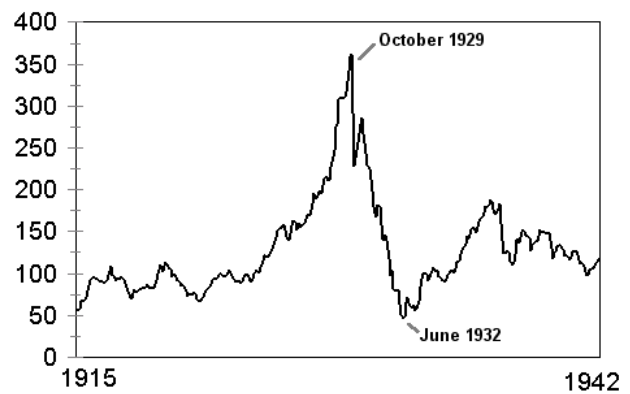
Name:______________________________________

Boom and BUST in the U.S. and World Economies

Fueled by easy money the nineteen-twenties were boom times like never before. The post-war recession was forgotten as everyone went on a spending spree. Credit, and not savings, enabled consumers to boost corporate profits to new levels.



The 1920's saw new discoveries and inventions in nearly every field of endeavor that became the foundation of thriving businesses. Patent attorneys did a roaring trade and nearly every man fancied himself as an inventor if the number of patent submissions was anything to go by.

New business and production methods allowed manufacturers to make large profits which they plowed

back into new factories and wage rises. Department store and service station chains used massive buying power and operating efficiencies to lower prices while increasing service and choice, helping wages to go further. Henry Ford used his huge buying power to setup discount grocery stores for his employees, much to the annoyance of local store owners.

1. Give two examples of inventions or new products that we discussed were introduced to the market prior to 1920:

Increased incomes, along with the introduction of credit funded a huge increase in consumer spending. Only some of the increased affluence found its way into insurance as a provision for retirement.

People living in the cities and areas of industry benefited most from the increased prosperity although there were arguments to the contrary. Those living in rural areas did not benefit to the same extent, and this was made worse by widespread drought. This encouraged population movement from rural areas to cities, a trend which has continued down to the present day. In 1926 alone the Department of Agriculture calculated that the net migration in favor of the cities was over one million people.

2. Why do you think that people favoring living in cities in times of prosperity?

Shoppers were able to buy big ticket consumer items like cars, fridges, washing machines, pianos, vacuum cleaners, furniture, and radios on time payment. Previously, these expensive items were only affordable by the wealthy. Once one manufacturer or retailer offered installment purchases the competition were forced to follow suit. About half of all installment debt was for automobiles. It was estimated that 75 per cent. of all automobiles, 85 or 90 per cent. of all furniture, 80 per cent. of all phonographs, 75 per cent. of washing-machines, 65 per cent. of vacuum cleaners, 25 per cent. of all jewelry, and the greater part of all pianos, sewing-machines, radios, and electric refrigerators, were sold by partial payment. About $140,000,000 worth of clothing was also sold per annum on this plan. When

British manufacturers saw how installment selling had boosted American business they introduced "buying on tick" to Great Britain. *NOTE: Unlike the boom times in America, it should be pointed out that people living in Europe in the 1920's, Germany and Austria especially, suffered massive hyperinflation that destroyed the wealth of the middle class and led to political and economic turmoil in the affected countries.*

3. Explain an installment payment in your own words:

4. What are the dangers of purchasing products on credit?

The growth in number of millionaires is shown in Tax Reports by the Treasury Department, who reported that there were 21 individuals with an annual income of over one million dollars in 1921, 75 in 1924, and 207 in 1926. There were an estimated fifteen thousand U.S. millionaires in 1927, and at least one billionaire (cumulative net worth), nearly four thousand of these living in New York, including three thousand living on or near Park Avenue.

The rich splurged on apartments on Park Avenue and filled them with antiques and expensive paintings. The upward spiral in prosperity seemed to have no end and as always happens in this situation the easy money found its way into speculation. Using borrowed money, speculators pushed up the price of houses, land and shares.

5. Define the term speculation (root word – speculate):

The Share Market (Stock Market) climbed to dizzy heights as speculators bought stock on margin, and following well publicized successes, the general public joined in looking for easy profits. Shares could be purchased for a **down-payment of 10% but a more common price was 50%,** the remainder of the

price being **financed by a loan** from the share broker. When stock prices eventually slumped (fell) many investors had to sell shares to meet "margin calls" forcing share prices to drop further, exacerbating the problem and leading to the Share Market crash of October and November 1929.

In other words, people were **buying stock on credit**. If the stock was worth $40.00/share, they only had to pay the stock broker 50% of this price or $20.00. The rest of the price of the stock was a "loan", so the stock broker would pay the other 50%. The investor then paid **interest** on the loan and this is how stock brokers made their money. Therefore, people who purchased stock on credit *hoped* that stock prices would rise enough for them to pay back the loan AND turn a profit. So if stock prices rose to $60.00/share, investors could sell, pay the broker the $20.00/share that they owed plus the interest and keep the rest of the profits.

6. What do you think it means to "buy on margin"? What were people buying?

7. Why is it dangerous or risky to "buy on margin"?

8. Why do you think so many people chose to take the risk of "buying on margin"?

If the value of the stocks were to **decrease** below 50% of the price that they were bought at, there would be a "broker's call" or "margin call", where the stock broker would require the investor to give more money to the broker or sell the stock and pay off his debt. When someone buys on margin, the stock itself is acting as collateral. If the value of the stock decreases below the margin, then even after selling the stock the investor would still owe the broker money.

9. Pretend you are an investor that is interested in investing in the stock market. Using the information below, explain how much you would need for a down payment, what your profit or loss was and what you owe the broker if anything:

You are purchasing AT&T stock. Your broker has decided that your margin will be 50%. You would like to purchase 10 shares of the stock and each share is $20.00/share. How much will you need as a down payment for this purchase?

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You are currently being charged 5%/month in interest. You have 12 months to pay off your loan. How much is your monthly payment to your stock broker?

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SCENARIO ONE: Stock prices have climbed to $30.00/share in the very first month! You decide to sell your stock. What is your profit? Remember you still need to pay your broker for the loan AND your first months interest

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SCENARIO 2: Stock prices have fallen to $10.00/share in the very first month! You panic and decide to sell your shares before things get any worse. What is your total loss? Remember you still need to pay your broker for the rest of the loan AND the interest that you owe.

It was no coincidence in this time of financial plenty that executive salaries ballooned to extravagant levels, widening the gap between management and the workers. Wall Street and the Banks grew fat on the fees involved in corporate mergers and paid large Christmas bonuses to their staff. Business ethics collapsed and corruption was widespread at high levels in politics and business, leading to some high profile trials. One of these was the Doheny oil lease corruption scandal. These were all signs that the boom times were about to end.

10. How did Wall Street and the banks benefit from the "boom" period?

11. If you were a Congressman in 1920 who knew what the outcome of the boom period would be. In other words, you have all the knowledge of someone living in 2012, what would you do to try to prevent the market crash and Great Depression? (10 lines or more)

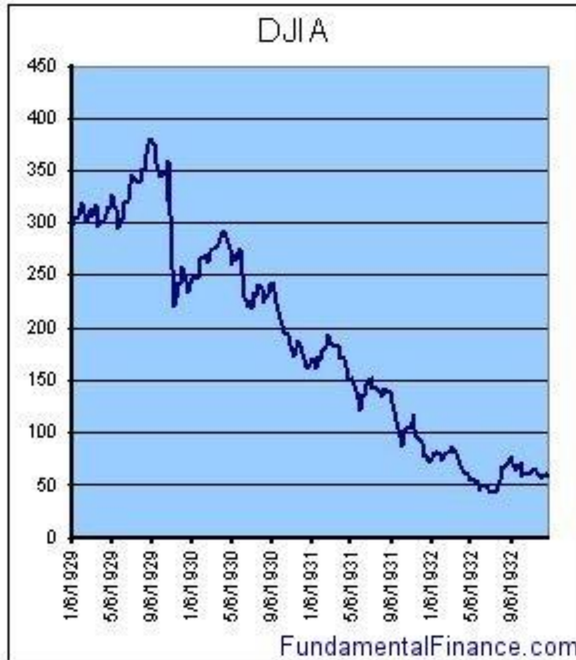
From one extreme to the other - Boom to Bust. The magical prosperity vanished almost overnight as people lost confidence following the Stock Market crash, and despite everything that governments could do, America and much of the world slipped into a harsh depression that only ended ten years later with the start of World War 2.

The media seems to have been part of the cause of the October sell-off. In the weeks preceding Black Thursday many articles surfaced asserting that there was too much speculation in the American stock market and that stocks were overpriced. In October front page headlines discussed recent market losses and questioned whether share-holders were beginning to pull out. Evidently this feeling trickled down to make investors nervous. The market lost about 6% from the beginning of September to October 27 (the Sunday before Black Tuesday).

1. ***What role did the media play in the 1929 crash? Do you think that the media plays a similar role in today's stock market? Explain:***

On Thursday, October 24, 1929, the largest volume ever traded on the New York Stock Exchange was recorded--12,894,650 shares--crushing the previous record of 8,246,742 shares set in March. The volume was so high that the market tickers got over an hour behind. The market lost value early in the day but then regained it later on. New York bankers were given credit for stopping the crash as they put about $1 billion into the market. Over the weekend the *New York Times* reported that Massachusetts regulators weren't going to be as friendly towards public utilities. On Monday 9,212,800 shares were traded. Finally on Tuesday, October 29, 1929, 16,410,030 shares were traded and the market suffered a staggering crash of about 13%. During the week the market would lose 30% of its value.

2. ***Why do you think that New York bankers sunk such an incredible amount of money into the stock market? (Hint – what were banks doing at this time that would have made them nervous about a market crash?)***



The nervousness that existed amoung investors caused many people to sell once they saw the high volume and the ticker-lag. It's as if you were in a movie theater and someone screams "Bomb!" Buying on margin also helped to push the market down once the crash began. When stock prices fell, investors were forced to sell their shares so that they could pay back their brokers. This forced prices further down and the cycle continued.

When investors couldn't pay back banks the money they had borrowed, banks began to fail. Banks had also invested money in the stock market, but even a well diversified portfolio couldn't protect anyone from the crash that occurred. For a while banks borrowed money from the Federal Reserve System, but eventually no more funds were available and banks began to break by the hundreds. If people thought that their bank was going to fail they would run to withdraw their money, making matters even worse.

3. *How did "buying on margin" lead to the failure of banks?*

4. *What ripple effects would failing banks have on the rest of the country?*

Eventually in 1932 the market bottomed out. By this time the Great Depression was very real and it would take another 23 years before the market would ever fully recovered from stock market crash of 1929.

Understanding Credit from the Modern Perspective

Directions: Pick out your dream car. Find the best deal that you can for your car. What is the make, model, year and price of your dream car?

Using the link below, insert the price of the car into the "Loan" portion of the Loan calculator. *Credit Costs Calculator: http://www.bankrate.com/calculators/mortgages/annual-percentage-rate-calculator.aspx*

Since you are a young teenager, you have no established credit. Therefore if you are able to get a loan, your interest rates will be very high. So in the interest portion of the Loan Calculator punch in 8.5.

You want your payments to be as low as possible so you will want to finance your car for 5 years. This is the maximum that you will be allowed to finance a new car. So in the year portion of the Loan Calculator punch in 5.

What is the final cost of your car?

How much did you end up paying in interest?

Now think about this in terms of a mortgage for a house where you are financing 5 times or 10 times more money and for 30 years instead of 5!

Think about this in terms of buying regular consumer items such as a new watch. When you buy on a credit card your interest rates can be as high as 28%! What is the risk/danger of buying on credit?

CAUTION, CAUTION, CAUTION!!

Credit Card Traps

Excessive Debt
It is all too easy to run up more debt than you can handle. Once you have one credit card you will get many offers for additional credit cards in the mail. In a short time your own credit card company will offer to raise your credit limit. It is all very flattering, but it is usually in your best interest to turn these offers down.

Grace Periods
Many credit cards don't charge interest on your purchases until a certain date. For example if you buy something on the 11 th of May and your monthly payment is due on June 7 th that charge is carried for 26 days interest free. That's your grace period. BUT other credit cards don't offer a grace period. From the minute you buy something interest is being charged. Over time that interest can really add up.

Bait and Switch Marketing
You want a credit card; you're offered the new "Titanium" card with a $5,000 credit limit at 6.9% interest. Sounds pretty good; you fill out an application. But when you get that new credit card in the mail be sure that you received the card you applied for. It is perfectly legal for the credit card company to send you the "Basic" card with a $1,000 limit and a 18.9% interest rate, if it determines that you don't qualify for the card you applied for. It might sound shady, but you agreed. It was on the application there in the fine print.

Changing "Terms and Conditions"
Every once in a while you will get a small legal document from your credit card company in the mail. Don't ignore it. It may be a change in the "Terms and Conditions" of your credit card agreement. The interest rate may have been raised, the grace period may have been eliminated, or an annual "membership fee" instituted. Read those documents carefully and close the account if you don't like the changes. The card you have now may not be the card you had last month.

Pretend that you are a credit counselor for a young person who is applying for their first credit card. Based on what you have learned, make a list of suggestions and warnings for this new creditor: