

Credit Crisis of 1772

The credit crisis of 1772 was a peacetime financial contagion which started in London before spreading to other parts of Europe. This crisis had its genesis in the preceding decade through a credit boom, which facilitated a major expansion in manufacturing and mining, as well as substantial growth in trade between Britain and the U.S. colonies.

The credit boom was driven in part by speculation and dubious financial practices. In Scotland, for example, bankers adopted "the notorious practice of drawing and redrawing fictitious bills of exchange...in an effort to expand credit."ⁱ Strong credit growth fuelled inflation, and artificially boosted economic activity beyond the economy's capacity based on underlying supply and demand.

At the time, people were awed by the apparent economic prosperity, while failing to detect the lurking dangers of unchecked credit growth distorting the real economy. The warning signals of the impending crisis, such as the overstocked shelves and warehouses in the colonies, were completely overlooked by British merchants and American planters.ⁱⁱ

The house of cards began to unravel in June 1772, when people began to lose confidence in the ability of banks to protect depositors' savings. In a scene that would be repeated throughout history, everyday people gathered on mass at the front steps of banks, demanding withdrawal of their deposits.

With many banks unable to meet these demands, up to twenty major banks were forced into bankruptcy or at least stopping withdrawals, thus reversing the credit expansion that had driven the real economy in the previous decade.ⁱⁱⁱ The decline in credit in turn reverberated throughout the real economy, leading to a spike in bankruptcies and a decline in economic activity, as the economy sought to correct the excesses brought about by credit expansion.

The impact of the collapse was also keenly felt in the U.S. colonies, especially in the south. Before the crisis, London merchants usually granted credit to planters for twelve months to finance the crop.

After the outbreak of the crisis, British merchants urgently called for debt repayment, and American planters were faced with the difficult problem of how to repay the debt. As the credit system broke down, bills of exchange were rejected and almost all heavy gold was sent to Britain. Without access to credit, planters were unable to continue producing and selling their goods.^{iv}

The 1772 crisis is notable for several reasons. Firstly, well-run banks that hadn't engaged in speculation didn't bear any losses and gained great prestige for their outstanding performance during the crisis.^v Secondly, it was one of the first times that the Bank of England responded to fears of financial contagion, taking forceful action to intervene directly in the money markets and advancing short-term credit to selected banks whose failure might exacerbate the crisis. Thirdly, though its impact was short-lived, the 1772-3 crisis was one of the earliest purely financial crises, with neither government policy nor European war at its core.^{vi} Finally, it negatively impacted the relationship between Britain and the American colonies, leading indirectly to the events of the Boston Tea Party in 1773.^{vii}

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- ⁱ "The British Credit Crisis of 1772 and the American Colonies" *The Journal of Economic History*
- ⁱⁱ "The British Credit Crisis of 1772 and the American Colonies" *The Journal of Economic History*
- ⁱⁱⁱ *Politics & Finance in the Eighteenth Century*. Retrieved 2013-03-23.
- ^{iv} "The British Credit Crisis of 1772 and the American Colonies" *The Journal of Economic History*
- ^v "The Failure of the Ayr Bank, 1772" *The Economic History Review*
- ^{vi} <http://www.ehs.org.uk/press/the-financial-crisis-of-1772-3-when-the-bank-of-england-first-responded-to-systemic-risk>
- ^{vii} "Tea and Antipathy" *American Heritage*