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Fitch Maintains Bank Hapoalim's 'A' IDR on Rating Watch Negative

Fitch Ratings - London - 13 Dec 2023: Fitch Ratings is maintaining Bank Hapoalim B.M.'s (Hapoalim) ratings including its 'A' Long-Term Issuer Default Rating (IDR) and its 'a' Government Support Rating (GSR) on Rating Watch Negative (RWN). The bank's Viability Rating (VR) has been affirmed at 'a-'.

Key Rating Drivers

State Support Drives IDRs: Hapoalim's IDRs reflect Fitch's view of a very high probability that Israel (A+/F1+ on RWN) would provide support to the bank. Fitch believes Israel's ability and propensity to support Hapoalim are very high, particularly given the systemic importance of the bank, which holds about 30% of the country's banking system assets.

Uncertain Economic Environment: The Israel-Hamas war has caused an initial contraction of economic activity. Our negative outlook on the operating environment reflects the uncertainty around the severity, duration and longer-term impact of the war. The Israeli government and the Bank of Israel have provided a variety of measures to support the economy and the most affected borrowers. Rising interest rates have supported net interest income, but Fitch believes this benefit peaked in 1H23 and will subsequently recede due to rising deposit costs and the Bank of Israel's decision to maintain the key interest rate at 4.75% in November.

Diversified Business Model: Hapoalim's VR reflects its strong franchise in retail and corporate banking in Israel. Asset quality and earnings are likely to come under pressure from the Israel-Hamas war, but we expect them to remain resilient from a strong starting position. The VR also reflects the bank's sound funding, given its diversified and granular deposit base, and adequate capitalisation.

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

Asset Quality Under Pressure: Hapoalim's impaired loans ratio increased to 1% at end-September 2023 (0.8% at end-September 2022), due to increased interest rates and high inflation (albeit lower than in many other countries). Disruption to economic activity in Israel due to the Israel-Hamas war and resulting uncertainty will likely weaken Hapoalim's asset-quality metrics.

Hapoalim increased its provision for credit losses by ILS662 million in 3Q23 to reflect the impact of the war. Its asset-quality score is supported by its strong metrics and solid historical performance, with low arrears underpinned by its modest risk appetite. We forecast the impaired loans ratio to remain below 2% over the next two years due to sound underwriting and Israel's resilient operating environment.

Earnings to Weaken: Profitability has benefitted from increasing interest rates and loan growth (4.5% in 9M23), which boosted net interest margins (NIM). However, we expect lower loan growth in 2024, which will only be partially offset by cost-efficiency programmes. We estimate profitability to have peaked, with NIM under pressure from rising deposit costs and lower margins on mortgages.

We forecast the bank's operating profit to remain above 2% of risk-weighted assets (RWAs) over the next two years, despite weakened credit demand, softening NIM and rising impairment charges.

Adequate Capital Buffers: Capital headroom is limited, with a common equity Tier 1 (CET1) ratio of 11.53% at end-3Q23. Hapoalim's 130bp buffer above its 10.23% regulatory CET1 minimum requirement at end-9M23 is small by international standards, but we view it as adequate for the high standardised risk-weights (end-9M23 RWAs/total assets: 68%) prevalent in the Israeli banking sector. Hapoalim has temporarily reduced its dividend pay-out ratio to 20% at 3Q23. Our capitalisation assessment also considers the bank's strong internal capital generation.

Large, Stable Deposit Base: Hapoalim's solid and stable funding base consists mostly of customer deposits, which represented 92% of total non-equity funding at end-9M23. Since the outbreak of the Israel-Hamas war, the bank has not noted material change in its liquidity ratios or funding mix. The bank has proven access to domestic and international debt markets. Liquidity is soundly above the 100% regulatory minimum requirement, with a 124% liquidity coverage ratio at end-September 2023.

Hapoalim's 'F1+' Short-Term IDR is the higher of two possible options 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 Hapoalim's GSR and IDRs.

A sharp deterioration of asset quality as a result of the war that would result in an impaired loan ratio of above 2% for an extended period, combined with the CET1 declining below current levels, and weakening internal capital generation, funding stability or liquidity could result in a VR downgrade. Given the bank's significant 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

Hapoalim's GSR and IDRs are likely to be affirmed and removed from RWN if Israel's ratings are affirmed and removed from RWN. An upgrade of the GSR and IDRs is unlikely due to the war and the

RWN on the sovereign IDRs.

A VR upgrade is unlikely given the bank's geographical concentration and 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

Subordinated Debt

Hapoalim's Tier 2 subordinated notes are rated two notches below the bank's VR to reflect poor recovery prospects in the event of a failure or non-performance of the bank.

IDRs (xgs)

The Long-Term IDR (xgs) of 'A-(xgs)' is at the level of the VR. The Short-Term IDR (xsg) of 'F1(xgs)' is the higher of two possible options that map to a 'A-' Long-Term IDR (xgs) due to Hapoalim's 'a' funding & liquidity score.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Subordinated Debt

The ratings are sensitive to changes in the bank's VR.

IDRs (xgs)

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 due to 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 due to the following adjustment reason: market position (positive).

The capitalisation & leverage score of 'a-' is above the 'bbb' implied category score due to 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

Hapoalim's IDRs and GSR reflect a very high probability of 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
Bank Hapoalim B.M.	LT IDR	A 	Rating Watch Maintained	A 
	ST IDR	F1+ 	Rating Watch Maintained	F1+ 

ENTITY/DEBT	RATING		RECOVERY	PRIOR
	Viability	a-	Affirmed	a-
	Government Support	a 	Rating Watch Maintained	a 
	LT IDR (xgs)	A-(xgs)	Affirmed	A-(xgs)
	ST IDR (xgs)	F1(xgs)	Affirmed	F1(xgs)
• subordinated	Affirmed	BBB	Affirmed	BBB

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Bank Rating Criteria \(pub.01 Sep 2023\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Bank Hapoalim B.M. UK Issued, EU Endorsed

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