



# 2008 FINANCIAL CRISIS: A TEN-YEAR REVIEW

November 8-9, 2018



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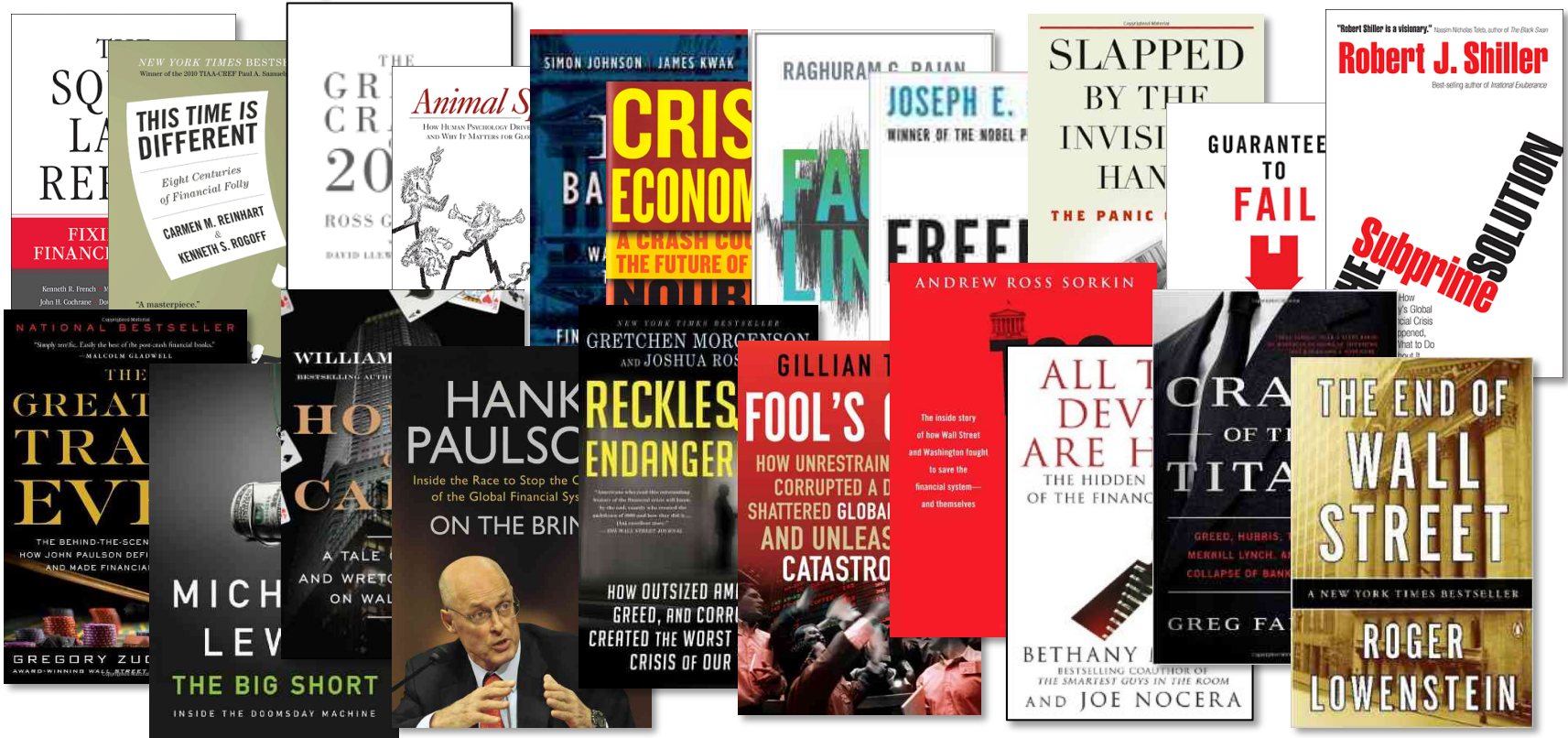
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# Volume 1, 2009

Preface to the <i>Annual Review of Financial Economics</i> <i>Andrew W. Lo and Robert C. Merton</i> .....	1	Volatility Derivatives <i>Peter Carr and Roger Lee</i> .....	319
An Enjoyable Life Puzzling Over Modern Finance Theory <i>Paul A. Samuelson</i> .....	19	Estimating and Testing Continuous-Time Models in Finance: The Role of Transition Densities <i>Yacine Aït-Sahalia</i> .....	341
Credit Risk Models <i>Robert A. Jarrow</i> .....	37	Learning in Financial Markets <i>Lubos Pastor and Pietro Veronesi</i> .....	361
The Term Structure of Interest Rates <i>Robert A. Jarrow</i> .....	69	What Decision Neuroscience Teaches Us About Financial Decision Making <i>Peter Bossaerts</i> .....	383
Financial Crises: Theory and Evidence <i>Franklin Allen, Ana Babus, and Elena Carletti</i> .....	97		
Modeling Financial Crises and Sovereign Risks <i>Dale F. Gray</i> .....	117		
Never Waste a Good Crisis: An Historical Perspective on Comparative Corporate Governance <i>Randall Morck and Bernard Yeung</i> .....	145		
Capital Market-Driven Corporate Finance <i>Malcolm Baker</i> .....	181		
Financial Contracting: A Survey of Empirical Research and Future Directions <i>Michael R. Roberts and Amir Sufi</i> .....	207		
Consumer Finance <i>Peter Tufano</i> .....	227		
Life-Cycle Finance and the Design of Pension Plans <i>Zvi Bodie, Jérôme Detemple, and Marcel Rindisbacher</i> .....	249		
Finance and Inequality: Theory and Evidence <i>Asli Demirgüç-Kunt and Ross Levine</i> .....	287		

# The Many Narratives of the Crisis



# The Many Narratives of the Crisis

*Journal of Economic Literature* 2012, 50:1, 151–178  
<http://www.aeaweb.org/articles.php?doi=10.1257/jel.50.1.151>

## Reading About the Financial Crisis: A Twenty-One-Book Review

ANDREW W. LO\*

*The recent financial crisis has generated many distinct perspectives from various quarters. In this article, I review a diverse set of twenty-one books on the crisis, eleven written by academics, and ten written by journalists and one former Treasury Secretary. No single narrative emerges from this broad and often contradictory collection of interpretations, but the sheer variety of conclusions is informative, and underscores the desperate need for the economics profession to establish a single set of facts from which more accurate inferences and narratives can be constructed. (JEL E32, E44, E52, G01, G21, G28)*

# The Many Narratives of the Crisis

- Crisis is all about subprime mortgage lending
- Policy and lower lending standards were at fault
- Bankers didn't have enough "skin in the game"
- No one saw the crisis coming
- Devotion to market efficiency caused the crisis
- Changes in regulation allowed huge increases in leverage

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Home / Annual Review of Financial Economics / Volume 10, 2018 / Adelino, pp 25-41

# The Role of Housing and Mortgage Markets in the Financial Crisis

## Annual Review of Financial Economics

Vol. 10:25-41 (Volume publication date November 2018)

<https://doi.org/10.1146/annurev-financial-110217-023036>

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The Role of Housing and Mortgage Lending in the U.S. Economy | annual review of financial economics

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## WIDESPREAD INCREASES IN MORTGAGE LEVERAGE

The significant increase in mortgage and other household debt in the period leading up to the 2008 crisis has been widely documented. **Brown et al. (2010)** show that household mortgage debt almost doubled between 2000 and 2007, and contrary to earlier periods, increases in mortgage debt were not offset by reductions in other household debt. Remarkably, in the run-up to the crisis, this increase in leverage was prevalent across all income groups and was closely tied to house-price appreciation across neighborhoods. **Adelino, Schoar & Severino (2016)** document that the increase in household leverage, measured as DTI levels, went up across all income groups and all credit scores. **Figure 1** shows the increase in mortgage credit during the period 2001–2007 and demonstrates that the flow of new (purchase) mortgages across incomes was stable over this period. **Adelino, Schoar & Severino (2016)** also document similar patterns across the credit score distribution. In other words, the fraction of credit going to middle- and high-income households did not change over the period 2001–2007. But since richer households with higher credit scores take out larger mortgages, the dollar value of mortgage credit held by middle-class and lower-middle-class borrowers increased significantly over this time period. **Adelino, Schoar & Severino (2017)** also show that the increase in DTI ratios was almost twice as high in states with high house-price appreciation compared to those with low appreciation.

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## HOW DID LENDING STANDARDS CHANGE IN THE BOOM?

In the previous section, we showed that DTI levels increased proportionally for all income groups. DTI levels are usually seen as an indicator of a household's ability to pay its mortgage. But since mortgage loans are collateralized by the value of the house, the key indicator of changing lending standards is CLTV ratios at origination. This is the amount of mortgage leverage including any second liens or home equity loans on the house. It is often argued that the way the financial sector can create a bubble in housing markets is by relaxing CLTV requirements (see, for example, [Geanakoplos 2010](#)).

**Figure 2** shows that the distribution of CLTV ratios at origination for purchase mortgages remained stable between 2001 and 2007. The median home purchased between 2001 and 2007 had a CLTV of 90%, and mo in the 90th percentile of the leverage distribution had a CLTV just lower than 100%. Furthermore, [Adelino, Schoar & Severino \(2017\)](#) show that there is no difference in the stability of the CLTV distribution between areas with high and low house-price growth. [Ferreira & Gyourko \(2016\)](#) also show that CLTV ratios between 1 2011 were stable and did not increase dramatically during the boom period. Somewhat contrary to popular belie.,



**NO EXPANSION OF HOMEOWNERSHIP**

Several researchers have explicitly asked if an erosion of credit standards happened at the extensive margin. In other words, did distortions in credit origination allow households with low income and poor credit quality, who previously were rationed out of the market, to become homeowners (see [Mian & Sufi 2015](#))? [Goodman & Mayer \(2018\)](#) present evidence that runs counter to this hypothesis. Using data from the American Housing Survey, they show that the overall US homeownership rate rose from 63.5% in 1985 to 68.8% in 2005. However, most of the increase was concentrated in the period before 2000, that is, before the onset of the mortgage expansion. It then dropped to 62.7% after the onset of the financial crisis.

But aggregate homeownership rates might mask important changes in the composition of borrowers if there is a significant expansion of credit to marginal households. [Adelino, Schoar & Severino \(2017\)](#) test this idea by comparing changes in homeownership rates for high- versus low-income households across regions. [Figure 3](#) shows that the housing boom made homeownership less accessible for the lowest-income households. In particular, starting in 2001, low-income households entered homeownership at lower rates than middle- and high-income households,

shows early summary statistics for the percentage of houses sold in a month that were also previously sold within the past 12 months. These statistics indicate that this measure of flipping or churn increased during the boom and increased most

1 of 1

**Table 1** Percentage of houses sold that were also previously sold in the past 12 months

Year	Percentage of houses sold that were also previously sold in past 12 months, grouped by house-price growth quartile				Increase from first quartile to fourth quartile
	First quartile	Second quartile	Third quartile	Fourth quartile	
2000	5.2	4.9	5.2	5.9	0.7
2001	5.3	4.9	5.2	6.1	0.8
2002	5.7	5.3	5.6	6.6	0.9
2003	6.1	5.7	5.9	7.0	0.9



Table  
Percentage

Chinco & Mayer (2015) provide evidence that the demand from out-of-town second-home buyers is increasing. They argue that out-of-town investors are consuming smaller dividends from their investments in the housing market.



**DEFAULTS IN THE MIDDLE CLASS**

Early in the crisis, most commentators focused on the high levels of subprime foreclosures experienced during the bust (using different definitions of subprime, as pointed out by [Mayer & Pence 2009](#)). This is not surprising, given that in some areas subprime foreclosure rates were as high as 20% during the crisis. Further, the cost to families and neighborhoods was very high ([Campbell, Giglio & Pathak 2011](#)). However, subprime default levels are high even in good economic times, with an average of almost 6%, and subprime mortgages are small compared to prime mortgages ([Amromin & Paulson 2009](#)).

[Adelino, Schoar & Severino \(2016\)](#) show that ex post defaults increased most sharply for middle-income and prime borrowers. Since these borrowers take on larger mortgages, the fraction of mortgage dollars in delinquent loans increased most steeply for this group. [Mayer, Pence & Sherlund \(2009\)](#) point out that, already at the beginning of the foreclosure crisis, the proportional increase in default rates for Alt-A, or near-prime, loans was larger than for subprime loans. [Ferreira & Gyourko \(2016\)](#) similarly estimate that, although defaults during the housing bust occurred on prime and subprime mortgages, almost twice as many prime as subprime borrowers lost their homes

## DISCLOSURE STATEMENT

The authors are not aware of any affiliations, memberships, funding, or financial holdings that might be perceived as affecting the objectivity of this review.

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38 Adhikari • Schuar • Severino

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# Volume 10, 2018

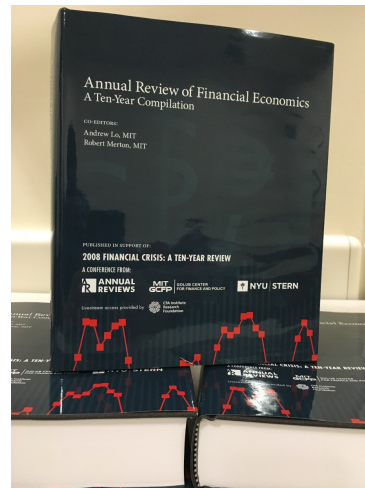
## 2008 Financial Crisis: A Ten-Year Review

Liquidity, Leverage, and Regulation 10 Years After the Global Financial Crisis <i>Tobias Adrian, John Kiff, and Hyun Song Shin</i> .....	1
The Role of Housing and Mortgage Markets in the Financial Crisis <i>Manuel Adelino, Antoinette Schoar, and Felipe Severino</i> .....	25
Financial Crises <i>Gary Gorton</i> .....	43
Mortgage-Default Research and the Recent Foreclosure Crisis <i>Christopher L. Foote and Paul S. Willen</i> .....	59
Recent Research on Banks' Financial Reporting and Financial Stability <i>Stephen G. Ryan</i> .....	101
Systemic Risk 10 Years Later <i>Robert Engle</i> .....	125
Regulatory Reform <i>Andrew Metrick and June Rhee</i> .....	153
Intermediary Asset Pricing and the Financial Crisis <i>Zhiguo He and Arvind Krishnamurthy</i> .....	173
Deregulating Wall Street <i>Matthew Richardson, Kermit L. Schoenboltz, and Lawrence J. White</i> .....	199
Deglobalization: The Rise of Disembedded Unilateralism <i>Harold James</i> .....	219

## Other Articles of Current Interest

Measuring Investor Sentiment <i>Guofu Zhou</i> .....	239
Risks in China's Financial System <i>Zheng (Michael) Song and Wei Xiong</i> .....	261

Shadow Banking in China <i>Kinda Hachem</i> .....	287
Liquidity, Risk Premia, and the Financial Transmission of Monetary Policy <i>Itamar Drechsler, Alexi Savov, and Philipp Schnabl</i> .....	309
Risk-Neutral Densities: A Review <i>Stephen Figlewski</i> .....	329
Capital Reallocation <i>Andrea L. Eisfeldt and Yu Shi</i> .....	361
Capital Structure and a Firm's Workforce <i>David A. Matsa</i> .....	387
Common-Ownership Concentration and Corporate Conduct <i>Martin C. Schmalz</i> .....	413
Forecasting Methods in Finance <i>Allan Timmermann</i> .....	449
Variance Risk Premia, Asset Predictability Puzzles, and Macroeconomic Uncertainty <i>Hao Zhou</i> .....	481
Recurring Firm Events and Predictable Returns: The Within-Firm Time Series <i>Samuel M. Hartzmark and David H. Solomon</i> .....	499



**Thank You!**