Moody's

**Rating Action:** **Moody's downgrades the deposit ratings of five Israeli banks; outlook on long-term deposit ratings is negative**

13 Feb 2024

Limassol, February 13, 2024 -- Moody's Investors Service (Moody's) had today downgraded to A3/P-2 from A2/P-1 the long- and short-term deposit ratings of Bank Leumi Le-Israel B.M. (Bank Leumi), Bank Hapoalim B.M. (Bank Hapoalim), Mizrahi Tefahot Bank Ltd. (Mizrahi), Israel Discount Bank Ltd. (IDB) and First International Bank of Israel Ltd. (FIBI). The outlook on the long-term deposit ratings is negative.

Concurrently the rating agency has also downgraded the five banks' long-term Counterparty Risk Ratings (CRRs) to A2, their long-term Counterparty Risk (CR) Assessments to A2(cr) and IDB's foreign currency senior unsecured debt rating to A3 with a negative outlook. At the same time, Moody's affirmed the five banks' baa2 Baseline Credit Assessments (BCAs) and Adjusted BCAs. The banks' P-1 short-term CRRs and P-1(cr) short-term CR Assessments were also affirmed.

The rating action follows Moody's downgrade of the Government of Israel's long-term issuer ratings to A2 with a negative outlook from A1 on 9 February 2024. For further information on the sovereign rating action, please refer to Moody's press release: https://ratings.moodys.com/ratings-news/415081.

Today's actions conclude the ratings review that Moody's initiated on 24 October 2023.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL485619 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

-- DOWNGRADE OF DEPOSIT RATINGS

The downgrade of the banks' long-term deposit ratings to A3 is driven by a lower government support uplift incorporated in those ratings because of the downgrade of Israel's sovereign ratings.

Moody's continues to assume a very high probability of government support for the five large Israeli banking groups that it rates given their systemic importance and the Israeli government's long standing practice of supporting such systemically important banks, in case of need. Given the A2 sovereign rating, this now results in two notches, down from three previously, of government support uplift from their baa2 Adjusted BCAs to their long-term deposit ratings.

The downgrade of the short-term deposit ratings to P-2 follows the downgrade of the long-term deposit ratings and reflects Moody's standard mapping for long-term ratings to short-term ratings.

-- NEGATIVE OUTLOOK

The negative outlook on the long-term deposit ratings captures both the negative outlook on the Government of Israel's rating and therefore the potential further weakening of the sovereign's capacity to provide support, together with the potential for a significantly more negative impact on the economy in the event of an escalation in the ongoing conflict, which could lead to the banks' standalone fundamentals being impacted more severely than is currently assumed. Furthermore social risks for the banks have increased because of the military conflict and the weakened security environment and are also a driver for the negative outlook.

Moody's lowered its Macro Profile for Israel to "Strong -" from "Strong", reflecting the weaker operating environment for banks, to capture the increased susceptibility to event risks (from elevated exposure to political risks) and weakened institutions, which together with the country's economic strength are sovereign inputs to the Macro Profile.

-- BCA AND ADJUSTED BCA AFFIRMATION

The affirmation of the banks' baa2 BCAs and Adjusted BCAs reflects their strong financial fundamentals coming into this period of uncertainty, and Moody's central expectation that the economy will recover relatively quickly from the conflict provided that it does not escalate further and that the banks' financial performance, particularly their capital and liquidity, will be broadly resilient to the impact of the current situation.

Moody's expects the banks' loan quality will deteriorate from strong levels because of the impact of the military conflict. The five banks have a relatively high, albeit varying, exposure to the construction and real estate sectors that had grown in previous quarters and which would be particularly affected in the event of a sustained disruption in real estate activity and demand. The construction industry, in particular, is facing a lack of workers. Underlying demand for residential units continues to be driven by a young and growing population and banks are mostly exposed to residential construction, but they also have exposure to income-generating properties and raw land.

The five banks are using strong revenues in 2023 to proactively book collective provisions against downside macroeconomic scenarios and affected sectors, such as construction and real estate. Credit costs had stayed contained over past economic downturns and underwriting standards are relatively conservative supported by close and proactive oversight by the Bank of Israel (BoI).

The Israeli authorities are providing support to affected businesses and households, and the banks have rolled out, in co-ordination with the BoI, a repayment deferral scheme that will cushion the impact of the war on borrowers.

Against the current uncertain environment, the five banks lowered their dividend payouts in Q3 2023. Capital retention together with modest credit growth will support capitalisation and therefore resilience against unexpected losses. Capital metrics at Israeli banks are moderate, but consistently stable and driven by conservative risk-weights, especially on mortgages.

Profitability, which benefited from higher interest rates, will also decline from recent exceptionally high levels because o higher cost of risk, lower credit growth, the support measures to customers and a planned increase in bank taxes. The banks had, however, achieved large cost efficiency gains in recent years that support profitability and enhance their ability to withstand and recover from shocks.

Israel banks' funding bases have remained stable, benefiting from a large domestic deposit base, mostly from households and small businesses, and liquidity remains ample.

BANK-SPECIFIC RATING DRIVERS

--- BANK LEUMI

Moody's downgraded Bank Leumi's long-term deposit ratings to A3 from A2 and affirmed its baa2 BCA and Adjusted BCA. The bank's standalone BCA reflects its strong domestic deposit-based funding structure, healthy liquidity and low problem loans and credit losses over a whole economic cycle. Bank Leumi's problem loans (defined as non-accruing loans and accruing loans that are more than 90 days overdue) were a 0.8% of gross loans as of September 2023.

The BCA also reflects downside risks from a significant exposure concentration to the Israeli property market. Lending to the construction and real estate sector made up 26% of total lending as of September 2023, growing by 20% year-over-year. Capitalisation is moderate with a tangible common equity (TCE)/risk-weighted assets (RWAs) ratio of 11.6% as of September 2023.

--- BANK HAPOALIM

Moody's downgraded Bank Hapoalim's long-term deposit ratings to A3 from A2 and affirmed its baa2 BCA and Adjusted BCA. The BCA reflects the bank's strong deposit-based funding structure, sound liquidity and low levels of problem loans and contained credit losses over an entire economic cycle. Problem loans were 1.0% as of September 2023.

The standalone BCA also reflects downside risks from a significant exposure concentration to the Israeli property market. Lending to the construction and real estate sector made up 20% of Bank Hapoalim's gross loans as of September 2023 and the bank's exposure grew by a high 13% year-over-year as of September 2023. Capitalisation is also moderate. Moody's TCE/RWAs ratio was 11.5% as of September 2023.

--- MIZRAHI

Moody's downgraded Mizrahi's long-term deposit ratings to A3 from A2 and affirmed its baa2 BCA and Adjusted BCA. The bank's standalone BCA reflects its strong asset quality and low-risk residential mortgage-lending focus in Israel, its deposit-based funding structure, mostly from households and small businesses, and adequate liquidity mostly made of cash and equivalents. Problem loans were 1.0% of gross loans as of September 2023. The bank had exposure concentration to real estate, whereby its lending to the construction and real estate sector made up 11% of Mizrahi's gross loans as of September 2023, although this is lower than peers.

Mizrahi's BCA also captures modest capitalisation, with a TCE/RWAs ratio of 9.8% as September 2023 that is lower than local and global peers, but it has been consistently stable and buffers are aided by the conservative risk-weightin on mortgages.

--- IDB

Moody's has downgraded IDB's long-term deposit ratings to A3 from A2 and affirmed its baa2 BCA and Adjusted BCA. The bank's BCA reflects its favourable deposit-based funding structure along with comfortable liquidity, its currently strong asset quality, with low problem loans and strengthened recurring profitability supported by recent efficiency gains. The bank's problem loans were 0.9% of gross loans as of September 2023.

The BCA also reflects modest but stable capital buffers, with a TCE/RWAs ratio of 10.5% as of September 2023 and downside risks from a significant exposure concentration to the property market. Lending to the construction and real estate sector made up 15% of IDB's gross loans as of September 2023 and the bank's exposure grew by a high 12% year-over-year as of September 2023 because of strong demand.

---FIBI

Moody's downgraded FIBI's long-term deposit ratings to A3 from A2 and affirmed its baa2 BCA and Adjusted BCA. The BCA reflects the bank's strong asset quality, stable retail deposit funding base, high liquidity, and a strong presence in niche segments that benefit it with consistent business opportunities. Problem loans were 0.5% of gross loans as of September 2023, a reflection of the bank's low-risk loan book structure and underwriting standards.

The bank's BCA also reflects additional downside risks from a significant exposure concentration to the Israeli property market. Lending to the construction and real estate sector made up 14% of FIBI's gross loans as of September 2023, although this was lower than most peers. The bank's capital buffers are adequate but modest with a TCE/RWAs ratio of 10.3% as of September 2023, which, however has been consistently stable.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

There is a limited scope for an upgrade of the banks' deposit ratings given the negative outlook. Moody's could stabilise the outlook on the banks' ratings in case the outlook on the sovereign rating changes to stable and/or downside risks to the economy and the banks subside. Over the longer-term, the banks' deposit ratings could be upgraded in case the sovereign rating is upgraded, or the banks individually demonstrate a more resilient performanc under significantly adverse conditions than in the past and address sector concentration risks.

Israeli banks' long-term deposit ratings could be downgraded if both the sovereign rating and their standalone BCAs are downgraded.

The banks' BCAs could be downgraded in case of a prolonged and wider conflict that could have a significant impact on their standalone fundamentals, or if any individual bank's performance proves more volatile than in previous conflicts and economic crises.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://ratings.moodys.com/rmc-documents/71997. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are a mix of solicited and unsolicited credit ratings. For additional information, please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL485619 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

• EU Endorsement Status

• UK Endorsement Status

• Rating Solicitation

• Issuer Participation

• Participation: Access to Management

• Participation: Access to Internal Documents

• Lead Analyst

• Releasing Office

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on https://ratings.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1355824.

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the issuer/deal page on https://ratings.moodys.com for additional regulatory disclosures for each credit rating.

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