

Non-Technical Summary

Contagion in Experimental Financial Markets

Abstract

The current research studies whether the news of a crisis in one market may result in a crisis in another market when there are no links between those markets. Furthermore, the research tries to test for significance of two possible channels through which news of a crisis may cause contagion.

Studying the role of the news of a crisis in contagion is important because news of a crisis in one market may affect other markets during any contagion. However, because it is very difficult to isolate the effect of news of a crisis in real data the effect of news of a crisis has not been studied. This study does the following:

- Suggests a novel method of addressing the issue.
- Uses financial market experiment where it is possible to isolate the effect of the news of a crisis and test for its significance.
- Uses Z-tree software for conducting the financial market experiment.

In the experiment two independent stock markets are traded simultaneously for 20 periods. In one of the markets prices are controlled in such a way that there is a drastic drop of prices in period 9. The study tries to test whether the latter drop of prices in one of two markets may result in drop of prices in the other market as well. Four treatments are designed to test possibility of contagion due to news of a crisis effect and to test for significance of two of possible channels of news of a crisis effect.

The preliminary results from 10 experimental sessions indicate that there may be effect of news of a crisis in contagion. However, more sessions are needed to be able to test whether this effect is significant and whether the two channels are significant as well.

Keywords: asset market, contagion, experiment