Stock Market Crash of 2008

Follow the Timeline to Understand Why It Crashed

A trader gestures as he works on the floor of the New York Stock Exchange September 29, 2008 in New York City. U.S. stocks took a nosedive in reaction to the global credit crisis and as the U.S. House of Representatives rejected the $700 billion rescue package, 228-205. Dow Jones Industrials fell as much as 700 points in midday trading. Photo by Spencer Platt/Getty Images

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The stock market crash of 2008 occurred on September 29. The stock market, as represented by the Dow Jones Industrial Average, fell 777.68 points in intra-day trading. That was the largest point drop in any single day in history. It was because Congress rejected the bank bailout bill. But the crash had been building for a long time.

The Dow hit its pre-recession, all-time high on October 9, 2007, closing at 14,164.43.

Less than 18 months later, it had dropped more than 50% to 6,594.44 on March 5, 2009. That wasn't the largest decline in history. During the Great Depression, the stock market took a 90% hit. But this fall was more vicious. It took only 18 months, compared to three years during the Depression. What caused the crash? Follow this timeline below to understand exactly how it happened.

2007

The Dow opened the year at 12,459.54. It rose fairly steadily throughout most of the year, despite concerns about a slowdown in the over-heated housing market. In fact, there had been warning signals as early as 2006 that the housing market was starting to falter. The Commerce Department warned on November 17, 2006, that October's new home permits were a whopping

28% below the October 2005 rate. Housing prices were falling in 2006, triggering the default of subprime mortgages. But government officials didn't think the housing slowdown would affect the rest of the economy.

By August 2007, the Federal Reserve recognized that banks had a liquidity problem. It began adding liquidity by selling its reserves of Treasuries and accepted subprime mortgages from the banks as collateral. Shortly after the Dow hit its peak, some economists warned about the potential general impact of widespread use of collateralized debt obligations and other derivatives.

By late November, Treasury Secretary Hank Paulson launched a bank-funded Superfund to purchase toxic debt. However, as the year drew to a close, the BEA revised its estimate of third-quarter GDP growth, (Gross Domestic Product) *up* to a phenomenal 4.9%. It seemed the healthy U.S. economy could shrug off a housing downturn, and financial market liquidity constraints, as 2007 drew to a close. The Dow ended the year just slightly off its October high, at 13,264.82.

2008

By the end of January, the BEA announced that GDP growth was a paltry .6% for the fourth quarter of 2007. The economy lost 17,000 jobs, the first time since 2004. The Dow shrugged off the news, and hovered between 12,000-13,000 until March. On March 17, the Federal Reserve intervened to save the failing investment bank Bear Stearns, the first casualty of the subprime mortgage crisis. The Dow dropped to an intra-day low of 11,650.44 but seemed to recover. In fact, many thought the Bear Stearns rescue would keep markets from sliding below 20% of the October high, and avoid a bear market. By May, the Dow rose above 13,000 again and it seemed the worst was behind us.

In July 2008, the subprime mortgage crisis had spread to government sponsored agencies Fannie Mae and Freddie Mac, requiring a government bailout.

The Treasury Department guaranteed $25 billion in their loans and bought shares of Fannie's and Freddie's stock. The FHA to guaranteed $300 billion in new loans. The Dow closed on July 15 at 10,962.54. It rebounded above 11,000 for the rest of the summer.

September 2008

The month started with chilling news. On Monday, September 15, 2008, Lehman Brothers declared bankruptcy. The Dow dropped 504.48 points.

On Tuesday (September 16), the Federal Reserve announced it was bailing out insurance giant AIG. It made an $85 billion "loan" in return for 79.9% equity, effectively taking ownership. AIG had run out of cash.

It was scrambling to pay off credit default swaps it had issued against now-failing mortgage-backed securities.

On Wednesday (September 17), money market funds lost $144 billion. Investors panicked, switching to ultra-safe Treasury notes. The Dow fell 449.36 points.

On Thursday (September 18), markets rebounded 400 points. Investors learned about a new bank bailout package. On Friday (September 19), the Dow ended the week at 11,388.44. It was only slightly below its Monday open of 11,416.37.The Fed established the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF). It loaned $122.8 billion to banks to buy commercial paper from money market funds. On September 21, the Treasury guaranteed $50 billion worth of money market funds. The fact that the Fed has announced this new purchase program shows that credit markets are still partially frozen.

On Saturday, September 20, Hank Paulson and Ben Bernanke sent the bank bailout bill to Congress. The Dow bounced around 11,000 until September 29 . That's when the Senate voted against the bailout bill. The Dow fell 777.68 points, the most in any single day in history. Global markets panicked, as well:

- The MSCI World Index dropped 6% in one day, the most since its creation in 1970.
- Brazil's Bovespa was halted after dropping 10%.
- The London FTSE dropped 15%.
- Gold soared to over $900 an ounce.
- Oil dropped to $95 a barrel.

To restore financial stability, the Federal Reserve doubled its currency swaps with foreign central banks in Europe, England, and Japan to $620 billion. The governments of the world were being forced to provide all the liquidity for frozen credit markets. (Source: "Stocks Crushed," CNNMoney, September 29, 2008. "Fed Pumps $630 Billion into Financial System," Bloomberg, September 29, 2008. "Stocks Plunge After Congress Rejects Bailout," September 29, 2008. "Bank bailouts sweep Europe," CNNMoney, September 29, 2008)

October 2008

Congress finally passed the bailout bill in early October, but by now panic had set in. The Labor Department reported that the economy had lost a whopping 159,000 jobs in the prior month. On Monday, October 6, the Dow dropped 800 points, closing before 10,000 for the first time since 2004.

The Federal Reserve fought the ongoing banking liquidity crisis by lending $540 billion to money market funds.That gave the funds enough cash to meet a continuing barrage of redemptions. Since August, more than $500 billion was withdrawn from money markets. That's where most businesses park their overnight cash. Businesses were hoarding cash because LIBOR rates were high. That's because banks have been reluctant to make loans.

JPMorgan Chase managed the Fed's Money Market Investor Funding Facility (MMIFF). It purchased up to $600 billion of certificates of deposit, bank notes, and commercial paper that would come due in 90 days. The remaining $60 billion came from the money markets themselves, who must purchase commercial paper from the MMIFF. (Source: Federal

Reserve, Press Release, October 21,2008; "Fed to provide $540 billion to aid money funds," Bloomberg, October 21, 2008)

The Fed also coordinated a global central bank bailout. It quickly lowered the Fed funds rate to just one percent. But the LIBOR bank lending rate *rose* to its high of 3.46%.

The Dow responded by plummeting 13% throughout the month. By the end of October, the BEA released more sobering news. The economy had contracted 0.3% in the third quarter. The nation was in recession. (Source: CNN Money, The Week That Broke Wall Street, October 6, 2008)

November 2008

The Labor Department reported that the economy had lost a staggering 240,000 jobs in October. The month revealed more bad news. The AIG bailout grew to $150 billion, Treasury announced it was using part of the $700 billion bailout to buy preferred stocks in the nations' banks. The Big 3 automakers asked for a Federal bailout. By November 20, 2008, the Dow had plummeted to 7,552.29, a new low.But the stock market crash of 2008 was not yet over.

December 2008

The Federal Reserve dropped the Fed funds rate to zero, its lowest level in history. The Dow ended the year at a sickening 8,776.39, down nearly 34% for the year.

2009

The Dow climbed to 9,034.69 on January 2, 2009, in a burst of optimism. Investors believed that the new Obama Administration could tackle the recession with his team of economic advisers. But the bad economic news continued. The Dow plummeted to 6,594.44 on March 5, 2009. This was the true market bottom.

Soon afterward, Obama's economic stimulus plan instilled the confidence needed to stop the panic. On July 24, 2009, the Dow reached a higher high. It closed at 9,093.24, beating its January high. For most, the stock market crash of 2008 was over.

But scars remained. Investors remained skittish throughout the next four years. On June 1, 2012, they panicked over a poor May jobs report and the eurozone debt crisis. The Dow dropped 275 points, and the 10-year benchmark Treasury yield dropped to 1.443 during intraday trading. This was the lowest rate in more than 200 years. It signaled that the confidence that evaporated during 2008 had not yet returned to Wall Street.