

# GCC & UAE Banking System Response to the US–Iran Conflict

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This policy brief provides a senior-level analysis of the structural reasons why GCC banking systems — and the UAE specifically — react rapidly and severely to the US–Iran conflict that erupted in late February 2026. It covers the economic anatomy of GCC and UAE, the transmission channels of geopolitical shocks, the available monetary tools, and the CBUAE’s historic five-pillar resilience package activated on March 18, 2026.

\$307B

Deposit Flight Risk: AED 920B

CBUAE System Liquidity: 5 Pillars

CBUAE Resilience Package

## SECTION 1 - WHY THE GCC REACTS FAST TO US–IRAN CONFLICT

### 1. GCC Banking Sensitivity to Geopolitical Shocks

**The Foundational Formula:**

$$\text{Speed of Reaction} = \frac{(\text{Real Estate Concentration} \times \text{Oil Revenue Dependence})}{\text{Monetary Policy Autonomy}}$$

Since monetary policy autonomy = zero (dollar peg), the denominator approaches zero — making the reaction speed theoretically instantaneous.

#### 1.1 The Dollar Peg — Zero Monetary Independence

All six GCC currencies are pegged to the US Dollar. This single structural decision eliminates the region’s ability to run an independent monetary policy. When the Federal Reserve moves — in response to US geopolitical events — GCC central banks must follow identically, regardless of domestic economic conditions.

- GCC countries resolved the Mundell–Fleming trilemma by choosing: fixed exchange rate + free capital mobility + no monetary independence
- 85% of GCC bank income is interest-based — making all banks acutely sensitive to Fed rate signals
- Any US–Iran escalation immediately resets the risk pricing framework under which Gulf banks operate

### 1.2 Oil Revenue — The System’s Ultimate Collateral

Oil revenues do not just fund government budgets — they are the foundational capital base of the entire GCC banking system. The transmission chain is direct and non-diversifiable:

#### Oil Revenue Transmission Chain

Oil revenues → Sovereign Wealth Funds → Bank capitalization → Lending capacity → Real estate & infrastructure → Economic activity. Disrupt oil, and every link in this chain is simultaneously stressed.

### 1.3 The GCC Economic Pyramid

Layer	Sector	% of Economy	Bank Role	Conflict Vulnerability
Foundation	Oil & Gas	~40–50% GDP	Sovereign capitalization	Critical — physical disruption
Primary	Real Estate + Construction	\$1.68T pipeline	Primary lending target	Severe — investor withdrawal
Secondary	Trade, Finance, Tourism	~17% non-oil	Transaction banking	High — aviation/ logistics
Emerging	Manufacturing, Tech	~12.5% non-oil	SME lending	Moderate — least exposed
Accelerator	Dollar Peg	N/A	Forces Fed transmission	Instantaneous — no buffer

### 1.4 Why Manufacturing Is Structurally Small

Manufacturing contributing only 12.5% of non-oil GDP is not accidental — it is a deliberate policy outcome. Three structural reasons suppress it:

- No competitive labor cost advantage — GCC has expensive migrant labor with no large industrial domestic workforce
- Dollar peg makes exports expensive — strong USD = costly GCC products on global markets, killing manufacturing competitiveness
- Governments deliberately chose the services/hub model (Singapore model) over industrial manufacturing (Germany model)

### 1.5 The Pre-Existing Liquidity Stress

Critically, GCC banks were already under structural funding pressure before the conflict began, making them more vulnerable to shock:

- Saudi Arabia’s loan-to-deposit ratio had exceeded 100% — loans already surpassed available deposits
- Qatar also exceeded 100% loan-to-deposit ratio
- Saudi banking financing expanded 14% annually (2019–2022) while deposits grew only 9% — a structural mismatch

## SECTION 2 — THE UAE ECONOMIC ANATOMY

### 2. UAE Economic Structure — Why It Is Uniquely Vulnerable

The UAE is not an oil economy — it is a confidence economy built on oil money. Abu Dhabi’s oil funds the sovereign base, but Dubai’s engine runs entirely on the perception that UAE is the safest, most open, most connected hub in an unstable region.

#### 2.1 The Four Products UAE Sells Simultaneously

Product	Mechanism	Who Buys It	Conflict Fragility
Zero Tax	No corporate/income tax	Multinationals, HNWIs	Medium — structural advantage remains
Free Zones	100% foreign ownership, full repatriation	Global companies	Medium — legal structure intact
Geography	Between Europe, Asia, Africa	Logistics, trade, aviation	High — Hormuz disruption
Stability	Political safety in unstable region	Refugees of capital	Critical — perception destroyed instantly

#### 2.2 The Critical Structural Fact — 89% Foreign Population

No other country in the world has 89% of its population as foreign nationals. This single fact makes the UAE’s banking system uniquely exposed to sentiment shocks:

##### The Expat Exit Cascade

89% foreign population → All hold UAE property, bank accounts, jobs → Conflict signal = 'UAE no longer safe' → Simultaneous exit decision: Property listed (prices fall) + Deposits withdrawn (liquidity stress) + Rental demand collapses + Consumer spending stops → Every bank balance sheet deteriorates at the same time.

#### 2.3 How Abu Dhabi Oil Flows Into the Banking System

- Abu Dhabi holds ~96% of UAE’s oil reserves
- Oil revenues flow into three sovereign wealth funds: ADIA (~\$1T), ADQ, and Mubadala (~\$302B total AUM)
- SWFs capitalize state-linked banks: Emirates NBD, First Abu Dhabi Bank (FAB), Abu Dhabi Islamic Bank

- Banks lend primarily to real estate developers (Emaar, Aldar) and infrastructure projects
- Real estate pre-sales attract foreign buyers — completing the circular capital flow

## SECTION 3 — WHY UAE REACTS FAST: THE 5 SHOCK CHANNELS

### 3. UAE's Five Simultaneous Shock Channels

When the US–Iran conflict erupted, five distinct transmission channels activated simultaneously — each damaging a different pillar of the UAE economic model at the same time.

#### **Channel 1 — Deposit Flight (Hours)**

The most immediate shock to the banking system. UAE banks hold massive foreign deposits from Russians, Indians, Pakistanis, Iranians, and Europeans using UAE as a safe-haven jurisdiction.

- S&P warned of a \$307 billion deposit flight risk across GCC banking systems
- Unlike domestic depositors, foreign depositors wire out within hours — no friction, no regulatory constraint
- Some international lenders shut most UAE client-facing operations after IRGC threatened attacks on banks linked to US and Israel
- UAE bank shares suffered double-digit falls for all major lenders within the first trading session

#### **Channel 2 — Strait of Hormuz Disruption (Days)**

- 20% of global oil passes through the Strait of Hormuz daily
- 30% of global LNG — Qatar's entire export model — transits through it
- Closure does not just hurt oil exports: it freezes the entire import supply chain UAE depends on for food, materials, and construction inputs
- Jebel Ali Port — world's 9th largest — depends entirely on free maritime passage for re-export revenues
- Oil price spiked from ~\$70 to over \$110/barrel within days — while physical exports were simultaneously blocked

#### **Channel 3 — Construction Suspension (Weeks)**

Real estate is not just an investment in UAE — it is the primary collateral behind bank loans. Construction suspension triggers a full credit cycle reversal:

**Construction Suspension Credit Chain**

Project stops → Developer cannot sell units → Developer cannot repay bank loan → Loan becomes NPL → Bank must provision capital → Bank restricts new lending → Economy contracts → Property prices fall → Collateral value falls → Further capital pressure.

**Channel 4 – Aviation Collapse (Immediate)**

- Dubai International Airport — the world’s busiest international hub — suspended operations indefinitely
- Aviation closure simultaneously: Tourism revenue = zero, Transit passengers = zero, Cargo imports/exports = frozen, Business travel = stopped
- All GCC states experienced airspace closures, inflicting expected losses of \$40 billion during Ramadan season
- SME banking loans — restaurants, hotels, retail, logistics — immediately under stress as customers disappear

**Channel 5 – Expat Confidence Collapse (Days to Weeks)**

This is the channel that makes UAE uniquely more vulnerable than any other GCC state. Saudi Arabia is 38% foreign, Kuwait 70% — but UAE at 89% means the entire economic engine can psychologically exit simultaneously.

- Property listed for sale → supply surge → prices fall
- Bank deposits withdrawn → liquidity stress → EIBOR spikes
- Rental demand collapses → real estate income falls → developer revenue dries up
- Consumer spending stops → retail banking stress → SME loan deterioration

Shock Channel	Speed	Primary Bank Impact	Secondary Impact
Deposit Flight	Hours	Liquidity crisis	EIBOR spike
Hormuz Disruption	Days	Trade finance collapse	Supply chain inflation
Construction Suspension	Weeks	NPL rise, collateral devaluation	Capital adequacy pressure
Aviation Collapse	Immediate	SME loan deterioration	Tourism revenue zero
Expat Confidence Exit	Days–Weeks	Real estate price collapse	Rental income, consumer banking

**SECTION 4 — CBUAE MONETARY TOOLS & AVAILABLE PROCEDURES**

**4. CBUAE Monetary Tools — How They Work & Their Limits**

**The Foundational Constraint**

The main pillar of the Dirham Monetary Framework is the overriding objective of maintaining the UAE Dirham peg to the US Dollar. All monetary tools exist to serve this single objective first. This means CBUAE CANNOT use interest rates as a tool — they are permanently surrendered to the Federal Reserve.

**Tool 1 — Reserve Requirements**

Every bank must park a percentage of deposits at CBUAE as idle cash. In crisis mode, CBUAE can unlock a portion of these frozen reserves to inject liquidity directly into the banking system.

- Normal: Bank deposits AED 100 → keeps AED 14 at CBUAE → can lend AED 86
- Crisis: CBUAE allows access to 30% of the reserve → unlocks AED 4.20 of additional lending capacity per AED 100 deposited
- Defends against: Deposit flight, liquidity squeeze, interbank stress
- Limit: Reserve drawdown is temporary — if not rebuilt, it weakens the peg defense buffer

**Tool 2 — The Interest Rate Corridor (Standing Facilities)**

Two permanent windows trap the overnight interbank rate (EIBOR) between a ceiling and a floor:

Facility	Direction	Rate	Purpose
Lending Facility (Repo)	CBUAE → Bank	Ceiling rate (5.40%)	Banks borrow emergency cash overnight
Deposit Facility	Bank → CBUAE	Floor rate (5.15%)	Banks park excess cash safely
EIBOR Overnight	Bank ↔ Bank	Floats between both	Actual market transmission rate

During conflict: EIBOR spikes toward the ceiling as banks distrust each other and hoard cash, signaling credit stress and freezing lending to businesses and real estate.

**Tool 3 — Liquidity Ratios (Basel III Arsenal)**

- LCR (Liquidity Coverage Ratio): Banks must hold liquid assets to survive a 30-day stress scenario. UAE actual: 146.6% vs minimum required 100%
- ELAR (Eligible Liquid Assets Ratio): UAE-specific domestic liquidity measure layered on top of Basel III
- NSFR (Net Stable Funding Ratio): Ensures banks are not overly reliant on short-term wholesale funding that can evaporate in crisis

- In crisis: CBUAE allows temporary operation below normal minimums without triggering regulatory breach

#### Tool 4 – Capital Buffers

The equity cushion banks hold to absorb losses. UAE capital adequacy: 17% — providing a 6.5 percentage point buffer above the 10.5% minimum. In crisis, the 2.5% conservation buffer can be released without triggering automatic dividend restrictions.

#### Tool 5 – Term Liquidity Facilities (Emergency Lending)

CBUAE acts as lender of last resort, providing cash for longer periods (weeks/ months). Crucially, facilities are available in BOTH AED and USD — the dual-currency dimension is critical given the dollar peg and foreign deposit base.

#### Tool 6 – Loan Classification Deferral (Macroprudential)

CBUAE allows banks to defer NPL classification for customers affected by conflict conditions. This breaks the credit contraction cycle by preventing simultaneous capital provisioning across the entire system.

Without Deferral	With Deferral (CBUAE Activated)
Developer misses payment	Developer misses payment
Bank classifies as NPL immediately	Bank defers classification 90–180 days
Bank provisions capital → ratio falls	No immediate capital hit
Bank cuts lending → economy contracts	Bank continues lending → economy supported

#### The Hard Limits – Where Tools Run Out

Scenario	CBUAE Can Handle	CBUAE Cannot Handle
Short conflict (weeks)	All 5 tools sufficient	—
Medium conflict (months)	Deferral window buys time	Mass capital recapitalization needed
Peg attack	Deploys FX reserves	If reserves fall below 3 months import cover
Sovereign downgrade	SWF injection backstop	Cannot stop DIFC capital flight
Hormuz closed 6+ months	Emergency liquidity maxed	Requires IMF / GCC multilateral support

### SECTION 5 — THE CBUAE FIVE-PILLAR RESILIENCE PACKAGE (MARCH 18, 2026)

#### 5. CBUAE Five-Pillar Resilience Package – March 18, 2026

##### Official Announcement

"CBUAE Board Reviews Strength and Resilience of the UAE's Financial System and Banking Sector and Approves a Proactive Financial Institution Resilience Package Backed by CBUAE's Assets of AED 1 Trillion." — CBUAE Official Press Release, March 18, 2026

Reuters described it as “the UAE central bank’s most significant policy move since the pandemic.” The package was activated proactively — before systemic stress materialized — signaling that authorities treated this as a structural event, not temporary volatility.

### 5.1 The Five Pillars

Pillar	Tool Activated	Shock Channel Targeted	Mechanism
1. Expanded Liquidity	30% reserve requirement release	Deposit flight	Unlocks frozen AED liquidity
2. Funding Ratio Relief	Temporary LCR/ NSFR floor reduction	Interbank stress	Allows below-minimum operation
3. Capital Buffer Flexibility	Conservation buffer release	NPL provisioning	Prevents automatic dividend restrictions
4. Loan Deferral	NPL classification postponement	Construction suspension	Breaks credit contraction cycle
5. Dual-Currency Liquidity	AED + USD term facilities	Foreign deposit flight	Provides USD to replace withdrawn foreign deposits

### 5.2 The Numbers Behind the Package

- Total system liquidity held at CBUAE and in eligible assets: AED 920 billion
- Reserve balances alone: More than AED 400 billion
- CBUAE total assets backing the package: AED 1 trillion (~\$272 billion)
- UAE banking sector capital adequacy entering the crisis: 17% (vs 10.5% minimum)
- Liquidity Coverage Ratio entering the crisis: 146.6% (vs 100% minimum)
- NPL ratio entering the crisis: 3.2% (multi-year historic low)

### 5.3 Market Reaction to the Package

The market responded immediately and positively when the package was announced:

- Emirates NBD: +6% in the session following announcement
- Abu Dhabi Islamic Bank: +6%
- Abu Dhabi Commercial Bank: +5%

Goldman Sachs analysts commented: **"We think this news should be positive for sentiment near term as it provides temporary liquidity and capital relief for the banks in what is a difficult time."**

### 5.4 Official Sources for the Package

Source	Type	Date	Key Reporting
CBUAE Official Website (centralbank.ae)	Primary Official	Mar 18, 2026	Original press release — primary source
Reuters (via WorldNews wire)	Tier-1 Global Wire	Mar 18, 2026	"Most significant move since pandemic"
The National (thenationalnews.com)	UAE Tier-1 English	Mar 18, 2026	Full 5-pillar breakdown and bank reactions
Gulf Business (gulfbusiness.com)	GCC Financial Media	Mar 18, 2026	Regulatory detail and pillar structure
WAM — UAE State News Agency (wam.ae)	Official State Media	Mar 18, 2026	UAE Banks Federation endorsement
Asharq Al-Awsat (english.aawsat.com)	Arab Financial Tier-1	Mar 19, 2026	Market reaction + Goldman Sachs note
IBS Intelligence (ibsintelligence.com)	Regulatory Specialist	Mar 18, 2026	Pre-emptive policy stance analysis

## SECTION 6 — SENIOR EXPERT CONCLUSIONS

### 6. Senior Expert Conclusions

#### 6.1 Why GCC Reacts Fast — The One Formula

##### The Core Equation

Speed of Banking Reaction = (Real Estate Concentration × Oil Revenue Dependence) ÷ Monetary Policy Autonomy Since Monetary Policy Autonomy = 0 (dollar peg), the denominator approaches zero — making the reaction speed theoretically instantaneous. This is structurally inevitable, not irrational.

#### 6.2 Why UAE Reacts Faster Than Any Other GCC State

- 89% foreign population — the entire economic engine can exit simultaneously
- Real estate is both the primary lending collateral AND the investment magnet for foreign capital
- Aviation hub model means geographic connectivity is a core revenue source, not just infrastructure
- The "stability as a product" positioning means a single conflict event destroys the competitive advantage
- EIBOR dollar-peg transmission means every Fed-related shock is imported at full strength with zero buffer

#### 6.3 The CBUAE Response — Assessment

The CBUAE entered this conflict with the strongest balance sheet in its history. The five-pillar package was technically well-designed and activated with textbook speed. However, three critical observations must be noted:

- Every tool buys time — none creates growth. The real question is whether the confidence economy can be rebuilt post-conflict.
- The loan deferral tool is the most critical intervention: it breaks the credit contraction cascade that would otherwise amplify the shock into a systemic crisis.
- The dual-currency (AED + USD) liquidity facility is the most innovative element — directly addressing the foreign deposit flight risk that makes UAE uniquely vulnerable.

#### 6.4 Final Synthesis — One Paragraph

##### Senior Expert Final Assessment

GCC banks are essentially highly leveraged real estate investment vehicles, capitalized by petrodollar sovereign wealth, funded by dollar-pegged deposits, with zero monetary independence — making them the most geopolitically sensitive banking system in the world relative to their size. The UAE, as the most foreign-dependent economy within this system, is the most exposed node. The CBUAE's March 18 package demonstrates institutional maturity and pre-emptive capability. But no central bank tool can rebuild a confidence economy from within a war zone. The duration of the conflict — not its intensity — will ultimately determine whether UAE's structural model survives intact.

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