The Great Mortgaging: Housing Finance, Crises, and Business Cycles

Ò scar Jordà
Federal Reserve Bank of San Francisco
University of California, Davis

and

Moritz Schularick
University of Bonn
Centre for Economic Policy Research
Hong Kong Institute for Monetary Research

and

Alan M. Taylor
University of California, Davis
National Bureau of Economic Research
Centre for Economic Policy Research

September 2014

Summary

The past three decades have seen an unprecedented surge in the scale and scope of financial activities in advanced economies. Understanding the causes and consequences of the growth of finance is a first order concern for macroeconomists and policymakers. Yet surprisingly little is known about the driving forces of these important new trends in modern financial history. Against this backdrop, this paper unveils a new resource for macroeconomic research: a long-run dataset covering disaggregated bank credit for 17 advanced economies since 1870.

We study the development of various subcomponents of loans on banks' balance sheets - secured and unsecured lending as well as lending to businesses and households - over a span of 140 years. We document the rising share of real estate lending (i.e., bank loans secured against real estate) in total bank credit and the declining share of unsecured credit to businesses and households. The share of mortgage loans in banks' total lending portfolios has roughly doubled over the course of the past century - from about 30% in 1900 to about 60% today. To a large extent the core business model of banks in advanced economies today resembles that of real estate funds: banks are borrowing (short) from the public and capital markets to invest (long) into assets linked to real estate.

Looking more deeply at the composition of bank credit, it becomes clear that the rapid growth of mortgage lending to households has been the driving force behind this remarkable change in the composition of banks' balance sheets. The intermediation of household savings for productive investment in the business sector - the standard textbook role of the financial sector - constitutes only a minor share of the business of banking today, even though it was a central part of that business in the 19th and early 20th centuries. We also demonstrate that the shifts in the composition of banks' balance sheets have important consequences for our understanding of the source of financial instability. Mortgage lending booms were only loosely associated with financial crisis risks before WWII, but real estate credit has become a more important predictor of impeding financial fragility in the postwar era. From the perspective of policymakers aiming to design new macro-prudential policies today, our work confirms the crucial role of mortgage credit in the buildup of financial fragility.