Wars, pandemics, or commodity price shocks destabilize economies.
- These can reveal pre-existing financial fragilities.
- Example: 1973 oil shock, 2022 Ukraine war effects.

6. Policy Mistakes

- **Too much monetary tightening:** Can choke credit and trigger banking collapses.
- **Too much monetary easing:** Can inflate bubbles and sow the seeds of crisis.
- Example: US Fed policies in the late 1920s (tightening worsened the Depression); low rates in the 2000s (fuelled housing bubble).

7. Loss of Confidence & Self-Fulfilling Runs

- Even solvent banks can collapse if depositors or investors panic.
- “Sunspot” crises: panic not tied to fundamentals but to psychology.
- Example: Panic of 1907, bank runs during the Great Depression.

✓ **In short:** crises usually involve **too much debt, too little trust, and a sudden stop in liquidity**. The *exact spark* varies (a bubble bursting, a policy misstep, a geopolitical shock), but the *fuel* is almost always **leverage and fragility in the financial system**.

Would you like me to show you how these causes **map onto the major crises of the last century** (e.g. which crises were mostly debt-driven, which were currency crises, which were banking fragility)? That would give you a quick comparative view.