

A TABF 40 Year Anniversary Event**Press Conference: Taiwan Financial Risk Index (TAIFRI)****Press Release**

2020.12.10

The Taiwan Financial Risk Index (TAIFRI)**Compiled and Published by the Taiwan Academy of Banking and Finance
(TABF)**

Taiwan's economy seems healthy, but how will the after effects of other countries' emergency measures in response to the COVID-19 pandemic affect it? TABF will systematically investigate questions like this through its new Taiwan Financial Risk Index (TAIFRI), and periodically issue reports for reference by the government and financial sector.

I. A milestone in financial data collection

The Taiwan Academy of Banking and Finance (TABF) pays close attention to risk trends in Taiwanese finance, and has completed a number of important and forward-looking studies on the topic. Starting in early 2019, its Chairman Wu Chung-Shu led an effort to understand international trends in financial risk and formulated a plan to design a financial risk index specifically for Taiwan's financial system: the Taiwan Financial Risk Index (TAIFRI).

The project team, combining the strength of TABF experts, other economists in Taiwan, and banking executives, has invested over a year researching, discussing, adjusting, and verifying TAITRI. The eve of TABF's 40th anniversary was selected to issue the first index, which consists of four indicators: asset valuation pressure, stability of the non-financial sector, stability of the financial sector, and spillovers/contagion. The results were presented at a press conference on December 10.

II. An index conforming to international trends, suited for Taiwan, and reflecting multifaceted risks

TABF's previous Bankers Executive Index (BEI) had been used evaluate changes in the domestic banking market and operating environment. 82 editions were produced from January 2014 to October 2020. TABF has tracked important financial risk trends and observed the ways that international financial institutions and countries measure risk. Based on this research, it designed TAIFRI specifically to assess the risks in Taiwan's financial system.

In early 2019, Chairman Wu convened a team comprised of internal experts and external financial scholars to work together on research to restructure the BEI. In line with international research trends, Taiwan's development, and the multi-faceted nature of risk, five major early decisions were made:

- To refer to the latest international risk dimensions
- To integrate and select statistical data with explanatory power
- To incorporate non-financial sectors
- To model forward-looking effects
- To emphasize real-time indicators

III. A new contagion model emphasizing both theory and practical application

TAIFRI's compilation process has six special characteristics:

- The methods and purposes of major international institution and central bank indicators
- Indicators with aggregate and simultaneous significance
- A focus on international asset trends
- Attention to the real estate market
- Timely data sources with broad coverage
- A measurement model to monitor spillovers and contagion.

In addition, TABF attaches great importance to international research trends, practical applications, and interoperability. TAIFRI has three important functional applications:

- Showing both short-term and medium-to-long-term trends
- Reflecting the characteristics of historical financial crises
- Identifying a variety of important aspects of risk

TAIFRI not only expands the focus of the BEI to capture and identify the sources of domestic financial risk, but also observes historical changes in the risk situation and their causes, and detects real-time changes in major domestic short- and medium-term risk facts. Aiming to provide reference for the financial industry, researchers, and policy makers, the index integrates international research conclusions, analyzes each risk aspect separately, observes important items that may influence future risks, and points to possible response measures.

IV. The four indicators of TAIFRI identify highlight different risk factors and their impact

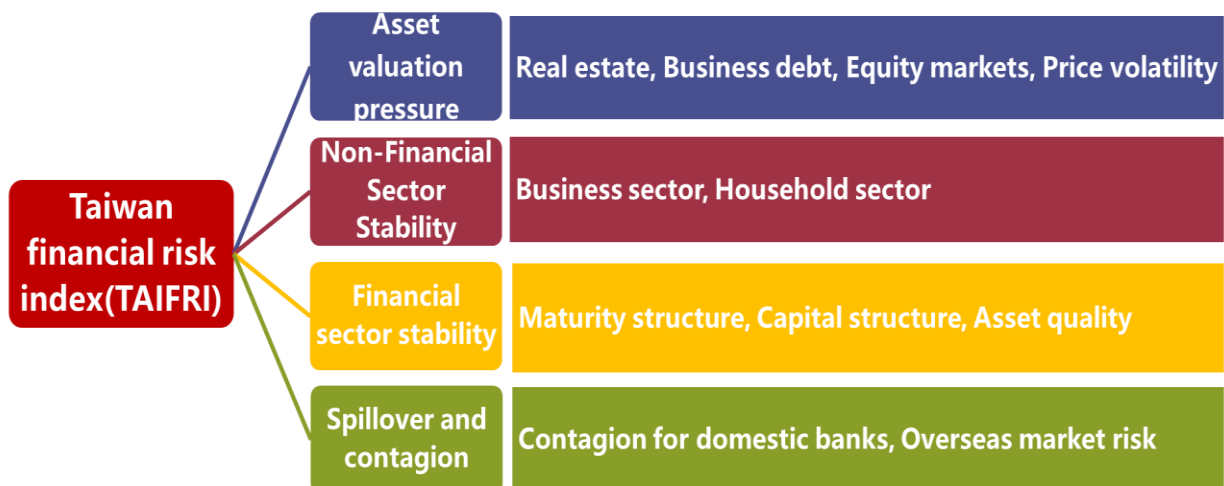
Each of the four indicators of TAIFRI have their own characteristics. The first one is asset valuation pressure. With reference to methodology of the European Central Bank, real estate, business debt, equity markets, and price volatility are set as its four sub-indices to assess domestic risks.

The second indicator, non-financial sector stability, has two sub-indices: business sector liabilities, and household sector investment, measuring the impact of its wealth and funds on financial risk.

The third indicator, financial sector stability, uses the maturity structure, capital structure, and asset quality of domestic banks as its three sub-indices, mainly monitoring risks to the banking industry arising from use of funds.

Finally, the fourth indicator is spillovers and contagion, an important dimension of financial risk assessment that has received increasing attention in recent years, and also a main feature of TAIFRI. This measure is comprised of two sub-indices: contagion for domestic financial institutions, monitoring the risk to their investments from commodified or closely linked assets, and overseas market risk, which incorporates the credit and asset price risks in those places, considers the year-on-year growth of overseas exposure by Taiwan's financial industry.

The 11 sub-indices within the four indicators are divided into 17 third-level indices.



V. The November 2020 results draw attention to the real estate market, stock market volatility, and domestic and international volatility.

i. The overall TAIFRI score was 98.11, reflecting low risk

In November 2020, the overall TAIFRI result was 98.11, down 0.6 from 98.71 in October, indicating relatively low risk for Taiwan compared to its historical performance. Asset valuation pressure scored 101.63, down 1.77 from 103.4 in October; non-financial sector stability scored 92.9, down 0.7 from 93.6 in October; financial sector stability scored 94.2, down 1.2 from 95.4 in October; and spillovers/contagion scored 104.3, up 0.9 from 103.4 in October.

ii. Commercial real estate remains solid; high volatility in equities market

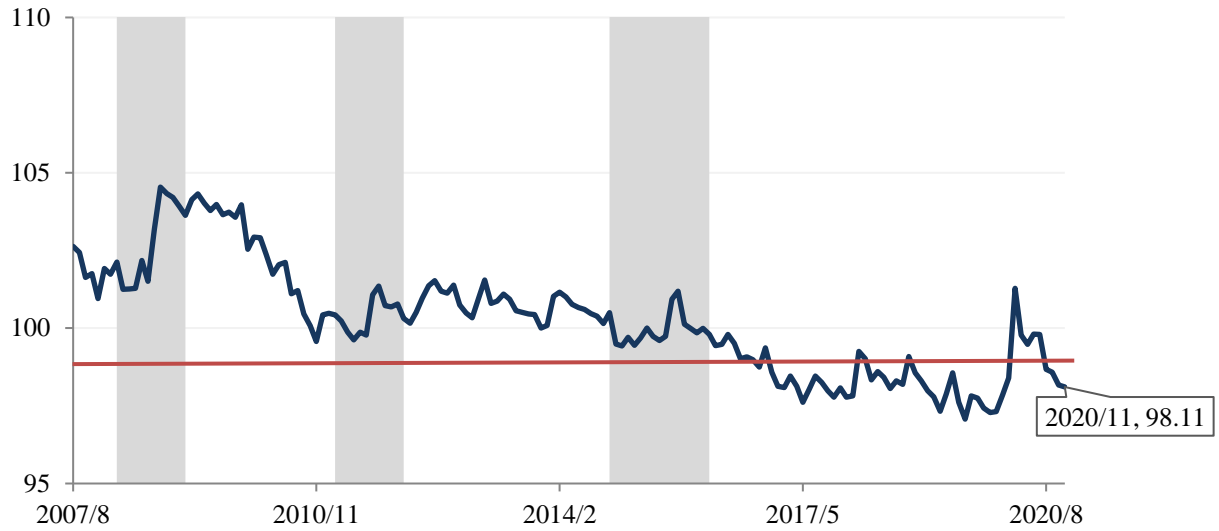
Analyzing the sub-indices, under asset valuation pressure, the real estate market sub-index has risen continuously since the beginning of the year, reaching a peak in July. The residential part is mainly due to housing prices increasing faster than rents since July, after the pandemic was controlled. However, prices and rents in the commercial office have continued rising steadily this year, indicating that continued attention is warranted on this sub-index. Due to a recent increase in price-to-earnings ratios, the stock market item reached a seven-year high of 20.74 in November. The spread between the market return and 10-year bonds shrunk for three consecutive months, causing an increase in this sub-index. There is a high chance that it will remain high for the rest of the year, but it's still in a stable range.

iii. Watch the impact of coronavirus pandemic and year-end corporate reports on contagion effect

Stability of the non-financial and financial sectors were both stable. Spillovers and contagion have declined steadily since its high of 113.2 in March, but not as rapidly as before, and in November they rebounded somewhat.

The contagion for domestic financial institutions sub-index score was dragged down by an international resurgence in COVID-19. After reaching a peak in April, it fell for five months in a row, but following its rebound, remains higher than in November 2019. Meanwhile, the decline in overseas market risk has slowed after declining for five months following the peak of the pandemic in Taiwan in March. In the fourth quarter, it rebounded due to a second international COVID wave, but slowed down after the United States presidential election. The effects of corporate and banking year-end results merit continued attention.

November 2020 TAIFRI composite index



November 2020 TAIFRI indicators

