Bank Leumi le-Israel B.M.

July 26, 2022

Rating reiterated

Reiteration of the ‘+1-ilAAA/ilA’ Rating, Stable Outlook

Primary credit analyst:

Regina Argenio, Milano, 39-02-72111208 regina.argenio@spglobal.com

Secondary contact person:

Avital Koren, Ramat Gan, +972-3-7539708 avital.koren@spglobal.com

Table of Contents

Rating reiterated

Reiteration of the ‘+1-ilAAA/ilA’ Rating, Stable Outlook

Summary

- A robust economic environment is likely to support the Israeli banking sector, despite the global economic slowdown.
- We are expecting the price increases in the real estate sector to continue, albeit at a more moderate pace compared with the last 12 months.
- We reiterate the ‘ilAAA/ilA-1+’ rating for Bank Leumi le-Israel B.M.The outlook is stable.

The Rating Action

On July 26, 2022, S&P Maalot reiterated the ‘ilAAA/ilA-1+’ rating assigned to Bank Leumi le-Israel B.M. The outlook is stable.

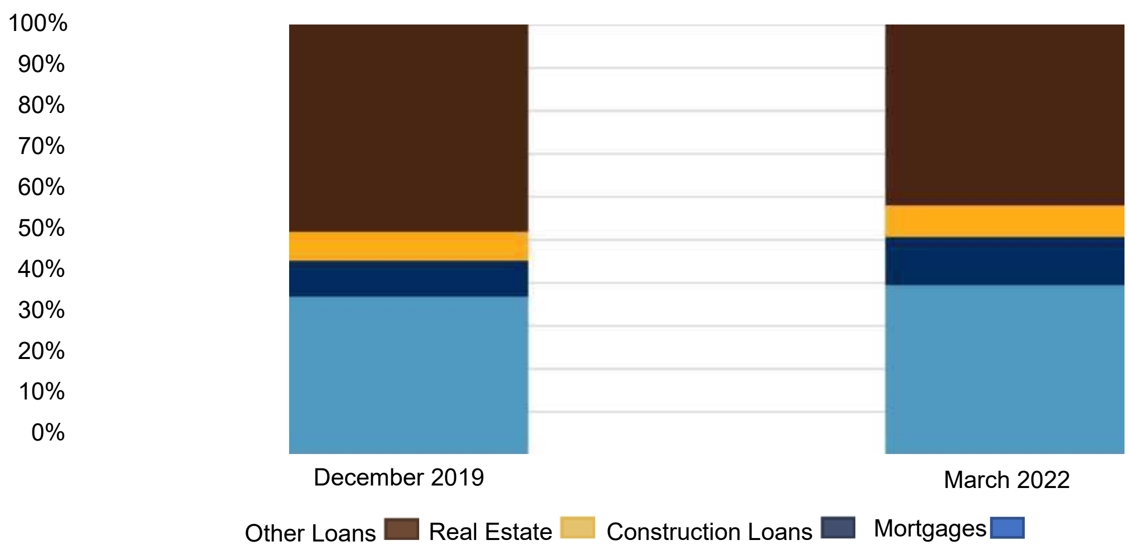
Main considerations

The economic conditions continue to support the banking system. Following the strong performance achieved in 2021, we are expecting the Israeli economy to remain generally robust, presenting a 5.5% growth in the GDP in real terms in 2022, despite the higher inflation and the Bank of Israel’s more austere monetary policy. However, the recovery following the peak of the Corona pandemic and the favorable monetary policy supported the real estate prices, which increased by 10% in the last 12 months, in real terms.

The banking system’s substantial exposure to the real estate sector presents a risk, but we believe this risk is still manageable. Against the backdrop of higher demand, Israeli banks expanded their credit portfolios by 14% last year. Most of the expansion was recorded in real estate-related loans, especially mortgages and construction financing loans, which comprise a substantial share of the bank credit in Israel. We continue to view the commercial real estate sector the most vulnerable. While offices and shopping malls demonstrated stability during the pandemic, there is still the risk of oversupply in the office sector, especially if demand in the high-tech sector slows down significantly.

The basis of the demand for real estate, driven by the population increase and limited supply, will continue to support price increases and credit volumes. However, we are currently expecting a slowdown in the market, because the higher interest rates, the high inflation, and the regulatory measures will encumber credit expansion and prices in 2022 and 2023. However, we expect the rate of increase in real estate prices to remain slightly above the 3% to 4% pre-pandemic average, and so, we are expecting a growing imbalance in the economy.

Chart 1: Credit to the Israeli real estate sector has grown in recent years



We believe the strict regulation and the banking system's adequate loan and underwriting standards mitigate the risks that follow from the high structural exposure to the real estate sector. Hence, we expect that by 2024, credit losses will gradually return to their original pre-pandemic levels of 25 basis points of the total bank credit, and that most of them will generate from unsecured consumer credit to small businesses.

The higher interest rates and the continued demand on the business sector's end will preserve the Israeli banks' profitability and capital. The revenues will support the strong growth in credit observed in the past quarters, higher interest rates, and a large quantity of consumer price index-linked assets, supported by higher inflation. However, strong competition will diminish the spreads. Closing branches and manpower cutbacks will continue to help banks limit the growth in operating expenses, and the banks will continue to invest in digitization. We estimate that the robust profitability and the financial flexibility

to raise capital or lower dividends will help stabilize the capital basis in the next 12 to 24 months. This, despite the erosion of the capital cushion on top of the regulatory capital as a result of the strong growth in credit, the renewed dividend distributions, and to a lower extent, the repricing of assets, after the pandemic's peak.

The reiterated rating assigned to Bank Leumi reflects our view regarding the bank's strong financial flexibility, and the robust economy in which it operates. The bank has recently raised NIS 2.7 billion in equity, that will support our estimate regarding its strong equity basis. Also note that the improvement in the bank's income generation capabilities will help it enhance the risk-adjusted capital ratio (the RAC) to 10.4%-10.9% by the end of 2024, compared with 9.4% at the end of 2021. At the same time, we recognize that Bank Leumi's capital basis is more volatile than its competitors' because of a large long-term securities portfolio, which are estimated at market value, beside large-scale pension liabilities, that do not fully cancel each other out during interest rate changes. We expect the increase in credit, the higher inflation, and the higher interest rates to support the revenues.

8% of the total assets are linked to the Consumer Price Index, which will support the net interest revenues, that the bank estimates are likely to grow by 10.6%, following a 100-basis point increase in interest rates. The higher revenues will help absorb the increasingly higher costs, as the credit loss expenses will return to their pre-pandemic levels, aiming at 18 to 23 basis points on average per year, out of the total credit, by the end of 2024. We expect that the bank will distribute a dividend equal to 40% of its net profit in the next three years.

We are expecting that, like its peers, the bank's credit growth will even out, having been at 18% (gross) since the end of 2020. Most of the increase focused on the local real estate and construction sectors, which grew by 45% since the end of 2020, and as of the end of March of 2022, comprise 25.1% of the total local credit. We note that there is a risk related to the bank's exposures to real estate, but we recognize that the limited LTV (loan-to-value) ratio mitigates the risk.

The Rating Forecast

The stable rating forecast reflects our estimate that the bank will retain its strong equity basis, and that the risk-adjusted capital ratio will remain at over 10% in the next two years, and that the asset quality levels will stay at a similar level to the sector-wide average.

The downside scenario

The rating might suffer in the event of a material deterioration in the Israeli economy, especially in the real estate sector. Such a deterioration might follow from a sudden correction in the local real estate market, economic pressure because of the global economy deteriorating, or a major escalation in the regional geopolitical situation. We will also consider a rating downgrade if the bank cannot maintain its capital basis, for example because of growth in the credit portfolio, especially the real estate-related credit, that will exceed our expectations, and stress the capital or the risk profile.

Methodology and Related Articles

- Methodology – General: The S&P Rating Principles, published on February 16, 2011
- Methodology – General: A Methodology for Linking the Long-Term Rating and the Short-Term Rating, published on April 7, 2017
- Methodology: A Methodology for Estimating the Financial Institutions' Risk-Adjusted Capital's Adequacy, published on July 20, 2017
- Methodology – General: Credit Rating in the Local Scales, published on June 25, 2018
- Methodology – General: Rating Group Companies, published on July 1, 2019
- Methodology – General: Credit Risks Resulting from Environment, Society, and Corporate Governance Factors, October 10, 2021
- Methodology: A Methodology for Rating Financial Institutions, published on December 9, 2021
- Methodology: A Methodology for Estimating Risk in the Banking Sector, published on December 9, 2021
- Methodology – General: Hybrid Capital Rating, published on March 2, 2022
- The S&P Global Ratings' Rating Definitions, published on November 10, 2021
- Opinions and Interpretation: The Correlation Between the Global Rating Scale and the Israeli Rating Scale, published on June 26, 2018

List of Ratings

Bank Leumi le-Israel B.M.	Rating	Publication date of initial rating	Last rating revision date
Issuer rating(s)			
Short term	ilA-1 +	Mar. 3, 2022	Mar. 3, 2022
Long term	ilAAA\Stable	May 1, 1998	Jan. 23, 2022
Issuer rating(s)			
Hybrid subordinated debt			
Subordinated bonds with a contractual loss absorption mechanism (Series 401, 402)	ilAA	May 31, 2018	Jan. 23, 2022
Subordinated bonds with a contractual loss absorption mechanism (Series 403)	ilAA	Jan. 17,2019	Jan. 23, 2022
Subordinated bonds with a contractual loss absorption mechanism (Series 405)	ilAA	Mar. 3, 2022	Mar. 3, 2022
Series 404	ilAA	Jun. 26, 2019	Jan. 23, 2022
Short term debt			
Series 1	ilA-1 +	Mar. 3, 2022	Mar. 3, 2022
Series 2	ilA-1 +	May 24, 2022	May 26, 2022
Unsecured senior debt			
Bonds Series 178	ilAAA	Jun. 21, 2015	Jan. 23, 2022
Bonds Series 179	ilAAA	May 31, 2018	Jan. 23, 2022
Bonds Series 182, 183	ilAAA	Nov. 9, 2021	Jan. 23, 2022
Bonds Series 184	ilAAA	Mar. 3, 2022	Mar. 3, 2022
Bonds Series 180	ilAAA	Jan. 17,2019	Jan. 23, 2022
Issuer rating history			
Long term			
Oct. 7, 2014	ilAAA\Stable		
May 5, 2010	ilAA+\Stable		
Apr. 30, 2009	ilAA+\Negative		
Jun. 21, 2007	ilAAA\Stable		
May 14, 2006	ilAAA		
Feb. 20, 2003	ilAA+		
May 1, 1998	ilAAA		
Short term			
March 9, 2022	ilA-1 +		
Additional details			
Time on which the event took place	Jul. 26, 2022, 10:52		
Date and time when the event first became known	Jul. 26, 2022, 10:52		
Rating initiated by	Rating agency		

S&P Maalot is the commercial name of S&P Global Ratings Maalot Ltd. To view the list of the most up-to-date ratings and for further information about the credit rating monitoring policy, please go to S&P Global Ratings Maalot Ltd.'s website at www.maalot.co.il

S&P receives financial compensation for its rating services and the analyses it carries out, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are available on S&P Maalot's website, www.maalot.co.il and S&P's website, www.spglobal.com/ratings, and may also be distributed through other means, including through S&P publications and third-parties.