EnglishWaves.fr
The French radio station that speaks English !

EconoMag
The Show that demystifies Economics
2008 Financial Crisis – part 5

The Eurozone Crisis: How America's economic problems managed to jump the pond ©

by Pierre Vercueil

Welcome back to another edition of Economag on EnglishWaves. Today we conclude our theme on the 2008 Financial Crisis. As you'll recall we've covered the ways in which the crisis manifested in the US financial system, and we left off with an example on how ordinary people lost almost all of their assets. If this was taking place in the US, the world's largest economy at the time, there must have been a ripple effect in the global economy. Indeed, events in the US laid the foundations for Europe's continuing economic malaise, known as the Eurozone Crisis.

The Eurozone Crisis can be described as a multi-year debt crisis in the European Union starting in 2009. The primary victims of the crisis have been Southern European countries, but the Eurozone's core economies, France and Germany, have also suffered due to slipping confidence in the European economy and its businesses. This has mainly been in the form of increased government debt, very low economic growth, and high unemployment rates, reaching 27% in Spain and Greece. But how did all of this come about in Europe, which is geographically very far from the United States?

We start in Iceland. Before 2008, Iceland's banking sector grew enormously - in other words, the country's three principal banks became very large relative to the normal size of a bank in a small economy. Remember how before the crisis US banks were lending money to all sorts of people? Well, they were also lending to foreign banks and governments. When the US financial system got into trouble, the now very large Icelandic banks could no longer borrow money cheaply and quickly to continue their operations, ultimately leading to the collapse of the country's banking sector. This was disastrous! The government couldn't service its own debt: when the banking sector collapses, economic growth disappears, and tax revenues fall significantly.

The interconnection in today's global financial system means that if one nation defaults on its sovereign debt, then the people or countries it owes money to also have a problem. Do you see how this is similar to our example of William who told the bank he could no longer pay his mortgage? In other words, countries too can say « Sorry but I can't pay what I owe! » This is exactly why in 2011, a couple of years into the Eurozone Crisis, France was very worried about Italy's economy: Italian borrowers owed French banks 366 billion US dollars, and if they were to say, « Sorry, we can't pay! », the French banking system would have been placed under significant pressure, in turn affecting countries from whom France had borrowed. In the financial world, this domino effect is referred to as 'financial contagion', and it spread across much of Western Europe.

Many Eurozone states (Greece, Portugal, Ireland, Spain and Cyprus) were unable to repay their debt without the assistance of the European Central Bank (ECB) or the International Monetary Fund (IMF). In 2015 Greece became the first developed country to miss a payment to the IMF, despite having received debt relief in 2012. Even though the US has largely recovered from the crisis, sluggish growth in the EU continues to be a result of the aftermath of the Financial Crisis.

That concludes our five-part series on the 2008 Financial Crisis. Our next theme will focus on the airline industry. How exactly does it work, and what are the modern trends?

Stay tuned to Economag on EnglishWaves.