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## **Main Developments in the Banking System during the First Half of 2012**

### **Summary of Developments**

During the first half of 2012, **the banking system** continued to maintain its resilience and stability, against the background of uncertainty in the global and domestic economies, regional geopolitical developments, and the low interest rate environment. Negative developments in the capital markets and the slowdown in domestic activity also influenced corporate risk, which remains high, although it is lower than it was during the height of the crisis (2008–09).

**Balance-sheet credit** increased by 3 percent, similar to the GDP growth rate. **Retail credit** continued to expand, particularly housing credit, the growth rate of which accelerated beginning in the second quarter as a result of the resurgence in the housing market. **Credit to the business sector** did not grow, particularly in light of the reduction in credit to the financial services industry. During the reviewed period, there was a decline in borrower concentration in the credit portfolio, but it remains high.

**The core tier 1 capital ratio** of the five banking groups increased from 7.9 percent to 8.3 percent as a result of the new capital targets, and as of June 2012, the core capital ratio in all of the banking groups was not less than 8.0 percent. The increase in the ratio is the result not only of the accumulation of profits and the non-distribution of dividends, but also the halt in growth of business sector credit.

**The profitability** of the banking groups in the first half of 2012 was similar to the long-term average, and was characterized by relatively high variance between the groups.

**Table 1**  
**Principal banking system indices, five major banking groups,**  
**December 2001 to June 2012**

Year	Ratio of market value to book value (MV/BV)	Average yield gap between bonds of the banks and government bonds		Loan loss provision to total balance sheet credit to the public <sup>a</sup> (percent)		Ratio of liquid assets <sup>b</sup> to liquid liabilities <sup>c</sup>	Ratio of credit to deposits	Total capital ratio (percent)	Core tier 1 capital ratio (percent)	ROE (percent)
		Ratio of credit to GDP (percent)	provision <sup>a</sup> (percent)	balance sheet credit to the public <sup>a</sup> (percent)	total					
2001	0.8	0.8	102.3	0.9			0.81	9.4		5.8
2002	0.6	0.8	107.5	1.3			0.83	9.9		2.8
2003	0.8	0.7	104.0	1.1			0.82	10.3		8.4
2004	1	0.8	100.0	0.9			0.80	10.7		13.2
2005	1.4	0.7	97.5	0.7			0.82	10.7		13.9
2006	1.3	0.6	94.8	0.5			0.80	10.8		17.3
2007	1.2	1.1	97.0	0.3			0.85	11.0		15.6
2008	0.6	1.9	101.6	0.7			0.90	11.2		0.3
2009	1.1	1.7	94.7	0.7			0.86	13.7 <sup>d</sup>		8.8
								13.6 <sup>e</sup>	7.9	
2010	1.1	1.7	95.1	0.4		0.34	0.91	14.0	8.0	9.8
2011	0.7	1.5	91.9	0.4		0.40	0.89	14.0	7.9	10.2
01/06/2012 <sup>f</sup>	0.7	1.6	90.3	0.4		0.40	0.89	14.4	8.3	9.0

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

<sup>b</sup>Liquid assets include cash as well as deposits at the Bank of Israel and at other banks with up to 1 month to maturity, and government bonds.

<sup>c</sup>Liquid liabilities include total deposits with up to 1 month to maturity.

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

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

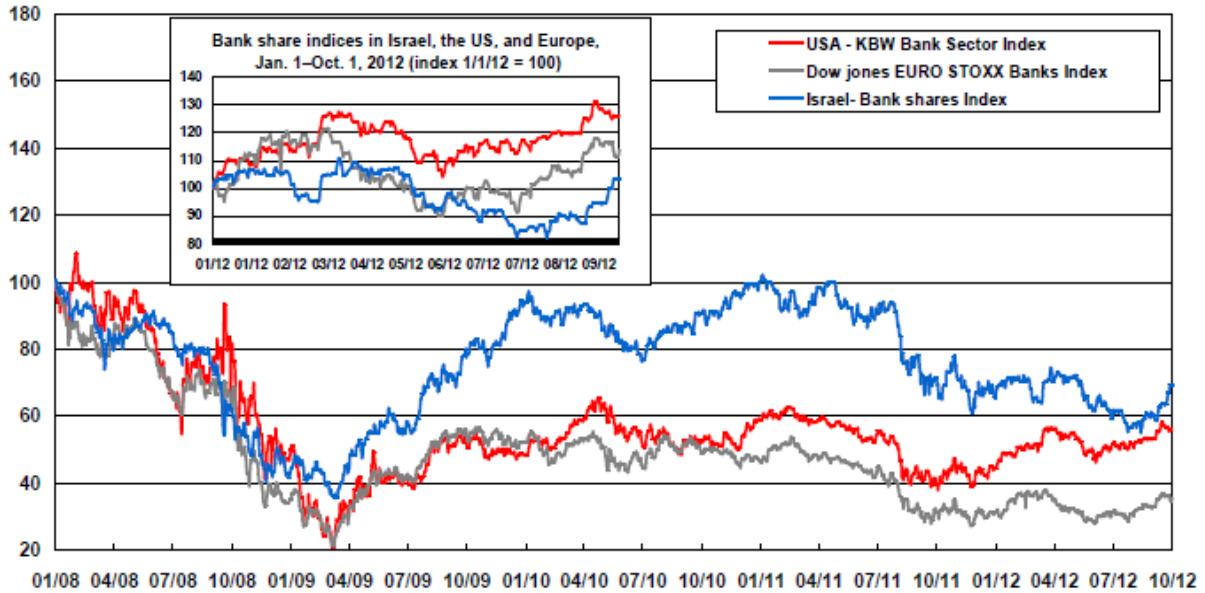
<sup>f</sup>The ratio of market value to book value (MV/BV) and the average yield gap between bonds of the banks and government bonds are as of October 18, 2012.

**SOURCE:** Central Bureau of Statistics, Bank of Israel, published financial statements, reports to the Banking Supervision Department and Banking Supervision Department calculations.

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**Figure 1**  
**Bank share indices in Israel, the US, and Europe, 2008–October 1, 2012<sup>a</sup>**  
 (index 1/1/08 = 100)



<sup>a</sup>On days with no trading, the previous figure was used  
 SOURCE: Tel Aviv Stock Exchange and finance.yahoo.com web site.

## 1. Evaluation of the banking system's performance based on capital market data

During the first half of the year, there was some increase in the risk level of the banking system, as reflected in the banks' yield levels, in the EDF index, and in the MV/BV ratio.

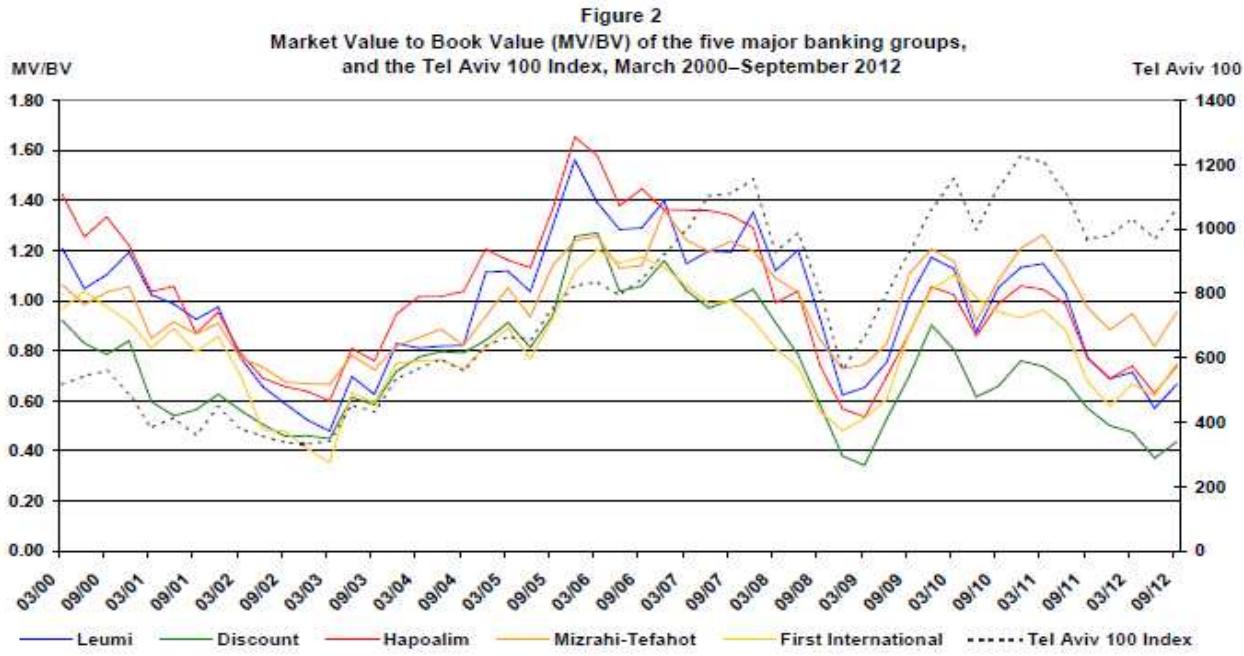
Trading on the Israeli stock market was characterized by high volatility, and ended with a decline in most stock indices, including the Bank Shares Index, which declined over the reviewed period (Figure 1).

Regarding the MV/BV indicator, which reflects investors' assessments, as of June 2012, the ratio's value was at a historic low, and stood at an average of 0.5 index points. The ratio, as calculated for June 2012, was similar and even lower for some of the banks than the low values recorded during the two last financial crises (Figure 2), though in recent months, we are seeing an improvement in the market value of the banks and a parallel improvement in the value of the MV/BV ratio which, as of October 2012, stands at a higher average value of 0.7 (Table 1).

Among the factors that have affected the decline in the ratio, we note investors' concerns about the future challenges expected for the banking corporations in light of: (1) the low

interest rate environment; (2) the negative developments and the uncertainty in the global and domestic economies; (3) regional geopolitical developments; and (4) Basel III's new core capital targets for the Israeli banks—which have an effect on, among other things, the expansion of future activities and the distribution of dividends. .

An assessment of the changes in the stock market and the developments in the market capitalization of the banking corporations shows that from the eve of the last financial crisis (June 2007) until today, the market capitalization of the banks has declined by rates that vary from 3 percent (Mizrahi-Tefahot) to 20 percent (First International) to 50 percent (Discount Bank), with the market capitalization of the largest two banks declining by about 30 percent.



1. The MV/BV ratio is calculated with a lag of one quarter between the market value and book value figures.  
SOURCE: TASE data and published financial statements.

## 2. Main developments in balance-sheet activity

**Assets:** The total aggregate balance sheet of the five major banking groups increased slightly in the first half of the year at a moderate annual rate of 1.9 percent (about NIS 11 billion), to a total of about NIS 1.2 trillion (Table 2). This growth rate is markedly lower than that of the second half of 2011 (about 17.6 percent) and 2011 as a whole (about 10 percent). Two main developments characterized the banks' asset portfolio during the reviewed period: (1) a slight increase in total net credit to the public (2.7 percent), which was driven mainly by demand for housing credit in light of a freeze in business credit, and (2) a change in the composition of the balance sheet and a significant increase in the securities portfolio (30 percent), mainly due to the purchase of government bonds, mostly at the expense of cash and deposits at banks.

**Liabilities:** Deposits from the public increased in the first six months of 2012, by a slight rate of 1.5 percent (about NIS 16 billion). Among the classical activity segments, the only ones showing growth in deposits were the small business segment (32 percent) and the commerce segment (4 percent). The most marked decline was in the households segment (8.8 percent). Bonds and subordinated debt notes increased by about 7 percent (some NIS 3 billion), and their weight in the total balance sheet continued to grow during the reviewed period, and totaled some 8 percent—a continuation of the growth trend in debt instruments that characterized the previous three years.

**Table 2**  
**The balance sheet of the five major banking groups<sup>a</sup>, December 2010 - June 2012, (NIS million)**

	06/2012	12/2010	06/2011	12/2011	Rate of change during the first half of 2012 (percent, in annual terms)	Rate of change during 2011 (percent)
<b>Assets</b>						
Cash and deposits at banks	150,041	126,747	149,401	173,578	-27.1	36.9
Securities	167,679	147,822	118,340	145,549	30.4	-1.5
Of which:						
Securities provided as collateral to lenders	12,237	13,201	11,604	13,184	-14.4	-0.1
At fair value	46,105	29,798	31,431	44,097	9.1	48.0
Securities borrowed or bought under agreements to resell	4,538	3,014	2,825	3,016	100.9	0.1
<b>Credit to the public<sup>b</sup></b>	<b>811,965</b>	<b>772,622</b>	<b>768,921</b>	<b>801,059</b>	<b>2.7</b>	<b>3.7</b>
Allowance for credit losses	12,270	34,200	12,971	12,555	-4.5	-63.3
Net credit to the public	799,695	738,422	755,950	788,504	2.8	6.8
Credit to the government	3,215	2,379	2,399	2,910	21.0	22.3
Investments in consolidated and affiliated companies	4,242	4,140	4,241	4,429	-8.4	7.0
Premises and equipment	13,213	13,400	13,140	13,270	-0.9	-1.0
Intangible assets	1,063	1,029	1,001	1,120	-10.2	8.8
Assets in respect of derivative instruments	29,271	21,786	20,225	30,217	-6.3	38.7
Other assets	14,504	10,239	13,687	13,813	10.0	34.9
<b>Total assets</b>	<b>1,187,461</b>	<b>1,068,978</b>	<b>1,081,209</b>	<b>1,176,406</b>	<b>1.9</b>	<b>10.0</b>
<b>Liabilities and equity</b>						
Deposits of the public	896,276	807,706	815,818	889,812	1.5	10.2
Deposits from banks	17,443	14,912	18,735	19,173	-18.0	28.6
Deposits from the government	3,168	3,424	3,078	3,234	-4.1	-5.5
Securities lent or sold under agreements to repurchase	8,270	8,619	7,720	8,447	-4.2	-2.0
Bonds and subordinated notes	95,634	81,491	85,618	92,383	7.0	13.4
Liabilities in respect of derivative instruments	34,909	28,024	26,116	35,376	-2.6	26.2
Other liabilities	55,397	53,486	53,944	54,768	2.3	2.4
<b>Total liabilities</b>	<b>1,111,097</b>	<b>997,662</b>	<b>1,011,029</b>	<b>1,103,193</b>	<b>1.4</b>	<b>10.6</b>
Minority interest	1,517	1,758	1,518	1,695	-21.0	-3.6
shareholders Equity	74,847	69,558	68,662	71,518	9.3	2.8
Total equity	76,364	71,316	70,180	73,213	8.6	2.7
<b>Total liabilities and equity</b>	<b>1,187,461</b>	<b>1,068,978</b>	<b>1,081,209</b>	<b>1,176,406</b>	<b>1.9</b>	<b>10.0</b>

<sup>a</sup> Includes the five major banks (Leumi, Hapoalim, Discount, First International and Mizrahi-Tefahot); does not include Union Bank, Bank of Jerusalem and Dexia Bank, or branches of foreign banks operating in Israel.

<sup>b</sup> Net credit to the public plus the allowance for credit losses.

**SOURCE:** Published financial statements and Banking Supervision Department calculations.

### 3. The credit portfolio and credit risk<sup>1</sup>

#### 3.1 Credit outstanding:

During the first half of 2012, the total credit portfolio (balance-sheet and off-balance-sheet) of the five banking groups grew at an annual rate of 4 percent, and totaled NIS 1,228 billion (Table 3). Balance-sheet credit grew at an annual rate of 3 percent, similar to the GDP growth rate (Figure 3), and is mostly attributed to the continued expansion of housing credit (about 9 percent). In contrast, business sector credit did not increase.

Table 3

Distribution of outstanding credit to the public by principal industries, the five major banking groups, December 2011 and June 2012

Principal industries	Total credit to the public <sup>a</sup>						Balance-sheet credit to the public <sup>b</sup>					
	Gross Balance		Distribution of credit balance		Change in credit balance <sup>c</sup>	Gross Balance		Distribution of credit balance		Change in credit balance <sup>c</sup>		
	12/2011	6/2012	12/2011	6/2012		12/2011	6/2012	12/2011	6/2012		12/2011	6/2012
	(NIS million)		(Percent)		(Percent)		(NIS million)		(Percent)		(Percent)	
<b>Business sector</b>	<b>633,065</b>	<b>638,949</b>	<b>52.6</b>	<b>52.0</b>	<b>1.9</b>	<b>406,950</b>	<b>406,845</b>	<b>49.2</b>	<b>48.4</b>	<b>-0.1</b>		
Agriculture	7,573	7,431	0.6	0.6	-3.8	6,128	5,831	0.7	0.7	-9.7		
Manufacturing	117,629	118,776	9.8	9.7	2.0	72,119	72,117	8.7	8.6	-0.0		
Construction and real estate <sup>d</sup>	200,192	202,888	16.6	16.5	2.7	112,010	113,196	13.5	13.5	2.1		
Of which : Purchase groups	10,760	10,003	0.9	0.8	-14.1	3,225	3,176	0.4	0.4	-3.0		
Electricity and water	13,929	15,764	1.2	1.3	26.3	6,999	7,320	0.8	0.9	9.2		
Commerce	77,431	80,526	6.4	6.6	8.0	58,191	61,622	7.0	7.3	11.8		
Tourism <sup>e</sup>	14,584	14,418	1.2	1.2	-2.3	12,724	12,633	1.5	1.5	-1.4		
Transport and storage	19,611	19,812	1.6	1.6	2.0	15,379	15,721	1.9	1.9	4.4		
Communications and computer services	27,277	25,883	2.3	2.1	-10.2	18,214	17,900	2.2	2.1	-3.4		
Financial services	98,579	95,707	8.2	7.8	-5.8	62,351	57,414	7.5	6.8	-15.8		
Other business services	35,300	36,867	2.9	3.0	8.9	26,270	26,743	3.2	3.2	3.6		
Public and community services	20,960	20,877	1.7	1.7	-0.8	16,565	16,348	2.0	1.9	-2.6		
<b>Private individuals</b>	<b>427,883</b>	<b>444,428</b>	<b>35.5</b>	<b>36.2</b>	<b>7.7</b>	<b>318,717</b>	<b>329,245</b>	<b>38.5</b>	<b>39.1</b>	<b>6.6</b>		
Of which: Housing loans	214,712	225,070	17.8	18.3	9.6	206,180	215,125	24.9	25.6	8.7		
Non-housing loans	213,171	219,358	17.7	17.9	5.8	112,537	114,120	13.6	13.6	2.8		
<b>Borrowers' activity abroad</b>	<b>142,841</b>	<b>144,502</b>	<b>11.9</b>	<b>11.8</b>	<b>2.3</b>	<b>102,152</b>	<b>105,038</b>	<b>12.3</b>	<b>12.5</b>	<b>5.7</b>		
<b>Total</b>	<b>1,203,789</b>	<b>1,227,879</b>	<b>100.0</b>	<b>100.0</b>	<b>4.0</b>	<b>827,819</b>	<b>841,128</b>	<b>100</b>	<b>100</b>	<b>3.2</b>		

<sup>a</sup> Includes outstanding credit to the public, investment in corporate bonds, other assets in respect of derivative instruments and credit risk in off-balance-sheet financial instruments, as calculated for the purpose of borrower indebtedness restrictions. The distribution of the credit balance is calculated based on borrowers' activity in Israel and abroad.

<sup>b</sup> Includes investments in corporate bonds.

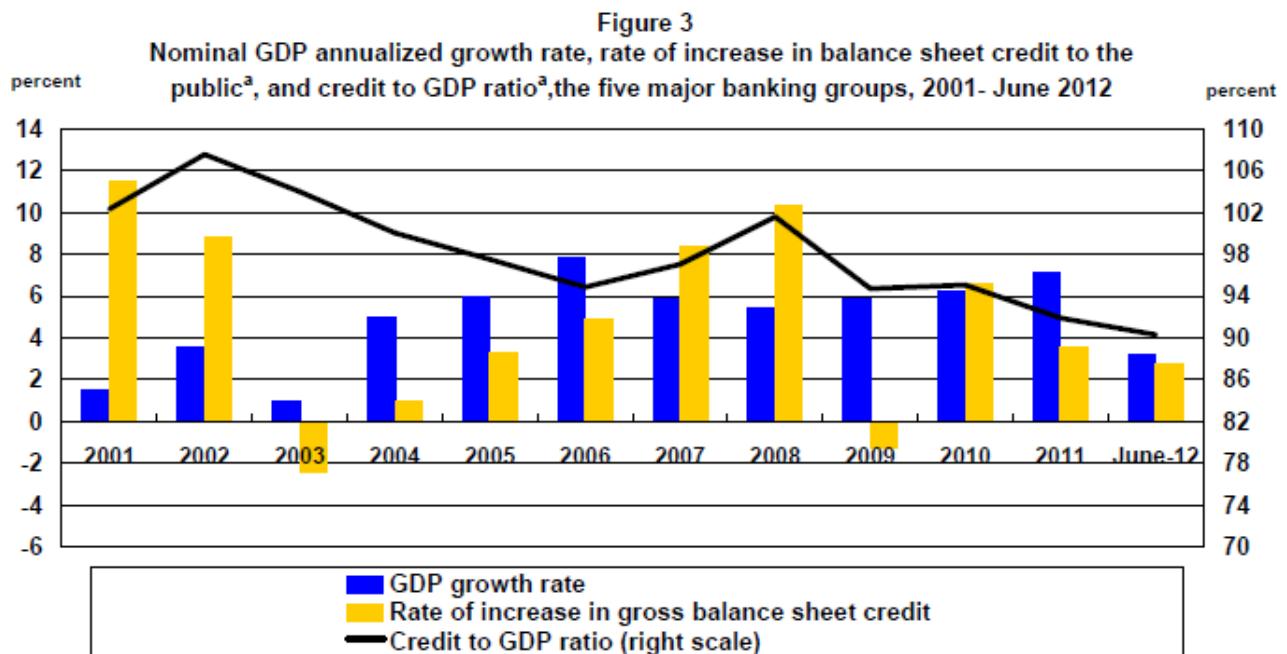
<sup>c</sup> The data for June 2012 is presented in annual terms.

<sup>d</sup> The method of calculating the industry figures is not the same as that used for the industry indebtedness limitation.

<sup>e</sup> Hotels, food services, and hospitality.

SOURCE: Published financial statements.

<sup>1</sup> The analysis in this chapter relates to gross credit.



<sup>a</sup> The analysis is based on gross credit. The development of the credit to GDP ratio and of the rate of increase in gross balance sheet credit includes as well the effect of the Impaired Debt Directive

SOURCE: Published financial statements, the Information and Statistics Department.

### 3.2 Business sector credit:

During the first half of the year, the balance of business sector balance-sheet credit remained unchanged, following growth of 5 percent, on average, during the two previous years (Table 3). This development was reflected in a reduction of some NIS 5 billion in credit to the financial services industry (a decline of 16 percent). In contrast, balance-sheet credit to the construction and real estate industry grew at an annual rate of 2 percent, and grew for the commerce industry at an annual rate of 12 percent, similar to their growth rates during the past two years.

Credit to the financial services industry also includes credit to holding companies which, during the recent period, showed a growth in risk in light of financing difficulties and difficulties in the repayment of their bonds. This development was reflected in an increase in bank credit risk as well, and in the high level of provisions in the industry, which reached a rate of 2.7 percent, compared with 0.6 percent for the whole business sector (Table 4).

**Table 4**  
**Measures of credit risk by industry, five major banking groups, December 2011 and June 2012**

<b>Principal industries</b>	Impaired loans to total balance-sheet credit		Loan-loss provision to total balance-sheet credit <sup>a</sup>		Write-offs to total balance-sheet credit <sup>a</sup>		Allowance for credit losses to total balance-sheet credit	
	12/2011	6/2012	12/2011	6/2012	12/2011	6/2012	12/2011	6/2012
(Percent)								
<b>Business sector</b>	<b>4.3</b>	<b>4.4</b>	<b>0.50</b>	<b>0.62</b>	<b>1.02</b>	<b>0.68</b>	<b>1.96</b>	<b>1.97</b>
Agriculture	2.9	2.7	-0.75	-0.65	2.25	-2.06	1.71	1.70
Manufacturing	4.7	4.4	0.00	0.44	1.41	1.02	2.56	2.30
Construction and real estate <sup>b</sup>	5.9	5.7	1.42	-0.34	2.00	0.85	2.80	2.38
<i>Of which</i> : Purchase groups	0.0	0.0	0.06	0.00	0.00	0.00	0.28	0.19
Electricity and water	0.9	0.8	0.13	0.14	0.77	0.22	0.73	0.56
Commerce	2.7	2.5	0.50	1.17	-0.12	0.66	1.53	1.89
Tourism <sup>c</sup>	11.7	10.0	-0.53	-0.25	0.97	0.32	1.89	1.50
Transport and storage	1.4	3.1	0.06	1.32	0.53	0.01	0.83	1.56
Communications and computer services	2.0	1.5	-0.88	-0.37	-0.15	-0.09	1.12	1.01
Financial services	4.4	5.4	0.31	2.75	0.57	1.17	1.31	2.02
Other business services	1.6	3.5	0.70	0.70	0.45	0.24	1.59	1.70
Public and community services	2.2	2.0	0.27	0.15	0.79	0.13	0.78	0.83
<b>Private individuals</b>	<b>0.4</b>	<b>0.4</b>	<b>0.18</b>	<b>0.15</b>	<b>0.22</b>	<b>0.17</b>	<b>1.31</b>	<b>1.24</b>
<i>Of which</i> : Housing loans	0.0	0.0	0.02	0.01	0.08	0.05	1.01	0.94
Non-housing loans	1.2	1.2	0.48	0.43	0.48	0.38	1.85	1.80
<b>Borrowers' activity abroad</b>	<b>4.7</b>	<b>4.0</b>	<b>0.51</b>	<b>0.17</b>	<b>0.77</b>	<b>0.49</b>	<b>1.78</b>	<b>1.51</b>
<b>Total</b>	<b>2.9</b>	<b>2.8</b>	<b>0.38</b>	<b>0.38</b>	<b>0.68</b>	<b>0.46</b>	<b>1.69</b>	<b>1.63</b>

<sup>a</sup> The data for June 2012 is presented in annual terms.

<sup>b</sup> The method of calculating the industry figures is not the same as that used for the industry indebtedness limitation.

<sup>c</sup> Hotels, food services, and hospitality.

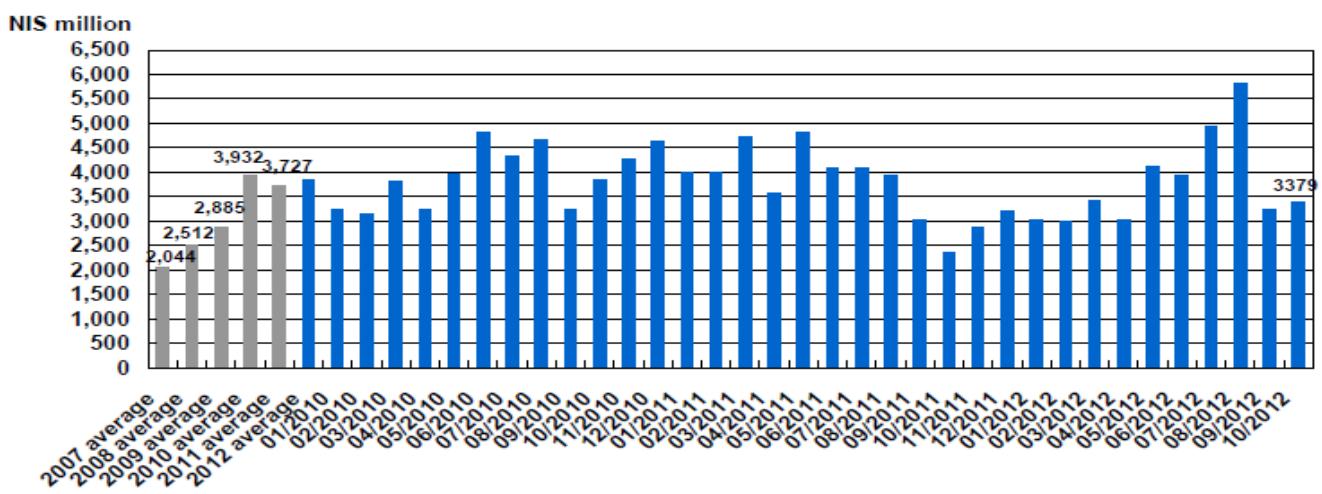
**SOURCE:** Published financial statements.

### 3.3 Household credit:

Outstanding balance-sheet credit to households increased by 7 percent during the reviewed period, with most of the increase coming from continued growth of housing credit (Table 3).

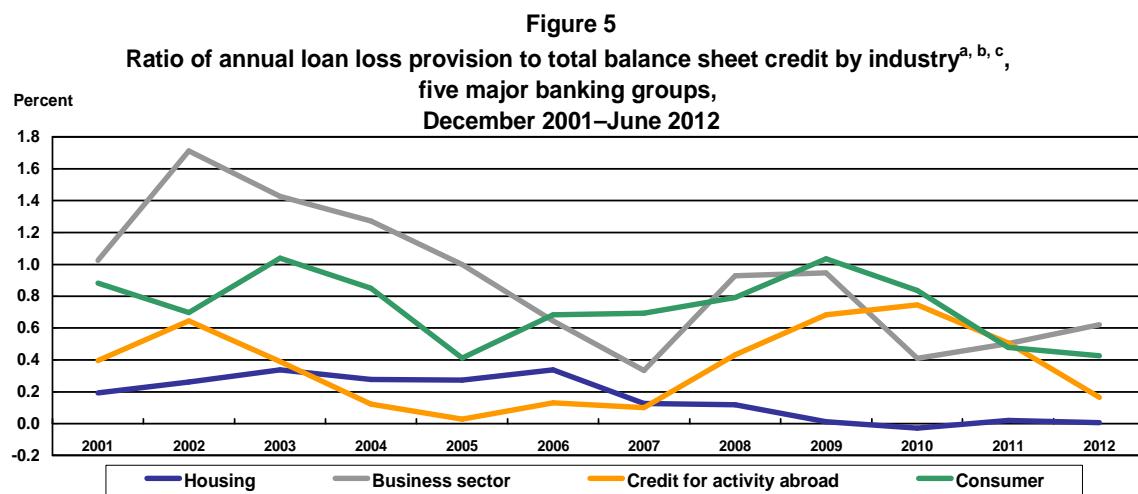
Developments in credit for housing in recent months were mixed: Since the last quarter of 2011, there has been a slowdown in its rate of growth, while during the second quarter of 2012, there has been a noticeable increase in the volume of new mortgages, which reached a peak in August of this year (Figure 4). The spike in the volume of mortgages in recent months (particularly in July and August) is attributed both to the low interest rate level, which brought investors back into the housing market, and to the 1 percent increase in VAT as of September 2012, which led to the bringing forward of new apartments purchases, which constitute a quarter of total housing transactions.

**Figure 4**  
**New loans granted for the purchase of residential property - monthly volume**  
**January 2010 to August 2012**



SOURCE: Reports to the Banking Supervision Department, and Banking Supervision Department calculations.

About one-third of the balance-sheet credit risk to households comes from consumer credit (credit excluding housing). During the first half of the year, this balance grew at an annualized rate of 3 percent, similar to its growth rate last year. Regarding risk, households' unemployment rate remained at a low level, while the value of their financial assets deteriorated against the background of declines in the capital markets. Credit risk indices show that the ratio of loan loss provisions to total credit was 0.4 percent, similar to its level in 2011, although it is significantly lower than the 2005–10 average (0.8 percent). The decline in this ratio can be attributed to, among other things, changes in measurement due to the impaired debts directive (Figure 5).



<sup>a</sup> Credit to the business sector, housing credit, and consumer credit are only in respect of activity in Israel.

<sup>b</sup> Credit in respect of activity abroad includes corporate credit and credit to individuals.

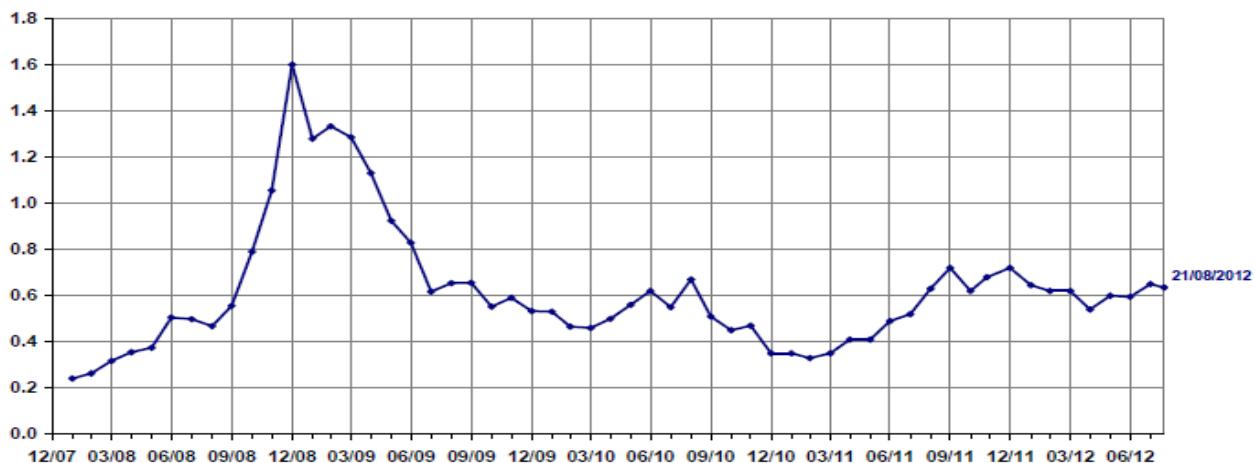
<sup>c</sup> The June 2012 calculation has been annualized.

SOURCE: published financial statements.

### 3.4 Credit quality:

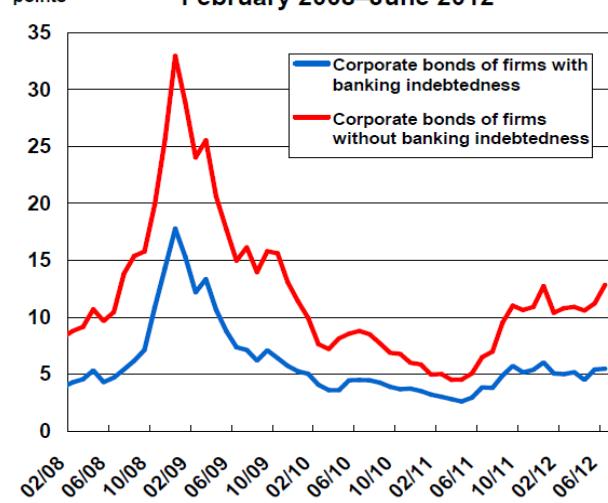
During the first half of 2012, the risk level of companies in the economy remained high compared to the economic boom years, although it is lower than during the height of the crisis in 2008–09 (Figure 6). This development is also noticeable in the banks' internal ratings (Figure 8) and in the ratio of loan loss provisions to total credit which was 0.4 percent in June 2012 (Table 5).

**Figure 6**  
EDF<sup>a</sup> of Israeli corporations, 2008–August 2012



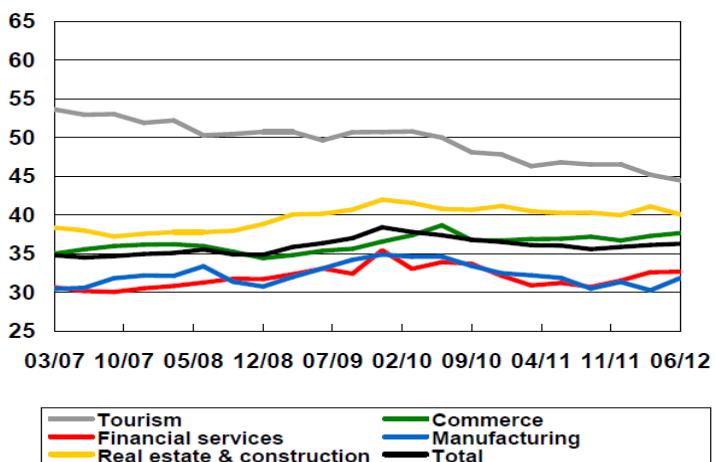
<sup>a</sup> The median EDF—Expected Default Frequency—is calculated based on 121 corporations.  
SOURCE: Moody's KMV and Banking Supervision Department calculations.

**Figure 7**  
Yield spread between corporate bonds  
and government bonds<sup>a</sup>,  
February 2008–June 2012



<sup>a</sup> The median rather than the average spread was calculated because the spread does not have a normal distribution. The calculation is based on data for 59 CPI-indexed bonds of companies without banking indebtedness, and 92 companies with banking indebtedness at the five major banking groups. Government bonds are represented by Galil bonds with the same duration as the corporate bonds.  
SOURCE: Bank of Israel, reports to the Banking Supervision Department, and Banking Supervision Department calculations.

**Figure 8**  
Average credit risk rating<sup>a</sup> by principal industries  
at the five major banks, March 2007–June 2012



<sup>a</sup> The banking corporations rank the credit risk of companies whose outstanding indebtedness exceeds NIS 20 million within the context of reports to the Banking Supervision Department. Since the rating scales reported by the banks differ from bank to bank, for the purposes of this review we constructed a standard rating scale for all five major banking groups, with values ranging from 0 to 100 . (credit ratings of 0-36 denote low risk, 37-57 medium risk, and 58-100 high risk). The lower the reported value, the higher the quality of the company's credit.  
SOURCE: Reports to the Banking Supervision Department.

**Table 5**  
**Indices of credit portfolio quality of the five major banking groups, December 2006 to June 2012**  
 (percent)

	Year	Leumi	Hapoalim	Discount	Mizrahi	First	Five
					Tefahot	International	groups
Ratio of total risk-weighted assets to total assets <sup>a</sup>	2006	67.0	72.2	59.8	66.6	61.3	66.9
	2007	69.0	72.8	61.9	68.2	58.8	68.0
	2008	69.5	72.3	64.8	66.9	59.1	68.3
	2009 <sup>b</sup>	64.2	67.9	60.6	67.1	54.4	64.1
	2009 <sup>c</sup>	67.0	69.2	63.3	59.6	56.2	65.2
	2010	68.3	68.7	67.2	58.7	61.0	66.4
	2011	67.7	67.3	60.4	58.3	60.0	64.6
	Q2/2012	68.3	66.8	61.8	58.8	59.1	64.8
Loan loss provision to total balance sheet credit to the public <sup>d</sup>	2006	0.51	0.53	0.63	0.44	0.42	0.52
	2007	0.21	0.25	0.44	0.31	0.33	0.28
	2008	1.01	0.68	0.67	0.44	0.39	0.72
	2009	0.74	0.93	0.87	0.39	0.44	0.75
	2010	0.25	0.44	0.66	0.43	0.17	0.39
	2011 <sup>e</sup>	0.30	0.48	0.66	0.28	0.14	0.39
	Q2/2012	0.46	0.51	0.40	0.18	0.15	0.40
Net write-offs to total gross balance sheet credit to the public	2011	0.84	0.84	0.72	0.44	0.15	0.71
	Q2/2012	0.59	0.57	0.52	0.18	0.19	0.48
Allowance for credit losses to total balance sheet credit to the public	2010 <sup>f</sup>	2.3	2.1	1.7	1.6	1.3	2.0
	2011	1.6	1.6	1.7	1.4	1.3	1.6
	Q2/2012	1.6	1.6	1.6	1.3	1.3	1.5
Impaired loans to total balance sheet credit to the public	2010 <sup>f</sup>	3.8	4.7	4.7	1.5	1.9	3.7
	2011	2.8	3.4	4.7	1.3	1.6	3.0
	Q2/2012	2.9	3.4	4.3	1.2	1.5	2.9
Allowance for credit losses <sup>g</sup> to impaired loans to the public	2010 <sup>f</sup>	53.5	41.7	31.2	52.1	62.6	44.8
	2011	50.9	43.1	31.1	48.1	74.5	44.2
	Q2/2012	47.7	42.2	32.6	53.7	75.1	43.9
Impaired loans net of provision to capital	2010 <sup>f</sup>	24.2	35.9	48.3	17.6	14.3	30.2
	2011	21.4	29.0	46.6	17.5	11.4	26.4
	Q2/2012	22.7	28.1	41.9	14.0	10.6	25.4

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

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

<sup>c</sup> The ratio is calculated in accordance with Basel II principles. Risk assets are calculated after deduction of credit risk (CRM).

<sup>d</sup> Until December 2010, net credit to the public was used; since 2011, gross credit to the public has been used.

<sup>e</sup> Due to the implementation of the Impaired Debt Directive as of January 1, 2011, the figures for December 2011 cannot be fully compared with previous periods.

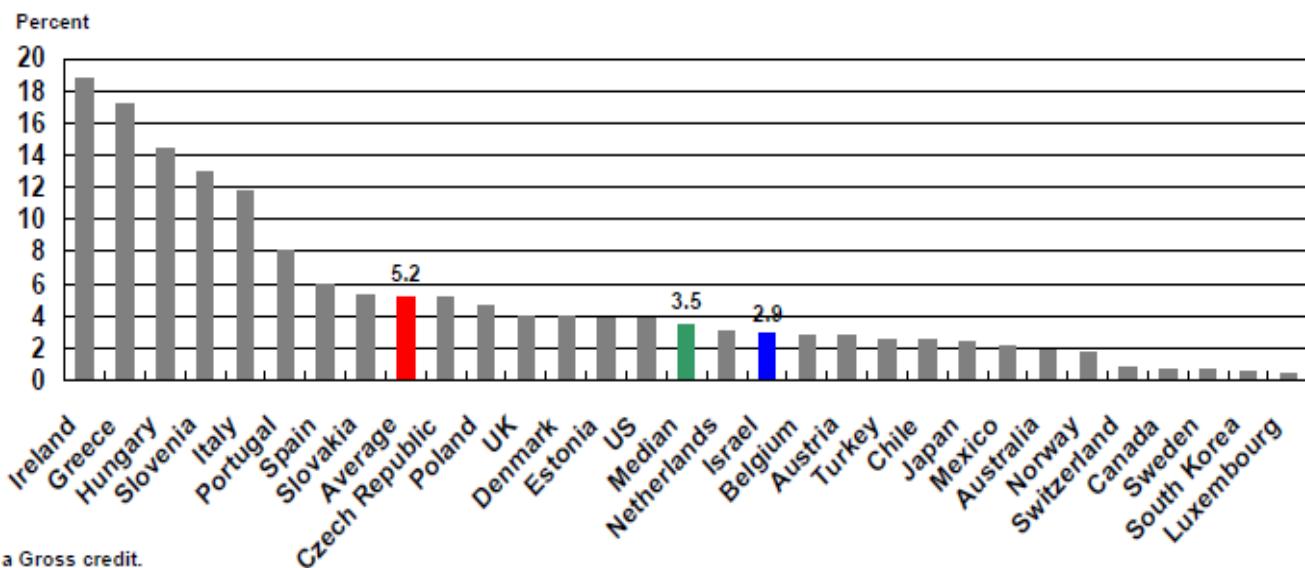
<sup>f</sup> Data calculated as of January 1, 2011 - after the implementation of the directive for impaired debt.

<sup>g</sup> Net of allowance for credit losses for housing loans, for which the credit loss allowance must be calculated according to days past due.

SOURCE: Published financial statements and Banking Supervision Department calculations.

The ratio of net write-offs to balance-sheet credit reached 0.48 percent in June 2012, and is slightly higher than the ratio of loan loss provisions to balance-sheet credit. The ratio of the allowance for credit losses to impaired debt to the public—which reflects the bank's estimation of expected credit losses relative to the size of the credit portfolio that they have classified as impaired, was 44 percent (Table 5). We note that there is high heterogeneity between the banks concerning credit quality indices from the financial statements, which are expressed in the ratio of loan loss provisions, the ratio of impaired credit to credit, and the coverage ratio (Table 5).

**Figure 9**  
**International comparison: Impaired loans to total loans<sup>a</sup>, 2011-12<sup>b</sup>**



a Gross credit.

b Data for Belgium as of December 2010. Data for Japan as of September 2011. Data for Italy, Spain, Poland, UK, Norway, Switzerland, and South Korea, as of December 2011. Data for Ireland, Greece, Hungary, Slovenia, Portugal, Slovakia, the Czech Republic, Denmark, Estonia, US, Austria, Mexico, Australia, Canada, and Sweden as of March 2012. Data for Chile as of April 2012. Data for Israel, the Netherlands, Turkey, and Luxembourg as of June 2012.

SOURCE: Data on foreign countries—IMF; Data on Israel—Published financial statements and Banking Supervision Department calculations.

### 3.5 Borrower concentration:

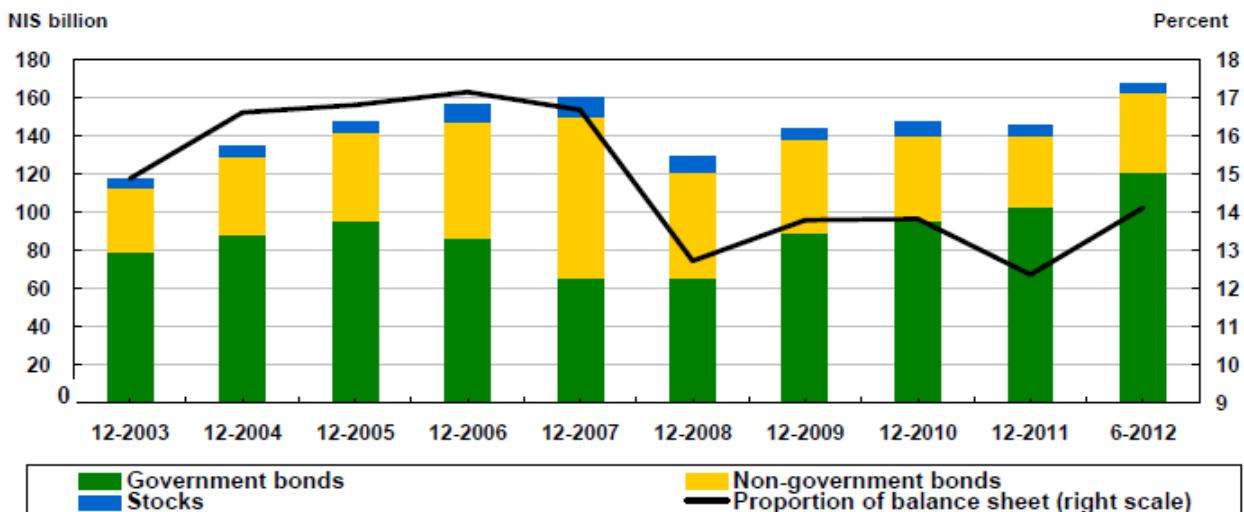
During the first half of the year, there was a decline in borrower concentration. Total net indebtedness of the largest borrower groups<sup>2</sup> declined during this period at most banks, and the net indebtedness of the largest group of borrowers decreased at all banks, and as of June 2012, its weight in the capital basis ranges from 16 percent to 23 percent.

An analysis of the credit portfolio of the entire banking system indicates that the largest borrowers in the banking system who borrowed from the capital market as well comprise about 15 percent of the banks' balance-sheet and off-balance-sheet business credit risk (NIS 98 billion), of which about NIS 7 billion is from borrowers whose bonds were traded in September 2012 at yields above 12 percent.

### 4. The securities portfolio

The securities portfolio of the five banking groups totaled NIS 168 billion in June 2012, constituting 14 percent of total assets (Figure 10). During the first half of the year, there has been an increase of NIS 22 billion in the securities portfolio, resulting from the purchase of Israel government bonds<sup>3</sup> (reflecting an annualized growth rate of 30 percent) (Table 6). The increase encompassed four of the five banking groups, and in some of the groups, the increase in the securities portfolio was accompanied by a decline in the cash and bank deposits item.

**Figure 10**  
**The five major banking groups' securities portfolio<sup>a</sup> - size and composition, 2003–June 2012**



<sup>a</sup>Excluding consolidated companies which are included in the group's equity basis.

SOURCE: Published financial statements and Banking Supervision Department calculation.

<sup>2</sup> The borrower groups whose net indebtedness is more than 10% of the bank's capital base.

<sup>3</sup> A small part of the increase is from increases in the value of the bonds, totaling about NIS 1 billion.

Table 6

Securities portfolio of the five largest banking groups, 2011 and June 2012<sup>a</sup>

	Bank Leumi				Bank Hapoalim				Bank Discount <sup>b</sup>				
	2011		June 2012		2011		June 2012		2011		June 2012		
	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	
	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	
Bonds held to maturity	Israeli government bonds	-	-	-	57	0.2	59	0.1	2,605	6.1	3,202	7.0	
	Foreign government bonds	-	-	-	-	-	-	-	2,184	5.1	2,082	4.6	
	Israeli financial institutions	-	-	-	804	2.3	758	1.9	-	-	87	0.2	
	Foreign financial institutions	-	-	-	8	-	-	-	58	0.1	87	0.2	
	MBS, ABS	-	-	-	-	-	-	-	1,028	2.4	1,801	4.0	
	Other bonds - Israeli	-	-	-	-	-	-	-	-	-	-	-	
	Other bonds - foreign	-	-	-	-	-	-	-	20	-	16	0.0	
	Total bonds held to maturity	-	-	-	869	2.5	817	2.0	5,895	13.7	7,275	16.0	
Securities available for sale	Israeli government bonds	19,775	41.3	28,104	46.6	23,859	69.3	27,495	67.5	16,991	39.6	19,948	43.9
	Foreign government bonds	3,675	7.7	4,445	7.4	2,053	6.0	2,373	5.8	1,004	2.3	906	2.0
	Israeli financial institutions	397	0.8	324	0.5	173	0.5	163	0.4	762	1.8	704	1.5
	Foreign financial institutions	7,854	16.4	6,714	11.1	1,026	3.0	1,327	3.3	2,067	4.8	2,380	5.2
	MBS, ABS	2,444	5.1	4,701	7.8	7	-	2	0.0	11,842	27.6	11,748	25.8
	Other bonds - Israeli	604	1.3	565	0.9	547	1.6	662	1.6	278	0.6	404	0.9
	Other bonds - foreign	1,254	2.6	1,135	1.9	747	2.2	1,068	2.6	32	0.1	10	0.0
	Total bonds available for sale	36,003	75.1	45,988	76.2	28,412	82.6	33,090	81.2	32,976	76.9	36,100	79.4
	Total stocks available for sale	2,191	4.6	1,929	3.2	1,538	4.5	1,372	3.4	658	1.5	607	1.3
	Total securities available for sale	38,194	79.7	47,917	79.4	29,950	87.0	34,462	84.6	33,634	78.4	36,707	80.8
Securities for trading	Israeli government bonds	8,153	17.0	10,149	16.8	2,924	8.5	4,451	10.9	3,218	7.5	1,324	2.9
	Foreign government bonds	183	0.4	275	0.5	50	0.1	78	0.2	6	-	4	0.0
	Israeli financial institutions	173	0.4	150	0.2	10	-	-	-	4	-	8	0.0
	Foreign financial institutions	366	0.8	130	0.2	348	1.0	652	1.6	45	0.1	44	0.1
	MBS, ABS	120	0.3	241	0.4	-	-	-	-	54	0.1	55	0.1
	Other bonds - Israeli	330	0.7	499	0.8	27	0.1	22	0.1	27	0.1	30	0.1
	Other bonds - foreign	56	0.1	828	1.4	181	0.5	200	0.5	10	-	4	0.0
	Total bonds for trading	9,381	19.6	12,272	20.3	3,540	10.3	5,403	13.3	3,364	7.8	1,469	3.2
	Total stocks for trading	361	0.8	159	0.3	52	0.2	46	0.1	5	-	4	0.0
	Total securities for trading	9,742	20.3	12,431	20.6	3,592	10.4	5,449	13.4	3,369	7.9	1,473	3.2
	Total securities, all types	47,936	100.0	60,348	100.0	34,411	100.0	40,728	100.0	42,898	100.0	45,455	100.0

**Table 6 (continued)**  
**Securities portfolio of the five largest banking groups, 2011 and June 2012<sup>a</sup>**

	Mizrahi-Tefahot				First International				Five largest banking groups				
	2011		June 2012		2011		June 2012		2011		June 2012		
	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	Fair value	Distribution	
Bonds held to maturity	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	(NIS million)	(Percent)	
	Israeli government bonds	703	8.3	1,059	11.1	328	2.8	303	2.6	3,693	2.5	4,623	2.8
	Foreign government bonds	-	-	-	-	-	-	-	-	2,184	1.5	2,082	1.2
	Israeli financial institutions	-	-	-	-	6	0.1	5	0.0	810	0.6	850	0.5
	Foreign financial institutions	-	-	-	-	110	0.9	74	0.6	176	0.1	161	0.1
	MBS, ABS	-	-	-	-	-	-	-	-	1,028	0.7	1,801	1.1
	Other bonds - Israeli	-	-	-	-	81	0.7	351	3.0	81	0.1	351	0.2
	Other bonds - foreign	-	-	-	-	266	2.2	-	-	286	0.2	16	0.0
Securities available for sale	Total bonds held to maturity	703	8.3	1,059	11.1	791	6.7	733	6.3	8,258	5.7	9,884	5.9
	Israeli government bonds	5,524	65.5	6,175	64.6	6,182	52.1	5,559	48.0	72,331	49.7	87,281	52.1
	Foreign government bonds	86	1.0	100	1.0	151	1.3	365	3.2	6,969	4.8	8,189	4.9
	Israeli financial institutions	159	1.9	121	1.3	131	1.1	154	1.3	1,622	1.1	1,466	0.9
	Foreign financial institutions	412	4.9	480	5.0	955	8.0	1,469	12.7	12,314	8.5	12,370	7.4
	MBS, ABS	61	0.7	33	0.3	413	3.5	457	3.9	14,767	10.1	16,941	10.1
	Other bonds - Israeli	81	1.0	60	0.6	375	3.2	425	3.7	1,885	1.3	2,116	1.3
	Other bonds - foreign	135	1.6	181	1.9	28	0.2	36	0.3	2,196	1.5	2,430	1.4
Securities for trading	Total bonds available for sale	6,458	76.6	7,150	74.8	8,235	69.4	8,465	73.1	112,084	77.0	130,793	78.0
	Total stocks available for sale	85	1.0	80	0.8	546	4.6	447	3.9	5,018	3.4	4,435	2.6
	Total securities available for sale	6,543	77.6	7,230	75.6	8,781	74.0	8,912	76.9	117,102	80.5	135,228	80.6
	Israeli government bonds	1,183	14.0	1,272	13.3	1,952	16.4	1,775	15.3	17,430	12.0	18,971	11.3
	Foreign government bonds	-	-	-	-	176	1.5	2	0.0	415	0.3	359	0.2
	Israeli financial institutions	-	-	-	-	82	0.7	90	0.8	269	0.2	248	0.1
	Foreign financial institutions	3	-	4	0.0	35	0.3	10	0.1	797	0.5	840	0.5
	MBS, ABS	-	-	-	-	-	-	-	-	174	0.1	296	0.2
Total securities, all types	Other bonds - Israeli	-	-	-	-	43	0.4	41	0.4	427	0.3	592	0.4
	Other bonds - foreign	-	-	-	-	2	-	2	0.0	249	0.2	1,034	0.6
	Total bonds for trading	1,186	14.1	1,276	13.3	2,290	19.3	1,920	16.6	19,761	13.6	22,340	13.3
	Total stocks for trading	-	-	-	-	10	0.1	18	0.2	428	0.3	227	0.1
Total securities for trading		1,186	14.1	1,276	13.3	2,300	19.4	1,938	16.7	20,189	13.9	22,567	13.5
Total securities, all types		8,432	100.0	9,565	100.0	11,872	100.0	11,583	100.0	145,549	100.0	167,679	100.0

<sup>a</sup> In this table, mortgage backed securities (MBS) issued by US government agencies (FNMA, FHLMC and GNMA) are included in the "MBS and ABS" item, whether or not a government guarantee exists for them.

<sup>b</sup> In the Discount Group, the asset backed and mortgage backed securities primarily are bonds of US government agencies.

SOURCE: Published financial statements and Banking Supervision Department calculations.

## 5. Country risk

The total balance-sheet exposure of the five banking groups to foreign countries totaled about NIS 140 billion in June 2012, constituting 12 percent of total assets ([Table 7](#)). About one-third of this exposure is to European countries, but the exposure to high risk European countries<sup>4</sup> remains relatively small (about NIS 1 billion) and does not endanger the stability of the banks.

NIS 47 billion of the exposure to foreign countries is from exposure to foreign financial institutions ([Table 8](#)). During the first half of the year, the banks continued to reduce their exposure to foreign financial institutions, and it declined by NIS 2.6 billion.

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<sup>4</sup> Portugal, Ireland, Greece, Italy and Spain.

**Table 7**  
**Exposure to foreign countries<sup>a</sup>, the five major banking groups, June 2012**  
(NIS million)

	Balance sheet exposure abroad			Net balance sheet exposure of overseas offices of the banking corporation to local residents <sup>a</sup>		Total balance sheet exposure to equity (%)	Total balance sheet exposure to assets (%)	Total off balance-sheet exposure <sup>c</sup>
	To governments <sup>b</sup>	To banks	To others	Total balance sheet exposure				
US	5,575	9,525	14,344	30,932	60,376	79.06	5.08	24,874
UK	-	9,463	6,857	7,255	23,575	30.87	1.99	7,174
Germany	116	3,106	2,633	0	5,855	7.67	0.49	1,460
France	25.0	3,241	1,234	-	4,500	5.89	0.38	1,816
Switzerland	-	714	1,268	6,598	8,580	11.24	0.72	1,434
Belgium	4.0	120	129	-	253	0.33	0.02	75
Turkey	-	82	6	3,054	3,142	4.11	0.26	874
The Netherlands	0	1,005	1,449	-	2,454	3.21	0.21	111
Italy	79	255	124	-	458	0.60	0.04	44
Spain	37	165	38	-	240	0.31	0.02	161
Portugal	-	-	1	-	1	0.00	0.00	-
Ireland	-	17	89	-	106	0.14	0.01	204
Greece	2.0	-	0	-	2	0.00	0.00	1
Other countries	1,210	11,254	16,125	2,010	30,599	40.07	2.58	8,065
<b>Total exposure to foreign countries</b>	<b>7,048</b>	<b>38,947</b>	<b>44,297</b>	<b>49,849</b>	<b>140,141</b>	<b>183.52</b>	<b>11.80</b>	<b>46,293</b>
Exposures to Ireland, Italy, Greece, Portugal, and Spain, which were not included above.	-	99	245	-	344	0.45	0.03	21
<i>Of which:</i> Total exposure to LDCs	340	1,710	3,164	4,415	9,629	12.61	0.81	3,036
<b>Total exposure to Europe</b>	<b>263</b>	<b>18,267</b>	<b>14,073</b>	<b>16,907</b>	<b>49,510</b>	<b>64.83</b>	<b>4.17</b>	<b>13,375</b>
<i>Of which:</i> Total exposure to Ireland, Italy, Greece, Portugal, and Spain	<b>118</b>	<b>536</b>	<b>497</b>	-	<b>1,151</b>	<b>1.51</b>	<b>0.10</b>	<b>431</b>

<sup>a</sup> Net balance sheet exposure after deduction of local liabilities.

<sup>b</sup> Governments, official bodies, and central banks.

<sup>c</sup> Credit in off balance-sheet financial instruments, as calculated for the borrower indebtedness limit.

SOURCE: Published financial statements and Banking Supervision Department calculations.

Table 8

Current credit exposure to foreign financial institutions<sup>a,b</sup>, five major banking groups, June 2012

(NIS million)

Credit rating <sup>c</sup>	Leumi		Hapoalim		Discount		Mizrahi-Tefahot		First International		Five groups, total	
	Total credit	Of which: Balance sheet credit	Total credit	Of which: Balance sheet credit	Total credit	Of which: Balance sheet credit	Total credit	Of which: Balance sheet credit	Total credit	Of which: Balance sheet credit	Total credit	Of which: Balance sheet credit
AAA to AA-	7,984	7,735	4,572	2,372	1,741	1,651	1,648	1,635	946	929	16,891	14,322
A+ to A-	9,806	9,380	9,536	8,950	4,979	4,276	1,512	1,329	2,596	2,543	28,429	26,478
BBB+ to BBB-	1,515	1,511	764	675	820	813	7	7	57	53	3,163	3,059
BB+ to B-	45	37	69	49	507	501	6	0	49	49	676	636
Below B-	96	63.00	50	50	-	-	-	-	-	-	146	113
Unrated	1,852	1,822	737	661	240	184	6	6	50	24	2,885	2,697
<b>exposure to foreign financial institutions</b>	<b>21,298</b>	<b>20,548</b>	<b>15,728</b>	<b>12,757</b>	<b>8,287</b>	<b>7,425</b>	<b>3,179</b>	<b>2,977</b>	<b>3,698</b>	<b>3,598</b>	<b>52,190</b>	<b>47,305</b>
Balance of problem debts	79	79	81	81	45	45	5	5	-	-	210	210
Share of exposure out of assets (%)		0.06		0.04		0.04		0.02		0.03		0.04
Share of exposure out of equity (%)	0.87	0.84	0.62	0.51	0.71	0.64	0.37	0.34	0.58	0.57	0.68	0.62

<sup>a</sup> Foreign financial institutions are: investment banks, broker/dealers, insurance companies, institutions and entities controlled by those institutions. Note that credit exposure does not include exposure to financial institutions which have clear and full government guarantees, and do not include investment in asset backed securities.

<sup>b</sup> Balance sheet credit: deposits in banks, credit to the public, fixed income investments, securities borrowed or bought in reverse repurchase agreements, and other assets in respect of instruments. Off balance-sheet credit: primarily guarantees and commitments to grant credit, including third-party indebtedness guarantees.

<sup>c</sup> External credit rating is based on ratings assigned by credit rating agencies Fitch, S&P, and Moody's.

**SOURCE:** Published financial statements and Banking Supervision Department calculations.

## 6. Market risks

### 6.1 Interest rate risk

The total exposure of the five major banking groups to interest rate risk<sup>5</sup> increased slightly at the end of the first half of 2012 compared with the end of the previous year. Albeit, there are big differences between the banking groups as to the level of exposure and changes in the exposure compared to the end of the previous year. The potential impact on profit or loss as a result of the maximum **increase** of interest rates ranges from a loss of 15.9 percent to a profit of 5.0 percent of the fair value of the banking group's capital, and the potential impact as a result of the maximum **decline** in interest rates ranges from a loss of 6.4 percent to a profit of 6.4 percent of the fair value of the banking group's capital (Table 9).

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<sup>5</sup> The interest rate risk analysis is based on a calculation of the hypothetical impact of the maximum change in the interest rate on the fair value of the net positions in the indexing sectors.

The maximum change in yield on the one-month *makam* in the unindexed sector, on indexed 5-year bonds in the indexed sector, and on the 3-month LIBOR in the foreign currency sector are derived from changes made in these sectors every ten business days, and vary over the past 7 years, assuming normal distribution, and a confidence level of 99 percent.

**Table 9**  
**Exposure to changes in interest rates, five major banking groups, December 2011 through June 2012**  
(NIS million)

	Leumi			Hapoalim			Discount <sup>f</sup>		
	2011	2012: Q1	2012: Q2	2011	2012: Q1	2012: Q2	2011	2012: Q1	2012: Q2
<b>Unindexed segment</b>									
<b>Net position in segment<sup>a</sup></b>	<b>17,512</b>	<b>11,920</b>	<b>14,389</b>	<b>15,662</b>	<b>16,292</b>	<b>14,853</b>	<b>3,087</b>	<b>-13</b>	<b>912</b>
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	-352	-174	-266	102	83	131	-138	-431	-455
1 percentage point decrease	357	212	339	-90	-72	-109	3	325	195
Maximum change in interest rates <sup>c</sup> (percentage points)	1.56	1.58	1.58	1.56	1.58	1.58	1.56	1.58	1.58
The change in the fair value of the net position in the segment as a result of the maximum change in the interest rate <sup>d</sup>									
Interest rate increase	-550	-275	-420	159	131	207	-216	-681	-719
Interest rate decrease	557	335	535	-141	-114	-172	5	513	308
<b>CPI-indexed segment</b>									
<b>Net position in segment<sup>a</sup></b>	<b>3,414</b>	<b>6,473</b>	<b>5,606</b>	<b>4,278</b>	<b>4,017</b>	<b>4,533</b>	<b>2,172</b>	<b>2,578</b>	<b>2,331</b>
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	109	170	164	195	238	107	-11	-2	-46
1 percentage point decrease	-132	-198	-138	-114	-243	-97	12	-8	32
Maximum change in interest rates <sup>c</sup> (percentage points)	0.50	0.51	0.51	0.50	0.51	0.51	0.50	0.51	0.51
The change in the fair value of the net position in the segment as a result of the maximum change in the interest rate <sup>d</sup>									
Interest rate increase	54	87	83	97	121	54	-5	-1	-23
Interest rate decrease	-66	-101	-70	-57	-124	-49	6	-4	16
<b>Foreign currency segment<sup>e</sup></b>									
<b>Net position in segment<sup>a</sup></b>	<b>-4,354</b>	<b>-1,970</b>	<b>-1,775</b>	<b>-2,173</b>	<b>-1,455</b>	<b>-1,457</b>	<b>-1,013</b>	<b>1,704</b>	<b>1,908</b>
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	-3	-170	-150	-76	38	-74	-154	-468	-150
1 percentage point decrease	-7	98	118	61	-35	86	-155	89	10
Maximum change in interest rates <sup>c</sup> (percentage points)	0.49	0.51	0.51	0.49	0.51	0.51	0.49	0.51	0.51
The change in the fair value of the net position in the segment as a result of the maximum change in the interest rate <sup>d</sup>									
Interest rate increase	-1	-87	-77	-37	19	-38	-76	-240	-77
Interest rate decrease	-3	50	60	30	-18	44	-76	46	5
<b>Total</b>									
<b>Total fair value of bank's net worth</b>	<b>16,572</b>	<b>16,423</b>	<b>18,220</b>	<b>17,767</b>	<b>18,854</b>	<b>17,929</b>	<b>4,246</b>	<b>4,269</b>	<b>5,151</b>
The change in the fair value of the bank's net worth as a result of an interest rate change <sup>b</sup>									
1 percentage point increase	-246	-174	-252	221	359	164	-303	-901	-651
1 percentage point decrease	218	112	319	-143	-350	-120	-140	406	237
The change in the fair value of the bank's equity as a result of the maximum change in interest rates <sup>d</sup>									
Interest rate increase	-497	-275	-413	219	272	223	-297	-921	-819
Interest rate decrease	488	284	526	-167	-255	-177	-66	555	329
<b>As a percent of the fair value of the bank's net worth</b>									
<b>Interest rate increase</b>	<b>-3.0</b>	<b>-1.7</b>	<b>-2.3</b>	<b>1.2</b>	<b>1.4</b>	<b>1.2</b>	<b>-7.0</b>	<b>-21.6</b>	<b>-15.9</b>
<b>Interest rate decrease</b>	<b>2.9</b>	<b>1.7</b>	<b>2.9</b>	<b>-0.9</b>	<b>-1.4</b>	<b>-1.0</b>	<b>-1.5</b>	<b>13.0</b>	<b>6.4</b>

<sup>a</sup> The difference between the present value of assets and the present value of liabilities, including the effect of futures transactions. The present value of assets and liabilities is obtained by discounting the future flow (principal and interest) by the market interest rate in accordance with the term structure of the relevant interest rates for each segment.

<sup>b</sup> Based on published financial statements - directors report.

<sup>c</sup> The maximum change in the yield-to-maturity on *makam* (short term securities) for a month in the unindexed segment, on 5-year CPI-indexed bonds in the indexed segment and on the 3-month LIBID in the foreign currency segment is derived from 10 days' change over the past 7 years, on the assumption of a normal distribution and a confidence level of 99 percent.

<sup>d</sup> Based on published financial statements - directors report, and on the Banking Supervision Department's estimate of the maximum change in the interest rate. This calculation is an approximation, as it assumes linear behavior of interest rate risk.

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

<sup>f</sup> The change in the net fair value in unindexed local currency and in foreign currency derives primarily from cancellation of the hedge of the investment in IDB New York.

**SOURCE:** Published financial statements and Banking Supervision Department calculations.

**Table 9-(continued)**  
**Exposure to changes in interest rates, five major banking groups, December 2011 through June 2012**  
 (NIS million)

	Mizrahi-Tefahot			First International			The five groups		
	2011	2012: Q1	2012: Q2	2011	2012: Q1	2012: Q2	2011	2012: Q1	2012: Q2
<b>Unindexed segment</b>									
<b>Net position in segment<sup>a</sup></b>	<b>1,526</b>	<b>-1,127</b>	<b>-1,422</b>	<b>3,567</b>	<b>3,198</b>	<b>3,308</b>	<b>41,354</b>	<b>30,270</b>	<b>32,040</b>
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	148	167	288	-57	-88	-78	-297	-443	-380
1 percentage point decrease	-174	-204	-357	65	98	87	161	359	155
Maximum change in interest rates <sup>c</sup> (percentage points)	1.56	1.58	1.58	1.56	1.58	1.58	1.56	1.58	1.58
The change in the fair value of the net position in the segment as a result of the maximum change in the interest rate <sup>d</sup>									
Interest rate increase	231	264	455	-89	-139	-123	-464	-700	-600
Interest rate decrease	-272	-322	-564	102	155	137	251	567	245
<b>CPI-indexed segment</b>									
<b>Net position in segment<sup>a</sup></b>	<b>4,991</b>	<b>7,528</b>	<b>8,015</b>	<b>415</b>	<b>553</b>	<b>720</b>	<b>15,270</b>	<b>21,149</b>	<b>21,205</b>
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	-109	-153	-198	-60	-82	-74	124	171	-47
1 percentage point decrease	247	293	209	70	94	86	83	-62	92
Maximum change in interest rates <sup>c</sup> (percentage points)	0.50	0.51	0.51	0.50	0.51	0.51	0.50	0.51	0.51
The change in the fair value of the net position in the segment as a result of the maximum change in the interest rate <sup>d</sup>									
Interest rate increase	-54	-78	-101	-30	-42	-38	62	87	-24
Interest rate decrease	123	149	106	35	48	44	41	-32	47
<b>Foreign currency segment<sup>e</sup></b>									
<b>Net position in segment<sup>a</sup></b>	<b>207</b>	<b>64</b>	<b>-166</b>	<b>-616</b>	<b>-330</b>	<b>-575</b>	<b>-7,949</b>	<b>-1,987</b>	<b>-2,065</b>
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	-70	-98	-65	2	6	0	-301	-692	-439
1 percentage point decrease	72	88	92	0	-5	0	-29	235	306
Maximum change in interest rates <sup>c</sup> (percentage points)	0.49	0.51	0.51	0.49	0.51	0.51	0.49	0.51	0.51
The change in the fair value of the net position in the segment as a result of the maximum change in the interest rate <sup>d</sup>									
Interest rate increase	-35	-50	-33	1	3	0	-149	-355	-225
Interest rate decrease	36	45	47	0	-3	0	-14	120	157
<b>Total</b>									
<b>Total fair value of bank's net worth</b>	<b>6,724</b>	<b>6,465</b>	<b>6,427</b>	<b>3,366</b>	<b>3,421</b>	<b>3,453</b>	<b>48,675</b>	<b>49,432</b>	<b>51,180</b>
The change in the fair value of the bank's net worth as a result of an interest rate change <sup>b</sup>									
1 percentage point increase	-31	-84	25	-115	-164	-152	-474	-964	-866
1 percentage point decrease	145	177	-56	135	187	173	215	532	553
The change in the fair value of the bank's equity as a result of the maximum change in interest rates <sup>d</sup>									
Interest rate increase	142	136	321	-118	-178	-161	-550	-967	-849
Interest rate decrease	-113	-128	-410	136	200	181	278	656	448
<b>As a percent of the fair value of the bank's net worth</b>									
<b>Interest rate increase</b>	<b>2.1</b>	<b>2.1</b>	<b>5.0</b>	<b>-3.5</b>	<b>-5.2</b>	<b>-4.7</b>	<b>-1.1</b>	<b>-2.0</b>	<b>-1.7</b>
<b>Interest rate decrease</b>	<b>-1.7</b>	<b>-2.0</b>	<b>-6.4</b>	<b>4.1</b>	<b>5.8</b>	<b>5.2</b>	<b>0.6</b>	<b>1.3</b>	<b>0.9</b>

<sup>a</sup> The difference between the present value of assets and the present value of liabilities, including the effect of futures transactions. The present value of assets and liabilities is obtained by discounting the future flow (principal and interest) by the market interest rate in accordance with the term structure of the relevant interest rates for each segment.

<sup>b</sup> Based on published financial statements - directors report.

<sup>c</sup> The maximum change in the yield-to-maturity on *makam* (short term securities) for a month in the unindexed segment, on 5-year CPI-indexed bonds in the indexed segment and on the 3-month LIBID in the foreign currency segment is derived from 10 days' change over the past 7 years, on the assumption of a normal distribution and a confidence level of 99 percent.

<sup>d</sup> Based on published financial statements - directors report, and on the Banking Supervision Department's estimate of the maximum change in the interest rate. This calculation is an approximation, as it assumes linear behavior of interest rate risk.

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

<sup>f</sup> The change in the net fair value in unindexed local currency and in foreign currency derives primarily from cancellation of the hedge of the investment in IDB New York.

**SOURCE:** Published financial statements and Banking Supervision Department calculations.

## 6.2 Indexation base risk

The total exposure of the five major banking groups to indexation base risk declined somewhat at the end of the first half of 2012, compared to the end of the previous year. The maximum loss of the five groups as a result of inflation risk at the end of the first half was NIS 165 million, and comprised 0.3 percent of the total capital of the five groups, while the maximum loss as a result of exchange rate risk was NIS 311 million at the end of the first half, about 0.6 percent of the total capital of the five groups. At the end of the first half of 2012, the five banking groups were exposed to an unexpected decline in prices, and most of them were exposed to a depreciation in the value of the shekel due to negative position in the sector<sup>6</sup> (Table 10).

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<sup>6</sup> In February 2012, the Supervisor of Banks issued a circular regarding "The operating currency of representative offices operating abroad", which amended the Directives for Reporting to the Public and enabled banking corporations to determine an operating currency different from the shekel for certain banking representative offices operating abroad. This change had a significant effect on the exchange rate risk of some of the banks.

Table 10

**Exposure to changes in the CPI and the exchange rate, the five major banking groups, December 2011 through June 2012**  
(NIS million)

	Leumi			Hapoalim			Discount <sup>j</sup>		
	2011	2012:Q1	2012:Q2	2011	2012:Q1	2012:Q2	2011	2012:Q1	2012:Q2
<b>Unindexed segment</b>									
Total assets (excluding futures transactions and options)	199,647	194,867	196,986	203,203	205,344	211,403	109,574	107,259	105,881
Total liabilities (excluding futures transactions and options)	164,770	165,310	166,770	185,628	183,434	186,301	99,833	99,088	98,670
Difference between assets and liabilities <u>excluding</u> the effect of futures transactions and options	34,877	29,557	30,216	18,663	19,327	19,877	5,619	5,744	6,265
Difference between assets and liabilities plus effect of futures transactions and options	19,557	14,429	16,849	14,502	15,073	14,306	2,839	-337	579
The bank's net worth <sup>a,b</sup>	15,208	15,965	16,422	18,663	19,327	19,877	5,619	5,744	6,265
<b>CPI-indexed segment</b>									
Total assets (excluding futures transactions and options)	61,163	62,131	62,878	60,607	59,997	60,931	26,211	26,436	26,212
Total liabilities (excluding futures transactions and options)	56,494	54,074	56,001	48,970	49,992	51,232	21,539	21,611	21,290
Effect of futures transactions and options	-4,472	-4,611	-5,397	-4,834	-3,975	-2,766	-1,700	-1,231	-1,795
Total position in the segment <sup>c</sup>	197	3,446	1,480	6,803	6,030	6,933	2,972	3,594	3,127
Maximum change in the CPI <sup>d</sup> (percent)	-0.8	-0.8	-0.8	-0.79	-0.80	-0.80	-0.79	-0.80	-0.80
<b>Loss as a result of the maximum change in the CPI<sup>e</sup></b>	<b>2</b>	<b>28</b>	<b>12</b>	<b>54</b>	<b>49</b>	<b>56</b>	<b>23</b>	<b>29</b>	<b>25</b>
<b>Foreign currency segment<sup>f</sup></b>									
Total assets (excluding futures transactions and options)	95,674	92,793	97,043	86,716	78,876	83,769	60,653	59,852	62,914
Total liabilities (excluding futures transactions and options)	120,012	114,442	117,714	97,265	91,464	98,693	69,445	67,104	68,782
Effect of futures transactions and options	19,792	19,739	18,764	7,907	10,812	13,562	8,600	9,739	8,427
Total position in the segment <sup>c</sup>	-4,546	-1,910	-1,907	-2,642	-1,776	-1,362	-192	2,487	2,559
Maximum change in the exchange rate <sup>g</sup> (percent)	-4.63	-4.76	-4.76	-4.63	-4.76	-4.76	-4.63	4.21	4.63
<b>Loss as a result of the maximum change in the exchange rate<sup>h</sup></b>	<b>210</b>	<b>91</b>	<b>91</b>	<b>122</b>	<b>84</b>	<b>65</b>	<b>9</b>	<b>105</b>	<b>119</b>
<b>Total maximum loss to the bank's net worth as a result of indexation base risk<sup>i</sup></b>	<b>212</b>	<b>119</b>	<b>103</b>	<b>176</b>	<b>133</b>	<b>121</b>	<b>32</b>	<b>133</b>	<b>144</b>
<b>As a percentage of the bank's net worth</b>	<b>1.39</b>	<b>0.74</b>	<b>0.62</b>	<b>0.94</b>	<b>0.69</b>	<b>0.61</b>	<b>0.58</b>	<b>2.32</b>	<b>2.29</b>

<sup>a</sup>The difference between assets and liabilities in all sectors includes the effect of futures transactions (excluding non-monetary items), per Note 16 to the financial statements.

<sup>b</sup>The bank's net worth is attributed (by definition) entirely 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 includes the effect of futures transactions.

<sup>d</sup>The maximum change in the CPI derived from changes in inflation expectations over moving 10-business-day periods during the past 7 years, on the assumption of a normal distribution and a confidence level of 99 percent.

<sup>e</sup>The change that will occur in the bank's position as the result of a maximum change in the CPI.

<sup>f</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>g</sup>The maximum change in the nominal shekel-dollar exchange rate, which is derived from changes in the exchange rate in moving 10-business-day periods over the past 7 years, on the assumption of a normal distribution and a confidence level of 99 percent.

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

<sup>i</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, on the assumption that the worst change will occur, from the bank's aspect, in both segments.

<sup>j</sup>The change in the total position in unindexed local currency and in foreign currency derives primarily from cancellation of the hedge of the investment in IDB New York following the publication of a Supervisor of Banks directive on "Currency of activities of overseas branches."

**SOURCE: Published financial statements, Central Bureau of Statistics data, and Banking Supervision Department calculations.**

Table 10 (continued)

## Exposure to changes in the CPI and the exchange rate, the five major banking groups, December 2011 through June 2012

(NIS million)

	Mizrahi-Tefahot			First International			The five groups		
	2011	2012:Q1	2012:Q2	2011	2012:Q1	2012:Q2	2011	2012:Q1	2012:Q2
<b>Unindexed segment</b>									
Total assets (excluding futures transactions and options)	80,612	80,819	82,145	67,891	68,898	68,538	660,927	657,187	664,953
Total liabilities (excluding futures transactions and options)	80,216	78,967	81,526	56,739	57,388	57,723	587,186	584,187	590,990
Difference between assets and liabilities <u>excluding</u> the effect of futures transactions and options	396	1,852	619	11,152	11,510	10,815	73,741	73,000	73,963
Difference between assets and liabilities plus effect of futures transactions and options	1,205	-1,150	-992	3,581	3,436	3,559	-32,057	-41,549	-39,662
The bank's net worth <sup>a,b</sup>	6,599	6,764	7,114	3,630	3,554	3,736	41,684	31,451	34,301
							49,719	51,354	53,414
<b>CPI-indexed segment</b>									
Total assets (excluding futures transactions and options)	45,856	47,500	48,922	15,872	15,742	16,829	209,709	211,806	215,772
Total liabilities (excluding futures transactions and options)	34,859	35,189	35,988	15,014	15,354	16,019	176,876	176,220	180,530
Effect of futures transactions and options	-5,754	-4,449	-4,607	-327	-14	-142	-17,087	-14,280	-14,707
Total position in the segment <sup>c</sup>	5,243	7,862	8,327	531	374	668	15,746	21,306	20,535
Maximum change in the CPI <sup>d</sup> (percent)	-0.8	-0.8	-0.8	-0.79	-0.80	-0.80	-0.79	-0.80	-0.80
<b>Loss as a result of the maximum change in the CPI<sup>e</sup></b>	<b>41</b>	<b>63</b>	<b>67</b>	<b>4</b>	<b>3</b>	<b>5</b>	<b>124</b>	<b>171</b>	<b>165</b>
<b>Foreign currency segment<sup>f</sup></b>									
Total assets (excluding futures transactions and options)	21,976	20,095	22,444	13,900	13,893	14,731	278,919	265,509	280,901
Total liabilities (excluding futures transactions and options)	26,795	27,490	28,884	22,280	22,237	22,620	335,797	322,737	336,693
Effect of futures transactions and options	4,970	7,447	6,219	7,898	8,088	7,398	49,167	55,825	54,370
Total position in the segment <sup>c</sup>	151	52	-221	-482	-256	-491	-7,711	-1,403	-1,422
Maximum change in the exchange rate <sup>g</sup> (percent)	4.21	4.21	-4.76	-4.63	-4.76	-4.76	-4.63	-4.76	-4.76
<b>Loss as a result of the maximum change in the exchange rate<sup>h</sup></b>	<b>6</b>	<b>2</b>	<b>11</b>	<b>22</b>	<b>12</b>	<b>23</b>	<b>370</b>	<b>294</b>	<b>308</b>
<b>Total maximum loss to the bank's net worth as a result of indexation</b>									
<b>base risk<sup>i</sup></b>	<b>48</b>	<b>65</b>	<b>77</b>	<b>26</b>	<b>15</b>	<b>29</b>	<b>495</b>	<b>466</b>	<b>473</b>
<b>As a percentage of the bank's net worth</b>	<b>0.72</b>	<b>0.97</b>	<b>1.09</b>	<b>0.73</b>	<b>0.43</b>	<b>0.77</b>	<b>0.99</b>	<b>0.91</b>	<b>0.89</b>

<sup>a</sup> The difference between assets and liabilities in all sectors includes the effect of futures transactions (excluding non-monetary items), per Note 16 to the financial statements.

<sup>b</sup> The bank's net worth is attributed (by definition) entirely 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 includes the effect of futures transactions.

<sup>d</sup> The maximum change in the CPI derived from changes in inflation expectations over moving 10-business-day periods during the past 7 years, on the assumption of a normal distribution and a confidence level of 99 percent.

<sup>e</sup> The change that will occur in the bank's position as the result of a maximum change in the CPI.

<sup>f</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>g</sup> The maximum change in the nominal shekel-dollar exchange rate, which is derived from changes in the exchange rate in moving 10-business-day periods over the past 7 years, on the assumption of a normal distribution and a confidence level of 99 percent.

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

<sup>i</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, on the assumption that the worst change will occur, from the bank's aspect, in both segments.

<sup>j</sup> The change in the total position in unindexed local currency and in foreign currency derives primarily from cancellation of the hedge of the investment in IDB New York following the publication of a Supervisor of Banks directive on "Currency of activities of overseas branches."

**SOURCE:** Published financial statements, Central Bureau of Statistics data, and Banking Supervision Department calculations.

## 7. Liquidity risk

The liquidity of Israel's banking system declined to some extent during the reviewed period, but its level is still high and similar to the globally accepted standards. The reduction in liquidity surplus is taking place despite the economic and geopolitical uncertainty, and it is notably the result of alternative cost considerations in light of the interest rate environment in the economy—which is higher than during the crisis years. An examination of the aggregate supervisory model of the five large banks shows a decline to a level of 1.51 (activity in Israeli and foreign currency), which was motivated mainly by reducing the liquidity surplus in the shekel sector (Table 11). At the same time, and despite the reduction in the general liquidity surplus, it should be noted that the ratio of liquid assets to liquid liabilities has been maintained, as shown by an analysis of liquidity indices that focus on these assets.

An examination of several ratios shows that the concentration of deposits in the system has remained stable this year (Table 11).

**Table 11**

**Liquidity risk measures of the five major banks<sup>a</sup>, and the highest and lowest figures among them, December 2010 through August 2012**

	The five major banks <sup>a</sup>			Lowest value among the five major banks			Highest value among the five major banks		
	2010	2011	8/2012	2010	2011	8/2012	2010	2011	8/2012
<b>Supervisory model ratio<sup>b</sup></b>									
Total activity (local and foreign currency)	1.36	1.59	1.51	1.21	1.41	1.25	1.60	1.74	1.77
<b>Concentration and stability of deposits (total activity)</b>									
Share of deposits up to NIS 1 million in total deposits	34.54	34.81	35.91	30.68	29.41	30.81	42.60	41.27	42.49
Share of deposits above NIS 50 million in total deposits	27.81	26.91	27.18	16.64	23.69	21.67	35.91	37.05	34.35
Ratio of 20 largest depositors for terms up to 1 month to public deposits of up to 1 month <sup>c</sup>	13.48	12.14	12.04	6.81	6.74	7.10	20.55	25.43	22.90

<sup>a</sup> The five major banks are Leumi, Hapoalim, Discount, First International, and Mizrahi-Tefahot.

<sup>b</sup> The supervisory model is calculated as the ratio of liquid assets to liquid liabilities for terms of up to 1 month, based on the methodology developed at the Banking Supervision Department, and is used in examining trends in liquidity of the banking corporations and allows system-wide comparison. A ratio of 1 is the minimum required in order to ensure meeting liquidity needs.

<sup>c</sup> The most recent figure for this ratio is as of June 2012.

**SOURCE:** Reports to the Banking Supervision Department and Banking Supervision Department calculations.

## 8. Capital adequacy

During the first half of 2012, the core tier 1 capital ratio of the five banking groups combined increased from 8.0 percent to 8.3 percent, and the capital adequacy ratio increased from 14.0 percent to 14.4 percent<sup>7</sup>, following the new capital targets ([Table 12](#) and [Figure 11](#)). As of June 2012, the core tier 1 capital ratio in all of the banking groups does not fall below 8.0 percent, with the First International group reaching a target of 9.0 percent. The increase in the capital ratios is derived from growth in accumulated earnings and the non-distribution of dividends on one hand, and a halt in the increase in business credit on the other hand.

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<sup>7</sup> The bank data to December 2011 are as published in the annual financial statements to that date, and do not include the effects of income taxes or of handling put options for minority interest holders.

**Table 12**  
**Distribution of capital, and capital ratios, at the five major banking groups, December 2011 and June 2012**

	Leumi		Hapoalim		Discount		Mizrahi-Tefahot		First International		Five groups	
	December		December		December		December		December		December	
	2011 <sup>e</sup>	June 2012	2011 <sup>e</sup>	June 2012	2011 <sup>e</sup>	June 2012						
Equity <sup>a</sup>	23,628	24,533	24,127	25,223	11,115	11,632	8054	8644	6289	6332	73213	76364
Core capital <sup>b</sup>	23,225	24,118	23,795	25,039	10,175	10,687	7912	8521	5778	6125	70885	74490
Tier 1 capital <sup>b</sup>	23,225	24,118	26,183	27,465	11,898	12,429	7912	8521	5778	6125	74996	78658
Tier 2 capital <sup>b</sup>	18,020	18,534	16,175	17,194	7,173	7,173	5722	5191	3147	3286	50237	51378
Tier 3 capital <sup>b</sup>	0	0	0	0	0	0	0	0	0	0	0	0
Total capital base	41,245	42,652	42,358	44,659	19,071	19,602	13634	13712	8925	9411	125233	130036
					(NIS million)							
Total balance sheet	365,854	366,082	356,688	362,105	202,491	200,641	150,246	155,311	101,127	103,322	1176406	1187461
Total exposure	464,761	466,822	523,429	531,189	256,525	255,967	201,226	207,646	127,267	129,823	1573208	1591447
Credit risk	258,601	257,990	274,063	274,037	120,256	122,870	92,973	96,992	60,240	59,976	806133	811865
Market risks	9,011	9,080	7,018	6,881	1,875	2,150	947	884	1,446	1,544	20297	20539
Operational risk	20,095	20,883	20,047	20,955	13,418	13,609	7,851	8,177	6,438	6,553	67849	70177
Total risk-weighted assets	287,707	287,953	301,128	301,873	135,549	138,629	101,771	106,053	68,124	68,074	894279	902582
					(Percent)							
Ratio of core capital to total exposure	5.0	5.2	4.5	4.7	4.0	4.2	3.9	4.1	4.5	4.7	4.5	4.7
Core tier 1 capital <sup>c</sup> ratio	8.1	8.4	7.9	8.3	8.1	8.3	7.8	8.0	8.5	9.0	8.0	8.3
Tier 1 capital ratio	8.1	8.4	8.7	9.1	8.8	9.0	7.8	8.0	8.5	9.0	8.4	8.7
Tier 2 capital ratio	6.3	6.4	5.4	5.7	5.3	5.2	5.6	4.9	4.6	4.8	5.6	5.7
<b>Total capital ratio</b>	<b>14.3</b>	<b>14.8</b>	<b>14.1</b>	<b>14.8</b>	<b>14.1</b>	<b>14.1</b>	<b>13.4</b>	<b>12.9</b>	<b>13.1</b>	<b>13.8</b>	<b>14.0</b>	<b>14.4</b>

<sup>a</sup> Including minority interest in accordance with the groups' balance sheet.

<sup>b</sup> After deductions.

<sup>c</sup> Balance-sheet and off-balance-sheet balances after balance-sheet and off-balance-sheet offsets, after allowance for credit losses and

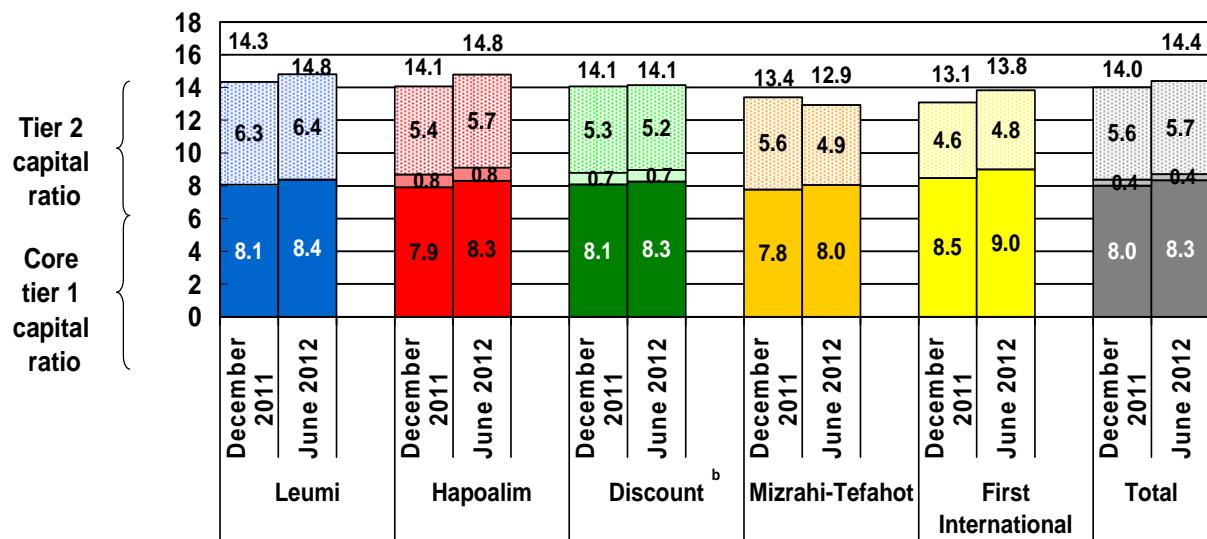
<sup>d</sup> The core tier 1 capital ratio of the Discount group does not include the deduction in respect of the group's investment in First International.

<sup>e</sup> The data for December 2011 are as reported in financial statements as of December 31, 2011.

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

Figure 11

Core tier 1 capital ratio and total capital ratio at the five major banking groups<sup>a</sup>, December 2011 and June 2012



<sup>a</sup> Data for December 2011 are as reported in the December 31, 2011 financial statements.

<sup>b</sup> The Discount group's core capital ratio does not include the deduction for the group's investment in the First International Bank.

SOURCE: Published financial statements and Banking Supervision Department calculations.

## 9. Financial results

The **total net profit** of the five major banking groups totaled NIS 3.2 billion in the first half of the year, a decline of 20 percent compared to the profits recorded by the groups during the first half of 2011. The return on equity was 9 percent (in annual terms), similar to the long-term average of 10% (Table 13). We note that there was wide variance in profitability during the first half of the year: the Leumi group recorded the lowest return on equity, 6 percent, and the Mizrahi group registered the highest return in the system, 14.3 percent.

**Net interest income** increased by 2.6 percent, to NIS 13 billion. This development was affected by the decline in the Bank of Israel's interest rate, apparently alongside an increase in the risk premium component in the price factor. The increase in the risk premium led to a very moderate decline in interest income relative to interest expenses. Furthermore, during the first half of the year, yields on bonds issued by banks declined and, as a result, there was a decline in interest expenses in respect of this item.

**Loan loss provisions** totaled NIS 1.6 billion, compared with just NIS 0.7 billion during the corresponding period of last year. At the same time, in annual terms, loan loss provisions during the first half of 2012 were at a similar level to 2011.

**Non-interest financing income**<sup>8</sup> totaled NIS 452 million during the first half of the year, a decline compared with the corresponding period of last year. However, in annual terms, this income increased by some 40 percent compared with 2011. We note that the decline in income resulted from the negative developments in the financial markets, which were reflected in a decline in income from equities, and from exchange rate differentials due to the devaluation in the shekel-dollar rate. In contrast, revenue from fair value adjustments of bonds, alongside an increase in the securities portfolio, mainly in government bonds, offset the decline in total non-interest financing income.

**Revenue from fees** declined by 3 percent in the first half of the year compared to the corresponding period of last year, and totaled NIS 7.3 billion. This decline resulted mainly from the decline in customer activity in securities in direct continuation of the developments registered in 2011.

While **operating and other expenses** registered a very small increase of one percent, there was a decline in salary and related expenses, which fell by 0.7 percent compared with the corresponding period last year.

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<sup>8</sup> This income includes operating income, and revenue from capital market activities, derivatives and exchange rate differentials.

**Table 13**  
**Main items in consolidated profit and loss statements of the five major banking groups,  
June 2011 - June 2012**

	Total for all five groups, NIS million			Rate of change, June 2011 to June 2012
	2011	2011:H1	2012:H1	
Interest income	48,345	24,927	24,329	-2.4%
Interest expenses	23,493	12,381	11,461	-7.4%
<b>Net interest income</b>	<b>24,852</b>	<b>12,546</b>	<b>12,868</b>	<b>2.6%</b>
Loan loss provisions	3,145	746	1,610	115.8%
<b>Net interest income after loan loss provisions</b>	<b>21,707</b>	<b>11,800</b>	<b>11,258</b>	<b>-4.6%</b>
<b>Non interest income</b>	<b>15,222</b>	<b>8,332</b>	<b>7,896</b>	<b>-5.2%</b>
<i>Of which:</i> Fee income	14,810	7,530	7,288	-3.2%
<i>Of which: Non-interest financing income<sup>a</sup></i>	<b>40</b>	<b>649</b>	<b>452</b>	<b>-30.4%</b>
<i>Of which: stocks<sup>b</sup></i>	110	278	94	-66.2%
<i>Of which: bonds<sup>c</sup></i>	751	211	572	171.1%
<i>Of which: derivatives activity<sup>d</sup></i>	1,888	-1,411	1,017	0.0%
<i>Of which: exchange rate differentials<sup>e</sup></i>	-2,682	1,511	-1,232	0.0%
<b>Total operating and other expenses</b>	<b>28,027</b>	<b>13,961</b>	<b>14,130</b>	<b>1.2%</b>
<i>Of which: Salaries and related expenses</i>	16,524	8,466	8,410	-0.7%
Pretax income	8,902	6,171	5,024	-18.6%
Tax expenses	2,071	2,228	1,731	-22.3%
Net income	6,831	3,943	3,293	-16.5%
<b>Net income attributed to shareholders</b>	<b>6,997</b>	<b>3,999</b>	<b>3,220</b>	<b>-19.5%</b>
<b>Return on equity (ROE)</b>	<b>0.1</b>	<b>12.1</b>	<b>9.0</b>	
<b>Return on assets (ROA)</b>	<b>0.62</b>	<b>0.74</b>	<b>0.55</b>	

<sup>a</sup> For 2011, the breakdown of non-interest financing income was derived from the financial statements for 2011.

<sup>b</sup> Includes profits/losses from investment in shares in the available for sale portfolio, profit from the sale of consolidated companies shares, dividends and profits/losses from adjustments to fair value of shares in the trading portfolio.

<sup>c</sup> Includes profits/losses from investment in bonds in the held to maturity and available for sale portfolios, and realized and unrealized income/expenses from adjustments to fair value of bonds in the trading portfolio.

<sup>d</sup> Includes derivative instruments which were not for hedging purposes (ALM instruments) and other derivative instruments.

<sup>e</sup> Revalued.

**Figure 12**  
**Return on Equity (ROE) of the five major banking groups,  
1991–June 2012**

