MOODY'S
RATINGS

Rating Action: Moody's Ratings downgrades the long-term deposit ratings of five Israeli banks following sovereign rating action, outlook remains negative

01 Oct 2024

Limassol, October 01, 2024 -- Moody's Ratings (Moody's) has today downgraded to Baa1 from A3 the long-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 remains negative.

At the same time, we affirmed the five banks' P-2 short-term deposit ratings, and their baa2 Baseline Credit Assessments (BCAs) and Adjusted BCAs.

We also downgraded the five banks' long- and short-term Counterparty Risk Ratings (CRR) to Baa1/P-2 from A2/P-1, their long- and short-term Counterparty Risk (CR) Assessments to Baa1(cr)/P-2(cr) from A2(cr)/P-1(cr) and IDB's long-term foreign currency senior unsecured debt rating to Baa1 from A3 with a negative outlook.

Today's rating action follows the downgrade of the Government of Israel's long-term issuer ratings to Baa1 from A2, with a negative outlook, on 27 September 2024. For more information on the sovereign rating action, please refer to the press release: https://ratings.moodys.com/ratings-news/429502 .

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL496466 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 Baa1 is driven by the downgrade of Israel's sovereign ratings to Baa1, which leads to lower government support uplift for deposits.

We continue to assume a very high probability of government support for the five large Israeli banking groups because of their systemic importance and the Israeli government's history of supporting systemically important banks, in case of need. This assumption together with the Baa1 sovereign rating, results in one notch, down from two previously, of government support uplift from the banks' baa2 Adjusted BCAs to their long-term deposit 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 risk that the banks' standalone fundamentals may be more severely and sustainably affected because of weaker economic growth and investment climate, and a more adverse impact from the conflict on key sectors to which banks are exposed to and individual borrowers.

To reflect the weaker operating environment for banks, we lowered our Macro Profile for Israel's Banking System to "Moderate+" from "Strong-". This captures a combination of a more durable weakening of the economy by the conflict and significantly higher geopolitical and rising domestic political risks that also point to a diminished quality of Israel's institutions and governance, all of which were drivers for the sovereign rating action and are inputs to the Macro Profile.

-- BCA AND ADJUSTED BCA AFFIRMATION

The affirmation of the banks' baa2 BCAs and Adjusted BCAs balances the banks' resilient financial performance to date, growing loss-absorption buffers and high liquidity against the damage to Israel's economy caused by the military conflict that has already lasted longer than most of its previous conflicts and the risk of a severe escalation along with the impact this could have on domestic security and economic growth.

We expect the five banks' loan quality to see some deterioration from historically strong levels, depending on the macroeconomic impact of the conflict. We continue to consider banks' relatively high, although varying, exposure to the construction and real estate sectors as being more at risk given potential further disruption in construction activity, which has slowed given an ongoing lack of workers, and real estate demand.

Exposures to small businesses that have more limited financial resources and consumer lending would also be more vulnerable, although buffered by government and the banking sector's support measures.

That said borrower concentration levels are contained and loan underwriting standards are relatively prudent supported by close and proactive oversight by the

Bank of Israel (BoI).

High interest rates, still elevated CPI and past cost efficiency gains have supported exceptionally high recent profitability for Israeli banks with a normalised net income to tangible assets of 1.1%-1.3% in the first half of 2024. This high profitability acts as a first-line of defence against potential credit losses. Banks have also built-up a buffer of collective provisions that incorporate downside scenarios, and against sectors and borrowers that are more at risk.

Banks also lowered their dividend payouts in the second half of 2023, and although dividends increased this year, capitalisation further strengthened given the high profits and more moderate credit growth. Capital metrics, which have reached recent record high levels, will also likely continue to increase in the coming quarters notwithstanding a crystallisation of stress scenarios. The sectorwide reported Common Equity Tier 1 (CET1) ratio averaged 11.3% and the buffer over the CET1 requirement was 1.6 percentage points as of June 2024. Capital buffers and their past stability are supported by the use of the standardised approach and conservative risk-weights, especially on mortgages.

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

BANK-SPECIFIC RATING DRIVERS

--- BANK LEUMI

We downgraded Bank Leumi's long-term deposit ratings to Baa1 from A3 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 past economic cycles. Bank Leumi's cost of risk (loan loss provision expenses to gross loans) averaged 0.3% in the period 2006-2019 (before the pandemic) and problem loans (defined as non-accruing loans and accruing loans that are more than 90 days overdue) were 0.6% of gross loans as of June 2024.

In addition to the aforementioned considerations the BCA also reflects the 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 June 2024. Capitalisation is moderate with a tangible common equity (TCE)/risk-weighted assets (RWAs) ratio of 12.3% as of June 2024.

--- BANK HAPOALIM

We downgraded Bank Hapoalim's long-term deposit ratings to Baa1 from A3 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. Cost of risk averaged 0.4% during the period 2006-2018 and problem loans were 0.9% as of June 2024.

The standalone BCA also reflects downside risks from exposure concentration to the Israeli property market whereby lending to the construction and real estate sector made up 21% of Bank Hapoalim's gross loans as of June 2024. Capitalisation is also moderate. Our TCE/RWAs ratio was 11.9% as of June 2024.

--- MIZRAHI

We downgraded Mizrahi's long-term deposit ratings to Baa1 from A3 and affirmed its baa2 BCA and Adjusted BCA.

The bank's standalone BCA reflects its low-risk residential mortgage-lending focus in Israel that has led to low problem loans and credit costs over past economic cycles, its deposit-based funding structure, mostly from households and small businesses, and adequate liquidity mostly made of cash and equivalents. The average cost of risk for 2006-2019 was 0.26% and problem loans were 1.1% of gross loans as of June 2024.

The bank had exposure concentration to real estate, whereby its lending to the construction and real estate sector made up 12% of Mizrahi's gross loans as of June 2024, although this is lower than peers.

Mizrahi's BCA also captures modest capitalisation, with a TCE/RWAs ratio of 10.2% as June 2024 that is lower than local and global peers, but it has been consistently stable and buffers are aided by the conservative risk-weighting on mortgages.

--- IDB

We downgraded IDB's long-term deposit and senior unsecured ratings to Baa1 from A3 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 efficiency gains. The bank's average cost of risk during 2006-2019 was 0.47% and problem loans were 0.9% of gross loans as of June 2024.

The BCA also reflects modest but stable capital buffers, with a TCE/RWAs ratio of 10.7% as of June 2024 and downside risks from a significant exposure concentration to the property market. Lending to the construction and real estate sector made up 16% of IDB's gross loans as of June 2024.

---FIBI

We downgraded FIBI's long-term deposit ratings to Baa1 from A3 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. Cost of risk averaged 0.21% during the period 2006-2019 and problem loans were 0.6% of gross loans as of June 2024, 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 15% of FIBI's gross loans as of June 2024, although this was lower than most peers. The bank's TCE/RWAs ratio of 10.8% as of June 2024 was modest when compared globally, but the buffer between regulatory capital metrics compared to minimum requirements was the highest among the five banks.

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

There is a limited scope for an upgrade of the banks' long-term deposit ratings given the negative outlook. We could stabilise the outlook on the banks' long-term deposit ratings in case the outlook on the sovereign rating changes to stable and downside risks for the economy and the banks subside.

Israeli banks' long-term deposit ratings could be downgraded if the sovereign rating is downgraded further, or if the banks' own standalone BCAs are downgraded by more than one notch.

As detailed in the sovereign press release, a severe escalation of the conflict with Hezbollah could be consistent with a markedly lower rating for the Government of Israel, in particular if Israel's economic and fiscal strength were to weaken further. The risk of a broader escalation involving Iran remains, even though it continues to be low.

The banks' BCAs could be downgraded in case of a severe escalation of the conflict and/or an adverse and long-term impact on the economy, and therefore a sustained or 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 March 2024 and available at https://ratings.moodys.com/rmc-documents/409852 . 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_ARFTL496466 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:

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• 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.

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