WALL STREET AND LOMBARD STREET

The Stock Exchange Slump of 1929 and the Trade Depression of 1930

BY

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INTRODUCTORY

In selecting a title for this small book, I was influenced by the first sentence of Bagehot's masterpiece: "I venture to call this Essay 'Lombard Street,' and not the 'Money Market,' or any such phrase, because I wish to deal, and to show that I mean to deal, with concrete realities." The astounding collapse of Overend Gurney & Co. and the panic which ensued, not long after Bagehot assumed the editorship of the *Economist,* were the original incentives to a long series of articles in that paper. These "obiter scripta," or occasional writings, were matured and eventually collected in 1873, seven years later, to form the Essay, or collection of essays, which constitute Bagehot's famous contribution to banking theory and practice, a contribution which time has not dulled nor later experience impaired.

I was appointed to the Chair of the *Economist* nearly thirty years after Bagehot's death, and only a year before the American crisis and panic of 1907. During that anxious time I was in close touch with the Bank of England and was largely guided in my criticisms by the sagacious advice of the late Mr. H. W. Search, then head of the Discount Department and an ardent but critical admirer of my celebrated predecessor. In the following year, when I visited the United States, the late Senator Aldrich invited me to co-operate with the Monetary Commission. Its members were then beginning the investigations that led up to their Report, and ultimately to the establishment, in President Wilson's first term, of a new and scientific system designed, under the control of the Federal Reserve Board, to govern and regulate the money and credit of the United States. On the successes and imperfections of that system Mr. Paul Warburg and other distinguished American authorities, with whose intimate knowledge and practical experience I cannot compete, have written at length. But whatever its faults the reformed system, to which both Republicans and Democrats have contributed their best thought, is entitled to high praise; for it surmounted the War panic in the autumn of 1914 and prevented the colossal slump of Wall Street in October, 1929, from degenerating into a total collapse of credit like that which precipitated a general suspension of cash payments throughout the United States after the panic of 1907.

This little essay of mine, ambitious in extent but modest in length, begins with a narrative of the events in Wall Street during October and November, 1929, when I was convalescing after a severe illness in the New York Hospital, a morbid but not indifferent spectator of a national catastrophe which was to turn the whole economic and political world upside down.

In tracing the headlong and disastrous course of this torrent from Wall Street to London, from the Stock Exchange to business, I have allowed my eye to roam all over the world and my mind to dwell upon other political occurrences and historical causes dating from the the Great War and the settlement, or rather unsettlement, which followed it. For this extensive view no apology is really needed. The examination of a world-wide malady cannot be confined to a diagnosis of conditions in a single country, however great and powerful; for after all, the United States is, as it were, only one limb of the political and economic leviathan, a huge body corporate of interdependent societies and nations.

A complete financial and economic history of the Wall Street panic and collapse of October-November, 1929, would comprise an account of the bull market from 1927 onwards and of the New York money market, together with the concomitant features of the London money market and of gold movements. It would trace in detail the ups and downs of American Stock Exchange prices for at least twelve months down to the week ending Saturday, October 25, 1930. In that week the average prices of shares in Wall Street reached the lowest level for more than two years, and the Republican administration at Washington, under the leadership of President Hoover, abandoning in practice the theory so long maintained that trade was about to revive, proclaimed the necessity of dealing energetically with unemployment by schemes of relief which, in the absence of unemployment benefit or systematic Poor Law, would at least stave off wholesale starvation, or acute destitution in industrial districts. In the course of his examination our historian would seek causal connections between the Stock Exchange collapse, the collapse of many commodity markets, and the depressed condition of business, not only in the United States but in other countries. Such an interpretation of economic history must be on a scale resembling rather Gibbon's *Decline and Fall* than Bryce's brilliant essay or sketch of the Holy Roman Empire. My own ambition will be amply fulfilled if, at this stage, while the events are still fresh and the losses still recent, I can provide an outline of the great disaster and place in due perspective and proportion its main causes and consequences, and so provide new guidance to investors and some new warnings to speculators in the future.

This method of treatment relieves me of the task, usually undertaken in a preface, of stating in detail obligations which would cover many pages of print. The account of the collapse in Wall Street is based upon reading day after day the minute descriptions, not wanting in colour, of the three great newspapers of New York—the *Times,* the *Herald Tribune* and the *World*—to which I would add the meditative criticisms of the *Commercial and Financial Chronicle* and of the London *Economist.* I dare not attempt a bibliography of the new literature which I have examined, or of the much larger mass of material which I have not examined, in the last year. My thanks to other writers must therefore be conveyed in vague and general terms; but I must express a special obligation to the British Broadcasting Corporation and to its weekly organ, the *Listener*, for allowing me to use freely a series of talks which I gave in the summer of 1930.

I am indebted to Miss P. G. Maclagan for much help throughout. But for her skilled assistance I should hardly have been able to undertake the book, and I should certainly have fallen into many more inaccuracies than those (few I hope) which sharp-eyed experts may detect and expose.

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I. THE WALL STREET COLLAPSE

CHAPTER I

THE BOOM, 1927 TO 1929

An upward movement of American stocks and shares in Wall Street, which was to be blown by a nation-wide gambling mania into the splendidly iridescent but fragile and transitory bubble that burst two years later, started on its course in 1927. In the second half of that year, to quote a leading authority, the Federal Reserve System "under a daring but carefully devised plan" reduced its discount rate to 3½ per cent, purchased Government securities on a large scale, and embarked upon a policy of easing money in the United States, partly to encourage trade and enterprise, partly to assist other countries, and especially Great Britain, in stabilizing depreciated currencies and re-establishing the gold standard. That such a policy would stimulate speculation became evident at the end of the year, and in the early months of 1928 the Federal Reserve Board, changing its course, raised its discount rate by three successive increases to 5 per cent in July of that year. But fear of "hurting business" and of interfering with profitable Stock Exchange activities prevented the adoption of any drastic policy, and the 5 per cent rate had practically no effect in restraining that exuberant spirit of speculation which was gripping "all classes in all parts of the country." In February, 1929, and again in April, the Board issued warnings, and in May several breaks occurred in the stock market. It was feared then that "frantic liquidation might degenerate into a panicky stampede," and for that reason, perhaps, the Board decided against a recommendation of the Advisory Council to increase the discount rate to 6 per cent. Meanwhile the New York banks came to the assistance of the bulls, instead of encouraging, as they should have done in Mr. Warburg's judgment, "a quiet but persistent liquidation." [1]

By this time the intrinsic weakness of the market was unmistakable to experienced observers. The prices of most railroad and industrial stocks could not be justified by past dividends or by any reasonable hope of immediate expansion, though well-known bankers and business men and even some economists of repute declared that "a new era" had arrived which would justify still further rises in stock values by a marvelous growth of earnings. Some ten billions of dollars in securities were already carried by brokers' loans and bank loans to support a nation-wide borrowing on margins to finance stock exchange speculation. But most of the leading bankers ignored the danger, and "the tottering brokers'

[1] See Mr. Paul M. Warburg's book *The Federal Reserve System*, Vol. I, Addendum II on The Stock Exchange Crisis of 1929. The Macmillan Company, 1930.

loan structure was permitted to rise by another billion dollars, while numberless investment trusts . . . operating to produce a further pyramiding of prices, were floated almost from day to day, and Stock Exchange quotations soared to new fantastic levels." At last on August 9, 1929, the Federal Reserve Board allowed the New York Reserve Bank to raise its rate to 6 per cent; but it was too late to sober the "frenzied mind of those wedded to the gospel of investing and speculating in inflated stocks." After blaming the Board for failing to arrest the Stock Exchange debauch, Mr. Warburg adds:

> In fairness it must be admitted, however, that any Board —no matter what its constitution—would have found it a Herculean, if not an impossible, task to perform its functions wisely and efficiently in circumstances such as surround it at present. In a country whose idol is prosperity, any attempt to tamper with conditions in which easy profits are made and people are happy, is strongly resented. It is a desperately unpopular undertaking to dare to sound a discordant note of warning in an atmosphere of cheer, even though one might be able to forecast with certainty that the ice, on which the mad dance was going on, was bound to break. Even if one succeeded in driving the frolicking crowd ashore before the ice cracked, there would have been protests that the cover was strong enough and that no disaster would have occurred if only the situation had been left alone.
>
> The Board, much to its credit, had the courage to warn the country; but it stayed its hand when it should have driven the people ashore before the ice broke. It hesitated to sacrifice what appeared to the country to be actual pros-

perity to what might have seemed to the people a problematical disaster.

Many other authorities in the United States agree with the two main conclusions drawn from the Stock Exchange panic of 1929 by Mr. Paul Warburg: first that a banking collapse even more disastrous than that of 1907 was averted by the existence of the Federal Reserve System and the vast improvement thereby effected in the currency and banking of the United States; and secondly that, as at present constituted, the Federal Reserve Board is too much exposed to interference from politics and business, and that a more expert and independent administration is needed to unite and regulate the action of the Reserve Banks.

However that may be; and however true the argument that cheap money helped to stimulate the boom which dearer money might have kept within bounds; and however true it may also be that the scarcity of money and the drain of gold to New York to earn the high rates offered in the summer of 1929, and finally the rise of the London bank rate to 6½ per cent on September 26th, precipitated the Stock Exchange crisis and slump of October—it is still true that the calamity we are now about to describe proceeded from the natural propensity of mankind to speculate and gamble, a propensity which has never manifested itself on such a scale, or by a nation so wealthy, as it did during 1928 and 1929 in the United States.

The relationship between the boom in stocks and the price of money was indeed very close, as might be expected when the whole nation—almost every town and village in the United States—was buying shares on margin with money borrowed from the banks. It was no casual coincidence that the high prices paid for securities were accompanied by very high rates for money. Thus at the end of March (to quote *The New York Times*) call money renewed at the money post of the Stock Exchange at 12 per cent, advanced to 15 per cent, 17 per cent and finally to 20 per cent, almost causing a panic. "The crisis was broken when the National City Bank put into the market funds secured by discounting in defiance of the Reserve Board's warning." After severe squeezes in March and April, an easier tone developed in May; but at the end of June the call-rate rose to 10 and 15 per cent. In August, call-money rates varied from 12 to 6 per cent, and in September they were usually from 8 to 10 per cent, while time money advanced to over 9 per cent. Towards the end of that month, a decline in share prices weakened call money, while time money remained at 9 per cent, influenced by the high discount rates of London and other European centres.

Thus, while stocks and marginal speculation governed money up to September, a reverse process began in October; and with a downward movement of stocks the stringency of the money market relaxed as the demand for accommodation by Stock Exchange speculators diminished. When this demand ended and a rapid decline in trade reduced the volume of commercial bills all over the world, the famine in gold disappeared and the scramble for it ceased so completely that for many months the precious metal, whose scarcity had forced up bank rates, seemed to be superabundant and, as it were, a glut in the world's money markets.

In September, while Wall Street prices were fluctuating uneasily, a disaster occurred in London which brought the crash in New York perceptibly nearer. An unscrupulous financier, who went by the name of Clarence Hatry, had formed a miscellaneous combination known as the Hatry group of companies, including various worthless concerns, bought with money obtained from the banks, largely by forgery of municipal stock certificates. Details of this colossal swindle need not be retold here. Those who desire to refresh their memories of it will find the story of the Hatry crisis in the *Economist* of September 28, 1929. Enough that Photomaton and other disreputable shares of the group, which had risen far above their nominal value, began to slump in the middle of September. The crash came on September 20th, and soon after the opening of the London Stock Exchange permission to deal in the Hatry "securities" was suspended by the General Purposes Committee. The arrest and conviction of Hatry and his accomplices followed; but the heavy losses inflicted upon members of the Stock Exchange and a credulous public cast a gloom over the city, and many weeks elapsed before the *débris* was cleared away.

This disaster to Stock Exchange gamblers was followed on Thursday, September 26th, by a rise in the official discount rate of the Bank of England from the high rate of 5½ per cent, to which it had been raised on February 7th, to the very high rate of 6½ per cent. Since the middle of June the Bank of England had been losing gold. In two months the Proportion of Reserve to Liabilities shrank from 57 to 27 per cent, and for some time the gold stock had been considerably below the 150 million limit or minimum suggested by the Cunliffe Committee. Whether the action of the Bank in raising its rate was right or wrong need not be discussed here; but it is certain that it hastened the downfall of speculation in the United States, though for several weeks longer quiet liquidation by shrewd bankers and business men was offset by the continued fervour and desperate belief of the gambling public that their favourite stocks would resume the rise, which had continued with minor interruptions for several years, until "the new era" arrived with Stock Exchange fortunes for everybody and nation-wide prosperity. Everyone, as the *Commercial and Financial Chronicle* of New York put it, "became seized with the idea that it was possible to get rich overnight by simply taking flyers in the stock market." Everyone was fascinated by the fluctuations on the Stock Exchange; everyone believed in the rising market, and