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Fitch Affirms Mizrahi Tefahot Bank at 'A-'; Outlook Negative

Fitch Ratings - London - 13 Nov 2024: Fitch Ratings has affirmed Mizrahi Tefahot Bank Ltd's (UMTB) Long-Term Issuer Default Rating (IDR) at 'A-' with a Negative Outlook and Short-Term IDR at 'F1'. The bank's Viability Rating (VR) has been affirmed at 'a-'.

Key Rating Drivers

VR and Support Drive IDRs: UMTB's IDRs are driven by its VR and underpinned by our view of a very high probability that Israel (A/Negative/F1+) would provide support to the bank, if needed. Fitch believes Israel's ability and propensity to support UMTB is very high, particularly given the bank's systemic importance in the country, holding about 20% of banking system assets.

Strong Mortgage Franchise: UMTB's VR reflects a strong franchise in retail and corporate banking in Israel, asset quality that we expect to remain resilient and adequate capitalisation. The VR also reflects the bank's sound funding, given its large and diversified deposit base, and strong profitability, which has benefited from loan growth, higher interest rates and consumer price inflation. UMTB's business model is less diversified than its two larger peers, but is particularly strong in residential mortgages as the largest mortgage lender.

Close Regulatory Oversight: UMTB's underwriting are conservative, helped by tight regulatory limits and oversight. Like other Israeli banks, UMTB has material exposure to the construction and real estate sectors, which results in risk concentration and makes its asset quality vulnerable to a sharp decline in real estate prices. However, most of its exposure is to residential projects, which we expect to perform adequately, given high population growth and structural demand for housing in Israel.

Asset Quality Remains Sound: UMTB's impaired loans ratio was 1.1% at end-1H24 (1H23: 0.9%) and has increased slightly, reflecting the macroeconomic impact of the war. We expect higher loan impairment charges as loans season, given high loan growth in recent years. Asset quality will also be affected by higher interest rates and inflation, but will be supported by sound underwriting standards. We expect the impaired loans ratio to remain below 2% over the next two years.

Strong Earnings Recovery: Profitability has benefited from loan growth and higher interest rates, which support net interest income. Higher inflation has also been beneficial in recent years, given the bank's net long exposure to the consumer price index. Cost efficiency has benefited from the successful Union Bank integration. We expect positive profitability trends to remain, driven by higher interest rates and improved efficiency. We forecast risk-adjusted operating profitability, which was 3.2% in 1H24, to remain above 2% over the next two years.

Capital Buffers Adequate: Headroom in our capitalisation score is limited, but capital remains adequate with a common equity Tier 1 (CET1) ratio of 10.44% at end-1H24, which is the lowest among domestic peers. UMTB calculates risk-weighted assets (RWA) using the standardised approach, resulting in RWAs at 63% of total assets at end-1H24, which is conservative for the bank's high proportion of lower-risk mortgage loans. Our assessment also considers improved internal capital generation.

Large, Stable Deposit Base: UMTB's stable funding base consists of customer deposits, which is well diversified. The bank has proven access to domestic and international debt markets and has made greater use of wholesale funding than domestic peers. Liquidity is sound, with a liquidity coverage ratio (quarterly) of 131% at end-1H24.

UMTB's 'F1' Short-Term IDR is the higher of two possible Short-Term IDR's that map to a 'A-' Long-Term IDR, because we view the sovereign's propensity to support as more certain in the near term.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of the sovereign rating is likely to result in a downgrade of UMTB's Long-Term IDR if accompanied by a downgrade of the bank's VR.

A sharp increase in the bank's risk environment that increases the likelihood of asset quality deterioration could result in a downgrade. A deterioration of asset quality as a result of the war that would result in an impaired loans ratio of above 2% for an extended period, combined with the CET1 ratio declining below current levels, and weakening internal capital generation, funding stability or liquidity could also result in a VR downgrade. Given the bank's exposure to the real estate sector, a sharp decline in real estate prices would put pressure on asset quality and therefore on the VR.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of UMTB's IDRs is unlikely due to the Negative Outlook on the sovereign's Long-Term IDR. We would revise the Outlook to Stable if the sovereign Outlook was revised to Stable.

An upgrade of UMTB's VR is unlikely given the bank's geographical concentration. It would require a material and structural improvement in profitability that allows the bank to generate stronger and more stable operating profit/RWAs while also maintaining materially higher capital ratios, which we do not expect.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

UMTB's Tier 2 subordinated notes are rated two notches below its VR, reflecting poor recovery prospects in the event of a failure of the bank.

The Long-Term IDR (xgs) of 'A-(xgs)' is at the level of the VR. The Short-Term IDR (xgs) of 'F2(xgs)' is the

lower of two possible options that map to a 'A-(xgs)' Long-Term IDR (xgs) due to UMTB's 'a-' funding and liquidity score.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The ratings of UMTB's Tier 2 notes are sensitive to changes in the bank's VR.

The IDRs (xgs) are sensitive to changes in the bank's VR.

VR ADJUSTMENTS

The operating environment score of 'a' is below the 'aa' implied category score for the following adjustment reasons: sovereign rating (negative), size and structure of economy (negative).

The business profile score of 'a-' is above the 'bbb' implied category score for the following adjustment reason: market position (positive).

The earnings and profitability score of 'bbb+' is below the 'a' implied category score for the following adjustment reason: earnings stability (negative).

The capitalisation and leverage score of 'a-' is above the 'bbb' implied category score for the following adjustment reason: leverage and risk weight calculation (positive).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

UMTB's IDRs and GSR reflect Fitch's expectation of a very high probability of state support from Israel.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Mizrahi Tefahot Bank Ltd	LT IDR	A- 	Affirmed	A- 
	ST IDR	F1	Affirmed	F1
	Viability	a-	Affirmed	a-
	Government Support	a-	Affirmed	a-
	LT IDR (xgs)	A-(xgs)	Affirmed	A-(xgs)
	ST IDR (xgs)	F2(xgs)	Affirmed	F2(xgs)
	• subordinated	BBB	Affirmed	BBB

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	○	

Applicable Criteria

[Bank Rating Criteria \(pub.15 Mar 2024\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Mizrahi Tefahot Bank Ltd UK Issued, EU Endorsed

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