Causes of the Great Depression

[Name of the Writer]

[Name of the Institution]

**Causes of the Great Depression**

The great depression brought a wider change in the society and economy of America. Its affects leave the questions for economists and researchers when almost all the economic theories become unable to cope with the situation. The main causes of the depression include stock fall, bank failure, smooth-Hawley tariff, failure of money supply strategy by Federal Reserve, and ineffectiveness of policies developed by presidents Hoover and Roosevelt. Some of the factors affect the aggregate supply while others had an impact on the aggregate demand of the economy, but bank failure was the factor that brought more complications and concerns in the nation. The bank collapsed, 700 banks failed in 1929 and 3000 more in 1930. In 1932, a new banking panic led to the loss of more than 1/3 of all banks in the country.

The bank failure starts after the crash in the stock market. In October 1929, the stock market collapsed due to which investors became worried about the future financial disaster. The sudden panic due to the bad condition of the stock market resulted in the withdrawal of money from the bank. People reached the bank and withdrew their deposits, this situation was known as "bank runs" where everyone in a hurry to get his money back before anyone else does. The withdrawal of a large amount of money resulted in lower investment rates and consumer spending. Due to the low consumer spending and investment, the employment level and production also start decreasing. Researches indicate that unemployment increased upto 20% because forty percent of all bank failed. The increase in unemployment and failure of banking resulted in the fall of GDP upto 30%. This factor was also crucial because it developed not only panic in consumer but also bank holders. About nine thousand banks were failed in the 1930s, which developed the situation of risk and concerns in bankers. Bankers were not confident to create new loans due to the fall in investment. All this situation leads to a rapid fall in expenditures and then great depression (*5causesofthegreatdepression.pdf*, n.d.).

Economist explains this situation largely caused by a series of negative aggregate demand shocks. Before 1929 both aggregate demand and aggregate supply were balanced, and the economy was growing with zero inflation. However, because of the stock market collapse in 1929, the situation began to change. Due to the failure of banks, the aggregate supply of money decreased, and investors lost a large proportion of their wealth. Bank failure happened in four waves, and each wave lead to low investment which decreased the aggregate supply furthermore. People were not confident upon consumption, and they hold their money which results in aggregate demand shocks. Investment falls upto 75% till 1933. In this situation, the Federal Reserve allowed the money supply to plunge upto 30%, but it resulted in the largest negative shock in aggregate demand. These shocks resulted in a deflation where inflation was -10%, and economic growth was also negative. This was a critical situation because the fall in aggregate demand increased the burden of debt (“Understanding the Great Depression,” 2017).

The bottom line is that due to the failure of banking, the bridge between consumption and investment fall. People lost their wealth and were not willing to spend money that was in hand. Everyone wanted to spend less and save more which resulted in a sharp fall in aggregate demand. Bank lost its investment and became unable to offer new loans which effected the aggregate supply. The theory that says, with the decrease in supply, demand increases failed here. This is because with the fall in aggregate supply, people become more worried about the future and hold their consumption for the sake of future conditions. This means the economy faced a fall in both aggregate demand and aggregate supply which ultimately resulted in the great depression.

**References**

*5causesofthegreatdepression.pdf*. (n.d.). Retrieved from http://www.cland.k12.ky.us/userfiles/13/classes/441/5causesofthegreatdepression.pdf?id=8459

Understanding the Great Depression. (2017, May 23). Retrieved October 16, 2019, from Marginal Revolution University website: https://mru.org/courses/principles-economics-macroeconomics/business-fluctuations-great-depression-ad-as-model