



Israeli Banks 2023 Outlook: Rising Risks Are Well Contained

S&P Global
Ratings

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This report does not constitute a rating action

Key Takeaways

- S&P Global Ratings believes Israeli banks will benefit from the economy performing better than that of most global peers, despite a slowdown in 2023.
- Default rates are likely to rise over the next year, albeit to relatively low levels, as customers' repayment ability could be pressured.
- Banks' underlying profitability is solid, due to efficiency improvements and rising interest rates.
- The banking system's capitalization could improve in 2023 as earnings increase, but we expect dividends and growth to largely consume new capital generation.
- High exposure to real estate (construction, mortgages, and real estate activities) remains a key risk, but banks' sound credit underwriting partly mitigates potential concerns.

Key Risks



Economy deteriorates more than expected

This could lead to an accelerated correction of real estate prices and a rise in credit losses.



Elevated geopolitical risks

We view Israel as a country that faces elevated domestic security and regional geopolitical risks. These risks were prominently highlighted, for example, in May 2021, when there was a major escalation in Gaza. Ultimately, it proved relatively short-lived, but the friction was arguably the most significant in years and was complicated by the flare-up in domestic inter-ethnic unrest within Israel.



Emergence of new players

Existing banks could face threats coming from competition and business model tech disruption.

Israeli Economy To Remain More Dynamic Than Peers'

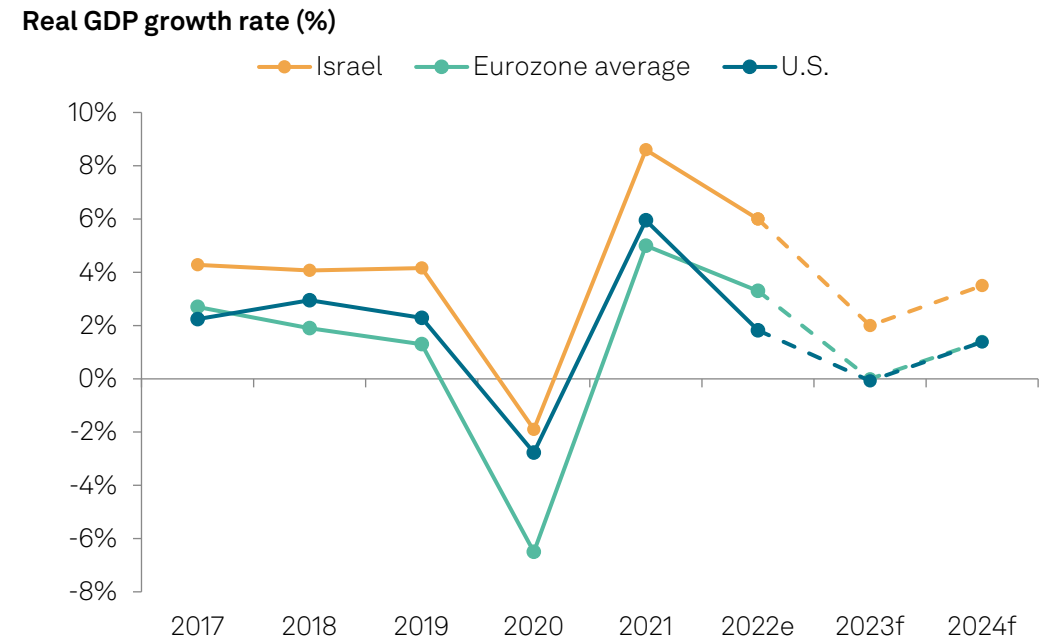
We believe strong monetary tightening, elevated inflation, and depressed global demand will take its toll on economic growth, but that the economy will perform better than that of global peers.

Inflation and Interest Rates Are Picking Up Rapidly



e--Estimate. Sources: S&P Global Ratings; Bank of Israel; Central Bureau of Statistics; European Central Bank; St Louis Fed.

Growth Will Moderate, But Remain Resilient

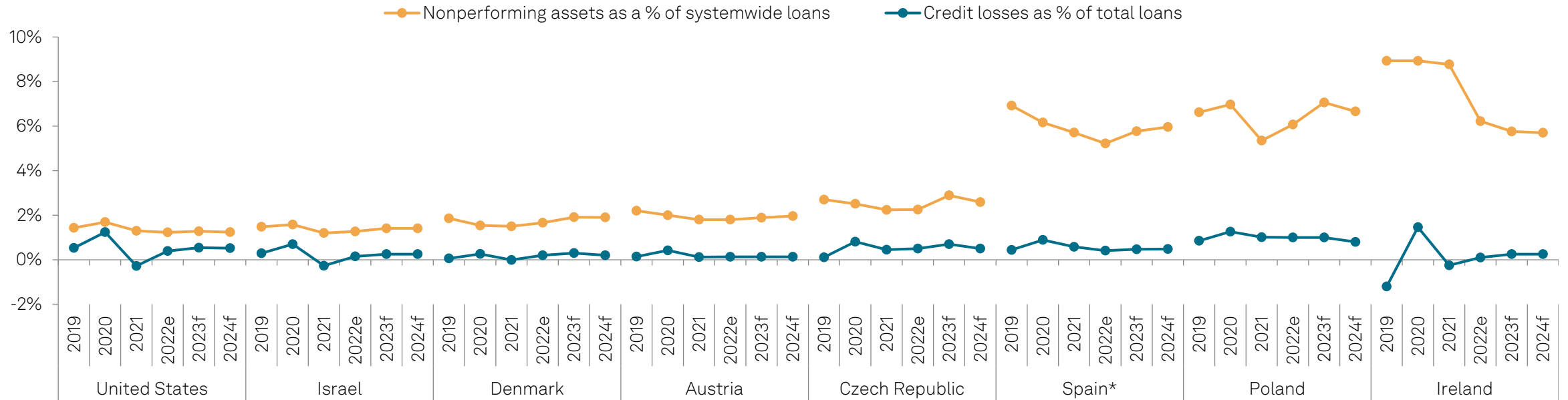


e--Estimate. f--Forecast. Source: S&P Global Ratings.

Israeli Banks Will Retain Strong Asset Quality

Credit losses will only moderately increase and the nonperforming exposures ratio will remain contained, in our view, in the absence of a rapid correction in real estate prices.

Israeli System Displays Better Asset-Quality Metrics Than Global Peers

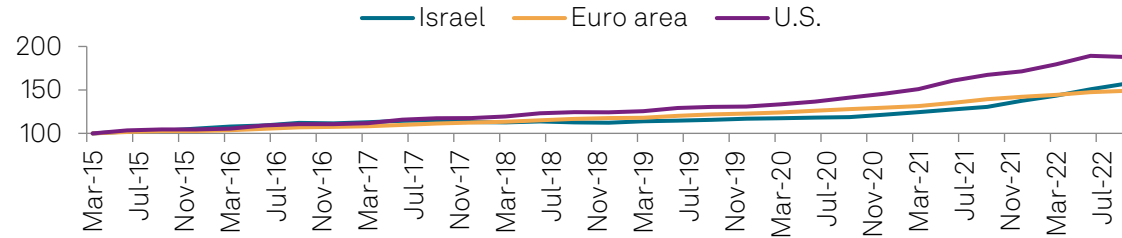


e--Estimate. f--Forecast. *Domestic nonperforming assets used. Source: S&P Global Ratings.

Real Estate Prices Expected To Stabilize

After Sizable Price Increases In The Real Estate Market...

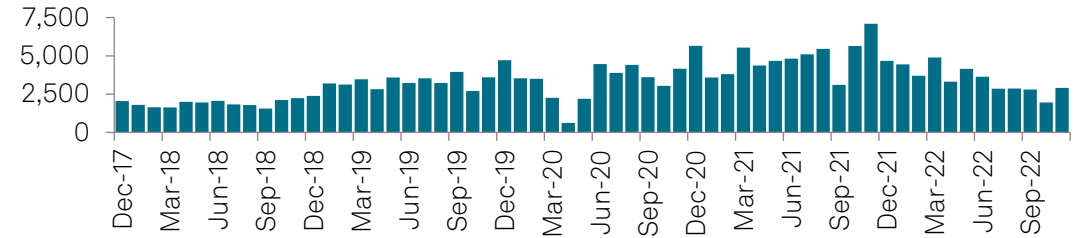
Housing price indexes (Q1 2015 = 100)



Sources: Eurostat Price Index, Central Bureau of Statistics' Dwellings Price Index, Federal Housing Finance Agency's Purchase-Only Index.

...Sales Are Slowing And Prices Are Set To Moderate

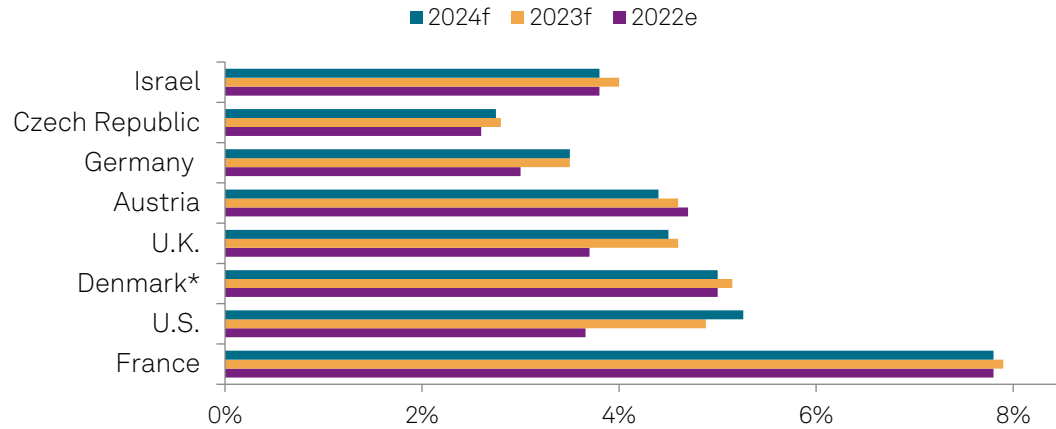
New apartments sold



Source: Central Bureau of Statistics.

But The Economy Is Resilient...

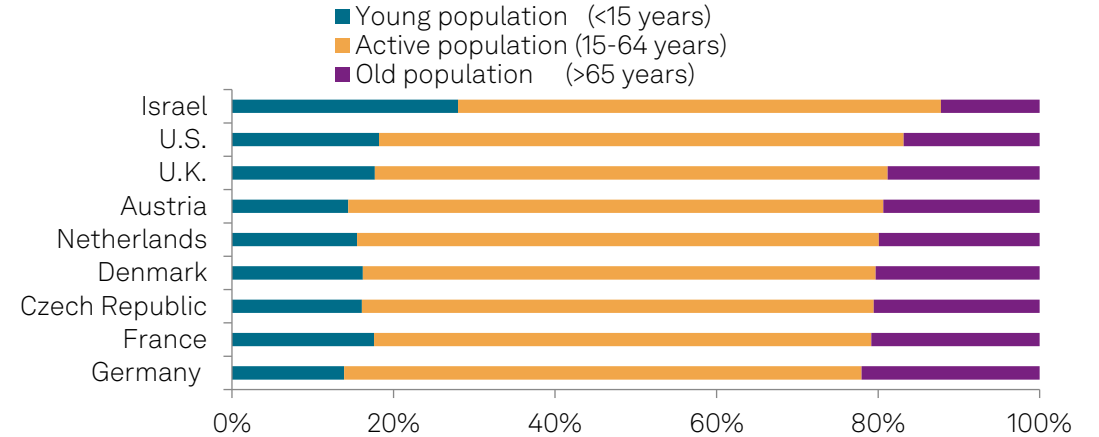
Unemployment rate (%)



*Actual data for 2022. e--Estimate. f--Forecast. Source: S&P Global Ratings.

...And Demand Is Structurally Strong

Demographic breakdown (%)



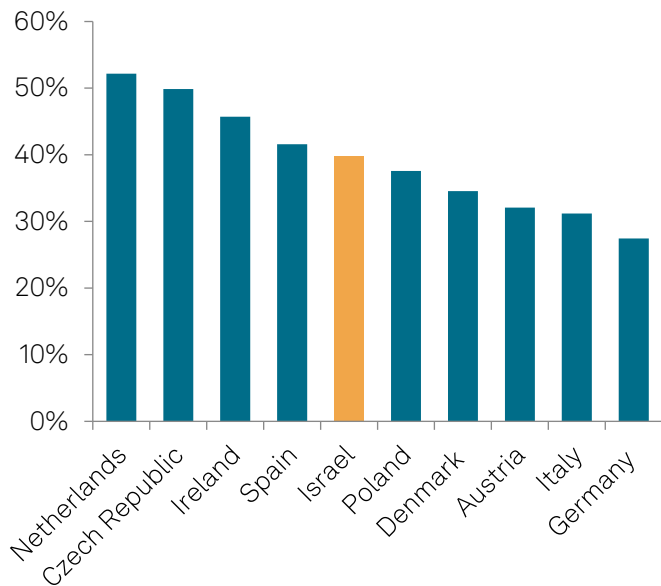
Source: Organisation for Economic Co-operation and Development as of 2021.

Overall Mortgage Exposure Represents A Contained Risk

Banks' conservative underwriting provides buffers in the event of a significant housing price correction.

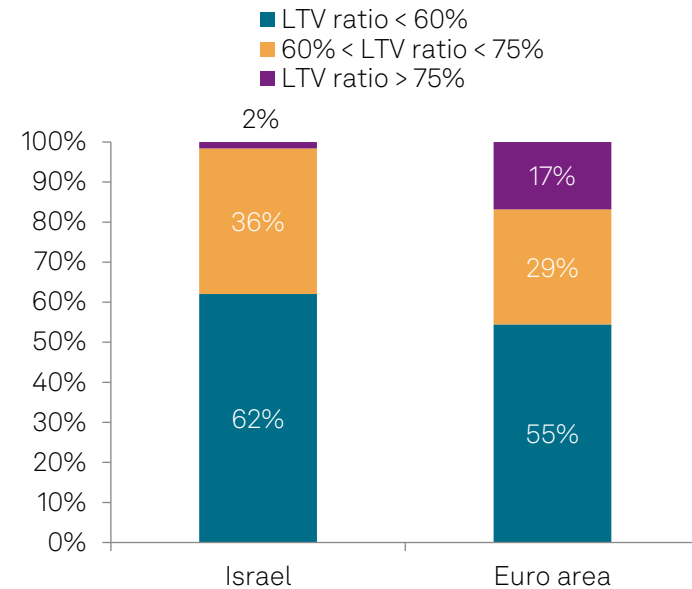
Exposure Is Significant, But In line With International Peers'

Relative size of residential portfolios



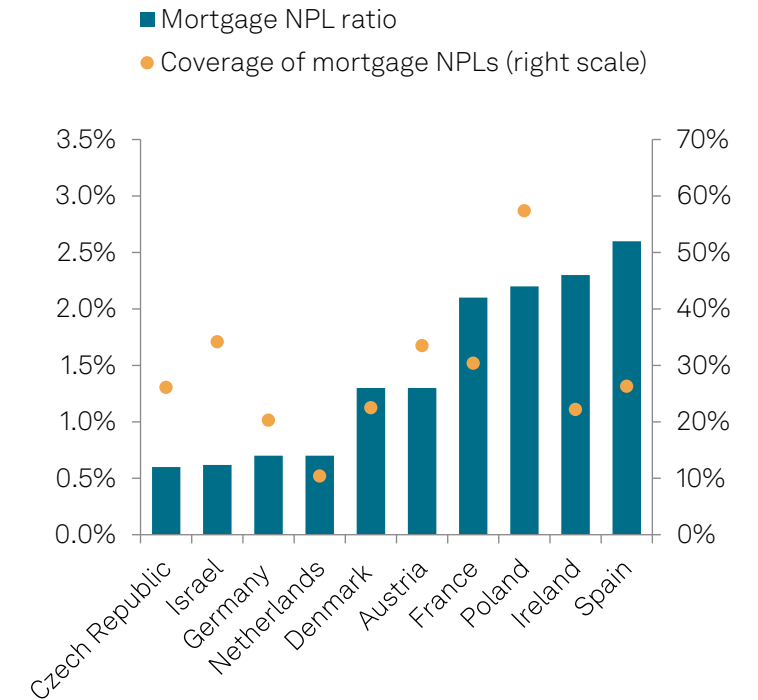
Data as of September 2022. Sources: EBA Risk Dashboard and banks' financials.

Lower-Than-Peers' LTV Ratio Provides Cushion If Prices Decline



For euro area, original breakdown of categories for LTV was the following: <60%, 60>X<80%, 80%<X<100%, and >100%. Data as of Q3 2022 for Israel and as of Q1 2022 for Euro area. LTV--Loan to value. Sources: Banks financials and EBA.

Solid Mortgage Loan Quality Metrics

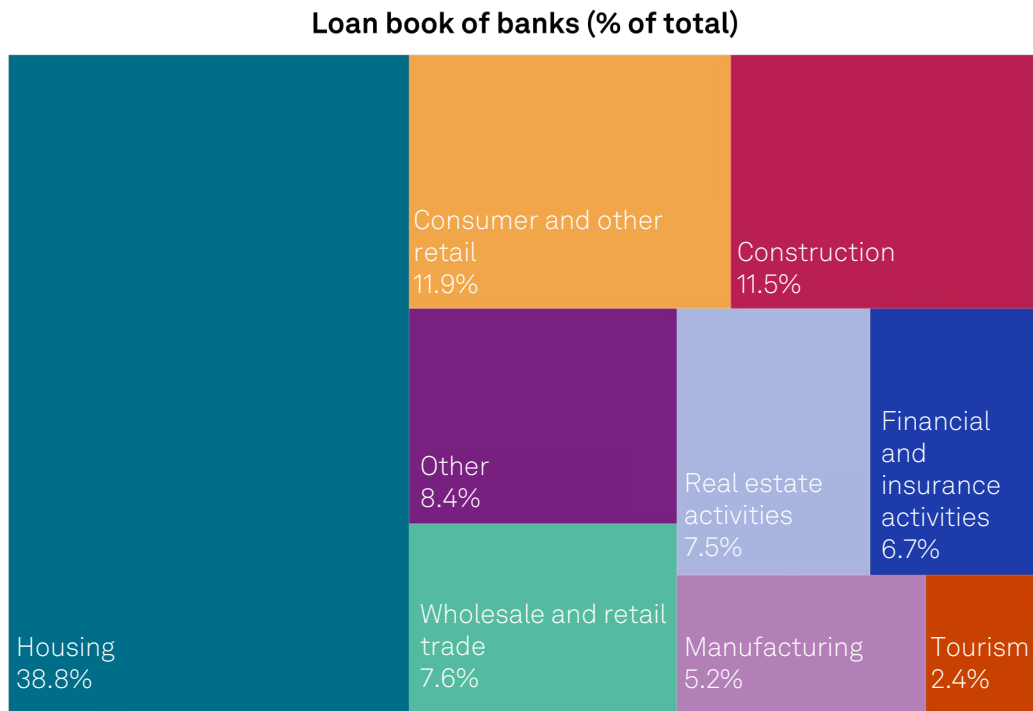


NPLs--Nonperforming loans. Data as of September 2022. Sources: EBA Risk Dashboard and banks' financials.

Banks' Corporate Book Shows Higher Concentration Risks Than Peers

Israeli banks display significant geographic concentration and relevant exposure to construction and real estate.

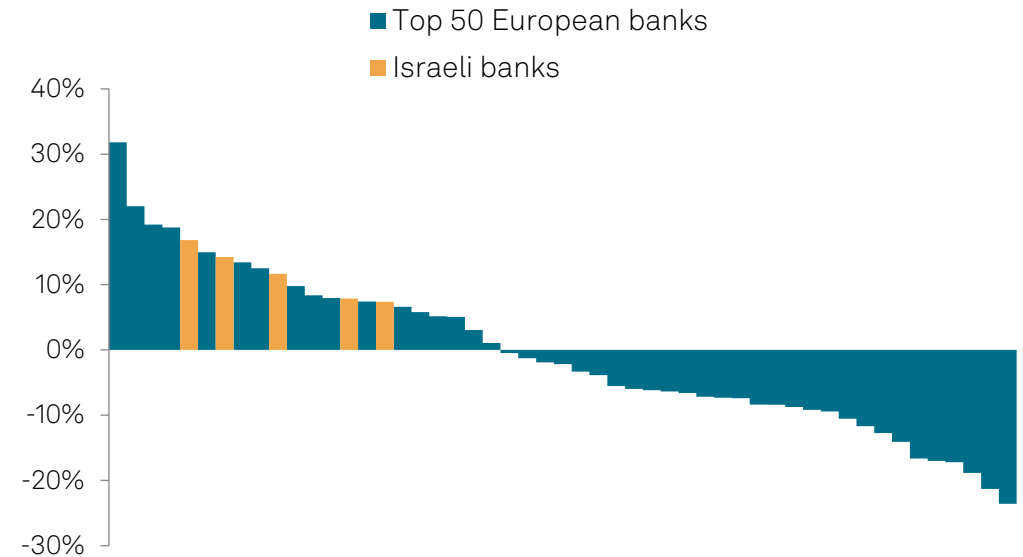
Banks Have Significant Exposures To Cyclical Sectors...



Data as of September 2022. Sources: Bank of Israel; S&P Global Ratings calculation method.

...And Display Significant Concentration Risk

S&P Global Ratings' concentration adjustments over total risk-weighted assets before diversification

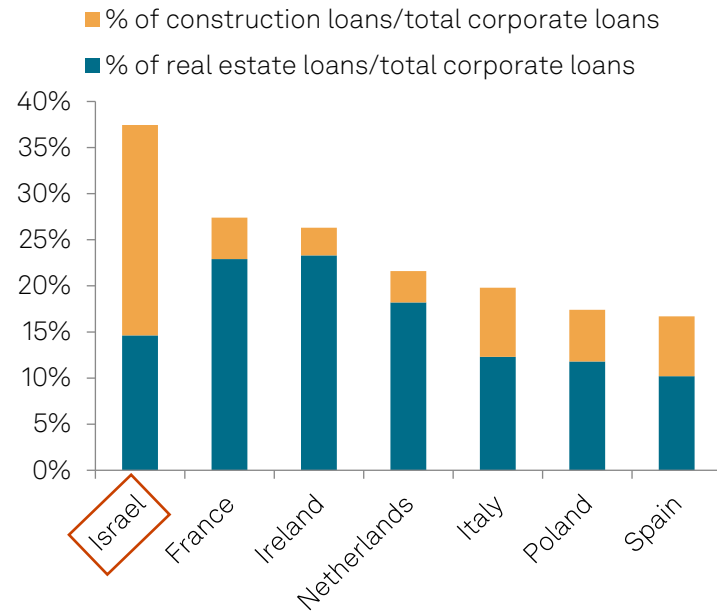


Data as of December 2021. We calculate an adjustment to risk-weighted assets to reflect the impact of concentration or diversification of risks. The adjustment is calculated by applying assumptions of correlations among different sectors, geographies, and business lines and by computing a concentration add-on to reflect single-name concentrations in the corporate portfolio. The higher the adjustment, the higher the concentration is. Source: S&P Global Ratings.

Real Estate And Construction Exposure Is The Main Tail Risk

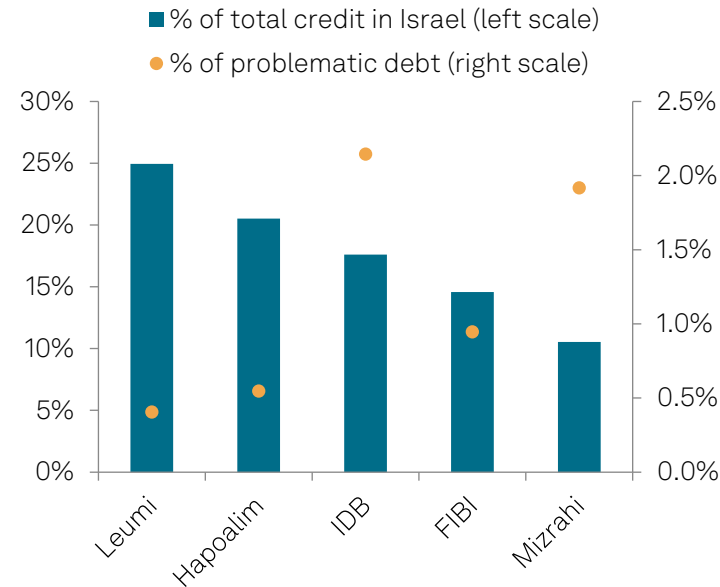
While somewhat mitigated by banks' underwriting standards and the Bank of Israel's disclosure and risk-management requirements, a material property price correction or weaker labor market could hurt asset quality.

Israeli Banks Have The Largest Exposure To Construction Of Peers...



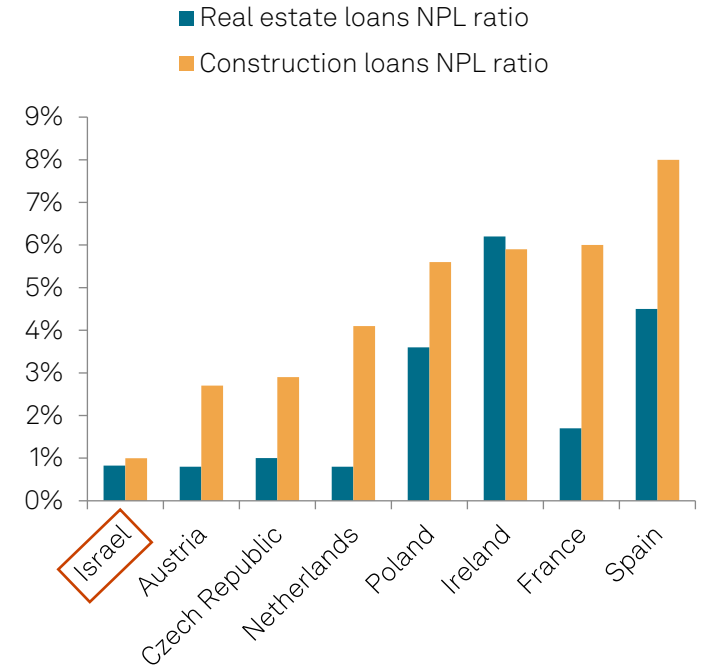
Data as of June 2022. Sources: EU Wide Transparency Exercise and banks' financials.

...With Market Champions The Most Exposed...



Source: Banks' financials, as of September-end 2022 with no credit risk mitigation included.

...But Have Stronger Asset Quality



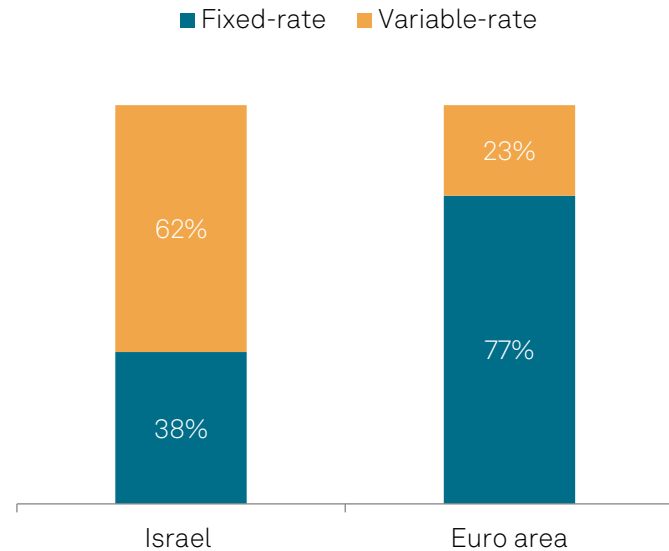
NPL--Nonperforming loans. Sources: EBA Dashboard. Banks' financials as of September-end 2022 for Israeli banks and as of June-end 2022 for global peers.

Sizable And Sharp Interest Rate Increases Offer Profitability Upsides

Largely floating balance sheets and funding profiles dominated by cheap retail deposits place banks in a good position, although wholesale funding will become more expensive.

Israeli Banks' High Share Of Variable-Rate Housing Loans Will Benefit Net Interest Income...

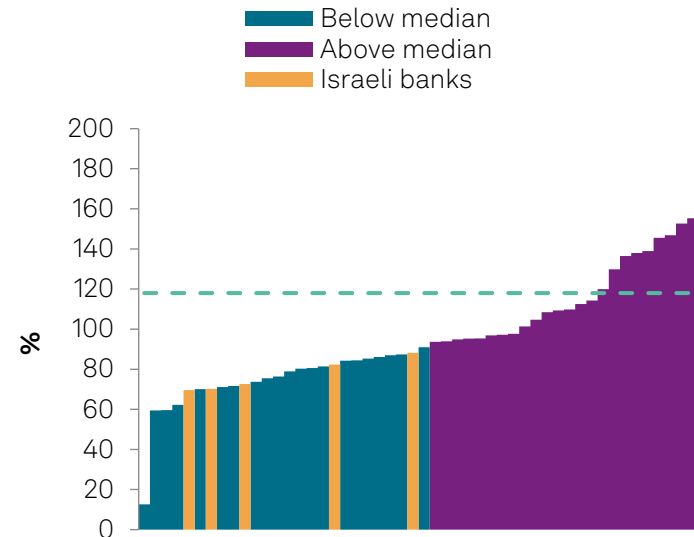
Share of variable rates housing loans (incl. consumer price index-linked loans)



Data as of September 2022. Sources: European Central Bank and banks' financials.

...Loan-to-Deposit Ratios Are Better Than Average...

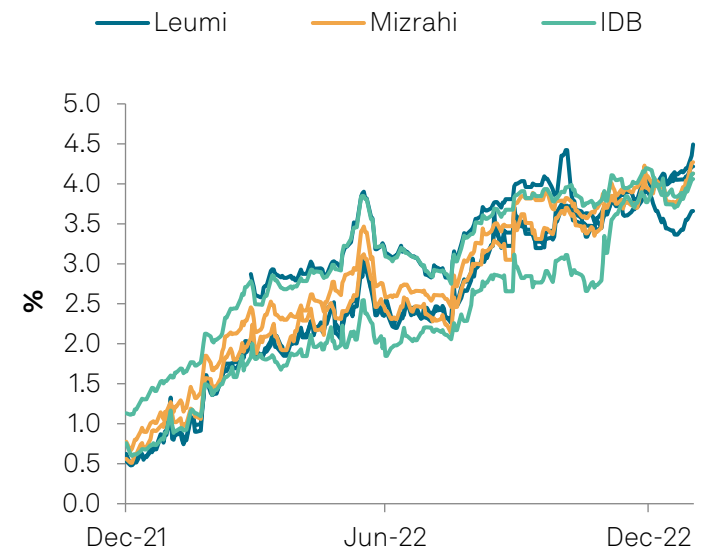
Current loan-to-deposit ratios for Top 50 European and Israeli banks



Source: S&P Global Ratings.

...But Recourse To Debt Capital Markets Will Be More Expensive

Yield to maturity (%) on banks' senior unsecured issuances denominated in Israeli shekel

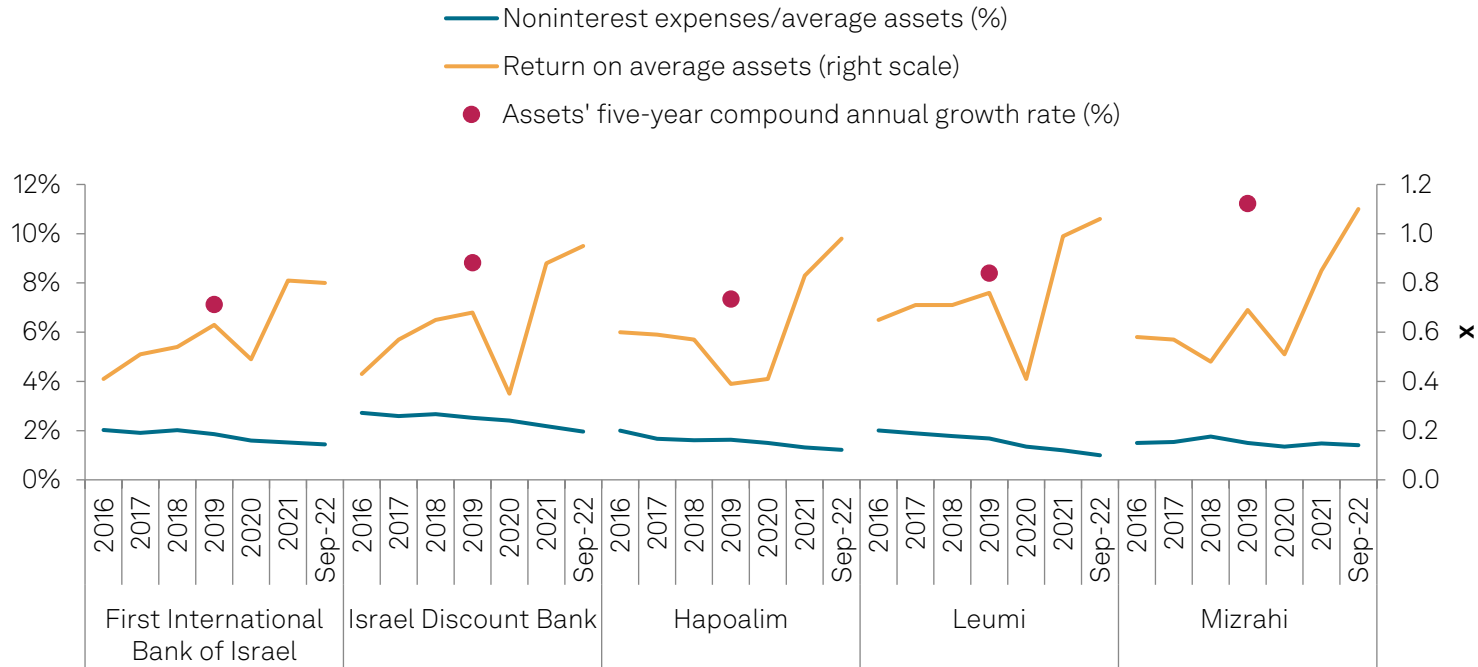


IDB--Israel Discount Bank. Source: Bloomberg, as of Jan. 31, 2023.

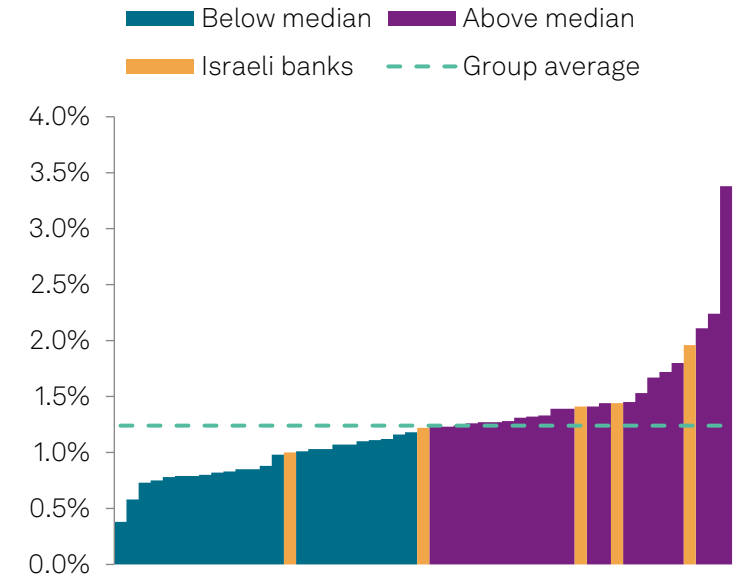
Recent Efficiency Improvements Will Pay Off

Rapid lending growth, coupled with tight cost management and some cost-reduction measures, has enabled banks to converge toward peers in terms of efficiency.

Growth And Tight Cost Management Strengthened Core Profitability



Noninterest Expenses / Average Assets For Top 50 European And Israeli Banks



Current data is the latest data available for each bank. Data can be as of June, September, or December 2021 or December 2022. Source: S&P Global Ratings.

Source: S&P Global Ratings.

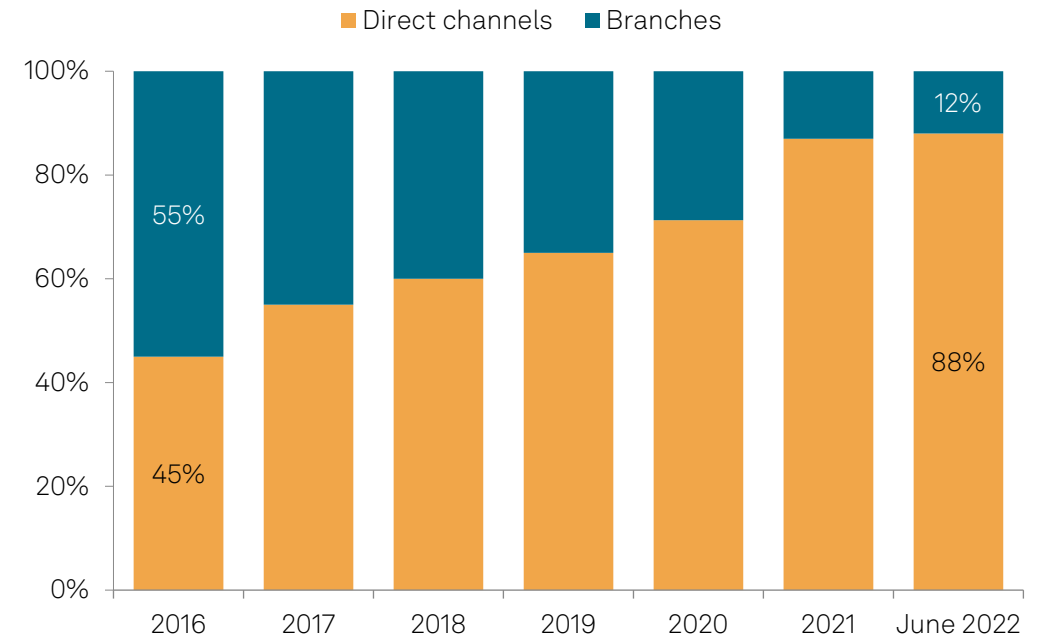
Digitalization Boosts Efficiency, Fintech Penetration Risks Are Limited So Far

New digital banks (like One Zero) could become a significant player, but in the medium-to-long term.

- We believe it will take time before traditional banks are challenged in their core markets. Cash and checks are still widely used, and customer loyalty prevails in the Israeli banking market.
- The banks are putting a lot of effort into developing technological solutions to meet customers' appetite and adopting their core system continues to be a challenge. We expect IT investments to be high.
- New risks will develop along with digital adoption. Those include rising cyber attacks and fraud as banks migrate data to the cloud and develop hybrid working models.

Usage Of Digital Tools Is Increasing

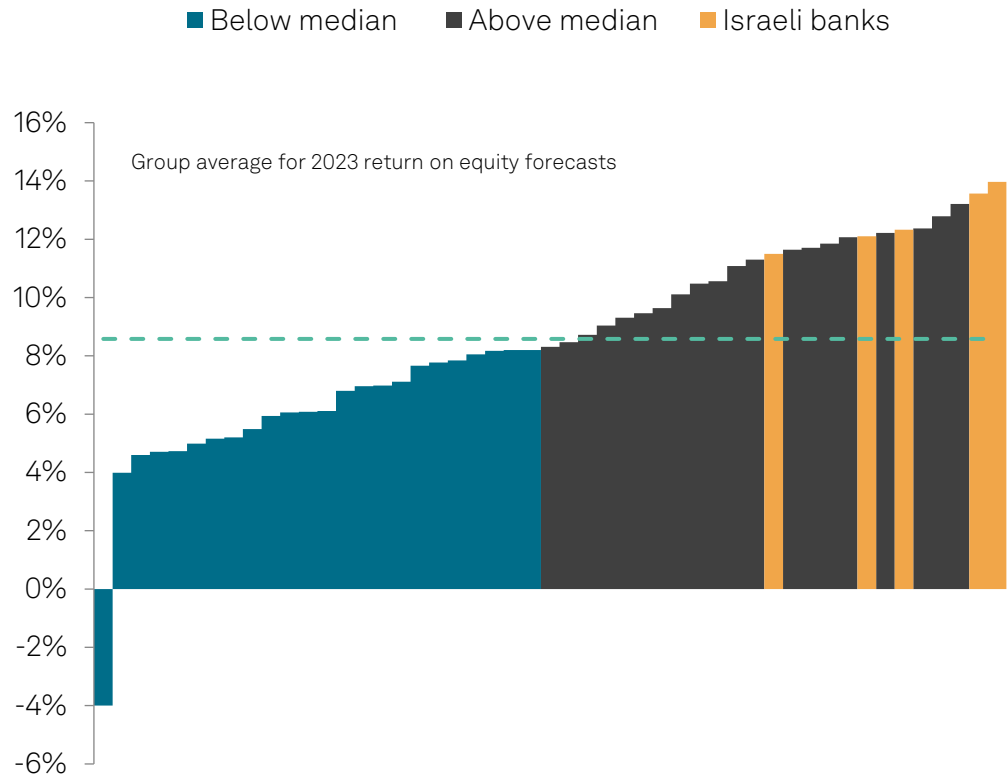
Banking by households via direct channels to total activities compared with branch banking



Source: Bank of Israel.

We See Most Israeli Banks Performing Above The Group Average In 2023

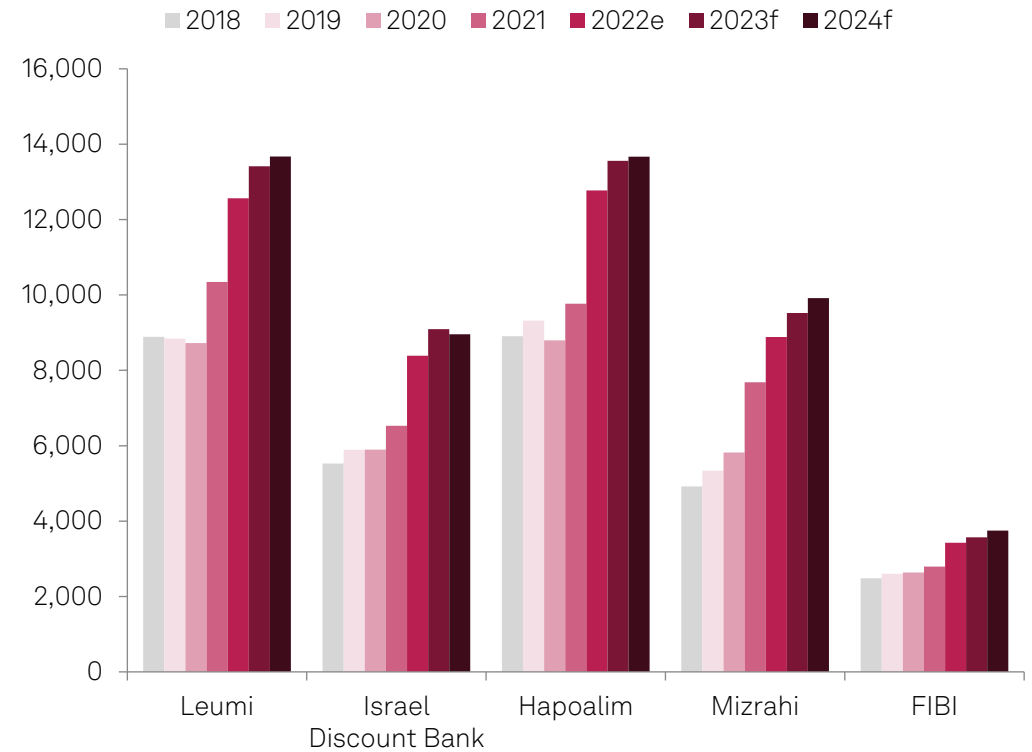
2023 Return On Common Equity Forecasts For Top 50 European And Israeli Banks



Source: S&P Global Ratings.

All Israeli Banks Will Benefit, But To Various Degrees

Net interest income (mil. ILS)

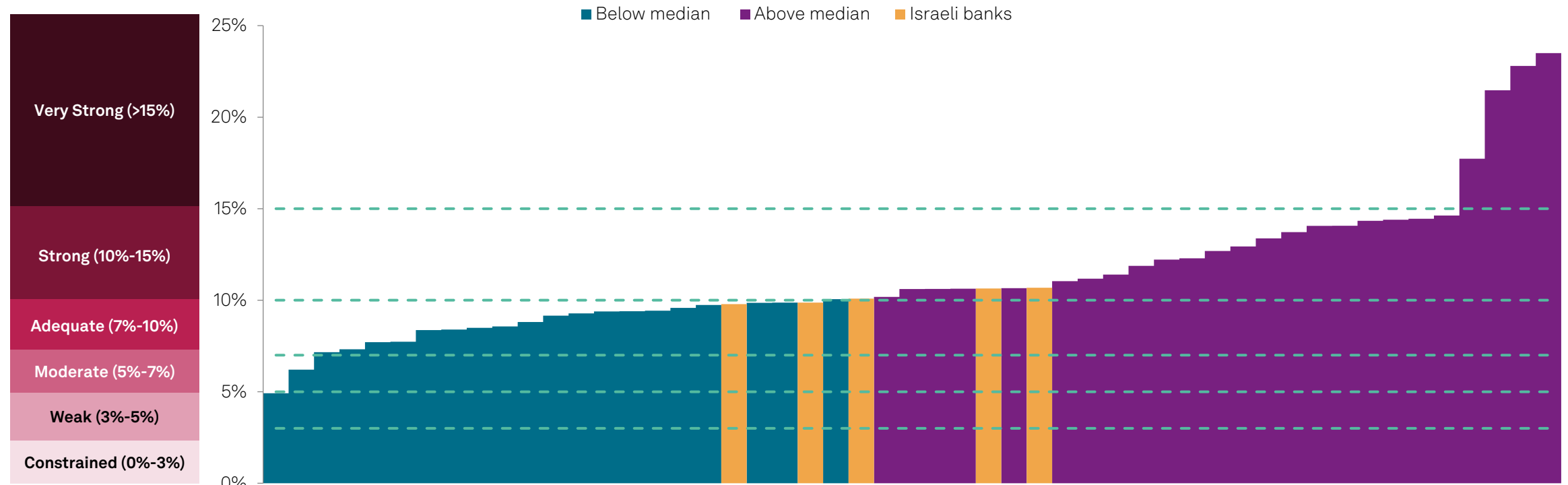


ILS--Israeli new shekel. Source: S&P Global Ratings.

Risk-Adjusted Capital Will Remain A Strength

Profitability improvements could benefit banks' capital position, but we expect gains will be offset in the long term by lending growth and dividends, leaving the sector's risk-adjusted capital near the 10% threshold.

2023 Risk-Adjusted Capital Ratio Forecasts For Top-50 European Banks And Israeli Banks

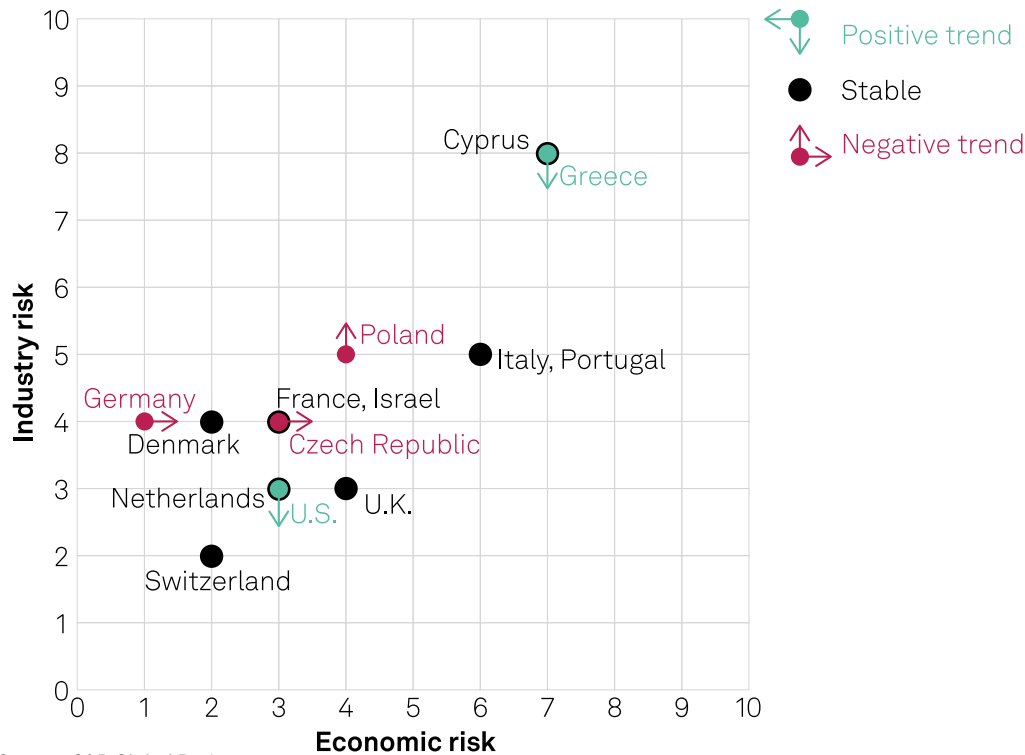


Source: S&P Global Ratings

Ratings Summary

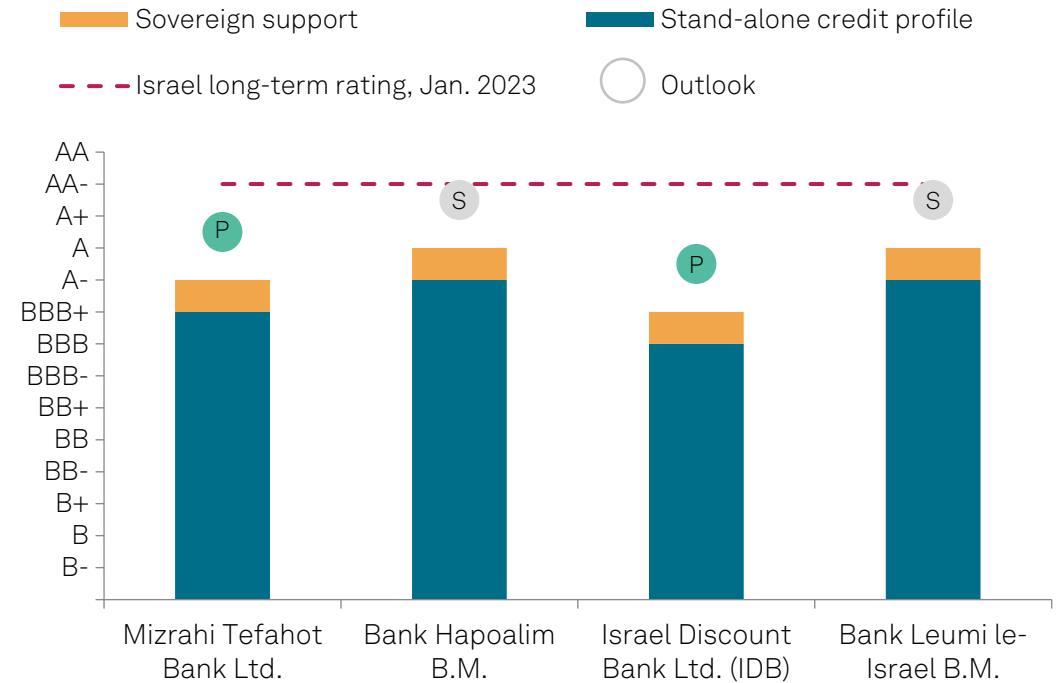
The Israeli banking system is well prepared to navigate economic challenges. Some bank outlooks are positive, reflecting that improved earnings and profitability could benefit creditworthiness, despite rising credit losses.

BICRA Scores And Economic And Industry Risks Trends



Source: S&P Global Ratings.

Mizrahi And IDB Have Positive Outlooks



P--Positive. S--Stable. Source: S&P Global Ratings.

Related Research

- [Bank Hapoalim B.M.](#), Jan. 30, 2023
- [Israel Discount Bank And IDB NY Affirmed At 'BBB+' On Improved Earnings Countering Risks; Outlooks Still Positive](#), Jan. 19, 2023
- [Bank Leumi le-Israel B.M.](#), Dec. 21, 2022
- [Israel Discount Bank Ltd.](#), Nov. 2, 2022
- [Mizrahi Tefahot Bank Ltd.](#), Aug. 18, 2022
- [Ratings Affirmed On Three Israeli Banks On Solid Domestic Economic Performance](#), July 20, 2022
- [Banking Industry Country Risk Assessment: Israel](#), Oct. 18, 2022
- [Israel Ratings Affirmed At 'AA-/A-1+'; Outlook Stable](#), Nov. 11, 2022
- [Global Banks: Our Credit Loss Forecasts: Manageable rise in credit losses as our base case](#), Dec. 13, 2022
- [Global Credit Conditions Downside Scenario Inflation, Geopolitics Are Twin Threats To Our Base Case](#), Dec. 8, 2022
- [Global Bank Outlook 2023 : Greater Divergence Ahead](#), Nov. 17, 2022
- [Single Resolution Board Says That Banks Must Go The Distance To Ensure Full Resolvability](#), July 13, 2022

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