

Research Update:

Israeli Bank Hapoalim 'A/A-1' Ratings Affirmed On Resilient Capitalization

July 20, 2020

Overview

- While we anticipate that Israeli GDP will contract by 5.5% in 2020 due to the impact of COVID-19, we believe that the domestic economy will rebound fast and recover fully in 2021.
- We also anticipate that Bank Hapoalim (BNHP) will be able to preserve its profitability to a level that is sufficient to absorb the impact of the pandemic, and maintain its sound capitalization.
- We are therefore affirming our 'A/A-1' ratings on the bank.
- The stable outlook reflects our view that BNHP will maintain a sufficient capital buffer amid the likely consequences of the pandemic.

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Rating Action

On July 20, 2020, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on Israeli Bank Hapoalim B.M. (BNHP). The outlook remains stable.

Rationale

The affirmation reflects our expectation that BNHP, in line with the Israeli banking sector, should be able to weather the economic shock from COVID-19 with a contained impact on its profitability in the medium term, buoyed by its strong capitalization and asset quality metrics before the crisis.

After more than a decade of sustained economic growth of about 3%, the spread of COVID-19 and the lockdown measures imposed to contain the virus pushed the Israeli economy into recession, with real GDP expected to fall by 5.5% in 2020. While we acknowledge a high degree of uncertainty around the evolution of the pandemic, in our central scenario, we expect the Israeli economy to weather this shock and rebound by over 6% in 2021. We base our view on the expected global recovery in second-half 2020 and the strong fundamentals of the Israeli economy, combined with the sizable support package to avoid permanent damage to the country's highly productive capacity.

In this context, we expect BNHP to report some asset quality and profitability deterioration in 2020

and 2021, before gradually restoring its financial profile to pre-COVID-19 levels in 2022.

Specifically, we expect lower interest margins and depressed economic activity to constrain revenues, with fees hit in the second and third quarters of 2020 in particular. We acknowledge that BNHP already increased its loan loss provisions in late 2019 and in the first quarter of 2020, and we expect its credit losses to amount to about 80-90 basis points (bps) in 2020 on the back of asset quality deterioration. We anticipate that nonperforming loans (NPLs) will increase in 2020 before gradually reducing afterwards.

We anticipate that lending growth will slow down amid the uncertain economic conditions. As such, we forecast that the bank's risk-adjusted capital (RAC) ratio will remain sound, hovering around 11% by 2022, given that we expect its capitalization level to absorb the impact of constrained earnings generation. In addition, we expect the bank will not distribute dividends in 2020, to support its capitalization under the current uncertain market conditions.

Our ratings continue to factor in BNHP's high exposure to the real estate sector (49% of its net loans, including mortgages). Though we expect a stagnation in the housing market in 2020, we anticipate that the risk associated with mortgage exposures will be contained, helped by macroprudential measures that the Bank of Israel introduced in the past. We expect a recovery in the labor market in 2021-2022, supporting mortgage borrowers' creditworthiness. A deviation from this expectation might have negative implications for the bank's asset quality.

We consider that the bank's exposure to income-producing real estate is more vulnerable in the current environment than other sectors in its real estate lending portfolio. For example, shopping malls were already under pressure from growing e-commerce activity and office segments already faced the risk of oversupply. The current situation heightens the sensitivity of these sectors to the economic downturn, where, in the case of a prolonged recession, we could see lower demand, rising vacancies, and reducing profitability and valuation of real estate players. At about 7.9% of the lending book, we consider the bank's exposure to this portfolio to be manageable as it benefits from the high level of collateralization with contained loan-to-value levels.

Outlook

The stable outlook on BNHP reflects our expectation that the bank will be able to maintain strong capitalization amid the current difficult economic conditions in Israel. Specifically, we expect the bank's RAC ratio to remain sustainably above 10% over the next two years, with asset quality metrics remaining broadly in line with the system average.

Downside scenario

We could lower the ratings if the Israeli economy deteriorated markedly, with a notable impact on the real estate sector. This might result from higher-than-expected economic stress amid the COVID-19 pandemic or a pronounced escalation in local geopolitical turbulence. Furthermore, a negative rating action could occur if credit losses rise much more than we expect and end up eroding the bank's capital position significantly beyond our current expectations. Finally, although less likely, we could take a negative rating action if there are major asset quality or operational issues in BNHP's U.S. operations, or if regulatory or legislative decisions have a prolonged, adverse effect on the bank's business profile.

Upside scenario

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Although unlikely during our two-year outlook period, an upgrade could happen if BNHP materially improved its capital policy or risk profile.

Ratings Score Snapshot

Issuer Credit Rating	A/Stable/A-1
SACP	a-
Anchor	bbb+
Business Position	Strong (+1)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	1
GRE Support	0
Group Support	0
ALAC Support	0
Sovereign Support	1
Additional Factors	0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Bank Hapoalim B.M.

Issuer Credit Rating A/Stable/A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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