

The Weighting Method of Financial Stress Index Matters: An Empirical Analysis
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Abstract

The financial turmoil originated in USA sub-prime debt market in 2007 has developed to global crisis, which is considered as the most severe financial crisis since 1980. Given the key character of financial market in modern economy, the performance of financial market largely affected the performance of the whole economy of one country. In 2009, IMF developed the Financial Stress Index (FSI) to evaluate the financial stress in developed countries and emerging countries, which includes three sectors of financial markets: banking sector, security market and foreign exchange market. This paper developed a different weighting method to construct FSIs, and established a VAR model for quantitative analysis. The paper focuses on comparing the performance of two sets of FSIs in capturing relationships between different economies and countries and the transmission of financial stress in different countries. Thereafter the two sets of FSIs are used in identifying financial episodes to see whether they are useful and accurate in the identification and whether there is any difference in the two FSIs' performance.