



## **Developments in the Banking System During the First Six Months of 2015**

In the first half of 2015, the banking system maintained its resilience and stability and presented adequate financial results, even though real economic activity in Israel and abroad continued to grow moderately and the interest rate environment remained low. The banking system's stability is supported by continued accumulation and strengthening of capital and the setting of capital targets that are appropriate to the banks' risk profile, by the adequate level of liquidity and the quality of Israeli banks' sources compared with the rest of the world, and by the strengthening of the banks' risk management framework and corporate governance. During the period reviewed, there was continued improvement in indices of portfolio credit quality and a continued trend of decline in concentration of banks' exposure to large borrowers. With that, the banking system faces several challenges. The share of credit to the construction and real estate industry and housing credit has been increasing for several years and in June 2015 reached 44 percent of the bank credit portfolio. The banks' high exposure to credit to the construction and real estate industry, to housing credit, and to consumer credit—and the correlations that exist between these types of credit—continue to pose a risk to the banking system. Likewise, the low interest rate environment, over time, is liable to encourage investors to take bigger risks in searching for returns, and increases the risk of overleverage by borrowers. An additional challenge facing the banking system is maintaining an appropriate level of profitability over time against the background of the interest rate environment and in view of the low operational efficiency of the system relative to other banking systems around the world. This challenge is expected to intensify in the coming years with enhanced competition that will be created due to the structural changes currently being advanced. In recent years an increase in operational risk has also been seen, particularly in view of increased cyber warfare against banks in Israel and abroad, data leakage risks, and required technological improvements in banks' core systems. In addition, banks' exposure to compliance risks and conduct and legal risks increased, against the background of numerous investigations of financial entities in Israel and abroad in a wide range of areas and the imposing of sanctions on some of them.

**Table 1**  
**Principal banking system indices, December 2001 to June 2015**

Year	Ratio of market value to book value <sup>a</sup> (MV/BV)	Average yield spread between bonds of the banks and government bonds <sup>b</sup> (percentage points)	Ratio of credit to GDP <sup>c,d</sup> (percent)	Rate of change in balance-sheet credit to the public <sup>e,f</sup> (percent)	Annual loan loss provision to total credit to the public <sup>e,f</sup> (percent)	Ratio of credit to deposits <sup>g</sup>	Capital adequacy ratio <sup>f</sup> (percent)	Common Equity/Core Tier I capital ratio <sup>h</sup> (percent)	Equity to total balance-sheet assets <sup>f</sup> (percent)	ROE <sup>f</sup> (percent)
2001	0.91	0.7	109.3	17.9	0.84	0.81	9.4		4.9	5.6
2002	0.56	0.8	104.6	-1.1	1.32	0.83	9.9		4.9	2.5
2003	0.85	0.7	102.9	-1.7	1.12	0.82	10.3		5.3	8.3
2004	1.06	0.7	98.5	0.1	0.92	0.80	10.7		5.5	12.4
2005	1.45	0.7	99.4	6.7	0.69	0.82	10.7		5.4	14.5
2006	1.33	0.6	94.3	2.0	0.52	0.80	10.8		5.9	17.3
2007	1.21	0.9	94.3	7.7	0.28	0.85	11.0		6.1	15.6
2008	0.56	2.0	98.6	10.4	0.72	0.90	11.2		5.7	0.3
2009	1.11	1.6	92.7	-1.4	0.75	0.86	13.7 <sup>i</sup>		6.3	8.8
2010	1.06	1.0	92.4	7.2	0.41	0.91	14.0	7.9 <sup>j</sup>		
2011	0.69	1.3	89.6	3.7	0.39	0.89	14.0	8.2	6.7	9.8
2012	0.78	1.0	85.6	2.1	0.41	0.87	14.9	8.0	6.2	10.2
2013	0.84	0.9	82.0	1.1	0.25	0.87	14.7	8.7	6.6	7.9
2014	0.72	0.9	82.6	4.3	0.15	0.85	14.2 <sup>k</sup>	9.3	6.9	8.7
Jun-15	0.83	1.0	81.9	3.6	0.11	0.86	13.9	9.2 <sup>k</sup>	7.0	10.9

<sup>a</sup> In calculating the MV/BV ratio, the book value (BV) of the five major banks is calculated with a delay of one quarter after the market value (MV).

<sup>b</sup> Average for December of that year.

<sup>c</sup> Measured using gross credit.

<sup>d</sup> Measured in relation to the entire banking system.

<sup>e</sup> Until December 2010—net credit to the public; from December 2011—gross credit to the public.

<sup>f</sup> The five banking groups.

<sup>g</sup> Calculated in relation to net credit.

<sup>h</sup> Until December 31, 2013, the banking corporations presented the Core Tier I capital ratio, in accordance with Basel II principles.

<sup>i</sup> Calculated in accordance with the Basel I principles.

<sup>j</sup> Calculated in accordance with Basel II principles.

<sup>k</sup> Calculated in accordance with Basel III principles in accordance with the transition directives.

SOURCE: Banking Supervision Department based on Central Bureau of Statistics, the Tel Aviv Stock Exchange, the Bank of Israel, published financial statements, and reports to the Banking Supervision Department.

## Table of Contents

<b>1. Main developments in balance sheet activity .....</b>	<b>4</b>
<b>2. Financial results .....</b>	<b>8</b>
<b>3. Capital adequacy .....</b>	<b>14</b>
<b>4. The credit portfolio and credit risk .....</b>	<b>20</b>
<b>5. Market risks .....</b>	<b>32</b>
<b>6. Liquidity risk .....</b>	<b>35</b>

## 1. Main developments in balance-sheet activity

The total aggregate balance sheet of Israeli banks increased in the first half of the year by a moderate annual rate (about 1 percent), to about NIS 1,399 billion (Table 2). The changes in the size and composition of the balance sheet were impacted this year by a range of factors that are exogenous to the system. The main ones are: (1) The housing market continued to present the trends that characterized it in recent years, which worked toward a further increase in the scope of credit to individuals, (2) Business activity moderated, acting toward a decline in the scope of business credit (and to offset the increase in overall credit balances), (3) The shekel appreciated vis-à-vis the dollar (by 3.1 percent) and euro (by 10.6 percent); net of the appreciation the balance sheet would have increased at a more rapid rate—about 2.4 percent<sup>1</sup>, and (4) regulation spurred continued growth in equity<sup>2</sup>, due to the need to met higher capital requirements.

On the **assets side**, the trend of growth in the amount of credit to the public continued (about 3.6 percent in annual terms), a trend that characterized 2014 (about 4.3 percent) as well. Credit increased despite the slowdown in the rate of growth, and derived entirely from expansion of housing credit and other consumer credit to individuals. It developed despite the decline in the volume of business credit. On the assets side there was also a decline in the cash and deposits at banks (about 13 percent in annual terms; Table 2). The decline in that item derived from, among other things, the low yield on cash and deposits at banks due to the low interest rate environment.<sup>3</sup>

The securities portfolio continued to display the volatility that has characterized it in recent years, increasing in the first half of the year by an annual rate of 17 percent, after declining by about 3.5 percent in the previous year (Table 3).

The portfolio grew against the background of the decline in cash and deposits at banks, and the increase derives mostly from a sharp increase in the Israeli government bonds component, but also from an increase in the volume of foreign government bonds. The securities portfolio was about 14.2 percent of the total balance sheet this year, compared with 13.2 percent last year (Figure 1).

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<sup>1</sup> During 2014, the balance sheet was positively affected by the depreciation of the shekel vs. the dollar.

<sup>2</sup> After deducting the effect of new accounting standards regarding employees' rights and discounting the costs of self-development of computer programs,

<sup>3</sup> Interest income in respect of cash and deposits at the Bank of Israel have continued to erode consistently over recent years, and in the second half of the year they were only NIS 78 million, while in the previous year they were about NIS 366 million and in the first half of 2013, they were about NIS 1.1 billion.

**Table 2**  
**Balance sheet of the total Israeli banking system<sup>a</sup>, December 2013– June 2015**

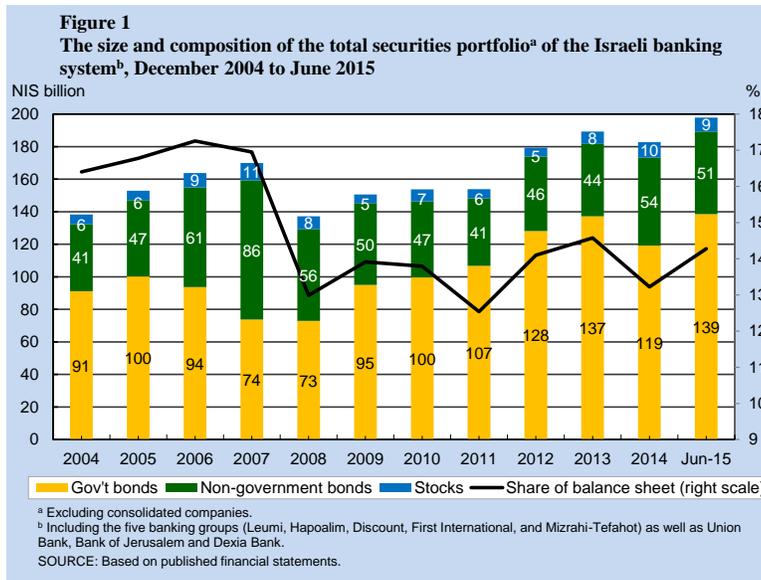
	In current prices				Rate of change in the past 12 months (percent)	Rate of change in the first half of 2015 (percent in annual terms)	Distribution	
	Dec-13	Jun-14	Dec-14	Jun-15			Dec-14	Jun-15
	(NIS million)						(percent)	
<b>Assets</b>								
Cash and deposits at banks	182,276	170,944	218,731	204,638	19.7	-12.9	15.7	14.6
Securities	189,946	182,358	183,515	199,034	9.1	16.9	13.2	14.2
Securities borrowed or bought under reverse repurchase agreements	3,090	3,839	3,708	4,474	16.5	41.3	0.3	0.3
<b>Credit to the public</b>	<b>866,149</b>	<b>874,571</b>	<b>903,524</b>	<b>919,686</b>	<b>5.2</b>	<b>3.6</b>	<b>64.9</b>	<b>65.7</b>
Allowance for credit losses	12,627	12,381	12,930	12,879	4.0	-0.8	0.9	0.9
Net credit to the public	853,522	862,190	890,594	906,807	5.2	3.6	63.9	64.8
Credit to governments	3,890	4,723	4,887	4,086	-13.5	-32.8	0.4	0.3
Investments in subsidiary and affiliated companies	3,936	2,360	2,941	1,626	-31.1	-89.4	0.2	0.1
Premises and equipment	13,185	12,128	12,332	12,045	-0.7	-4.7	0.9	0.9
Intangible assets	756	693	616	539	-22.1	-24.8	0.0	0.0
Assets in respect of derivative instruments	33,468	31,787	46,910	39,033	22.8	-33.6	3.4	2.8
Other assets	23,470	25,648	28,599	26,913	4.9	-11.8	2.1	1.9
<b>Total assets</b>	<b>1,307,538</b>	<b>1,296,670</b>	<b>1,392,832</b>	<b>1,399,195</b>	<b>7.9</b>	<b>0.9</b>	<b>100.0</b>	<b>100.0</b>
<b>Liabilities and equity</b>								
Deposits of the public	987,926	978,883	1,049,237	1,059,093	8.2	1.9	75.3	75.7
Deposits from banks	18,143	16,919	17,938	17,732	4.8	-2.3	1.3	1.3
Deposits from governments	2,711	2,700	2,411	2,600	-3.7	15.7	0.2	0.2
Securities lent or sold under repurchase agreements	4,538	4,546	6,070	5,723	25.9	-11.4	0.4	0.4
Bonds and subordinated notes	100,749	97,691	100,714	100,490	2.9	-0.4	7.2	7.2
Liabilities in respect of derivative instruments	36,520	33,807	47,175	42,183	24.8	-21.2	3.4	3.0
Other liabilities	67,697	71,991	76,721	73,793	2.5	-7.6	5.5	5.3
<b>Total liabilities</b>	<b>1,218,283</b>	<b>1,206,536</b>	<b>1,300,265</b>	<b>1,301,614</b>	<b>7.9</b>	<b>0.2</b>	<b>93.4</b>	<b>93.0</b>
Minority interest	1,606	1,611	1,733	1,768	9.7	4.0	0.1	0.1
Shareholders equity	87,649	88,522	90,834	95,813	8.2	11.0	6.5	6.8
Total equity	89,255	90,133	92,567	97,581	8.3	10.8	6.6	7.0
<b>Total liabilities and equity</b>	<b>1,307,538</b>	<b>1,296,670</b>	<b>1,392,832</b>	<b>1,399,195</b>	<b>7.9</b>	<b>0.9</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> On a consolidated basis. Includes the five banking groups (Leumi, Hapoalim, Discount, First International and Mizrahi-Tefahot), and the three independent banks (Union Bank, Bank of Jerusalem and Dexia Bank).  
SOURCE: Banking Supervision Department based on published financial statements.

Table 3  
Securities portfolio of the total banking system, 2014 and June 2015

	Bank Leumi						Bank Hapoalim						Discount Bank					
	December-14		June-15		December-14		June-15		December-14		June-15		December-14		June-15			
	Book value (NIS) (million)	Distribution (percent)																
<b>Securities</b>																		
Mortgage-backed / asset-backed securities <sup>a</sup>	22,205	42.6	34,341	53.0	39,920	67.9	66.6	19,391	51.9	19,785	54.1							
Of Israeli governments	5,220	10.0	8,070	12.5	3,541	6.0	3,401	6.0	1,887	4.2	1,887	5.2						
Of Israeli financial institutions	439	0.8	204	0.3	1,328	2.3	1,103	2.0	634	1.7	436	1.2						
Of foreign financial institutions	5,942	11.4	5,946	9.2	5,437	9.3	5,447	9.7	2,005	5.4	1,857	5.1						
Other - Israeli	9,125	17.5	8,637	13.3	-	-	-	-	9,059	24.3	8,326	22.8						
Other - foreign	1,226	2.4	1,553	2.4	2,304	3.9	2,050	3.6	809	2.2	871	2.4						
Stocks	3,262	6.3	1,362	2.1	3,635	6.2	4,104	7.3	2,206	5.9	2,091	5.7						
<b>Total securities, all types</b>	<b>52,113</b>	<b>100</b>	<b>64,810</b>	<b>100</b>	<b>58,778</b>	<b>100</b>	<b>56,232</b>	<b>100</b>	<b>37,353</b>	<b>100</b>	<b>36,590</b>	<b>100</b>						
	<b>First International</b>																	
Mortgage-backed securities <sup>a</sup>	13,631	95.6	13,895	87.8	7,817	62.3	9,523	61.7	108,783	59.3	121,834	61.2						
Of Israeli governments	115	0.8	1,436	9.1	128	1.0	1,141	7.4	11,149	6.1	17,158	8.6						
Of Israeli financial institutions	123	0.9	124	0.8	611	4.9	612	4.0	3,965	2.2	3,257	1.6						
Of foreign financial institutions	219	1.5	211	1.3	1,670	13.3	1,871	12.1	15,565	8.4	15,437	7.8						
Other - Israeli	-	-	-	-	633	5.0	414	2.7	18,904	10.3	17,463	8.8						
Other - foreign	66	0.5	63	0.4	95	0.8	260	1.7	9,322	5.1	7,950	4.0						
Stocks	104	0.7	104	0.7	311	2.5	272	1.8	9,544	5.2	9,247	4.6						
<b>Total securities, all types</b>	<b>14,259</b>	<b>100</b>	<b>15,833</b>	<b>100</b>	<b>12,554</b>	<b>100</b>	<b>15,434</b>	<b>100</b>	<b>183,515</b>	<b>100</b>	<b>199,034</b>	<b>100</b>						

<sup>a</sup> Mortgage-backed securities (MBS) issued by US government agencies (FNM A, FHLMC and GNM A) are included in the "Asset-backed or mortgage-backed" item whether there is a government guarantee for them or not.  
<sup>b</sup> Including the five banking groups as well as Union Bank, Bank of Jerusalem, and Dexia Israeli Bank.  
 SOURCE: Banking Supervision Department based on published financial statements.



On the **liabilities side**, total deposits of the public increased by about 2 percent (about NIS 10 billion, [Table 2](#)) during the first half of the year. This increase continues the growth from the second half of the previous year (about 7 percent), and it came despite the low interest rate environment and even though additional developments worked to reduce it.<sup>4</sup> Segmenting deposits by type indicates that the increase occurred even though there was a decrease in deposits by institutional investors (about 17 percent), and it derived from an increase in the scope of business deposits (about 5 percent) and in retail deposits (8 percent). The latter are a more stable source of liquidity. It can also be seen that there is some substitution between short term deposits and demand deposits: while the former have declined consistently (from 63 percent in December 2014 to around 56 percent in June 2015), the share of the latter has increased (from around 37 percent in December 2014 to around 44 percent in June 2015).

**Total equity** of the banking corporations continued to grow during the reviewed period as well, (after excluding the negative effect deriving from implementation of the directive related to workers' rights and the directive related to discounting the costs of self development of software), and totaled about NIS 98 billion (an increase of about NIS 5 billion, [Table 2](#)). Equity increased due to the accumulation of profits, and it was partially offset by some of the banks distributing dividends.

<sup>4</sup> This includes a decrease of about NIS 4 billion in the deposits of the public, due to the sale of Leumi Switzerland's retail operations, and an erosion in the value of foreign-currency deposits, due to the appreciation of the shekel vs. the dollar and the euro (excluding the effect of the appreciation, deposits of the public increased by about 4.4 percent).

## 2. Financial results

**Total net profit** of the five major banking groups totaled about NIS 4.7 billion during the first half of 2015, a sharp increase of about 37 percent over the corresponding period last year (Table 5). Net profit was adversely impacted this year by the moderate rate of growth in the economy and by the low interest rate environment—factors that worked to continue the erosion in net interest income—and by the increase in loan loss provisions. Nonetheless, profit increased, due to one-off noninterest income<sup>5</sup> and a decline in operational expenses.<sup>6</sup> Return on equity in the first half of the year was 10.9 percent<sup>7</sup> in annual terms (Figure 2), above the long-term average (about 9.5 percent).

**Net interest income** declined by about 1.8 percent compared with the first half of 2014, to about NIS 12.2 billion. The decline derived from the negative price effect being stronger than the positive quantity effect (Table 6). The price effect stems from the low interest rate environment, and is reflected this year mainly in the interest rate spread between credit activities and deposits—a spread that declined from 3.15 percent last year to about 2.95 percent this year—and in the continued erosion of interest income from deposits with the Bank of Israel (Table 7). The interest rate spread declined because the rate of income from credit activities declined by a much greater extent than the rate paid on deposits. The financial margin<sup>8</sup> continued to erode, from about 2.26 percent in June 2014 to around 2.06 percent this year.

**Loan loss provisions** totaled NIS 0.5 billion in the first half of 2015, compared with near-zero provisions in the first half of last year<sup>9</sup> (Table 5). They constituted about 0.1 percent of balance-sheet credit—a slightly lower share than the average over the past five years (about 0.3 percent). The increase in provisions encompassed most of the banking groups, though to varying extents.

**Noninterest income** increased during the reviewed period by about 16 percent compared with the corresponding period of last year, and totaled about NIS 10.25 billion (Table 5). The increase derives mainly from the sharp growth of **noninterest financing income**, which was about NIS 2.5 billion over the half, while during the entire year of 2014 it was only NIS 2.7 billion. This item, as a share of total assets, has been growing since 2012 (Figure 3). The source is the increase in sales of equities<sup>10</sup> and the continued trend of realizing securities in the available for sale portfolio. In addition, **income from fees** increased by about 2.9 percent relative to the corresponding period of last year, and totaled about NIS 7.5 billion. The increase occurred due to the increase in income from fees in respect of handling credit and in arranging contracts and due to the increase in income from fees in respect of capital market activity and financing transactions, and despite the decline in revenue from account management fees.

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<sup>5</sup> In the first half of 2015, the Leumi Group had a (pre-tax) gain of NIS 522 million in respect of the sale of “Israel Corp.” shares and of NIS 288 million in respect of the sale of “Mobileye” shares.

<sup>6</sup> In the first half of 2014, operating expenses reached relatively high levels because Leumi Group set aside a provision of NIS 529 million in respect of the investigation by US authorities, and because Discount Group implemented a voluntary retirement plan at a cost of NIS 306 million.

<sup>7</sup> Excluding the effect of the profit (after tax) derived from the sale of Israel Corp. shares, the return on equity for the total system declines to 10.0 percent.

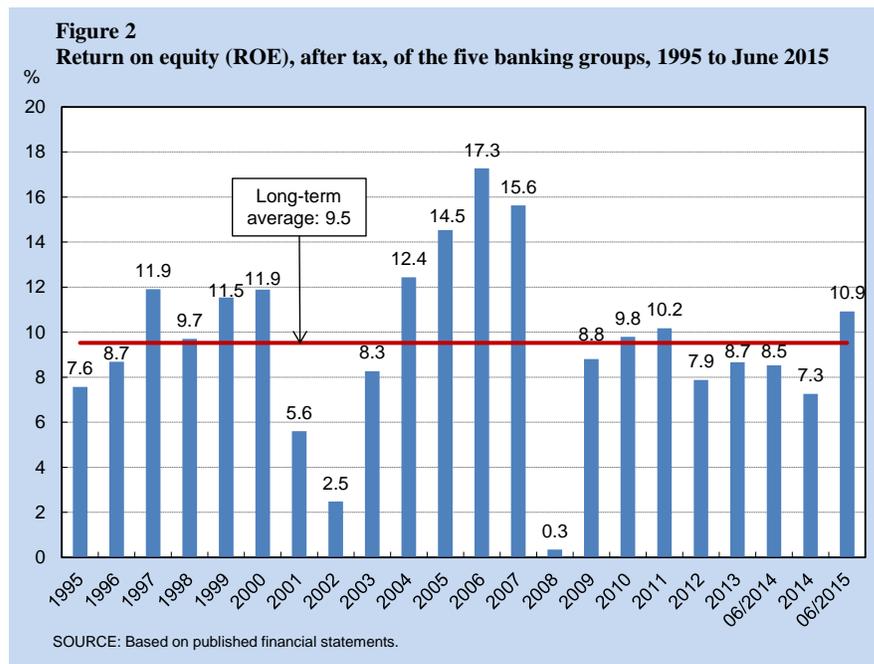
<sup>8</sup> Net interest income to total interest-bearing assets.

<sup>9</sup> The near-zero expenditure in the first half of 2014 derived mainly from the increase in the volume of recovery of debts written off in the previous year and from the decrease in individual allowances and in allowances in respect of debts assessed on a group basis.

<sup>10</sup> See footnote 1.

**Total operating and other expenses** totaled about NIS 14.5 billion in the first half, similar to the average over recent years. This figure reflects a decline of about 5.7 percent compared to the first half of 2014<sup>11</sup> (Table 5). **Salary and related expenses** declined by 5.2 percent relative to the first half of 2014, and totaled NIS 8.7 billion.

Average **operating efficiency** of the five major banking groups improved during the period reviewed: The operating efficiency ratio<sup>12</sup> declined from about 72.2 percent to around 64.4 percent and the average cost<sup>13</sup> declined from about 2.47 percent to about 2.17 percent (Table 4). The improvement derives from an increase in noninterest income, and from a decline in operating expenses, relative to the preceding year. Nonetheless, when looking at the average over the past 3 years (2012–14), the ratio is found to be high in international comparison (Figure 4).

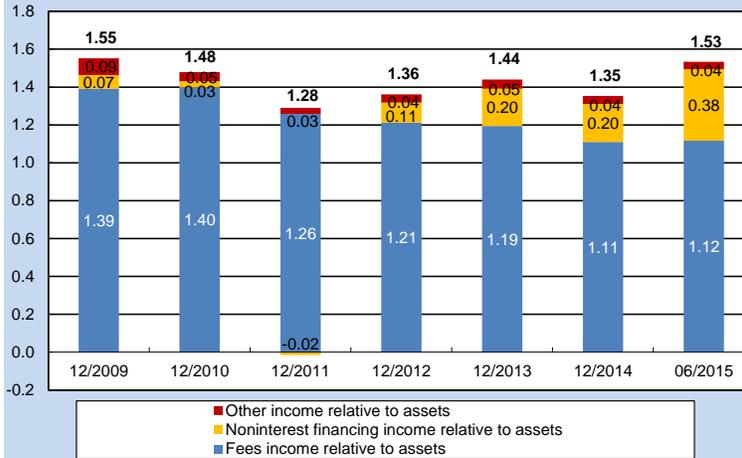


<sup>11</sup> See footnote 2.

<sup>12</sup> The ratio of total operating and other expenses to total net interest income and noninterest income (cost to income ratio).

<sup>13</sup> The ratio of total operating and other expenses to average asset balance (average cost ratio).

**Figure 3**  
Composition of noninterest income relative to total assets, the five banking groups, December 2009 to June 2015



SOURCE: Based on published financial statements.

**Table 4**  
Average cost<sup>a</sup> and efficiency ratio<sup>b</sup> of the banking corporations in Israel, December 2013 to June 2015  
(percent)

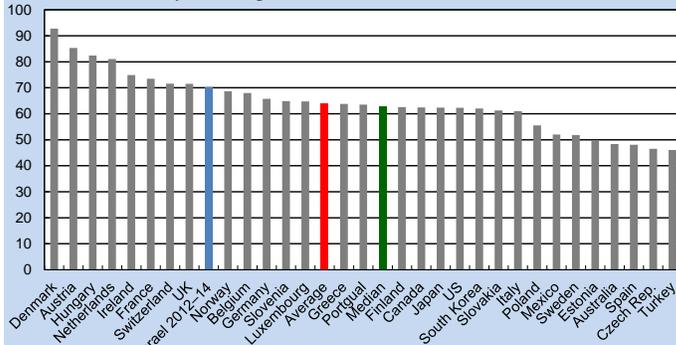
Bank	Average cost ratio				Efficiency ratio			
	Dec-13	Dec-14	Jun-14	Jun-15	Dec-13	Dec-14	Jun-14	Jun-15
Leumi	2.38	2.43	2.59	2.22	69.4	74.9	76.2	63.5
Hapoalim	2.39	2.33	2.37	2.08	66.2	65.5	63.9	58.3
Discount	2.97	3.14	3.18	2.78	78.5	87.0	86.8	76.0
Mizrabi-Tefahot	1.73	1.61	1.59	1.58	59.6	60.9	60.5	60.7
First International	2.66	2.54	2.58	2.21	74.4	77.3	75.9	74.8
<b>Average of the five banking groups</b>	<b>2.41</b>	<b>2.40</b>	<b>2.47</b>	<b>2.17</b>	<b>69.3</b>	<b>72.5</b>	<b>72.2</b>	<b>64.4</b>
Union Bank	2.07	2.08	2.11	2.00	79.5	87.9	86.2	81.1
Bank of Jerusalem	2.23	2.56	2.50	2.59	78.8	75.8	74.7	75.0
Dexia Israel Bank	0.58	0.51	0.52	0.58	37.3	32.2	31.3	32.0
<b>Total</b>	<b>2.39</b>	<b>2.38</b>	<b>2.45</b>	<b>2.16</b>	<b>69.5</b>	<b>72.7</b>	<b>72.3</b>	<b>64.8</b>

<sup>a</sup> The ratio between total operating and other expenses and the average balance of assets (average cost).

<sup>b</sup> The ratio between total operating and other costs and total net interest income and non-interest income (cost to income).

SOURCE: Banking Supervision Department based on published financial statements.

**Figure 4**  
International comparison of the banking system efficiency ratio<sup>a</sup> in OECD countries<sup>b</sup>, three-year average<sup>c</sup>



<sup>a</sup> Total operating expenses out of net total interest income and noninterest income.

<sup>b</sup> Chile was not included due to a lack of data.

<sup>c</sup> Data are calculated as the average for the years 2012–2014. The data for Finland, France and Germany are calculated as the average for the years 2012–2013. The data for Israel are calculated as the average of the five banking groups for the years 2012–2014, as well as the data for June 2015.

SOURCE: Foreign countries—International Monetary Fund; Israel—Based on published financial statements.

**Table 5**  
**Main items in consolidated profit and loss statements of the five banking groups, June 2014 to June 2015**  
(NIS million, at current prices)

	Leumi				Hapoalim				Discount			
				% change in				% change in				% change in
	Dec-14	Jun-14	Jun-15	June 2015 compared with June 2014	Dec-14	Jun-14	Jun-15	June 2015 compared with June 2014	Dec-14	Jun-14	Jun-15	June 2015 compared with June 2014
Interest income	10,012	5,013	4,320	-13.8	10,673	5,422	4,802	-11.4	5,736	2,905	2,632	-9.4
Interest expenses	2,649	1,351	804	-40.5	2,905	1,516	993	-34.5	1,518	787	517	-34.3
<b>Net interest income</b>	<b>7,363</b>	<b>3,662</b>	<b>3,516</b>	<b>-4.0</b>	<b>7,768</b>	<b>3,906</b>	<b>3,809</b>	<b>-2.5</b>	<b>4,218</b>	<b>2,118</b>	<b>2,115</b>	<b>-0.1</b>
Loan loss provisions	472	-67	93	-	425	-18	273	-	164	40	4	-90.0
<b>Net interest income after loan loss provisions</b>	<b>6,891</b>	<b>3,729</b>	<b>3,423</b>	<b>-8.2</b>	<b>7,343</b>	<b>3,924</b>	<b>3,536</b>	<b>-9.9</b>	<b>4,054</b>	<b>2,078</b>	<b>2,111</b>	<b>1.6</b>
<b>Noninterest income</b>	<b>5,141</b>	<b>2,652</b>	<b>3,408</b>	<b>28.5</b>	<b>6,254</b>	<b>3,068</b>	<b>3,562</b>	<b>16.1</b>	<b>3,153</b>	<b>1,520</b>	<b>1,635</b>	<b>7.6</b>
<i>of which: Noninterest financing income</i>	795	495	1,214	145.3	916	472	835	76.9	549	238	287	20.6
<i>of which: stocks<sup>a</sup></i>	485	151	1,068	607.3	136	110	172	56.4	63	81	48	-40.7
<i>bonds<sup>b</sup></i>	628	347	16	-95.4	343	195	381	95.4	307	157	166	5.7
<i>activity in derivative instruments<sup>c</sup></i>	1,906	-307	-974	-	1,933	32	-476	-	854	-172	-663	-
<i>exchange rate differentials</i>	-2,252	304	1,104	-	-1,496	135	758	-	-675	172	725	-
<i>of which: Fees</i>	4,167	2,080	2,086	0.3	5,207	2,547	2,652	4.1	2,586	1,268	1,312	3.5
<b>Total operating and other expenses</b>	<b>9,371</b>	<b>4,814</b>	<b>4,397</b>	<b>-8.7</b>	<b>9,183</b>	<b>4,453</b>	<b>4,296</b>	<b>-3.5</b>	<b>6,414</b>	<b>3,157</b>	<b>2,851</b>	<b>-9.7</b>
<i>of which: salaries and related expenses</i>	5,151	2,736	2,763	1.0	5,343	2,600	2,509	-3.5	4,086	2,066	1,703	-17.6
<b>Pre-tax profit</b>	<b>2,661</b>	<b>1,567</b>	<b>2,434</b>	<b>55.3</b>	<b>4,414</b>	<b>2,539</b>	<b>2,802</b>	<b>10.4</b>	<b>793</b>	<b>441</b>	<b>895</b>	<b>102.9</b>
Income tax provision	1,278	702	862	22.8	1,713	1,048	1,142	9.0	271	145	344	137.2
<b>After tax profit</b>	<b>1,383</b>	<b>865</b>	<b>1,572</b>	<b>81.7</b>	<b>2,701</b>	<b>1,491</b>	<b>1,660</b>	<b>11.3</b>	<b>522</b>	<b>296</b>	<b>551</b>	<b>86.1</b>
<b>Net income attributed to shareholders</b>	<b>1,413</b>	<b>820</b>	<b>1,700</b>	<b>107.3</b>	<b>2,713</b>	<b>1,508</b>	<b>1,694</b>	<b>12.3</b>	<b>505</b>	<b>296</b>	<b>522</b>	<b>76.4</b>
<b>Total after-tax ROE (percent)</b>	<b>5.40</b>	<b>6.60</b>	<b>13.10</b>		<b>9.07</b>	<b>10.60</b>	<b>11.00</b>		<b>4.20</b>	<b>5.00</b>	<b>8.30</b>	
<b>Total ROA (percent)</b>	<b>0.37</b>	<b>0.44</b>	<b>0.86</b>		<b>0.69</b>	<b>0.80</b>	<b>0.82</b>		<b>0.25</b>	<b>0.30</b>	<b>0.51</b>	
	Mizrahi-Tefahot				First International				Total for the five groups			
				% change in				% change in				% change in
	Dec-14	Jun-14	Jun-15	June 2015 compared with June 2014	Dec-14	Jun-14	Jun-15	June 2015 compared with June 2014	Dec-14	Jun-14	Jun-15	June 2015 compared with June 2014
Interest income	5,347	2,630	2,401	-8.7	2,664	1,383	1,112	-19.6	34,432	17,353	15,267	-12.0
Interest expenses	1,972	994	620	-37.6	563	299	155	-48.2	9,607	4,947	3,089	-37.6
<b>Net interest income</b>	<b>3,375</b>	<b>1,636</b>	<b>1,781</b>	<b>8.9</b>	<b>2,101</b>	<b>1,084</b>	<b>957</b>	<b>-11.7</b>	<b>24,825</b>	<b>12,406</b>	<b>12,178</b>	<b>-1.8</b>
Loan loss provisions	173	18	75	316.7	89	3	26	766.7	1,323	-24	471	-
<b>Net interest income after loan loss provisions</b>	<b>3,202</b>	<b>1,618</b>	<b>1,706</b>	<b>5.4</b>	<b>2,012</b>	<b>1,081</b>	<b>931</b>	<b>-13.9</b>	<b>23,502</b>	<b>12,430</b>	<b>11,707</b>	<b>-5.8</b>
<b>Noninterest income</b>	<b>1,612</b>	<b>781</b>	<b>832</b>	<b>6.5</b>	<b>1,667</b>	<b>814</b>	<b>813</b>	<b>-0.1</b>	<b>17,827</b>	<b>8,835</b>	<b>10,250</b>	<b>16.0</b>
<i>of which: Noninterest financing income</i>	173	79	80	1.3	230	89	103	15.7	2,663	1,373	2,519	83.5
<i>of which: stocks<sup>a</sup></i>	11	7	3	-57.1	60	18	36	100.0	755	367	1,327	261.6
<i>bonds<sup>b</sup></i>	114	45	88	95.6	197	117	54	-53.8	1,589	861	705	-18.1
<i>activity in derivative instruments<sup>c</sup></i>	1,614	-87	-563	-	870	-122	-226	-	7,177	-656	-2,902	-
<i>exchange rate differentials</i>	-1,566	114	552	-	-897	75	239	-	-6,886	800	3,378	-
<i>of which: Fees</i>	1,395	686	721	5.1	1,375	682	701	2.8	14,730	7,263	7,472	2.9
<b>Total operating and other expenses</b>	<b>3,039</b>	<b>1,462</b>	<b>1,586</b>	<b>8.5</b>	<b>2,912</b>	<b>1,440</b>	<b>1,324</b>	<b>-8.1</b>	<b>30,919</b>	<b>15,326</b>	<b>14,454</b>	<b>-5.7</b>
<i>of which: salaries and related expenses</i>	1,866	912	958	5.0	1,780	884	786	-11.1	18,226	9,198	8,719	-5.2
<b>Pre-tax profit</b>	<b>1,775</b>	<b>937</b>	<b>952</b>	<b>1.6</b>	<b>767</b>	<b>455</b>	<b>420</b>	<b>-7.7</b>	<b>10,410</b>	<b>5,939</b>	<b>7,503</b>	<b>26.3</b>
Income tax provision	657	347	351	1.2	328	190	178	-6.3	4,247	2,432	2,877	18.3
<b>After tax profit</b>	<b>1,118</b>	<b>590</b>	<b>601</b>	<b>1.9</b>	<b>439</b>	<b>265</b>	<b>242</b>	<b>-8.7</b>	<b>6,163</b>	<b>3,507</b>	<b>4,626</b>	<b>31.9</b>
<b>Net income attributed to shareholders</b>	<b>1,092</b>	<b>576</b>	<b>578</b>	<b>0.3</b>	<b>455</b>	<b>269</b>	<b>243</b>	<b>-9.7</b>	<b>6,178</b>	<b>3,469</b>	<b>4,737</b>	<b>36.6</b>
<b>Total after-tax ROE (percent)</b>	<b>10.60</b>	<b>11.90</b>	<b>10.80</b>		<b>6.80</b>	<b>8.30</b>	<b>7.20</b>		<b>7.26</b>	<b>8.53</b>	<b>10.92</b>	
<b>Total ROA (percent)</b>	<b>0.58</b>	<b>0.63</b>	<b>0.58</b>		<b>0.40</b>	<b>0.48</b>	<b>0.41</b>		<b>0.48</b>	<b>0.56</b>	<b>0.71</b>	

<sup>a</sup> Includes profit/loss from investment in shares available for sale, profit from the sale of subsidiary companies, dividends and profit/loss from adjustments to fair value of tradable shares.

<sup>b</sup> Includes profit/loss from investment in bonds held to maturity and available for sale and income/expenses realized and notes realized from adjustments to fair value of tradable bonds.

<sup>c</sup> Includes derivative instruments not designated for hedging ratios (ALM instruments) and other derivative instruments.

SOURCE: Banking Supervision Department based on published financial statements.

**Table 6**  
**The effect of quantity<sup>a</sup> and price<sup>b</sup> on interest income and expenses, Israel and abroad the five banking groups, June 2014 to June 2015**  
**(NIS million)**

	Jun 2015								
	Quantity effect			Price effect			Net change		
	Assets side	Liabilities side	Net	Assets side	Liabilities side	Net	Assets side	Liabilities side	Net
Credit to the public / deposits of the public in Israel	608	-4	612	-2,128	-1,419	-709	-1,520	-1,423	-97
Credit to the public / deposits of the public abroad	123	14	109	-43	-5	-38	80	9	71
Total credit to the public / deposits of the public	731	10	721	-2,171	-1,424	-747	-1,440	-1,414	-26
Other interest-bearing assets / liabilities in Israel	72	9	63	-694	-445	-249	-622	-436	-186
Other interest-bearing assets / liabilities abroad	35	3	32	-59	-11	-48	-24	-8	-16
Total other interest-bearing assets / liabilities	107	12	95	-753	-456	-297	-646	-444	-202
Total interest income / expenses	838	22	816	-2,924	-1,880	-1,044	-2,086	-1,858	-228
	Jun 2014								
	Quantity effect			Price effect			Net change		
	Assets side	Liabilities side	Net	Assets side	Liabilities side	Net	Assets side	Liabilities side	Net
Credit to the public / deposits of the public in Israel	302	36	266	-2,853	-2,224	-629	-2,551	-2,188	-363
Credit to the public / deposits of the public abroad	-71	-6	-65	30	-252	282	-41	-258	217
Total credit to the public / deposits of the public	231	30	201	-2,823	-2,476	-347	-2,592	-2,446	-146
Other interest-bearing assets / liabilities in Israel	41	-98	139	-865	-860	-5	-824	-958	134
Other interest-bearing assets / liabilities abroad	-53	-29	-24	41	-23	64	-12	-52	40
Total other interest-bearing assets / liabilities	-12	-127	115	-824	-883	59	-836	-1,010	174
Total interest income / expenses	219	-97	316	-3,647	-3,359	-288	-3,428	-3,456	28
	Dec 2014								
	Quantity effect			Price effect			Net change		
	Assets side	Liabilities side	Net	Assets side	Liabilities side	Net	Assets side	Liabilities side	Net
Credit to the public / deposits of the public in Israel	824	31	793	-6,230	-4,812	-1,418	-5,406	-4,781	-625
Credit to the public / deposits of the public abroad	-86	-13	-73	94	-54	148	8	-67	75
Total credit to the public / deposits of the public	738	18	720	-6,136	-4,866	-1,270	-5,398	-4,848	-550
Other interest-bearing assets / liabilities in Israel	30	-115	145	-1,893	-1,859	-34	-1,863	-1,974	111
Other interest-bearing assets / liabilities abroad	-69	-64	-5	81	13	68	12	-51	63
Total other interest-bearing assets / liabilities	-39	-179	140	-1,812	-1,846	34	-1,851	-2,025	174
Total interest income / expenses	699	-161	860	-7,948	-6,712	-1,236	-7,249	-6,873	-376

a The quantity effect is calculated as the change in the balance-sheet balance (current year versus previous year) multiplied by the price during the current period, divided by 1,000.

b The price effect is calculated as the change in price (current year versus previous year) multiplied by the balance-sheet balance for the corresponding period in the previous year, divided by 1,000.

SOURCE: Banking Supervision Department based on published financial statements.

Table 7

**Average balances, interest income and expense rates, and interest rate gap in respect of assets and liabilities, the five banking groups, June 2014 to June 2015 (NIS million, percent in annual terms)**

		June 2015							
Assets				Liabilities					
	Average yearly balance (NIS million)	Interest income	Income rate (%)		Average yearly balance (NIS million)	Interest expenses	Expense rate (%)	Interest rate gap	
Credit to the public	834,945	13,972	3.37	Deposits of the public	760,175	-1,577	-0.42	2.95	
Deposits at banks	32,363	112	0.69	Deposits from banks	16,813	-47	-0.56	0.13	
Deposits at central banks	141,888	113	0.16	Deposits from central banks	437	-	-	0.16	
Bonds	171,944	1,012	1.18	Bonds	90,466	-1,368	-3.05	-1.87	
Other assets <sup>a</sup>	9,271	58	1.26	Other liabilities <sup>a</sup>	10,517	-97	-1.84	-0.58	
Total interest-bearing assets	1,190,411	15,267	2.58	Total interest-bearing liabilities	878,408	-3,089	-0.70	1.88	
Net yield on interest-bearing assets (net interest margin) <sup>b</sup>	1,190,411	12,178	2.06						
		June 2014							
Assets				Liabilities					
	Average yearly balance (NIS million)	Interest income	Income rate (%)		Average yearly balance (NIS million)	Interest expenses	Expense rate (%)	Interest rate gap	
Credit to the public	790,741	15,412	3.94	Deposits of the public	755,717	-2,991	-0.79	3.15	
Deposits at banks	24,086	110	0.92	Deposits from banks	15,122	-92	-1.22	-0.30	
Deposits at central banks	108,897	366	0.67	Deposits from central banks	20	-	-	0.67	
Bonds	172,666	1,399	1.63	Bonds	92,209	-1,749	-3.83	-2.20	
Other assets <sup>a</sup>	8,952	70	1.57	Other liabilities <sup>a</sup>	8,965	-115	-2.55	-0.98	
Total interest-bearing assets	1,105,342	17,353	3.16	Total interest-bearing liabilities	872,033	-4,947	-1.14	2.02	
Net yield on interest-bearing assets (net interest margin) <sup>b</sup>	1,105,342	12,406	2.26						
		December 2014							
Assets				Liabilities					
	Average yearly balance (NIS million)	Interest income	Income rate (%)		Average yearly balance (NIS million)	Interest expenses	Expense rate (%)	Interest rate gap	
Credit to the public	801,005	30,939	3.86	Deposits of the public	756,110	-5,493	-0.73	3.13	
Deposits at banks	26,670	224	0.84	Deposits from banks	15,909	-174	-1.09	-0.25	
Deposits at central banks	111,345	551	0.49	Deposits from central banks	89	-	-	0.49	
Bonds	167,933	2,584	1.54	Bonds	92,454	-3,694	-4.00	-2.46	
Other assets <sup>a</sup>	10,089	134	1.33	Other liabilities <sup>a</sup>	9,510	-246	-2.59	-1.26	
Total interest-bearing assets	1,117,042	34,432	3.08	Total interest-bearing liabilities	874,072	-9,607	-1.10	1.98	
Net yield on interest-bearing assets (net interest margin) <sup>b</sup>	1,117,042	24,825	2.22						

a Other liabilities and assets also include, among other things, credit to the government and government deposits, and securities loaned or borrowed in repurchase agreements.

b The net interest margin is the ratio between net interest income and total interest-bearing assets. The spread is shown in percent.

SOURCE: Banking Supervision Department based on published financial statements.

### 3. Capital adequacy

In recent years, the banking system has been in a process of building up capital that has led to its improved resilience and stability, and this trend continued in the reviewed period: **Total equity** of the five banking groups increased in the first half of 2015 by 5.5 percent, due to profits accumulated by the banks and the increase in the market value of the available for sale securities portfolio attributed to the capital fund, and after some of the banks distributed a dividend<sup>14</sup> (Table 8). Due to the continued expansion of capital, its share out of the total balance sheet in June 2015 reached 7 percent, similar to the generally accepted level among OECD countries (Figure 5).

**Common Equity Tier 1 Capital** was also affected during this period by the implementation of the transitional provisions related to employee rights and by the continued implementation of transitional provisions related to Basel III, and it increased by 2.5 percent, a development that led to an increase of 0.2 percentage points in the Common Equity Tier 1 Capital ratio, to 9.5 percent (Table 8, Figure 6).

The Common Equity Tier 1 Capital ratio in Israel's banking system is lower than generally accepted in other OECD banking systems. One of the reasons for this is that banks in Israel allocate capital in accordance with the standard and conservative approach, and not according to advanced approaches. The differences in approaches impact on the credit risk weighted assets and are reflected in the differences among banking systems regarding the ratio of risk assets to total assets (Figure 7).

The **capital base** contracted by 2 percent in the first half of the year, as a result of a decline in Tier 2 capital and in Additional Tier 1 capital, due to a reduction in the balance of capital instruments that no longer qualify as regulatory capital, and the overall capital ratio declined by 0.2 percentage points, to 13.9 percent. The banks are gradually reducing their balance of capital instruments that are no longer eligible as regulatory capital, through January 1, 2022, in accordance with the transition provisions. At the same time, they are expected to issue capital instruments in the near future that are eligible to be considered as part of Tier 2 capital.

Credit risk weighted assets increased slightly during the reviewed period, in view of the expansion of the bank credit portfolio (Table 8). However, the change in the composition of the portfolio—an increase in the share of retail credit and a decline in the share of business credit—led to a decline in the ratio of risk components to total components (Table 9).

In the coming years, Israel's banking system is expected to continue expanding and strengthening capital. First, capital targets are expected to increase gradually through January 1, 2017, due to the directive on the issue of increasing capital buffers against the housing credit portfolio. Second, banks set Common Equity Tier 1 Capital targets for themselves that are higher than those set in the March 2012 directive, and in any case the Supervisor of Banks is permitted to require of banks, at any time, differential targets of Common Equity Tier 1 Capital, in accordance with the risk profile derived for them from the Supervisory Review and Evaluation Process (SREP). Finally, as noted, the banks are expected to issue in the near future capital instruments that will be considered as part of Tier 2 capital.

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<sup>14</sup> We are restating common equity for December 2014 due to the retroactive implementation of US Generally Accepted Accounting Principles regarding employee rights.

Due to the Basel III reform, the Basel Committee in January 2014 published the work framework and disclosure requirements for the Leverage Ratio.<sup>15</sup> This publication defined a leverage ratio that is simple, transparent, and not risk-based, with the objective of creating complementary and reliable measurement of risk-based capital requirements. In addition, it set a minimum leverage ratio of 3 percent, although some supervisory authorities around the world set higher requirements. In April 2015 the Banking Supervision Department published a directive adopting the Basel III framework regarding the Leverage Ratio. Accordingly, the directive defined the Leverage Ratio as the ratio between Tier 1 capital and total exposure—that is, the amount of balance sheet exposures, exposures to derivatives and to securities-financing transactions, and to off-balance sheet items. The directive also established that all banking corporations have to meet, on a consolidated basis, a leverage ratio of not less than 5 percent by January 1, 2018.<sup>16</sup> When a banking corporation's total balance sheet assets on a consolidated basis are at least 20 percent of total balance sheet assets in the banking system, it is required to meet, at that time, a leverage ratio of at least 6 percent.<sup>17</sup> Beginning on April 1, 2015, the banking corporations are required to include on their financial statements a disclosure regarding the leverage ratio. As of June 2015, all five banking groups meet the required ratio, and some are at an even higher level (Table 10).

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<sup>15</sup> Basel III Leverage Ratio Framework and Disclosure Requirements (January 2014).

<sup>16</sup> If a banking corporation meets the Leverage Ratio requirement as of the date of publication of the directive, it is not permitted to decline from the threshold set in it. If a banking corporation does not meet the requirement on the day the directive is published, it is required to increase the ratio by fixed quarterly increments until January 1, 2018.

<sup>17</sup> As of June 2015, the Leumi and Hapoalim groups are required to meet the 6 percent ratio, as their total balance-sheet assets, on a consolidated basis, are at least 20 percent of the total balance sheet assets in the banking system.

**Table 8**  
**Distribution of capital and capital ratios at the five banking groups<sup>a</sup>, December 2014 and June 2015**

	Leumi		Hapoalim		Discount		Mizrahi Tefahot		First International		The five groups	
	Dec-14	Jun-15	Dec-14	Jun-15	Dec-14	Jun-15	Dec-14	Jun-15	Dec-14	Jun-15	Dec-14	Jun-15
Equity <sup>b,c</sup>	26,138	28,607	31,216	32,490	12,889	13,460	11,304	11,796	7,089	7,235	88,706	93,588
Common Equity Tier 1 capital / Core Tier 1 capital <sup>d</sup>	27,725	28,613	31,482	32,370	13,284	13,353	11,273	11,703	7,173	7,213	90,935	93,252
Tier 1 capital <sup>d</sup>	14,684	13,355	16,041	14,612	6,285	5,683	4,883	4,473	3,357	2,878	45,250	41,001
Capital base	42,407	41,968	49,477	48,691	20,994	20,283	16,156	16,176	10,530	10,091	139,564	137,209
Total balance sheet	396,922	395,751	408,633	416,614	207,185	203,662	198,513	201,764	117,823	121,440	1,324,476	1,337,231
Credit risk	273,881	274,341	311,329	314,258	126,716	125,008	116,159	117,255	66,148	66,820	894,233	898,182
Market risks	10,839	6,000	5,289	6,517	2,629	2,677	1,020	1,123	1,226	1,281	20,938	17,608
Operational risk	20,317	20,103	22,275	22,496	12,345	12,404	7,383	7,443	6,459	6,177	68,779	68,623
Risk-weighted assets	305,037	300,454	338,873	343,771	141,600	140,089	124,562	125,821	73,833	74,278	983,995	984,413
Common Equity Tier 1 / Core Tier 1 capital <sup>d</sup> ratio	9.1	9.5	9.3	9.4	9.4	9.5	9.1	9.3	9.7	9.7	9.2	9.5
Tier 1 capital ratio	9.1	9.5	9.9	9.9	10.4	10.4	9.1	9.3	9.7	9.7	9.6	9.8
Tier 2 capital ratio	4.8	4.4	4.7	4.3	4.4	4.1	3.9	3.6	4.5	3.9	4.6	4.2
<b>Capital ratio</b>	<b>13.9</b>	<b>14.0</b>	<b>14.6</b>	<b>14.2</b>	<b>14.8</b>	<b>14.5</b>	<b>13.0</b>	<b>12.9</b>	<b>14.3</b>	<b>13.6</b>	<b>14.2</b>	<b>13.9</b>

The banking corporates allocate capital in accordance with Basel III rules and based on transition directives.

<sup>b</sup> Including minority interest in accordance with the group's balance sheet.

<sup>c</sup> Equity for December 2014 was restated due to retroactive implementation of the guidance regarding employee rights and regarding the discounting of software development costs.

<sup>d</sup> After deductions.

SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

**Table 9**  
**Main capital indices of the five banking groups, December 2008 to June 2015**  
(percent)

	Year	Leumi	Hapoalim	Discount	Mizrahi- Tefahot	First International	The five groups
Ratio of total risk-weighted assets to total assets <sup>a</sup>	2008	69.46	72.28	64.83	66.87	59.09	68.32
	2009 <sup>b</sup>	64.17	67.88	60.56	67.15	54.44	64.12
	2009 <sup>c</sup>	67.01	69.16	63.89	59.59	55.50	65.22
	2010	68.30	68.62	67.17	58.66	61.00	66.39
	2011	67.67	67.33	60.45	58.26	60.02	64.59
	2012	65.67	64.83	61.27	58.03	57.69	63.05
	2013	64.56	64.98	59.09	56.12	55.66	61.91
	2014 <sup>d</sup>	66.36	67.72	60.07	55.82	56.21	63.44
	June 30, 2015	65.74	67.29	58.98	55.08	54.58	62.69
Common Equity Tier 1 capital / Core Tier 1 capital ratio <sup>e</sup>	2010	8.57	8.23	7.89	8.01	8.11	8.25
	2011	8.07	7.90	8.07	7.77	8.48	8.01
	2012	8.55	8.87	8.57	8.55	9.65	8.74
	2013	9.32	9.30	9.30	9.01	9.92	9.32
	January 1, 2014 <sup>d</sup>	9.09	9.08	8.92	8.73	9.98	9.08
	2014	9.09	9.29	9.38	9.05	9.72	9.24
	June 30, 2015	9.52	9.42	9.53	9.30	9.71	9.47
Equity to total balance-sheet assets	2010	7.19	7.13	6.01	5.62	6.12	6.67
	2011	6.46	6.76	5.44	5.36	5.93	6.19
	2012	6.71	7.19	6.04	5.70	6.41	6.59
	2013	7.07	7.65	6.25	5.75	6.33	6.86
	2014	6.59	7.65	6.27	5.69	5.99	6.68
	June 30, 2015	7.27	7.80	6.61	5.85	5.96	7.00

<sup>a</sup> Total risk-weighted assets are assets (balance sheet and off-balance-sheet) weighted by risk weights. Total assets are the total assets (balance sheet and off-balance-sheet), without risk weighting.

<sup>b</sup> The ratio is calculated in accordance with Basel I rules.

<sup>c</sup> As of this date, the ratio is calculated in accordance with Basel II rules.

<sup>d</sup> As of this date, the ratio is calculated in accordance with Basel III rules in accordance with the transition directives.

<sup>e</sup> Until December 31, 2013, the banking corporations presented the Core Tier 1 capital ratio, in accordance with Basel II principles. From January 1, 2014, they present the Common Equity Tier 1 capital ratio, in accordance with Basel III principles.

SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

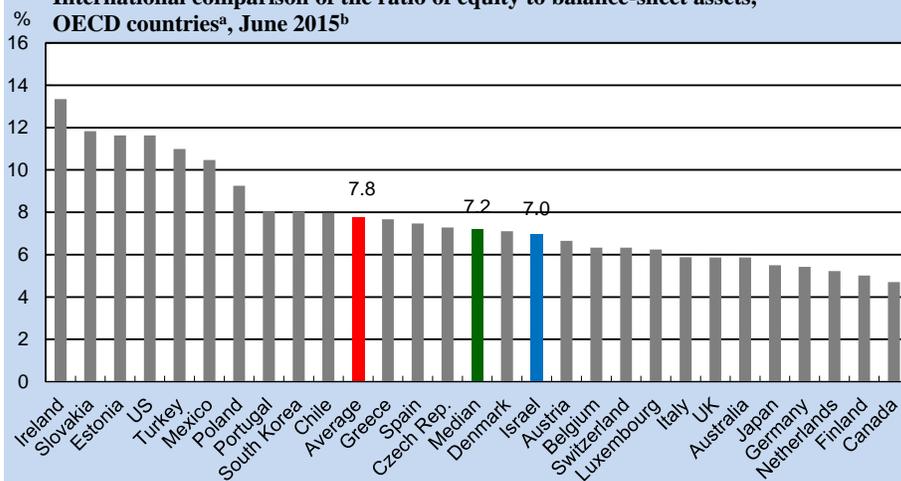
**Table 10**  
**The leverage ratio in Israel's banking system<sup>a</sup>, calculated based on Basel III, June 2015**

	Leverage ratio	Minimum leverage ratio required
		(percent)
<b>Hapoalim</b>	<b>7.2</b>	<b>6.0</b>
Israecard	12.0	5.0
<b>Leumi</b>	<b>6.5</b>	<b>6.0</b>
Arab Israel Bank	8.2	5.0
Leumi Card	11.6	5.0
<b>Discount</b>	<b>6.6</b>	<b>5.0</b>
Mercantile Discount Bank	6.7	5.0
Discount Bancorp Inc.	8.4	4.0
Cal (Cartisey Ashrai		
Le'Israel)—Israel Credit Cards	9.9	5.0
<b>Mizrachi-Tefahot</b>	<b>5.2</b>	<b>5.0</b>
Bank Yahav	4.8	5.0
<b>First International</b>	<b>5.5</b>	<b>5.0</b>
Otzar Hahayal Bank	6.0	5.0
Poalei Agudat Israel Bank (PAGI)	9.1	5.0
Ubank	3.8	5.0
Bank Massad	7.9	5.0
<b>Union Bank</b>	<b>5.4</b>	<b>5.0</b>
<b>Bank of Jerusalem</b>	<b>5.1</b>	<b>5.0</b>

<sup>a</sup> The five banking groups are presented on a consolidated basis.

SOURCE: Based on public financial statements.

**Figure 5**  
**International comparison of the ratio of equity to balance-sheet assets, OECD countries<sup>a</sup>, June 2015<sup>b</sup>**

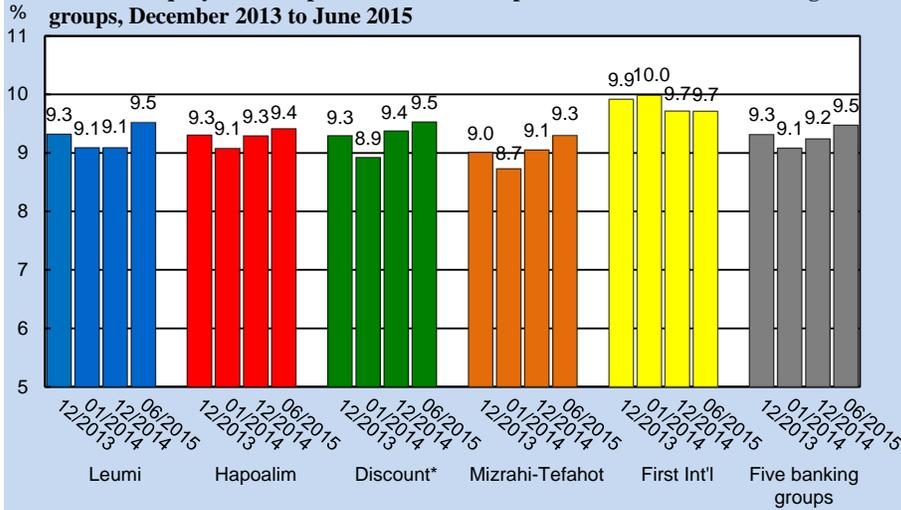


<sup>a</sup> Hungary, Norway, Slovenia, Sweden and France are not included due to a lack of data.

<sup>b</sup> Data for Finland are as of December 2013. Data for Belgium, Italy, South Korea and UK are as of June 2014. Data for Chile, Japan and Poland are as of September 2014. Data for Switzerland are as of December 2014. Data for Australia, Austria, Canada, Denmark, Estonia, Mexico, Germany, Greece, Ireland, Luxembourg, Netherlands, Portugal, Slovakia, Spain, Turkey and the US are as of March 2015. Data for the Czech Republic and Israel are as of June 2015.

SOURCE: Foreign countries—International Monetary Fund; Israel—Based on published financial statements.

**Figure 6**  
Common Equity Tier 1 capital / Core Tier 1 capital ratios<sup>a</sup> of the five banking groups, December 2013 to June 2015

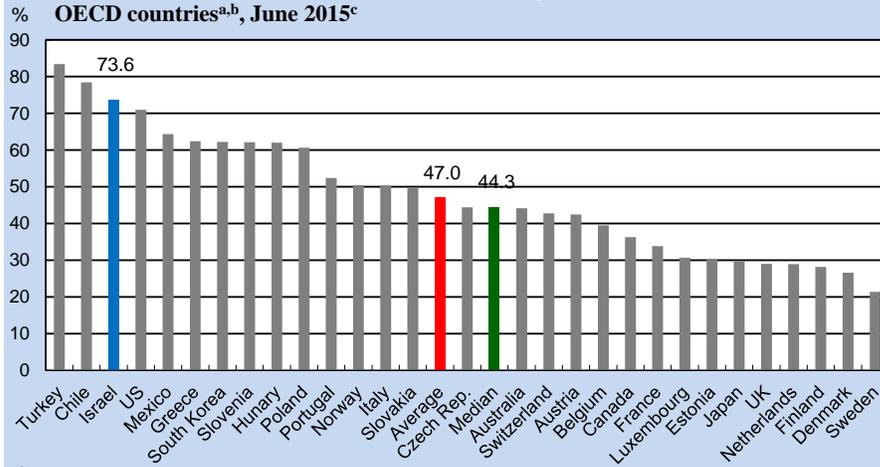


<sup>a</sup> Data for December 2013 are in Basel II terms (Core Tier 1 capital ratio). Data from January 2014 onward are in Basel III terms (Common Equity Tier 1 capital ratio) in accordance with the transition directives.

\* The Core Tier 1 capital ratio of the Discount Group for December 2013 does not include the deduction in respect of the Group's investment in the First International Group.

SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

**Figure 7**  
International comparison of the ratio of risk-weighted assets to total assets in OECD countries<sup>a,b</sup>, June 2015<sup>c</sup>



<sup>a</sup> Risk assets in Israel are weighted in by the conservative standard approach.

<sup>b</sup> Germany, Spain and Ireland are not included due to lack of data.

<sup>c</sup> Data for Finland and France are as of December 2013. Data for Belgium, Italy, South Korea, Portugal, and the UK are as of June 2014. Data for Chile, Japan and Poland are as of September 2014. Data for Estonia and Switzerland are as of December 2014. Data for Australia, Austria, Canada, Denmark, Greece, Hungary, Mexico, Netherlands, Norway, Slovenia, Slovakia, Sweden, Turkey and the US are as of March 2015. Data for Luxembourg, the Czech Republic and Israel are as of June 2015.

SOURCE: Foreign countries—International Monetary Fund; Israel—Based on published financial statements.

#### 4. The credit portfolio and credit risk

##### **Main developments in the bank credit portfolio**

The total balance of bank credit risk<sup>18</sup> at the five banking groups expanded by 2 percent in the first half of 2015 to NIS 1,354 billion. Total balance-sheet credit grew by 4 percent, slightly lower than the GDP growth rate, to NIS 881 billion (Table 11, Figure 8). Balance-sheet credit grew because housing credit continued to increase, by 9 percent, and consumer credit<sup>19</sup> continued to increase, by 8 percent, and even though credit to borrowers whose main activity is abroad contracted by 1 percent, and business sector credit remained essentially unchanged (-0.4 percent, Figure 9).

The increase in housing credit and consumer credit is a trend that has characterized those categories in recent years, alongside the trend of contraction of business credit (Figure 10, Figure 11).

Despite the virtual standstill in business sector credit, credit to the construction and real estate industry expanded by 10 percent. Banks' high exposure to credit to the construction and real estate industry, to housing credit and to consumer credit, and the correlations between those types of credit, are a risk to the banking system. In the first half of 2015, the share of credit to the construction and real estate industry and housing credit reached 44 percent of the bank credit portfolio (Table 11).

The low interest rate environment prevailing in the economy also increases the risk to the banking system, as it is liable to support taking greater risks in order to attain returns, and as a result it is liable to increase the risk of over-leverage by borrowers and to lead to an increase in prices of assets and possibly even to underpricing of risks inherent in them.

##### **Business sector credit**

Business sector credit essentially did not grow in the first half—continuing its trend of recent years—and totaled NIS 385 billion (Figure 9). This development is based in the continuing contraction of credit to large borrowers. In contrast, credit to small businesses expanded. Business sector credit to large borrowers has contracted in recent years due to a range of factors. On the supply side, the Banking Supervision Department acted to reduce the banking system's exposure to concentration of credit, and banks strove to moderate the growth rate of credit risk assets by reducing credit to large borrowers. On the demand side, it appears that some of the large companies reduced their demand for credit, among other things in view of their wish to reduce their leverage level. This possibility is supported by two developments: in recent years, the balance of nonbank credit increased only moderately, and Companies Survey data indicate a decline in financing constraints for companies.

Analysis of credit by industry indicates prolonged trends in most major industries: a decline in credit to the manufacturing industry (-9 percent) and to the financial services industry (-6 percent), and an increase in credit to the trade industry (4 percent) and to the construction industry<sup>20</sup> (5 percent, Table 11). Credit to the real estate industry<sup>21</sup> expanded during the

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<sup>18</sup> Balance sheet and off-balance sheet.

<sup>19</sup> Nonhousing credit to individuals.

<sup>20</sup> Main construction industry activity (developing construction sites, constructing entire or partial buildings, carpentry and framing work, installing water, electricity and air conditioning facilities and other systems, completing construction, upgrading and repairing buildings, constructing and setting up prefabricated buildings) and civil engineering work (earthworks, paving and infrastructure, other engineering work, equipment leasing and construction or demolition with operator).

<sup>21</sup> Main work includes: real-estate trade and intermediation, management and maintenance, rent collection and related activities.

period by 4 percent—while in the previous three years it declined by 4 percent, on average—and in parallel, companies from the industry raised debt through the nonbank market.

**Nonbank credit market:** Nonbank credit continues to provide about half (52 percent) the supply of credit to the business sector. There are several types: domestic-market tradable and nontradable bonds (44 percent), loans from institutional investors (12 percent) and credit from nonresidents<sup>22</sup> (43 percent). Nonbank credit contracted in the period reviewed by about NIS 6 billion, to NIS 422 billion. Only one channel grew during the period reviewed—direct loans provided from institutional investors, which increased by NIS 6 billion and continued a trend that has characterized it in recent years.

### **Credit to households**

Credit to individuals (housing and consumer credit) increased in the first half of 2015 by 8 percent, to NIS 415 billion (Table 11). In recent years, this credit has served as a main source for growth of banking credit, and it expanded over this period against the background of the low interest rate environment, the increase in home prices, and the increase in private consumption. Between December 2007 and June of this year, its average rate of growth was 10 percent, and its share in the bank credit portfolio increased from 32 percent to 47 percent. During this period an increase can be seen in household leverage: the ratio between credit to individuals and GDP increased from 28 percent to 37 percent (Figure 12), and the ratio between credit to individuals and disposable income in the economy increased from 44 percent to 54 percent<sup>23</sup> (Figure 13). However, the leverage ratio of households in Israel is still lower than in advanced economies worldwide.

**Housing credit** makes up about two-thirds of credit to individuals, and during the course of the period it expanded by 9 percent, similar to its rate of growth in recent years, reaching NIS 276 billion (Figure 9). The monthly volume of loans granted for housing was NIS 5.6 billion, on average, in the first half of the year, compared with NIS 4.3 billion in 2014, and in June it even reached a record of NIS 7 billion (Figure 17). The risk characteristics of housing loans granted during the period remained low (Figure 18): the average PTI ratio was 26 percent and the average LTV ratio was 52 percent.

**Consumer credit** expanded by 8 percent in the first half of the year, to NIS 139 billion. Between December 2007 and June 2015, such credit increased by 7 percent, on average, and its share in the total credit portfolio increased from 13 percent to 16 percent (Figure 9, Figure 11). As total consumer credit expanded rapidly in recent years, there was an increased need to verify that the loan loss allowances in respect of it are conservative enough. The Supervisor of Banks therefore published, in January 2015, a directive establishing that beginning with the financial statements for 2014, the share of quality adjustments included in the group allowance for credit losses in respect of consumer credit is not to be less than 0.75 percent. As of June 2015, the share of the balance of loan loss allowances out of total consumer credit was 1.6 percent (Table 12).

### **Credit portfolio quality**

When analyzing the indicators calculated from financial statements, the quality of the bank credit portfolio is seen to have remained similar to its December 2014 level: the ratio of loan loss provisions in total balance-sheet credit to the public declined slightly during the period, reaching a historic low of 0.11 percent. This ratio is similar to the ratio of net write-offs to total balance-sheet credit to the public, a figure that also reached a historic low (Table 13). The ratio of allowance for loan losses to total balance-sheet credit to the public was essentially unchanged, at a level of 1.4 percent, of which 0.33 percent was in respect of the

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<sup>22</sup> Includes loans from nonresidents and tradable corporate bonds abroad.

<sup>23</sup> Updated to December 2014.

allowance calculated on an individual basis and 1.1 percent was in respect of the allowance calculated on a collective basis (Figure 20).

Impaired credit and credit that is not impaired but that is 90 days or more in arrears are the risky part of problematic credit, and they remained without major change. Their share in total credit to the public remained 2.2 percent (Table 13), a level that is lower than the median level in OECD countries.

The banking system's ability to absorb losses through capital buffers and allowances is represented by Coverage Ratios<sup>24</sup>, which remained essentially unchanged (Table 13).

### **Borrower concentration**

In the first half of 2015 the decline in concentration in the credit portfolio, by borrower size, continued, similar to the trend of recent years. With that, concentration remains high. This is because, among other things, the Israeli economy has a concentrated structure of ownership and control. The decline occurred, among other things, against the background of tighter restrictions on indebtedness of borrowers and groups of borrowers<sup>25</sup>, and against the background of the banking system's focus on the household and small business sectors.

In June 2015, total exposure<sup>26</sup> of the five banking groups to the ten largest business groups was NIS 109 billion, a decrease of NIS 8 billion from December 2014. In June 2015, the share of these groups in the total credit portfolio was 8 percent, compared with 9 percent in December 2014, and their share in total equity was 116 percent, compared with 132 percent in December 2014. In addition, credit to the 100 largest borrowers reached 11.7 percent of the credit portfolio, compared with 12.5 percent in December 2014, and 169 percent of equity, compared with 189 percent in December 2014 (Figure 16).

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<sup>24</sup> Coverage ratios include the ratio of allowance for credit losses to impaired credit and unimpaired credit that is 90 days or more in arrears, and the ratio between impaired credit and unimpaired credit that is 90 days or more in arrears, net, to total equity.

<sup>25</sup> In May 2015, the Supervisor of Banks published a draft directive updating the existing guidelines regarding limitations on the indebtedness of a borrower and of a group of borrowers. The draft was published further to the activities of the Banking Supervision Department to reduce the concentration of the credit portfolio in the banking system and against the background of recommendations by the Basel Committee regarding large exposures (Supervisory Framework for Measuring and Controlling Large Exposures, April 2014). The main points of the revisions in the directive are: (1) The definition of the capital used for calculating the limitations on indebtedness of a borrower and group of borrowers was narrowed to Tier 1 Capital; (2) The limitation on the share of indebtedness of a group of borrowers that includes a bank was tightened, as it was reduced from 25 percent to 15 percent; (3) The method of calculating the deductions permitted under Directive 313 was brought in line with the method of calculating eligible credit risk reductions included in Directive 203. The start date of the directive is January 1, 2016.

<sup>26</sup> Includes the balance of balance sheet credit risk and of off-balance sheet credit risk.

**Table 11**  
**Distribution of outstanding credit to the public, by principal industries, the five banking groups, December 2014 and June 2015**

	Total balance of credit risk <sup>a</sup>					Balance-sheet credit <sup>b</sup> (debts)				
	Balance		Distribution of credit to the public		Change in credit <sup>c</sup>	Balance		Distribution of credit to the public		Change in credit <sup>c</sup>
	December-14	June-15	December-14	June-15	June-15	December-14	June-15	December-14	June-15	June-15
	(NIS million)		(percent)		(percent)	(NIS million)		(percent)		(percent)
<b>Borrower activity in Israel</b>	<b>1,183,388</b>	<b>1,198,469</b>	<b>88.1</b>	<b>88.5</b>	<b>2.5</b>	<b>783,410</b>	<b>799,372</b>	<b>90.5</b>	<b>90.7</b>	<b>4.1</b>
<b>Business sector</b>	<b>660,874</b>	<b>652,676</b>	<b>49.2</b>	<b>48.2</b>	<b>-2.5</b>	<b>385,367</b>	<b>384,664</b>	<b>44.5</b>	<b>43.7</b>	<b>-0.4</b>
Agriculture	7,407	7,180	0.6	0.5	-6.1	5,883	5,551	0.7	0.6	-11.3
Manufacturing	106,951	99,914	8.0	7.4	-13.2	59,291	56,501	6.9	6.4	-9.4
Mining and quarrying	5,318	5,695	0.4	0.4	14.2	3,555	3,289	0.4	0.4	-15.0
Construction and real estate	215,960	219,188	16.1	16.2	3.0	111,184	113,595	12.8	12.9	4.3
Of which: Construction	149,105	150,739	11.1	11.1	2.2	53,794	55,125	6.2	6.3	4.9
Real estate	66,855	68,449	5.0	5.1	4.8	57,390	58,470	6.6	6.6	3.8
Electricity and water	23,645	21,236	1.8	1.6	-20.4	12,001	11,275	1.4	1.3	-12.1
Commerce	99,004	100,233	7.4	7.4	2.5	75,610	77,222	8.7	8.8	4.3
Tourism	17,051	17,014	1.3	1.3	-0.4	14,384	14,391	1.7	1.6	0.1
Transport and storage	19,949	20,970	1.5	1.5	10.2	15,793	16,505	1.8	1.9	9.0
Communications and computer services	19,966	20,534	1.5	1.5	5.7	13,187	13,047	1.5	1.5	-2.1
Financial services	95,709	90,062	7.1	6.7	-11.8	38,629	37,495	4.5	4.3	-5.9
Other business services	29,255	29,768	2.2	2.2	3.5	19,871	19,607	2.3	2.2	-2.7
Public and community services	20,659	20,882	1.5	1.5	2.2	15,979	16,186	1.8	1.8	2.6
<b>Private individuals</b>	<b>522,514</b>	<b>545,793</b>	<b>38.9</b>	<b>40.3</b>	<b>8.9</b>	<b>398,043</b>	<b>414,708</b>	<b>46.0</b>	<b>47.1</b>	<b>8.4</b>
Of which: housing loans	279,107	293,048	20.8	21.6	10.0	264,677	276,043	30.6	31.3	8.6
nonhousing loans	243,407	252,745	18.1	18.7	7.7	133,366	138,665	15.4	15.7	7.9
<b>Borrowers' activity abroad</b>	<b>159,681</b>	<b>155,390</b>	<b>11.9</b>	<b>11.5</b>	<b>-5.4</b>	<b>82,135</b>	<b>81,628</b>	<b>9.5</b>	<b>9.3</b>	<b>-1.2</b>
<b>Total</b>	<b>1,343,069</b>	<b>1,353,859</b>	<b>100.0</b>	<b>100.0</b>	<b>1.6</b>	<b>865,545</b>	<b>881,000</b>	<b>100.0</b>	<b>100.0</b>	<b>3.6</b>

a Includes balance-sheet and non-balance-sheet credit risk.

b Includes credit to the public, excludes bonds and securities borrowed or purchased under reverse repurchase agreements.

c In annual terms

SOURCE: Banking Supervision Department based on published financial statements.

**Table 12**  
**Credit quality indices, by principle industry, the five banking groups, December 2014 and June 2015**

	Impaired loans to total balance-sheet credit to the industry		Loan loss provisions to total balance-sheet credit to the industry <sup>a</sup>		Net write-offs to total balance-sheet credit to the industry <sup>a</sup>		Allowance for credit losses to total balance-sheet credit to the industry		Coverage ratio: Allowance for credit losses to impaired loans to the industry	
	December-14	June-15	December-14	June-15	December-14	June-15	December-14	June-15	December-14	June-15
	(percent)									
<b>Borrowers' activity in Israel</b>	<b>1.84</b>	<b>1.88</b>	<b>0.14</b>	<b>0.13</b>	<b>0.06</b>	<b>0.07</b>	<b>1.59</b>	<b>1.59</b>	<b>86.8</b>	<b>84.7</b>
<b>Business</b>	<b>3.46</b>	<b>3.63</b>	<b>0.02</b>	<b>0.16</b>	<b>0.00</b>	<b>-0.04</b>	<b>2.14</b>	<b>2.25</b>	<b>62.0</b>	<b>62.0</b>
Agriculture	1.87	1.89	-0.19	0.36	0.12	-0.79	1.16	1.69	61.8	89.5
Manufacturing	3.77	3.57	-0.43	0.12	-0.02	-0.09	2.50	2.68	66.4	75.1
Mining and quarrying	0.06	0.00	-0.14	-0.30	-0.11	0.00	0.56	0.40	1000.0	
Construction and real estate	4.37	3.92	-0.28	-0.53	-0.23	-0.43	2.51	2.41	57.35	61.51
Of which: Construction	3.71	3.72	-1.51	-0.22	-0.88	-0.29	2.44	2.41	65.8	64.8
Real estate	4.99	4.11	0.88	-0.81	0.37	-0.55	2.56	2.41	51.4	58.7
Electricity and water	0.12	0.12	0.42	-0.02	0.01	-0.02	0.67	0.86	540.0	746.2
Commerce	2.75	3.65	0.78	1.02	0.28	0.31	2.34	2.69	85.1	73.7
Tourism	5.58	5.52	-0.25	0.18	-0.24	0.18	1.06	1.05	18.9	19.0
Transport and storage	3.80	3.25	-0.19	0.01	0.28	-0.16	1.04	1.16	27.3	35.6
Communications and computer services	10.59	15.19	-0.27	2.94	1.06	0.61	3.44	4.56	32.4	30.0
Financial services	2.19	2.39	0.38	-0.23	-0.19	0.15	2.21	2.13	100.7	89.0
Other business services	1.29	1.19	0.22	0.39	0.38	0.35	1.43	1.41	110.5	118.9
Public and community services	0.84	0.73	-0.37	-0.33	-0.51	-0.11	0.93	0.73	110.4	100.0
<b>Private individuals</b>	<b>0.26</b>	<b>0.26</b>	<b>0.25</b>	<b>0.05</b>	<b>0.12</b>	<b>0.18</b>	<b>1.06</b>	<b>0.98</b>		
Of which: Housing loans	0.01	0.01	0.00	0.02	0.02	0.08	0.72	0.66		
Nonhousing loans	0.76	0.74	0.73	0.25	0.31	0.38	1.75	1.62		
<b>Borrowers' activity abroad</b>	<b>2.98</b>	<b>2.22</b>	<b>0.31</b>	<b>-0.07</b>	<b>0.56</b>	<b>0.41</b>	<b>1.83</b>	<b>1.57</b>		

<sup>a</sup> In annual terms.

SOURCE: Banking Supervision Department based on published financial statements.

**Table 13**  
**Indices of credit portfolio quality of the five banking groups, 2010 to June 2015**  
 (percent)

	Year	Leumi	Hapoalim	Discount	Mizrahi- Tefahot	First International	The five groups
<b>Loan loss provisions to total balance-sheet credit to the public<sup>a</sup></b>							
	2010	0.26	0.46	0.69	0.44	0.18	0.41
	2011	0.30	0.48	0.65	0.28	0.14	0.39
	2012	0.50	0.39	0.61	0.21	0.20	0.41
	2013	0.11	0.34	0.49	0.21	0.14	0.25
	2014	0.18	0.16	0.13	0.12	0.13	0.15
	Jun-15 <sup>b</sup>	0.07	0.20	0.01	0.10	0.07	0.11
<b>Net write-offs to total gross balance-sheet credit to the public</b>							
	2011	0.84	0.84	0.72	0.44	0.15	0.71
	2012	0.47	0.38	0.51	0.26	0.24	0.39
	2013	0.21	0.38	0.42	0.40	0.13	0.32
	2014	0.12	0.06	0.24	0.10	0.05	0.11
	Jun-15 <sup>b</sup>	0.13	0.08	0.09	0.06	0.23	0.10
<b>Allowance for credit losses to total balance-sheet credit to the public</b>							
	2010 <sup>c</sup>	2.30	2.12	1.66	1.62	1.33	1.96
	2011	1.62	1.64	1.67	1.35	1.33	1.57
	2012	1.68	1.61	1.74	1.22	1.22	1.56
	2013	1.59	1.54	1.81	0.94	1.19	1.46
	2014	1.55	1.56	1.68	0.90	1.25	1.44
	Jun-15	1.51	1.57	1.62	0.89	1.17	1.41
<b>Problematic loans to total balance-sheet credit to the public</b>							
	2012	4.95	5.28	6.58	2.88	3.49	4.84
	2013	4.42	6.05	5.73	1.99	3.50	4.62
	2014	3.96	4.46	4.84	1.38	3.48	3.76
	Jun-15	3.71	3.97	3.96	1.46	2.67	3.35
<b>Impaired loans and non-impaired loans 90 days or more past due to total balance-sheet credit to the public</b>							
	2010 <sup>c</sup>	4.13	5.06	5.38	2.90	2.31	4.29
	2011	3.26	3.74	5.19	2.57	2.02	3.49
	2012	3.54	3.79	5.11	2.55	2.11	3.57
	2013	2.81	3.54	3.71	1.70	1.83	2.89
	2014	2.23	2.74	2.69	1.20	1.54	2.22
	Jun-15	2.09	2.64	2.90	1.22	1.48	2.17
<b>Allowance for credit losses to impaired loans and non-impaired loans more than 90 days past due</b>							
	2010 <sup>c</sup>	55.6	41.8	30.8	55.8	57.6	45.7
	2011	49.5	43.7	32.1	52.6	66.1	44.9
	2012	47.3	42.5	34.1	47.9	57.7	43.6
	2013	56.4	43.6	48.7	55.4	65.0	50.5
	2014	69.6	56.9	62.4	75.4	81.6	64.7
	Jun-15	72.5	59.5	55.9	73.3	79.0	64.9
<b>Impaired loans and non-impaired loans 90 days or more past due, net, to total equity</b>							
	2010 <sup>c</sup>	18.2	30.5	41.7	18.9	10.5	25.2
	2011	17.1	21.9	37.9	18.3	7.5	21.2
	2012	18.1	20.4	33.2	18.7	9.1	20.5
	2013	11.2	17.7	18.6	10.3	6.4	13.8
	2014	6.7	10.2	9.5	3.9	2.8	7.6
	Jun-15	5.2	9.1	11.6	4.2	3.1	7.2

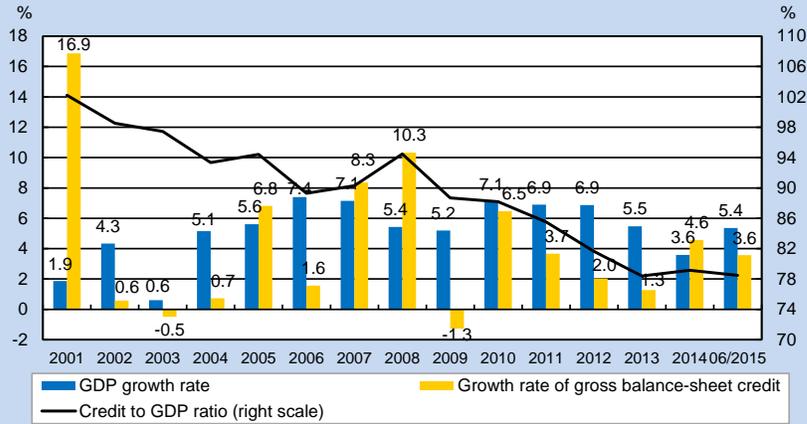
a Until December 2010, net credit to the public was used; since 2011, gross credit to the public has been used.

b In annual terms.

c Data calculated as of January 1, 2011—after the implementation of the directive for the measuring and disclosure of impaired debt, credit risk and credit loss allowance.

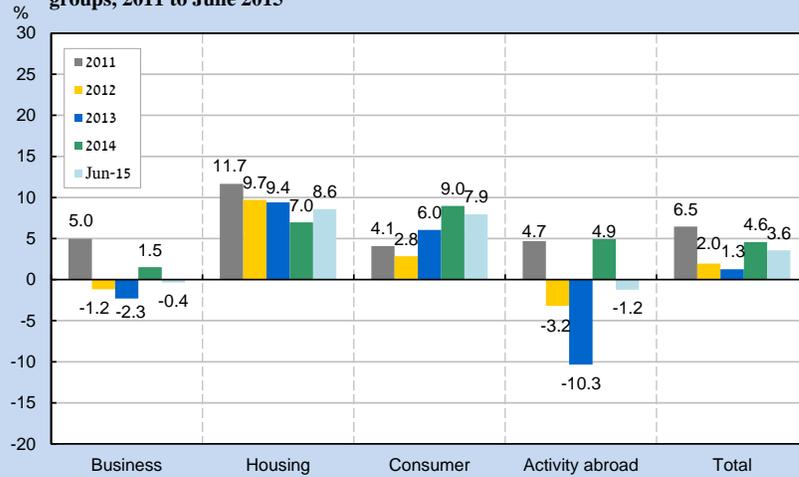
SOURCE: Banking Supervision Department based on published financial statements.

**Figure 8**  
Annual growth rate of nominal GDP<sup>a</sup>, growth rate of the five banking groups' balance-sheet credit to the public<sup>b</sup>, and credit to GDP ratio<sup>a</sup>, 2001 to June 2015



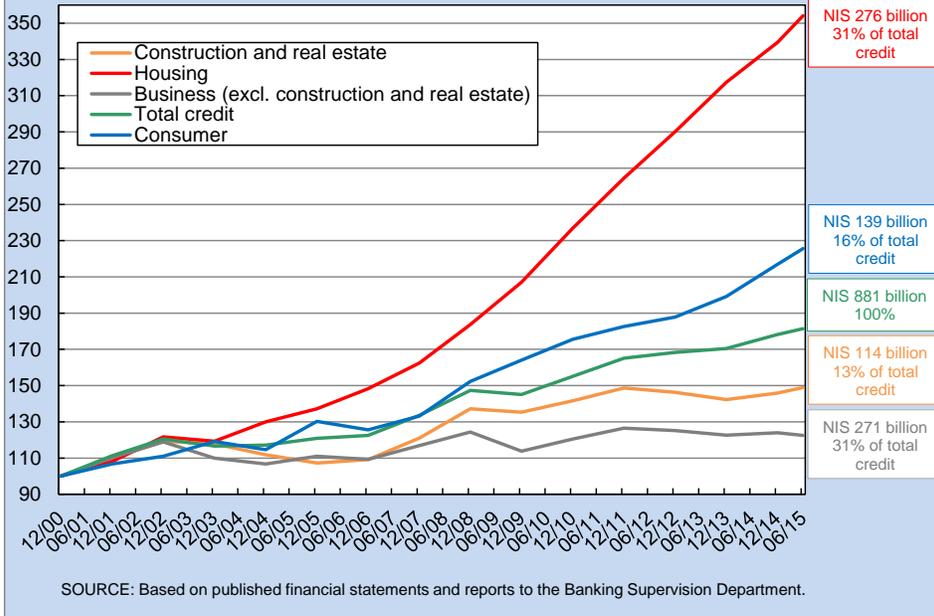
<sup>a</sup> During 2013, the Central Bureau of Statistics changed the method of calculation of the National Accounts, and revised all of the data series dating back to 2006, including GDP figures. The level of GDP over the period from 2001 to 2006 was recalculated according to the rate of change.  
<sup>b</sup> According to gross balance-sheet credit.  
SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

**Figure 9**  
Annual rate of change in balance-sheet credit to principal sectors, the five banking groups, 2011 to June 2015

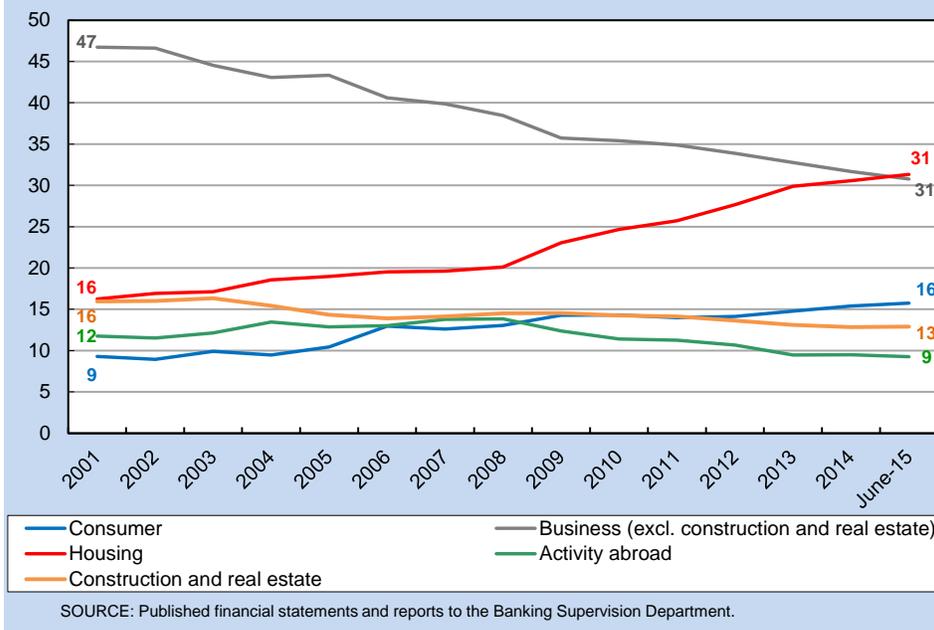


SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

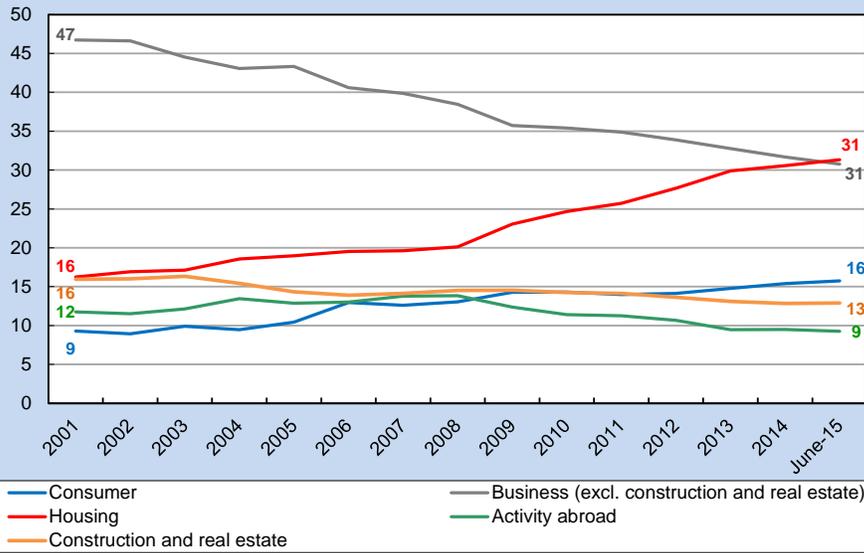
**Figure 10**  
**Development of balance-sheet credit in the principal sectors, the five banking groups,**  
**2000 to June 2015 (December 2000 = 100)**



**Figure 11**  
**Distribution of balance-sheet credit, the five banking groups, 2001 to June 2015**

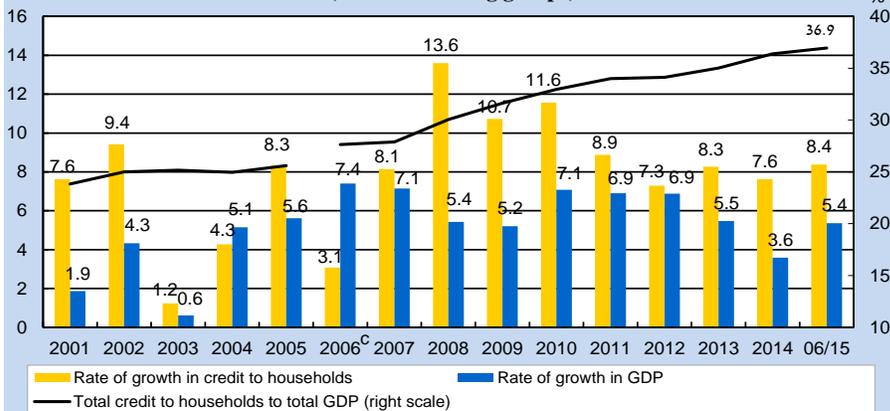


**Figure 11**  
**Distribution of balance-sheet credit, the five banking groups, 2001 to June 2015**



SOURCE: Published financial statements and reports to the Banking Supervision Department.

**Figure 12**  
**Growth rate of nominal GDP<sup>a</sup> and of credit to households<sup>b</sup>, and ratio of credit to households to nominal GDP<sup>c</sup>, the five banking groups, 2001 to June 2015**



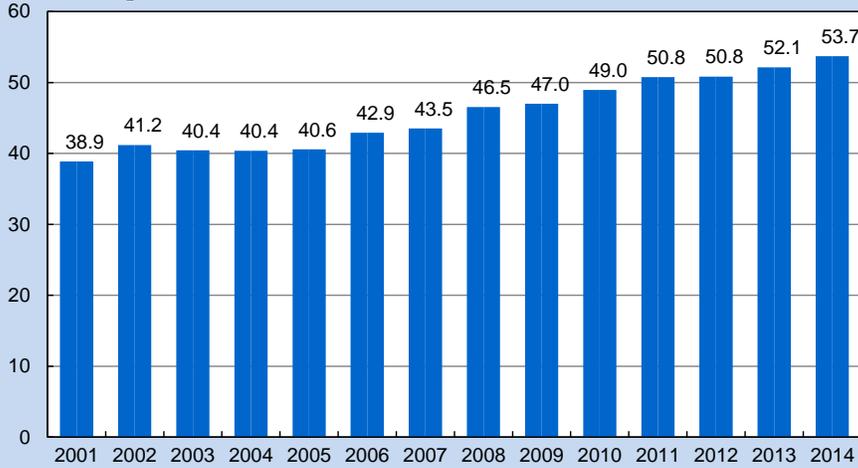
<sup>a</sup> In 2013, the Central Bureau of Statistics changed the method of calculation of the National Accounts, and revised all of the data series dating back to 2006. The level of GDP over the period from 2001 to 2006 was recalculated according to the rate of change.

<sup>b</sup> Until December 2010, net balance-sheet credit was used. From 2011, gross credit to the public was used.

<sup>c</sup> Until 2005, open credit card transactions were recorded as non-balance-sheet credit, and from 2006, they were recorded as balance-sheet credit.

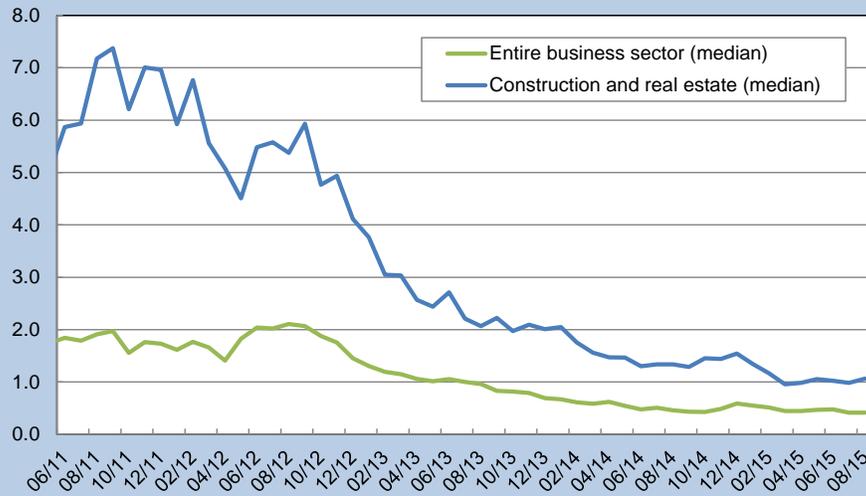
SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

**Figure 13**  
**The Ratio Between Total Credit to Households in the Five Banking Groups and Disposable Income<sup>a</sup>, 2004–14<sup>b,c</sup>**



<sup>a</sup> Net private disposable income in Israel from all sources.  
<sup>b</sup> Until December 2010, net balance-sheet credit was used. From 2011, gross credit to the public was used.  
<sup>c</sup> In 2013, the Central Bureau of Statistics made methodological adjustments to the calculation of National Accounts data, and revised all of the data series dating back to 2006.  
 SOURCE: Based on published financial statements.

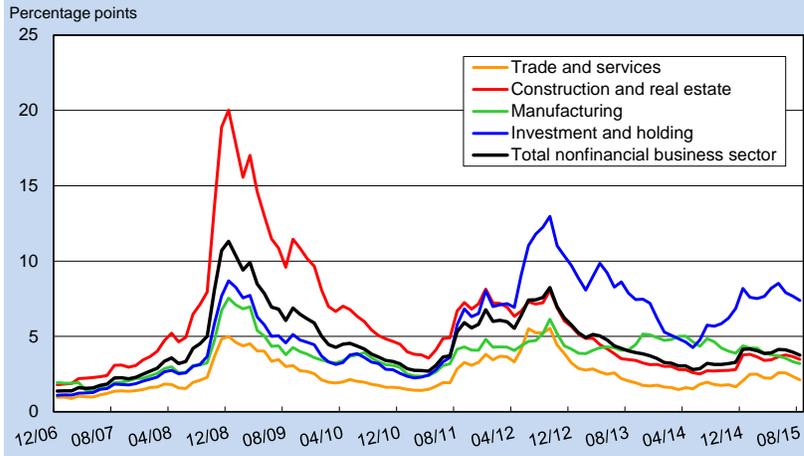
**Figure 14**  
**The EDF<sup>a</sup> index of Israeli corporations and of construction and real estate companies, June 2011 to August 2015**



<sup>a</sup> EDF (Expected Default Frequency) reflects the expected probability of default. The median EDF for construction and real estate companies is calculated on the basis of 29 publicly traded Israeli companies. The median EDF for all companies in the business sector is calculated on the basis of 289 publicly traded Israeli companies.

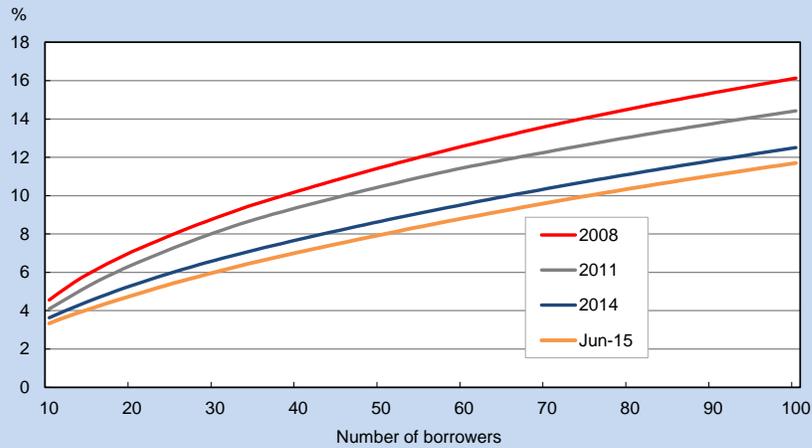
SOURCE: Based on Moody's-KMV.

**Figure 15**  
**Yield spread between corporate bonds<sup>a</sup> and CPI-indexed government bonds, by industry, December 2006 to August 2015 (monthly average)**



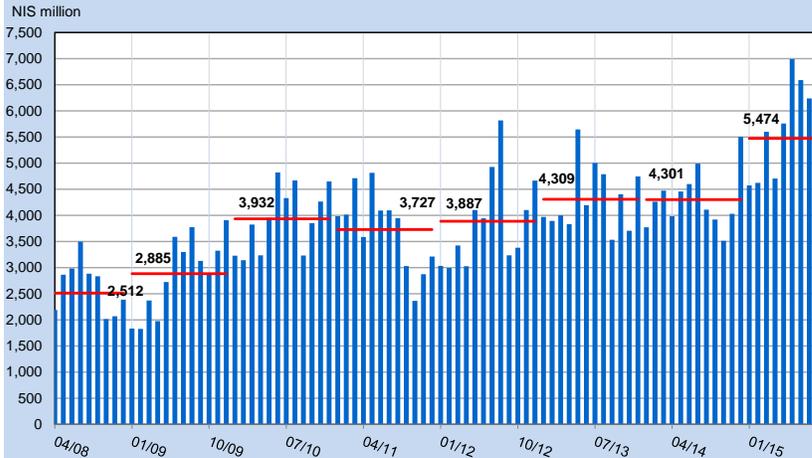
<sup>a</sup> Bonds traded on the Tel Aviv Stock Exchange, excluding convertible bonds and structured bonds.  
 SOURCE: Bank of Israel.

**Figure 16**  
**Credit Risk of the 100 Largest Borrowers<sup>a</sup> Out of Total Credit Risk, the Five Banking Groups, 2008, 2011, 2014, and June 2015**



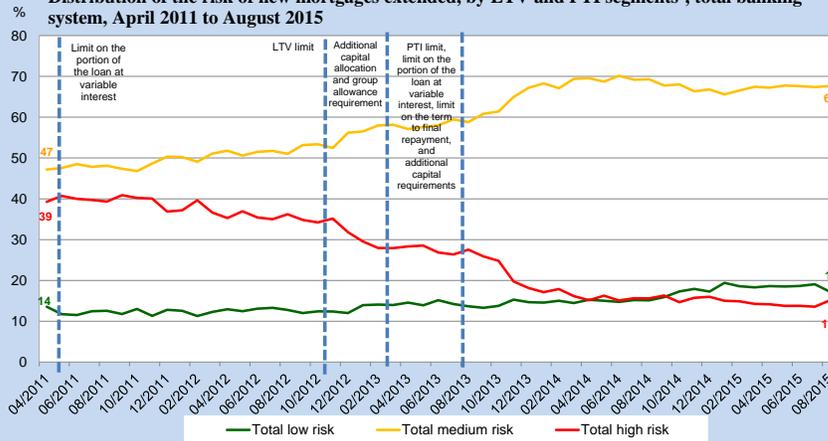
<sup>a</sup> The large borrowers do not include banking corporations.  
 SOURCE: Based on published financial statements and reports to the Banking Supervision Department.

**Figure 17**  
**New housing loans granted, monthly levels and monthly averages, total banking system<sup>a</sup>, March 2008 to September 2015**



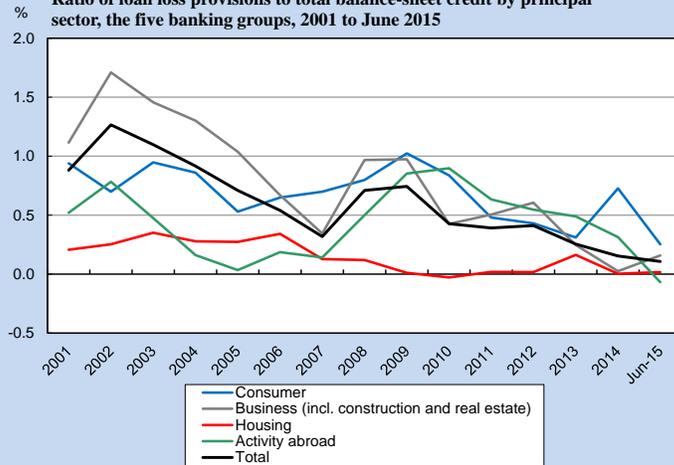
SOURCE: Based on reports to the Banking Supervision Department.

**Figure 18**  
**Distribution of the risk of new mortgages extended, by LTV and PTI segments<sup>a</sup>, total banking system, April 2011 to August 2015**



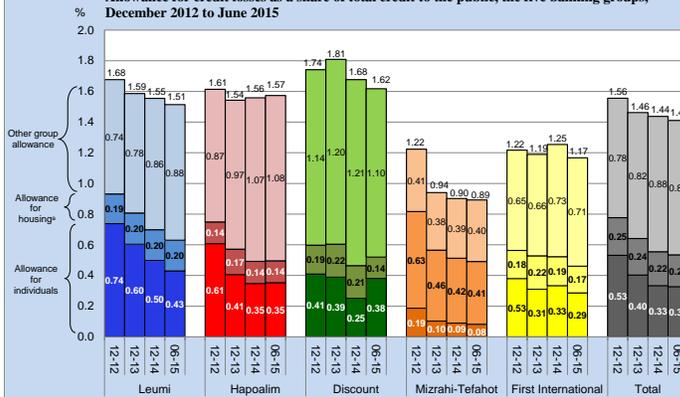
<sup>a</sup> The risk is low if (PTI ≤ 20% and LTV ≤ 60%).  
 The risk is medium if (20% < PTI ≤ 40% and LTV < 60%) or (PTI ≤ 30% and 60% < LTV ≤ 75%) or (PTI ≤ 10% and LTV > 75%).  
 The risk is high if (PTI > 40%) or (30% < PTI ≤ 40% and LTV > 60%) or (10% < PTI ≤ 30% and LTV > 75%).  
 SOURCE: Based on reports to the Banking Supervision Department.

**Figure 19**  
Ratio of loan loss provisions to total balance-sheet credit by principal sector, the five banking groups, 2001 to June 2015



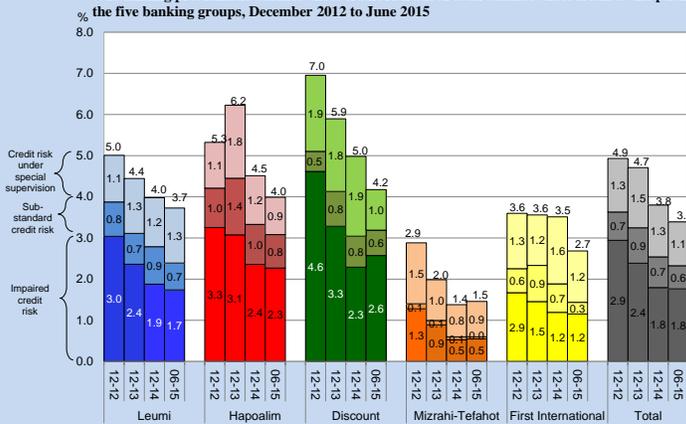
SOURCE: Based on published financial statements.

**Figure 20**  
Allowance for credit losses as a share of total credit to the public, the five banking groups, December 2012 to June 2015



Including the allowance for housing calculated according to the depth of arrears.  
SOURCE: Based on published financial statements.

**Figure 21**  
Outstanding problematic balance-sheet credit risk out of total balance-sheet credit to the public, the five banking groups, December 2012 to June 2015



SOURCE: Based on published financial statements.

## 5. Market risks

### a. Interest rate risks

During the first half of 2015, total exposure to interest rate risk at most of the large banking groups increased compared with the previous year, primarily in the unindexed sector. The increase in risk occurred against the background of an increase at most of the groups in net positions in the unindexed sector, and against the background of some increase in duration of capital. Most of the groups were exposed to an increase in the interest rate in all sectors, similar to last year. At the end of the first half of the year, the potential loss to the five banking groups as a result of a one percentage point increase in the interest rate ranged from 3.3 percent to 9.1 percent of the fair value of the bank's capital<sup>27</sup>, compared to a range of 0.1–8.6 percent at the end of 2014<sup>28</sup> (Table 14). Among the groups, there is considerable variance in the levels of exposure to interest rate risk, and these levels change over time. Although the levels of exposure to interest rate risk are lower than the levels of exposure to credit risk, the materialization of the interest rate risk is liable to lead to immediate losses and to losses in the medium term. It should be noted that the analysis relates to risk deriving from a parallel change in the yield curve, and does not take into account the risk deriving from a change in the slope of the curve and the effect of the convexity that characterizes the relationship between the interest rate and present value.

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<sup>27</sup> The fair value of the bank's capital is defined as the difference between the fair value of the assets and the fair value of the liabilities in all indexation segments, in addition to the effects of futures transactions.

<sup>28</sup> The calculation is based on board-of-directors reports of the banking groups. These reports show how hypothetical parallel changes in interest rates impact on the net fair value of the financial instruments of the bank and its affiliated companies.

**Table 14**  
**Exposure to changes in interest rates, the five banking groups, December 2014 to June 2015**  
(NIS million)

	Leumi			Hapoalim			Discount			Mizrahi-Tefahot			First International			The five groups—total		
	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2
<b>Unindexed segment</b>																		
Net position in segment <sup>a</sup>	21,555	16,746	15,900	20,454	22,932	20,814	2,405	3,700	4,096	1,378	4,528	4,623	4,276	4,752	5,604	50,068	52,658	51,037
The change in the fair value of the net position in the segment as a result of an interest rate change <sup>b</sup>																		
1 percentage point increase	-871	-930	-1,003	-21	132	-678	-132	-151	-224	-289	-366	-738	-223	-218	-316	-1,536	-1,533	-2,959
1 percentage point decrease	961	1,023	1,097	20	-120	767	289	394	390	189	320	960	255	252	373	1,714	1,869	3,587
The change in the fair value of the net position in the segment as a percentage of the fair value of the bank's total equity																		
Interest rate increase	-4.0	-4.2	-4.5	-0.1	0.5	-2.7	-1.6	-1.6	-2.4	-3.7	-4.4	-8.9	-4.4	-3.8	-5.7	-2.3	-2.1	-4.2
Interest rate decrease	4.4	4.6	4.9	0.1	-0.5	3.1	3.5	4.1	4.2	2.4	3.8	11.5	5.0	4.4	6.7	2.5	2.6	5.1
<b>CPI-indexed segment</b>																		
Net position in segment <sup>a</sup>	2,758	6,614	8,169	4,099	2,958	5,042	3,090	2,837	2,574	7,057	3,937	3,938	866	810	-108	17,870	17,156	19,615
The change in the fair value of the net position in the segment as a result of an interest rate change <sup>b</sup>																		
1 percentage point increase	-123	-211	-307	13	30	166	-86	-128	-75	52	281	243	-104	-65	-72	-248	-93	-45
1 percentage point decrease	153	270	373	20	-30	-123	87	174	102	-88	-280	-291	130	91	97	302	225	158
The change in the fair value of the net position in the segment as a percentage of the fair value of the bank's total equity																		
Interest rate increase	-0.6	-0.9	-1.4	0.1	0.1	0.7	-1.0	-1.3	-0.8	0.7	3.4	2.9	-2.0	-1.1	-1.3	-0.4	-0.1	-0.1
Interest rate decrease	0.7	1.2	1.7	0.1	-0.1	-0.5	1.0	1.8	1.1	-1.1	-3.4	-3.5	2.5	1.6	1.8	0.4	0.3	0.2
<b>Foreign currency segment<sup>c</sup></b>																		
Net position in segment <sup>a</sup>	-216	-82	-221	-21	67	-328	-493	-509	-548	-2	5	-43	-37	-26	-41	-769	-545	-1,181
The change in the fair value of the net position in the segment as a result of an interest rate change <sup>b</sup>																		
1 percentage point increase	168	97	164	-24	-29	508	249	226	357	11	1	55	47	23	51	451	318	1,135
1 percentage point decrease	0.58	0	0	1	0	0	1	0	0	1	0	0	1	0	0	1	0	0
The change in the fair value of the net position in the segment as a percentage of the fair value of the bank's total equity																		
Interest rate increase	-1.0	-0.4	-1.0	-0.1	0.3	-1.3	-5.9	-5.3	-5.9	0.0	0.1	-0.5	-0.7	-0.5	-0.7	-1.1	-0.8	-1.7
Interest rate decrease	0.8	0.4	0.7	-0.1	-0.1	2.0	3.0	2.4	3.8	0.1	0.0	0.7	0.9	0.4	0.9	0.7	0.4	1.6
<b>Total</b>																		
Total fair value of bank's total equity <sup>d</sup>	21,775	22,280	22,328	24,416	26,092	25,088	8,292	9,570	9,349	7,888	8,347	8,331	5,114	5,673	5,540	67,485	71,962	70,636
The change in the fair value of the bank's total equity as a result of an interest rate change <sup>b</sup>																		
1 percentage point increase	-1,210	-1,223	-1,531	-29	229	-840	-711	-788	-847	-239	-80	-538	-364	-309	-429	-2,553	-2,171	-4,185
1 percentage point decrease	1,282	1,390	1,634	16	-179	1,152	625	794	849	112	41	724	432	366	521	2,467	2,412	4,880
The change in the fair value of the bank's total equity as a percentage of the fair value of the bank's total equity																		
Interest rate increase	-5.6	-5.5	-6.9	-0.1	0.9	-3.3	-8.6	-8.2	-9.1	-3.0	-1.0	-6.5	-7.1	-5.4	-7.7	-3.8	-3.0	-5.9
Interest rate decrease	5.9	6.2	7.3	0.1	-0.7	4.6	7.5	8.3	9.1	1.4	0.5	8.7	8.4	6.5	9.4	3.7	3.4	6.9

<sup>a</sup> The difference between the fair value of assets and the fair value of liabilities, including the effect of futures transactions in each indexing segment.

<sup>b</sup> Based on published financial statements - directors report: "The effect of potential changes in interest rates on the net fair value of financial instruments".

<sup>c</sup> Including the foreign-currency-indexed segment.

<sup>d</sup> The total of net positions in the three indexing segments.

SOURCE: Banking Supervision Department based on published financial statements.

**Table 15**  
**Exposure to changes in the CPI and the exchange rate, the five banking groups, December 2014 to June 2015**

	(NIS million)																	
	Leumi			Hapoalim			Discount			Mizrabi-Tefahot			First International			The five groups—total		
	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2	2014	2015:Q1	2015:Q2
<b>Unindexed segment</b>																		
Total assets (excluding futures transactions and options)	234,474	242,113	246,999	245,679	250,905	270,956	119,097	121,997	123,562	119,977	123,619	124,787	82,505	85,984	87,644	801,732	824,618	853,948
Total liabilities (excluding futures transactions and options)	189,987	202,410	208,003	222,142	230,333	235,790	103,351	105,774	107,690	109,086	108,880	112,115	67,877	72,306	74,854	692,443	719,703	738,452
Effect of futures transactions and options	-18,978	-17,337	-17,779	-3,487	959	-14,436	-13,678	-14,002	-12,687	-9,111	-9,686	-7,449	-10,308	-9,154	-7,341	-55,562	-49,220	-59,692
Total position in the segment <sup>c</sup>	25,509	22,366	21,217	20,050	21,531	20,730	2,068	2,221	3,185	1,780	5,053	5,223	4,320	4,524	5,449	53,727	55,695	55,804
<b>The bank's total equity<sup>a,b</sup></b>	<b>19,530</b>	<b>19,207</b>	<b>20,349</b>	<b>25,173</b>	<b>25,418</b>	<b>25,985</b>	<b>9,161</b>	<b>9,299</b>	<b>9,542</b>	<b>9,797</b>	<b>9,964</b>	<b>10,152</b>	<b>4,955</b>	<b>5,288</b>	<b>5,348</b>	<b>68,616</b>	<b>69,176</b>	<b>71,376</b>
<b>CPI-indexed segment</b>																		
Total assets (excluding futures transactions and options)	54,203	53,174	53,295	55,301	53,931	54,245	21,772	20,348	19,489	54,521	53,448	52,897	15,393	15,197	13,937	201,190	196,098	193,863
Total liabilities (excluding futures transactions and options)	54,018	53,388	50,059	43,111	43,843	44,030	16,919	15,831	15,105	38,936	39,286	38,796	13,887	13,598	13,501	166,871	165,946	161,491
Effect of futures transactions and options	-2,177	-1,398	-1,702	-5,925	-4,923	-3,787	-759	-603	-977	-7,258	-9,103	-9,057	-841	-945	-572	-16,960	-16,972	-16,095
Total position in the segment	<b>-1,992</b>	<b>-1,612</b>	<b>1,534</b>	<b>6,265</b>	<b>5,165</b>	<b>6,428</b>	<b>4,094</b>	<b>3,914</b>	<b>3,407</b>	<b>8,327</b>	<b>5,059</b>	<b>5,044</b>	<b>665</b>	<b>654</b>	<b>-136</b>	<b>17,359</b>	<b>13,180</b>	<b>16,277</b>
Maximum change in the CPI <sup>d</sup> (percent)	1.3	0.9	0.9	1.3	0.9	0.9	1.3	0.9	0.9	1.3	0.9	0.9	1.3	0.9	0.9	1.3	0.9	0.9
Loss as a result of the maximum change in the CPI																		
CPI increase	25	15	-	-	-	-	-	-	-	-	-	-	-	-	1	25	15	1
CPI decline	-	-	14	79	47	59	52	36	31	105	46	46	8	6	-	244	135	150
<b>Foreign currency segment<sup>e</sup></b>																		
Total assets (excluding futures transactions and options)	94,589	92,999	82,897	99,570	113,955	83,908	61,364	61,137	56,378	22,115	22,118	22,220	15,154	15,508	15,879	292,792	305,717	261,282
Total liabilities (excluding futures transactions and options)	121,081	113,931	105,102	110,124	119,197	103,304	72,802	72,578	67,092	38,798	41,055	38,844	26,333	25,497	23,757	369,138	372,258	338,099
Effect of futures transactions and options	22,505	19,385	19,803	9,412	3,964	18,223	14,437	14,605	13,664	16,373	18,789	16,509	11,149	10,099	7,913	73,876	66,842	76,112
Total position in the segment <sup>f</sup>	<b>-3,987</b>	<b>-1,547</b>	<b>-2,402</b>	<b>-1,142</b>	<b>-1,278</b>	<b>-1,173</b>	<b>2,999</b>	<b>3,164</b>	<b>2,950</b>	<b>-310</b>	<b>-148</b>	<b>-115</b>	<b>-30</b>	<b>110</b>	<b>35</b>	<b>-2,470</b>	<b>301</b>	<b>-705</b>
Maximum change in the exchange rate <sup>g</sup> (percent)	6.6	5.3	5.3	6.6	5.3	5.3	6.6	5.3	5.3	6.6	5.3	5.3	6.6	5.3	5.3	6.6	5.3	5.3
Loss as a result of the maximum change in the exchange rate <sup>h</sup>																		
Weakening of the shekel (depreciation)	263	83	128	75	68	63	-	-	-	20	8	6	2	-	-	361	159	197
Strengthening of the shekel (appreciation)	-	-	-	-	-	-	198	169	157	-	-	-	-	6	2	198	175	159
<b>Total maximum loss to the bank's total equity as a result of indexation base risk<sup>b</sup></b>	<b>288</b>	<b>97</b>	<b>142</b>	<b>154</b>	<b>116</b>	<b>121</b>	<b>250</b>	<b>205</b>	<b>189</b>	<b>126</b>	<b>54</b>	<b>52</b>	<b>10</b>	<b>12</b>	<b>3</b>	<b>605</b>	<b>310</b>	<b>347</b>
As a percentage of the bank's total equity	1.5	0.5	0.7	0.6	0.5	0.5	2.7	2.2	2.0	1.3	0.5	0.5	0.2	0.2	0.1	0.9	0.4	0.5

<sup>a</sup> The difference between assets and liabilities in the segment, including the effect of futures transactions (excluding nonmonetary items), per Note 16 to the published financial statements.

<sup>b</sup> The bank's total equity is attributed entirely (by definition) to the unindexed segment, with the result that the nominal exposure to indexation bases occurs in the indexed segment and in the foreign currency segment.

<sup>c</sup> The difference between assets and liabilities in all segments includes the effect of futures transactions.

<sup>d</sup> The maximum change in the CPI derived from monthly changes in inflation expectations during the past 7 years, assuming a normal distribution and a significance level of 99 percent.

<sup>e</sup> Including foreign-currency indexed. The calculation of the banking corporations' exposure to foreign currency in this survey is based on the positions obtained from Note 16 to the financial statements. The positions presented do not take into account taxation effects, which the banking corporations may take into account when managing the exposure.

<sup>f</sup> The maximum change in the nominal shekel-dollar exchange rate is derived from monthly changes in the exchange rate over the past 7 years, assuming a normal distribution and a significance level of 99 percent.

<sup>g</sup> The change that will occur in the bank's position as the result of a maximum change in the shekel-dollar exchange rate.

<sup>h</sup> The total maximum loss as a result of indexation base risk is obtained by simple addition of the maximum losses as a result of risks in the indexed segment and the foreign currency segment, assuming that the maximum change will occur in the direction that causes the bank the maximum loss in each segment.

SOURCE: Banking Supervision Department based on published financial statements and Central Bureau of Statistics data.

## b. Indexation base risks

The total exposure of the banking system to indexation base risk declined during the first half of 2015, primarily because of declines at some of the banks in the foreign currency segment and in the CPI-indexed segment positions. At the end of the half year, the potential loss as a result of the maximum change in the exchange rate and inflation<sup>29</sup> was NIS 347 million, which constitutes 0.5 percent of the total capital of the five groups (Table 15). Among the groups, there is considerable variance in the level of exposure, and the potential loss ranges from 0.1–2.0 percent of the bank's capital.

Similar to previous years, most of the major banking groups had surplus assets over liabilities in the CPI-indexed segment. As such, they were exposed to unexpected price decreases. In the period reviewed, there was a decline in exposure to CPI-indexation risk, and the potential loss as the result of the maximum change in inflation was NIS 150 million—0.2 percent of total capital of the five groups, as opposed to 0.4 percent at the end of 2014.

In the foreign currency segment, the exposure of most of the banking groups to the exchange rate in the first half of the year declined relative to the previous year. Most of the large banking groups were exposed to depreciation of the shekel due to surplus

<sup>29</sup> The maximum change in inflation and in the exchange rate is determined according to the monthly changes in inflation expectations and in the nominal exchange rate of the shekel against the dollar, respectively, over the past seven years, assuming a normal distribution and a confidence level of 99 percent.

liabilities over assets in the segment<sup>30</sup>, but some were exposed to appreciation. The potential loss of the five large groups as a result of the maximum depreciation in the shekel was about NIS 200 million, and the potential loss as a result of the appreciation of the shekel was about NIS 160 million.

## 6. Liquidity risk

At the end of the first half of the year, Israel's banking system had an adequate level of liquidity. This was reflected in the aggregate value of the Liquidity Coverage Ratio<sup>31</sup> (LCR) being about 101 percent in June 2015 (Figure 22), as well as in the high share of Level 1 High Quality Liquid Assets. Among the banks there is considerable variety in the LCR, though for every bank it was over 60 percent, the minimum regulatory requirement by April 2015.<sup>32</sup> A comparison with EU banks indicates that the liquidity of most banks in Israel, as reflected by the LCR, is lower than the level of similar banks in the EU (Figure 22), in both size groups examined, though part of that gap is a result of modifications introduced to the LCR specification by EU authorities, which in most cases positively affect the LCR value.<sup>33</sup> With that, the quality of Israeli banking corporations' assets, particularly for the smallest banks (Size Group 2), is greater than at corresponding banks in the EU,<sup>34</sup> made up nearly fully by Tier 1 assets, primarily cash and central bank deposits (Figure 23).

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<sup>30</sup> The banking corporations' foreign currency exposures were calculated for this survey on the basis of the positions obtained from the explanation to "Assets and liabilities by currency and by term to maturity" in the financial statements. The positions shown below do not take into account the taxation effects that banking corporations may bear in mind when managing their exposures. Changes in the exchange rate have an impact on the effective tax rate, because exchange rate differentials between investments abroad are not taken into account in calculating the income basis for the purpose of calculating provisions for taxes, while exchange rate differentials in respect of sources of financing are taken into account, so that a lack of symmetry develops in respect of exchange rate differentials. In calculating the scope of investments abroad, these changes may have a significant effect on provisions for taxes. Some of the banks hedge against tax exposure in respect of investments abroad.

<sup>31</sup> The Liquidity Coverage Ratio (LCR) was developed by the Basel Committee with the goal of promoting the short-term resilience of banking corporations' liquidity profile. The ratio shows the quantity of High Quality Liquid Assets (HQLA) that banking corporations need to hold in order to survive a significant stress scenario lasting 30 calendar days. The LCR is made up of two components: the numerator contains the stock of High Quality Liquid Assets. This stock is made up of two asset levels—Level 1 includes quality assets, and there is no limit on the extent to which they can be held, and Level 2 assets include assets that are limited in that they may not represent more than 40 percent of HQLA. (Level 2 is broken down into 2 parts: Level 2a and Level 2b. Level 2b assets are limited in that they may not account for more than 15 percent of HQLA.) The denominator of the LCR contains total net cash outflows, which are the total cash outflows expected during the stress scenario minus total cash inflows expected during the stress scenario. Total expected cash outflows are calculated by multiplying the balances of various categories or types of balance sheet and off-balance sheet liabilities by their expected run off or draw down rates. Total expected cash inflows are calculated by multiplying the balances of contractual receivables by the rate at which they are expected to be received in the scenario, up to an aggregate threshold of 75 percent of total expected cash outflows.

<sup>32</sup> As of April 1, 2015, the minimum regulatory requirement is 60 percent. At the beginning of January 2016, the requirement will be 80 percent, and in January 2017 it will reach its target of 100 percent.

<sup>33</sup> Size Group 1 includes banks whose Tier 1 Capital is greater than €3 billion and have cross-border activities (comparable to Leumi, Hapoalim and Discount). Size Group 2 includes banks whose Tier 1 Capital is less than €3 billion, or is greater than €3 billion but do not have cross-border activities (comparable to all banking corporations in Israel, excluding the three largest ones).

<sup>34</sup> This finding becomes more significant taking into account the modifications made by EU authorities broadening the definition of eligible HQLA.

In terms of quality of sources, they are known to be stable, and Israeli banks finance their activity mainly through deposits of the public and less so through retail sources. In December 2014, deposits from individuals made up about 45 percent of total deposits of the five large banking groups, deposits from business entities were about 35 percent, institutional investors about 11 percent and sources abroad—about 9 percent.

