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The Financial Services Sector: Boom and Recession

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Many analysts have argued that a housing bubble preceded the recent financial crisis and economic slowdown. Innovations in mortgage finance (such as offering mortgages to borrowers who declined to document either their income or assets and greatly expanded global securitization via collateralized debt obligations and similar instruments) likely contributed to the bubble and generated outsized profits for financial firms. The housing boom created jobs in mortgage, financial services, and insurance firms. Overall, 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. Focusing only on hourly production workers (omitting any "bonuses"), the sector's average hourly earnings in 2008 of $21.54 were above the $17.77 average hourly earnings for workers in all private service-producing sectors.

The fluctuations in housing construction and house prices have been widely discussed, but swings in the financial services sector also are important elements of economic activity in certain states. Mortgage origination and securitization generates significant employment and earnings. Securitization in particular has been publicized as a component of mortgage lending before the onset of the financial crisis. 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 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.

The shrinking financial services sector has played a prominent role in the national 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, finance, and insurance. Such slowdowns contributed to slower state-level growth in 38 states. Among all indus-

Financial Services Industry by Region/State

Region/state	Growth 2002-06 (% annual rate)	Growth 2006-08 (% annual rate)	Region/state share of national GDP that originates in financial services (2006) (%)
BEA region			
New England	3.93	2.68	7.51
Mideast	7.33	2.00	27.47
Great Lakes	6.03	–0.77	14.20
Plains	5.49	1.58	6.55
Southeast	7.65	–2.08	18.59
Southwest	6.59	1.93	8.44
Rocky Mountain	5.52	3.16	2.59
Far West	6.44	–2.99	14.65
State			
New York	8.86	3.46	16.49
California	6.48	–4.46	11.11
Florida	7.90	–2.19	4.67
North Carolina	11.82	–7.43	4.39
Nevada	7.99	6.55	0.83
Ohio	6.57	–2.17	3.42
Michigan	5.85	–5.22	2.42
Arizona	9.07	–5.36	1.86

tries, these accounted (algebraically) for the largest contribution in six states and the District of Columbia. 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 (Florida) and the Far West (Arizona, Nevada, California).

The table reports the magnitude of the swings in selected states. 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 more to securitization than to mortgage originations. Recently North Carolina, New York, California, and Arizona have had sharp contractions, likely related to the rapid slowing of mortgage originations. The swings in Michigan and Ohio perhaps were related to pre-2007 increased subprime lending and mortgage refinancing; industry reports suggest that such actions delayed foreclosure for workers affected by slowing economic activity.

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. ■

[1] See Coakley, Catilin E.; Reed, Daniel A. and Taylor, Shane T. "Gross Domestic Product by State: Advance Statistics for 2008 and Revised Statistics for 2005-2007." *Survey of Current Business*, June 2009, Page 64, Table A.

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