Newsletter 48:

Some Hidden History Behind 1929 Wall Street Crash

Dear readers,

With world stock prices generally at record highs and apparently going higher, many market insiders since months are predicting “crash.” This comes little more than ten years after the colossal 2008 financial Tsunami and market meltdown. I have written often than major market bubbles or crashes, at least in the Anglo-American world, tend to be the result not of financial chart trends but rather of high-level political decisions. The following is a selection of something I wrote well before 2008 on a largely buried background role of Bank of England Governor Montagu Norman to the October 1929 Wall Street crash. Those of you who are interested in such history might enjoy reading my book, ***Gods of Money: Wall Street and the death of the American Century***. The book details USA history from the standpoint of the growing power and influence of Wall Street banks and even why the same banks created the Federal Reserve to expand their domination of global money.

If you find my writings and comments interesting please consider making a donation of support via my PayPal.

Thank you and my best regards,

William Engdahl
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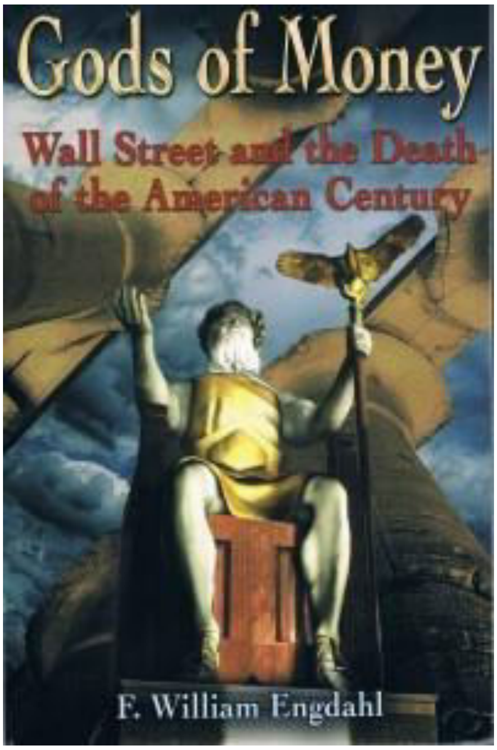

CHAPTER FIVE:

"UPENDING THE WORLD CHESS BOARD"

Hitting two birds with one stone

The 1925 return of Britain to the Gold Standard at the pre-war dollar parity did not restore the pre-war role of the City of London as the world financial center. That place had long since been decisively assumed by New York. It did, however, place the City of London and the Bank of England again in the nerve center of the world banking system. That position would later serve as the vehicle through which London would shift the global balance of power once more to its long-term advantage. British strategic interests, not nostalgia, dictated the 1925 decision by Chancellor of Exchequer, Winston Churchill, and Bank of England Governor, Montagu Norman, to go back to the Gold Standard. How Britain was to use its new international banking position was soon to become evident.

In addition to alarm over the prospect that an anti-British government in South Africa had decided, unilaterally, to join an American-led postwar gold standard system, England was concerned when, in April 1924, Germany agreed to the reparations plan put forward by the American, Charles Dawes, a plan which resulted in Germany's also putting the Reichsmark on the gold standard, along with the United States and a handful of other nations.

Within less than a year after the Dawes Plan, in early 1925, Norman and Churchill had brought Sterling into the small circle of nations on the gold standard. By insisting on an artificially high value of the Pound Sterling in relation to the Dollar, the Bank of England and the City of London created a mechanism which, in the space of some months, would put the City of London in a position to bring down the world's mightiest economy, the United States, and with it, the economies of Austria, Germany and much of the world.

But almost no one was thinking about such things in spring of 1925, when the New York Federal Reserve and a syndicate of New York banks, led by J.P. Morgan, agreed to make available to the Bank of England a $300 million credit line to defend the return of Sterling to gold.

Since the earliest days he took over leadership of the Bank of England, Norman had concentrated his energies on cultivating a special relation with America's Benjamin Strong, Governor of the New York Federal Reserve Bank, and the single most powerful figure in the American central banking structure. Up until the time of Strong's death in 1928, the New York banker maintained an extraordinary deference to the requests of his British friend Norman, even when Norman's demands occasionally ran contrary to the genuine national interests of the United States.

Montagu Norman and others in the City of London financial establishment had convinced Strong and the large, internationally active New York banks, that by supporting the return of Britain to the Gold Standard at $4.86, the pre-1914 parity, the possibility for New York banks to extend huge (and very profitable) loans to Germany, and other countries of Continental Europe, would be greatly enhanced. London, they argued, would become the entrepôt for such American loans to Germany, Italy, Poland, Rumania and the rest of Europe.

Norman had gone to great lengths to cultivate the personal friendship of Strong, so much so that Norman was able to persuade Strong, after Britain had come back on the Gold Standard, to lower U.S. interest rates. This allowed gold to go out of New York into London, and thus benefit the role of Sterling as a center of the re-established Gold Standard. Step-by-step, Norman was entangling the New York financial system and with it, Washington, through a complex web of financial commitments to Sterling.

In summer 1927, on Montagu Norman's request, Strong called a secret conference of the world's four leading central bankers. That July, in a quiet exclusive part of Long Island, Benjamin Strong, together with German Reichsbank Governor, Hjalmar Schacht, and Bank of France Deputy Governor, Charles Rist, met to hear Montagu Norman argue for central bank cooperation to allow London to hold its gold, while at the same time permitting the Bank of England to grant interest rate relief to British industry, a blatant violation of the basic tenet of the Gold Standard.

Norman demanded a commitment from the others that they lower their interest rates to encourage gold to flow into London, and thus enable British interest rates to ease, without endangering the role of the City of London as a gold center.

Schacht, whom Norman had also gone to great lengths to cultivate as an ally, was not pleased with the brazen violation of the rules of the game. "Don't give me a low rate. Give me a true rate, and then, I shall know how to keep my house in order," he told Norman.

In France, the government of Raymond Poincaré had made its top priority the stabilization of the battered Franc on a solid gold reserve backing, and placing French state finances back in order, following the devastating economic effects of the earlier French occupation of the Ruhr. France had been steadily rebuilding its gold reserves through purchases of gold from New York and London, and was not about to hear any pleas to reverse that in July 1927, in order to help the Bank of England.

But Norman got the backing of the one central banker there who counted the most. Benjamin Strong agreed to back Norman's call, and on July 29, 1927 Federal Reserve regional banks began a series of sharp cuts in interest rates, politically concealed for domestic consumption, as steps, "to help the farmers." At the time, the conservative *Chicago Tribune* was one of the few voices raised in protest. They editorially demanded the resignation of Strong for making aid to the Bank of England the number one priority of the Federal Reserve. The aid continued unabated.

The Federal Reserve's discount rate soon fell from 4% to 3.5%. Federal Reserve purchases of U.S. Government Treasury notes pumped liquidity into the banking system, further lowering commercial interest rates. Those lower rates were to ignite the U.S. stock market into the most dramatic speculative frenzy in U.S. history.

A coup de whiskey to help Montagu

The spectacular collapse of the Wall Street stock market in October 1929, and the ensuing collapse of European financial markets, banks, industry and, ultimately, entire national economies, came as an unimaginable shock to most Americans and Europeans. They had been in no way prepared for what happened.

It was no surprise, however, to a handful of leading figures in the inside circles of the City of London, or to a smaller handful of financial insiders on Wall Street, such as Winston Churchill's good friend and financial advisor, Bernard Baruch.

They knew very well that the primary fuel for the speculation into the New York Stock Exchange after 1925, had come from the easy money policy pursued by the New York Federal Reserve. They also understood that Strong's easy money policy had been undertaken largely in order to help Norman's Bank of England stabilize Sterling on the new Gold Standard.

Governor Strong had also been aware that his low interest rate policies would ignite a speculative rise in the New York Stock Exchange. He told a friend in 1927 that his easy money policy would give the stock market "a little coup de whiskey."

In February 1926, the first detailed report on U.S. bank loans made against holdings of stock as collateral, so-called "call loans," showed a significant sum of $3.5 billion of such stockbroker loans, loans which were used to fuel more speculative buying of stocks. By early 1929, call loans had risen almost double to an impressive $6 billion. Low interest rates, fed by Benjamin Strong's policy of supporting the Pound, were adding fire to a stock market boom unlike any seen before.

But the rising New York stock market was of minor concern. Foremost in Strong's mind was the importance of forging international central bank cooperation, and, as priority for such cooperation, to help Montagu Norman stabilize Sterling, thereby helping London become the transfer point for the rapidly expanding U.S. bank lending to postwar Europe.[i]

The United States had been the first major nation to resume linking its currency to gold in 1919, just after the war. During the years following, gold reserves of the world's major central banks came to New York, partly to repay war loans, partly to finance growing American imports. Up until 1925, gold from around the world continued to find its way to the United States in record volumes. By 1928, the United States possessed more than 40% of total world monetary gold stocks, some $ 4,141,000,000 at the day's gold standard value. By contrast, France, the second largest holder of gold, held only $1.2 billion, while Britain held a mere $754 million, and Germany, $666 million.

Under terms of the Gold Standard, the amount of physical gold in the monetary reserves of the United States Federal Reserve System, and of its member banks, directly determined the amount of credit available to the general economy, through reserve member banks. More gold implied more bank credit potential, while a decline in gold reserves meant a contraction in credit, where banks were forced to call in outstanding loans, and reduce new lending sharply. From 1921 through the end of 1928, the ample supplies of gold served to ignite the most spectacular financial bubble in American history.

As a consequence of the record levels of gold inflow during the early 1920's, the U.S. banking system's primary reserves increased nearly 44%. Using these greatly expanded reserves, banks issued added credit of an unprecedented $4,050 millions, an increase of fully 67%. Bank deposits were thereby increased by $12,054 millions or 60%, in the period between 1921 and the peak of the stock market speculation in 1929.

The enormous U.S. gold reserves and expanded bank deposits also gave J.P. Morgan & Co., National City Bank, Chase National Bank and other New York big banks, ample funds for lending to capital-starved European industry and governments. During this period, everything seemed to work to their advantage for the internationally-minded bankers of New York.

The Achilles' heel

However, here was also the Achilles heel of the post-Versailles international financial structure.

A significant share of the dollars that had been created in the U.S. banking system in the 1920's began to go to Europe, seeking far higher returns than possible in America. These included large credits such as a $100 million loan to the Mussolini government in November 1925, led by J.P. Morgan & Co., to stabilize the Lira. As well, loans flowed from New York banks to France, Rumania, Poland, Belgium and other European governments.

For a powerful faction of the American establishment building intimate links with government, industry and banking in Europe, represented a vital part of their decision to dominate the credit markets of western Europe after the war. It was largely new territory for the Americans, but as the world's largest source of capital, they pursued it vigorously, if recklessly.

And no country was more the focus of American financial interest than Germany, with its enormous industrial potentials. In September 1923 the German government of Gustav Stresemann capitulated, after months of French military occupation of the Ruhr, and called an end to economic passive resistance. In October a currency stabilization scheme, the *Rentenmark*, was imposed by the Reichsbank to restore a semblance of stability and end to the hyperinflation.

That same month, American President Coolidge requested that the international Reparations Committee name a commission of experts to study the entire problem of German reparations. Germany agreed to a proposal to, in effect, put the credit of the country under international supervision, in return for regaining international creditworthy status, a policy termed by Stresemann as the "policy of fulfillment."

The Dawes Plan also gave Germany a clearly defined, if large, annual reparations burden, rather than the earlier open-ended one which France had used to its advantage to constantly blackmail Germany. From the German view, perhaps most importantly, the Dawes Plan guaranteed an end to the occupation of Germany's industrial heartland by foreign troops by a fixed future date.

The committee, chaired by a close J.P. Morgan associate, Charles G. Dawes, was charged with examination of the entire finances of Germany. In April 1924 they issued a proposal to place Germany under control of a central reparations authority for the coming 50 years, whose members would include 7 Germans and 7 foreign representatives, and whose chief executive, the Agent-General for Reparations, to be based in Berlin, was another Morgan ally, S. Parker Gilbert. Gilbert's job was to secure an annual sum of 1,250 million *Goldmarks* from German customs duties on alcohol, tobacco and sugar. Any revenues above that sum went to the German Finance Ministry for their domestic budget.

In 1924, with the new *Reichsmark* backed by gold, Germany joined the United States-led gold standard. This gold-backed currency stability enabled New York banks to lend to German government and industry, reassured that "their man" in Berlin, Gilbert, would protect their loans, guarantee stability of the *Reichsmark*, and ensure orderly repayment of any loans.

Confident that their loans to German banks or other entities could be easily converted into dollars again at a fixed rate, and that the Reichsbank policy of high official interest rates, in 1925 more than 5% higher than in New York, would reward their efforts handsomely, New York bankers enjoyed the seemingly ideal conditions, and began flooding into the new "risk-free" lending to Germany after introduction of the Dawes Plan.[ii]

No sooner was the ink dry on the American-authored Dawes Plan in 1924, than the large New York banks and investment houses entered the highly profitable German market with their dollars. From 1924, when the Dawes Plan was finalized, until the beginnings of the international financial crisis in 1930, fully 62% of all long-term foreign borrowing by German banks, industry and municipalities, an impressive amount of well over 6 billion *Reichsmarks* ($1,440 million, an enormous sum for its day), came from U.S. banks and financial institutions.

In some cases, the credit went to build American manufacturing inside Germany, such as a Ford Motor plant in Cologne, or the purchase by General Motors of Adam Opel AG of Rüsselsheim. Much went as interbank loans to large German banks, who, in turn, financed the rebuilding of the German steel and other large industry. Fully one-fifth of all American capital export in the decade of the 1920's went to Germany, far the largest absorber of dollar funds.

Increasingly, as the German Reichsbank under Hjalmar Schacht took measures at the end of 1926 to discourage German industry from such heavy long-term borrowings abroad, U.S. banks turned instead to highly-volatile short-term bank loans, to be able to continue to extend the lucrative credits.

New York banks, led by J.P. Morgan & Co., made loans at highly profitable interest rates, to credit-starved German industrial companies such as AEG and Siemens. With long-term credit discouraged, U.S. bankers lent over 15 billion *Reichsmarks* to German borrowers from 1924 up to the end of 1929, in short-term credit or loans whose repayment or refinancing was due in less than 12 months. Many of those loans had to be rolled over or renewed each 3 months, putting the entire poorly-capitalized German credit structure on a short-fuse, should the constant inflow of funds from New York through London ever reverse.

By the end of the 1920's, partly because of the availability of this flood of American capital, Germany's economy appeared to the world as vibrant, healthy and growing. But behind the facade, its banks and industry were fragile to any shocks which would interrupt the continuing flow of new American bank credits, to roll over their existing loans.

Germany had borrowed from abroad, mostly the United States, a total of 25 billion *Reichsmarks* ($6 billion) in combined long and short-term foreign debt, as of the beginning of 1929. Fully 43% of all German bank deposits at that point were owed, short-term, to foreign creditors, the vast bulk of it to American banks. The borrowing by German companies and municipalities of foreign short-term capital was even greater.

This amount, $6 billion, was, coincidentally, a sum equivalent to the total of bank "call loans" to speculators in the New York stock market in the same year. Ironically, conditions in the U.S. banking market, where corporations tended to turn to the stock market and not banks to raise capital, were just the opposite of those in the German market. In Germany, the stock market remained depressed, and companies were dependent on bank credit to restructure or expand. One might even think it an elegant, almost intentional balance of U.S. bank commitments between foreign and domestic risk, but it was to prove quite the opposite.

The same exposure to short-term foreign borrowing was true, if in smaller dimensions, in postwar Austria, where industry had not been able to recover their capital base after the war. A similar dependence on short-term foreign borrowing in the later 1920's, hid the underlying rot of the Austrian credit structure, at least until it collapsed in 1931.[iii]

The continued flow of funds to refinance short-term credits to Germany, Austria and other European centers, however, was entirely dependent on a U.S. banking system which itself had gotten locked into an inherently unstable dynamic called Wall Street speculation.

The Wall Street stock boom

While the newly-created Federal Reserve Bank diligently watched for any hint of inflation in commodity prices during the 1920's, they had ignited a far more dangerous inflation, that of financial paper. Bank funds which were not going abroad to Germany and such destinations were going into broker loans in the stock market bonanza of the "Roaring Twenties."

The greatest speculative bubble in American history was underway. Most domestic bank loans in the 1920's went directly to finance securities purchases, mostly stocks. After the war, large U.S. corporations had turned for the first time to the growing New York Stock Exchange to raise their capital for expanded investment, through new issue of stock shares to an eager investing public. The American automobile industry was expanding at breathtaking speed, most of the expansion of plant and equipment, financed by new stock issues from Chrysler, Ford Motor or General Motors.

Further, because of these changes in how American big business financed their expansion, through selling stock to the public, rather than through traditional bank borrowing, banks were awash with liquidity, with few traditional places to profitably invest. So, ever resourceful, they turned to the "financing of finance."

The private American banking system, backed by the large U.S. gold reserves, had extended credit for purchase of stocks on an unprecedented scale. The stocks and other securities were themselves then taken by banks as collateral for further new lending. A vast financial pyramid was under construction.

In this manner the Wall Street stock market bubble assumed gargantuan dimension during the late 1920's. In 1925 alone, as bank loans to stock brokers to finance stock purchases more than doubled, to a record $2.8 billion, the New York Stock Exchange index inflated by 40%.

By early 1929 fully two-thirds of all U.S. bank credit was collateralized by various securities, usually stock shares. The potential of a stock market collapse to collapse the entire banking system, was clear for anyone to see. But in the growing frenzy by citizens of all walks of life, to share in the new riches of being a stock owner, few took heed of such unthinkable prospects.

With easy bank credit available to finance stock purchases, and a belief that interest rates would go ever lower, the demand began to grow for stocks from ordinary citizens with their small savings to invest, not merely those with a large wealth. As the stock market itself continued to rise on the back of the new demand, most on borrowed money, the public's interest in stock ownership grew even more, as family after family began to put their life savings into the marvelous new money machine called Wall Street.

Stock prices ballooned another 69% from the end of 1927 to the peak in September 1929. People were encouraged by their bankers to borrow money to buy stocks on margin, that is, by putting up only a few percent of the face value of the shares bought, the rest to be paid at a future date from the presumed rise in stock values. This risky practice pushed the stock prices ever higher, drawing ever more people into the market, at ever riskier levels. Businesses which financed their capital needs by issuing stock in this climate reaped the rewards, as the public's appetite appeared insatiable. The total volume of common stock financing by companies increased by 661% between 1926 and 1929, a rise from $579 million to $4,406 million. Not since the 1620's Holland tulip bulb speculation, had the world seen such a speculative delusion.

Far from trying to prevent this unhealthy flow of bank credit into stock speculation during the 1920's, Benjamin Strong and the New York Federal Reserve attempted to feed the stock boom, at least until it was too far advanced to respond to ordinary reason. Strong told his Federal Reserve colleagues at the time that the advantages to the nation of an "active and rising stock market" were a primary goal of his monetary policy.

This significant shift in credit policy by the New York Federal Reserve bank in the period up to the October 1929 market panic, was of immense importance to what was to follow. By allowing the very heart of the established U.S. bank credit mechanism, based on gold reserves, to finance stock market speculation, Strong and his associates set the stage for the greatest economic contraction in American history. The pyramid of postwar U.S. credit in the 1920's, much like that of Japan during the 1980's, was built on the assumption of ever-rising stock values. When that rise reversed, the entire edifice collapsed, with breathtaking speed and efficiency.[iv]

Hatry and Norman: springing the trap

Just as huge sums of capital had gone via the City of London into Germany and the Continental economies of Europe after 1925, so, by the end of that decade, as the Wall Street stock market caught fire in its speculative frenzy, the City of London became the crossroads for a reverse flow, as capital began going out of Germany and the rest of Europe, Britain included, into Wall Street's feverish stock market speculation.

Within a short time, following the 1925 resumption of the gold standard, Montagu Norman had secured the role of "primus inter pares" among the world's major central bankers, largely through his skillful alliance with Benjamin Strong. The American Agent General for Reparations, Parker Gilbert, referred to Norman, with good cause, as, "the most powerful man in the world."

Emil Moreau of the Bank of France protested what he called an alarming "imperialism" of Norman's Bank of England, since their rejoining the Gold Standard, despite the fact that French gold reserves had grown to be far more substantial than England's. In 1928 Moreau wrote to French president Poincare, complaining that Norman and the British managed to dominate the Financial Committee of the League of Nations in Geneva, headed by Montagu Norman's intimate friend, Sir Henry Strakosch, and were using that position to establish crucial influence over European economies.

Moreau charged, "England, having been the first European country to re-establish a stable and secure money, has used that advantage to establish a basis for putting Europe under a veritable financial domination. The Financial

Committee at Geneva," Moreau continued, "has been the instrument of that policy. The method consists of forcing every country in monetary difficulty to subject itself to the Committee at Geneva, which the British control. The remedies prescribed always involve the installing in the central bank of a foreign supervisor, who is British or designated by the Bank of England, which serves both to support the Pound and to strengthen British influence. To guarantee against possible failure, they are careful to secure co-operation of the Federal Reserve Bank of New York. In addition, they pass on to America the task of making some of the foreign loans if they seem too heavy, always retaining the political advantages of these operations." In many respects it was similar to the post-1944 International Monetary Fund only with London not Wall Street control.

Moreau noted that such maneuvers by Montagu Norman and the British government had allowed England to become "completely or partly entrenched in Austria, Hungary, Belgium, Norway and Italy."[v]

Such little-publicized maneuvers by Norman were significantly to determine the ultimate fate in the 1930's of Germany, Austria and much of the world.

The financial distress of an unconventional and since long-forgotten British businessman, Clarence Hatry, was to be the vehicle for Norman and the political establishment of the City of London in their far larger design.

Hatry, a financier who had built a large industrial conglomerate by merging financially troubled companies and reorganizing them after the war, had bought and later sold such known British firms as Leyland Motors. He created British Glass Industries, owned the London "Globe" newspaper, as well as the Commercial Bank of London. He created Allied Ironfounders by merging 23 small firms in the British steel industry during the 1920's. He was widely regarded, on the way up, to have had a 'midas' touch.

Hatry's empire, however, like many in the day, had been built on borrowed funds and was badly overextended, when Montagu Norman and the Bank of England began to take steps in summer of 1929 to clamp down on the speculative frenzy which had also come into the London Stock Exchange, by tightening bank credit.

That fateful summer, Hatry's fate depended on securing an emergency infusion of new credit to weather his short-term cash problems. It was a top down decision by no less than Montagu Norman personally, and City of London financier, Marcus Samuel (Lord Bearstead), head of the Samuel & Co. banking house tied to Royal Dutch Shell, which triggered the collapse of the Hatry empire, and with it, the largest collapse on the London Stock Exchange on September 17, 1929.

Hatry insisted he had initially been given a verbal assurance by Lord Bearstead, for an emergency "bridge loan" of 4 million Pounds, enough to have saved the large conglomerate business empire from collapse. In the event, Bearstead did not extend any loan. Hatry then went directly to the Bank of England's Norman for help such was his stature that he could get such a meeting.

At this critical juncture, Norman used the hapless Hatry to detonate a financial crisis of world dimension. Norman not only refused to help Hatry in what was, to be sure, a financial problem which could well have been managed with a small injection of new credit. Norman even went further, and issued a warning to all financial houses of the City of London, to refuse Hatry credit. Hatry had been blackballed, and as his large business empire collapsed, it triggered the collapse of the London Stock Exchange. On September 20, 1929 the London Stock Exchange Committee suspended share dealings, after three days of panic selling with no buyers. Hatry was the largest business failure in Britain of the century.

Norman had little interest in Hatry per se, or even in the reports that Hatry had engaged in dubious bookkeeping methods to keep his empire afloat. After all, as Norman well knew, the difference between fraud and speculative acumen in finance was often a matter of timing and connections. Hatry was for Montagu Norman merely a useful opportunity.

Indeed, it might be said, the difference between J.P. Morgan during the 1907 New York bank panic, and Hatry in September 1929, was that Morgan was able to rally the political support of no less than the White House, to shore up a shaky and overextended banking and corporate empire, much of it based on equally dubious and legally doubtful arrangements, while Hatry was the victim of a political decision to do the opposite. Hatry was to go down in history as the fraudster and scoundrel, while Morgan was to be revered as a philanthropist and lender to nations. Montagu Norman was well aware of what he was doing in blackballing Hatry, and it had little to do with any moral crusade against fraud in the London Stock Exchange.

The unravelling begins

For want of extending a mere four million Pounds to a British company, Norman allowed the entire post-Versailles international monetary and economic system to collapse. No single individual in international banking was more aware than Montagu Norman, of just how fragile the international capital markets on both sides of the Atlantic were, as the Bank of England had carefully positioned itself in the center of post-1925 world capital flows.

The Bank of England began to reverse the global financial flows initially on February 6, 1929 when Norman raised the Bank of England's main lending rate by a full 1% to 5 1/2%, after two years at 4 1/2%. The New York Federal Reserve, then becoming alarmed at the out-of-control flood of funds into stock market speculation, reacted at the same time with a verbal "warning" of possible U.S. interest rate rise, from the 5% Discount rate levels it had been for some months, but took no immediate action.

There was an attempt by the Federal Reserve banks by late March to withhold funds from the New York stock market, which triggered a "minor correction," a 5% drop in stock prices. But the effect was overshadowed by a public statement from the influential head of New York's National City Bank, Charles Mitchell. Mitchell announced that he was prepared to extend his bank's capital to support the stock market. Wall Street stock speculation soon resumed its pace, as the players saw the Federal Reserve firmly resisting any decisive increase in its central Discount rate.

The Bank of England's rate rise had immediate impact, however, in the most fragile capital market, Germany. By the end of that February, Germany began to see a sharp outflow of capital to London, attracted by the higher rates, and by German short-term borrowers attempting to pay down their foreign 3-month loans. Action by Hjalmar Schacht's Reichsbank to tighten the German Discount rate to 7 1/2%, slowed the German capital outflow but only somewhat during the summer of 1929.

But the Reichsbank's rate action also exposed the fragility of the German economy to the huge foreign short-term capital borrowing. In September a disaster was narrowly averted, when a large insurance group, Frankfurter Allgemeine, was rescued by a consortium of German banks and the German insurance company, Allianz. Frankfurter owed 35% of its debt to foreign banks. The crisis brought to the fore an inherent conflict between the foreign bank creditors of German companies and domestic German creditors. It was the first tiny crack in the fragile edifice of post-1925 financing of Germany. It was to be far from the last.

Finally, after months of vacillation and unconvincing action to dampen the speculative fever in Wall Street stocks, the New York Federal Reserve Bank raised its Discount rate a full 1% to 6% on August 6, 1929. The stated intent was to discourage further purchase of stocks on borrowed funds, and to facilitate a gradual deflation of the dangerous Wall Street stock market levels, while maintaining easy credit to agriculture and business.

Thus, while the New York Federal Reserve Bank raised the Discount, it simultaneously lowered another critical rate, the so-called bankers' bills of acceptance rate, to 5 1/8%, convincing market speculators that the overall climate would not change. Banks merely took funds from the bankers' bills of acceptance market, from the financing of agriculture and commercial credit, sold them to the New York Federal Reserve to get funds at 5 1/8%, and used the funds to continue the speculative activity on the Wall Street stock market.

As Clarence Mitchell's National City Bank told clients that month, "There is a good deal of doubt the Federal Reserve can control the use to which credit is put, and once Federal Reserve credit has been released, it is likely to go where there is the greatest demand for it. After all, there is nothing to prevent a bank from selling acceptances to the Reserve Banks and using the proceeds in the stock market." And in August 1929, demand was for more stocks on credit.

Stocks, not surprisingly, soon resumed their upward climb to new record highs as the total of broker loans passed the $6.2 billion level.

At this juncture, conditions were primed for the decisive blow from Montagu Norman, when Clarence Hatry presented Norman his convenient target of opportunity. On September 26, the Bank of England announced that it had raised its principal Base rate by another full percent, to 6 1/2%, five days after the collapse of the shares of the Hatry Group of Companies closed the Stock Exchange, citing a loss of Bank of England gold reserves as the reason. With this move by the Bank of England, a full-scale international crisis was detonated.

The Hatry affair provided the credible pretext for the Bank of England to raise its interest rates. No one could deny there was a crisis in the London financial markets. What few realized, was that the decision to precipitate such a crisis was willfully and knowingly made by Norman and the inner court of the City of London establishment, fully aware of the consequences of forcing Hatry's collapse.

By early October, share prices on the New York Stock Exchange had fallen 15% from the pre-Hatry crisis levels of early September. Stock prices of American steel, automobile and copper companies led the way down. The selling in New York came primarily from investors in the City of London. British investors were liquidating their holdings in the vulnerable New York market, partly to cover losses triggered by the collapse of the far-flung interests of the Hatry Group of Companies, but significantly, to get out of the vulnerable New York market, taking advantage of the higher interest rates in London. In liquidating their U.S. holdings during the month of September, these British investors set the stage for what was to be the greatest collapse in U.S. stock market history only weeks later.

By Thursday, October 24, 1929 the selling across the board of New York shares reached such a tempo that an emergency meeting was called by J.P. Morgan & Co.'s Thomas Lamont, of the city's leading bankers, to try to restore market confidence. It succeeded for all of two trading days, before renewed panic selling resumed. In one week, more than $1 billion in brokers' loans had been liquidated, bringing the reduction in such loans down by almost $2.5 billion alone for the month of October, more than one third of the total such loans. On October 31, the New York Federal Reserve signaled its attempt to calm matters by lowering the Discount rate from 6% back to 5%, an attempt to ease liquidation pressures on those who had gone heavily into debt to buy stocks.

By mid-November, when the New York Federal Reserve again lowered its Discount rate, this time to 4 1/2% to try to calm matters, the value of stocks on the New York exchange had already fallen by 30%, a paper loss of a staggering

$26 billion, since the September 1929 peak. It was the beginning of the unwinding of the entire credit structure of postwar America.

Because most of the credit structure of America after 1920 had been built on a pyramid of rising stock prices, when those stock prices no longer rose, but, instead, began to fall precipitously, millions of citizens found their life savings wiped out, as banks demanded "margin calls" of new cash collateral to replace the disappearing market value of stocks that had been used as collateral to borrow during the market's heady rise.

Further, during the 1920's, the United States had become the world's leading advocate of buying consumer goods or housing on installments or "time," rather than for cash, as had been the practice earlier. In countless families, investment in the stock market had been used or was to be used as collateral, against purchase of a new car or a house. When this began to collapse, new home construction and automobile production dropped precipitously. That meant people who built cars and homes were suddenly unemployed, and without any state insurance to cushion the blow. People who were unfortunate enough to be living in homes or with a car bought against stock as collateral, found themselves evicted, as they were unable to afford higher mortgage payments to compensate loss of stock values, or their car repossessed. In 1929, almost half of all homes in urban areas carried a bank mortgage, with total mortgage debt held by the banking system of some $19 billion. Rates of default on home mortgage payments, generally the last payment families sacrifice in a crisis, rose in many cities to double-digit levels. All this had dramatic impact on U.S. industrial output, which fell fully 12% from the peak in June to the end of December, two months following the October 1929 crash.

The collapse of the New York Stock Exchange in 1929 was not, then, merely a collapse of an isolated part of the American savings; it decimated the very heart of the entire economy, in ways unimaginable even six months earlier.

Baruch and Churchill

One of the most prominent Wall Street speculators, Bernard Baruch, had spent the summer of 1929 in England and Scotland, where he met his close friend, Winston Churchill. Curiously, Churchill managed to be in the Gallery of the New

York Stock Exchange on October 24, "Black Thursday," with his friend Baruch, to personally watch the panic below on the exchange floor. Already in early September, when the market was near its highest peak, Baruch had sold his shares and advised Churchill to do the same. Baruch later advertised the fact that he had avoided the disaster, as proof of his investment acumen. It was more likely proof of his well-placed friends in London who had tipped him to the plans of Montagu Norman.

The stock market collapse of October 1929 created the necessary pre-conditions for the most dramatic transformations of international policy over the decade of the 1930's. England's most troublesome world rival, the United States, was to be plunged into a decade of economic depression, taking its attention and energies far away from events in Europe or the Far East, leaving Britain an essentially open field.[vi]

Footnotes:

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[i] The intimate ties between the New York Federal Reserve of Benjamin Strong, and Montagu Norman's Bank of England are a matter of record. A useful account is contained in Grant, James, "Money of the Mind," Farrar, Straus, Giroux, New York, 1992. Details of the British side of the return to gold after 1925, albeit one-sided, are in Cain, P.J. and Hopkins, A.G., "British Imperialism: 1914-1990," Longman, London, 1993. The role of Strong's New York Federal Reserve at this time is also usefully summarized in, Studenski, Paul and Krooss, Herman, "Financial History of the United States." McGraw-Hill, New York, 1952; Chandler, Lester V., "Benjamin Strong: Central Banker," The Brookings Institution, Washington, 1958, and Greider, William, "Secrets of the Temple: How the Federal Reserve Runs the Country," Simon & Schuster, New York, 1987, provide additional details of the ties between the New York Federal Reserve and Montagu Norman.

[ii] Ringer, Fritz K., "The German Inflation of 1923." New York, Oxford University Press. 1969. Details of the 1925 credit of Morgan and the New York Federal Reserve to the Bank of England are found in Burk, Kathleen, "Finance, Foreign Policy and the Anglo-American Bank: the House of Morgan, 1900-1931," in "Historical Research" Vol. LXI, no. 145, June 1988.

[iii] Luther, Hans, "Vor dem Abgrund: 1930-1933," Berlin, Propylaen Verlag, 1964. And, James, Harold. "The German Slump: 1924-1936" Oxford, Clarendon Press, 1986. An account of the politically important role of New York banks in European monetary stabilization during the 1920's is in Meyer, Richard H., "Bankers' Diplomacy." New York, Columbia University Press. An unusual German view of the postwar short-term credit problem is in, Schacht, Hjalmar, "The Money Markets before and after the War," in "Harvard Business Review," Cambridge, Mass. January 1931. For a very useful background on the German side of this period from one of the central figures, see Luther, Hans, "Vor dem Abgrund: 1930-1933 Reichsbankpr"sident in Krisenzeiten," Berlin, Propyl"en Verlag, 1964. As well, Balderston, Theo, "German Banking Between the Wars," in "Business History Review," no. 65, Autumn 1991. Harvard College, Cambridge, Mass.

[iv] The policy of Benjamin Strong to support the stock market as well as the Bank of England's Pound stabilization, was openly laid out in an internal memorandum from Strong to officers of the U.S. Federal Reserve, made public after the onset of the depression in 1931. See, U.S. Senate Hearings (Senate Res. 71), Washington D.C., 1931, Part VI. A useful account of the stock market frenzy of 1925-29 is in Pontecorvo, Giulio, "Investment Banking and Security Speculation in the Late 1920's," in "Business History Review," Harvard College, Cambridge, Mass.

The role of the huge gold inflows in the creation of the inflationary stock market bubble during the 1920's is well detailed by Willis, H. Parker, "Credit Policies of the Federal Reserve System: A Retrospect," in, "Annals of the American Academy," Washington, 1934; and, Noyes, C. Reinold, "Gold Inflation in the United States:1921-1929," in "The American Economic Review," Vol. XX, no. 2, June 1930. The details of the Strong-Norman 1925-28 coordination and its effect on the stock prices are detailed in Grant, James, "Money of the Mind," Farrar, Straus, Giroux, New York, 1992.

[v] The comments of Moreau are cited in Boyle, Andrew, "Montagu Norman, A Biography," London, Cassell & Co. 1967. The remarks offer revealing insight into the skillful deployment of financial and political "leverage" to magnify the role of the Bank of England over world events far beyond its nominal monetary resources in the period. Thos role of Norman's and the Bank were to be decisive in the ensuing British geopolitical strategy of the 1930's.

[vi] Details of the little-known Hatry case can be found in Franklin, Charles, "They Walked a Crooked Mile," New York, Hart Publishing Co. 1969. The collapse in New York is detailed in Galbraith, John Kenneth, "The Great Crash: 1929," Houghton Mifflin Press, Boston, 1955. Useful details of the capital flows from New York to London are found in the weekly accounts of "The Economist," London, January-November 1929. Also useful is Baruch, Bernard M., "Baruch: The Public Years," New York, Holt Rinehart & Winston, 1960. Chandler, Lester V., "America's Greatest Depression: 1929-1941," New York, Harper & Row, 1970, contains many details of the real economic impact of the 1929 crash.