

News Release

THE FEDERAL RESERVE BANK of KANSAS CITY
DENVER • OKLAHOMA CITY • OMAHA

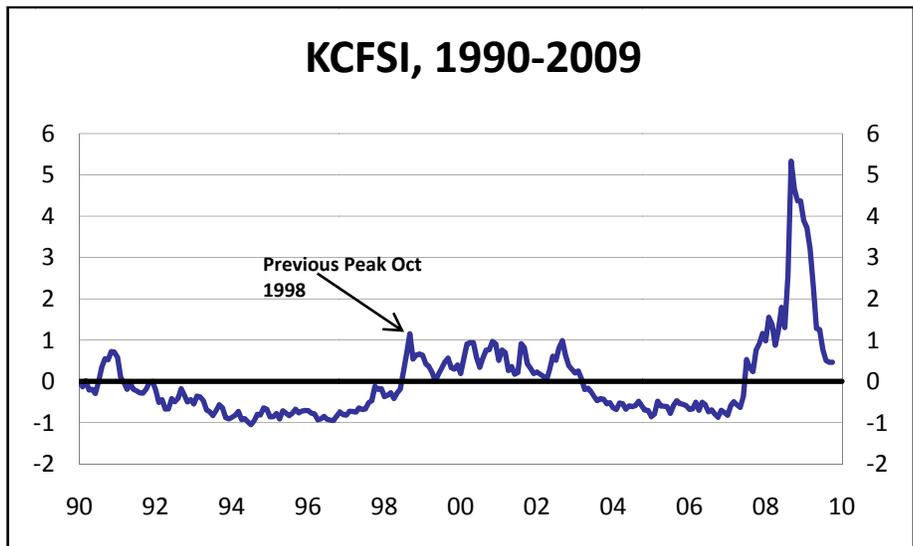
One Memorial Drive • Kansas City, MO 64198 • Phone: 816.881.2683

FOR IMMEDIATE RELEASE
Nov. 9, 2009

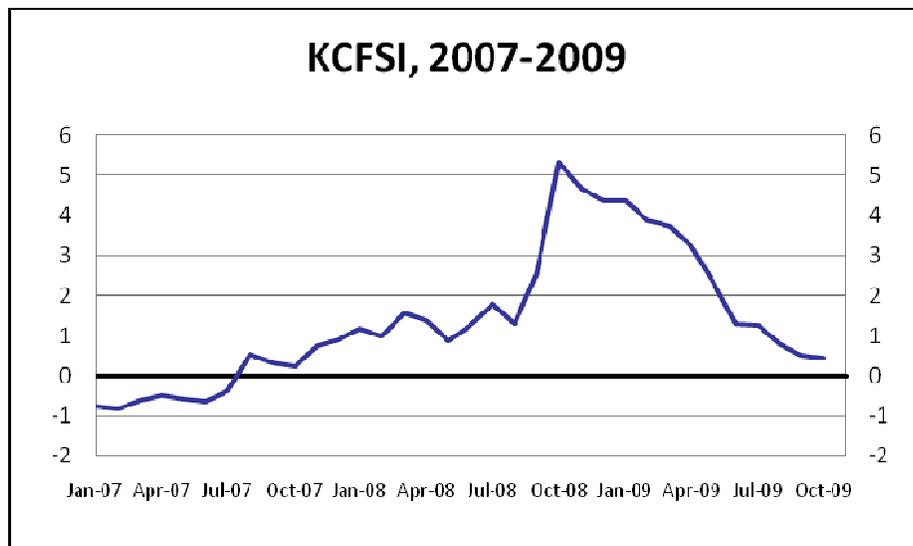
CONTACT: Tim Todd
816-881-2308
timothy.todd@kc.frb.org

THE KCFSI SUGGESTS FINANCIAL STRESS WAS LITTLE CHANGED IN OCTOBER, DOWN SHARPLY FROM A YEAR AGO BUT HIGHER THAN BEFORE THE CRISIS

The Kansas City Financial Stress Index (KCFSI) was 0.46 in October, down slightly from 0.51 in September. The modest change followed a series of more substantial declines in the index since its peak in October 2008. For the third consecutive month, the KCFSI was below the previous peak in October 1998, when financial stress was high due to the Russian debt default and the collapse of Long-Term Capital Management. However, the KCFSI was still higher than at the beginning of the crisis in July 2007.



Five of the eleven variables making up the KCFSI fell from September to October, contributing to the overall decline of 0.04 point in the index. Changes in the seven yield spreads reduced the KCFSI by a total of 0.08 point, while changes in the four measures of asset price behavior increased the index by 0.04 point. The variable with the greatest negative contribution to the index was the high-yield bond/Baa spread, which subtracted 0.04 point. The greatest positive contribution to the index came from the idiosyncratic volatility of bank stock prices, which added 0.02 point from September to October.



KCFSI for October 1998, July 2007, and the last six months								
KCFSI	Oct '98	Jul '07	May '09	Jun '09	Jul '09	Aug '09	Sep '09	Oct '09
Current	1.15	-0.36	2.31	1.28	1.25	0.77	0.51	0.46
Previous	1.15	-0.36	2.31	1.28	1.26	0.81	0.52	NA
Note: Previous index values are from the October 10, 2009 release. NA = not applicable								

Sources of Change in KCFSI from September 2009 to October 2009		
Variable	Contribution to change in index	Rank (lowest to highest value)
Yield spreads	-0.08	
3-month Libor/3-month Treasury (TED) Spread	0.01	7
2-year swap spread	0.01	8
Off-the-run/on-the-run 10-year Treasury spread	-0.04	2
Aaa/10-year Treasury spread	0.01	6
Baa/Aaa spread	-0.01	3
High-yield bond/Baa spread	-0.04	1
Consumer ABS/5-year Treasury spread	-0.01	5
Behavior of asset prices	0.04	
Correlation between stock and Treasury returns	0.01	9
Implied volatility of overall stock prices (VIX)	-0.01	4
Idiosyncratic volatility of bank stock prices	0.02	11
Cross-section dispersion of bank stock returns	0.01	10
Total	-0.04	
Note: The contribution of each variable equals the change in the standardized value of the variable times the coefficient of the variable in the index. Contributions may not add to totals due to rounding.		

Frequently Asked Questions

What is the KCFSI? The KCFSI is a monthly composite index of 11 variables reflecting stress in the U.S. financial system. These variables fall into two broad categories--average yield spreads, and measures based on the actual or expected behavior of asset prices. The index is calculated using the principal components procedure. Under this procedure, the coefficients of the 11 variables are chosen so that the index explains the maximum possible amount of total variation in the variables from February 1990 through the current month. Further details on the variables and the construction of the index can be found in Section II of “Financial Stress: What Is It, How Can It Be Measured, and Why Does It Matter?” by Craig S. Hakkio and William R. Keeton, *Economic Review*, Federal Reserve Bank of Kansas City, Second Quarter 2009.

Why are past values of the index sometimes revised? Most revisions are due to recalculating the index using the additional data from the current month. These revisions are inherent in the principal components procedure and are explained in more detail in Appendix B of the article by Hakkio and Keeton. Other changes in past values of the index may result from revisions to the data used to construct the variables. Finally, the index may occasionally be revised due to a change in the data sources or in the method of constructing a variable. In this last case, an explanation for the revision is included in the monthly summary.

How should the index be interpreted? A positive value of the KCSFI indicates that financial stress is above the long-run average, while a negative value signifies that financial stress is below the long-run average. A useful way to assess the level of financial stress is to compare the index in the current month to the index during a past, widely-recognized episode of financial stress, such as October 1998. For more information on interpreting the index, see Section III of the article by Hakkio and Keeton.

