

## Chapter 2

# THE FINANCIAL CRISIS OF 2008 AND ITS CONTAGIOUS EFFECTS ON EUROPEAN COUNTRIES

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### Introduction

From the beginning of the 1970s, many countries started to liberate their economies, and the free floating exchange rate system was adopted across the world. As a result of this, economies became more integrated with each other and thus became more vulnerable to economic shocks. In the literature the main crises known as contagious crises are the 1992 European Monetary System Crisis, the 1994 Mexican Crisis, the 1997 Asian Crisis, the 1998 Russian Crisis, the 2008 Crisis, and the European Debt Crisis which emerged after the 2008 crisis.

### Contagion

Contagion is an observable increase in the correlation of a financial crisis in a time of crisis (Classens 2001: 3-17). It is the transmission of shocks from one country to another. Although they are mostly used in the commonly accepted meaning, we can define contagion and spill-over in different ways. According to some economists like Reinhart and Kaminsky, contagion has a faster and severer effect than spill-over (Reinhart, et al., 2003: 6). In the literature, the main economists who have focused on the subject of contagion are Krugman, Obstfeld, Hamao, Kuusk, Forbes, Rigobon, Sachs, Corsetti, Fratzcher, Sell, Classens, and Radelet.

In recent years the interest shown by economists in contagion has been growing rapidly, initially after the 1994 Mexican crisis, but especially after the 1997 Asian crisis, when “contagion” started to be used as an economics term rather than the medical term of “infection” in newspapers and economics articles. Contagion can occur as a result of financial linkages between countries, real linkages between countries such as international commercial joint ventures and international commercial competition, neighbourhood relations, behaviours of multinational companies, herding behaviour, and the speculative behaviours of investors and companies (Sell, 2001: 94).

### The 2008 Crisis

The US mortgage market had a value of approximately 10 trillion dollars before the crisis, making it the largest mortgage market in the world. The highest risk

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