Taiwan Academy of Banking and Finance (TABF)
Taiwan Financial Risk Index (TAIFRI)
Monthly Report

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MAY TAIFRI Highlights

- **May TAIFRI index scores 99.3, reflecting higher risk**

TAIFRI			
99.3 ↑ (+0.46)			
Asset Valuation Pressure	Non-financial Sector Stability	Financial Sector Stability	Spillover and Contagion
100.9 ↑ (+0.17)	95.2 ↓ (-0.11)	92.8 ↓ (-0.04)	104.1 ↑ (+1.18)

- **Real estate risks have eased, but stock market volatility increased**

  Due to a new government policy, loan-to-value of new mortgage has slowed in Taipei for two months. In April, mortgages in the five major banks declined and rates rose, indicating that banks are cooperating with the policy. The price -to-rent ratio did not changes significantly in May, real estate market risk remained stable. In equities, following outstanding Q1 performance, the market P/E ratio of Q1 declined, and risk declined, but following the local outbreak, the Taiwan VIX increased by 50% month-on-month, indicating higher asset price volatility risk.

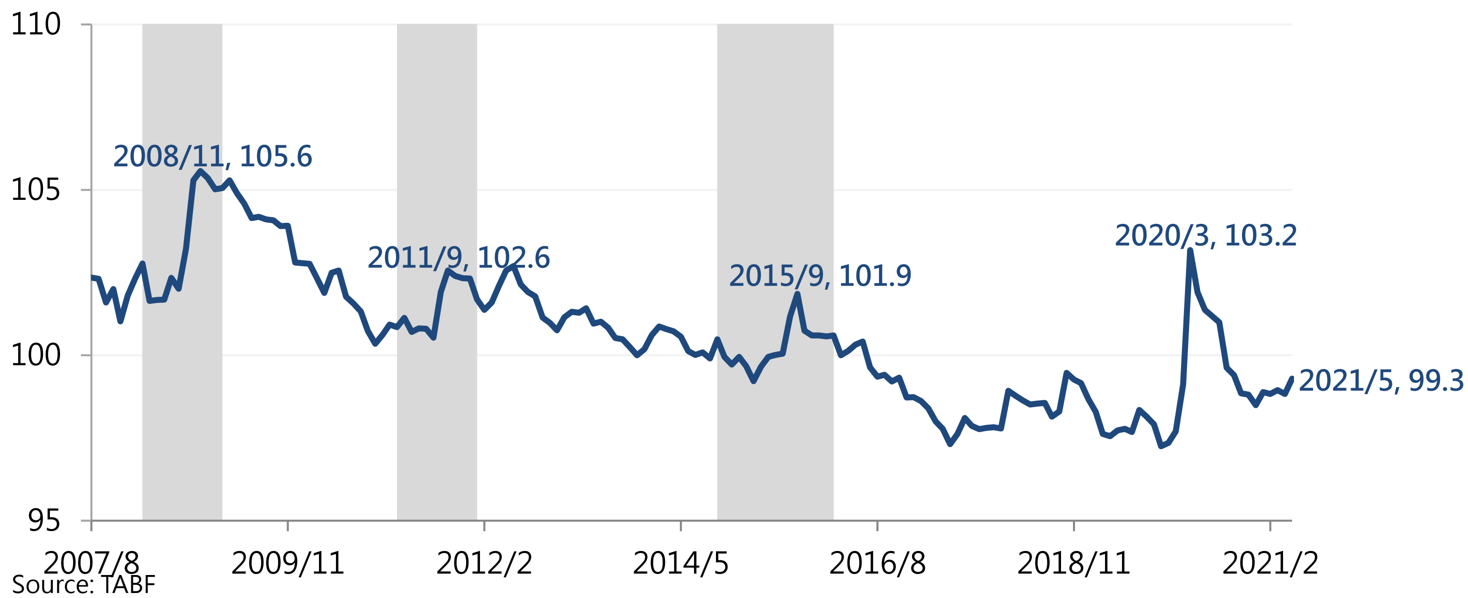
- **The volatility of overseas asset prices increased sharply, and contagion risk among domestic financial institutions rose**

  The Asia ex. Japan credit default swap index has risen for two months in a row to a 10-month high. In Mid-May, the US stock market fluctuated due to inflation concerns, and the fear index soared 40% in two days. Price volatility in Chinese, Japanese, and European markets also increased significantly, which is the main source of increased risk this month. The contagion risk in domestic financial institutions has grown for two consecutive months.

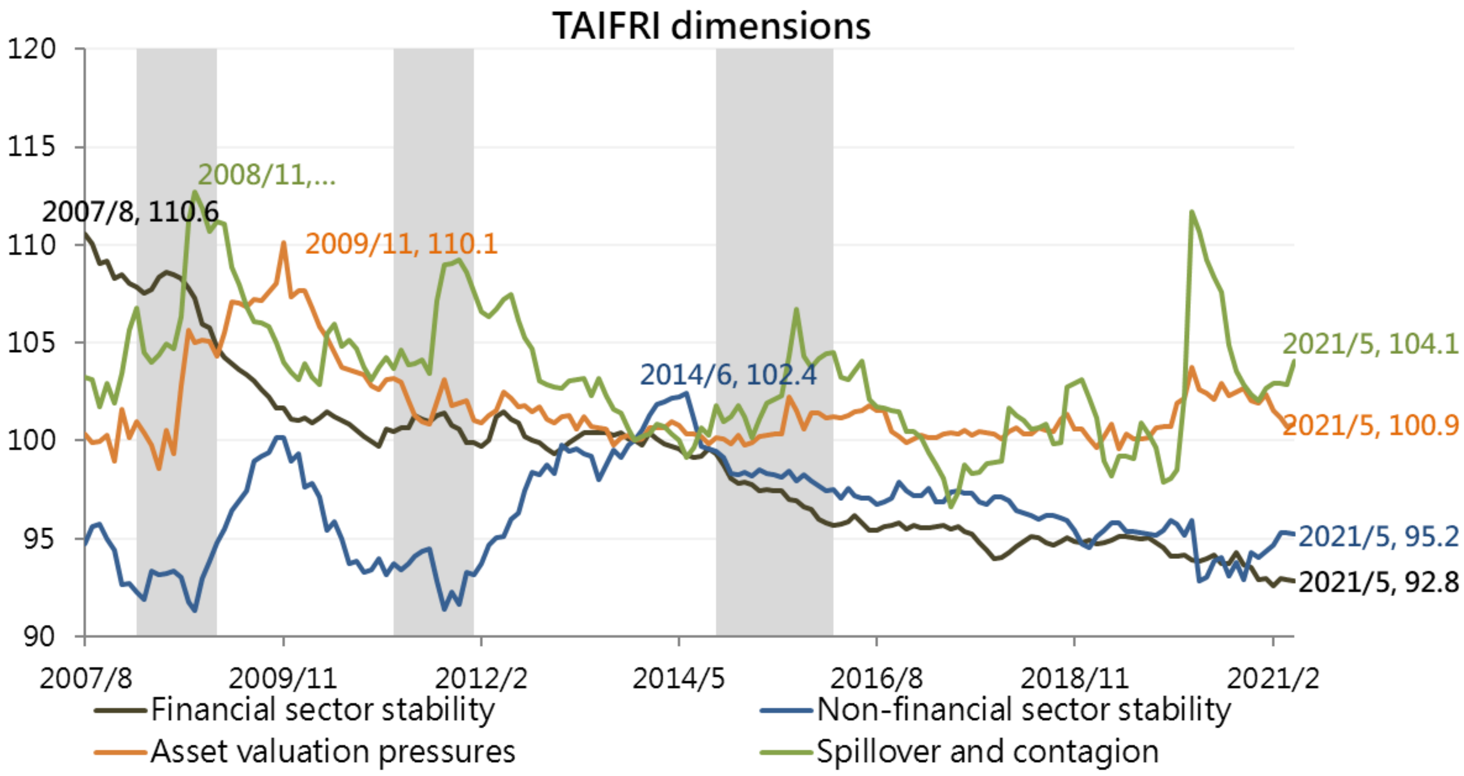
- **Lower risk in financial and non-financial sectors, but credit risk persists**

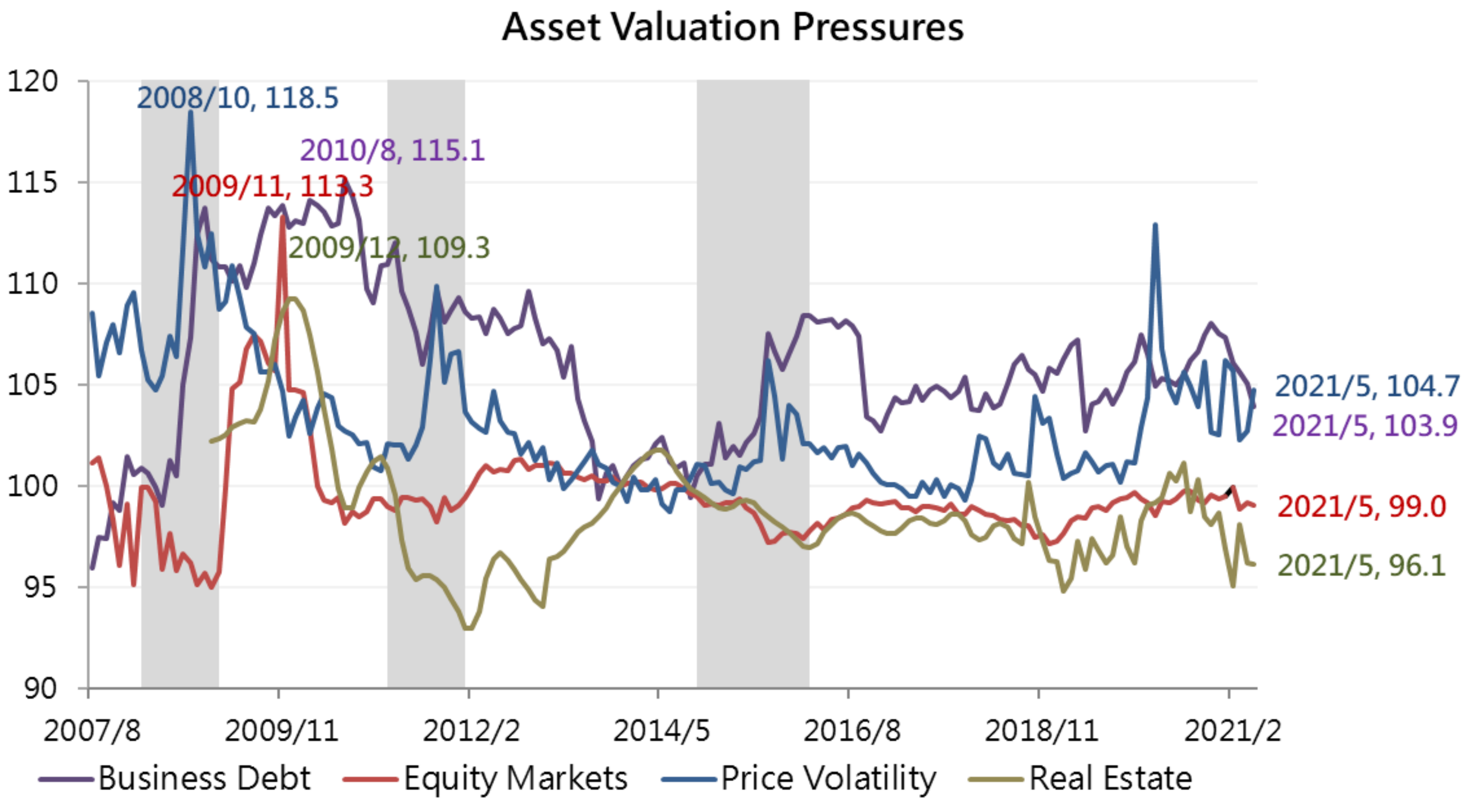
  In the household part of the non-financial sector, investment in overseas high-yield funds has exceeded 10 times that in general funds for two months, but down slightly from the previous month. In the corporate sector, the BBB bond yield has fallen for three months. Due to the bailout loan, corporate funding is expected to remain low-risk. NPL ratios and coverage ratio may however be slightly affected by the pandemic.

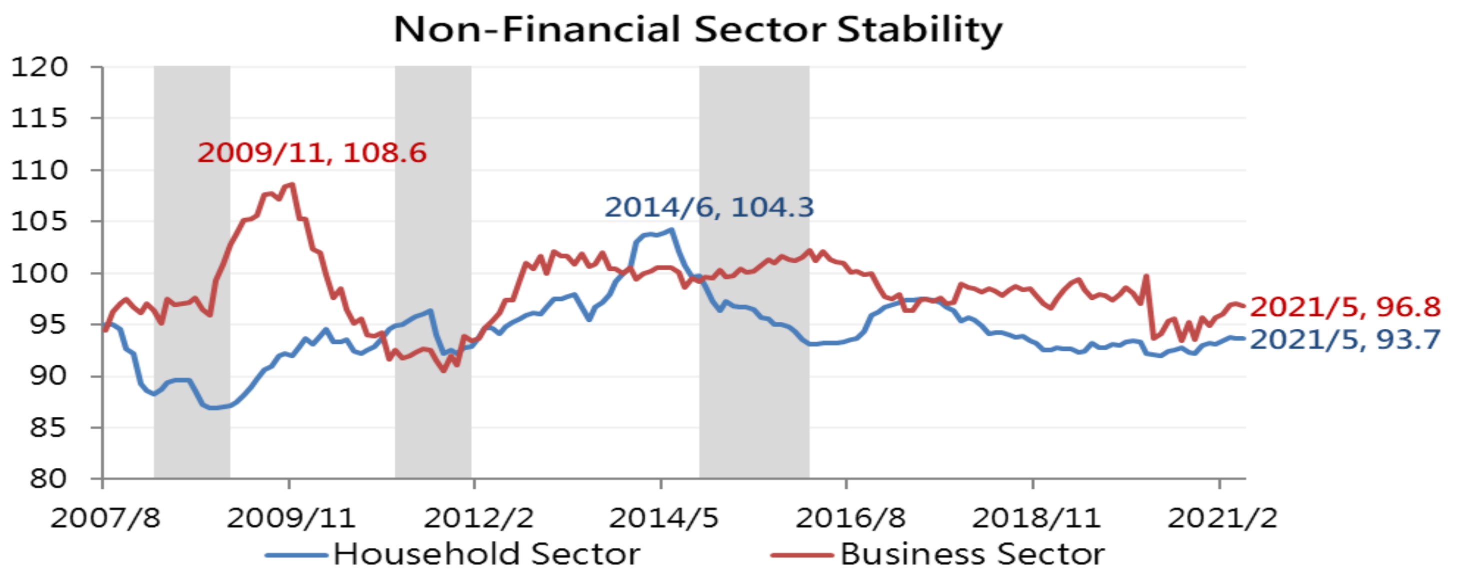
TAIFRI composite index

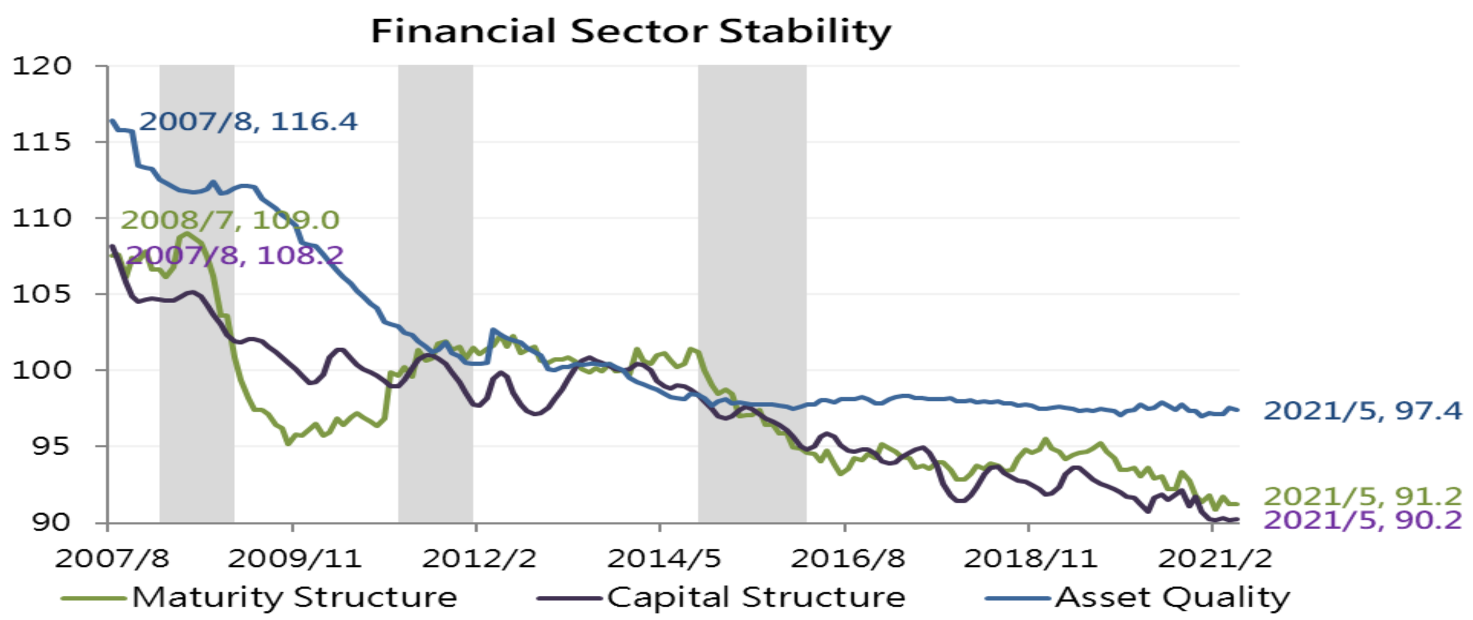


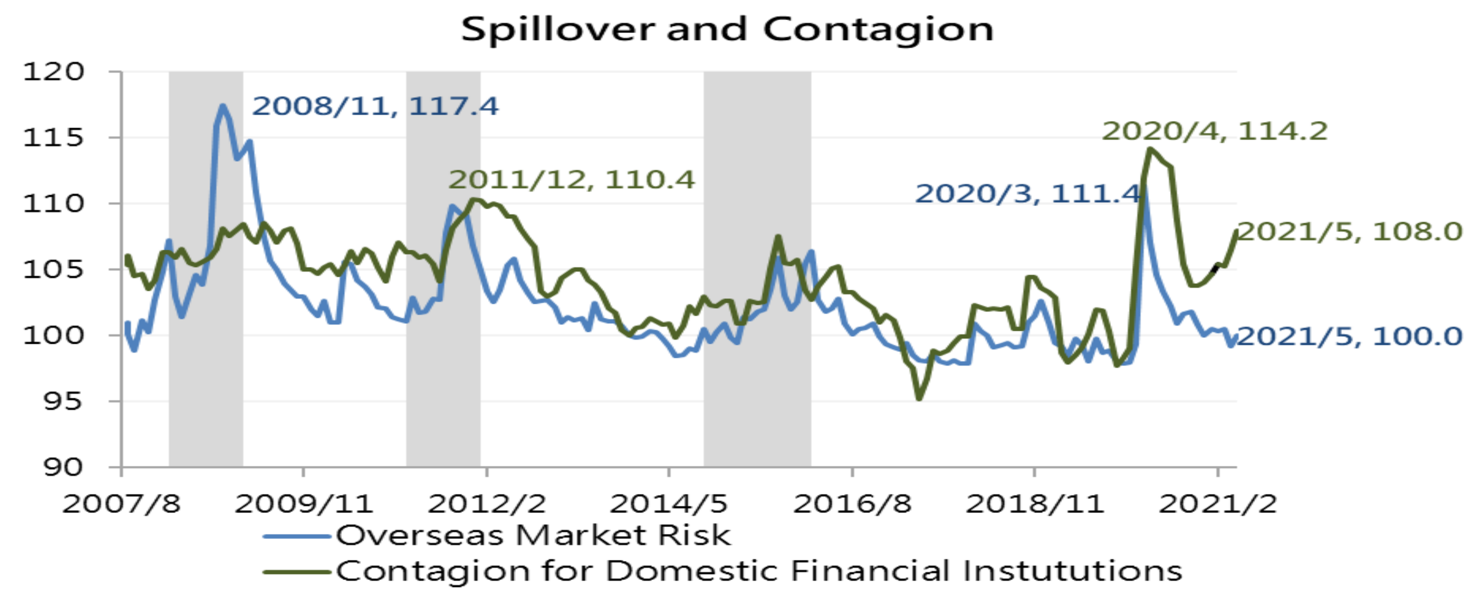
Source: TABF


TAIFRI dimensions
120
115
110
105
100
95
90
2008/11,...
2007/8, 110.6
2009/11, 110.1
2014/6, 102.4
2021/5, 104.1
2021/5, 100.9
2021/5, 95.2
2021/5, 92.8
2007/8
2009/11
2012/2
2014/5
2016/8
2018/11
2021/2
Financial sector stability
Non-financial sector stability
Asset valuation pressures
Spillover and contagion


Asset Valuation Pressures
120
115
110
105
100
95
90
2008/10, 118.5
2010/8, 115.1
2009/11, 113.3
2009/12, 109.3
2021/5, 104.7
2021/5, 103.9
2021/5, 99.0
2021/5, 96.1
2007/8
2009/11
2012/2
2014/5
2016/8
2018/11
2021/2
Business Debt
Equity Markets
Price Volatility
Real Estate


Non-Financial Sector Stability
120
115
110
105
100
95
90
85
80
2009/11, 108.6
2014/6, 104.3
2021/5, 96.8
2021/5, 93.7
2007/8
2009/11
2012/2
2014/5
2016/8
2018/11
2021/2
Household Sector
Business Sector


Financial Sector Stability
120
115
110
105
100
95
90
2007/8, 116.4
2008/7, 109.0
2007/8, 108.2
2021/5, 97.4
2021/5, 91.2
2021/5, 90.2
2007/8
2009/11
2012/2
2014/5
2016/8
2018/11
2021/2
Maturity Structure
Capital Structure
Asset Quality


Spillover and Contagion
120
115
110
105
100
95
90
2008/11, 117.4
2011/12, 110.4
2020/4, 114.2
2020/3, 111.4
2021/5, 108.0
2021/5, 100.0
2007/8
2009/11
2012/2
2014/5
2016/8
2018/11
2021/2
Overseas Market Risk
Contagion for Domestic Financial Instutions

Domestic Bankers' Three-month Financial Risk Forecasts

- **Expectations of senior banking executives on business and market risks**

Higher operating risks	Higher market risk
1. Changes in overseas exposures	1. Higher exchange rate volatility
2. More mortgage NPLs	2. Compressed spreads
3. More corporate NPLs	3. Higher stock market volatility

- **Sharply higher market volatility in H2; overseas investment and credit risks from exchange effects cannot be ignored**

  Driven by Taiwan's outstanding export performance in the H1 and the recovery of the US stock market, stock market index has repeatedly broken new highs in 2021, but the Taiwan VIX, the "fear index," also fluctuated sharply. The impact of the outbreak on the domestic economy is not yet clear, and with the market impact of the Fed and other central banks discussing the end of easing, domestic stock market volatility may increase significantly in H2.

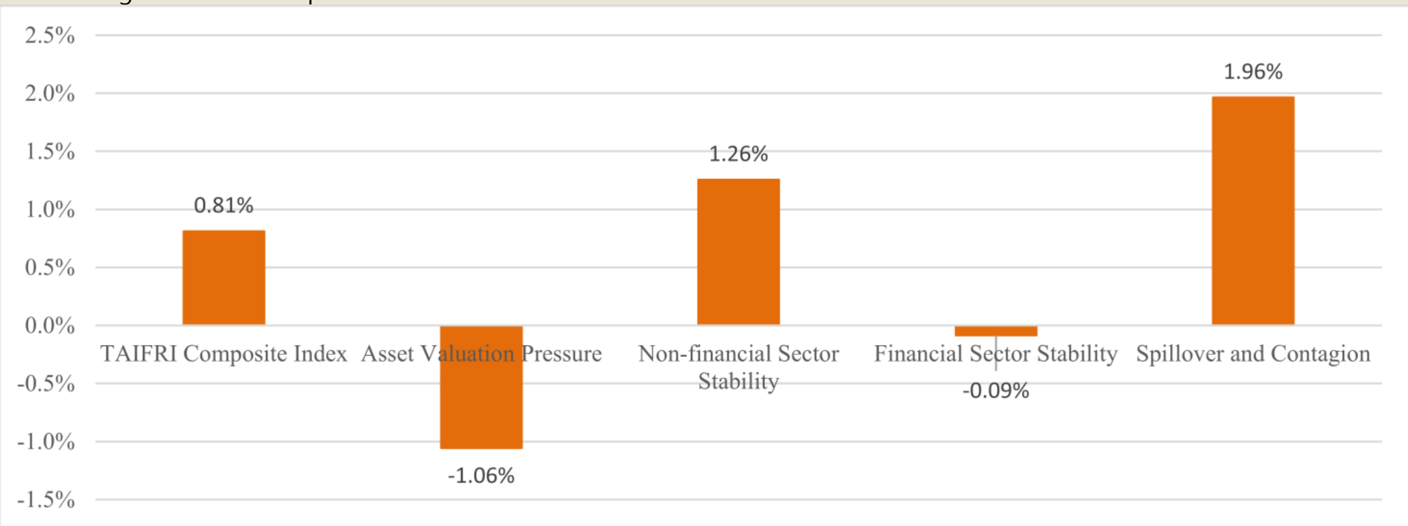
  Outbreaks have been reported in Guangzhou, China, also spreading to Vietnam and Malaysia. The US, where Taiwan has the largest investment exposure, is on the rebound, but with a strong local equity market and foreign expectations of NTD appreciation, plus USD sales by exporters and continued USD weakness, currency risks cannot be ignored.

- **The domestic outbreak will hit banks NPLs over H2, and narrowing spread may further compress profits**

  Mortgages hit a record high balance in April, indicating they are still important for banks. Although the current mortgage NPL ratio is only 0.12%, with the new outbreak, more corporate bailout loans are on the way. In addition, monetary loosening and a resulting possible further reduction in spread could affect bank profitability over the next 3 months.

Analysis of Q2 2021 TAIFRI Trends

- <u>The domestic pandemic situation is changing quickly, affecting corporate and consumer finance</u>
- Observing each dimension since December of last year, Spillover and Contagion has increased the most (1.96%), followed by Non-financial Sector Stability (1.26%).
- Based on the changes since last year, first, foreign positions, as well as rapidly changing domestic outbreak, have impacted the business environment and private consumption, affecting asset quality and bank profit prospects; second, under the low-rate environment, willingness to invest in higher-yielding overseas assets remains high. Excessive concentration and changes in individual positions could increase default risks.



- Regarding the sub-indices, among the dimensions with increasing risk, Spillover in the domestic financial market rose the most (3.84%), followed by Price volatility (2.18%), and Business sector (1.96%), showing that market volatility has increased greatly with the domestic outbreak. Since the previous stimulus loans ended at the end of 2020, the growth rate of lending to the corporate sector has decreased slightly. With another round launching this month, the corporate sector has sufficient funds and risks will ease again, but banks must monitor specific industries and which these sub-indices.
- Business debt dropped the most among all sub-indices (-3.3%), because the spread between domestic BBB bond and Treasury has narrowed; Real estate (-2.57%) has dropped since the beginning of the year, because residential rents rose faster than sale prices.