How Banks In Selected Emerging Markets In EMEA Will Cope With Lower Rates

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Jan. 13, 2025

S&P Global
Ratings

This report does not constitute a rating action

Key Takeaways

- In general, lower rates will dent the net interest income of banks in selected emerging markets in EMEA.
- Yet higher lending growth, improving asset quality, a lower cost of risk, or higher reliance on local funding sources will protect banks' bottom lines.
- Banking systems that depend more on external funding--such as those in Turkiye, Qatar, and, to a much lesser but increasing extent, Saudi Arabia--will benefit from the lower rates and higher global liquidity as this will make funding cheaper.
- Markets in Central Asia and the Caucasus and most African countries will likely see a limited effect from decreasing interest rates and should be able to maintain their margins.
- The key factors to watch are management reactions, balance-sheet repositioning, and shifting global narratives about monetary easing resulting in fewer interest rate cuts.

Ongoing Monetary Easing

We expect only mildly negative implications for selected emerging market banking systems' profitability

- We expect monetary easing to continue, albeit only gradually. The risk of the Fed's easing bias being disrupted has increased due to ongoing consumer resiliency, excess inflation in the system, and uncertainty about expectations. The incoming U.S. administration's likely introduction of trade tariffs and immigration curbs could increase inflation in the U.S.
- After the Fed decreased rates by 100 bps in 2024, it could afford to slow the pace of rate cuts in the months ahead. We now expect the Fed to reduce rates by 75 bps in 2025, which is less than we previously anticipated.
- We anticipate that the European Central Bank (ECB) will cut rates more quickly than we expected due to persistently weak confidence and better visibility on disinflation. We now project that the main policy rate will reach 2.5% before the summer of 2025, before our previous expectation of September 2025.
- The first round of tariffs would primarily dent China's economic growth, and to certain degree, that of its key trading partners, mostly in Asia. We expect emerging markets to be able to withstand moderate tariffs, as these would lead to a slowdown in economic growth rather than a sudden stop.
- Lower rates are likely to have a differentiated effect on selected emerging markets in EMEA, depending on the structure of their banking systems' balance sheets, the correlation between their monetary policies and those of developed markets, and their dependence on external debt.

Factors Influencing Net Interest Income: What Banks Control And What They Don't

Outside banks' control

- Evolution of policy rates and yields on government and corporate bonds.
- Correlation between global and local rates.
- Level of competition between banks and nonbank financial institutions on lending and deposit rates.
- Customer price sensitivity/inertia.
- Evolution of funding costs on the markets.

Within banks' control

- Structure of fixed-income investment books and overall liquidity position.
- Lending mix (retail/corporates; high- and low-margin loans, etc.).
- Risk appetite (higher exposure to risky but lucrative segments, percentage of loans in foreign currency).
- Mix of term funding instruments (secured/unsecured, subordinated, etc.).

Relative Sensitivity To Factors Influencing Net Interest Income

This table covers only the most important channels of transmission.

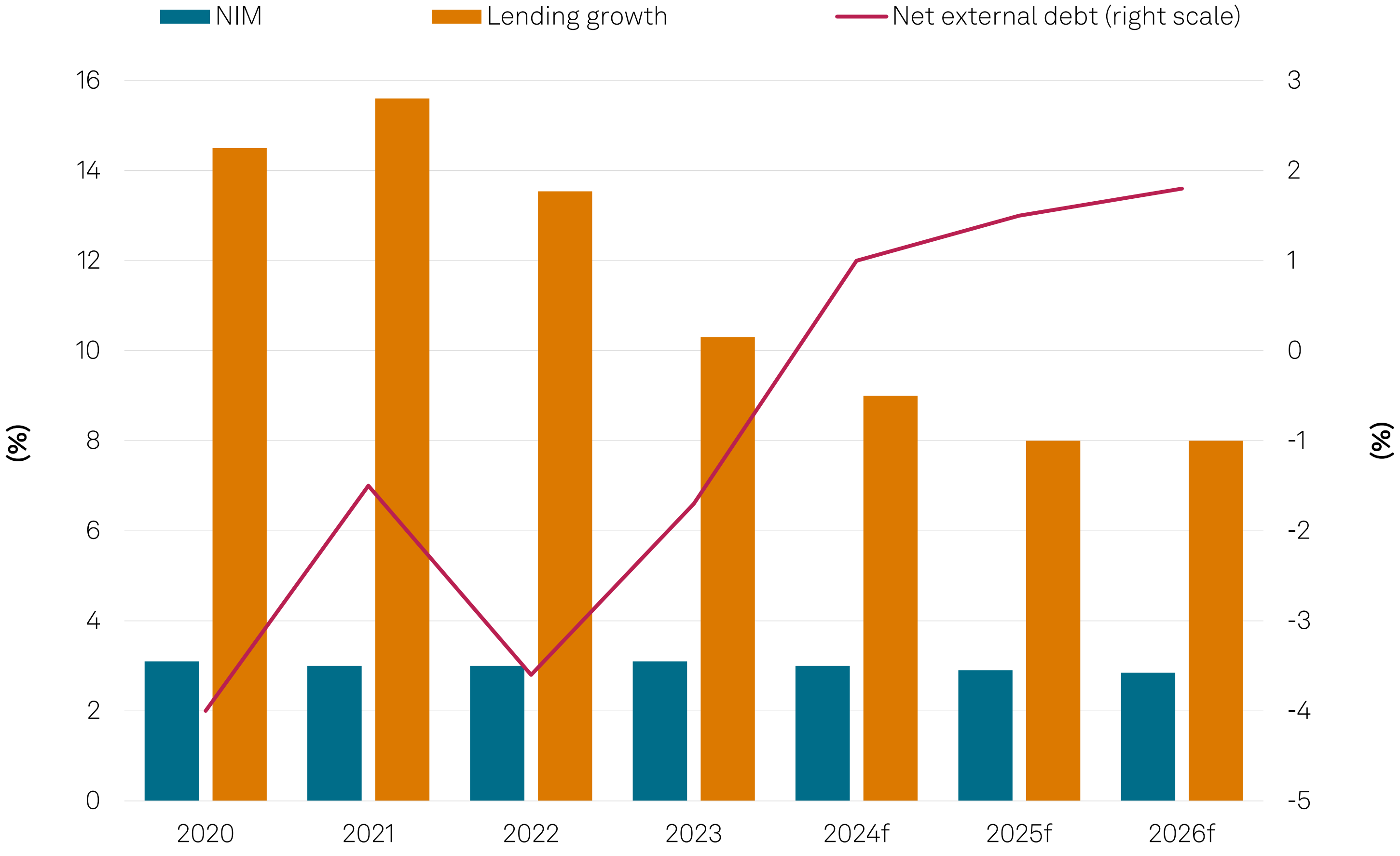
Correlation between local and global rates	Level of competition	Customer price sensitivity	Structure of investment books	Lending mix	Risk appetite
Gulf Cooperation Council (GCC), Jordan		Georgia, Jordan, South Africa, Turkiye, Uzbekistan	Egypt	GCC, South Africa	Egypt, Georgia, Kazakhstan
Morocco	Armenia, GCC, Jordan, Kazakhstan, Turkiye, Uzbekistan.	Armenia, Azerbaijan, Egypt, Kazakhstan, Morocco	GCC, Jordan, Kazakhstan, Morocco, South Africa, Turkiye, Uzbekistan	Armenia, Georgia, Turkiye, Uzbekistan	Armenia, Jordan, Morocco, Turkiye, Uzbekistan
Armenia, Azerbaijan, Egypt, Georgia, Kazakhstan, South Africa, Turkiye, Uzbekistan	Azerbaijan, Egypt, Georgia, Morocco, South Africa	GCC	Armenia, Azerbaijan, Georgia	Azerbaijan, Egypt, Jordan, Morocco, Kazakhstan	Azerbaijan, GCC, South Africa

High sensitivity	Moderate sensitivity	Limited sensitivity

Gulf Cooperation Council

Higher Lending Growth And A Lower Cost of Risk Will Compensate For Declining Margins

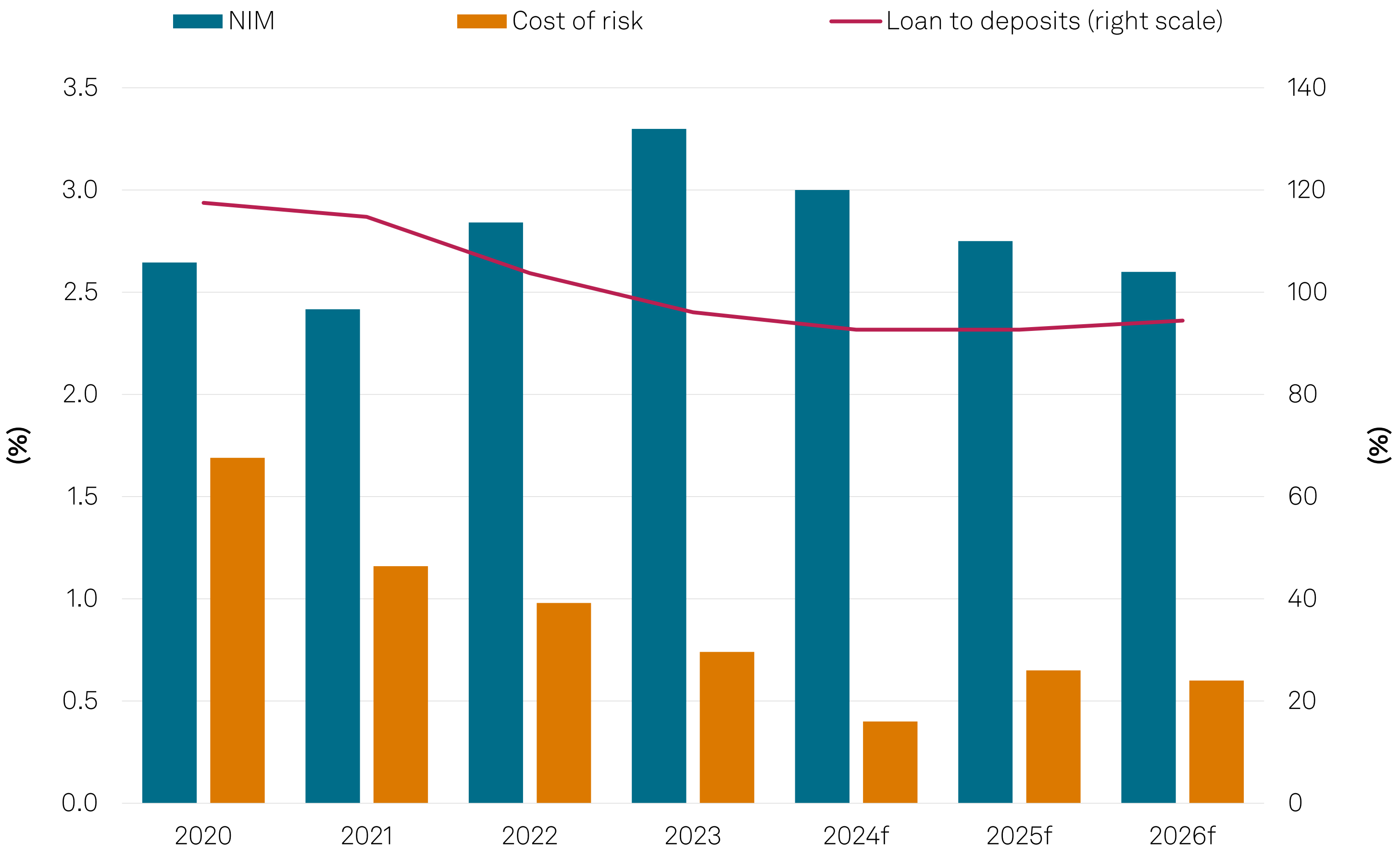
Saudi Arabia: Strong Lending Growth And An Increasing Reliance On External Funding



f--Forecast. Source: S&P Global Ratings.

- We expect net interest margins (NIMs) to drop by about 20 bps-30 bps by the end of 2025 relative to 2023, as the Saudi Central Bank mirrors the Fed's cuts to preserve its currency peg.
- Largely floating-rate corporate loans (50% of total loans at mid-2024) will reprice quickly, leading to lower interest income. Fixed-rate and long-term mortgages (25% of the total on the same date) will partly offset this.
- Reliance on external funding amid slower deposit growth will continue to increase due to large funding needs for Vision 2030 projects. Positively, lower interest rates will reduce the cost for banks.

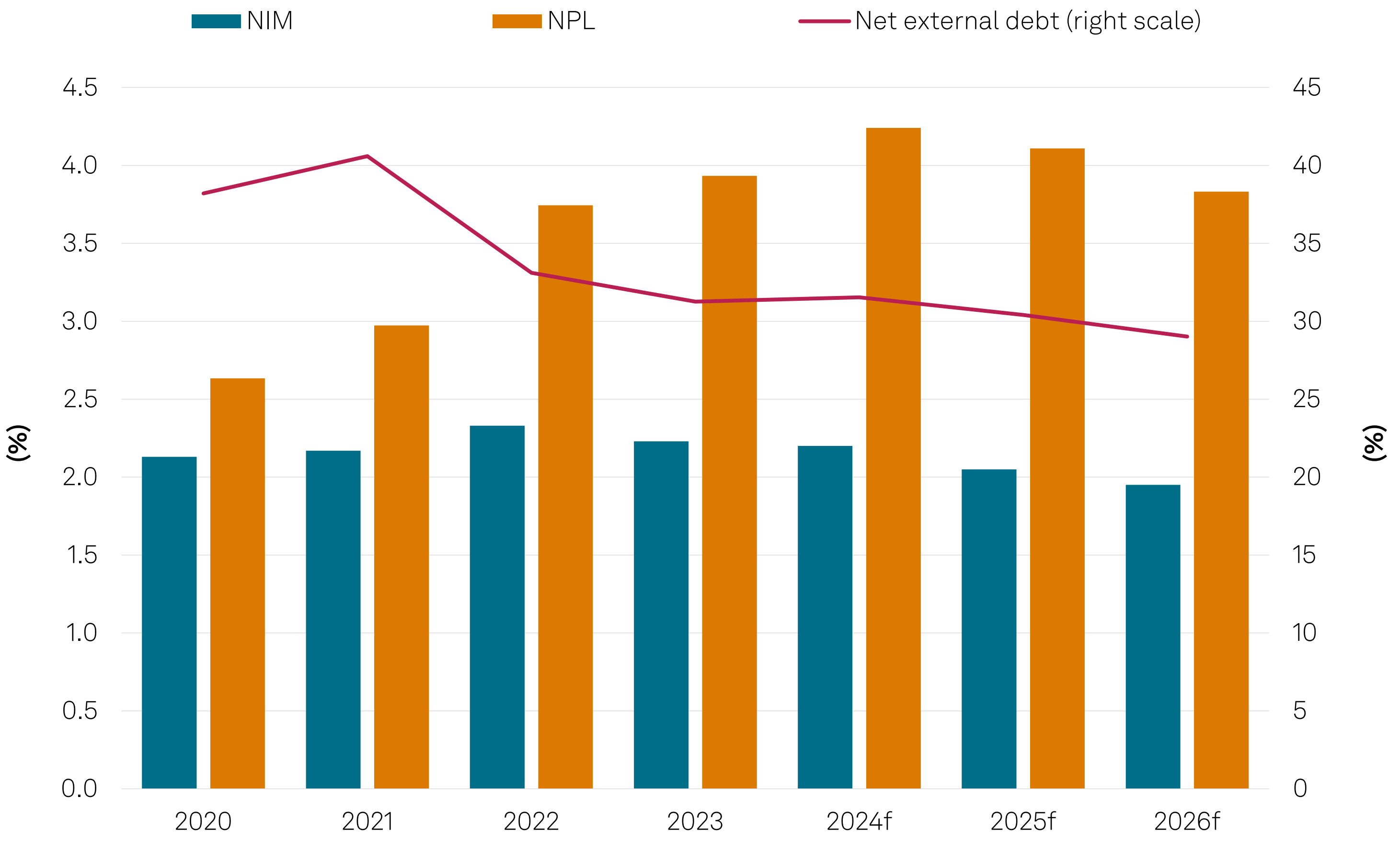
United Arab Emirates (UAE): Lower NIMs But Ample Liquidity



f--Forecast. Source: S&P Global Ratings.

- We expect NIMs to decline by about 40 bps-60 bps by the end of 2025 as the Central Bank of the UAE mirrors the Fed's decisions.
- While corporate loans and mortgages typically have floating rates and reprice quickly, a lower cost of risk from precautionary provisioning in the past will alleviate the pressure on the bottom line.
- The migration of deposits from remunerated products to current accounts and savings accounts, as well as solid lending growth of around 8%-10%, funded by deposit growth, could also help profitability.

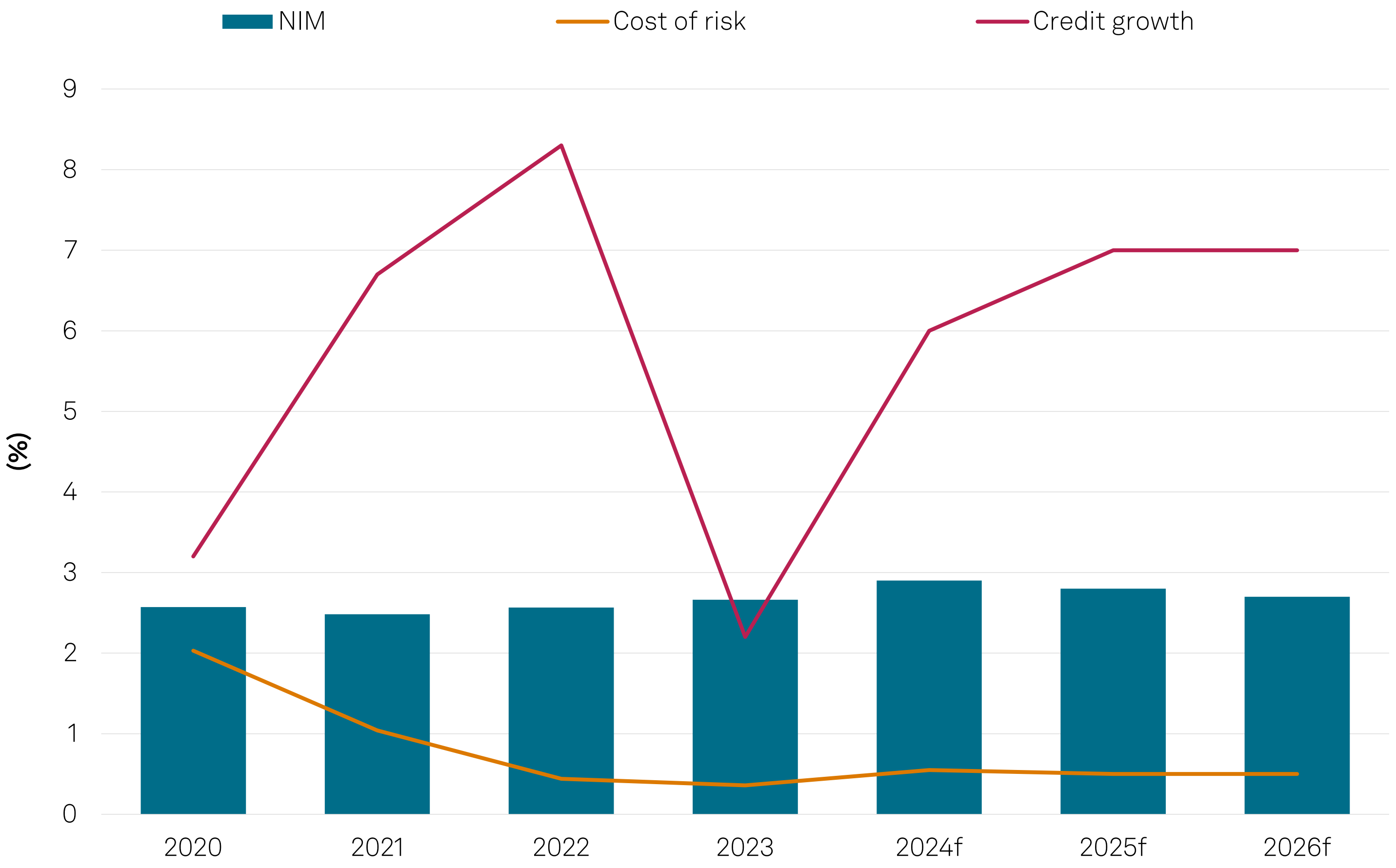
Qatar: Margins Will Decline Modestly But Asset Quality Will Get A Boost



f--Forecast. Source: S&P Global Ratings.

- Stabilizing external debt, a related increase in funding costs from typically more expensive domestic sources, and interest rate cuts will crimp the margins by about 10 bps-20 bps by the end of 2025.
- At the same time, oversupply in the real estate sector because of the World Cup will likely ease with lower rates. This, in turn, will reduce banks' cost of risk.
- Despite lower rates, we expect credit growth to decelerate to an average of 5% in 2025 compared with an average of 8% in 2019-2022, as the completion of many infrastructure projects means lower funding needs.

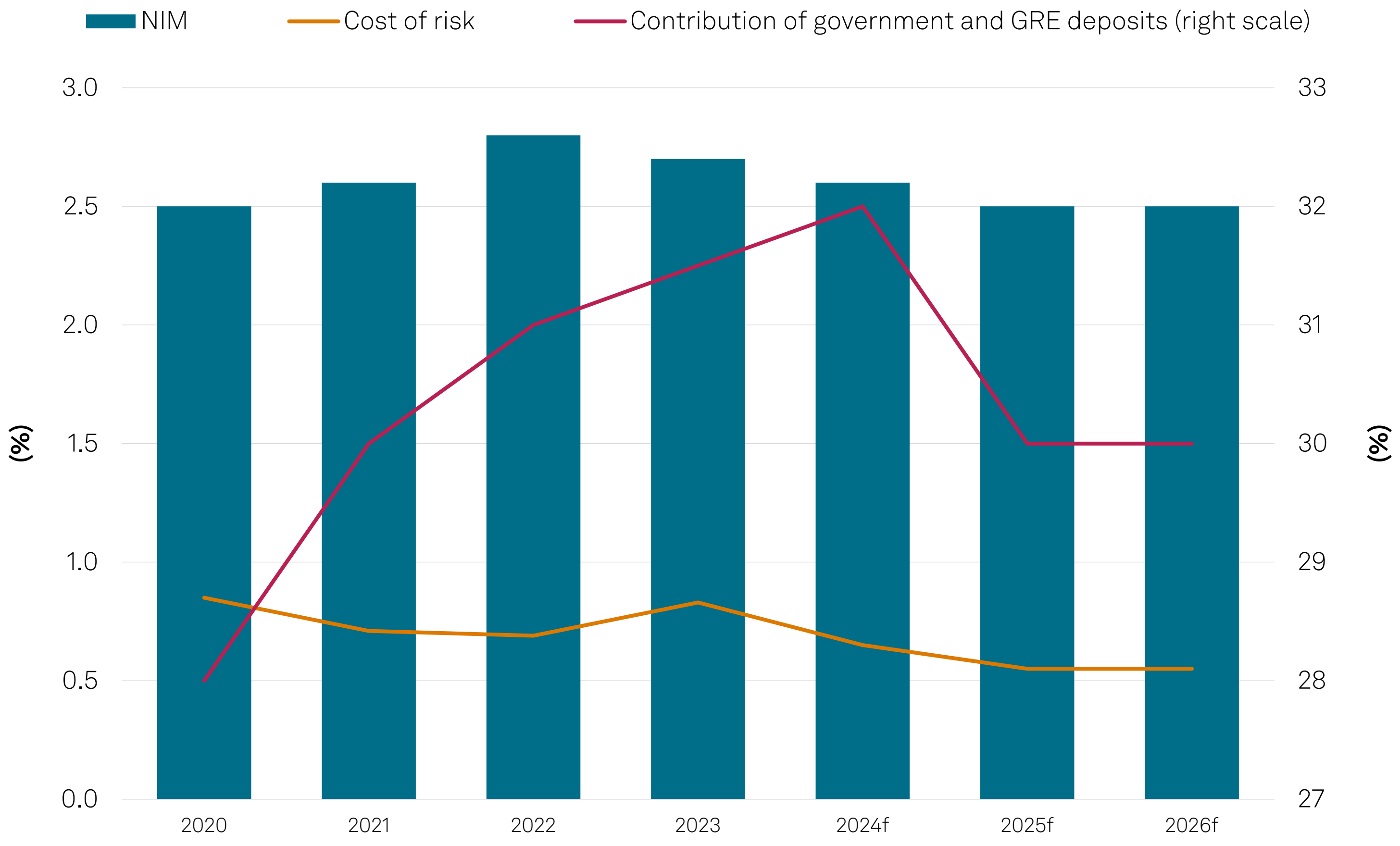
Kuwait: Lagging Interest Rate Cuts Will Moderate The Impact On Banks' Profitability



f--Forecast. Source: S&P Global Ratings.

- We expect the Central Bank of Kuwait to implement lower interest rate cuts than the Fed, as it has not fully reflected the previous rate increases between 2022-2024.
- We foresee a 30 bp-50 bp drop in NIMs by 2025 compared to 2023.
- Stronger lending growth of around 7% in 2025, a likely decline in the cost of risk, and deposit migration to nonremunerated products will likely alleviate some of the pressure.

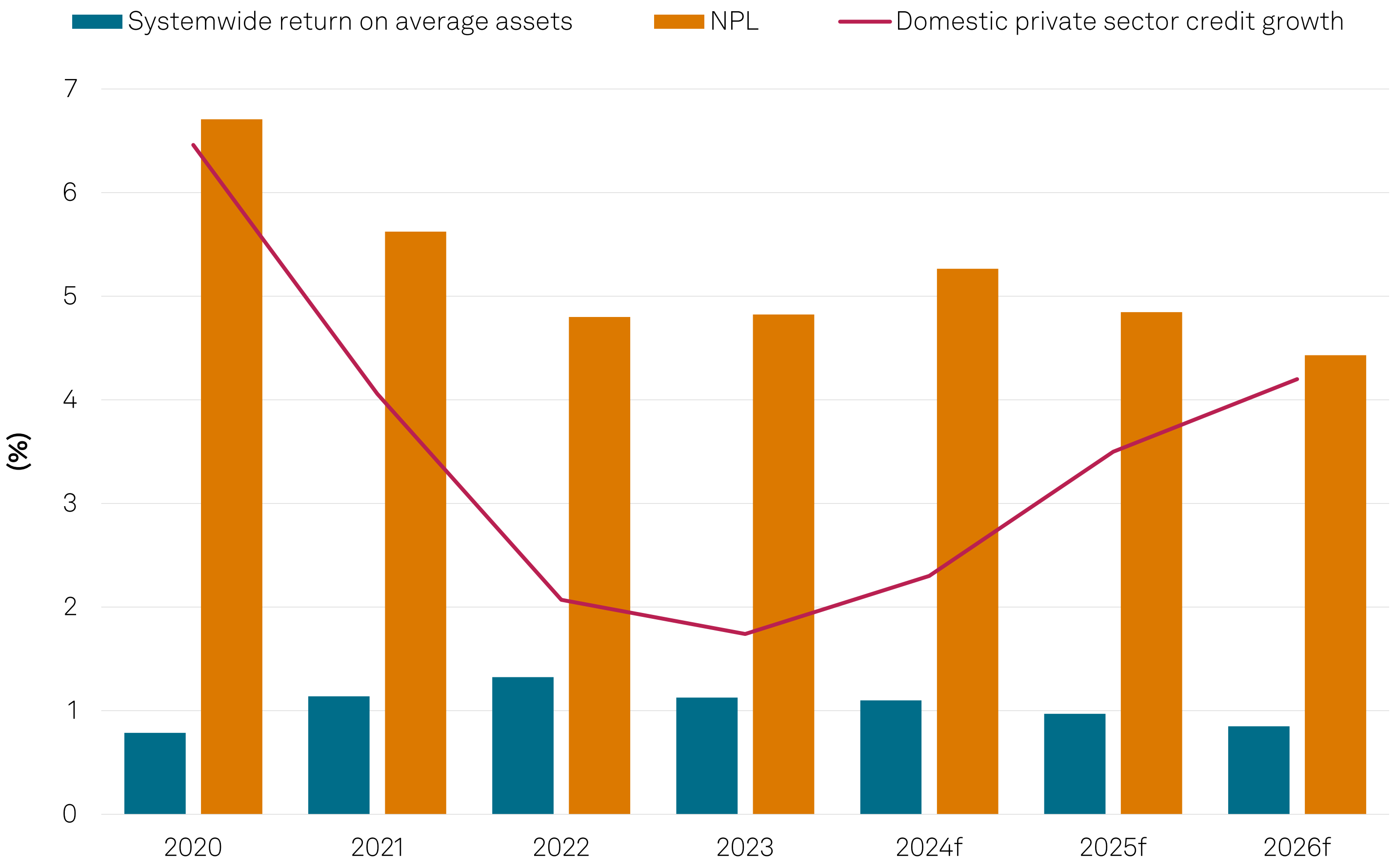
Oman: An Improving Cost Of Risk Will Alleviate NIM Pressure



f--Forecast. Source: S&P Global Ratings.

- We expect a 10 bp-20 bp decline in NIMs for banks in Oman by 2025 from 2023 levels, assuming the central bank follows the Fed's cuts due to the currency peg.
- We project that the cost of risk will remain at cyclical lows of about 55 bps-65 bps, which will help banks' bottom lines.
- We expect lending growth to increase to around 5% in 2025 thanks to the improving economic performance.

Bahrain: Lower Interest Rates Will Boost Retail Lending But Pressurize NIMs



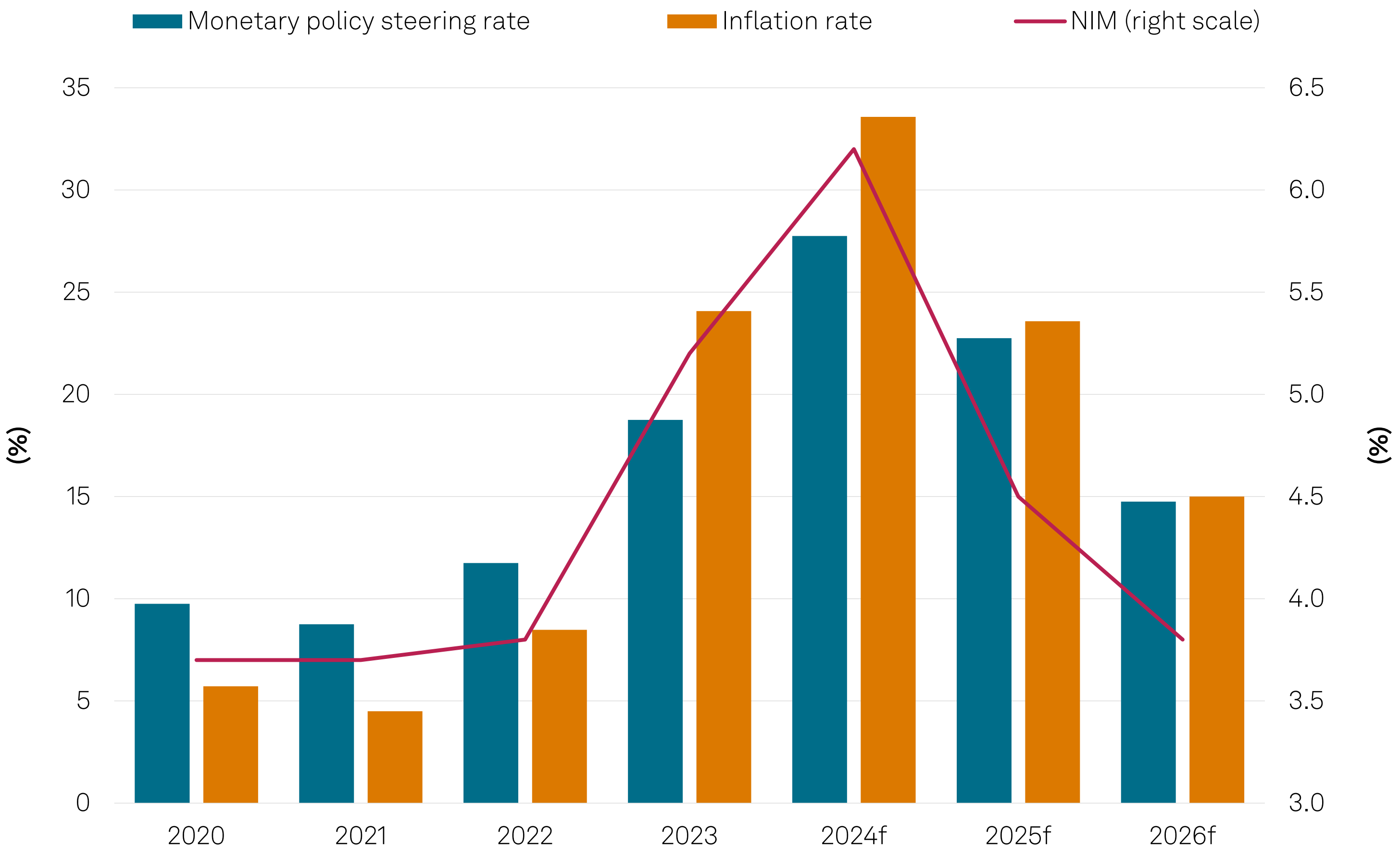
f--Forecast. Source: S&P Global Ratings.

- We expect Bahraini retail banks to see moderating profitability due to a 30 bp-50 bp reduction in NIMs as the Central Bank of Bahrain mirrors the Fed's interest rate cuts.
- The decline we expect in credit costs alongside the interest rate cuts could further improve demand for real estate, helping to alleviate pressure on banks' asset quality.
- The decline in rates will likely boost subsidized housing financing, supporting about 4% credit growth in 2025, compared to an average of 2% in 2022-2024.

Africa

Low Dependence On External Funding And Resilient Profitability

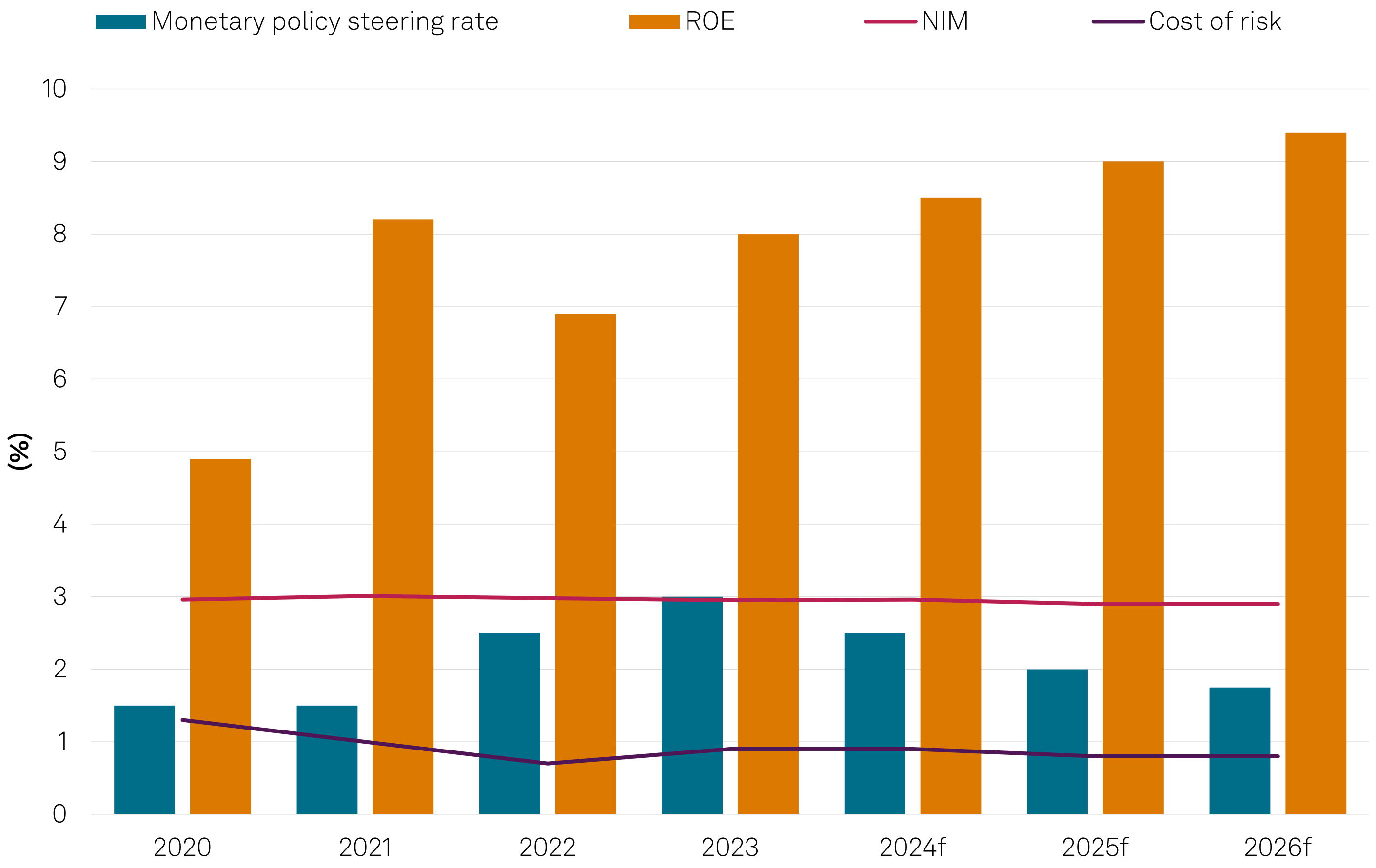
Egypt: Margins Will Reduce, But From Strong Levels



f--Forecast. Source: S&P Global Ratings.

- Inflation and the performance of the Egyptian pound are the main drivers of interest rates in Egypt. The Fed's cuts could reduce the pressure on the Egyptian pound, helping disinflation and in turn easing monetary policy in Egypt.
- Banks' reliance on customer deposits means that they can adjust their cost of funding quickly when local rates start to decline.
- However, the overall impact on margins will be negative due to the repricing of short-term government exposures (26% of total assets on June 30, 2024).

Morocco: Interest Rate Sensitivity Is Low



f--Forecast. Source: S&P Global Ratings.

- Domestic interest rates will follow the Fed and ECB rates, but with a lag due to uncertainties about global trade and potential pressure on inflation from geopolitical developments in the Middle East.
- The fact that a significant portion of mortgage lending is at fixed rates and lending demand from corporates is subdued will limit asset repricing.
- On June 30, 2024, about 70% of Moroccan banks' deposits were noninterest bearing, which supports banks' profitability.

South Africa: Profitability Will Hold Despite Dynamic Repricing Of Banks' Balance Sheets

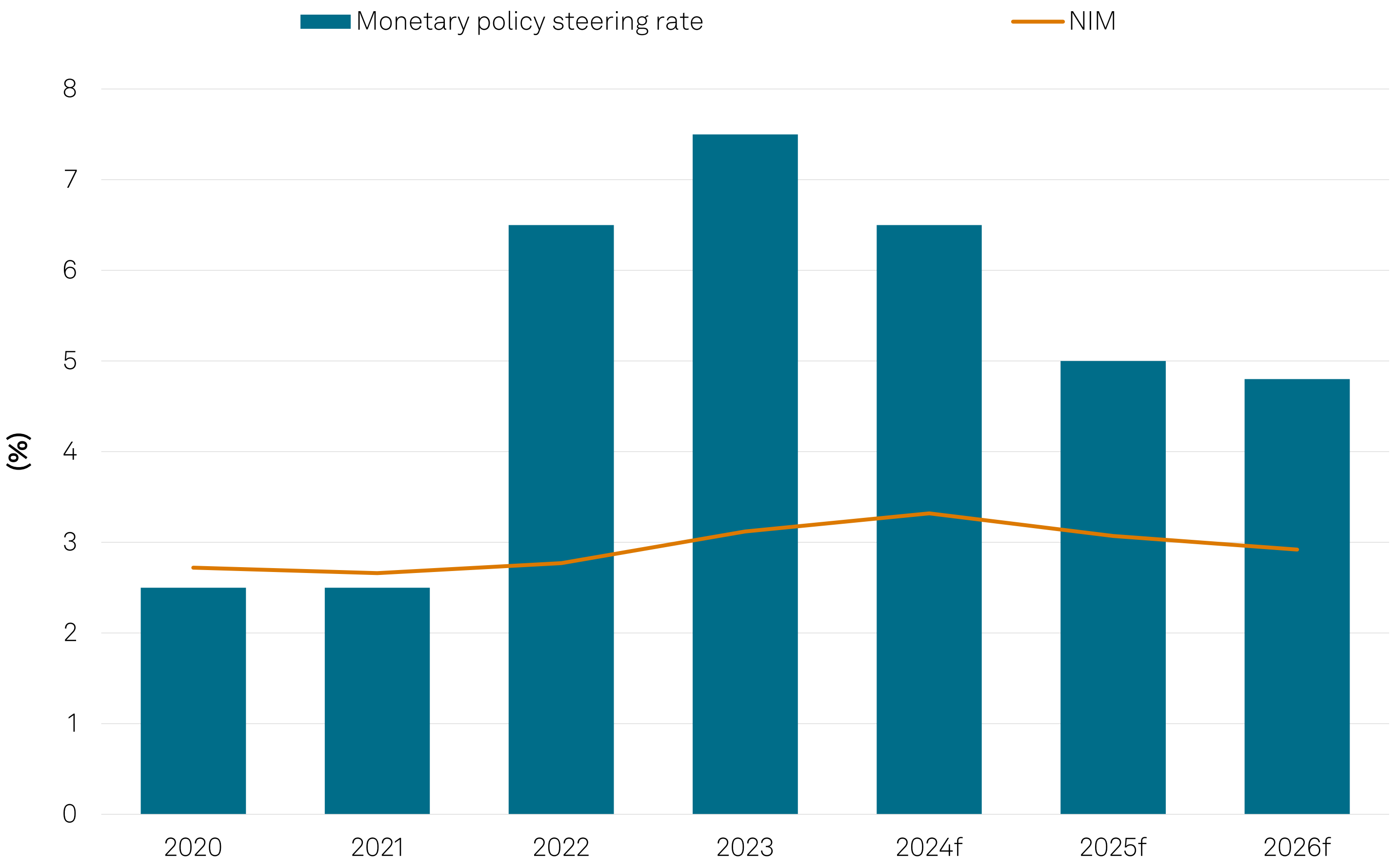
f--Forecast. Source: S&P Global Ratings.

- Improving credit conditions will support lending growth. We expect the South African Reserve Bank to lower its benchmark rate by another 100 bps by the end of 2025, as inflation is within the 3%-6% target range.
- Lower rates will support banks' funding costs, which have increased over the past 12 months. While we expect customer deposits to grow in line with loans, the phase-in of First Loss After Capital instruments sometime in 2026 will add to funding costs.
- We expect a 20 bp NIM compression by the end of 2025 relative to 2024. This will not affect banks' profitability materially as a large share of noninterest income underpins their operating revenue.

Other Middle Eastern Countries

A Mixed Bag

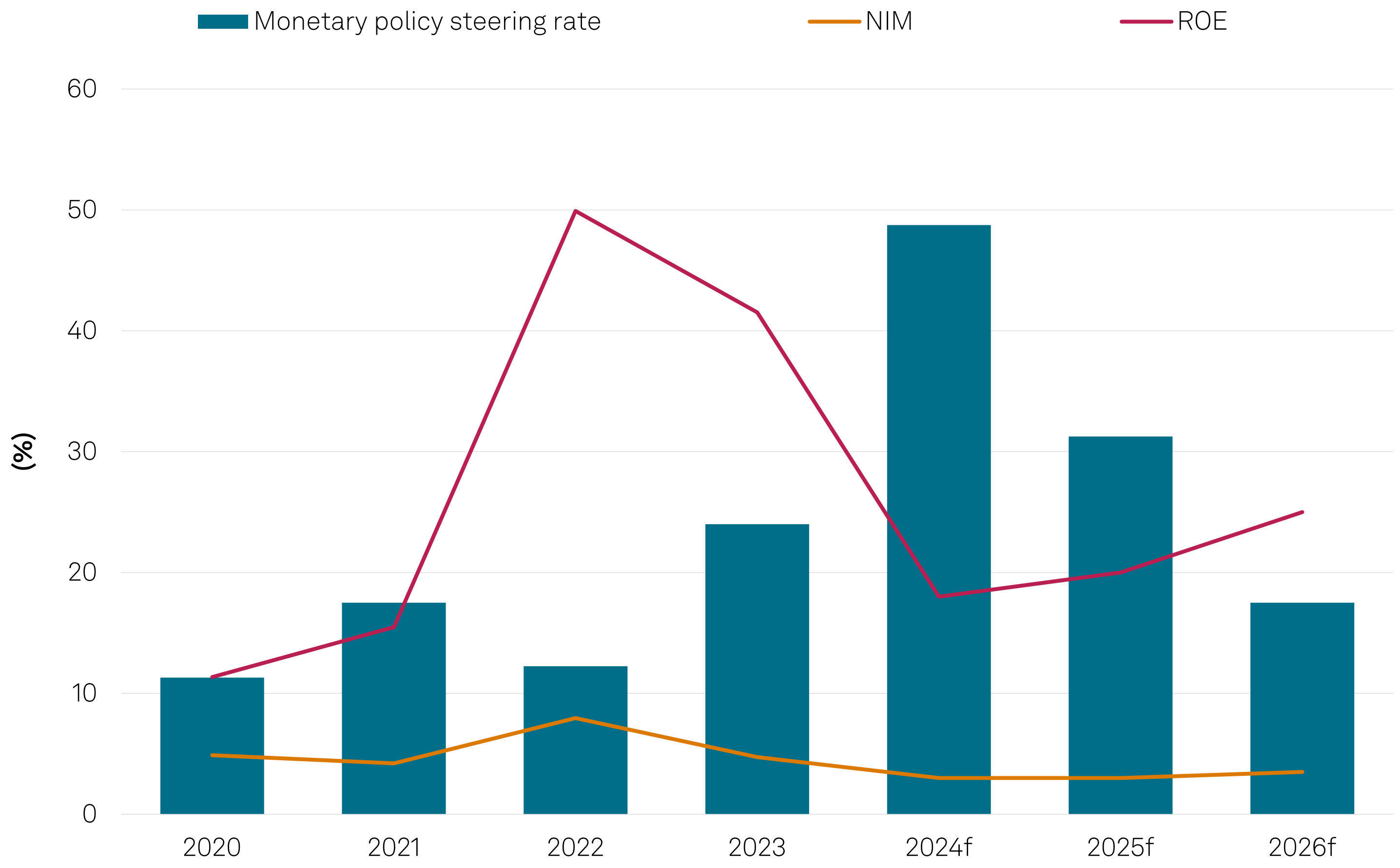
Jordan: Reliance On Deposits And A High Share Of Fixed-Rate Loans Support Margins



f--Forecast. Source: S&P Global Ratings.

- Jordan's economic activity will recover from 2025--assuming no major increase in geopolitical risks--and domestic interest rates will mirror the Fed's interest rate cuts as the Jordanian dinar is pegged to the U.S. dollar.
- Domestic banks' NIMs are likely to decrease by 40 bps-45 bps by end-2026, a pass-through rate of about 25% of the cumulative decrease we expect in domestic interest rates in 2025-2026.
- Protecting NIM from high volatility are a high share of fixed-term loans (above 60% of banks' portfolios) and banks' funding structures, which mostly comprise retail deposits (55%-60% of the funding structure).

Turkiye: Interest Rate Evolution Depends On Inflation



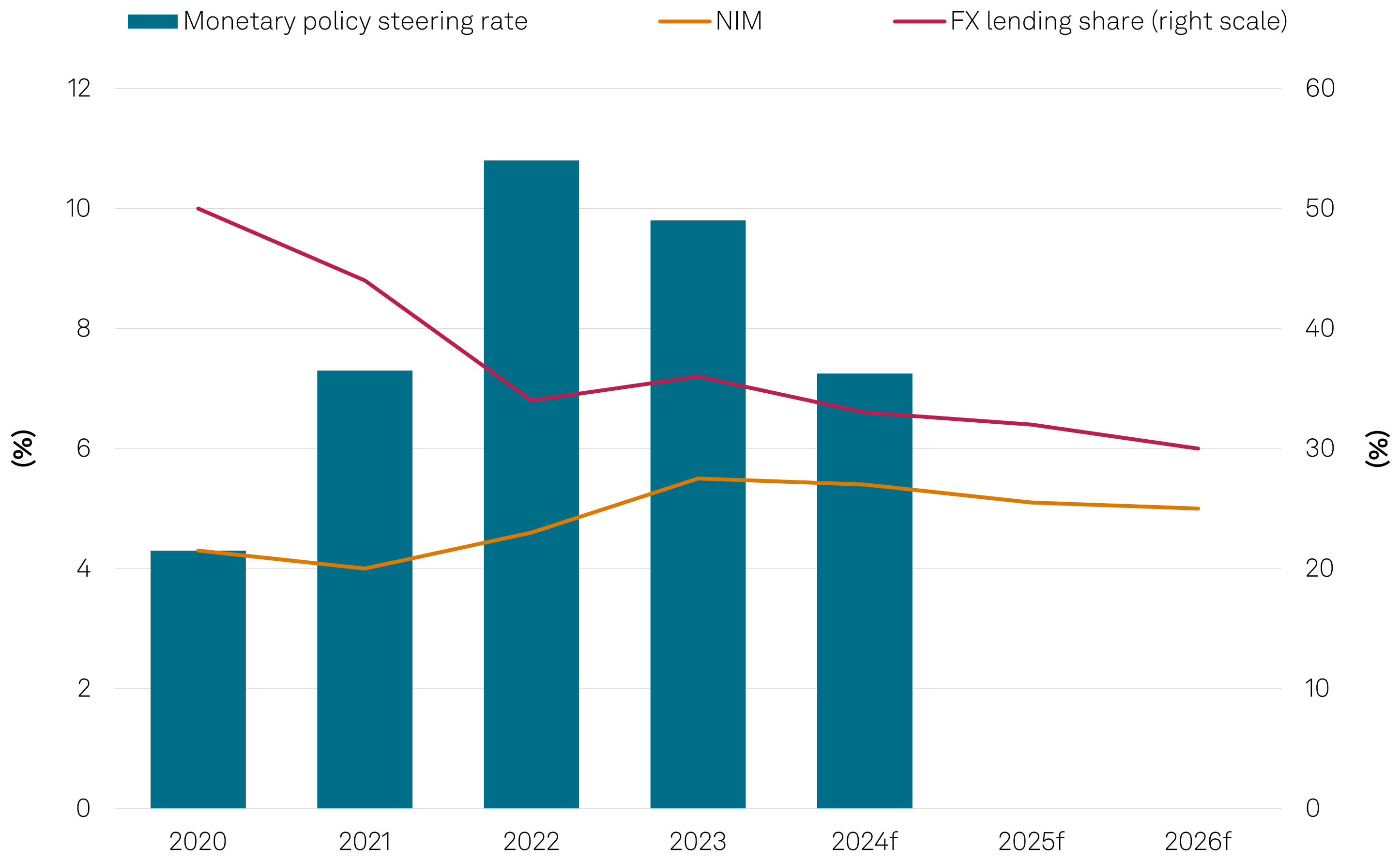
f--Forecast. Source: S&P Global Ratings.

- The decline in global interest rates will help banks roll over their external debt (21% of total funding at mid-2024), with a positive impact on pricing and demand.
- We expect a gradual decline in domestic rates depending on the success of efforts to reduce inflation.
- Lower rates will support banks' profitability as deposits reprice faster than assets, and lending growth will partially compensate for lower yields.

Central Asia And The Caucasus

Largely Insulated

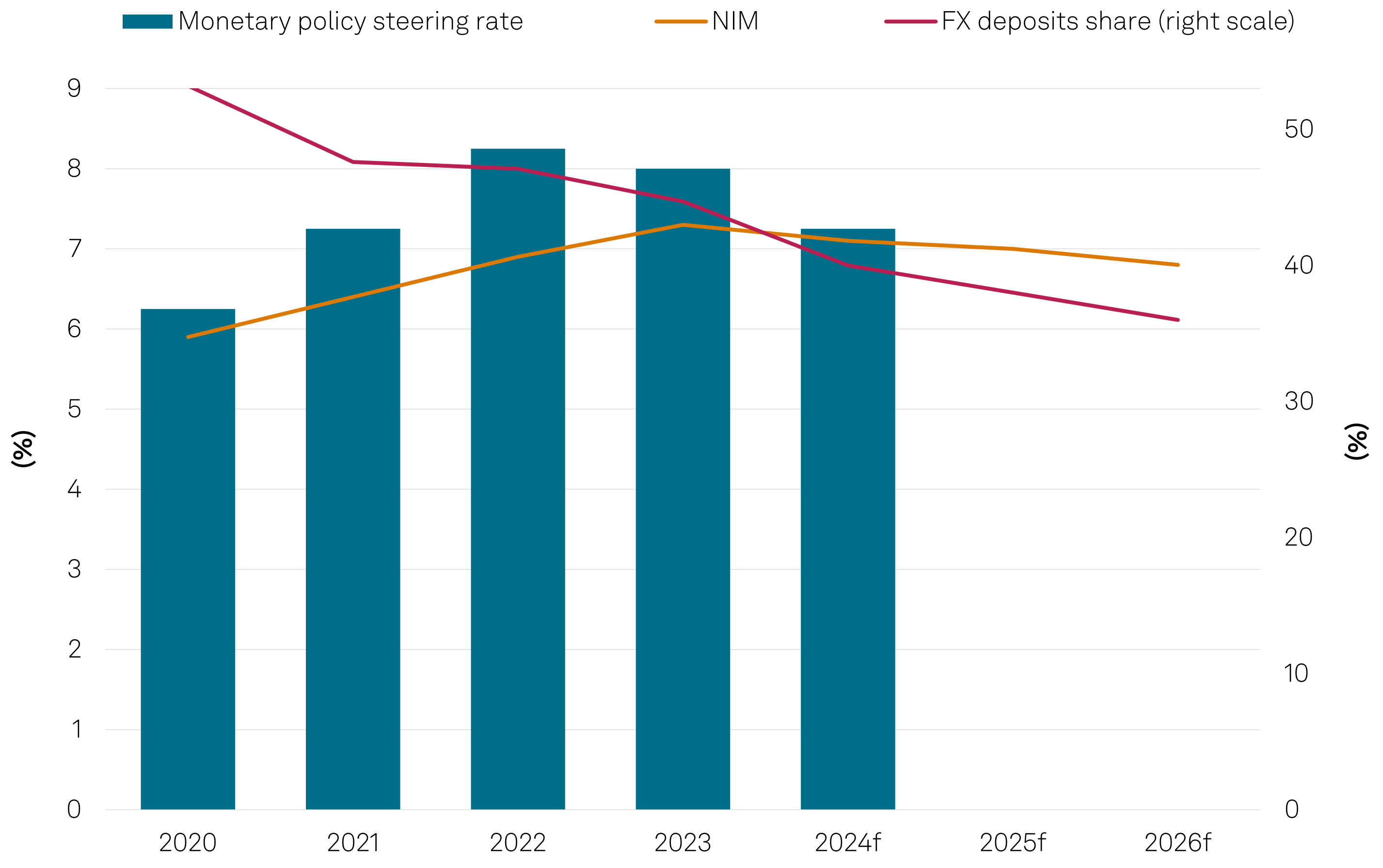
Armenia: Higher Consumer Lending Will Help Alleviate The Impact Of Lower Rates



f--Forecast. Source: S&P Global Ratings.

- The Armenian Central Bank's monetary policy decisions have only had a modest impact on lending and deposit rates in local currency over the past interest rate cycle.
- Similarly, domestic lending rates in foreign currency have been relatively stable and deposit rates have been very low, supported by inflows of money from Russia over 2022-2023.
- We expect lower Fed rates to affect banks' earnings from U.S. dollar liquidity placements and the shift of deposits to securities.
- Higher consumer lending will support the margins on local currency-denominated business.
- We expect systemwide NIMs to decline by about 35 bps in 2025 and by another 10 bps-15 bps in 2026.

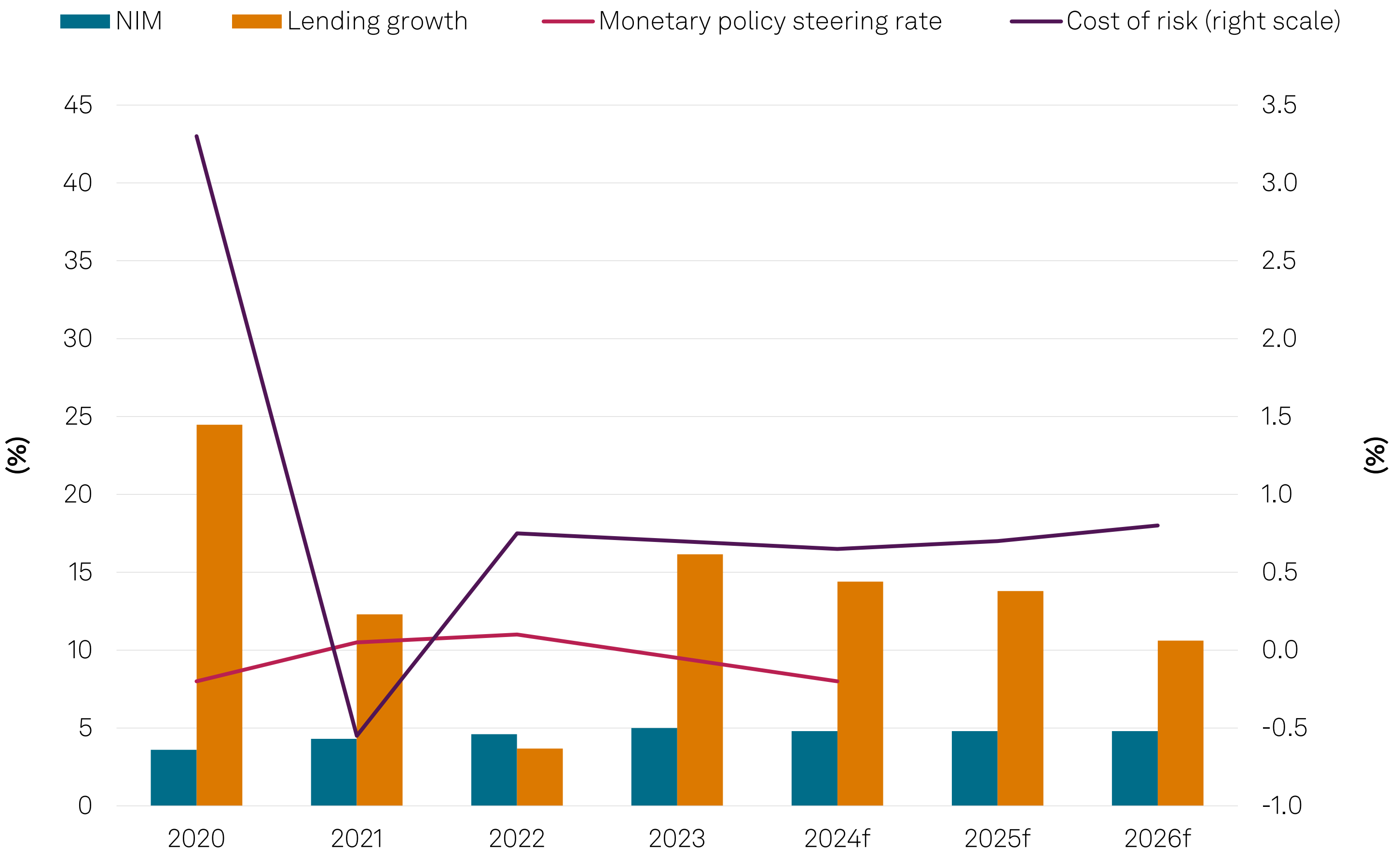
Azerbaijan: A Lower Cost of Funding Will Help Offset The Impact Of Competition On Margins



f--Forecast. Source: S&P Global Ratings.

- The key refinancing rate has had a limited influence on lending and term deposit rates in local currency in Azerbaijan over the past five years.
- Rates have been stable for consumer loans and mortgages, and have slightly increased for corporate clients, reflecting a growing share of loans to small and midsize enterprises (SMEs).
- Azerbaijan has a lower share of foreign-currency loans than peer countries--18% at mid-2024, mostly to exporters. Dollarization of deposits remains higher, at 40% at mid-2024. Fed rates will therefore have a more pronounced effect on the cost of funding.
- We expect a slight decline in NIMs of 10 bps-30 bps over the next 12-24 months due to growing competition. An increase in the share of higher-margin consumer and SME loans will only slightly offset this.

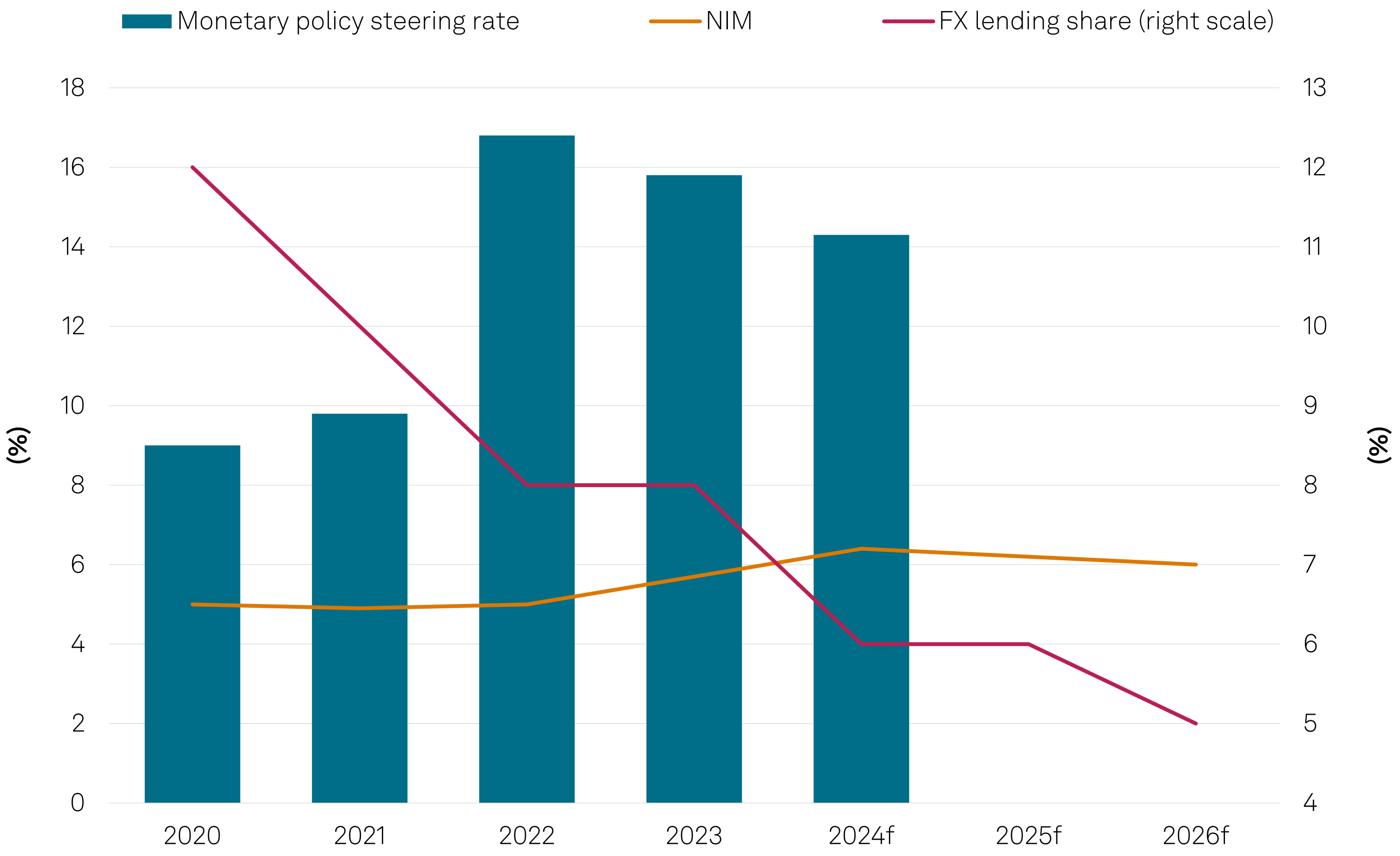
Georgia: A Lower Cost Of Risk Will Support Stable Profitability



f--Forecast. Source: S&P Global Ratings.

- We expect that banks' profitability will benefit from a lower cost of risk and stronger asset-quality indicators.
- As banks' main source of financing is customer deposits, they can manage their cost of funding well.
- Lower interest rates will also support banks' profitability through their positive impact on the cost of external funding.

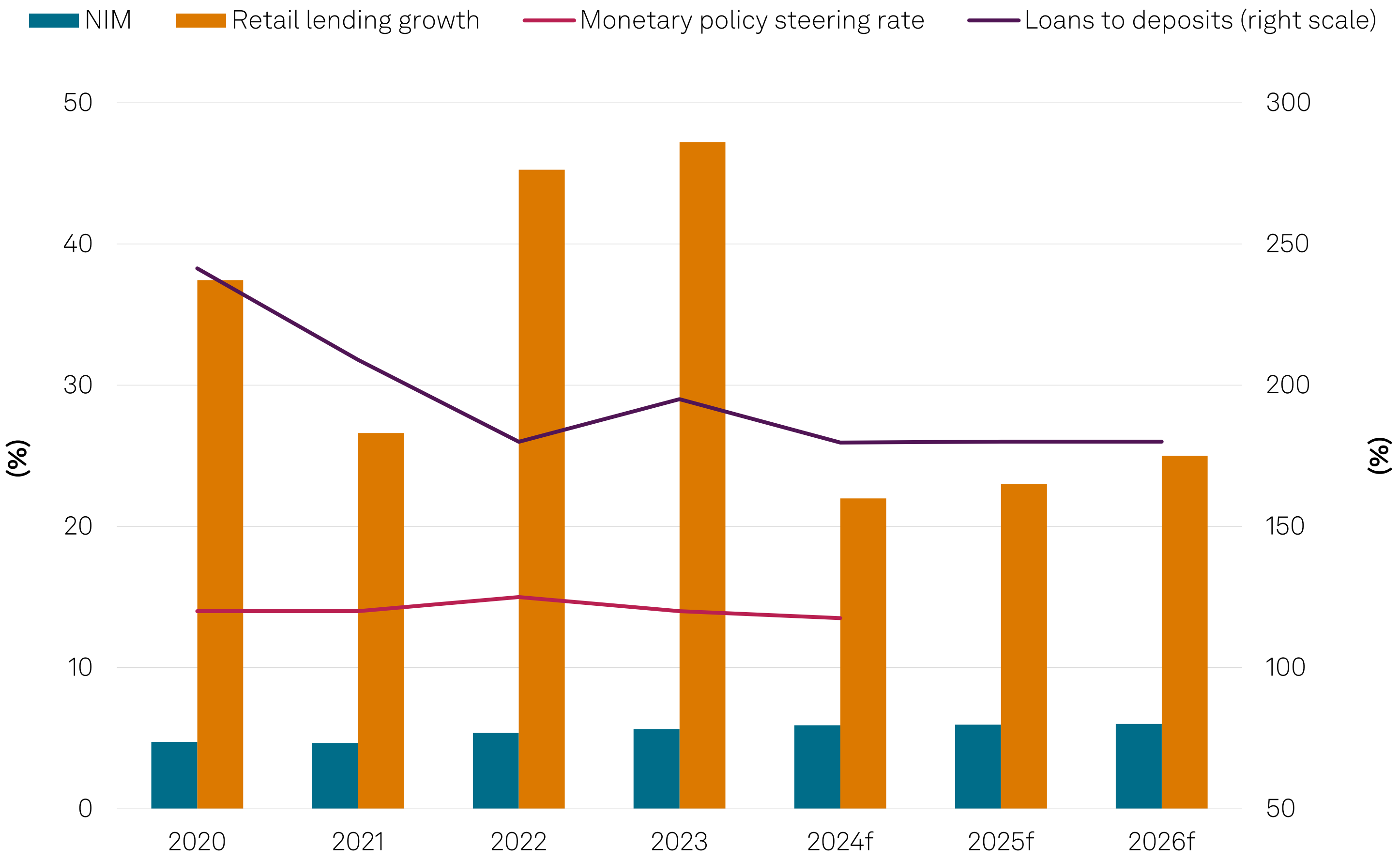
Kazakhstan: Increasing Retail Activity Will Support Margin Resilience



f--Forecast. Source: S&P Global Ratings.

- The cost of funding mostly depends on domestic interest rates and economic dynamics due to a high reliance on core customer deposits.
- Banks have shifted their business toward retail banking in the past three years (60% of total loans at mid-2024). As a result, NIMs expanded by about 150 bps in this period.
- We anticipate that retail lending will continue to drive major lending growth in 2025 and therefore foresee only a moderate margin compression of 15 bps-20 bps.

Uzbekistan: Growth Of Retail And SME Lending Will Support Margin Resilience



f--Forecast. Source: S&P Global Ratings.

- Banks' focus on increasing retail and SME lending will support margins over the next two years. Solid economic growth prospects, a young and expanding population, and a gradual rise in disposable income will continue to support strong lending demand.
- The loan-to-deposit ratio has been gradually improving, but it remains the highest among the peers. This reflects the underdeveloped domestic financial markets, limited financial inclusion, and low income levels.
- We expect that demand deposits will account for about one-third of total domestic deposits. This, along with a material share of funding from the government, sovereign funds, and international financial institutions, will keep the funding base and cost of funding stable.

Related Research

- United Arab Emirates Banking Sector 2025 Outlook Balancing Growth And Risks Amid Economic Expansion, Jan. 8, 2025
- Qatar Banking Sector 2025 Outlook Resilient Performance To Continue, Jan. 8, 2025
- Kuwait Banking Sector 2025 Outlook: Economic Recovery To Boost Performance, Jan. 8, 2025
- Your Three Minutes In Banking: When Rates Drop, GCC Banks' Profitability Will Follow, May 14, 2024
- Receding Economic Imbalances In Morocco Will Support Moroccan Banks' Future Performance, Oct. 24, 2024
- Strong Economic Growth Supports Armenian Banks' Performance; Economic Risk Now Stable; BICRA Group Remains '8', Oct. 24, 2022

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