On October 25, 1929 the New York Stock Exchange saw 13 million shares being sold in panic selling. During the 1920s the American economy grew at 42 percent and stock market values had increased by 218 percent from 1922 to 1929 at a rate of 20 percent a year for 7 years. No country had ever experienced such a run-up of stock prices which attracted millions of Americans into financial speculation. Nobody had seen the stock market crash coming and Americans believed in permanent prosperity till it happened. There was no rational explanation for the collapse of the American markets in October 1929. Nearly US $ 30 billion were lost in a day, wiping out thousands of investors. In the aftermath of the US stock market crash, a series of bank panics emanated from Europe in 1931 spreading financial contagion to United States, United Kingdom, France and eventually the whole world spiraled downward into the Great Depression. The Great Depression lasted from 1929 to 1939 and was the worst economic downturn in history. By 1933, 15 million Americans were unemployed, 20,000 companies went bankrupt and a majority of American banks failed.

Early in 1928, the US Federal Reserve began a monetary contraction to reduce stock market speculation. This coupled with declining value of bank assets resulted in a rush of bank withdrawals. As Americans held onto liquidity, the ability of the Banking system to generate money through deposits was curtailed. The US Banking system could have been saved by a massive recapitalization of Banks but the Federal Reserve did not intervene. In that period, the United States maintained significant current account surplus and Germany a substantial current account deficit. Borrowings by German public and private sector occurred in foreign currencies through dollar denominated bonds and credits from United States, routed through banks in the Netherlands, Switzerland and Austria. Monetary contraction in the United States culminated in a depression in Germany. The Reichsbank’s foreign reserves of gold and foreign exchange declined sharply. In May 1931, Austria’s largest Bank, the Kreditanstalt collapsed. As investors feared that their moneys would be frozen or lost, there was a huge capital exodus. Germany

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failed to obtain the foreign credits needed to halt the crisis. To halt the capital outflow, Germany had to close banks, devalue the mark, negotiate standstill agreements with foreign creditors and impose exchange controls. In the period 1930-32, money supply in the United States fell by 26 percent, Germany by 27 percent, in United Kingdom and France by 18 percent.

The German currency and banking crisis impacted the British pound. Vulnerabilities emerged in the British economy, given the United Kingdom’s large short term indebtedness and slim gold reserves. European Banks whose assets were frozen by the German standstill agreements were making significant withdrawals from the United Kingdom resulting in a weakening of the pound. On September 16, 1931 United Kingdom suspended gold convertibility and allowed the pound to float. The Bank of England revalued its gold stock and expanded its domestic credit enabling a faster recovery than in United States and Germany. France felt the impact of the Great Depression once the pound became a floating currency and the dollar devalued. The French Franc was forced off the gold standard in 1936.

By 1933, 35 Nations had abandoned gold and gold-exchange standards. The trade of countries with stable currencies – France, Germany and United States declined substantially higher than the trade of countries with depreciated currencies – the United Kingdom and Canada. The decreases in value of exports in 1932 from the previous year was 35 percent in France, 40 percent in Germany and 33 percent in the United States as compared to 7 percent in United Kingdom and 19 percent in Canada. It was broadly felt that currency depreciation would stimulate a country’s exports if other conditions are favorable. The United States promulgated the Tariff Act authorizing the President to raise or lower tariff rate by a maximum of 50 percent to ensure that the foreign currency depreciation did not result in millions of Americans losing their employment.

The United States did not lead the recovery in 1933. Economic recovery as indicated by industrial activity was visible in Great Britain, France and Germany, with the United States witnessing a rapid industrial upturn during April and May 1933. The “New Deal” of President Franklin Roosevelt brought in a sweeping reformation of the US economy, laying the foundations of the American welfare state – federal aid to the unemployed, stiffer regulation of industry, legal protections for workers, and the Social Security program. The “New Deal” was the first step in the United States muscular emergence from the Great Depression, and the beginning of the country’s rise to become the undisputed “leader of the free world.”

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MAJOR FINANCIAL CRISIS OF 21ST CENTURY

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