

Various Rating Actions On Israeli Banks On Increased Geopolitical Risks; All Outlooks Negative

May 2, 2024

Overview

- On April 18, 2024, we lowered our sovereign ratings on Israel to 'A+/A-1' from 'AA-/A-1+' on heightened geopolitical risk. The outlook on the ratings is negative.
- In addition, we think the incremental increase in security risk in Israel makes the economic environment less supportive for Israeli banks.
- We have therefore lowered our ratings on Bank Hapoalim B.M. (Hapoalim) and Bank Leumi le-Israel B.M. (Leumi) and affirmed our ratings on Mizrahi Tefahot Bank Ltd. (Mizrahi), Israel Discount Bank Ltd. (IDB), and Israel Discount Bank of New York (IDB NY).
- The outlooks on these banks remain negative.

MILAN (S&P Global Ratings) May 2, 2024--S&P Global Ratings today took the following rating actions on Israeli banks (see the Ratings List for full details):

- We lowered our long- and short-term issuer credit ratings on Hapoalim and Leumi to 'A-/A-2' from 'A/A-1'. The outlooks are negative.
- We have affirmed our 'A-/A-2' long- and short-term issuer credit ratings on Mizrahi. The outlook remains negative.
- We have affirmed our 'BBB+' long-term issuer credit ratings on IDB and its core subsidiary IDB NY and our 'A-2' short-term rating on IDB. The outlook remains negative.

The rating actions follow the lowering of the sovereign ratings on Israel. Subsequent to an increase in confrontation with Iran and the lengthening of the Israel-Hamas war and hostility with Hezbollah, we think the already high geopolitical risks faced by Israel have further increased. While we still expect a wider regional conflict will be avoided, we see several possible military escalation risks, including a more substantial military confrontation with Iran or a widening of the conflict with Hezbollah at Israel's northern border (see "Israel Long-Term Ratings Lowered To 'A+' From 'AA-' On Heightened Geopolitical Risk; Outlook Negative," published April 18, 2024, on RatingsDirect).

Increased geopolitical risks also affect the Israeli banking system. Weaker economic prospects increase risks for banks. We expect real GDP growth in Israel to be 0.5% in 2024 and quarterly output to remain below pre-war levels throughout 2024, given the continuing disruption and high

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uncertainty. While we expect growth will rebound in 2025 by 5%, it remains uncertain whether there could be longer-term scarring for the Israeli economy. An escalation of the conflicts could present additional security and social risks for Israel, having a deeper impact on the domestic economy. We therefore see higher economic risk for the Israeli banking sector, and we have revised down the anchor we use as a starting point for rating financial institutions operating primarily in Israel to 'bbb' from 'bbb+'.

Economic slowdown, coupled with higher debt service, will impact asset quality. The increase in nonperforming loans was limited in the final quarter of 2023, but recourse to payment deferrals, affecting about 3.7% of loans at the system level as of end March 2024, has increased significantly. This reflects banks accommodating weaker borrowers' requests to help them cushion the impact of the war, and providing customers with additional liquidity buffers. We think tourism-focused businesses, small and midsize enterprises (SMEs), unsecured lending, and real estate and construction are the most vulnerable to direct and indirect impact from the conflict. Construction, representing about 12% of the banking sector loans and 5% of GDP, has been directly affected by the war. This is also because construction companies used to rely significantly on Palestinian workers commuting daily from Gaza and the West Bank, but now this is no longer possible due to severe restrictions introduced by Israeli authorities. The government has taken a number of measures to fill the gap with foreign workers, but these possible solutions are unlikely to fully offset the lack of workers in the near future. A prolonged low volume of sales, and pressure on commercial real estate valuation could weigh on developers and construction companies and erode their financial standing. We consequently expect asset quality to deteriorate in this sector as well as in some of the others more affected in this environment. We forecast credit losses will remain elevated after having reached about 50 basis points (bps) in 2023.

Strong profitability and good capitalization help banks cushion the impact of the more negative environment. Despite banks recording large collective provisions in the last two quarters of 2023, pushing cost-of-risk in 2023 to 45-60 bps, average return on equity stood at a strong 15% in 2023, thanks to still high interest rates and past cost-containment efforts. We anticipate resilient profitability will help the banks cushion the overall negative impact from the weaker economic environment ahead, and will continue to support their overall solvency and capital position, including as measured by our risk-adjusted capital (RAC) ratio. While we estimate the change in our sovereign rating and our economic risk score will affect banks' RAC ratio by between 95 bps and 135 bps, depending on the composition of banks' assets, we expect organic capital generation to partially offset the negative impact.

Nevertheless we expect the sector's buffer to be eroded if the geopolitical scenario further deteriorates. Escalation of the war could have severe negative implications for the banking sector as it could lead to meaningful asset quality deterioration, particularly in the real estate sector, considerable decline in profitability, or materially higher exposure to financial and nonfinancial risks.

Bank Hapoalim B.M. (Hapoalim)

Primary credit analyst: Regina Argenio

The lowering of the issuer credit ratings (ICRs) reflects our sovereign downgrade and our view of the higher economic risk that Israeli banks face. The ratings now reflect the uncertain

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macroeconomic environment and high exposure to security and geopolitical risk, as well as Hapoalim's high concentration in the real estate sector. At the same time, the ratings benefit from Hapoalim's leading position in the Israeli market, its strong track record and conservative underwriting, and its robust capitalization supported by resilient profitability. While we expect returns to decrease due to compression of the net interest margin (NIM) and still high cost of risk, we expect subdued growth and prudent dividend payouts to support capitalization. We therefore anticipate Hapoalim's RAC ratio to gradually progress to about 10.2%-10.7% in 2025 from 9.3% as of Dec. 31, 2022, pro forma for the new economic risk assessment.

The downgrade of Hapoalim's subordinated debt follows our downward revision of the bank's stand-alone credit profile (SACP), the starting point for the rating on the subordinated contingent capital notes. We don't use the ICR as the starting point, since it includes government support and we do not expect these instruments to benefit from state support.

Outlook

The negative outlook on Hapoalim mirrors that on the sovereign and reflects our view that an escalation of the war could have negative implications for Hapoalim's creditworthiness over the next 12-24 months.

Downside scenario

We could lower the rating on Hapoalim if we lowered the rating on Israel as we would consider less likely that the government would provide Hapoalim with extraordinary support in case of need. We could also lower the rating on Hapoalim if we considered that security risk had escalated with negative consequences for the banking sector and Hapoalim's asset quality, capitalization, or earnings.

Upside scenario

We could revise the outlook to stable if we revised the outlook on Israel to stable and thought that security risk and pressure on domestic economic prospects had lessened.

Hybrids. We do not assign outlooks to bank issue ratings. However, we will continue to notch down the ratings on Hapoalim's hybrids from the SACP. Therefore, we would lower the rating on the bank's rated subordinated instruments if we were to lower our SACP on Hapoalim.

Ratings score snapshot

| | To | From |
|-----------------------------|------------------------|-----------------------|
| Issuer Credit Rating | A-/Negative/A-2 | A/Negative/A-1 |
| Stand-alone credit profile | bbb+ | a- |
| Anchor | bbb | bbb+ |
| Business position | Strong (+1) | Strong (+1) |
| Capital and earnings | Strong (+1) | Strong (+1) |
| Risk position | Moderate (-1) | Moderate (-1) |
| Funding and liquidity | Adequate (0) | Adequate (0) |

| Issuer Credit Rating | To A-/Negative/A-2 | From A/Negative/A-1 |
|-----------------------------|-----------------------|------------------------|
| Comparable ratings analysis | 0 | 0 |
| Support | +1 | +1 |
| ALAC support | 0 | 0 |
| GRE support | 0 | 0 |
| Group support | +1 | +1 |
| Sovereign support | 0 | 0 |
| Additional factors | 0 | 0 |

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Israel Discount Bank Ltd. (IDB) and Israel Discount Bank of New York (IDB NY)

Primary credit analyst: Pierre Hollegien

The affirmation reflects our view of IDB's improved operational efficiency and profitability that could preserve its creditworthiness from negative spillovers stemming from higher economic risk. We believe IDB's high concentration in the real estate sector and SMEs will lead to higher provisioning than domestic peers with a more conservative lending portfolio. That said, we expect deterioration to be manageable thanks to IDB's recent efficiency improvements. This resulted in cost-to-income falling to 51% in 2023 from a high 65% in 2019, leading return on equity to improve to 15.7% from 9.4% over the same period. Consequently, although the bank faces higher risks, for now we see the rating as comparable with peers, and we therefore apply a one-notch upward adjustment under our comparable rating analysis, reflecting our holistic view of the bank's operating performance, supporting a 'bbb' stand-alone credit profile.

Outlook

The negative outlook on IDB and its core subsidiary IDB NY reflects our view that an escalation of the war could have negative implications for the banks' creditworthiness over the next 12-24 months.

Downside scenario

We could lower the rating on IDB and IDB NY if we considered that security risk had escalated with negative consequences for the banking sector and IDB's financial profile. We could also lower the rating if we anticipated the bank's relative strengths were not sufficient to cushion the impact of the war on the economy. This could happen if the bank failed to deliver a resilient performance and its asset quality, capitalization, or earnings weakened.

Upside scenario

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We could revise the outlook to stable if we thought that security risk and pressure on domestic economic prospects had lessened and, at the same time, if the bank's strong operating performance remained resilient.

| | To | From |
|-----------------------------|-------------------|-------------------|
| Issuer Credit Rating | BBB+/Negative/A-2 | BBB+/Negative/A-2 |
| Stand-alone credit profile | bbb | bbb |
| Anchor | bbb | bbb+ |
| Business position | Adequate (0) | Adequate (0) |
| Capital and earnings | Adequate (0) | Adequate (0) |
| Risk position | Moderate (-1) | Moderate (-1) |
| Funding and liquidity | Adequate (0) | Adequate (0) |
| Comparable ratings analysis | +1 | 0 |
| Support | +1 | +1 |
| ALAC support | 0 | 0 |
| GRE support | 0 | 0 |
| Group support | +1 | +1 |
| Sovereign support | 0 | 0 |
| Additional factors | 0 | 0 |

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Bank Leumi le-Israel B.M. (Leumi)

Primary credit analyst: Regina Argenio

The lowering of the ICRs reflects the sovereign downgrade and our view of the higher economic risk that Israeli banks face. The ratings reflect Israel's uncertain macroeconomic environment and high exposure to security and geopolitical risk as well as Leumi's high concentration in the real estate sector. We expect resilient profitability, limited shareholder distribution, and more moderate business growth than recent years to sustain Leumi's capital over the next 24 months. However, we do not think it will be sufficient to push up the RAC ratio to above 10% by end 2025 from about 8.8% as of Dec. 31, 2022, pro forma the new economic risk. Despite weaker capitalization, for now we see the rating as comparable with peers', and we have applied a one-notch upward adjustment under our comparable rating analysis, reflecting our holistic view of the bank's creditworthiness, as we think that the bank's resiliency, strong franchise, and financial flexibility support a 'bbb+' stand-alone credit profile.

The downgrade of Leumi's subordinated debt follows our downward revision of the bank's SACP, the starting point for the rating on the subordinated contingent capital notes. We don't use the ICR as the starting point, since it includes government support and we do not expect these instruments to benefit from state support.

Outlook

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The negative outlook on Leumi mirrors that on the sovereign and reflects our view that an escalation of the war could have negative implications for Leumi's creditworthiness over the next 12-24 months.

Downside scenario

We could lower the rating on Leumi if we lowered the rating on Israel as we would consider less likely that the government would provide Leumi with extraordinary support in case of need. We could also lower the rating on Leumi if we considered that security risk had escalated, with negative consequences for the banking sector and Leumi's asset quality, capitalization, or earnings.

Upside scenario

We could revise the outlook to stable if we revised the outlook on Israel to stable and thought that security risk and pressure on domestic economic prospects had lessened.

Hybrids. We do not assign outlooks to bank issue ratings. However, we will continue to notch down the ratings on Leumi's hybrids from the SACP. Therefore, we would lower the rating on the bank's rated subordinated instruments if we were to lower our SACP on Leumi.

| | To | From |
|-----------------------------|------------------------|-----------------------|
| Issuer Credit Rating | A-/Negative/A-2 | A/Negative/A-1 |
| Stand-alone credit profile | bbb+ | a- |
| Anchor | bbb | bbb+ |
| Business position | Strong (+1) | Strong (+1) |
| Capital and earnings | Adequate (0) | Strong (+1) |
| Risk position | Moderate (-1) | Moderate (-1) |
| Funding and liquidity | Adequate (0) | Adequate (0) |
| Comparable ratings analysis | +1 | 0 |
| Support | +1 | +1 |
| ALAC support | 0 | 0 |
| GRE support | 0 | 0 |
| Group support | +1 | +1 |
| Sovereign support | 0 | 0 |
| Additional factors | 0 | 0 |

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Mizrahi Tefahot Bank Ltd. (Mizrahi)

Primary credit analyst: Pierre Hollegien

The ratings affirmation reflects our view that mortgage-focused Mizrahi is better positioned than

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the rest of the sector to face higher economic risk and, at the same time, that Mizrahi has sufficient earnings buffers to absorb the expected deterioration in asset quality while preserving its robust capitalization, commensurate with its SACP. About two-thirds of Mizrahi's book is mortgages, which we see as more resilient than Israel's construction and commercial real estate sectors. The mortgage market will benefit from the still strong housing demand and low unemployment. We expect Mizrahi's profitability to fall as contribution from high rates and inflation reduces, only partly offset by efficiency gains from the Union Bank merger. That said, we expect lower growth, still high earnings generation, and prudent dividend payouts to support capitalization. We therefore anticipate Mizrahi's RAC ratio will gradually progress to about 10.0%-10.5% in 2025 from 8.7% as of Dec. 31, 2022, pro forma the new economic risk.

Outlook

The negative outlook on Mizrahi mirrors that on the sovereign and reflects our view that an escalation of the war could have negative implications for Mizrahi's creditworthiness over the next 12-24 months.

Downside scenario

We could also lower the rating on Mizrahi if we lowered the rating on Israel, since we would consider it less likely that the government would provide Mizrahi with extraordinary support in case of need.

We could also lower the rating on Mizrahi if we considered that security risk had escalated with negative consequences for the banking sector or if Mizrahi's performance was less resilient to the current environment than we currently estimate. This could happen if we anticipated the bank's RAC ratio would not improve above 10% over the next 24 months due to significant asset quality deterioration.

Upside scenario

We could revise the outlook to stable if we revised the outlook on Israel to stable and thought that security risk and pressure on domestic economic prospects had lessened.

Hybrids. We do not assign outlooks to bank issue ratings. However, we will continue to notch down the ratings on Mizrahi's hybrids from the SACP. Therefore, we would lower the rating on the bank's rated subordinated instruments if we were to lower the SACP on Mizrahi.

| Issuer Credit Rating | To | From |
|-----------------------------|------------------------|------------------------|
| | A-/Negative/A-2 | A-/Negative/A-2 |
| Stand-alone credit profile | bbb+ | bbb+ |
| Anchor | bbb | bbb+ |
| Business position | Adequate (0) | Adequate (0) |
| Capital and earnings | Strong (+1) | Strong (+1) |
| Risk position | Adequate (0) | Moderate (-1) |
| Funding and liquidity | Adequate (0) | Adequate (0) |
| Comparable ratings analysis | 0 | 0 |

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| Issuer Credit Rating | To | From |
|----------------------|-----------------|-----------------|
| | A-/Negative/A-2 | A-/Negative/A-2 |
| Support | +1 | +1 |
| ALAC support | 0 | 0 |
| GRE support | 0 | 0 |
| Group support | +1 | +1 |
| Sovereign support | 0 | 0 |
| Additional factors | 0 | 0 |

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

BICRA Score Snapshot*

Israel

| | To | From |
|----------------------------|-------------------|-------------------|
| BICRA group | 4 | 3 |
| Economic risk | 4 | 3 |
| Economic resilience | High risk | Intermediate risk |
| Economic imbalances | Intermediate risk | Intermediate risk |
| Credit risk in the economy | Low risk | Low risk |
| Trend | Negative | Negative |
| Industry risk | 4 | 4 |
| Institutional framework | Intermediate risk | Intermediate risk |
| Competitive dynamics | High risk | High risk |
| Systemwide funding | Low risk | Low risk |
| Trend | Stable | Stable |

Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on RatingsDirect.

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021

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- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Israel Long-Term Ratings Lowered To 'A+' From 'AA-' On Heightened Geopolitical Risk; Outlook Negative, April 18, 2024
- Banking Industry Country Risk Assessment: Israel, Jan. 31, 2024
- Outlooks On Israeli Banks Revised To Negative On Increased Geopolitical Risk; Ratings Affirmed, Oct. 31, 2023
- Bank Hapoalim B.M., Feb. 8, 2024
- Israel Discount Bank Ltd., Jan. 31, 2024
- Mizrahi Tefahot Bank Ltd., Dec. 20, 2023
- Bank Leumi le-Israel B.M., July 31, 2023

Ratings List

***** Bank Hapoalim B.M. *****

Downgraded

| To | From |
|----|------|
|----|------|

Bank Hapoalim B.M.

Bank Hapoalim B.M. (New York branch)

| | | |
|----------------------|-----------------|----------------|
| Issuer Credit Rating | A-/Negative/A-2 | A/Negative/A-1 |
|----------------------|-----------------|----------------|

Bank Hapoalim B.M.

| | | |
|---------------------|------|-----|
| Junior Subordinated | BBB- | BBB |
|---------------------|------|-----|

***** Bank Leumi le-Israel B.M. *****

Downgraded

| To | From |
|----|------|
|----|------|

Bank Leumi le-Israel B.M.

| | | |
|----------------------|-----------------|----------------|
| Issuer Credit Rating | A-/Negative/A-2 | A/Negative/A-1 |
|----------------------|-----------------|----------------|

Bank Leumi le-Israel B.M.

| | | |
|------------------|----|---|
| Senior Unsecured | A- | A |
|------------------|----|---|

| | | |
|---------------------|------|-----|
| Junior Subordinated | BBB- | BBB |
|---------------------|------|-----|

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***** Israel Discount Bank Ltd. *****

Ratings Affirmed

Israel Discount Bank Ltd.

Issuer Credit Rating BBB+/Negative/A-2

Israel Discount Bank of New York

Issuer Credit Rating BBB+/Negative/--

***** Mizrahi Tefahot Bank Ltd. *****

Ratings Affirmed

Mizrahi Tefahot Bank Ltd.

Issuer Credit Rating A-/Negative/A-2

Mizrahi Tefahot Bank Ltd.

Junior Subordinated BBB-

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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