Wall Street suffers its worst day since 1987
Michael Mackenzie and David Oakley

The failure of US lawmakers to gather enough votes to pass the $700bn bail-out package yesterday sparked the worst day on Wall Street since the crash of 1987 and accelerated the buying of safe haven assets including Treasuries and gold.

The House of Representatives failed to produce the 218 votes needed to send the troubled asset relief programme (Tarp) legislation to the Senate for approval.

Already under pressure from the prospect of a diluted Tarp and worries about a number of hanks, equities plunged on the news. The S&P 500 closed 8.8 per cent lower, its largest percentage decline since October 1987. The Vix volatility index, Wall Street's fear gauge, soared to a record closing high.

The Dow Jones Industrial Average suffered its largest points decline in history, falling 777.68 points, a slide of 7 per cent.

Emerging-market bonds, currencies and stocks also plunged after the vote failed and Brazil's Bovespa fell more than 10 per cent before trading was suspended.

"The plunge in stocks reflects the fear that we have to go back to the drawing board and now we have less time to find a solution that helps ailing banks," said Doug Peta, strategist at J&W Seligman.

The news sent Treasury yields tumbling and the yield on the two-year note fell as low as 1.64 per cent, down 45 basis points.

Oil fell 10 per cent, gold surged above $900 an ounce, while the dollar fell further against the yen. "Congress apparently doesn't understand the stakes," said TJ Marta, strategist at RBC Capital Markets.

European markets were closed when the House vote was cast and they had already suffered a bruising day after a spate of bank failures in Europe.

Both the FTSE 100 and the FTSE Eurofirst 300 fell more than 5 per cent and recorded their biggest one-day falls since January 21.

The Irish stock exchange fell 12.7 per cent, its biggest one-day plunge in a quarter of a century.

The rescue of four European banks, including Bradford & Bingley and Fortis, and a takeover of Wachovia's banking operations by Citigroup also alarmed market participants. Concerns mounted that troubles in the financial sector would constrain lending further, slowing the global economy.

It also underlined why the money markets have been frozen for more than a week as funds have stopped lending to a banking system they believe is in serious trouble.

Thiery Lacraz, strategist at Pictet & Cie, said: "Fear is driving the markets today. It is probably the first time you are seeing the banking crisis directly hit Europe with Fortis and Bradford & Bingley in trouble."

A huge injection of liquidity by central banks across the globe, liquidity failed to stem a further deterioration in money markets.

In the money markets, overnight index swap rates, one of the best measures of credit risk, rose to all-time highs in a sign of fresh strains among banks.

Don Smith, economist at Icap, said: "This is measuring the increasing risk aversion, which just keeps going up and up every day. This ratchets up the levels of difficulty for banks."

Oil fell below $100 a barrel on concerns over the global outlook.

Credit default swaps saw Iceland come under pressure as Glitnir, one of its leading banks, was nationalised. The country's CDS, a kind of insurance against bonds defaulting, rose 23bp, or €2,300 for every €10m of debt, to 390bp. The spread is 130bp higher than at the start of the month.

The cost to insure Glitnir against default now stands at a record level of 1,450bp, almost double its level of 850bp on September 1.

The cost of insuring US investment grade credit accelerated with the CDX jumping 22bp to 185bp.

Bonds across the curve gained on safe-haven play. The yield on 10-year US Treasuries falling 21bp to 3.62 per cent.

The dollar held its gains against the euro and sterling as currency investors switched their concerns from worries about the US bail-out to the state of the European banking sector.

Emerging markets were another casualty amid the increased selling pressure on riskier asset classes. Emerging market sovereign bond index saw spreads against US Treasuries rise 32bp to 411bp, more than 100bp up on a week ago.

Fonte: Financial Times, London, September 30 2008, Companies & Markets, p. 34.