FitchRatings

12 DEC 2023

Fitch Maintains Israel Discount Bank's 'A' IDR on Rating Watch Negative

Fitch Ratings - London - 12 Dec 2023: Fitch Ratings is maintaining Israel Discount Bank Limited's (IDB) ratings including its 'A' Long-Term Issuer Default Rating (IDR) and its 'a' Government Support Rating (GSR), on Rating Watch Negative (RWN). The bank's Viability Rating (VR) has been affirmed at 'a-'.

Key Rating Drivers

State Support Drives IDRs: IDB's IDRs reflect Fitch's view of a very high probability that Israel (A+/F1+ on RWN) would provide support to IDB. Fitch believes Israel's ability and propensity to support IDB are very high, particularly given the systemic importance of the bank, which holds about 15% of the country's banking system assets.

Uncertain Economic Environment: The Israel-Hamas war has caused an initial contraction of economic activity. Our negative outlook on the operating environment reflects the uncertainty around the severity, duration and longer-term impact of the war. The Israeli government and the Bank of Israel have provided a variety of measures to support the economy and the most affected borrowers. Rising interest rates have supported net interest margins (NIM), but Fitch believes this benefit peaked in 1H23 and will subsequently recede due to rising deposit costs and the Bank of Israel's decision to maintain the key interest rate at 4.75% in November.

Diversified Business Model: IDB's VR reflects a strong franchise in retail and corporate banking in Israel. Asset quality and earnings will come likely under pressure from the Israel-Hamas war, but we expect them to remain resilient due to their strong starting position. The VR also reflects the bank's sound funding, given its diversified and granular deposit base, and adequate capitalisation. IDB is required to reduce its shareholding in its credit card subsidiary, Israel Credit Cards Ltd. (Cal), to increase competition, but this does not significantly alter our view of IDB's business profile.

Close Regulatory Oversight: IDB's underwriting standards are conservative, helped by tight regulatory limits and oversight from the Bank of Israel. Like other Israeli banks, IDB's material exposure to the construction and real estate sectors makes its asset quality vulnerable to a sharp decline in real estate prices. However, the majority of its exposure is to residential projects, which we expect to continue to perform adequately given high population growth and structural demand for housing in Israel.

Asset Quality Under Pressure: IDB's impaired loans ratio increased to 0.8% at end-September 2023 (0.6% at end-September 2022), due to increased interest rates and high inflation (albeit lower than many other countries). Disruption to economic activity in Israel due to the Israel-Hamas war and resulting uncertainty will likely weaken IDB's asset-quality metrics.

IDB took a loan impairment charge of ILS596 million in 3Q23 to reflect the impact of the war. IDB's asset-quality score is supported by its strong metrics and solid historical performance, with low arrears underpinned by its modest risk appetite. We forecast the impaired loans ratio to remain below 2% over the next two years due to sound underwriting and Israel's resilient operating environment.

Earnings to Weaken: Profitability has benefitted from increasing interest rates and loan growth (7.7% in 9M23), which boosted net interest income. However, we expect lower loan growth in 2024, which will only be partially offset by cost-efficiency programmes. We forecast a Fitch-calculated cost/income ratio of 48%, compared with an average of 73% over the past decade. We expect the bank's operating profit to remain above 2% of risk-weighted assets (RWAs) over the next two years, despite weakened credit demand, softening NIM and higher impairment charges.

Adequate Capital Buffers: Capital headroom is limited, with a common equity Tier 1 (CET1) ratio of 10.36% at end-3Q23. IDB had a 117bp buffer above its 9.19% regulatory CET1 requirement at end-9M23, which is small by international standards, but we view it as adequate for the high standardised risk-weights (end-9M23 RWAs/total assets: 68%) used by the Israeli banking sector. IDB has temporarily decreased its dividend pay-out ratio to 15% at 3Q23. Our capitalisation assessment also considers the bank's strong internal capital generation.

Large, Stable Deposit Base: IDB's solid and stable funding base consists mostly of customer deposits, which represented 88% of total non-equity funding at end-9M23, broadly in line with domestic and international peers'.

Since the outbreak of the Israel-Hamas war, the bank has not noted material change in its liquidity ratios or funding mix. Funding benefits from the bank's granular deposit base, split equally between retail and corporate deposits. Liquidity is soundly above the 100% minimum regulatory requirement, with a liquidity coverage ratio of 136% at end-9M23. IDB recently accessed international wholesale funding markets by issuing USD800 million senior unsecured notes.

Short-Term Support More Certain: IDB's 'F1+' Short-Term IDR is the higher of two possible options that map to an 'A' Long-Term IDR. This is because we view the sovereign's propensity to support as more certain in the near term.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

A downgrade of the sovereign rating is likely to result in a downgrade of IDB's GSR and IDRs.

A sharp deterioration of asset quality as a result of the war that would result in an impaired loan ratio of above 2% for an extended period, combined with the CET1 declining below current levels, and weakening internal capital generation, funding stability or liquidity could result in a VR downgrade. Given the bank's significant exposure to the real estate sector, a sharp decline in real estate prices would put pressure on asset quality and therefore on the VR.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

IDB's GSR and IDRs are likely to be affirmed and removed from RWN if Israel's ratings are affirmed and removed from RWN. An upgrade of the GSR and IDRs is unlikely due to the war and the RWN on the sovereign IDRs.

A VR upgrade is unlikely given the bank's geographical concentration and would require a material and structural improvement in profitability that allows the bank to generate stronger and more stable operating profit/RWAs while also maintaining materially higher capital ratios, which we do not expect.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Senior Debt

IDB's senior unsecured notes are rated in line with the Long-Term IDR as they constitute the bank's unsecured and unsubordinated obligations.

IDRs (xgs)

The Long-Term IDR (xgs) of 'A-(xgs)' is at the level of the VR. The Short-Term IDR (xsg) of 'F2(xgs)' is the lower of two possible options that map to a 'A-' Long-Term IDR (xgs) due to IDB's 'a-' funding & liquidity score.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Senior Debt

The rating on the senior unsecured notes is sensitive to a change in IDB's IDR.

IDRs (xgs)

The IDRs (xgs) are sensitive to changes in the bank's VR.

VR ADJUSTMENTS

The operating environment score of 'a' is below the 'aa' implied category score due to the following adjustment reasons: sovereign rating (negative), size and structure of economy (negative).

The business profile score of 'a-' is above the 'bbb' implied category score due to the following adjustment reason: market position (positive).

The capitalisation & leverage score of 'a-' is above the 'bbb' implied category score due to the following adjustment reason: leverage and risk-weight calculation (positive).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

IDB's IDRs and GSR reflect a very high probability of support from Israel.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visithttps://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Israel Discount Bank Limited	LT IDR	A ⬙	Rating Watch Maintained		A ⬙
	ST IDR	F1+ ⬙	Rating Watch Maintained		F1+ ⬙
	Viability	a-	Affirmed		a-
	Government Support	a ⬙	Rating Watch Maintained		a ⬙
	LT IDR (xgs)	A-(xgs)	Affirmed		A-(xgs)
	ST IDR (xgs)	F2(xgs)	Affirmed		F2(xgs)
• senior unsecured	LT	A ⬙	Rating Watch Maintained		A ⬙
• senior unsecured	LT (xgs)	A-(xgs)	Affirmed		A-(xgs)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◈	◆
STABLE	▣	

Applicable Criteria

[Bank Rating Criteria (pub.01 Sep 2023) (including rating assumption sensitivity)]

Additional Disclosures

Solicitation Status

Endorsement Status

Israel Discount Bank Limited	UK Issued, EU Endorsed

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