The Financial Services Sector: Boom and Recession

Many analysts have argued that a housing boom preceded the recent financial crisis and economic slowdown. Innovations in mortgage finance likely contributed, generating outsized profits for financial firms. The housing boom created desirable jobs in mortgage and financial services, and insurance firms. Focusing only on hourly production workers, the sector’s average hourly earnings in 2008 of $20.27 were above the $17.77 average for all private service-producing workers. Overall, however, the size of the financial services and insurance sector is modest. In 2008, financial services and insurance comprised approximately 7½ percent of aggregate national gross domestic product (GDP) and 4½ percent of employment.

The fluctuations in home construction (and prices) have been widely discussed, but swings in the financial services sector also are important elements of economic activity within U.S. states. Mortgage origination and securitization generate significant employment and earnings. During the housing boom, such sector activities contributed greatly to economic growth, albeit unevenly across states; the largest beneficiaries were states with large mortgage originations and extensive securitization activity. For the boom period 2002-06, the Bureau of Economic Analysis (BEA) identified Arizona, California, Florida, and Nevada as the states “most affected” by housing-related industries.¹

The shrinking financial services sector has played a prominent role in the economic slowdown. The BEA reports that in most states and regions the largest sectors contributing (algebraically) to the 2007-08 slowdown are those tied to the housing expansion: construction and finance and insurance. Such slowdowns contributed to slower state-level growth in 38 states. Among all industries, these accounted for the largest contribution in six states. At a broader level, in 2008 economic activity (measured by real GDP) decelerated in all eight BEA economic regions, led by these sectors. Not surprisingly, the most-affected BEA regions are the Southeast and the Far West.

The table reports the magnitude of the swings in selected states and BEA regions. North Carolina experienced the most rapid growth in GDP originating in financial services during the expansion, likely due to activity at large banks in Charlotte. New York’s swing in growth likely was related to securitization. Recently North Carolina, New York, California, and Arizona have had sharp contractions, resulting from the rapid slowing of mortgage originations. The swings in Michigan and Ohio perhaps were related to pre-2007 increased subprime lending and mortgage refinancing.

Every economic expansion and contraction may be decomposed (arithmetically) into changes in individual business sectors. Too much must not be made of such exercises. Yet, the fluctuations in the financial services and insurance sectors add additional perspective to the recent housing bubble and financial crisis.

—Richard G. Anderson