

http://ec.europa.eu/economy_finance/explained/the_financial_and_economic_crisis/why_did_the_crisis_happen/index_en.htm

Why did the crisis happen?

Europe's debt crisis was initially triggered by events in the American banking sector.

When a slowdown in the US economy caused over-extended American homeowners to default on their mortgages, banks all over the world with investments linked to those mortgages started losing money.

America's fourth largest investment bank, Lehman brothers, collapsed under the weight of its bad investments, scaring other banks and investors with which it did business. The fear that more banks could fail caused investors and banks to take extreme precautions. Banks stopped lending to each other, pushing those reliant on such loans close to the edge.

European banks that had invested heavily in the American mortgage market were hit hard. In an attempt to stop some banks from failing, governments came to the rescue in many EU countries like Germany, France, the UK, Ireland, Denmark, the Netherlands and Belgium. But the cost of bailing out the banks proved very high. In Ireland, it almost bankrupted the government until fellow EU countries stepped in with financial assistance.

As Europe slipped into recession in 2009, a problem that started in the banks began to affect governments more and more, as markets worried that some countries could not afford to rescue banks in trouble. Investors began to look more closely at the finances of governments. Greece came under particular scrutiny because its economy was in very bad shape and successive governments had racked up debts nearly twice the size of the economy.

The threat of bank failures meant that the health of government finances became more important than ever. Governments that had grown accustomed to borrowing large amounts each year to finance their budgets and that had accumulated massive debts in the process, suddenly found markets less willing to keep lending to them.

What started as a banking crisis became a sovereign debt crisis.