



Islamic banking:
Resilience in a geopolitically
volatile environment
Resilience Redefined

Executive summary

Islamic banking remains a cornerstone of the Middle East's financial system, playing a central role in liquidity, capital formation, and economic stability. However, in today's environment, resilience can no longer be assessed in isolation from external forces.

Geopolitical volatility is no longer an external backdrop; it is a direct and measurable influence on how financial risk is evaluated and managed.

As regional tensions, global fragmentation, and shifting economic alliances continue to evolve, Islamic financial institutions must reassess resilience through a more dynamic and forward-looking lens, one that integrates geopolitical context into risk judgement.

1

Reframing resilience: from structure to risk judgement

As the largest segment of the global Islamic financial services industry (71.6% of IFSI assets in 2024)¹ and a dominant force in the GCC², Islamic banking's resilience cannot be evaluated through conventional frameworks alone. Its strength is shaped by the following structural pillars:



Asset-backed financing models that distribute credit risk differently;



Shari'ah-compliant market infrastructure (Sukuk and Islamic money markets) operating under distinct governance frameworks; and



Dual regulatory architecture combining Shari'ah oversight with prudential supervision.

However, in a geopolitically volatile environment, these structural characteristics must now be complemented by enhanced risk judgement capabilities.



Key Insight

Resilience is no longer only structural. It is increasingly defined by the ability to translate external volatility into measurable and actionable risk insights.

2

Liquidity constraints in a fragmented environment

Where Shari'ah-compliant High-Quality Liquidity Assets (HQLA), Islamic money markets, or central bank facilities remain limited, liquidity management becomes a binding constraint. Unlike conventional institutions, Islamic banks cannot fully rely on interest-based instruments or traditional liquidity infrastructure. This creates a structural gap that becomes more pronounced under geopolitical stress.

This elevates the importance of:

- Tradable sukuk as Shari'ah-compliant liquidity instruments.
- Contingency liquidity planning tailored to Islamic finance.
- Ongoing development of domestic Islamic market infrastructure.

Without these mechanisms, institutions face:

- Higher funding costs.
- Reduced operational flexibility.
- Constrained growth capacity.



Key Insight

Liquidity resilience is increasingly dependent on both infrastructure and the ability to anticipate and respond to external shocks.

3

The need for enhanced analytical frameworks

Traditional risk models—largely backward-looking and based on stable assumptions—are insufficient in capturing the impact of geopolitical volatility.

Islamic banking requires **distinct analytical frameworks** that incorporate:

- External geopolitical signals
- Sector-level sensitivity to global disruptions
- Forward-looking risk indicators and scenario analysis

This reflects a broader shift from:

- Static risk assessment
- Dynamic, forward-looking risk judgement



Key Insight

What cannot be measured cannot be managed. Geopolitical volatility must be translated into quantifiable risk signals.

4

Short-term implications (0–12 months)

As of March 2026


1. Infrastructure-dependent liquidity resilience

Liquidity outcomes remain closely tied to the maturity of Islamic financial infrastructure. In jurisdictions with limited Shari’ah-compliant HQLA or interbank markets, liquidity pressures intensify under stress. Access to sovereign and central bank sukuk becomes critical, alongside the need for contingency liquidity frameworks ³.

2. Financing stress in sensitive sectors

Trade-, energy-, and import-sensitive sectors face increased pressure due to:

 Rising input costs


 Supply chain disruptions

 Volatile cash flows

Restructuring efforts must align with contractual structures, Shari’ah governance, and regulatory expectations, adding complexity compared to conventional approaches ⁴.

3. Sukuk market depth as a resilience differentiator

The depth and liquidity of sukuk markets vary significantly across jurisdictions.

 Deeper markets provide buffers against volatility

 Shallow markets increase exposure to liquidity shocks ⁵

Key Insight

 Market depth directly influences resilience under geopolitical stress.



5

Medium- to long-term implications (one year and beyond)

1. Strategic infrastructure development

Scaling domestic sukuk and Islamic money markets is essential for long-term stability. This includes:



Expanding HQLA-eligible instruments



Strengthening Shari'ah-compliant monetary operations



Enhancing market liquidity and participation

This is not a product issue; it is a system-level imperative ⁶⁷.

2. Sukuk as strategic financing infrastructure

Sukuk will play an increasingly central role in financing:



Infrastructure development



Energy transition and security



Regional reconstruction efforts.

Their asset-linked structure supports long-term capital formation while aligning with Shari'ah principles .

3. Regulatory and supervisory evolution

As Islamic banking grows in scale and systemic importance, regulatory frameworks must evolve.

Key areas include:



Enhanced prudential standards



Recovery and resolution mechanisms



Supervisory approaches reflecting dual governance structures ⁶⁸.



Overall perspective

Geopolitical volatility is often viewed as a source of disruption. However, it also presents a critical inflection point. For Islamic banks, resilience will increasingly depend not only on structural strengths, but on the ability to:

- Understand external risk drivers
- Quantify their impact
- Act with speed and precision

Final point of view

The future of resilience in Islamic banking lies in translating geopolitical volatility into quantified risk judgement—enabling better decisions, stronger stability, and sustainable growth.

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Sources:

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