THE FED’S PIVOT

Implications for GCC Banking Sector

RECENT POLICY UPDATE

On December 11, 2025, the U.S. Federal Reserve cut its benchmark interest rate by 25 basis points (bps) to a target range of 3.50%–3.75%. Due to the USD peg, GCC central banks (Saudi Arabia, UAE, Qatar, Bahrain, Oman) moved in lockstep, reducing rates by 25 bps. This marks a pivotal transition for regional banks: from a margin-expansion cycle driven by high rates to a volume-driven cycle supported by credit demand and asset quality improvement.

STRATEGIC OUTLOOK: 2026 & BEYOND

DEC 2025	H1 2026	FUTURE
25bps Cut (Done)	Pause & Assess Strategy	Data-Dependent Easing

GLOBAL CONTEXT: THE 'CAUTIOUSLY DOVISH' PIVOT

KEY DRIVERS

- **Labor Cooling:** Job creation decelerated in H2 2025, accompanied by a gradual rise in the unemployment rate. The Fed now assesses that downside risks to the labor market outweigh upside inflation risks, triggering a policy pivot to safeguard maximum employment.
- **Economic Slowdown:** Moderate economic expansion in the US resulted in slower growth momentum in 2025.

MARKET REACTION

- **US Equities:** Welcomed the cut, though the rally was short-lived due to AI stock valuation concerns.
- **GCC Impact:** GCC central banks mirrored the Fed’s rate cut, except Kuwait, which is pegged to the Basket of Currencies.

BANKING IMPACT: THE MARGIN VS. VOLUME TRADE-OFF

A. LIABILITY REPRICING (Benefit)

Context: During 2023-24, customers shifted massive capital from CASA to high-yielding Time Deposits (TDs), spiking Cost of Funds.

The Cut Impact:

Interest paid on deposits reprices downward immediately or upon maturity. Banks with high wholesale funding/TDs see interest expenses drop, cushioning margins.

B. ASSET REPRICING (Lag)

Context: Corporate loans (Floating Rate) reprice lower almost immediately, exerting downward pressure on interest income.

The Sweet Spot (Retail):

Retail/Mortgage books (Fixed Rate, common in KSA) continue to earn high yields while funding costs drop. Result: Expect NIM expansion for retail-heavy banks over the next 2–3 quarters.

ASSET QUALITY: THE PRIMARY BENEFICIARY

SME Relief

Small/Medium Enterprises operating on thin margins get breathing room from high debt servicing, preventing slippages into NPL status.

Corporate De-leveraging

Large corporates can now refinance debt at more attractive terms, improving their Interest Coverage Ratios (ICR).

Provisioning Release

Rate cut leads to a sustained decline in IFRS 9 Probability of Default (PD). Banks may reduce ECL provisions, improving profitability.

Saudi Mega Projects

Saudi banks exposed to contracting firms on Giga-projects see reduced default risk as lower financing costs improve contractor cash flows.

SECTORAL DEEP DIVE: REAL ESTATE RESURGENCE

WHERE WILL THE CAPITAL FLOW?

Financing ease acts as catalyst for GCC Property (Affordability Unlocked)

Mortgage Demand

Lower interest rates directly reduce mortgage rates, bringing 'borderline' buyers hampered by affordability back into the market.

Intl. Demand (UAE)

Strong demand from Asian subcontinent buyers. Accustomed to high rates at home, they find the new GCC pricing attractive.

Govt Incentives

Active government promotion of first-time home buyer programs + lower rates = Enhanced affordability.

KEY TAKEAWAYS FOR INVESTMENT MANAGERS

- **Shift to Volume:** Pivot exposure towards banks with high Liquidity Coverage Ratios (LCR) to capture the incoming surge in credit demand (Volume > Margin).
- **Sector Overweight:** Capitalize on the resurgence in Real Estate and Saudi Giga-Projects; construction-linked lenders stand to benefit most from unlocked financing.
- **Asset Quality Floor:** Expect lower Cost of Risk (CoR) as SME debt servicing capacity improves; reduced provisions will directly boost bottom-line earnings.
- **Yield Opportunity:** As risk-free rates decline, GCC banks offer an increasingly attractive dividend yield spread vs. US Treasuries.

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