Historical Banking Crises: What do we know? What can we learn?

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Historical Lessons for Monetary and Fiscal Policy Conference

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Some background

- Incredibly large literature on historical banking crises

- My discussion here is based on “Banking Crises in Historical Perspective,” with Chenzi Xu (*Annual Review of Financial Economics,* 2023)

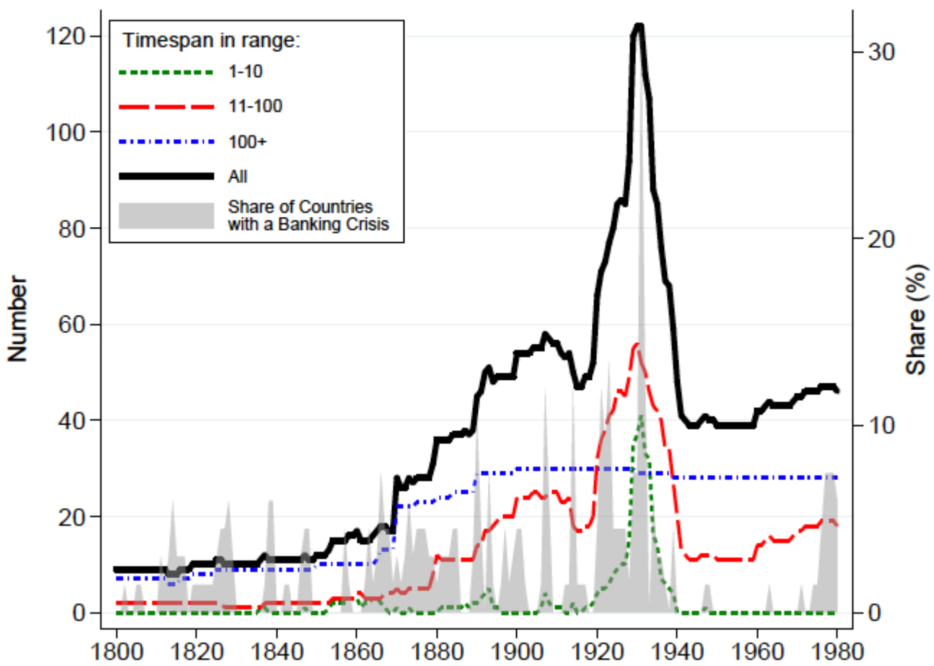
    - Focus on recent empirical literature and on events taking place before 1980
    - Identify main advances of recent work, and key general lessons
    - Identify some gaps in the literature

Recent literature—some evidence

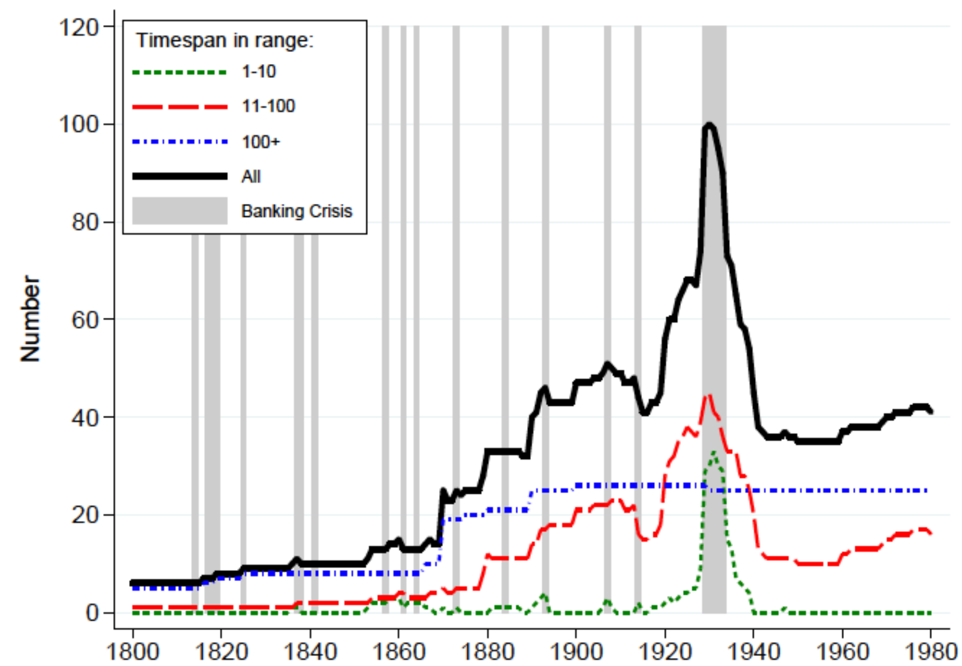
- Analyzed all articles related to banking crises in 24 leading journals between 2000 and 2022

  - 218 papers
  - Cover primarily the 1800-1980 period
  - Vary significantly by time span and number of countries studied
  - Studies largely focused on the US, and on the Great Depression

Number of papers studying a given year



(a) All Articles



(b) Only Articles Including US

Recent work—Two distinct styles

- Earlier work on historical crises largely descriptive

- Data availability and methodological advancements have led to two main distinct styles of work:
  - Establishing new stylized patterns out of lots of crises, lots of countries, lots of years
  - Identifying causal relationships, primarily levering idiosyncratic features of a specific crisis or historical institutions

  - Each of these styles has advantages and disadvantages

Styles—A comment

- Papers using large number of crises have helped establish robust general facts
  - Often limited to developed economies, and a small set of outcomes (and controls)
  - Limited ability to study heterogeneity or specific institutions

- Studies of specific events can help to establish causality and understand role of specific institutions/features of the environment
  - Hard to generalize, and to contrast across studies
  - Limited reconciliation of differences in findings

Styles going forward

- My hunch…

  - More papers intersecting these styles, for example building micro data across many crises to study heterogeneity
  - More structural estimation
  - Better connection to theory
  - More causal estimation based on specific episodes

Progress in identifying crises

- Long tradition in economic history
  - Based on qualitative assessments of historiographies of specific events, which requires survival of historical records

- Improved data access has expanded on events, criteria, and objectives
  - Text analysis of newspapers or single qualitative records (e.g., Jalil, 2015; Romer and Romer, 2017)
  - Decline in market value of bank equity (e.g.; Baron et. al, 2020)
  - Government interventions (Metrick and Schmelzing, 2024)

Factors that lead to crises

- Both theory and empirics point to <u>leverage</u> as an important source of financial fragility
  - Large buildups pre-crisis make crisis about 1.6x more likely to occur
  - Type of credit expansion may matter (e.g., housing, tradeables vs non-tradeables)

- Other bank-specific characteristics, institutional features of banking system matter

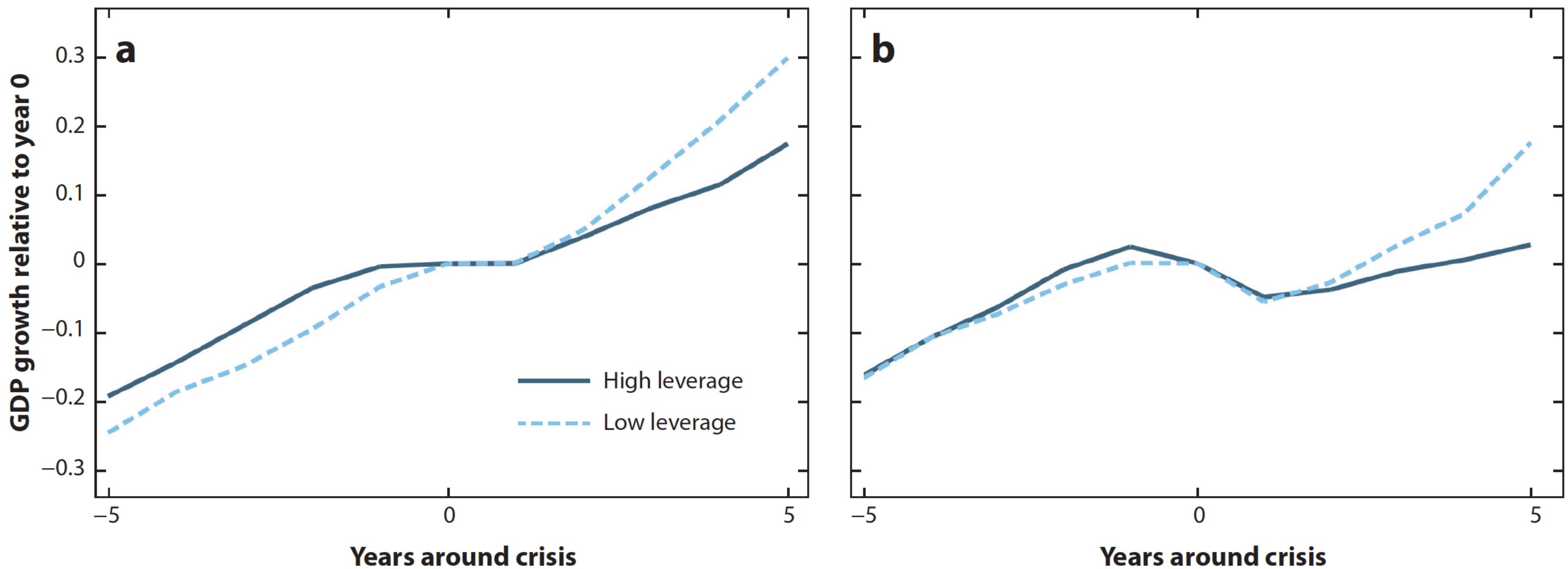
- We know less about causes of credit expansion, and about non-regulated institutions

Effects of crises

- Banking crises are especially costly for the real economy

Leverage and output revisited

All crises in JST (2017) | Crises followed by recession



Effects of banking crises

- Banking crises are especially costly for the real economy
  - Stylized facts have shown negative correlation between leverage and aggregate output
  - But know less about role of other determinants and outcomes, which may be hard to measure systematically across time and space

- Micro studies present strong causal evidence, and for a wider range of outcomes

- Effects can be very persistent

Real effects—What is missing?

- Evidence from specific episodes suggests that causes and mechanisms that trigger crises, and process by which it unfolds can be quite complex
  - Consensus on negative effects of bank disintermediation on real economy, but specific process by which disintermediation happens is not well understood

- Contrasting and aggregating causal estimates across studies is extremely challenging

- Opportunity to understand how interventions and structure of financial system affects elasticities

History as a source of experiments

- Historical settings can be especially helpful to isolate the role of institutional features related to bank stability and effects of interventions

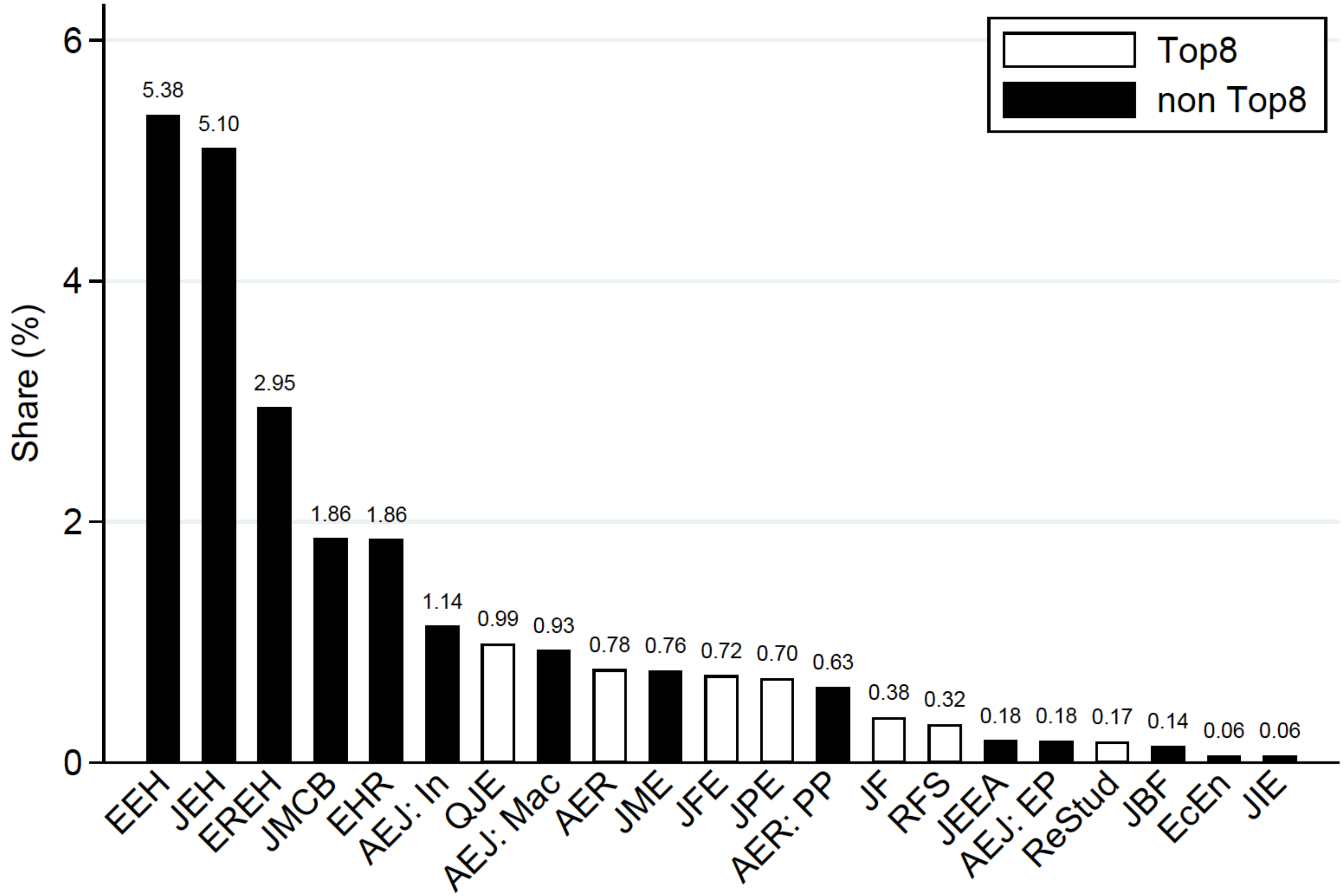
- Some interesting settings:
  - State-level deposit insurance systems
  - Bank-branching regulations and competition
  - Arbitrary thresholds in capital requirements
  - Variation in monetary policy across Fed District borders

- External validity vs useful analogies

What else can we learn?

- Expand focus beyond US and other developed countries; Great Depression; and regulated institutions
- Further need for causal estimates, and standardization across studies
- Potential for empirical work to more closely test theories of sources of panics, their transmission, and reasons for breakdown of intermediation
- Need to improve comparison across studies, and deepen understanding for why findings often differ across settings

Who publishes papers on historical crises?



Notes: There are no crises-related publications from *AEJ: AP*, and *AEJ: Mic* in our sample.

My two cents for young researchers

- Be immersed in current literature in macroeconomics and finance
- Have a good understanding of current institutions and what is relevant for policymaking
- Ask deep economic questions
- Develop a strong historical knowledge of the institutions, context and period you study