

News Release

THE FEDERAL RESERVE BANK of KANSAS CITY
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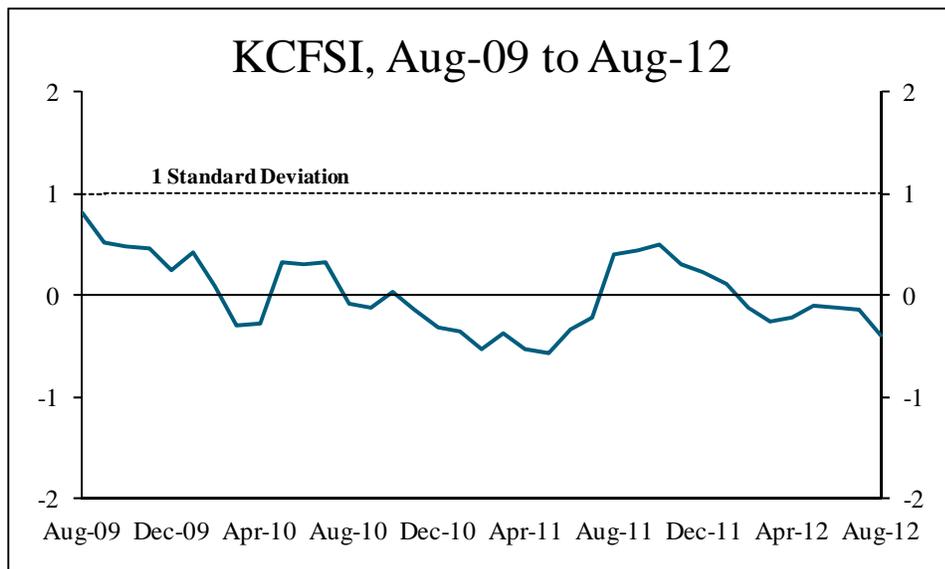
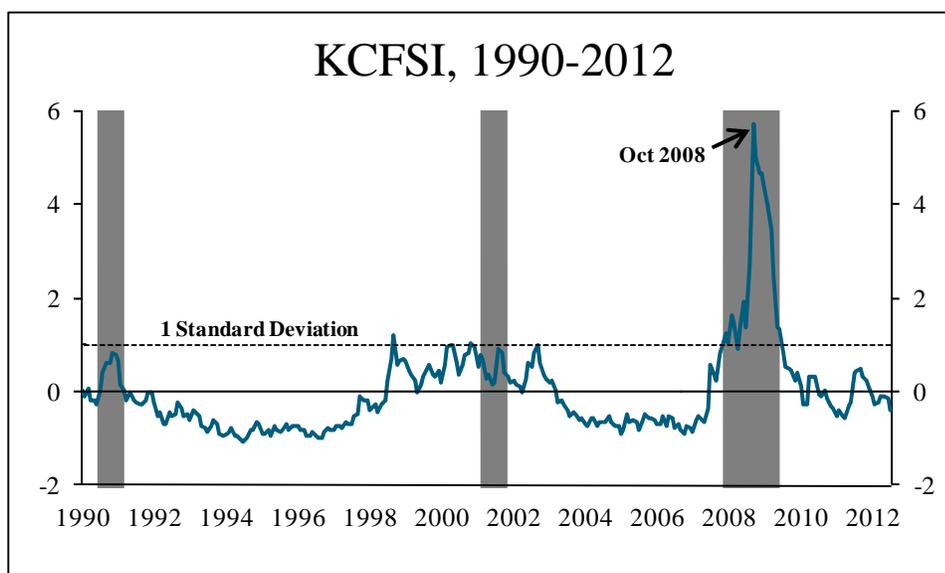
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The KCFSI suggests financial stress decreased in August. Historical real-time dataset now available.

The Kansas City Financial Stress Index (KCFSI) measured -0.40 in August, down from -0.13 in July. The decline follows two months of little change in the KCFSI. The index has now been below its long-run average of zero for seven consecutive months.

The second table on the following page describes the contribution of each of the eleven variables comprising the KCFSI. No indicator conveyed an elevated level of financial stress. The behavior of asset prices decreased the KCFSI by 0.19 point, as bank stock prices and VIX indicate low levels of financial stress. Yield spreads also suggest subdued levels of financial stress, as they collectively decreased the index by 0.08 point.

Beginning this month, the Kansas City Fed will maintain a real-time dataset of the KCFSI, available at the Kansas City Fed website. The purpose of the data is to provide researchers with a real-time measure of financial stress.



KCFSI: one year ago and most recent six months							
KCFSI	Aug '11	Mar '12	Apr '12	May '12	Jun '12	Jul '12	Aug '12
Current	0.41	-0.26	-0.22	-0.10	-0.11	-0.13	-0.40
Previous	0.40	-0.26	-0.22	-0.10	-0.11	-0.13	NA
Note: Previous index values are from the August 8, 2012 release. NA = not applicable							

Sources of Change in KCFSI from July 2012 to August 2012		
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	9
2-year swap spread	-0.02	6
Off-the-run/on-the-run 10-year Treasury spread	0.02	11
Aaa/10-year Treasury spread	-0.02	7
Baa/Aaa spread	-0.01	8
High-yield bond/Baa spread	-0.02	4
Consumer ABS/5-year Treasury spread	-0.02	5
Behavior of asset prices	-0.19	
Correlation between stock and Treasury returns	0.00	10
Implied volatility of overall stock prices (VIX)	-0.03	3
Idiosyncratic volatility of bank stock prices	-0.08	2
Cross-section dispersion of bank stock returns	-0.08	1
Total	-0.27	
Note: The contribution of each variable equals the change in the standardized value of the variable multiplied by 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.

