Moody's

Rating Action: Moody's places the ratings of five Israeli banks on review for downgrade

24 Oct 2023

Limassol, October 24, 2023 – Moody's Investors Service ("Moody's") has today placed the deposit ratings of the five Israeli banks it rates on review for downgrade. Specifically, the rating agency has placed on review for downgrade the A2/P-1 long- and short-term deposit ratings of Bank Leumi Le-Israel B.M., Bank Hapoalim B.M., Mizrahi Tefahot Bank Ltd., Israel Discount Bank Ltd. (IDB) and First International Bank of Israel Ltd. Previously, the outlook on the long-term deposit ratings was stable.

Concurrently, Moody's also placed the banks' long-term Counterparty Risk Ratings and Counterparty Risk Assessments on review for downgrade, as well as IDB's long-term foreign currency senior unsecured debt rating. At the same time, Moody's affirmed the five banks' baa2 Baseline Credit Assessments (BCAs) and Adjusted BCAs.

Today's rating action follows the review for downgrade on the Government of Israel's A1 long-term issuer ratings, opened by Moody's on 19 October 2023. For further information on the sovereign rating action, please refer to Moody's press release: https://ratings.moodys.com/ratings-news/410047. In line with the sovereign ratings review, the review on the bank ratings may take longer than the usual three months.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL481686 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

– RATINGS REVIEW

Today's rating action is driven by the review for downgrade on the Government of Israel's A1 rating.

Moody's assumes a very high probability of government support for Israel's five large banking groups that it rates give their systemic importance and the Israeli government's long standing practice of injecting capital into such systemically important banks, in case of need. This results in three notches of government support uplift from their baa2 Adjusted BCAs to their long-term deposit ratings of A2.

During the review Moody's will assess the impact of a potential weakening of the sovereign's capacity to provide support, indicated by the Government of Israel's rating and whether this may reduce the support uplift incorporated in the banks' ratings.

Additionally, Moody's will also consider whether the military conflict risks weakening the operating environment for banks sustainably. The longer and more severe the military conflict, the greater its impact is likely to be on the economy. Moody's will also assess during the review whether the conflict negatively affects Israel's institutional strength, in particular the effectiveness of policymaking.

– BCA AND ADJUSTED BCA AFFIRMATION

The affirmation of the five banks' baa2 BCAs and Adjusted BCAs reflects their strong and resilient financial fundamentals and potential for these to withstand the impact of the current situation.

Asset quality is strong, demonstrated by a problem loan ratio of below 1% for each of the five banks as of June 2023 and contained credit costs over economic cycles, driven by relatively conservative underwriting and close and proactive oversight by the Bank of Israel (BoI).

The banks have a deposit-based funding structure, mostly from households and small businesses, and healthy liquidity.

Capital metrics are moderate (average tangible common equity/risk-weighted assets ratio of 10.6% as of June 2023) but consistently stable and driven by the BoI's conservative risk-weightings, especially on mortgages.

However Moody's expects that the banks' asset quality will deteriorate over time because of the impact the military conflict will have on Israel's economy. The extent of this will depend on its duration and scale, as well as actions by the authorities to cushion the impact on affected businesses and households. Banks also have relatively high, albeit varying, exposure concentrations to the construction and real estate sector that have grown in recent quarters and which could be affected in the event of a sustained disruption in real estate activity and demand.

The Israeli economy recovered relatively swiftly from past episodes of violent conflict and its dynamism benefits from a diversified high-tech sector as the main engine of growth. However, this conflict is more severe than the episodes of violence in the last few decades. As a result, there is a risk of a diversion of resources, drop in investment and loss of confidence, which would undermine Israel's economic outlook. There was already a slowdown in real estate transactions before the conflict and a slight decline in property prices from recent highs. However, although activity in the sector has been curtailed by the current security situation, underlying demand for residential units continues to be driven by a young and growing population.

Profitability will also materially decline from recent exceptionally high levels because of a higher cost of risk, lower credit growth and support measures to customers affected by the conflict, such as interest free loan repayment holidays for the most affected individuals and small businesses. Profitability, which had been moderate in the past, benefited significantly from higher interest rates given banks' low-cost deposit bases, and was well above historical levels prior to the conflict. The five banks reported net income/tangible assets of between 1.1% to 1.3% in the first half of 2023. Positively, banks' had also made significant cost efficiency gains in recent years, which enhances their ability to withstand and recover from shocks.

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

Potential for upgrades of the banks' ratings is limited, as indicated by the review for downgrade. However, the ratings could be confirmed at their current levels if Israel's A1 issuer rating were confirmed. This would also depend upon banks' standalone fundamentals, notably their solvency and liquidity, being maintained

Israeli banks' ratings could be downgraded if the sovereign rating is downgraded, given the significant government support uplift that is incorporated in their ratings.

The banks' ratings could also be downgraded in case of a prolonged and wider conflict that could have a significant impact on the operating environment for banks and 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 July 2021 and available at https://ratings.moodys.com/rmc-documents/71997. 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_ARFTL481686 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:

• EU Endorsement Status

• 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.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on https://ratings.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the issuer/deal page on https://ratings.moodys.com for additional regulatory disclosures for each credit rating.

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