The Causes of the Great Depression

A Depressing Power Point Presentation Brought to You by Ms. Shen
The bustling economy of the 1920s inspired trust in the business world.

- Between 1925 and 1928, the market value of all stocks rose from $27 billion to $38.4 billion. By 1929, stock values hit $87 billion.
- **Real wages** (what $ could actually buy) had increased more than 40%.
- Unemployment averaged below 4%.
People started to believe that anybody could be rich.

- Lots of people started wildly buying stocks with borrowed money.
- Lots of people hoped to “get rich quick.”
- It was definitely a time of great optimism.
However, there were some troubles under the surface.

• In reality, the economy was out of balance.
• It was mostly the rich who were getting richer.
• Huge corporations, rather than small businesses, dominated American industry. (In 1929, 200 large companies controlled 49% of American industry.)
• And, 71% of individuals and families earned less than $2,500 dollars/year and 80% of households had no savings.
Plus, with the advent of credit, things got complicated.

- Advertising made goods irresistible.
- Store owners had enough confidence in the economy to let customers buy goods “on time” or with an **installment plan** (and interest).
- Credit buying also meant that people were pumping money into the economy that actually didn’t exist.
Changes in stock buying practices allowed more people to buy stock.

- Consumers were encouraged by brokers, banks and even the president to **speculate in stocks**, whereby consumers would freely invest in stocks which they had not actively researched.

- Many stockbrokers allowed people to **buy on margin**, meaning that they would pay a fraction of the price (10 to 50%) and borrow the rest.

- Brokers charged high interest and could demand payment of the loan at any time, but if the price of stocks went up, the borrower could sell at a price high enough to pay off the loans and interest and **STILL** make money.
Margin Buying

How it Works:
1. You open a margin account with your broker.
2. You purchase 1,000 shares at $10 each.
3. Stock value rises to $15.
4. You profit if stock price rises.
5. Stock value drops to $7.

The value of your investment:
- Stock value $10:
  - Your broker's investment: $5,000
- Stock value $15:
  - Your broker's investment: $5,000
- Stock value $7:
  - Your broker's investment: $5,000

Your break-even point is when the stock value is $10,000.
• Brokers also inflated their claims about a company's assets and profitability, and sold stocks and bonds in excess of the company's actual value. This practice, known as “stock watering" was introduced to the New York financial district by a cattle driver turned financier. The term was derived from the practice of feeding cattle salt to induce them to drink large amounts of water just before they are sold, thereby increasing their weight. Thus, the buyer - whether of stock or of livestock - pays for more than is actually received.
Also, when all was said and done, there were too many goods produced and too little demand.

- By the late 1920s, the country’s warehouses held piles of un-bought consumer goods.
- People could not afford to buy the goods as fast as they were made.
Lastly, farmers never shared in the 1920s prosperity.

• Advances in technology enabled farmers to be more efficient, but once the war ended, the demand for food dropped off suddenly.
• As a result, crop prices fell so low that farmers could not pay back their loans.
• And of course, workers in factories, textile mills, and coal mines suffered as usual.
The Great Depression was also rooted in the aftermath of WWI.

- Germany’s economy collapsed because of the reparations imposed by the Treaty of Versailles.
- High tariffs reduced economic trade.
- American investment in Europe slowed, and European economies declined.
- Americans purchased fewer European goods, and Europeans got along without American products.
- As the European economy worsened, so did the American economy.

<table>
<thead>
<tr>
<th>Date</th>
<th>German Marks needed to buy one ounce of gold</th>
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<tbody>
<tr>
<td>Jan 1919</td>
<td>170.00</td>
</tr>
<tr>
<td>Sept 1919</td>
<td>499.00</td>
</tr>
<tr>
<td>Jan 1920</td>
<td>1,340.00</td>
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<tr>
<td>Sept 1920</td>
<td>1,201.00</td>
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<td>Jan 1921</td>
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<td>Sept 1921</td>
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<td>Jan 1922</td>
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<td>Sept 1923</td>
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Post-war inflation in Germany caused the DM to be so worthless it could not buy wallpaper or firewood—therefore it was used for wallpaper and firewood.
Why did the stock market crash?

• After President Hoover’s election in 1928, stock prices climbed and climbed.

• The **Dow Jones industrial average**, an average of stock prices of the leading industries, went from 191 to 122 to 381 on September 3, 1929.

• Prices for many stocks soared far above their real value.
• After the peak in September, stock prices fell slowly.
• As the stock market closed on October 23, the Dow Jones average dropped 21 points in a single hour.
• The next day, worried investors started to sell, and thus stock prices started to fall even more.
Stock Market before and after Black Tuesday

The Great Stock Market Crash of 1929

Dow Jones

1927 1928 1929 1930 1931 1932 1933

Black Tuesday

Market Low
On October 29, 1929, known as Black Tuesday...

- A record 16.4 million shares were sold.
- By November 13, the Dow Jones had fallen from its September high of 381 to 198.7.
- Overall losses amounted to $30 billion.
How did the stock market crash affect the American people?

• By 1929, about 4 million out of 120 million Americans had invested in the stock market. These people lost basically everything.

• Eventually, it ended up affecting the people who had never owned a single share of stock, and even people from other countries.
• For example, as income & profits fell, factories closed and thousands of workers lost their jobs or had their pay cut.

• When Henry Ford shut down his Detroit car factories, for example, over 75,000 people lost their jobs.

• By 1932, a quarter of the American labor force was out of a job.
• By 1933, the **Gross National Product** (total annual value of goods and services a country produces) was half of what it had been in 1929.

• Restaurants and other small businesses closed because customers could no longer afford to go there.

• Rich families could no longer afford to hire household workers.

• Farm prices, already low, fell even more.

• For example, a bushel of wheat that sold in 1929 for $1.04 brought $.38 in 1932.

• Thousands of banks closed because they could not return their depositors’ money or sell foreclosed properties.
So let’s put it all together.

• We should consider the stock market crash of 1929 to be the “straw that broke the camel’s back” in terms of causing the Great Depression.
Deeper problems were the real underlying causes of the Great Depression.

• Because so many people bought stock on margin, the boom in the stock market was based on borrowed money and optimism as opposed to real value.
• The seemingly prosperous economy lacked a firm base.
• National wealth was unevenly distributed.
• The families who had the most money tended to invest or save rather than buy goods.
• Industry produced more goods than customers wanted or could afford.
• Even though wages increased, most felt that their incomes did not keep up with prices.
• Farmers and many workers did not share in the economic boom.
Because of the aforementioned reasons, rapid recovery after the crash was impossible.

And so we had a big depression!