How to spot a financial crisis in four steps, with Linda Yueh

A decision will be made before it's too late, or soon thereafter
– Michael Eisner

Every crisis is unique; and yet they all share common causes, even if only in hindsight. As climate and other systemic issues constellate new types of 21st-century financial risk, it is more important than ever for us to learn to identify the signs of a financial crash in advance – before it's too late.

This is where students of history can find an edge. Our most recent Conversations on Climate *episode was a sit-down with* ***Linda Yueh, Fellow in Economics at the University of Oxford.*** *She is the author of* The Great Crashes: Lessons from Global Meltdowns and How to Prevent Them, *and gave us this masterclass in identifying the signs of the next crash – before it happens.*

STEP ONE: To spot a crisis, be looking for a crisis.

"We will not prevent the next crisis. We will have another crash," Yueh believes. This is inherent to capitalism; but so is the belief that 'this time is different.' Don't believe anyone who says we have solved the cycle this time - you can't see it coming with your eyes closed. **SEE: 2008**

STEP TWO: Identify (and inoculate against) euphoria

"Irrational exuberance...it's human nature to just believe that asset prices can only go up," says Yueh. Inflection points occur when sentiment becomes detached from fundamentals. Euphoria can be monitored quantitatively – but learn to read language and cultural mood as well. **SEE: 1929**

STEP THREE: Follow the leverage

"Not every crash leads to a global meltdown, but the ones that are fuelled with debt can bring down the banking system." What distinguish brief panics from economic disaster is debt. Banks over-extend as assets values rise, which will magnify losses and create contagion. Remember to monitor the shadow banking sector and financial innovation too. **SEE: 1997 Asian Financial Crisis**

STEP FOUR: (in)credible response?

"Crises are only resolved when there is credible policy," Yueh insists. Government (in)action is as much a cause as a response to a crisis, until feedback loops are interrupted and confidence restored. Beware the three Ds – delay, denial and de-emphasis – which precede a wider collapse. **SEE: Japan's Lost Decades**

To learn more about the history of economic disasters – and the lessons they offer for mitigating the climate crisis - listen to Linda Yueh's appearance om *Conversations on Climate* here

You can find out more about Linda Yueh here