The New York Times
nytimes.com

October 25, 2008

Currencies Fall as Fears Spread and Stocks Slip

By MARK LANDLER and VIKAS BAJAJ

WASHINGTON — Fear that the financial crisis is infecting once-healthy economies created another white-knuckle day for investors Friday, causing stocks to tumble from Tokyo to New York.

Uncertainty also roiled currency markets as investors continued to turn to the security of the United States dollar and the Japanese yen and drove down currencies of developing countries like Brazil, Ukraine and South Korea and even of developed countries like Britain.

In the United States, where the crisis began, investors were less alarmed than elsewhere. A rout in Asian and European stock markets sent the Dow Jones industrial average swooning by more than 500 points in early trading in New York, but trading recovered enough ground through the day to leave the Dow down 312.30 points, or 3.6 percent.

Just a year ago, a drop of that size would have been considered a black day in the markets, but in these days of routine triple-digit declines, it offered a modicum of relief to traumatized investors.

Still, there were chilling new developments that attested to the wide scope of the crisis, despite efforts by heads of state, central bankers and corporate leaders to stop the bleeding. Cash flowed into the dollar and the Japanese yen, the two most sought-after safe havens in a storm-tossed world, as it fled from emerging markets.

Hedge funds and other investors are pulling money out of these countries on an immense scale, analysts said, and putting it into dollars and yen. There were few safe harbors, as commodities also tumbled. Fears of a spreading global recession caused oil prices to fall 5 percent, to $64.15, even after OPEC, the oil cartel, announced it was cutting output. Government-backed mortgage bonds and debt issued by top-rated corporations were also dragged down in the undertow.

“This is a panic in the way of the fine 19th-century panics, where we all run around like headless chickens,” said R. Jeremy Grantham, chairman of the Boston-based investment firm GMO, who had predicted stocks would tumble. “I have been in the business for 40 years, and I have never seen anything like this.”

So great are the concerns among policy makers about the turmoil in currency markets that it has prompted talk of a coordinated intervention by the leading industrial countries in coming days, to quell the soaring dollar and put a floor under emerging-market currencies.

Such a move — in which the Federal Reserve and other central banks would sell dollars and yen and buy other currencies — has been used extremely sparingly by the United States in recent years.

“The risk is huge, but it is appropriate at this point, because if the emerging markets go into default, the consequences would be catastrophic,” said Kenneth S. Rogoff, an economist at Harvard.

When a developing country’s currency loses value rapidly, it impedes the ability to pay back loans from Western banks. That could cause a rash of corporate or even government defaults — a feature of previous financial crises in Asia and Latin America.

In the United States, the rescue effort may also grow. The Treasury Department, officials said, is weighing whether to expand its program of capital injections to encompass insurance companies, many of which own savings and loans, and is under pressure to include the financing arms of the auto companies. The government injections are currently reserved for banks.

The Treasury secretary, Henry M. Paulson Jr., appears to be drawing the line at investing in hedge funds, which, officials note, do not supply credit to the economy and are in the business of taking on large risks.

Indeed, hedge funds accounted for some of the turmoil on Friday. They are being forced to sell their stocks, bonds and other instruments to pay off their investors and lenders. Beyond that, investors are increasingly convinced that the global economy is headed for a long, painful recession.

“There has been tremendous activity in the currency markets, the commodity market and the stock market that reveal the fingerprints of forced selling,” said Marc D. Stern, chief investment officer of Bessemer Trust, an investment firm based in New York.

The flight to safety is hurting once-mighty currencies like Britain’s pound. On Friday, worries about how the financial crisis would affect Britain’s economy caused the pound to lose 8 cents against the dollar, falling to $1.53.

While a strong dollar might be a boon for American tourists abroad, it creates a host of problems for economies.

And the downdraft of the pound and the euro — which fell to $1.26 against the dollar on Friday, its lowest level in two years — is less serious for the economic well-being of Britain and Europe than the deterioration of currencies like the Mexican peso or the Russian ruble.

Even if the Federal Reserve, the Bank of Japan and other central banks intervened in the foreign-exchange markets, it was not clear that it would reverse the pressure on these currencies.

“I don’t see this as a crisis breaker,” said Simon Johnson, a former chief economist at the International Monetary Fund. “But it would help emerging-market companies, and give everyone a chance to catch their breath.”

The last time the Federal Reserve intervened in currency markets was in September 2000, when it teamed up with the European Central Bank and the Bank of Japan to shore up the faltering euro. Before that, the United States and Japan teamed up to buy yen during the Asian crisis in June 1998.

With President Bush convening a meeting of the Group of 20 nations in Washington on Nov. 15, analysts said there would be pressure on the United States and other Western countries to show they were trying to cushion the blow of the crisis on developing countries.

The International Monetary Fund is trying to arrange a large credit line to help developing countries desperate for dollars. On Friday, Iceland announced it had reached a tentative deal for a $2 billion emergency loan from the fund — making it the first country to seek aid from the fund during this crisis, and the first Western country to do so since 1976.

The bad news started early Friday in Tokyo and Seoul, where big companies like Toyota, Sony and Samsung disappointed investors with their earnings. It continued as trading opened in Europe, with Britain reporting that its economy shrank in the third quarter.

By the time investors awoke in New York, stock futures had fallen so far that trading in them had been halted. Investors were on notice that the market could fall at least 6 percent, perhaps much more.

As trading started, the Dow dropped 450 points, or about 5 percent, and the floor appeared calm. Some traders said they took solace in the fact that the decline had not been greater — and far from the 1,100-point drop that would force a trading halt on the Big Board.

“It was frightening, absolutely frightening,” Warren Meyers, a floor trader for Walter J. Dowd Inc., said early on Friday. “Every day we are walking on shaking ground.”

Stocks seesawed for much of the rest of the day. A report that existing home sales jumped 5.5 percent in September as banks unloaded foreclosed homes did little to help the market.

But at about 2 p.m., stocks started rallying, and by 3 p.m., the Dow was down by just 100 points for the day. It was unclear what was fueling the rally, though investors seemed cheered by reports that the Treasury was weighing investments in insurance companies.

The Dow, however, was not able to build on those gains and fell sharply at the end of trading, dropping 183 points in 10 minutes.

The Treasury’s benchmark 10-year note fell 3/32, to 102 18/32, and the yield, which moves in the opposite direction from the price, was at 3.69 percent, up from 3.67 percent late Thursday.

As is often the case when stocks fall steeply, the market is starting to entice some investors, many of whom say they have never seen prices so low, to buy. Among them is Mr. Grantham, the GMO chairman.

After years of warning that stocks were unreasonably overpriced, he said he now believed they were below their fair value and had been slowly acquiring holdings in blue-chip companies.

“It’s a very nerve-racking time to be a value investor,” Mr. Grantham said. “You put a little bit into the market, and the next day you think, ‘What an idiot, what an idiot.’ ”

Edmund L. Andrews contributed reporting in Washington, and Michael M. Grynbaum in New York.