Section 1

The Stock Market Crash

READING FOCUS

- What events led to the stock market's Great Crash in 1929?
- Why did the Great Crash produce a ripple effect throughout the nation's economy?
- What were the main causes of the Great Depression?

KEY TERMS

Dow Jones Industrial Average
Black Tuesday
Great Crash
business cycle
Great Depression

TAKING NOTES

As you read, complete the following diagram to show some of the causes and effects of the Stock Market's Great Crash in 1929.

CAUSES
- Overspeculation during the 1920s
- Overproduction of goods

THE GREAT CRASH

EFFECTS
- Investors and businesses lose millions
- Thousands of banks fail, savings are wiped out

MAIN IDEA

In October 1929, panic selling caused the United States stock market to crash. The crash led to a worldwide economic crisis called the Great Depression.

Setting the Scene On October 29, 1929, fear gripped the floors of the New York Stock Exchange as investors watched millions of dollars slip away. The "wonderful prosperity" of the 1920s had come to an abrupt end. Writers Gordon Thomas and Max Morgan-Witts captured the scene:

> *"A messenger struggling through the crowd suddenly found himself yanked by his hair off his feet. The man who held him kept screaming he had been ruined. He would not let the boy go. The terrified youth at last broke free, leaving the man holding tufts of his hair. Crying in pain, the messenger fled the Exchange. His hair never regrew.*
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> *Behind, he left a scene of increasing pandemonium. As huge blocks of shares continued to be dumped, . . . 1,000 brokers and a support army of 2,000 page boys, clerks, telephonists . . . and official recorders could sense this was going to be the 'day of the millionaire's slaughter.'*
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> *William Crawford, swept along helplessly by the great tide of people, would always remember how 'they roared like a lot of lions and tigers. They hollered and screamed, they clawed at one another's collars. It was like a bunch of crazy men.'"*
>
> —Gordon Thomas and Max Morgan-Witts from *The Day the Bubble Burst*

VIEWING HISTORY As stock market prices fell, the ticker tape could not report market activity fast enough. Nervous investors crowded into Wall Street hoping to hear the latest news. **Identifying Central Issues** *Why did investors panic in October 1929?*

The Market Crashes

Before the panic on that fateful October day, most people saw no reason to worry. In early 1928, the **Dow Jones Industrial Average,** an average of stock prices of major industries, had climbed to 191. By Hoover's Inauguration

Day, March 4, 1929, it had risen another 122 points. By September 3, the Dow Jones average reached an all-time high of 381.

The rising stock market dominated the news. Keeping track of prices became almost as popular as counting Babe Ruth's home runs. Eager, nervous investors filled brokerage houses to catch the latest news coming in on the ticker tape. Prices for many stocks soared far above their real value in terms of the company's earnings and assets.

Black Thursday After the peak in September, stock prices fell slowly. Some brokers began to call in loans, but others continued to lend even more. One bank official assured the nervous public: "Although in some cases speculation has gone too far, . . . the markets generally are now in a healthy condition."

When the stock market closed on Wednesday, October 23, the Dow Jones average had dropped 21 points in an hour. The next day, Thursday, October 24, worried investors began to sell, and stock prices fell. Investors who had bought General Electric stock at $400 a share sold it for $283 a share.

Again, business and political leaders told the country not to worry. Another banking executive said that only a nation as rich as the United States could "withstand the shock of a $3 billion paper loss on the Stock Exchange in a single day without serious effects to the average citizen." President Hoover maintained that the nation's business "is on a sound and prosperous basis."

Black Tuesday To stop the panic, a group of bankers pooled their money to buy stock. This action stabilized prices, but only for a few days. By Monday, prices were falling again. Investors all over the country raced to get their money out of the stock market. On October 29, **Black Tuesday,** a record 16.4 million shares were sold, compared with the average 4 million to 8 million shares a day earlier in the year.

This collapse of the stock market is known as the **Great Crash.** Despite efforts to halt it, the Crash continued beyond Black Tuesday. By November 13, the Dow Jones average had fallen from its September high of 381 to 198.7. Overall losses totaled $30 billion. The Great Crash was part of the nation's **business cycle,** a span in which the economy grows, then contracts.

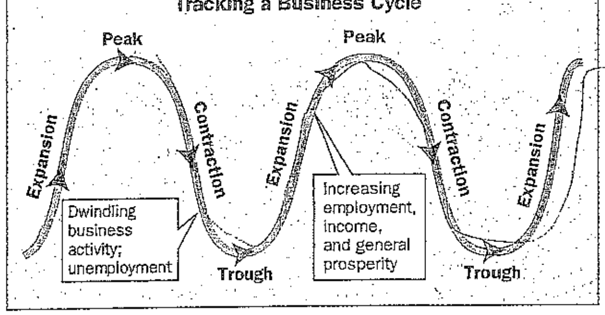
Focus on ECONOMICS

Business Cycle *The periodic growth and contraction of a nation's economy.*

The Historical Context The Crash of 1929 brought an abrupt end to the economic expansion of the 1920s and ushered in a prolonged period of economic contraction known as the Great Depression. During the Depression, political leaders debated whether to stimulate the economy through higher government spending or to rely on the natural operation of the free market to restore economic expansion and prosperity.

The Concept Today The American economy continues to alternate between periods of higher growth and slower growth, or contraction. Both the federal government, through its taxing and spending fiscal policies, and the Federal Reserve, through its monetary policies that regulate the nation's supply of money, seek to prevent shocks that would bring about severe downturns in the economy.

Tracking a Business Cycle



The Ripple Effect of the Crash

Initially the effects of the Crash were felt only by those who were heavily invested in the stock market. By 1929, that number was about 4 million people out of a population of 120 million. Some investors lost everything. One wealthy Bostonian who lost heavily in the market wrote in his diary, "The profit in my little book melted yesterday to seven thousand. It is probably nil [nothing] today. . . . My dreams of a million—where are they?"

Within a short time, however, the effects of the Great Crash began to ripple throughout the nation's economy. Soon millions of people who had never owned a share of stock were affected. The following list explains how the effects of the Crash spread to all Americans.

READING CHECK
Who felt the effects of the Great Crash?

Risky loans hurt banks Banks earn their profits on the interest they earn from lending out their deposits. Throughout the 1920s, banks loaned huge sums of money to many high-risk businesses. When stock prices fell, these businesses were unable to repay their loans.

Consumer borrowing Banks also make money on loans they lend to consumers. Consumers had borrowed heavily from banks throughout the 1920s to purchase consumer goods. When banks called in their loans, customers did not have cash to pay them.

Bank runs The Great Crash resulted in widespread bank runs. Fearful that banks would run out of money, people rushed to make withdrawals from their accounts. To pay back these deposits, banks had to recall loans from borrowers. However, many businesses and consumers hurt by falling stock prices could not repay their loans. Even if loans were repaid, banks could not get the money fast enough to pay all the depositors demanding their money.

Bank failures The combination of unpaid loans and bank runs meant that many banks across the country failed. Thousands of banks closed their doors when they could not return their depositors' money. In just a few years, more than 5,500 banks failed.

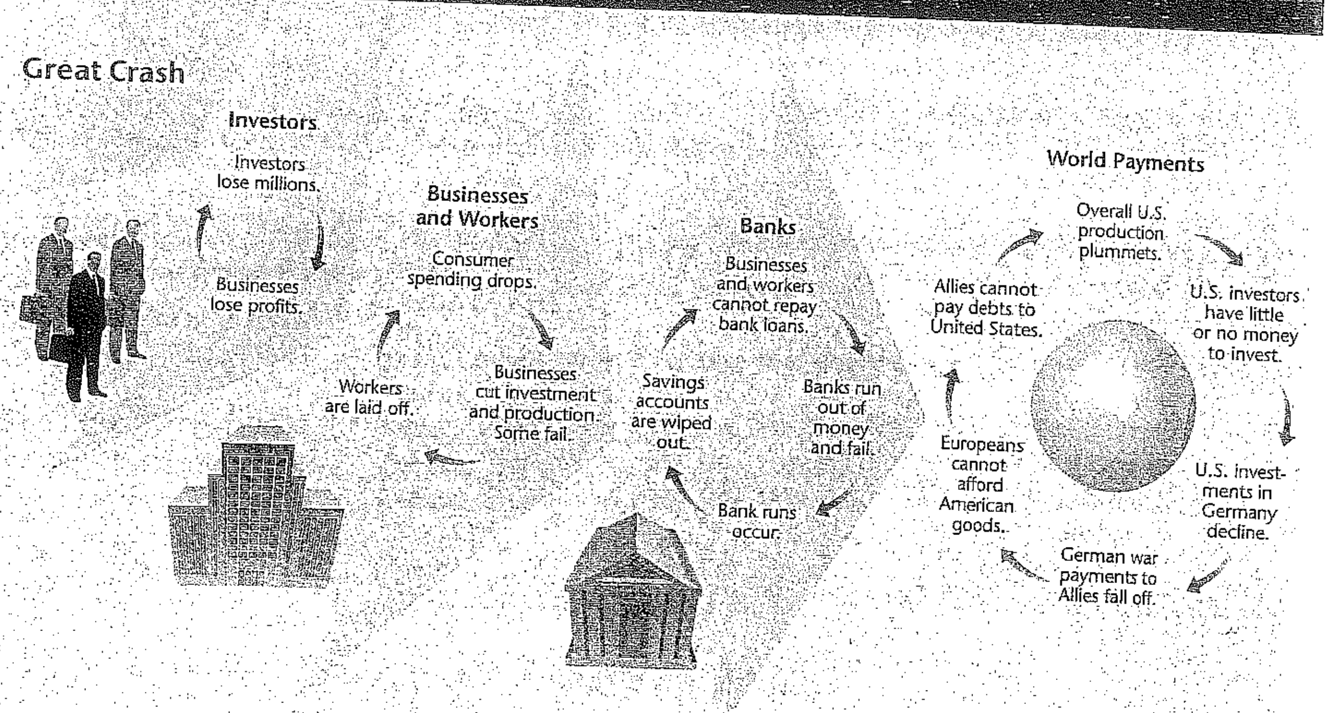
Savings wiped out Bank failures wiped out what little savings people had. By 1933, the money from 9 million savings accounts had vanished.

Cuts in production Businesses now could not borrow money to use to produce more goods. In addition, businesses lacked any incentive to spend money producing goods. Few people had money to buy them.

Rise in unemployment As businesses cut back on production, they laid off workers. Unemployment grew.

INTERPRETING DIAGRAMS
After the Great Crash, each sector of the economy experienced a damaging cycle of events. Each cycle also directly influenced the others. **Expressing Problems Clearly** *How did the events following the Great Crash interact and affect one another?*

Effects of the Great Crash, 1929



Further cuts in production As unemployment grew and incomes shrank, consumers spent less and less money and businesses produced still fewer goods. The overall output of goods in the economy dropped.

Economic Contraction The results of the Great Crash described above are all symptoms of an economy beginning to contract. A contraction is an economic decline marked by a falling output of goods and services. A particularly long and severe contraction is known as a depression. The contraction that began with the Great Crash triggered the most severe economic downturn in the nation's history—the **Great Depression.** The Great Depression lasted from 1929 until the United States entered World War II in 1941.

Impact on Workers and Farmers With no money and little incentive to produce more goods, factories throughout the country began to close. Thousands of workers lost their jobs or endured pay cuts. In August 1931, Henry Ford shut down his Detroit automobile factories, putting at least 75,000 people out of work.

Soon after local factories closed, small local businesses began to suffer as well. Restaurants and other small businesses closed because customers could no longer afford to go to them. Formerly wealthy families dismissed household workers. Farm prices, already low, fell even more, bringing disaster to many families. In 1929, a bushel of wheat had sold for $1.18; in 1932 it brought a mere 49 cents. Cotton dropped from 19 to 6.5 cents a pound.

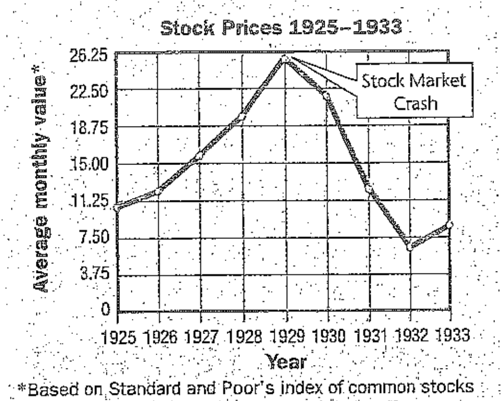
By 1932, more than 12 million people were unemployed, which accounted for about a quarter of the labor force. (See the graph to the right.) Others worked only part-time or had their wages cut. The Gross National Product (GNP)—the total value of goods and services a country produces annually—dove from $103 billion in 1929 to just $56 billion in 1933.

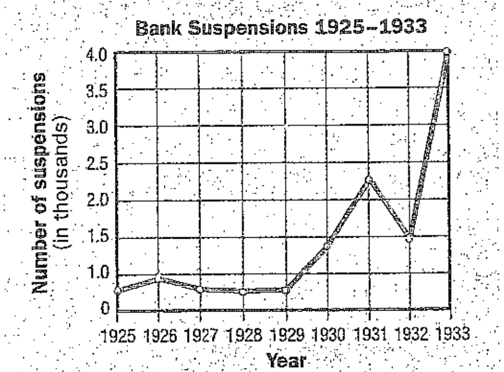
Impact on the World By the 1930s, international banking, manufacturing, and trade had made nations around the world interdependent. For example, Latin America depended on U.S. markets for its goods. Europeans depended on the United States for investments and loans. When the world's leading economy fell, the global economic system began to crumble or contract in much the same way the U.S. economy had.

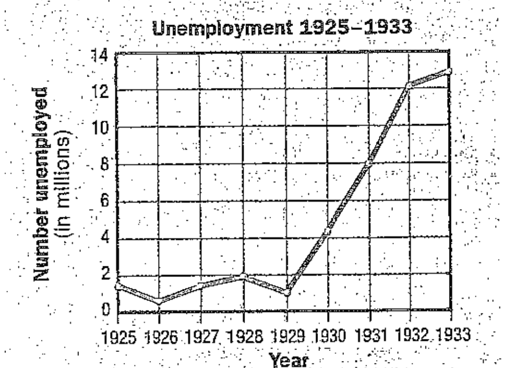
After World War I, the United States had insisted that France and Britain, its wartime allies, repay their war debts. At the same time, Congress kept import taxes high, making it hard for European nations to sell goods in the United States. With economies weakened by the war and little chance of selling goods in the United States, the Allies had to rely on Germany's reparations payments for income.

As long as American companies invested in Germany, reparations payments continued. But with the Depression, investments fell off. German banks failed, Germany suspended reparations, and the Allies, in turn, stopped paying their debts. Industrial production fell by 40 percent in Germany, 14 percent in Britain, and 29 percent in France. Europeans could no longer afford to buy American-made goods. Thus the American stock market crash started a downward cycle in the global economy.

Economic Impact of the Great Depression

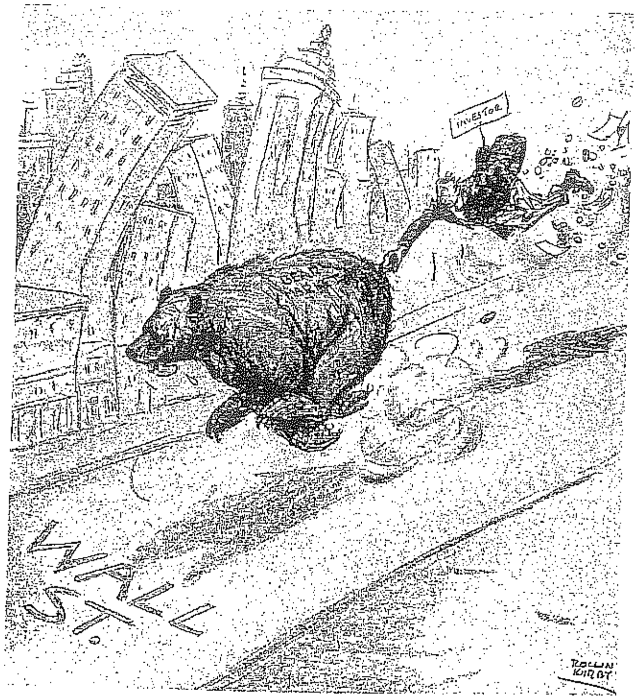






SOURCE: *Historical Statistics of the United States, Colonial Times to 1970*

INTERPRETING GRAPHS
The stock market crash caused a series of economic disasters.
Analyzing Information *Roughly how many people became unemployed between 1929 and 1933?*



INTERPRETING POLITICAL CARTOONS This cartoon was published three weeks before the Great Crash, at the beginning of a "bear market." A bear market exists when the stock market falls for a period of time. **Analyzing Visual Information** *What effect did the cartoonist predict the bear market would have on Wall Street?*

Underlying Causes of the Depression

The stock market crash of 1929 did not cause the Great Depression. Rather, both the Great Crash and the Depression were the result of deep underlying problems with the country's economy.

An Unstable Economy Overall, the seemingly prosperous economy of the 1920s lacked a firm base. National wealth was unevenly distributed, with most money in the hands of a few families who tended to save or invest rather than buy goods. Industry produced more goods than most consumers wanted or could afford. Farmers and many workers had not shared in the economic boom. The uneven prosperity of the 1920s made rapid recovery from an economic downturn impossible.

Overspeculation During the 1920s, speculators bought stocks with borrowed money and then pledged those stocks as *collateral* to buy more stocks. Collateral is an item of value that a borrower agrees to forfeit to the lender if the borrower cannot repay the loan. Brokers' loans went from under $5 billion in mid-1928 to $850 billion in September 1929. The stock market boom was based on borrowed money and optimism instead of real value.

Government Policies Mistakes in monetary policy were also to blame. During the 1920s, the Federal Reserve system, which regulates the amount of money in circulation, cut interest rates to spur economic growth. Then in 1929, worried about overspeculation, the Federal Reserve limited the money supply to discourage lending. As a result, there was too little money in circulation to help the economy recover after the Great Crash.

Section 1 Assessment

READING COMPREHENSION

1. What is the **Dow Jones Industrial Average?**
2. What happened on **Black Tuesday?**
3. Which part of the **business cycle** did the **Great Depression** represent?
4. What could cause a country's Gross National Product to decrease?
5. How did the unstable economy in the 1920s contribute to the Great Depression?

CRITICAL THINKING AND WRITING

6. **Recognizing Cause and Effect** How did the Great Depression have such a huge impact on the economies of other countries?
7. **Making Comparisons** Many people today use credit cards and charge accounts to buy on credit. Is this practice as dangerous now as it was in 1929? Why or why not?
8. **Writing to Inform** It is the day after Black Tuesday. Write a brief newspaper report describing the scene at local banks.

Take It to the NET

Activity: Writing a Diary Entry Research the events of October 1929 leading up to the Great Crash. Then write a diary entry from the perspective of a stockbroker in New York noting your experiences. How are you affected by the crash? What is your reaction? Use the links provided in the *America: Pathways to the Present* area of the following Web site for help in completing this activity.
www.phschool.com