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According to the Union of Arab Banks (UAB) in its article, “*Potential Implications of the War in the Middle East on the Arab Banking Sector*,” published in the Quarterly Economic Bulletin (Issue 2, July/August 2026), the ongoing conflict in the Middle East represents more than a geopolitical crisis, as it has become a significant source of financial and economic uncertainty affecting banking systems across the Arab region. The article explains that banking stability is no longer determined solely by financial fundamentals but is increasingly influenced by geopolitical developments that shape liquidity conditions, financing costs, asset quality, and investor confidence. It also highlights that heightened geopolitical tensions have increased market volatility, weakened confidence, and raised the vulnerability of banking systems, particularly in economies heavily dependent on energy exports, as cited by the International Monetary Fund (IMF), the World Bank, and the Bank for International Settlements (BIS). Although the ceasefire has helped reduce immediate pressures, uncertainty remains elevated, allowing the economic consequences of the conflict to continue affecting trade, public finances, inflation, capital flows, and ultimately the banking sector.

A major focus of the article is the strategic importance of the Strait of Hormuz, which serves not only as a critical global energy route but also as a key driver of liquidity within oil-exporting Arab economies. Since roughly one-fifth of globally traded seaborne oil passes through the Strait, any disruption threatens government revenues and the flow of financial resources into the banking system. The article stresses that the main risk lies not simply in higher oil prices but in interruptions to export revenues and delays in government receipts.

Given that government and quasi-government deposits account for a substantial share of banking deposits in Gulf countries, where government spending represents 60-80% of overall economic liquidity, any slowdown in these revenues would weaken liquidity conditions, slow deposit growth, and reduce banks' ability to finance economic activity. As a result, banking systems in resource-dependent economies become increasingly vulnerable to geopolitical shocks affecting external financial inflows.

Building on these transmission channels, the report explains how geopolitical tensions gradually affect the main banking indicators. Lower government revenues reduce public spending and liquidity injections into the economy, while heightened uncertainty weakens deposit growth and increases financing costs through higher interest rates and wider risk premiums. The article estimates that financing costs could increase by 50-150 basis points during periods of elevated geopolitical risk, while slower capital inflows create additional pressure on foreign currency liquidity and external funding. Consequently, banks are expected to tighten lending standards, causing credit growth to slow to below 3-4%. At the same time, deposit growth, which normally averages 5-7%, could fall to around 0-3%, while government deposit growth may decline to below 2-3% or even contract. The report also anticipates a deterioration in asset quality, with non-performing loans rising by approximately 1-2 percentage points, requiring banks to increase provisioning despite any temporary gains resulting from wider lending margins.

Banking Index	Trend During the Crisis	Expected Impact
Deposit Growth	Slows	Declines From an average of 5-7% to around 0-3%
Cost of Funding	Increases	Rises by approximately 50-150 basis points
Credit Growth	Slows	Falls to below 3-4%
Non-Performance Loans (NPLs)	Gradually Increases	Expected to rise by approximately 1-2 percentage points
Foreign Currency Liquidity	Comes Under Pressure	Decline in funding lines and higher funding costs
Profitability	Becomes More Volatile	Partial improvement in margins offset by higher provisioning

Source: UAB

The article further notes that the effects of the conflict extend beyond liquidity and lending to banks' overall profitability and operational performance. While higher interest margins may initially support earnings, these benefits are likely to be offset by rising funding costs, larger credit-loss provisions, and increased compliance and correspondent banking expenses. Consequently, profitability becomes more volatile and increasingly dependent on banks' ability to manage risk rather than simply expand lending. The report therefore argues that the impact of geopolitical shocks develops gradually across multiple financial indicators, reflecting the close link between banking performance and broader economic conditions.

To evaluate possible short-term outcomes, the article outlines three scenarios for the Arab banking sector. The first assumes a fragile ceasefire while disruptions in the Strait of Hormuz continue, resulting in slower deposit growth, persistent liquidity pressures, elevated financing costs, and only limited improvements in asset quality. The second scenario considers continued regional tensions with intermittent disruptions in the Strait, leading to unstable liquidity conditions, fluctuating deposits, ongoing pressure on foreign currency funding, and financing costs remaining 50-150 basis points above normal levels. The third and most optimistic scenario assumes a lasting ceasefire together with the reopening of the Strait and the normalization of energy exports. Under these conditions, government revenues, liquidity, lending activity, and profitability would gradually recover as financing costs decline and asset quality improves. Nevertheless, the report emphasizes that financial markets generally require between six months to one year to fully absorb geopolitical shocks and restore normal market conditions.

Overall, the article concludes that the impact of the war on the Arab banking sector extends well beyond immediate financial market reactions. Rather than resulting from higher oil prices alone, the shock is transmitted through disruptions in energy revenues, trade, public finances, and capital flows, ultimately affecting liquidity, deposits, funding costs, asset quality, lending activity, and profitability. As emphasized by the Union of Arab Banks the resilience of Arab banks will increasingly depend not only on strong financial positions but also on their ability to manage liquidity, adapt to prolonged geopolitical uncertainty, and maintain operational flexibility in an increasingly volatile environment.

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