

1. MACROPRUDENTIAL RISK ASSESSMENT

The global economic and financial environment in 2025 was characterised by heightened geopolitical tensions and the renewed shift towards protectionist trade policies. Such developments fuelled uncertainty on global supply chains, and contributed to volatility in energy, commodity and financial markets. Geopolitical fragmentation further weighed on global growth prospects, and increased the risk of cyber-attacks, including state-sponsored ones.

Against this backdrop, the near-term global outlook has weakened with the IMF (April 2026) projecting global GDP growth to slow to 3.1% in 2026.¹ Notwithstanding these adverse developments, financial markets benefitted from the strong investment in advanced technologies, including AI, broadly accommodative financial conditions, and efforts by the private sector to adapt to the evolving challenges.

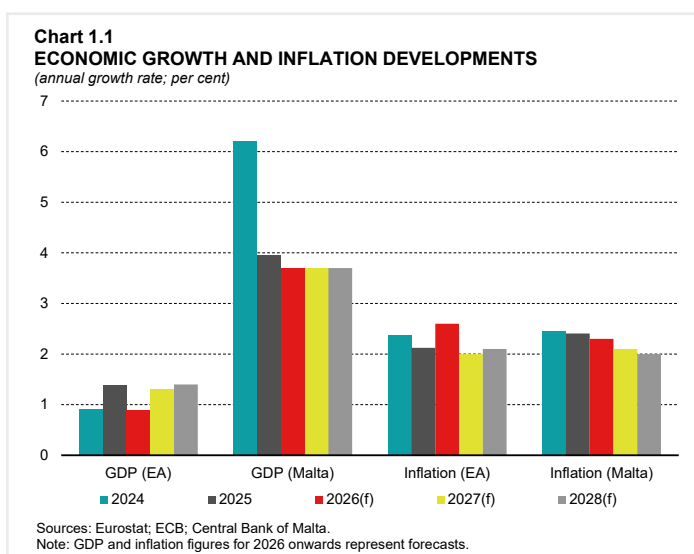
Nevertheless, across the euro area, elevated public debt levels, together with structural pressures and new demands related to defence-related expenditure, are reducing fiscal space, while increasing borrowing requirements. Meanwhile, concerns over stretched asset valuations and vulnerabilities among leveraged non-bank financial intermediaries persisted, heightening the risk of abrupt market repricing. Such dynamics could spill over to the broader financial system through tighter financial conditions, cross holdings of these assets, and increased credit and liquidity risks. Despite these challenges, both the euro area and Malta's financial system continued to demonstrate resilience, supported by a strong regulatory environment. The Maltese financial system continues to remain sound, underpinned by existent macroprudential and supervisory measures and favourable economic conditions.

1.1 Vulnerabilities outside the financial system

Economic activity and inflation

In 2025, the euro area economy grew by 1.4% in real terms, driven primarily by robust domestic demand (see Chart 1.1).^{2,3} Investment activity showed tentative signs of improvement reflecting better financing conditions, as monetary policy eased gradually. Inflationary pressures moderated compared to 2024, with harmonised index of consumer prices (HICP) inflation declining to 2.1%, supported by the fading impact of past energy price shocks, the normalisation of supply chains and subdued imported inflation. Overall, inflation fluctuated in a narrow range around 2% during most of the year, although upside risks persisted due to geopolitical developments and renewed volatility in energy and commodity prices.

While Malta's economic growth has eased somewhat from recent elevated levels, to 4.0% in 2025, it nevertheless continued to outperform the euro area. Activity was driven primarily by both domestic and foreign demand amid tight labour market conditions and resilience in key services sectors, including tourism, remote gaming and professional services.⁴ HICP inflation stood largely stable at about 2.4%, although still exceeding the euro



¹ [World Economic Outlook, April 2026: Global Economy in the Shadow of War](#)

² Economic Bulletin Issue 2, 2026.

³ Eurostat, ECB staff macroeconomic projections for the euro area – March 2026.

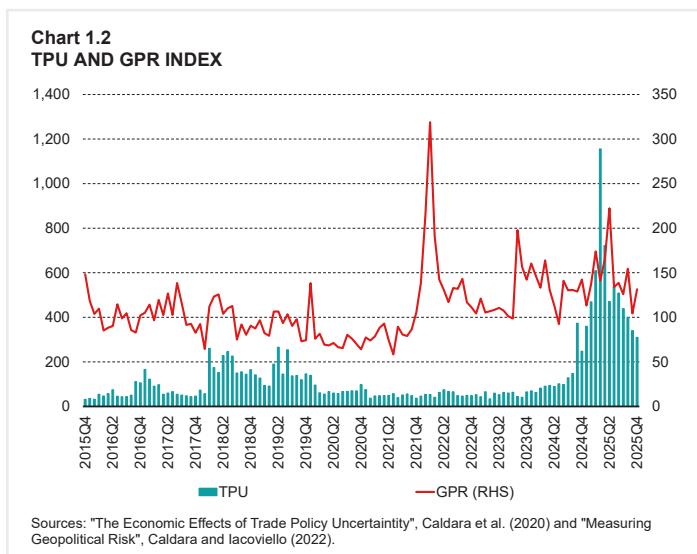
⁴ Central Bank of Malta, *Quarterly Review*, 2025 Vol.58 No. 4.

average, almost entirely due to the negative contribution of energy inflation in the euro area, which in Malta remained at zero. Inflationary pressures stemmed primarily from food prices and services, especially tourism-related activities, alongside strong wage growth in the context of a tight labour market.⁵

Geopolitical and trade-related uncertainty

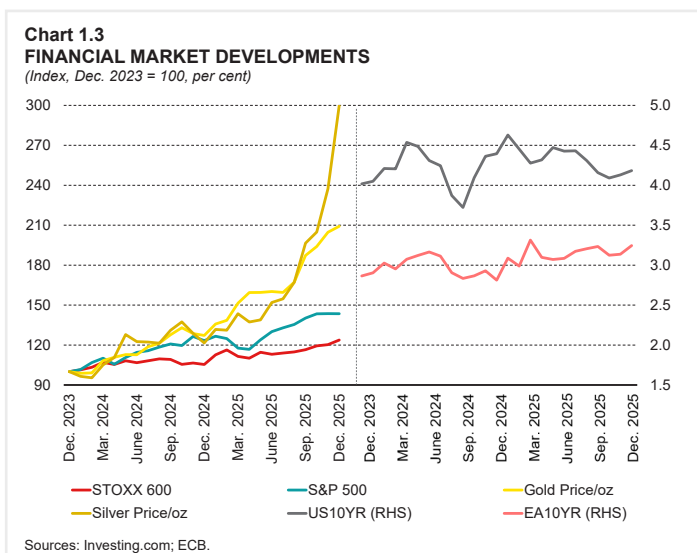
The renewed shift to protectionist trade policies led to a significant increase in various measures of policy uncertainty. In particular, the trade policy uncertainty (TPU) index peaked in April 2025.⁶ Subsequently, it retreated somewhat but remained high by historical standards, owing to a partial easing of trade-related tensions and greater policy clarity among key economies (see Chart 1.2). The geopolitical risk (GPR) index also followed a similar pattern, retreating in the second half of the year after peaking in June. This reflected fewer abrupt escalations, clearer diplomatic signalling and partial de-escalation in some conflict hotspots, which collectively reduced the perceived likelihood of severe tail-risk events.⁷ Concurrently, in the latter half of 2025, financial market pricing pointed to a degree of investor complacency, with compressed risk premia and subdued volatility.

These developments set the backdrop for the strong performance in several asset classes during 2025, notably equities and precious metals.



Financial market developments and asset valuations

After a slow and volatile start in the first half of the year, equity markets recovered markedly in the second half, with the STOXX 600 and the S&P 500 recording annual gains of around 17% (see Chart 1.3). This performance reflected a combination of supportive developments, including expectations of monetary policy easing and improved investor sentiment. Corporate profitability also proved more resilient than anticipated, underpinned by continued productivity gains, especially in the technology sector, cost containment and strong balance sheets. However, the strong performance



⁵ National Statistics Office (NSO), NR 009/2026.

⁶ Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2020), "The Economic Effects of Trade Policy Uncertainty," *Journal of Monetary Economics*, 109, pp.38-59. Caldara, Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk," *American Economic Review*, April, 112(4), pp.1194-1225.

⁷ Both the GPR and TPU indices rose sharply in the beginning of 2026 amid reignited GPRs, especially with the war in the Middle East.

contributed to increasingly stretched valuations in certain market segments, heightening the risk of abrupt repricing.

Developments in government bond markets diverged across major regions in 2025. In the United States, the ten-year Treasury yield declined slightly, driven by moderating inflation and increasing confidence in future policy easing. By contrast, long-term government bond yields in the euro area increased over the year, a trend evident across key ten-year benchmarks. This upward pressure reflected several factors, including a repricing of term premia amid persistent fiscal concerns, higher sovereign issuance to finance elevated deficits, and the diminished presence of central banks as marginal buyers, following balance sheet normalisation.

Precious metals were by far the best performing asset class in 2025, with gold and silver prices rising by almost 65% and 150%, respectively.⁸ During the year, expectations of US monetary policy easing, the depreciation of the US dollar and declining real interest rates raised the appeal of non-yielding precious metals, while heightened geopolitical and fiscal uncertainties reinforced safe-haven demand, including from central banks, as investors sought diversification amid elevated market uncertainty. In the case of silver, these factors were complemented by robust industrial demand linked to the energy transition, notably in solar and electrification technologies, as well as ongoing supply constraints.

Public debt sustainability

The euro area government debt-to-GDP ratio increased slightly to 87.8% in 2025, up from 87.0% a year earlier.⁹ This reflected several factors, including primary deficits, higher interest expenditure and increased sovereign issuance amid rising borrowing costs. All of these factors, in turn, constrained the pace of debt reduction. These effects were partly offset by favourable growth-interest rate differentials and the unwinding of crisis support in some of the euro area countries. However, structural pressures such as ageing, defence spending, and green and digital investment persist, and are expected to weigh on fiscal sustainability over the medium term. Furthermore, public debt levels across the euro area remained highly heterogeneous, reflecting differences in legacy debt levels, fiscal policy choices, growth performance and exposure to past crises. This divergence implies uneven fiscal space and varying sensitivities to interest rate shocks across Member States.

In Malta, government debt-to-GDP ratio remained well below the euro area average and the Maastricht threshold standing at 46.4% in 2025, thereby providing more fiscal space relative to the euro area. This favourable position was supported by strong economic growth and a significant narrowing of the fiscal deficit. Nevertheless, the debt ratio continued to face upward pressure in 2025, driven by persistent fiscal deficits, in part driven by subsidies.¹⁰

Private sector indebtedness

In 2025, euro area private sector debt as a share of GDP contracted, on the back of developments in both the corporate and household sectors. Euro area corporate debt-to-GDP ratios declined from 67.3% to 65.8% in 2025. However, while lower interest rates helped ease financing pressures, the full effects of past rate increases continued to filter through and thus continued to weigh on corporates.¹¹ Meanwhile, households' vulnerabilities remained contained, supported by easing financing conditions, higher real incomes and strong labour markets. This resilience was also reflected in a comparatively high household savings ratio, although part of this may have stemmed from precautionary behaviour amid elevated geopolitical uncertainty.

Domestically, corporate debt remained stable at about 146% of GDP, largely reflecting intra-company lending. On a consolidated basis, indebtedness stood at 61.9% of GDP, below the euro area average

⁸ Gold and silver prices experienced a sharp sell-off towards the end of January 2026, in part reflecting profit-taking after the sharp rally and appreciation of the USD.

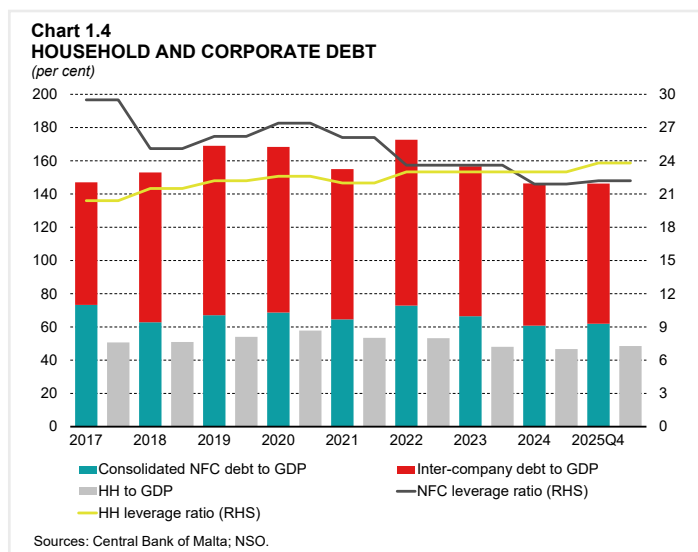
⁹ Source: Eurostat.

¹⁰ Refer to Annual Report, 2025 – Box 3 – [The Sustainability of Maltese Government Debt](#).

¹¹ *ECB Financial Stability Review*, November 2025.

(see Chart 1.4). The leverage ratio remained low at 22.2%, below the euro area average of 25.4%, partly due to the predominance of services-oriented sectors with lighter balance-sheet. The household sector also remained resilient, supported by favourable labour market conditions. Household debt stood at 48.5% of GDP, below the euro area average of 50.5%, and was supported by significant financial assets amounting to 145.8% of GDP.

The majority of these assets were held in cash and deposits, consistent with the elevated savings rate, which reached 19.4% in 2024, the third highest in the EU.¹² Although disposable income grew by 7.7%, the leverage ratio continued to trend upwards, increasing to 23.8%, slightly above the euro area average of 22.6%.

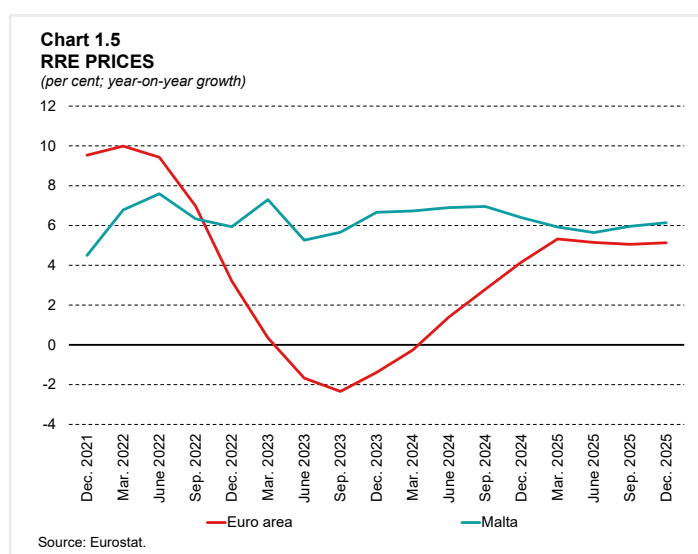


Real estate market developments

The euro area real estate market recorded broadly positive developments, with both the residential and commercial markets showing signs of recovery and stabilisation. The residential real estate (RRE) market remained resilient, supported by robust mortgage demand, driven by lower interest rates and improved housing market prospects. These developments are consistent with evidence from the euro area BLS.¹³

At the same time, the commercial real estate (CRE) market stabilised following a sharp correction earlier in the year. Transaction activity saw a modest pickup, and while the quality of CRE loan portfolios has continued to weaken, the pace of deterioration slowed, with nonperforming loan (NPL) flows standing at close to zero in recent quarters.¹⁴ Nevertheless, in the euro area, certain segments, particularly office space and non-prime assets, continued to experience subdued market activity.

At the domestic level, RRE price growth stabilised at around 6% (see Chart 1.5). This was mirrored in transaction-based indicators, with registered deeds involving households increasing by 4.5% and promises-of-sale agreements rising by 6.2%, pointing to sustained activity in the near term. On



¹² Source: NSO, NR 226/2025.

¹³ Refer to Box 2 *Insights from the Banking Lending Survey*.

¹⁴ See footnote 11.

the supply side, building permits for dwellings rose by just over 40%, helping to accommodate the persistent strong demand for housing.

Lending standards remained prudent, as evidenced by the average Loan-to-Value (LTV) ratio of around 76% and an average Loan Service-to-Income (LSTI) ratio at just above 25%. As expected, first-time buyers exhibited higher ratios, with their average LTV and LSTI standing at 80% and 26.5%, respectively.

In the CRE segment, evidence points to emerging signs of recovery, corroborated by the NSO's statistical insights showing that commercial property prices rose by 11% in 2024, after the declines recorded in 2020.¹⁵

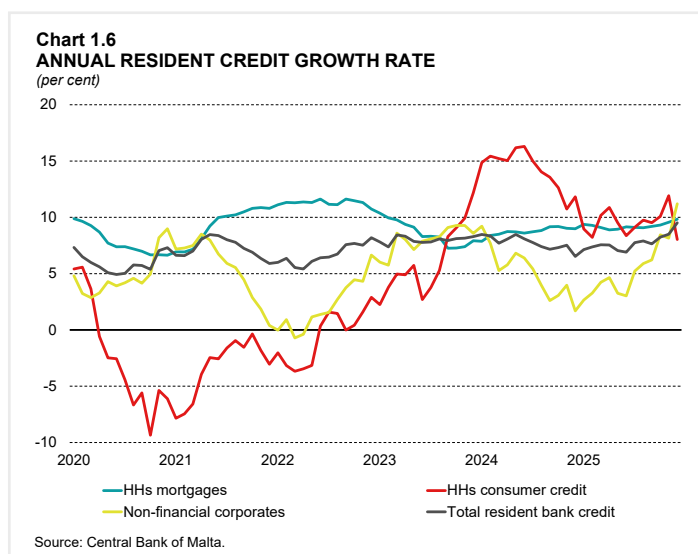
1.2 Vulnerabilities within the financial system

Banking sector developments

Profitability of euro area banks increased only marginally in 2025, although it remained at healthy levels, with an ROA of 0.73%.¹⁶ The modest improvement in profitability was driven by non-income sources, including trading and investment income as well as net fee income. At the same time, NII continued to decline amid further compression in net interest margins, with the NII as a share of operating income dropping by 2 percentage points to 58.3%. Euro area banks maintained solid cost efficiency with a cost-to-income ratio of 53.3%, alongside strong capital and liquidity buffers. The total capital ratio stood at 20.4%, while liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) stood at 163.1% and 126.9%, respectively. Asset quality improved further, with the NPL ratio declining slightly to 1.8%.

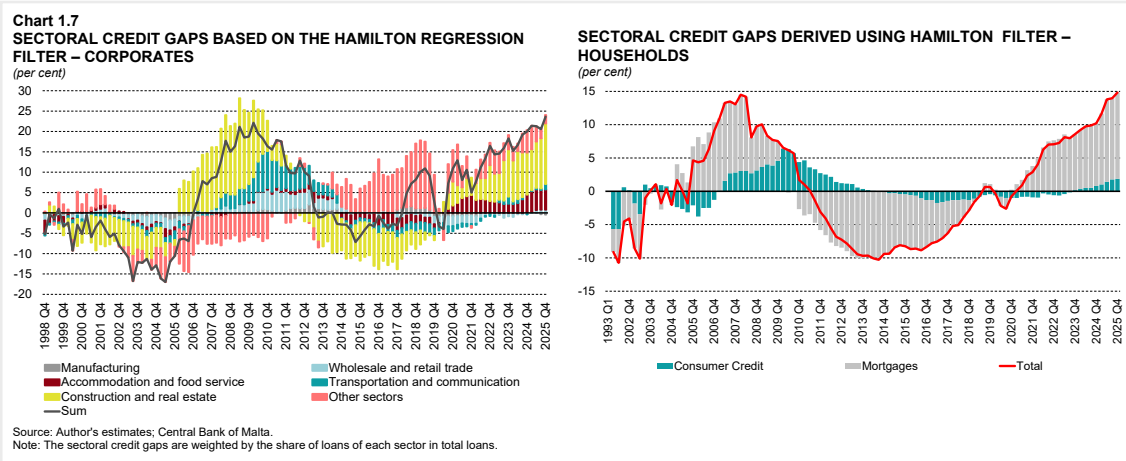
Domestic banks recorded a marginal improvement in profitability, with the ROA rising to 0.8%. This improvement was driven by the return to profitability of international banks, as both core and non-core domestic banks experienced a decline in profitability, with ROA declining by 0.3 and 0.2 percentage points to 0.8% and 0.2%, respectively. These developments reflected lower NII alongside higher operating expenses across both groups. At the same time, growth in non-interest income highlighted the increasing importance of diversifying revenue streams.

Resident credit continued to expand at a robust pace, increasing by 9.5% in 2025, exceeding the 6.5% growth registered in the previous year (see Chart 1.6). This acceleration was driven primarily by strong growth in resident credit to non-financial corporations (NFCs), which increased by 11.2%, compared to just 1.7% in the previous year. Resident mortgage lending also remained buoyant, with annual growth reaching 9.8%. The dynamics on both mortgage and NFC credit to real estate related sectors continued to contribute to an already elevated concentration risk in the banks' loan books, with such property-related lending accounting for 73.7% of overall resident loan portfolio. The strong expansion of such credit is also reflected in the widening positive



¹⁵ NSO: [Commercial Property Price Index 2024](#).

¹⁶ EBA risk dashboard 2025Q4.



credit gaps, signalling the potential build-up of cyclical pressures (see Chart 1.7). Domestic banks reported a further improvement in asset quality, with the NPL ratio declining to 1.7%. At the same time, they continued to operate with ample capital and liquidity buffers, as evidenced by a total capital ratio of 27.8%, LCR of 370.4% and an NSFR of 179.7%, respectively.

Insurance and investment fund sectors

The euro area insurance sector continued to exhibit solid solvency metrics, with ratios remaining comfortably above regulatory requirements across both life and non-life segments. In December 2025, the median Solvency Capital Requirement (SCR) ratios stood at 244.4% for life insurers and 219.0% for non-life insurers.¹⁷ Underwriting and investment performance remained broadly stable, with a sector-wide ROA of 0.9%. Premium growth moderated compared to the previous year, easing to 6.6% for the life segment and around 4.5% for non-life insurance.

Domestically relevant insurers mirrored this solid performance supported by robust capital buffers across both business lines. SCR ratios for 2025 stood at 271.5% and 238.3% for life and non-life insurers, comfortably above euro area medians. Life premia grew by 6.8%, while non-life insurers continued to outperform their euro area peers in underwriting efficiency. In fact, the combined ratio of non-life insurers stood at 71.8%, significantly below the euro area median of 94.8%. Profitability remained strong, with a median ROA of 6.8%, driven primarily by the non-life sector. Liquidity across both sectors remained broadly in line with the euro area, with a median liquid assets ratio of 45.2%.

The euro area investment funds sector recorded strong growth in 2025, with total assets expanding by 12.2%. This growth was largely underpinned by favourable conditions in both equity and bond markets. Leverage increased modestly, as reflected in the rise in the assets-under-management to net-asset-value (AUM-to-NAV) ratio rising from 109% to 110.5%. Euro-area funds maintained an equity-heavy portfolio structure, with equities and investment funds units accounting for 57.5% of total assets at end-2025.

By contrast, domestically relevant investment funds experienced a more subdued growth of 2% during the year. The slower expansion largely reflected differences in portfolio composition, as domestically relevant funds exhibited lower exposure to equities and fund units, which accounted for 34.4% of portfolios at the end of 2025. These funds also continued to operate at significantly lower leverage levels, with an AUM-to-NAV ratio of 100.2%. From a liquidity perspective, domestically relevant investment funds held high-quality liquid assets (HQLA) equivalent to 57.7% of total assets, although this share has continued its gradual decline in recent years. Redemptions increased during the year but remained within manageable levels, while holdings of cash and deposits decreased. Overall, profitability of domestically relevant funds declined slightly over the year.

¹⁷ See [Insurance Risk Dashboard](#), April 2026.

1.3 Risk outlook and emerging risks

Macroeconomic outlook and external risks

Looking ahead, the euro area economy is expected to grow by 0.8% in 2026, representing a downward revision compared with previous forecasts. This mainly reflected expected weaker contribution from net trade and government consumption, alongside the adverse impact of higher energy prices, and elevated geopolitical uncertainty. Growth is expected to recover thereafter to 1.2% in 2027 and 1.5% in 2028. Inflation is projected to reach 3.0% in 2026 before converging to the 2% target.^{18,19}

Nevertheless, risks to the outlook remain tilted to the downside. Heightened geopolitical tensions, particularly related to the war in the Middle East, and ongoing trade fragmentation pose material risks to growth and inflation dynamics. These risks are already starting to materialise, notably through higher global energy prices and disruptions to oil supply routes. Such developments may keep inflation high, tighten financial conditions and weigh on global growth, especially if the conflict is prolonged.

Domestically, economic growth is expected to remain robust, stabilising at around 3.7% for the next three years. Growth will continue to be primarily driven by private consumption, alongside contributions from investment and net exports.²⁰ Inflation is projected to remain at around 2.4% in 2026 and gradually decline towards the ECB's medium-term target by 2028.

Fiscal and sovereign risks

Despite the monetary policy easing in the first half of 2025, limited fiscal space in several Member States may constrain the ability of policymakers to respond to adverse shocks. Rising public financing needs, also driven by higher defence spending and population ageing, are expected to increase sovereign vulnerabilities and strengthen sovereign-bank linkages, thereby heightening sensitivity to fiscal shocks.

In Malta, however, public debt remains well below the euro area average. The debt-to-GDP ratio is projected to peak in 2026 before gradually declining, supported by narrowing of fiscal deficits and favourable growth-interest rate differential.²¹

Private sector outlook and domestic macroeconomic risks

A deterioration in the macroeconomic outlook could weaken the debt servicing capacity of the private sector, with implications for credit quality and bank profitability. At the same time, abrupt market repricing could lead to valuation losses and tighter financial conditions.

While the domestic sector remains broadly resilient, a deterioration in confidence, particularly in the context of intensified geopolitical tensions, could weigh on consumption. This risk is, however, more pronounced for low-income and highly indebted households, which remain more exposed to adverse shocks despite the overall resilience of the household sector supported by favourable labour market conditions.

Financial sector risks

Both the euro area and domestic banking systems remained resilient, supported by strong capital and liquidity buffers, and profitability. Nevertheless, downside risks remain. A weaker macroeconomic outlook may lead to higher credit losses with some early signs of a modest increase in Stage 2 loans already observed. At the same time, elevated market volatility may weigh on fee and trading income. Rising operational and investment costs, particularly those related to digitalisation, may also pose challenges to profitability. Indeed,

¹⁸ [Eurosystem staff macroeconomic projections for the euro area, June 2026](#).

¹⁹ Economic Bulletin Issue 2, 2026.

²⁰ Central Bank of Malta, [Outlook for the Maltese Economy 2026:1](#).

²¹ See footnote 20.

some domestic banks have already experienced higher cost-to-income ratios, underlining the importance of maintaining cost discipline and diversifying income sources.

The high concentration of domestic banks' loan portfolios in property-related loans remains a key vulnerability, although the sector continues to be supported by strong economic environment, a resilient labour market and a sound household financial position.

The insurance and investment funds sectors also entered 2026 in a broadly sound position. However, they remain exposed to downside risks stemming from geopolitical developments and heightened market volatility, which could affect liquidity conditions and profitability.

Structural and systemic risks

Structural risks remain significant. The rapid digitalisation of financial services has increased exposure to cyber threats, with potential cross-sectoral and cross-border spillovers. The growing use of generative AI, while enhancing efficiency, introduces new operational and model risks and may increase the potential for market disruptions.

Moreover, rising regulatory fragmentation at the global level could encourage regulatory arbitrage and the build-up of risks in less-regulated segments of the financial system.

The transition to a low-carbon economy entails financial risks arising both from the adjustment process itself, as well as from the physical impacts of climate change, with implications for financial institutions' lending, investment and underwriting activities. These structural challenges, combined with existing cyclical vulnerabilities, may interact in ways that amplify shocks through feedback loops, posing risks to financial stability.

Table 1.1 SUMMARY OF RISKS		
Main vulnerabilities and risks to financial stability		Risk assessment (2025) and Outlook (2026)
Vulnerabilities outside the financial system		
Geopolitical uncertainties	GPR affecting the euro area remained characterised by persistent global trade tensions, renewed protectionist measures, and heightened political uncertainty, alongside escalating regional conflicts, including the ongoing war in the Middle East. These developments heightened economic uncertainty and amplified downside risks to growth and upside risks to inflation. External shocks, including shifts in US trade policy and continued global supply chains disruptions may further weigh on the economic outlook, while also affecting confidence and financial market sentiment.	↑
Inflationary pressures	Domestic inflation remained broadly stable during 2025, although it continued to be driven by food prices and tourist-related services and is projected to return to around 2% by 2028. Across the euro area, inflationary pressures eased further and stabilised at around 2% until early 2026. Looking ahead, upside risks remain across the euro area, particularly from energy and commodity prices, with possible spillovers to domestic inflation through indirect effects, prompting the ECB to raise its key policy rates by 25 basis points in June 2026.	↑
Reassessment in risk premia	Global financial markets hovered close to record levels despite lingering concerns over elevated asset valuations. Such conditions increase the likelihood of abrupt repricing episodes and disorderly market corrections in the event of adverse shocks. Sovereign bond yields also remained relatively high, reflecting geopolitical uncertainty and renewed concerns regarding public debt sustainability in several euro area countries. Despite a temporary sell-off in early 2026, valuation pressures continued to pose risks to market stability.	↑
Euro area economic activity and public debt sustainability	Economic growth in the euro area remained modest in 2025. At the same time, rising defence expenditure, structural spending pressures linked to population ageing, and persistently elevated sovereign yields continued to weigh on public finances. In several Member States these factors may intensify existing debt sustainability concerns and increase sensitivity to fiscal shocks.	↑
Domestic macroeconomic activity and public debt sustainability	The domestic economy remained resilient, supported by strong labour market despite a volatile external economic environment. Public debt dynamics remained sound, and although the government debt-to-GDP ratio increased in 2025, it continued to remain comfortably below the levels observed in most other euro area economies, while the fiscal deficit declined markedly to 2.2% of GDP.	↔
Real estate market developments	Malta's RRE market remained resilient, with house price growth staying firm, albeit on a gradually moderating path and increasingly converging with euro area levels. The sector continues to be underpinned by solid macroeconomic fundamentals, sustained labour market strength, and robust tourism activity, and generally healthy household balance sheets. Strong supply dynamics, as reflected in rising building permits, also helped accommodate persistent demand.	↔
Vulnerabilities within the financial system		
Developments in mortgage lending	Growth in resident mortgage lending remained buoyant, in line with continued strength in the domestic housing market. This was reflected in a positive household credit gap, suggesting that credit growth may be outpacing underlying fundamentals. Nevertheless, prudent lending standards and targeted macroprudential measures continue to provide important safeguards against the accumulation of systemic risks.	↔
Developments in NFC lending	After moderating in 2024, lending to resident NFC rebounded strongly in 2025, with growth registered across most sectors. This contributed to the widening of positive sectoral credit gaps, particularly in property-related activities, which remained a key driver of overall credit expansion and a potential source of vulnerability.	↑
Concentration in sectoral lending	Loan portfolio concentration in the Maltese banking sector increased further, with resident mortgages and lending to construction, real estate, and accommodation activities now accounting for almost three-quarters of total resident credit. This rising concentration heightens the sector's sensitivity to cyclical downturns and sector-specific adverse shocks.	↑
Credit quality of the loan portfolio	Asset quality indicators showed continued improvement underpinned by continued declines in NPL ratios across both mortgage and NFCs portfolios, as well as reduced forbore exposures. Nevertheless, the marginal increase in Stage 2 loans may point to the potential emergence of some credit risk and thereby warrants continued close monitoring.	↑
Profitability developments	Profit growth was primarily driven by international banks, while both core and non-core domestic banks recorded weaker profitability. Nonetheless, the ROA of core domestic banks, as well as the overall banking sector, remained strong and broadly in line with the EU average and well above pre-pandemic levels. Looking ahead, downside risks to profitability remain, stemming from both income and cost pressures.	↑
Liquidity developments	Domestic banks maintained a strong liquidity position, supported by continued deposit inflows. Funding conditions improved further during the year, with funding costs continuing to decline in line with the lower-interest rate environment.	↔
Operational risk	Accelerated digitalisation across the financial sector improved operational efficiency but also increased exposure to cyber risks, potential data breaches, and technological disruptions. Despite these emerging threats, operational risk-weighted assets have remained broadly stable, however, close monitoring is warranted given potential systemic implications from such improvements.	↑
Domestically relevant insurances	Both life and non-life insurers expanded their balance sheets while maintaining strong capital positions. Life insurers sustained their recovery in gross written premia and profitability improved notably. Non-life insurers continued to post solid results, supported by resilient underwriting performance. However, vulnerabilities persist due to euro area macroeconomic and geopolitical uncertainty.	Life insurers ↔
		Non-life insurers ↔
Domestically relevant investment funds	Domestically relevant investment funds recorded modest asset growth amid market volatility. Leverage declined slightly and remained contained, while liquidity weakened due to falling cash holdings. Cross-sector interconnectedness remained elevated and profitability stayed strong. Looking ahead, sustained market volatility and tighter financial conditions could pose challenges for liquidity management and asset valuations.	↑
Cross-cutting risks		
Climate and nature-related risks	Climate and nature related risks are becoming increasingly evident, including through more frequent and severe weather-related events, which are affecting market behaviour and risk assessment. While transition risks remained relevant, physical risks are becoming more prominent, with the potential to disrupt economic activity, infrastructure, and financial stability. These risks are also relevant for Malta, given its geographic exposure and structural characteristics.	
Risk level:	Limited Moderate Elevated	
Risk direction:	Increased ↑ Stable ↔ Decreased ↓	

BOX 1: MONITORING FINANCIAL STABILITY RISKS: A HEATMAP APPROACH¹

Introduction

Effective monitoring of financial stability depends on the timely identification of emerging risks and vulnerabilities that could undermine the resilience of the financial system. By aggregating information across a broad set of indicators, including macroeconomic conditions, financial market developments, credit dynamics and confidence measures, the financial stability heatmap facilitates the identification of areas where vulnerabilities may be gradually accumulating. Within the broader financial stability surveillance framework, the heatmap provides a concise system-wide perspective that complements the more in-depth sectoral analyses presented elsewhere in the *Financial Stability Report*.

From a financial stability perspective, this approach strengthens risk monitoring by enabling policymakers to track changes in the risk environment over time and across sectors. It supports the identification of emerging vulnerabilities, helping to prioritise areas for further analysis and inform discussions on appropriate macroprudential responses. This boxed article begins by describing the methodology underpinning the heatmap, then presents the results and associated insights, and concludes with a summary of key findings.

Methodology

The heatmap monitors potential risks and vulnerabilities across seven broad categories. Of these, three capture developments in the financial sector, while the remaining indicators cover macroeconomic conditions and developments in the real economy relevant for financial stability assessment.

For the financial sector, the framework evaluates key indicators for the core domestic banks, domestically relevant insurance companies, and domestically relevant investment funds. It focuses on metrics related to solvency, profitability and liquidity alongside business model-specific indicators, as derived from the respective internal dashboards (see Table 1a). Given that most of the categories comprise multiple indicators, variables were standardised using z-scores to ensure comparability. These standardised indicators are then aggregated within each category using equal weighting. The aggregated standardised indicators for each category are weighted according to the relative size of the respective financial institutions, ensuring that larger entities have a proportionate influence on the final assessment. Where necessary, indicators are transformed so that higher values consistently correspond to higher levels of risk, thereby ensuring a coherent and intuitive interpretation across indicators and categories.²

The domestic and external macroeconomic environment also serves as a backdrop through which potential risks may transmit to the financial sector. Accordingly, the framework incorporates indicators capturing the economic sentiment and systemic stress for both Malta and the euro area, alongside other headline macroeconomic variables such as GDP growth, inflation, government debt levels and the current account balance.³ In addition, the heatmap considers vulnerabilities arising from domestic non-financial corporates (NFC) and households, including indicators related

¹ Authored by Mr Christian Mamo, Principal Economist within the Financial Stability Surveillance and Risk Assessment Department. The author would like to thank Mr Stefan Scerri, Ms Luana Camilleri, and Mr Luke Camilleri for their work on the risk dashboards, as well as Mr Andrew Spiteri, Ms Wendy Zammit, Mr Alan Cassar, Deputy Governors Oliver Bonello and Rita Schembri, and Governor Alexander Demarco for their valuable suggestions.

² These include indicators such as Tier 1 capital, LCR and ROA.

³ For the ESI, the current account-to-GDP ratio and the GDP growth rate, scores are inverted, such that higher values correspond to lower levels of risk. GDP growth and the inflation rate refer to annual growth rates. GDP growth is in real terms. The current account as a share of GDP is calculated as a four-quarter moving average.

Table 1a
SUMMARY OF RISKS

Risk Category	Core Domestic Banks	Domestically relevant Insurance companies	Domestically relevant Investment funds
Solvency	Tier 1 capital buffers	SCR coverage ratio	Leverage ratio
	Leverage ratio	Quality of own funds	
	Total risk exposures as a share of overall risk exposure	MCR coverage ratio	
		Gross technical reserves / gross premium written	
Credit	NPL ratio	Weighted external credit rating for bond holdings	Weighted external credit rating for security holdings
	Coverage ratio	Weighted external credit rating for equity holdings	
	Forbearance ratio	Exposure to non-traditional investments	
	Share of low & unrated securities		
Profitability	ROA	ROA	ROA
	Cost-to-income	Expense ratio (Life)	Net profit margin
		Combined ratio (Non-life)	
Liquidity	LCR	Liquid assets ratio	Liquid assets ratio
	Customer loans to deposits ratio		Price spread on bonds
	Asset encumbrance ratio		Redemption coverage ratio
Operational	Operational risk exposure to total risk exposures		
Concentration	Net large exposures		
	Top three sectoral loans over total assets		
Market	Trading financial assets to total assets	Modified duration	Modified duration
		Corporate bonds volatility indicator	Securities volatility indicator
		Sovereign bonds volatility indicator	
		Equity volatility indicator	
Underwriting		Premia growth	
		Claims growth	
		Reinsurance part of premium	

to indebtedness, leverage and credit gaps.^{4,5} Monitoring these sectors is important as financial distress in these sectors can lead to higher defaults, tighter credit conditions, and spillovers to the banking system and the wider economy.

⁴ William Gatt (2024), [A semi-structural credit gap for Malta: A multivariate filter approach](#), Central Bank of Malta Working Paper 04/2024.

⁵ The classification of the CSRI, together with the household and corporate credit gaps, is derived from their position within the quintile distribution of historical observations, rather than from indicator-specific risk thresholds.

The heatmap is based on quarterly data, with most indicators available from December 2015 onwards.⁶ Indicators are assessed relative to their historical distributions, allowing for the identification of deviations from past patterns and help distinguish between normal cyclical fluctuations and developments that may signal the accumulation of vulnerabilities. To operationalise this approach, observations are classified into quintiles of each indicator's historical distribution.

Table 1b
HEATMAP CLASSIFICATION BASED ON QUINTILES OF HISTORICAL DISTRIBUTION

Historical distribution percentile	Colour scale
0 - 20%	Dark Green
20 - 40%	Light Green
40 - 60%	Yellow
60 - 80%	Orange
80 - 100%	Red

Values falling within the lowest quintile (bottom 20%) are considered significantly below their historical range and are denoted in dark green, while those in the highest quintile (top 20%) reflect relatively elevated positions within the historical distribution, and denoted in red (see Table 1b). Importantly, these classifications are distribution-based and relative in nature. As such, higher quintiles may point to a build-up of risks or increased vulnerabilities, but do not necessarily imply elevated risk in absolute terms. In some cases, an indicator may lie in the upper part of its historical distribution while remaining within levels that are not, per se, associated with material financial stability concerns.

Overall, this framework facilitates a consistent interpretation of developments over time and supports crosssectoral comparison of risk signals.

Interpretation of results

Core domestic banks

The heatmap indicates a broad-based improvement in the profile of the core domestic banks over time, with most categories falling within the lower two quintiles by the end of 2023 and remaining at those levels thereafter (see Table 1c). This improvement is partly attributable to a combination of strengthened regulatory frameworks, proactive de-risking strategies by the banks themselves, and ongoing supervisory-driven reforms. The positive developments are particularly evident in asset quality, with indicators having shown sustained improvement. Notably, the NPL ratio declined to a historical low of 1.8% by end-2025, reflecting the continued resilience of both the household and corporate sectors, as well as the underlying strength of the domestic economy. Banks have maintained strong solvency positions, supported by ample capital buffers. The main exception is operational risk, remaining in the higher quintiles since 2023. This reflects a relative increase in operational risk exposures, with their share of total risk exposures rising to 9.9% as at December 2025 from around 8.8% in 2021. Notwithstanding this increase, operational risk exposures remained lower than the EU average, where the corresponding share stood at 13.4%.⁷

Profitability shows a slight deterioration, to move in the third quintile as at end 2025. This reflects in large part the shift towards a more neutral monetary policy stance, as declining interest rates have weighed on banks' NII. In addition, some banks registered higher operational costs, partly driven by one-off factors. Notwithstanding, the ROA of core domestic banks is still slightly higher than the euro area average. Concentration risk indicators rose, reflecting a more concentrated loan portfolio, as otherwise the share of net large exposures to total capital declined. Overall, the

⁶ Insurance and investment funds data is available from December 2016.

⁷ EBA risk dashboard 2025Q4.

Table 1c
FINANCIAL STABILITY HEATMAP

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
CORE DOMESTIC BANKS										
Solvency										
Asset Quality										
Profitability										
Liquidity										
Operational										
Concentration										
Market										
LIFE & NON-LIFE INSURANCE SECTOR										
Profitability										
Solvency										
Liquidity										
Underwriting										
Credit										
Market										
INVESTMENT FUNDS SECTOR										
Credit										
Leverage										
Profitability										
Market										
Liquidity										
EXTERNAL MACROECONOMIC ENVIRONMENT										
GPR index										
Composite indicator of systemic stress										
Economic sentiment indicator										
DOMESTIC MACROECONOMIC ENVIRONMENT										
GDP growth										
Cyclical Systemic Risk Indicator										
Economic sentiment indicator										
Current account-to-GDP										
Government debt-to-GDP										
Inflation (HICP)										
NFC SECTOR										
Consolidated debt-to- GDP										
Leverage ratio										
Forebearance ratio										
Credit gap										
HOUSEHOLD SECTOR										
Debt to GDP										
Leverage ratio										
House price/Disposable income										
Forebearance ratio										
Credit gap										

Sources: GPR, STOXX 50 Volatility, CISS, ESI, GDP, Current account, Government debt, Inflation rate (HICP), Consolidated debt, NFC leverage, HH leverage, NFC and HH credit gaps, House price to disposable income.

heatmap suggests that banking sector vulnerabilities have generally improved over recent years and remained contained, with no evidence of a broad-based or persistent deterioration across risk categories.

Domestically relevant insurers

Turning to the domestically relevant insurance sector, overall conditions remained favourable, with most risk indicators improving since 2022-23. The sector remained well capitalised, with underwriting and credit risk generally around the historical norm. Market risk also recovered significantly following the peaks reported in the second quarter of 2025. Profitability stood in the fourth quintile, largely reflecting the moderation in the life insurance segment, although the ROA remained broadly in line with the euro area median. Meanwhile, the liquidity metric stood in the top quintile, largely driven by larger insurers recording liquidity positions below their own historical averages, alongside some operators with relatively weaker liquidity ratios. Nonetheless, the median liquidity ratios of domestically relevant insurers remained broadly in line with the euro area median, indicating no widespread deterioration across the sector.

Domestically relevant investment funds

The domestic investment funds sector also appears broadly resilient, with gradual improvements in market and profitability indicators. Profitability, however, moderated somewhat in 2025, settling in the middle quintile.⁸ While leverage and liquidity indicators⁹ have been more volatile, these generally remained benign, with leverage in particular showing only marginal divergences. At the same time, the heatmap highlights that credit risk has remained in the top quintile, following a deterioration in 2024. This may partly reflect increased risk-taking and search-for-yield behaviour as the ECB entered a rate-cutting cycle, which however seems to have ended in mid-2025.

External macro-financial environment

Financial systems are influenced by the global and domestic macroeconomic and geopolitical environment in which they operate. Looking at the indicators related to the external environment, the heatmap points to a scenario shaped primarily by geopolitical developments. The GPR index¹⁰ rose sharply following the outbreak of war in Ukraine in February 2022. While it recovered somewhat during the first three quarters of 2023 as markets and policymakers adjusted, it peaked once again in the last quarter of that year as the Israel-Hamas war erupted, giving rise to heightened uncertainty and risks of regional escalation. It has since remained elevated amid ongoing tensions, including in the Middle East, reaching very high levels in 2025. The heatmap shows that while the initial shock in 2022 was associated with a pronounced increase in the composite indicator of systemic stress,¹¹ more recent geopolitical tensions have not resulted in comparable increases in market-based stress indicators as some risks may have already been priced in. This divergence reflects strong financial sector fundamentals, which have resulted in contained market volatility and limited transmission of geopolitical shocks to financial markets. By contrast, the economic sentiment indicator fluctuated within the top two quintiles, highlighting that expectations among firms and households have remained sensitive to heightened uncertainty and persistent cost pressures.

Domestic macro-financial environment

On the domestic front, the financial sector can be seen as operating in a benign macroeconomic environment when one interprets the statistical movement of the indicators in relation to economic fundamentals. Annual real GDP growth stood in the top two quintiles throughout 2025. This, however, largely reflected base effects following exceptional growth rates recorded in previous years. Indeed, while real GDP growth remained strong at 4.0%, significantly exceeding the euro area average, it fell below the long-term average of 6.4% estimated since 2015Q4, and was well below the peaks recorded in late 2021 and early 2022, when the economy was recovering from the pandemic. The government debt-to-GDP ratio has declined from around 51% in the first quarter of 2022, to now stand in the second-lowest quintile.

Domestic inflation rose sharply following the outbreak of war in Ukraine, exceeding 7% in late 2022 and early 2023. Since then, inflation has moderated considerably to hover between 2.0% and 2.5% as earlier supply-side pressures unwound. This moderation also reflects the lagged effects of the previous tightening monetary policy cycle of 2022-2023. Nevertheless, it remains within the top quintile, given that average inflation stood at just above 1% prior to 2022.

⁸ Profitability is assessed using data up to September 2025 to ensure consistency in the analysis, given the implementation of revised reporting templates towards the end of the year.

⁹ The RCR within the liquidity indicators is estimated based on the worst-case outflow observed over the previous three years. For observations between December 2016 and June 2019, this measure reflects the worst-case outflow within that specific period. This approach differs from the Section 4.2 of the 2025 FSR, which instead considers the worst-case outflow recorded since December 2016 on a cumulative, to-date basis.

¹⁰ The GPR index is based on Caldara Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk". It measures the level of geopolitical tensions based on news coverage (e.g. wars, terrorism, political conflicts).

¹¹ The Composite Indicator of Systemic Stress captures actual stress in financial markets (e.g. volatility, credit spreads, market liquidity), reflecting how those risks are being priced by investors.

The cSRI, which measures the potential build-up of cyclical systemic risks, fluctuated between the third and fourth quintile in 2025, mainly driven by strong real bank credit and debt levels. Improving financial conditions and a supportive banking sector may have incentivised economic agents to take on more leverage, potentially contributing to a build-up of vulnerabilities in the system. Meanwhile, both the domestic Economic Sentiment Indicator (ESI) and the current account balance as a share of GDP point to an improved position in 2025. The improvement in the ESI reflects rising confidence and optimism among businesses and consumers about the economic outlook, partly due to stronger economic activity. Moreover, after recording a current account deficit in 2022, the current account balance swung to a surplus.

Overall, the heatmap suggests that domestic macroeconomic conditions have been shaped by specific and largely exogenous events, rather than indicative of sustained macro-financial stress. While several indicators, mostly outside the domestic financial system, remained in the top two quintiles, this primarily reflected the exceptionally low levels observed prior to the pandemic and the intensification of geopolitical conflicts, rather than the emergence of new or intensifying underlying imbalances. In contrast, the resilience of the domestic financial system has improved over the time period under review, buttressed by strong capital and liquidity buffers. Therefore, most risks to the domestic financial system originate from the volatile external macroeconomic environment.

Conditions in the domestic NFC and household sectors improved markedly over the review period, as reflected by the generally stable or declining risk signals across most balance sheet indicators. The key exception relates to the semi-structural credit gap, which has remained in the higher two quintiles for the past two years, indicating significantly elevated levels with respect to the historical distribution. This development is primarily driven by strong credit growth, particularly in mortgage lending and lending to corporates mainly operating in property-related activities. It is however noted that during 2025, private corporate lending growth became more broad-based, with a recovery also observed in non-property-related sectors. The household leverage ratio is also indicating historically elevated levels, with the leverage ratio standing at around 23.8%, slightly exceeding the euro area average of 22.7%. However, households' net financial wealth remained very strong and highly liquid, providing an important buffer at the aggregate level. Taken together, this suggests that while credit dynamics warrant continued close monitoring, balance sheet buffers currently provide a meaningful degree of resilience.

Conclusions

The analysis indicates that the domestic financial sector remains sound. However, some well-identified pockets of vulnerability have emerged, particularly in the banking sector's operational risk profile, in tentative signs of concentration risks, and credit risk developments within the investment funds sector. The heatmap shows that these vulnerabilities are largely concentrated rather than system-wide, with limited evidence of risk spillovers across segments. The observed overall improvement is largely driven by tighter regulatory standards, strategic de-risking initiatives, and sustained reform efforts prompted by supervisory expectations, which together have reinforced resilience and compliance. Externally, geopolitical events have been the primary driver behind the top quintile position of some macroeconomic indicators compared to historical distributions. Importantly, the heatmap highlights a divergence between elevated geopolitical uncertainty and relatively contained market-based systemic stress, pointing to the resilience of financial markets amid heightened global tensions.

Domestically, the above-historical-norm levels of certain macroeconomic indicators largely reflected base effects following exceptionally strong economic growth and historically benign fiscal and inflation conditions, rather than a material weakening in fundamentals or the emergence of macro-financial imbalances. Despite some moderation, overall domestic economic conditions remained robust and continued to support financial stability. The heatmap therefore points to a resilient domestic financial system which is nonetheless navigating an uncertain and stressed external environment.

At the same time, risks associated with strong and persistent credit growth dynamics both for mortgages and, more recently, in the domestic corporate sector, appear to be building. While the balance sheets of both households and NFCs remained strong, the persistence of elevated credit gaps and debt levels may suggest a potential build-up of risks. In response, the Bank has expanded the coverage of its sectoral systemic risk buffer (sSyRB) with effect from 30 June 2026 to capture loans backed by all real estate, and not only residential property.¹²

When using the heatmap as a tool to assess financial stability, certain limitations should be acknowledged. A purely mechanical approach cannot fully distinguish between phases of financial deepening and periods characterised by excessive risk-taking or economic overheating. This reflects the fact that the heatmap evaluates risk levels solely relative to historical distributions, which may be influenced by structural shifts in the economy or financial system. Accordingly, expert judgement remains essential when interpreting the signals provided by the heatmap, which should therefore be regarded as a complementary tool supporting ongoing financial stability analysis. The heatmap will be updated regularly, with a summary table included in future *Financial Stability Reports*.

¹² Central Bank of Malta: [Statement of decision on the extension of the sectoral systemic risk buffer in Malta](#), December 2025.