# CHAPTER III

## *3.1 FINANCIAL IMPLICATION*

The collapse of Barings Plc sent shock waves throughout the world's financial institutions.

The collapse even caused the British pound to drop to an all-time low against other major currencies such as the German mark. It also caused stock markets across Asia to fall.

Feb 25 (Saturday), Barings Plc was put to the Administrators, Ernst and Young.

When news broke on Feb 27 (Monday) about the Barings collapse, the losses (which dwarfed the bank's total net worth) was estimated at *f*860 million (RM 3.44 billion).

On March 1, a saviour in the name of ING of the Netherlands put up a nominal *f*1 (RM 4) to take over Barings, thus saving the 233-year old institution from going into oblivion.

If the Bank of England (BOE) failed to find a buyer and Barings went bankrupt, the BOE would have to cover Barings losses. Failure to do so would cause a crisis of confidence in the entire banking institution and hurt the London Stock Exchange.

## *3.2 IMPACT ON GLOBAL STOCK MARKETS (27 Feb 1995)*

Repercussions of the the Barings collapse were quickly felt on the markets. (as illustrated in chart 3.2)

Prices on the Tokyo Stock Exchange nosedived over the Barings affair. The 225-issue Nikkei Stock Average declined 664.24 points, or 3.80 percent, ending the day at 16,808.70, a 15-month low. The Japanese markets woes aggravated those of Barings, because many of the unauthorised trades were still-open futures and options contracts on the Nikkei 225, the benchmark Japanese stock index.

Barings Securities Ltd was suspended from trading on the Tokyo over-the-counter market. South Korea froze the assets of the Seoul branch of Barings Plc, suspended its business and barred repatriation of its Korean assets to its head office. Korean authorities said their action against Barings was the first since the Seoul stock market was opened to foreign investors in 1992.

Hong Kong regulators stopped trading in Barings companies and halted activities of the bank's branch in the British colony. The Hang Seng Index, Hong Kong's leading indicator, opened 2.6 per cent lower, down 174 points, but recovered to 92 down, 1.12% lower at the end of trading day.

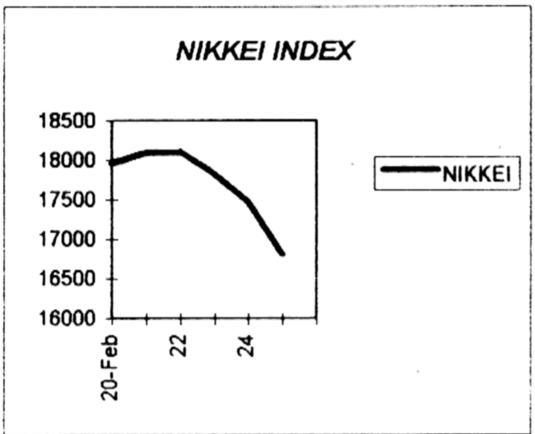
In Singapore, Baring future operations on the foreign exchange market were suspended. Singapore's SBT Composite Index dropped 34.91 points to 1,981.43, or 1.73% as againgst previous close.

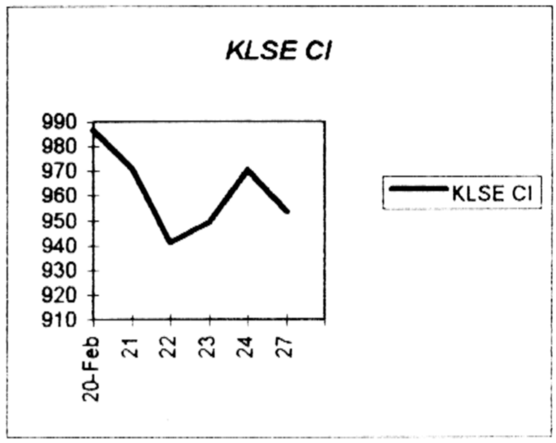
In London, the leading FTSE 100 index finished at 3,025.3 points, down 12.4 (or 0.41%), investors fearing Barings would unload its huge inventory of stocks in the market.

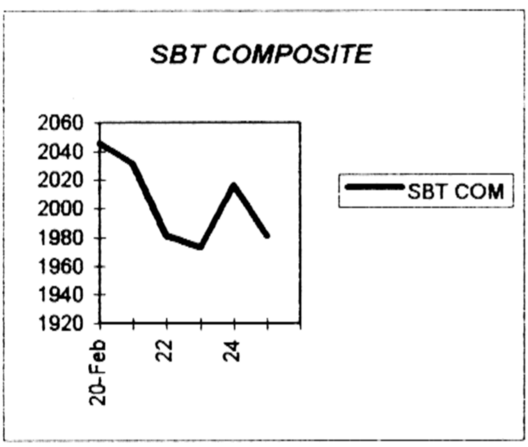
In New York, Wall Street Dow Jones Average Index reacted to the Barings collapse, falling 0.58 per cent, or 23.17 points.

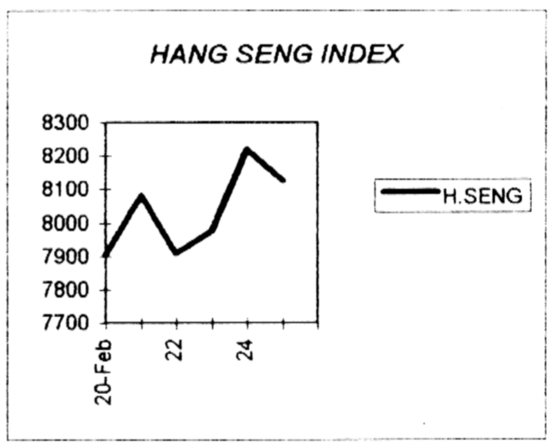
In Kuala Lumpur, the benchmark Kuala Lumpur Stock Exchange Composite Index ended 16.66 points down at 953.79 (or 1.72%), after plunging to an intra-day low of 946.72. The drop was considered mild as Bank Negara Malaysia announced that no Malaysian bank, or overseas branches and subsidiaries, was in anyway affected by Barings' collapse. Banking instituitions in Malaysia did not have any exposure to Barings, neither had they transacted in any derivative deal with Baring Securities in Singapore.

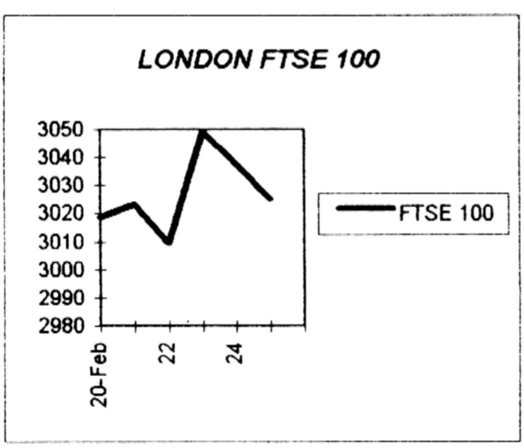
## *MONDAY CLOSES (27TH FEB 1995) ON SELECTED MARKETS*



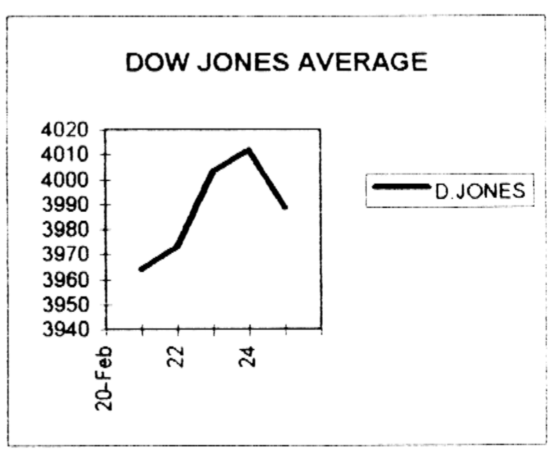




**Chart 3.2**

24th Feb 1995 (Friday) - News broke on Friday evening.

27th Feb 1995 (Monday) - Impacts were seen on Monday trading.

## *3.3 GRAPHICAL ANALYSIS*

The indexes used in this study are the Nikkei 225 Index (Tokyo), Dow Jones Average (New York), London FTSE 100 (London), Hang Seng Index (Hong Kong), SBT Index (Singapore) and Kuala Lumpur Composite Index (Malaysia). These indexes were chosen because they are widely referred and considered to be representative of the respective markets. The period of the study is from October 1994 to May 1995.

End of the day closing prices were used as they were the official figures quoted in all the financial reports. Moreover, it is the only price which many investors read and also it represents the final evaluation of the stock market at the end of the day.

To see the market impact/performance due to the collapse of this financial institution, a series of economic events happened before and after the collapse date (i.e 24th February 1995) were considered .

### 3.3.1 Nikkei 225 Index

Chart 3.3.1 exhibits a patern of general downturn.

Event 1 : (Mid January 1995)

Prior to the 17 January 1995 Kobe earthquake, the broad base Nikkei Index were hovering above 18,600 level. The earthquake measuring 7.2 devastated not only the city of Kobe, plummeted Nikkei from 19,331.17 (on 13 January 1995) to 18,840.22 (on 20 January 1995) within a week.

Event 2 : (End February 1995)

The market started to fall since then and things were made worse with the collapse of Barings Plc towards the end of February 1995. The downturn situation continued until end of March 1995.

Event 3 : (Early April)

The stock market was also dampened in reaction to continued weakness of the US dollar against the Yen. The heavy intervention by the Bank of Japan and the US Federal Reserve Board could not hold the dollar above 87 Yen.

Japan economy has not been doing well for the past few years and this was reflected in the stock market. Things were made worst with the Jan 17 Kobe earthquake. Together with it, the market was pulled down.

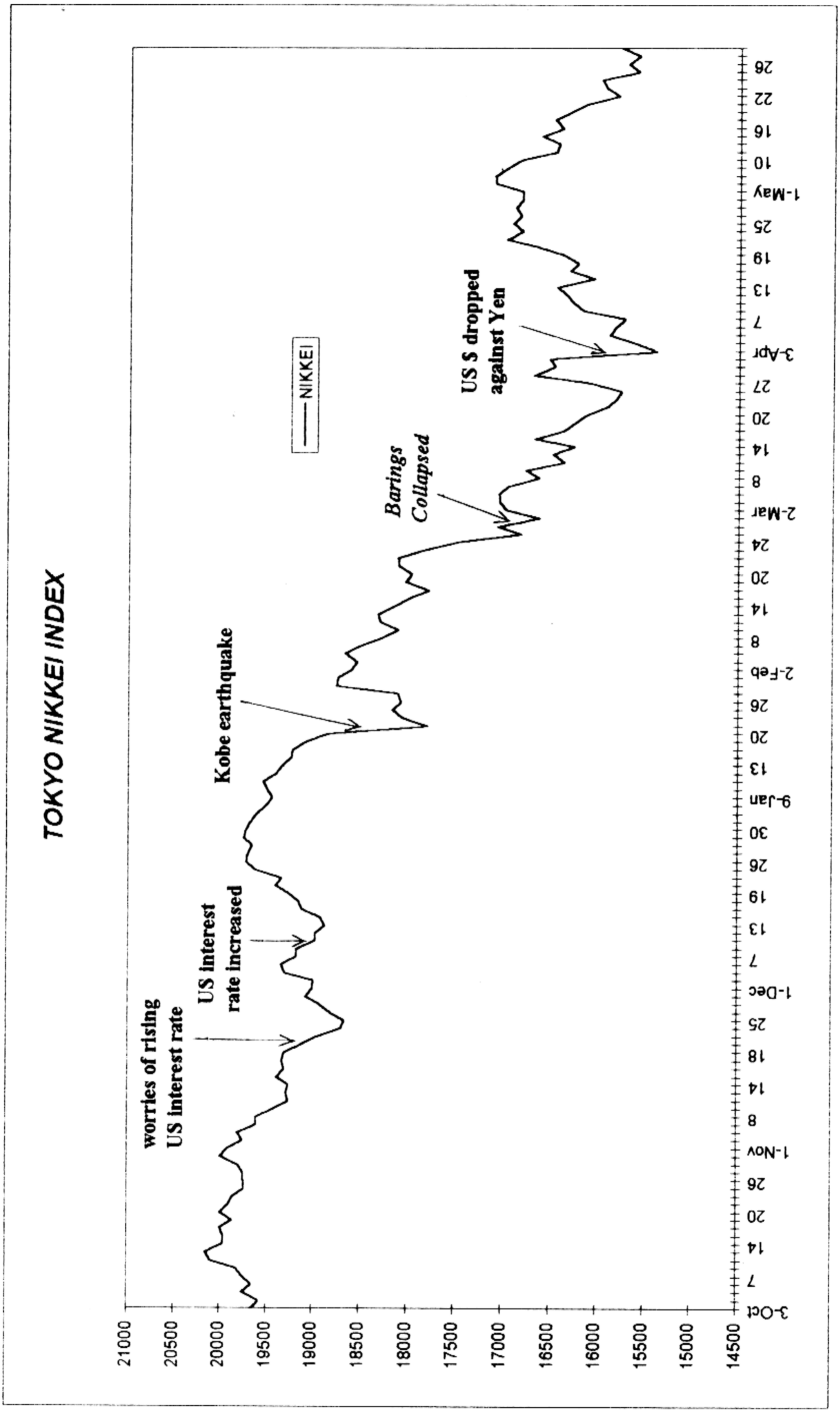

TOKYO NIKKEI INDEX
NIKKEI
worries of rising US interest rate
US interest rate increased
Kobe earthquake
Barings Collapsed
US $ dropped against Yen
21000
20500
20000
19500
19000
18500
18000
17500
17000
16500
16000
15500
15000
14500
3-Oct
7
14
20
26
1-Nov
8
14
18
25
1-Dec
7
13
19
26
30
9-Jan
13
20
26
2-Feb
8
14
20
24
2-Mar
8
14
20
27
3-Apr
7
13
19
25
1-May
10
16
22
26

Chart 3.3.1

### 3.3.2 Dow Jones Average

During the study period, the market could be roughly seen in two phases i.e horizontal trend and upward trend with the turning point at early February 1995 (please refer to chart 3.3.2).

Phase 1 : Horizontal (before February 1995)

During this period, the index was tracking sideways with the high of 3,940 and a low of 3,670 (a difference of 270 points).

From the makro point of view, the sluggishness in Wall Street happened during the period of 1994 and early 1995 was mainly due to the US Federal Reserve Board tightened its monetary policy progressively to pre-empt inflationery pressures in view of its rapid economic expansion at a pace exceeding the potential output growth.

The Federal Reserve Board (The Fed) acted to raise the Federal funds rate six times by a total of 2.5 percentage points from 3% per annum at the end of 1993 to 5.5% per annum on Nov 15, 1994. As a result, investors shifted from stock market to bond market.

*(Note : The control of the US's monetary policy rests in the hands of the Fed with its primary responsibility is to manage the liquidity (the supply of money) and interest rate structure of the economy to meet the government's goals. The Fed can do this in one of two ways : first, it can directly change the interest rate that commercial banks must pay to borrow money. Second, it can increase or decrease the supply of money, or in a way, interest rate too as it always refered as the price of money).*

At the mean time, there were some minor corrections occured which sent the stock market down. These included :

a. California's Orange County filed for bankrupcy protection after it lost US$1.5 billion on investment in the volatile derivative market in December 1994.

b. In January 1995, investors jittery over the prospect of another credit tightening by the Fed following the congressional approval of a package of loan quarantee for Mexico after its peso crisis.

c. End January 1995, investors feared that businees investment would be constrained by the appreciation of the Yen which recorded a post-war high against the dollar, thereby eroding sales revenues.

Phase 2 : Upward (after February 1995)

On the other hand, clear indication of upward trend was seen after February 1995. On 24th March 1995, it soared above 4,100 for the first time on more evidence that the US economy is headed for a "soft landing", after a report of a 0.8% decline on durable goods orders, suggesting a cooling of the manufacturing sector, which helped ease inflation fears.

The impact of the collapse of Barings Plc on 27th February 1995 did not create much ripple to the stock market. This could be seen by only 23.17 points or 0.58 percent decline on that day. The general upward trend was obviously undettered with an additional 22.48 points recovered the next day on 28th February 1995 and the market was on its way up since then.

Generally, Dow Jones was more influenced by its internal economic activities rather than external event such as the Barings fiasco.

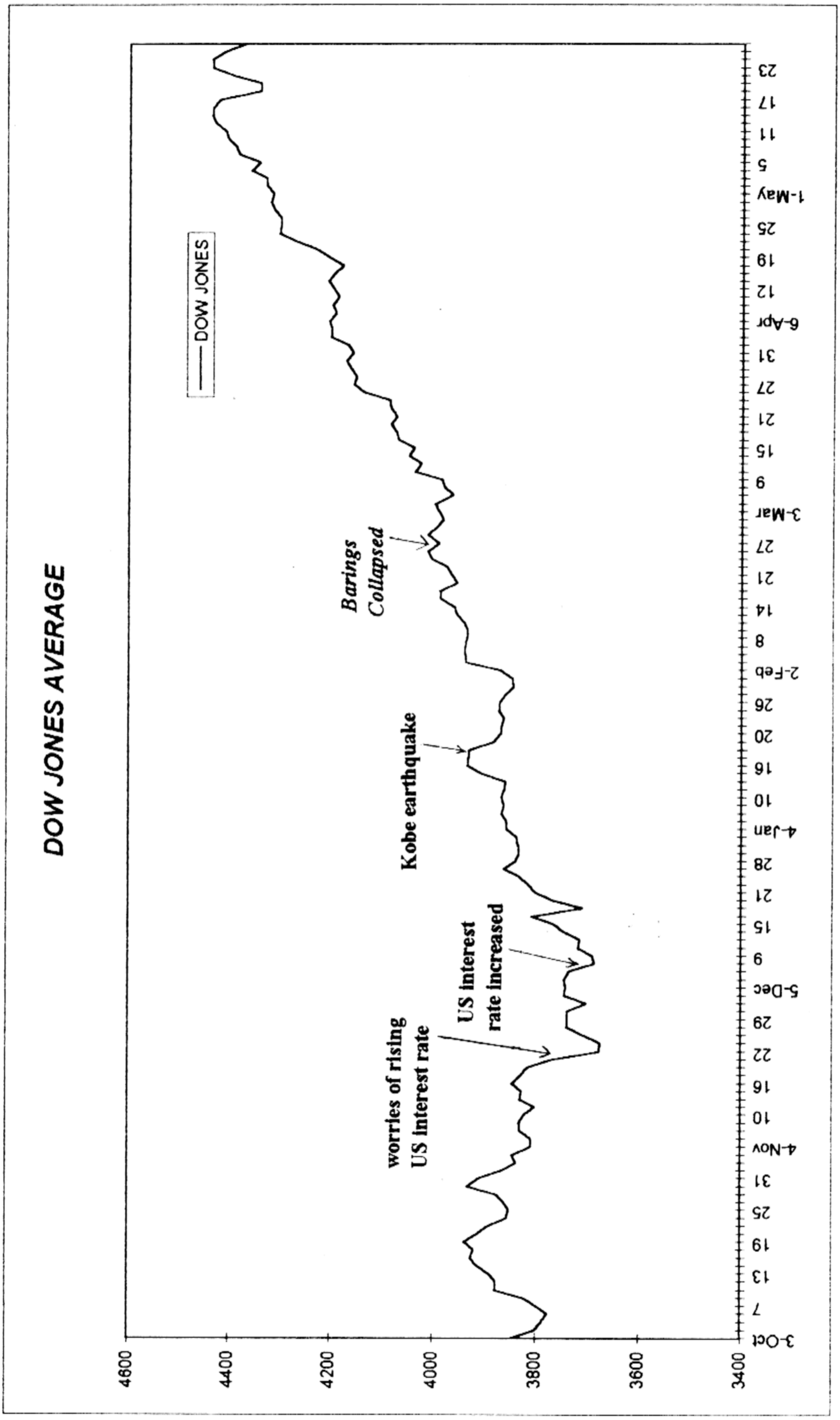

DOW JONES AVERAGE
DOW JONES
Barings Collapsed
Kobe earthquake
US interest rate increased
worries of rising US interest rate
4600
4400
4200
4000
3800
3600
3400
3-Oct
7
13
19
25
31
4-Nov
10
16
22
29
5-Dec
9
15
21
28
4-Jan
10
16
20
26
2-Feb
8
14
21
27
3-Mar
9
15
21
27
31
6-Apr
12
19
25
1-May
5
11
17
23

Chart 3.3.2

### 3.3.3 London FTSE 100 Index

Chart 3.3.3 exhibits a patern similar to that in Chart 3.3.2.

The market was moving sideways from month of October 1994 to mid March 1995 and showed an upward trend after that. The synchronisation was mainly caused by the comovement of these two markets. Whenever Dow Jones retreated due to the Fed's interest rate hike, London would react similarly. Moreover, Britain had also raised interest rate twice in 1994 to cool its economy growing at an annual rate of 4.2 percent in the third quarter of 1994, well ahead of average growth of 2.25 percent over the past fourty years.

Besides the influence of Wall Street, the stock market was also influenced by the local economic events such as the unemployment rate.

On the 27th February 1995, the leading FTSE 100 Index only shed 12.4 points or a meagre 0.41 percent. Later, the upward trend of the market did not suggest any impact to the stock market, be it short term nor long term.

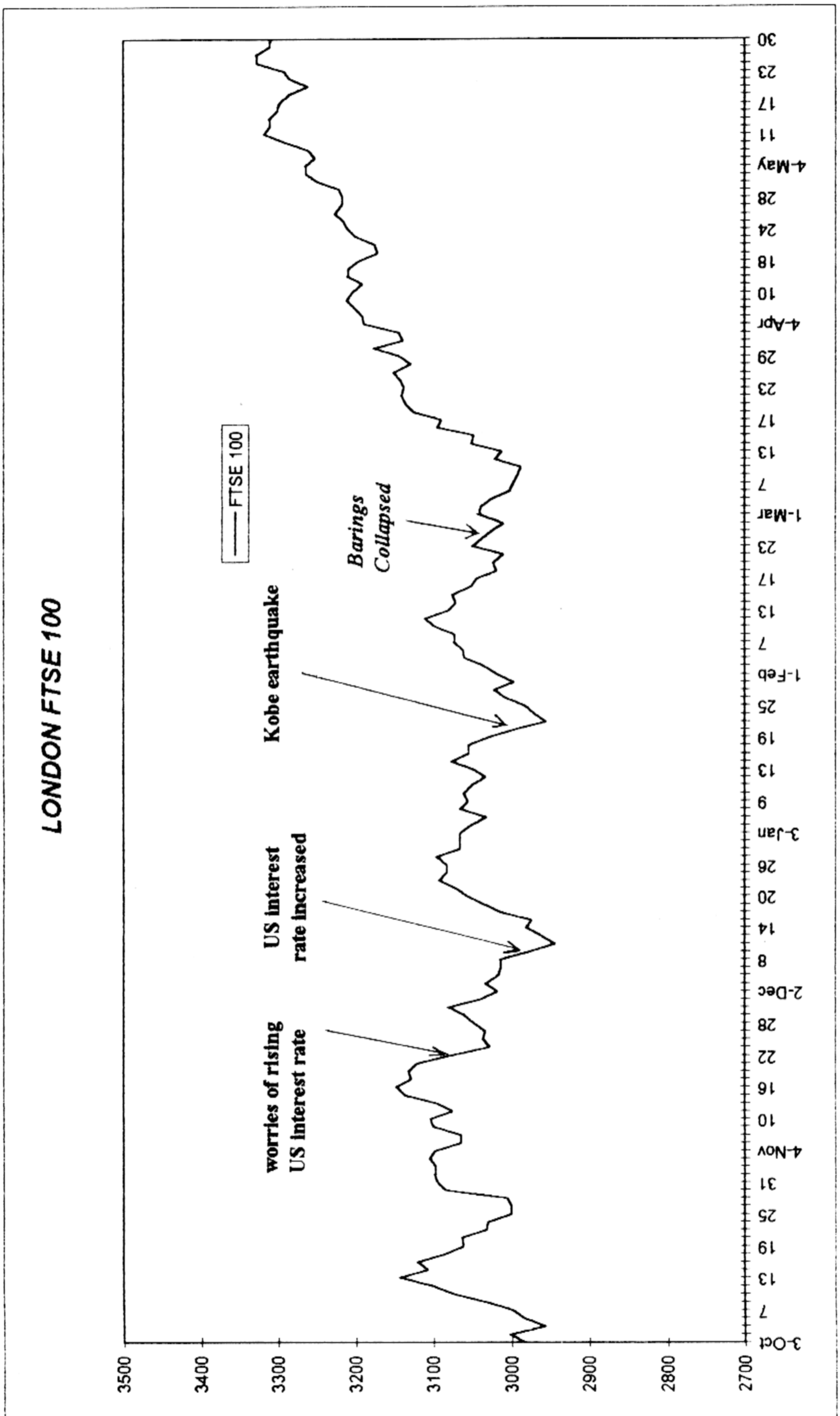

LONDON FTSE 100
FTSE 100
worries of rising US interest rate
US interest rate increased
Kobe earthquake
Barings Collapsed
3500
3400
3300
3200
3100
3000
2900
2800
2700
3-Oct
7
13
19
25
31
4-Nov
10
16
22
28
2-Dec
8
14
20
26
3-Jan
9
13
19
25
1-Feb
7
13
17
23
1-Mar
7
13
17
23
29
4-Apr
10
18
24
28
4-May
11
17
23
30

Chart 3.3.3

### 3.3.4 Hang Seng Index

Chart 3.3.4 exhibits a broad 'V' shape with the bottom occured at the third week of January 1995.

The weak market prior to the turning point was mainly due to investors' worries about the US interest rates, the health of China's paramount leader Deng Xiao Ping, the impact of Mexico peso crisis and the Kobe earthquake.

The collapse of Barings Plc did not seem to have any impact to this British collonial, at the end of the trading day on 27th February 1995, only 92 points down or 1.12 percent (a daily fluctuation of 200 points in Hang Seng Index is not uncommon).

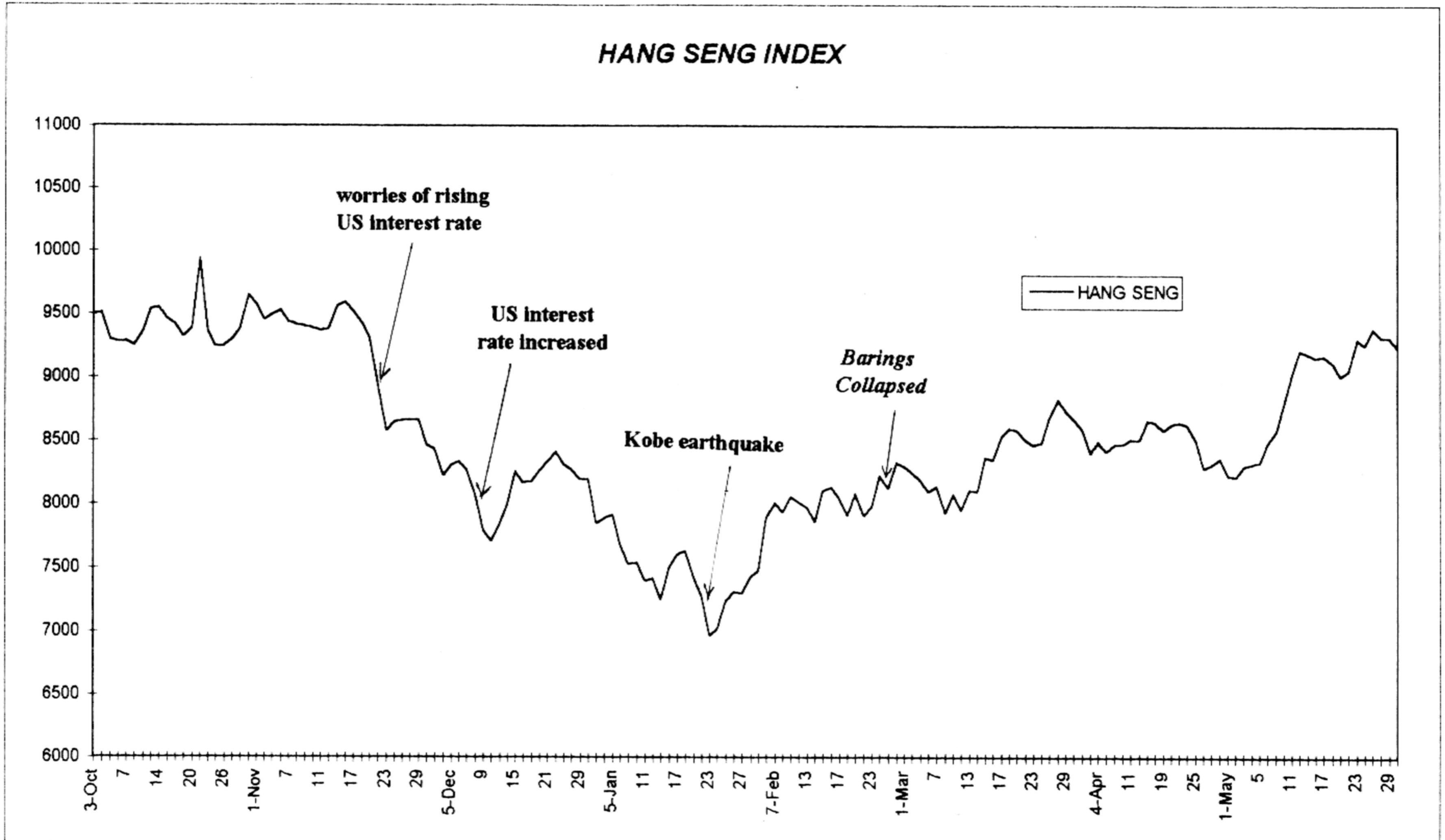

HANG SENG INDEX
11000
10500
10000
9500
9000
8500
8000
7500
7000
6500
6000
worries of rising
US interest rate
US interest
rate increased
Kobe earthquake
Barings
Collapsed
HANG SENG
3-Oct 7 14 20 26 1-Nov 7 11 17 23 29 5-Dec 9 15 21 29 5-Jan 11 17 23 27 7-Feb 13 17 23 1-Mar 7 13 17 23 29 4-Apr 11 19 25 1-May 5 11 17 23 29

Chart 3.3.4

### 3.3.5 Singapore SBT Composite Index

As one of the emerging markets, Singapore Stock Exchange tend to follow the direction of foreign developed market like Dow Jones to chart its own course. (please refer to chart 3.3.5)

The two troughs which were seen on first week of December 1994 and third week of January 1995 were simply caused by bearish signals generated from Wall Street which put pressure on the local sentiment, sending share prices plunged. The impact of the interest rate hike by the US Federal Reserve was felt throughout the world (with no exception of Singapore), as funds were agreesively liguidated and shifted to other financial instruments (like bond market) with better returns.

As expected, the collapse of Barings Plc did not pose any major threat to the exchange as it only dropped 35 points (1.73 percent) as against the previous close.

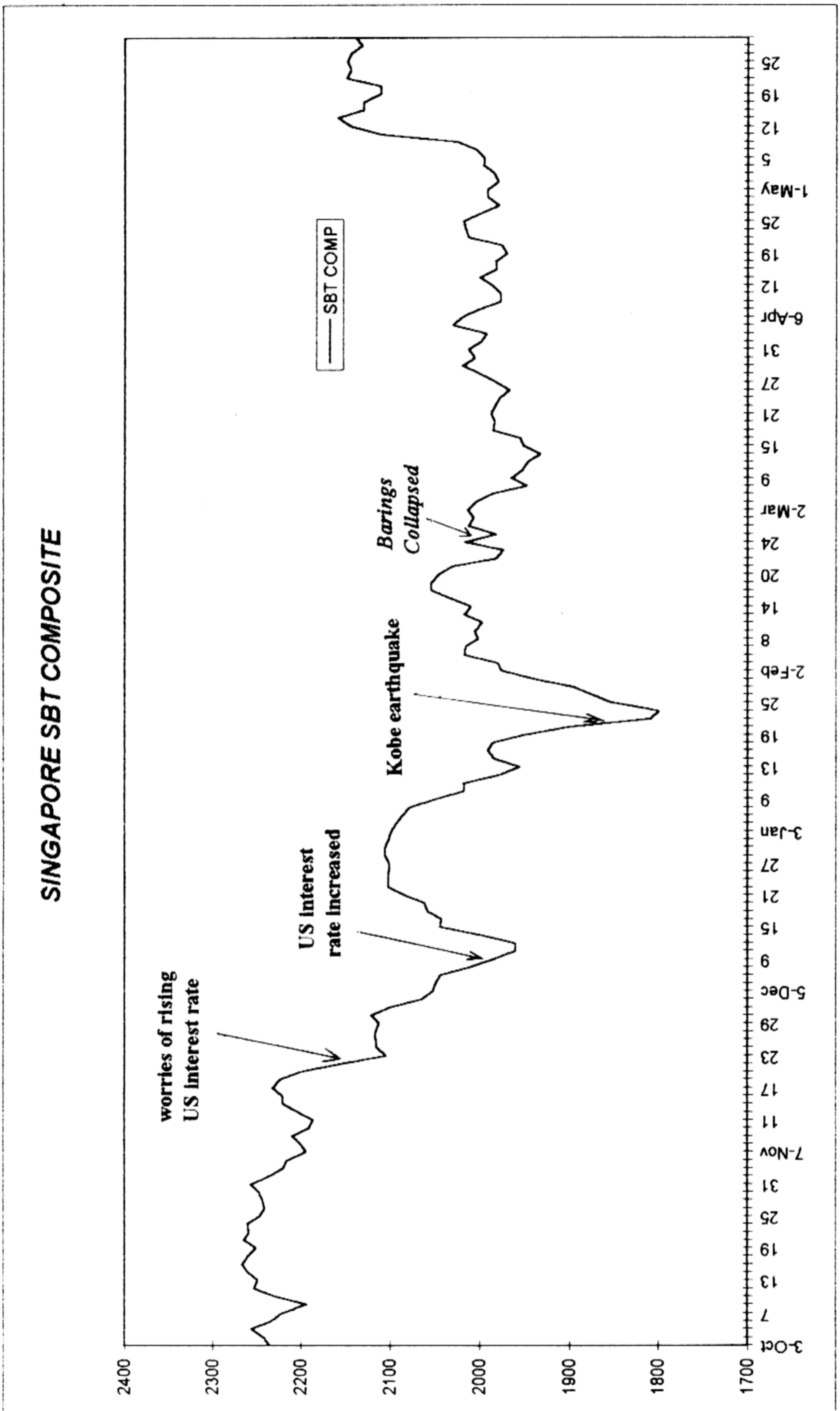

SINGAPORE SBT COMPOSITE
SBT COMP
worries of rising
US interest rate
US interest
rate increased
Kobe earthquake
Barings
Collapsed
2400
2300
2200
2100
2000
1900
1800
1700
3-Oct
7
13
19
25
31
7-Nov
11
17
23
29
5-Dec
9
15
21
27
3-Jan
9
13
19
25
2-Feb
8
14
20
24
2-Mar
9
15
21
27
31
6-Apr
12
19
25
1-May
5
12
19
25

Chart 3.3.5

### 3.3.6 KLSE Composite Index

Chart 3.3.6 exhibits a similar pattern to that of chart 3.3.5 i.e Singapore SBT Composite Index. This is expected as Kuala Lumpur Stock Exchange and Singapore Stock Exchange are considered emerging market which at a large extent, reacts to the ups or downs of developed market, especially Dow Jones and Tokyo Stock Exchange.

On a few occasions, price movements shifted downwards in line with the Dow Jones's movement on fears over possible US interest rate increase.

The sluggishness were also due to the local inflationery pressure, enlarged trade deficit, the devaluation of Mexico peso crisis (which caused suspicious to foreign investors on emerging market like Malaysia) and reluctance of foreign funds to take position.

The 1995 general election did not auger well either amist the above negative issues.

The disastrous earthquake in Japan and the collapse of Barings Plc affected local market sentiments, caused prices to slip. These drops were temporary as the local strong economic fundamental are intact. The panic selling of a few institution were well absorbed throughout a short period.

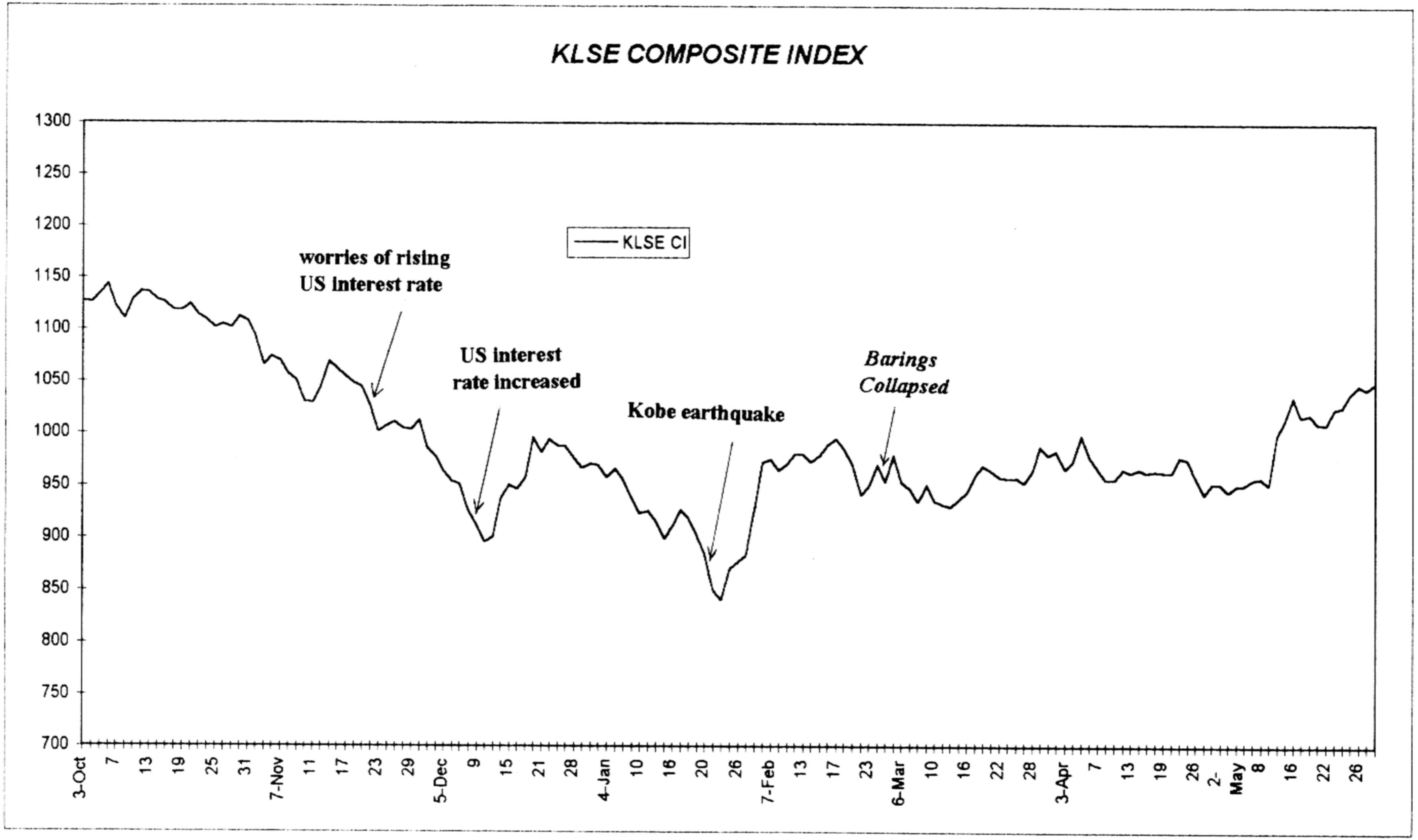

KLSE COMPOSITE INDEX
KLSE CI
worries of rising US interest rate
US interest rate increased
Kobe earthquake
Barings Collapsed
1300
1250
1200
1150
1100
1050
1000
950
900
850
800
750
700
3-Oct 7 13 19 25 31 7-Nov 11 17 23 29 5-Dec 9 15 21 28 4-Jan 10 16 20 26 7-Feb 13 17 23 6-Mar 10 16 22 28 3-Apr 7 13 19 26 2-May 8 16 22 26

Chart 3.3.6