Financial Stability and Banking Transformation amid a Changing Global Monetary System

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The Union of Arab Banks' (UAB) quarterly economic bulletin, in its second issue for July-August 2026, examines the changing concept of financial balance and the transformation of banking policies amid major shifts in the global monetary and financial environment. In its report, *"Financial Balance, Shifting Banking Policies, and the Future of the Global Monetary and Financial System,"* the UAB argues that the global financial system is undergoing a profound restructuring. The period of low interest rates, abundant liquidity, and relatively easy financial conditions that followed the global financial crisis and continued through the COVID-19 era has been replaced by higher borrowing costs, persistent inflationary pressures, geopolitical uncertainty, elevated public debt, and tighter financial conditions. Consequently, financial balance is no longer limited to balancing government revenues and expenditures, but increasingly depends on the ability of economies and banking systems to absorb shocks without triggering liquidity, confidence, or debt crises.

This transition is occurring against a relatively weak global growth outlook. According to World Bank estimates cited by UAB, global growth is expected at around 2.5% in 2026, while energy price pressures, inflation risks, and geopolitical uncertainty continue to challenge policymakers. Meanwhile, the International Monetary Fund (IMF) has warned of elevated risks to global financial stability due to the interaction between higher bond yields, tighter financial conditions, sovereign debt vulnerabilities, and the possibility of financial-market pressures spreading to banks and the real economy. The IMF also estimates that global public debt could exceed 100%

of global GDP by 2029, its highest level since 1948. Accordingly, UAB argues that restoring financial balance requires more than reducing fiscal deficits; governments must also improve expenditure efficiency, strengthen revenue collection, and direct resources toward infrastructure, productive development, human capital, and digital transformation.

Financial balance has therefore become increasingly dependent on the interaction between public finances, monetary policy, and banking sector stability. Higher debt-servicing costs place pressure on government budgets, while rising interest rates affect bond yields and reduce the market value of financial assets held by banks, potentially reinforcing the link between sovereign and banking risks. This interconnectedness has also transformed banking strategies. Banks are shifting away from prioritizing credit expansion and increasingly focusing on asset quality, deposit stability, liquidity, capital adequacy, and stronger risk management.

In credit policy, this has resulted in greater selectivity and stricter assessment of borrowers' creditworthiness, with greater emphasis on the quality rather than the volume of loans. Banks are also building larger liquidity buffers and monitoring deposit flows more closely instead of relying mainly on the traditional stability and abundance of deposits. At the same time, higher interest rates have increased the importance of managing the repricing of assets and liabilities to protect profitability and capital. Funding sources are becoming more diversified, while banks are seeking to strengthen stable deposit bases and reduce their vulnerability to rapid deposit migration. Regulatory practices are similarly becoming more proactive through stronger supervision, stress testing, and risk governance. Moreover, banks are gradually reducing their dependence on interest income by diversifying revenues through digital services, fees, and wealth management.

Policy Area	Previous Approach	New Direction	Strategic Significance
Credit Policy	Expansion in lending in pursuit of growth	Greater selectivity and stricter assessment of creditworthiness	Focus on loan quality rather than volume
Liquidity Management	Reliance on abundant deposits and their relative stability	Building larger liquidity buffers and daily monitoring of deposit flows	Avoiding sudden withdrawal shocks and funding gaps
Interest Rates	Benefiting from low interest rates to support lending	Careful management of interest-rate risk and repricing of assets and liabilities	Protecting profit margins and capital
Deposit Structure	Reliance on traditional low-cost deposits	Diversifying funding sources and strengthening stable deposits	Reducing banks' vulnerability to deposit migration
Regulation and Compliance	Compliance with minimum regulatory requirements	Proactive supervision, stress testing, and stricter risk governance	Strengthening the capacity to absorb shocks
Business Model	Heavy reliance on interest income	Diversifying income through digital services, fees, and wealth management	Reducing dependence on interest-rate and credit cycles

Source: Union of Arab Banks

The banking disruptions experienced in several advanced markets in 2023 demonstrated why these changes are necessary. The report highlights how unrealized losses on investment portfolios, weak interest-rate risk management, and rapid deposit withdrawals can combine to create significant financial stress. Higher interest rates affect not only funding costs but also the market value of bonds and other securities held by banks, particularly when asset maturities are significantly longer than liability maturities. Consequently, banks are increasingly improving the matching of assets and liabilities and strengthening contingency funding plans. Digitalization has made this challenge more important, as customers can transfer their deposits between banks or into alternative financial instruments much more rapidly. The Financial Stability Board, as cited by the UAB, has warned that technology and social media can accelerate deposit withdrawals during periods of stress, making depositor behavior and the stability of funding bases central elements of bank risk management.

Credit allocation is also becoming more targeted. Rather than simply reducing lending, banks are lowering exposure to highly risky or interest rate sensitive sectors while giving greater priority to sectors capable of generating stable cash flows, including essential trade, energy, infrastructure, export industries, and activities associated with digital transformation. This does not mean that banks are retreating from financing the economy; instead, financing decisions are becoming more closely linked to borrowers' financial sustainability and repayment capacity rather than relying mainly on collateral.

At the same time, traditional banks face growing competition from investment funds, fintech companies, payment firms, and private credit funds. According to Financial Stability Board figures, non-bank financial intermediation reached approximately $257 trillion in 2024, equivalent to around 51% of total global financial assets, after expanding by approximately 9.4%. This rapid growth requires banks not only to adapt their operating models to greater competition but also to manage the increasing interconnectedness between banks, financial markets, and non-bank institutions. Overall, UAB sees banking policy moving away from a narrow focus on credit growth toward more flexible business models centered on risk management, liquidity stability, and the ability to absorb shocks.

The broader international monetary system is also expected to change, although the Union does not anticipate the disappearance of traditional banks or major international currencies. Instead, existing financial institutions are likely to become integrated into a more digital and interconnected system. Central bank money should retain its fundamental role in confidence and final settlement, while commercial banks increasingly provide deposits, credit, and financing through faster digital channels. One important development is the tokenization of financial assets, allowing deposits, bonds, and other assets to be represented as digital units that can be traded and settled electronically. According to the Bank for International Settlements (BIS), future financial arrangements could increasingly rely on unified platforms combining central bank reserves, commercial bank money, and tokenized government securities, potentially lowering the cost and operational risks of cross border payments and settlements.

Central bank digital currencies are another important part of this transformation. A 2024 BIS survey found that 91% of surveyed central banks were studying central bank digital currencies, with greater progress in wholesale CBDCs designed for transactions between financial institutions than in retail currencies for individuals. Nevertheless, the report does not expect digitalization to eliminate the dollar's international role. IMF figures show that the US dollar accounted for 56.8% of global official foreign exchange reserves in the fourth quarter of 2025, compared with 20.2% for the euro and 1.95% for the Chinese yuan. The dollar therefore remains dominant, although the gradual diversification of reserve assets and settlement currencies points toward a somewhat more diversified international monetary system.

Digitalization, however, introduces significant new vulnerabilities, particularly cyber risk. According to IMF assessments, the number of cyberattacks has roughly doubled compared with the pre-COVID-19 period, while the banking sector has been exposed to around one-fifth of recorded cyber incidents. A growing dependence on cloud computing means that a major disruption could interrupt payments and essential services while damaging market and depositor confidence. The IMF estimates that the maximum direct loss from a cyber incident for a financial institution could reach around $152 million in a given year, while an extreme scenario could generate losses of approximately $2.2 billion, with such an event statistically expected around once every ten years. UAB therefore stresses that even initially limited technological disruptions can become liquidity or solvency problems if they undermine confidence.

Moreover, digital access does not necessarily translate into financial resilience. Referring to the World Bank's Global Findex Database 2025, based on 2024 data across 148 countries, the report notes that 79% of adults worldwide hold a financial account and 84% of adults in low and middle income economies own a mobile phone, yet only 56% of adults can reliably obtain additional funds during an emergency. This gap illustrates that expanding digital services alone is insufficient unless individuals also develop a genuine capacity to save, manage risks, and access secure financing. UAB therefore emphasizes the need to combine digital transformation with financial inclusion, financial education, and consumer protection.

Turning specifically to the Arab region, UAB describes the Arab banking sector as relatively large and generally capable of absorbing economic and financial shocks, although substantial differences remain between countries. Total Arab banking assets reached approximately $5.5 trillion at the end of 2025, while credit facilities amounted to around $3.2 trillion, or 58% of total assets, and customer deposits stood at approximately $3.3 trillion. Capital buffers also remain relatively strong, with the average capital adequacy ratio of Arab banks at around 18.4%, above the 10.5% minimum regulatory requirement under Basel standards.

However, the broader Arab financial system remains highly bank-dependent. Excluding pension funds, non-bank financial institutions represented only around 6.7% of total Arab financial sector assets at the end of 2024, while insurance penetration stood at approximately 1.7% of GDP, compared with a global average of around 7%. This highlights the limited diversification of financing channels outside the banking sector. By contrast, progress in digital payments has been more encouraging. According to the Arab Monetary Fund, mobile payment services are available across all Arab countries, while 94% have established legal frameworks regulating payment systems. Further progress, however, requires stronger credit-rating systems, movable collateral registries, data protection, cybersecurity, and greater integration of national infrastructure through cross-border Arab payment and settlement platforms.

Looking ahead, UAB recommends that central banks and supervisory authorities adopt more proactive and forward looking risk management frameworks capable of addressing financial, technological, and geopolitical shocks. Capital and precautionary liquidity buffers should be strengthened, while stress tests should incorporate scenarios such as large scale cyberattacks, payment system disruptions, rapid digital deposit withdrawals, market volatility, and sudden changes in interest rates. Commercial banks should diversify funding, strengthen liquidity management, and use financial technology not only for customer services but also to modernize operational infrastructure, improve data analysis and fraud detection, and strengthen credit and operational risk management. Cybersecurity and data protection should consequently be treated as fundamental elements of banking safety rather than merely additional technological costs.

The report also calls for stronger coordination between central banks, regulators, and financial institutions, particularly regarding digital currencies, virtual assets, cross-border payments, and dependence on major technology and cloud service providers. Internationally, faster and less expensive payment and settlement systems should be developed while preserving central banks' role in maintaining confidence, monetary sovereignty, and currency stability. For Arab banks specifically, priorities include modernizing digital infrastructure, strengthening governance and risk management, expanding regional cooperation in payment systems, sharing information on cyberattacks and financial crimes, maintaining sufficient capital and liquidity, diversifying credit portfolios, and directing more financing toward productive sectors and sustainable projects.

Overall, UAB presents the current transformation as a structural change in the meaning of financial stability rather than a temporary response to higher interest rates. Banking strategies are moving from maximizing credit growth toward improving asset quality, liquidity, income diversification, digital capabilities, and resilience to shocks. Meanwhile, the international monetary system is becoming more digital and interconnected without eliminating the traditional roles of central banks, commercial banks, or major reserve currencies. For Arab banks, strong capitalization and stable deposits provide an important foundation, but greater financial diversification, cybersecurity, regional digital integration, and proactive risk management will be increasingly important. Ultimately, future financial balance will depend not simply on controlling deficits or maintaining liquidity, but on building financial systems capable of adapting to technological change, absorbing shocks, preserving confidence, and supporting sustainable economic growth.

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