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## Banking Industry Country Risk Assessment: Israel

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# Banking Industry Country Risk Assessment: Israel

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## Major Factors

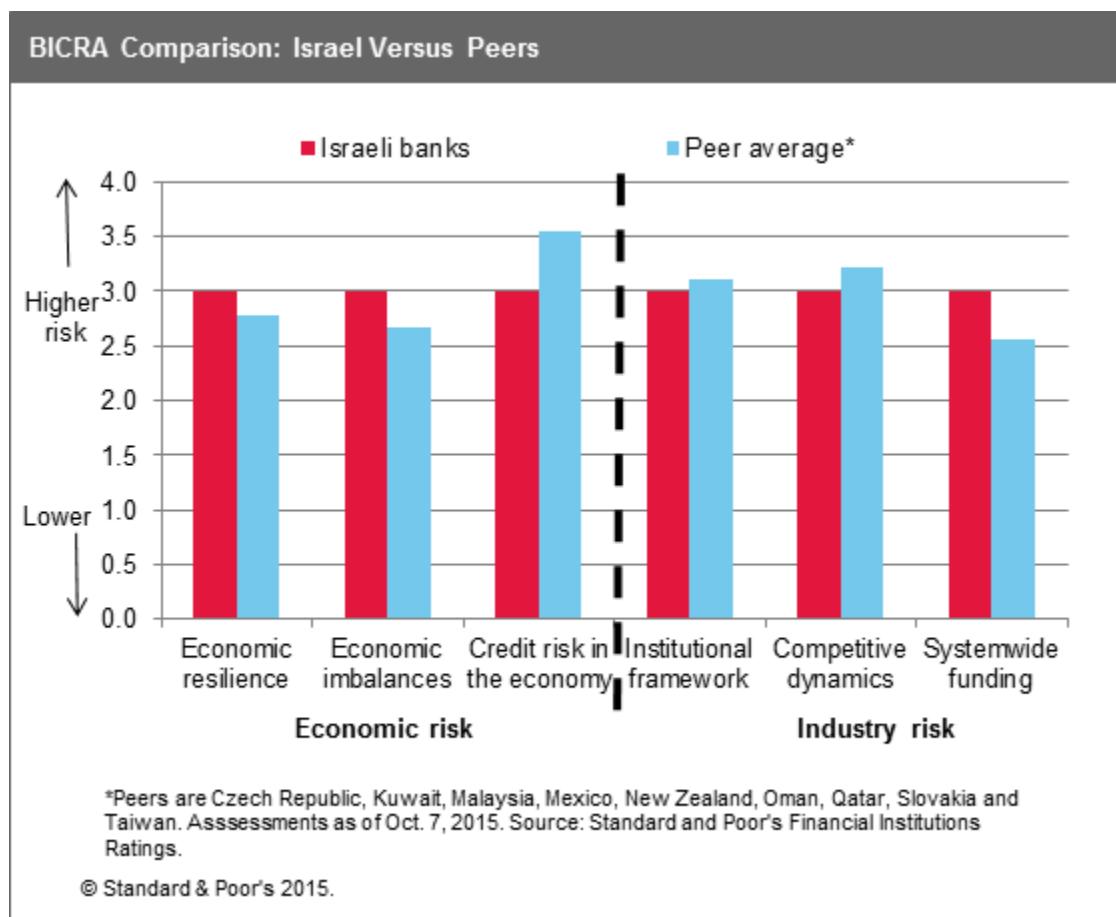
| Strengths:   | Weaknesses:  |
|--|--|
| <ul style="list-style-type: none"><li>Limited number of banks with a stable customer franchise.</li><li>Good funding profile thanks to a stable core customer deposit base.</li><li>Adequate banking regulation and supervision.</li></ul> | <ul style="list-style-type: none"><li>High political risk in the economy.</li><li>Still high, albeit reduced, credit concentration risk, and increased exposure to the local real estate sector.</li><li>Constrained efficiency and earnings capacity.</li></ul> |

## Rationale

Standard & Poor's Ratings Services classifies the banking sector of Israel (A+/Stable/A-1) in group '4' under its Banking Industry Country Risk Assessment (BICRA). Other countries in group '4' are the Czech Republic, Kuwait, Malaysia, Mexico, New Zealand, Oman, Qatar, Slovakia, and Taiwan (see chart 1).

Our bank criteria use our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Israel is 'bbb'.

Chart 1



The Israeli economy is prosperous and resilient despite comparably high geopolitical risks. Our projection of GDP per capita of close to \$38,000 in 2015 reflects the country's high wealth in an international context. Leverage in the economy is relatively stable, and domestic lending has grown slower than GDP per capita in recent years. Some monetary flexibility supports economic resilience. Israel's external fundamentals remain strong, with a positive current account and an improved net creditor position. However, the local real estate market grapples with limited supply that fails to satisfy demand, triggering spikes in prices in recent years. These conditions could, however, prove somewhat fragile considering the high political risk in the country.

The banking sector is characterized by high single-name corporate concentrations and high real estate exposure, though concentration is on a decreasing trend. We think that domestic banks will maintain their competitive nature as they focus on the retail and small and midsize enterprise (SME) segments to boost their activity, while facing increased competition from nonbanks in corporate lending. Among banks' weaknesses are relatively low efficiency compared with global peers' and restrained earnings capacity. We believe the Israeli banking system will continue to benefit from a sound domestic core deposit base and adequate regulation and supervision that we regard as in line with international standards.

We classify the Israeli government as "supportive" toward its banking sector. This classification reflects our view that

the government would likely be willing and able to provide extraordinary support to its banking system in times of crisis.

## Economic And Industry Risk Trends

We assess Israel's economic risk trend as stable, based on our view of its resilient economy. We anticipate that the economy will continue growing, while maintaining high wealth relative to the levels of peers. We think economic imbalances are likely to remain contained, mainly due to the shortage in housing supply and fairly positive economic indicators.

The trend in Israel's industry risk is also stable, in our opinion. We think regulation and supervision will remain effective, with fairly conservative standards. We also believe that future reforms, including separating credit card companies from the largest banks, would not undermine the sector's stability. We anticipate that the sector will continue facing substantial competition from nonbank institutions, particularly in corporate sector lending. Although we do not see significant upside for banks' profitability coming from revenue growth, we consider that risk appetite will likely remain at current levels. We also believe banks' funding profiles will remain a strength for the industry.

## Economic Risk | 4

We base our economic risk score for Israel on our assessment of economic resilience, economic imbalances, and credit risk in the economy, all of which our criteria define.

### **Economic resilience: High income and growing economy but still facing geopolitical risks**

**Economic structure and stability.** Israel became a full member of the Organization for Economic Cooperation and Development (OECD) in 2010, affirming its status as a high-income industrialized economy, with our projection of GDP per capita of about \$38,000 for 2015.

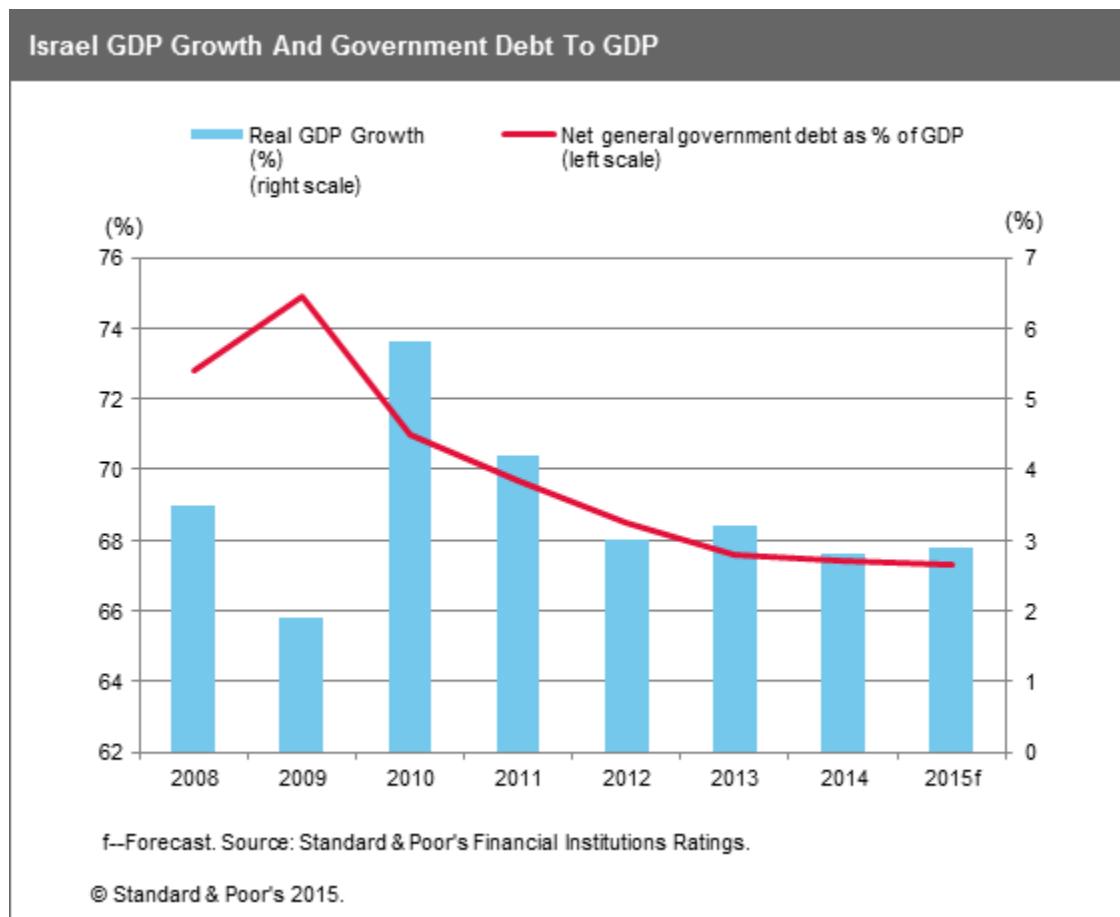
As a small, open, and diverse economy, Israel depends heavily on exports. High-technology industries in particular represent a high share of total industrial exports (excluding diamonds) and testify to the country's high levels of education and research and development spending. The importance of the high-tech sector renders the economy vulnerable to a technology downturn as seen in 2001-2002, but the risk is mitigated by increasing diversification of Israel's product and export base in resilient sectors not oriented toward consumer goods, such as pharmaceuticals, defense, and, in the future, natural gas.

In our base-case scenario, we assume Israel's annual real GDP growth will reach 3.1% over 2015-2017 on average, which would support a per capita GDP growth rate of close to 1.5%, a pace we consider high given the country's wealth levels. We also expect inflation to be relatively moderate at 1.8% on average over 2015-2017, while interest rates will probably rise from historically low levels.

Natural gas production in the Mediterranean Sea should make a consistent contribution to economic growth, which could be offset by external and domestic risk. In the short term, demand for Israeli exports could drop due to economic weakness in core markets, especially in Europe and to a lesser extent in North America and other parts of the world. This is compounded by the threat of currency appreciation, which could undermine Israeli competitiveness.

These risks are mitigated by Israel's decision to establish a sovereign wealth fund to invest future proceeds from natural gas in external assets. However, political and security uncertainty will continue to overshadow confidence and add to downside risk, in our view.

Chart 2



**Macroeconomic policy flexibility.** Frequent elections have traditionally been one factor explaining Israel's relatively weak public finances. This has resulted in volatile expansionary and contractionary budgets. Currently, the recently formed coalition is negotiating its 2015-2016 budget, while for the time being only one-twelfth of the 2014 budget can be spent each month. As a result, we estimate that the general government deficit will be about 2.8% of GDP this year, owing to the 2014 budget, which had a deficit of 2.6% of GDP as the July/August 2014 Gaza conflict was financed by spending cuts and fiscal reserves.

We expect the budget deficit to remain below 3% of GDP in coming years, a deviation from the former government plans, mainly due to reversal of spending cuts forced by current partners of the coalition. This should enable Israel's net government debt burden to remain stable at about 63% of GDP in 2015, and to decrease slightly in 2016-2017. The low interest rate environment is also helping lower the government's interest payments, which we expect will average about 10.5% of government revenues by 2017.

We consider Israel's monetary policy a strength. The central bank is purchasing foreign exchange to offset the effects

of natural gas production, while lowering interest rates to a record low of 0.1% in March 2015, given low inflation and the Israeli shekel's strength.

**Political risk.** Israel still faces multiple geopolitical risks, which we view as a relevant constraint on its economic resilience. In this respect, Israeli-Palestinians relations continue to be prone to violent outbreaks, as we recently witnessed, and risk inviting international penalties. Other areas (Lebanon, Syria, and Sinai) pose medium-term security risks, in our view.

Any significant armed conflict could have a negative impact on economic resilience if it significantly deters investment, weakens the economy's growth potential, or strains fiscal flexibility. We do not expect the U.N. Security Council's nuclear deal with Iran will impact our assessment of Israel's political risk.

**Table 1**

**Israel Economic Resilience**

|   | --Fiscal year end Dec. 31-- |        |        |        |        |
|---|-----------------------------|--------|--------|--------|--------|
|   | 2011                        | 2012   | 2013   | 2014   | 2015f  |
| Nominal GDP (bil. \$)                           | 262                         | 259    | 292    | 305    | 301    |
| Per capita GDP (\$)                             | 34,688                      | 33,927 | 37,821 | 39,055 | 37,949 |
| Real GDP growth (%)                             | 5.0                         | 2.9    | 3.3    | 2.6    | 2.9    |
| Inflation (CPI) rate (%)                        | 3.5                         | 1.7    | 1.5    | 0.5    | 0.1    |
| Change in general government debt (as % of GDP) | 2.8                         | 3.5    | 2.9    | 2.2    | 2.8    |
| Net general government debt (as % of GDP)       | 63.7                        | 65.0   | 64.2   | 63.3   | 63.3   |

f-Forecast. CPI--Consumer price index. Source: Standard & Poor's Financial Institutions Ratings.

**Economic imbalances: Rising housing prices enhanced by lasting low interest rates**

**Expansionary phase.** The Israeli economy remains in an expansionary phase. We expect real GDP growth to reach 2.9% in 2015 and a 3.1% average in 2015-2017.

**Private sector credit growth.** We believe credit growth will remain in line with the GDP growth trend in the coming years. Increasing household debt, including mortgage loans, would remain the main contributor to credit growth. Private sector credit stood at about 88% of GDP as of December 2014 (115% including capital market corporate debt), and we expect it will increase slightly compared with GDP in the near future.

While corporate debt has increased by only 4% since 2010, household debt has increased by about 29% during the same period, with the rise attributed mainly to residential mortgage loans. Yet, overall leverage to GDP decreased due to GDP growth.

**Real estate prices.** Housing prices have increased by an annual average of 4.3% in the past four years (2010-2014) in real terms as supply failed to satisfy demand, and added another 2.8% as of May 2015. In nominal terms, housing prices have increased by about 91% since 2007, which weighs on our assessment of economic imbalances.

We see current real estate prices as elevated and assume they will continue to rise in the near future, perhaps at a slower pace than in recent years. The relatively favorable economic environment, lack of supply, increased demand from investors (who buy to let), population growth, and low interest rates all contributed to recent years' price appreciation. Household credit (mortgage loans in particular) has also increased substantially, as low interest rates increased households' borrowing capacity.

The government, which holds most of the country's land, initiated several plans to release land for building dwellings, however these have yet to affect prices.

We anticipate that prices will continue to be elevated, which increases chances of a price correction, although we have yet to encounter triggers for such a correction. However, a housing bubble or a significant price correction is not part of our base-case scenario for the next 18-24 months, given the above factors. We will continue to follow trends in real estate prices in light of banks' increased exposure to the sector.

### Chart 3



**Equity prices.** Market trends in 2015 are quite positive so far, with a 9% increase in the TA-25 Index (as of mid-September). This follows a 10% rise in 2014, and is broadly in line with the global trend in equity prices, given low yields in alternative asset classes.

**Current account and external debt position.** Israel's external fundamentals remain strong, as it continues to maintain its net creditor position. The current account balance was positive at 4.2% of GDP in 2014, and we project it will average 1.6% for 2015-2017. We regard the surplus position as small and sustainable, but it will depend on future exchange rate trends and the severity of potential slowing in the global economy. Israel continues to improve its net creditor position, with narrow net external assets to current account receipts (CAR) of 28% at year-end 2014 and our forecast of a 24.4% average for 2015-2017.

**Table 2****Israel Economic Imbalances**

| (%)   | --Fiscal year end Dec. 31-- |        |        |        |        |
|---|-----------------------------|--------|--------|--------|--------|
|   | 2011                        | 2012   | 2013   | 2014   | 2015f  |
| Annual change domestic credit (in % points of GDP)            | 0.5                         | (1.7)  | (1.3)  | 0.9    | 1.6    |
| Annual change in residential house price (real): National (%) | 0.5                         | 7.0    | 5.8    | 3.8    | 2.8    |
| Annual change in inflation-adjusted equity prices (%)         | (21.6)                      | 7.5    | 10.6   | 9.7    | 16.9   |
| Current account balance (as % of GDP)                         | 2.6                         | 1.7    | 2.7    | 4.2    | 2.0    |
| Net external debt as % of GDP                                 | (25.6)                      | (29.2) | (31.7) | (36.6) | (39.1) |

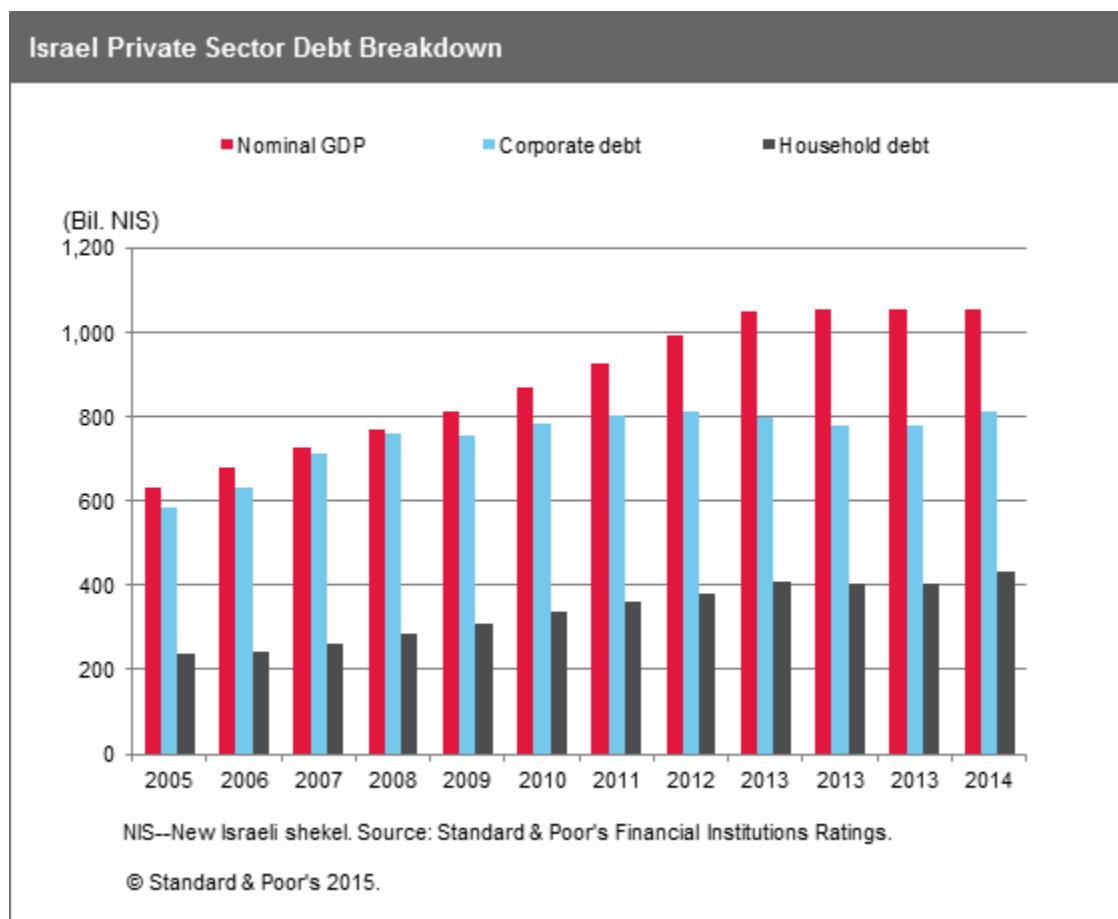
f--Forecast. Source: Standard & Poor's Financial Institutions Ratings.

**Credit risk in the economy: Adequate private-sector leverage and decreasing concentration in corporate loan books**

**Private-sector debt capacity and leverage.** Overall, the level of private-sector leverage is adequate, in our opinion. Households' leverage remains low--with debt to GDP at about 40% at year-end 2014--despite rapid growth in recent years, particularly in mortgage loans. We expect households' leverage to remain around current levels in the near future. Given its higher leverage, the corporate sector's financial profile is weaker, which is a key risk for the banking system. Corporate debt to banks and to capital markets as a percentage of GDP stood at about 75% as of year-end 2014. This proportion has decreased in recent years, though, as GDP increased while corporations mostly deleveraged and refinanced rather than taking on additional debt.

Banks have gradually decreased their exposure to the corporate sector, while increasing exposure to the retail (mortgages and consumer loans) and SME sectors, a trend we think will continue in the near future. The rapid growth of household credit in recent years--up about 29% since 2010--could put pressure on banks' asset quality under less favorable economic conditions, but this is not part of our base case scenario.

Chart 4



**Lending and underwriting standards.** In our view, lending and underwriting standards in Israel still weigh on our assessment of credit risk. This is reflected by the still-high level of single-name loan concentration in banks' corporate books, which is in part a reflection of the concentrated Israeli economy. That said, concentration has decreased in recent years, mainly owing to regulation by the Bank of Israel (BoI), and we believe it will continue to decrease given updated directives.

Local banks are also highly exposed to the local residential real estate sector; however underwriting standards for mortgages are stricter, chiefly because of regulation. Exposure to foreign currency lending and risky complex credit products is limited.

Exposure to the 20 largest corporate borrowers ranged from 90% to 100% of tier 1 capital at Dec. 31, 2014, while exposure to the 20 largest borrower groups ranged from 160%-260%. We believe further reduction will take place in the next three years, given recent changes in the BoI directive to measure single borrower and borrower group concentrations in relation to common equity tier 1 capital (CET1) rather than total capital (ATE), but would not be significant.

Recent years have shown that potential contingency risks are smaller than we previously estimated, which partly mitigates our concerns with regard to concentration. The collapse of some big local conglomerates has not affected

their operating subsidiaries, and losses at the holding-company level were relatively low and manageable systemwide.

Another risk component of Israeli banks' loan books, in our view, is the financing of leveraged buy-out deals and lending to holding companies. Still, banks are gradually decreasing their exposure to such financing, which is also closely monitored by the BoI.

The banking sector's exposure to the real estate and construction sector (excluding mortgages) is high, in our view, and as of June 2015 stood close to 20%, which is the BoI's maximum. Exposure to real estate is higher if we add banks' exposure to mortgages, and we expect it will remain high given our forecast of growth in such lending.

Residential mortgage lending is all prime and with full recourse. Outstanding balances have increased noticeably in recent years, mainly on rising housing prices, low interest rates, natural population growth, and an increased number of second-home buyers. Mortgage lending carries low credit risk in our view, given the historically very low credit losses in this segment; however, this could be put to test if we witness significant economic slowdown.

The BoI has introduced several macroprudential measures, including limiting the permissible loan-to-value (LTV) ratio of mortgage loans for both first-time home buyers and second-home buyers, limiting the payment-to-income ratio, and just recently raising banks' CET1 capital requirements depending on their mortgage exposure. These measures somewhat contained credit growth to the housing sector, and improved the financial profile of new mortgages as indicated by the BoI itself. The systemwide LTV ratio was 60%-70% as of the first half of 2015, as measured at loan initiation, and is actually lower given recent years' price appreciation.

Retail (nonmortgage) loans usually carry higher interest margins and are not secured by pledges or guarantees. The credit quality of such loans was high in recent years, but we consider that it needs monitoring in light of recent growth. A substantial increase in unemployment in a slowing economy, in tandem with higher interest rates, could challenge the credit quality of banks' mortgage and retail loan portfolios, and we will continue following trends in such credit.

**Payment culture and rule of law.** We consider Israel's legal infrastructure as supportive for banks in terms of predictability and timeliness of recovery of collateral in the event of bankruptcy or foreclosure. We base our opinion on the World Bank's governance indicators for Israel for the "rule of law" and "control of corruption". Social issues could arise in the event of a significant residential real estate crisis, and change our estimate.

**Table 3**

**Credit Risk In The Israeli Economy**

|   | --Fiscal year end Dec. 31-- |         |         |         |         |
|---|-----------------------------|---------|---------|---------|---------|
|   | 2011                        | 2012    | 2013    | 2014    | 2015f   |
| Per capita GDP (\$)   | 34,688                      | 33,927  | 37,821  | 39,055  | 37,949  |
| Domestic credit private sector & NFPEs (as % of GDP)        | 69.0                        | 67.3    | 66.0    | 66.9    | 68.5    |
| Household debt (as % of GDP)                                | 38.5                        | 38.0    | 38.8    | 39.6    | 39.5    |
| Household net debt (as % of GDP)                            | (230.6)                     | (218.2) | (242.4) | (250.3) | (251.0) |
| Corporate debt (as % of GDP)                                | 85.6                        | 81.2    | 75.6    | 74.3    | 71.8    |
| NPAs (as % of systemwide loans; year-end)                   | 3.6                         | 3.5     | 2.9     | 2.2     | 2.6     |
| Domestic NPAs (as % of systemwide domestic loans; year-end) | 4.0                         | 3.9     | 3.2     | 2.4     | 2.8     |
| FC lending (as % of total lending)                          | 19.8                        | 17.6    | 15.0    | 14.7    | 14.8    |

**Table 3****Credit Risk In The Israeli Economy (cont.)**

f—Forecast. NFPEs—Nonfinancial private-sector enterprises. NPA—Nonperforming assets. FC—Foreign currency. Source: Standard & Poor's Financial Institutions Ratings.

**Base-case credit losses.** Banks' loan loss provisions in recent years have been lower than we expected, standing at 0.11% in the first half of 2015, 0.16% in 2014, 0.26% in 2013, and 0.42% in 2012 on a net basis. The main contributors to this were recoveries from previously provided for credit supported by extensive financing from capital markets, low interest rates, and the overall stable economic and financial environment. We assume provisions would increase from their current level mainly due to fewer recoveries on the corporate side, but would remain at a manageable level.

**Table 4****Israel Base-Case Loss Provisions**

| (%)                             | 2012a | 2013a | 2014a | 2015e | 2016f |
|---------------------------------|-------|-------|-------|-------|-------|
| Corporate, commercial, and SMEs | 0.64  | 0.30  | 0.07  | 0.73  | 0.78  |
| Residential mortgages           | 0.01  | 0.16* | 0.04  | 0.12  | 0.16  |
| Other nonsecured retail         | 0.35  | 0.30  | 0.60* | 0.35  | 0.40  |
| Total                           | 0.42  | 0.26  | 0.16  | 0.47  | 0.51  |

\*Includes a nonrecurring general provision dictated by the Bank of Israel. SMEs—Small and midsize enterprises. a—actual. e—Estimate. f—Forecast.

## Industry Risk | 4

We base our industry risk score for Israel on our assessment of institutional framework, competitive dynamics, and systemwide funding.

### Institutional framework: Regulation, supervision, and transparency in line with international standards

**Banking regulation and supervision.** We assess local banking regulation as broadly in line with international standards. Regulatory coverage is broad and covers many types of financial risks. We believe supervision is effective and hands on. Banks are monitored closely and frequently. Supervision standards are fairly conservative, although challenged by risks related to the structure of the economy (namely concentration risk).

**Regulatory track record.** In recent years, the regulator has taken several preventative measures that reduced banks' vulnerability to financial crises. Israeli banks now operate under Basel III regime. As part of that, the BoI requires a core tier 1 capital ratio of 9% as of year-end 2014 and 10% by year-end 2016 for the two largest banks, Bank Leumi le-Israel B.M and Bank Hapoalim B.M.

In addition, banks are to gradually increase their capital over the next two years as a proportion on their mortgage portfolio. The central bank also urges each bank to set an individual core tier 1 capital target in line with its specific risk exposures. The BoI also introduced several restrictions on mortgage lending, leveraged finance, and tightened limitations on single-name and group concentrations. Just recently, Basel III liquidity measurements were introduced, taking full effect in the near future.

**Governance and transparency.** Accounting transparency and standardization of Israeli banks are high and steadily improving owing to the BoI's additional disclosure requirements. Banks' financial reporting standards are a mix of Israeli and U.S. Generally Accepted Accounting Principles, and International Financial Reporting Standards. Banks report to the regulator on a frequent basis, and publish quarterly financial statements to the public.

**Competitive dynamics: Moderate profitability, with distortions from nonbanks in corporate lending**

We focus on the structural implications of the competitive landscape a bank faces within the broader banking industry, as determined by risk appetite, industry stability, and market distortions.

**Risk appetite.** We base our assessment of risk appetite on the Israeli banking industry displaying moderate profitability relative to other sectors, with a long-term average return on equity (ROE) in the high single digits. We believe this results in part from stiff competition in some business lines in which banks operate (mainly mortgage lending which carries low interest margins), and low operational efficiency.

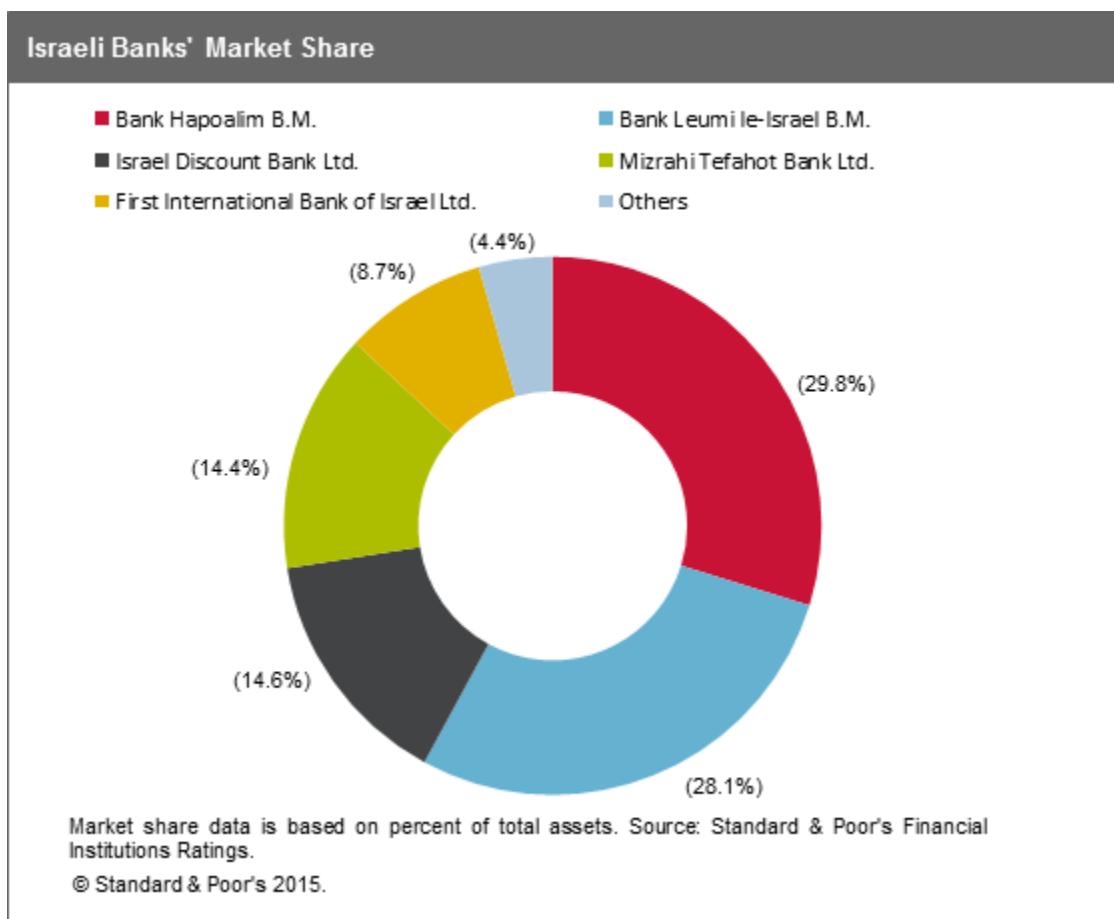
The relatively low growth in overall credit and low interest rate environment, which will likely persist over the coming quarters, could heighten competitiveness among banks, in our view. Competitive dynamics in mortgage lending have resulted in narrow interest spreads in this business line, and perhaps some underpricing of risk, although historically these loans carry very low loss rates.

Local banks' have generally low operational efficiency, based on cost-to-income ratios in the 60%-80% range, mainly as a result of strong labor unions and relatively low cost flexibility. Additional factors affecting our risk appetite assessment are a low asset growth rate (broadly in line with GDP growth), the relative absence of innovative or complex products, including securitization, and compensation practices that reward long-term profitability and prudent risk management.

**Industry stability.** Our assessment of industry stability relies on the sector being competitive and relatively concentrated, with five commercial banking groups holding 95% of the market. Banks' operations are mainly domestic and likely to remain so, in our view. We expect no new entrants to the local banking sector at this stage.

Both the government and the regulator aim to increase competition within the overall financial system to satisfy public discontent with the banking industry. Suggested reforms include at this stage forming a credit bureau and separating credit card companies from big banks. We believe that it is too early to tell whether those reforms will materialize and if so when. However, we believe that these reforms are unlikely to jeopardize the stability of the banking system.

Chart 5



**Market distortions.** There are no market distortions due to government or related financial institutions.

We think there is high competition from nonbank players, mainly insurance groups and institutional investors focusing in corporate lending. This follows structural and regulatory changes over the past decade: privatization of pension funds, banks selling their holdings in provident and mutual funds, regulatory limits on banks' credit concentrations, and increased capital demands. Currently, these distortions exist solely in corporate lending, while the banking system still has tight control on lending to the retail and SME sectors.

These will continue to weigh on banks' competitive positions and profitability from corporate lending. However, we expect more loan syndications and cooperation between bank and nonbanks in the future, given that banks have the knowledge and experience in financing corporates and complex deals, and nonbanks have the long-term funds to finance them.

Chart 6



Table 5

## Israel Competitive Dynamics

| (%)  | --Fiscal year end Dec. 31-- |      |      |      |       |
|--|-----------------------------|------|------|------|-------|
|  | 2011                        | 2012 | 2013 | 2014 | 2015f |
| ROE of domestic banks  | 9.5                         | 7.3  | 8.1  | 6.8  | 7.8   |
| ROE of corporate sector  | 20.1                        | 17.3 | 16   | 17   | N/A   |
| Systemwide return on average assets for banking sector           | 0.6                         | 0.5  | 0.6  | 0.5  | 0.5   |
| Net interest income to average earning assets for banking sector | 2.7                         | 2.6  | 2.5  | 2.4  | 2.4   |
| Market share of largest three banks                              | 74.9                        | 74.5 | 73.0 | 72.6 | 73.6  |

f—Forecast. ROE—Return on equity. N/A—Not applicable. Source: Standard & Poor's Financial Institutions Ratings.

### Systemwide funding: Strong core customer deposit base with marginal external funding

We assess this factor on the basis of the stability of a banking sector's funding sources and its access to alternative funding sources.

**Core customer deposits.** Israel's banking system funding benefits from a solid core customer deposit base, being a relatively closed banking system. Despite low interest rates, core customer deposits have increased annually by about 7% since year-end 2010. We believe local banks enjoy high confidence from local depositors, which, together with

their home bias, will likely continue supporting banks' deposit base in the future.

**External funding.** On aggregate, the banking sector has very low reliance on external funding, which we assume will continue in the future. External debt as a percentage of systemwide funding stood at 6% as of year-end 2014, and has been on decreasing trend in recent years. The very low reliance on external funding is mainly due to the sector's strong domestic customer deposit base and limited foreign operations. Local banks focused on their domestic activity while closing or selling some foreign operations in recent years.

**Domestic debt-capital markets.** Our view on Israel's domestic debt capital market is neutral for our overall assessment of the funding profile.

There is an active market for long-term issues by financial institutions and medium-term issues by corporate entities, although not as active and deep as in countries like the U.S., U.K., Germany, and Canada, among. Banking issues--both long and short term--are usually overbooked and enjoy relatively high trading volumes on the secondary market.

Private-sector debt issued in the domestic market stood at about 29% of GDP as of Dec. 31, 2014, and we expect it will remain at this level in the near future.

**Government role.** The Israeli banking system has faced no significant systemic crisis over the past 20 years requiring government support, including during the 2008-2009 financial crises. We assess the government as having a moderately successful track record of providing guarantees and liquidity during market crises. Central bank facilities are adequate in terms of their capacity to support the industry's funding needs, in our view.

**Table 6**

**Israel Systemwide Funding**

| (%)  | --Fiscal year end Dec. 31-- |      |       |       |       |
|--|-----------------------------|------|-------|-------|-------|
|  | 2011                        | 2012 | 2013  | 2014  | 2015f |
| Systemwide domestic core customer deposits/systemwide domestic loans                   | 86.3                        | 89.1 | 89.1  | 88.1  | 88.6  |
| Banking sector net external debt/systemwide domestic loans                             | 4.9                         | 1.4  | (0.4) | (4.7) | (2.7) |
| Systemwide domestic loans/consolidated systemwide assets                               | 60.0                        | 59.3 | 59.0  | 57.6  | 57.1  |
| Outstanding bonds and CPs issued by the private sector in the domestic markets/GDP (%) | 30.1                        | 30.5 | 28.9  | 28.7  | 29.3  |

f-forecast. CPs--Commercial papers. Source: Standard & Poor's Financial Institutions Ratings.

## Peer BICRA Scores

We rank a number of peers in BICRA group 4, including the Czech Republic, Kuwait, Malaysia, Mexico, New Zealand, Oman, Qatar, Slovakia, and Taiwan (see table 7). Israel's economic resilience score compares well with scores for most peers. Only New Zealand, Kuwait, and Qatar have stronger scores, mainly supported by their higher GDP per capita.

We consider that Israel has economic imbalances that are in line with most peers or lower, but greater economic imbalances than for other peers, such as Mexico, Malaysia, and Oman. We assess credit risks in the Israeli economy as in line with the Czech Republic, New Zealand, Qatar, and Taiwan, but lower than for most peers in BICRA group 4.

We view Israel's institutional framework and competitive dynamics as generally in line with most peers. Based on the sound funding profiles of domestic banks, Israel's systemwide funding is on a par with most peers'.

**Table 7****Israel Peer BICRA Scores**

|                               | Israel     | Slovakia   | Czech Republic | Taiwan            | Malaysia          | Mexico     | New Zealand | Kuwait            | Oman              | Qatar             |
|-------------------------------|------------|------------|----------------|-------------------|-------------------|------------|-------------|-------------------|-------------------|-------------------|
| BICRA group                   | 4          | 4          | 4              | 4                 | 4                 | 4          | 4           | 4                 | 4                 | 4                 |
| Economic risk score           | 4          | 5          | 4              | 3                 | 5                 | 5          | 4           | 4                 | 4                 | 4                 |
| Economic resilience           | Intermed.  | Intermed.  | Intermed.      | Intermed.         | High              | High       | Very low    | Low               | Intermed.         | Low               |
| Economic imbalances           | Intermed.  | Intermed.  | Intermed.      | Low               | Low               | Very low   | High        | Intermed.         | Low               | High              |
| Credit risk in the economy    | Intermed.  | High       | Intermed.      | Intermed.         | High              | High       | Intermed.   | High              | High              | Intermediate      |
| Industry risk score           | 4          | 4          | 4              | 5                 | 3                 | 3          | 4           | 5                 | 4                 | 5                 |
| Institutional framework       | Intermed.  | Intermed.  | Intermed.      | Intermed.         | Intermed.         | Intermed.  | Low         | Very high         | Intermed.         | Intermediate      |
| Competitive dynamics          | Intermed.  | Intermed.  | Intermed.      | Very high         | Intermed.         | Intermed.  | Low         | Intermed.         | Intermed.         | High              |
| Systemwide funding            | Intermed.  | Intermed.  | Intermed.      | Very low          | Low               | Low        | High        | Low               | Intermed.         | Intermed.         |
| Government support assessment | Supportive | Supportive | Supportive     | Highly supportive | Highly supportive | Supportive | Uncertain   | Highly supportive | Highly supportive | Highly supportive |

All assessments as of Oct. 7, 2015. Source: Standard & Poor's Financial Institutions Ratings.

**Government Support**

We classify the Israeli government as "supportive" toward its banking system, reflecting our expectation that it is willing and able to support the system if needed.

We think Israel's isolated geopolitical position, concentrated banking system, and fear of contingency risks would push the government to go great lengths to avoid any economic or financial crisis. However, we are unaware of any explicit policy of the government to support the banking system, and we think that the authorities would prefer market-led solutions to banking failures. We would reconsider our assessment of government support if regulatory authorities introduce an updated bank resolution framework, although we do not expect one in the near future.

**Table 8****Five Largest Israeli Financial Institutions By Total Assets**

|                           | Long-term counterparty credit rating/outlook | Israeli national scale rating/outlook | Total assets* (Bil. NIS) | Likelihood of government support | Market share (%) |
|---------------------------|--|---------------------------------------|--------------------------|----------------------------------|------------------|
| Bank Hapoalim B.M.        | A-/Stable                                    | ilAAA/Stable                          | 417                      | Moderately high                  | 29.8             |
| Bank Leumi le-Israel B.M. | A-/Stable                                    | ilAAA/Stable                          | 394                      | Moderately high                  | 28.1             |
| Israel Discount Bank Ltd. | BBB-/Positive                                | ilAA/Stable                           | 204                      | Moderate                         | 14.6             |
| Mizrahi Tefahot Bank Ltd. | N.R.   | ilAAA/Stable                          | 202                      | Moderate                         | 14.4             |

**Table 8****Five Largest Israeli Financial Institutions By Total Assets (cont.)**

|  |       |              |     |          |     |
|--|-------|--------------|-----|----------|-----|
| First International<br>Bank of Israel Ltd. | N.R.  | iiAA+/Stable | 121 | Moderate | 8.7 |
| Industry's total assets                    | 1,399 |              |     |          |     |

NIS--New Israeli shekel. N.R.--Not rated. \*Data as of June 30, 2015. Ratings as of Oct. 19, 2015. Source: Standard & Poor's Financial Institutions Ratings.

## Related Research And Criteria

### Related Criteria

- Sovereign Government Rating Methodology And Assumptions, June 24, 2013
- Analytical Linkages Between Sovereign And Bank Ratings, Dec. 6, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

### Related Research

- Banking Industry Country Risk Assessment Update: October 2015, Oct. 7, 2015
- Research Update: Israel 'A+/A-1' Ratings Affirmed On Expected Policy Continuity; Outlook Stable, Aug. 7, 2015
- S&P To Publish Economic And Industry Risk Trends For Banks, March 12, 2013

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