EXECUTIVE SUMMARY

The global macroeconomic environment became increasingly challenging in 2025, reflecting heightened geopolitical tensions and a renewed shift towards protectionist trade policies. Against this backdrop, the Maltese economy continued to expand strongly, with real gross domestic product (GDP) growth reaching 4.0% in 2025, outpacing the euro area average, supported by both domestic demand and exports. While inflation in the euro area moderated, inflation in Malta remained largely stable, though higher than the euro area, almost entirely due to differences in energy inflation. Looking ahead, inflation could pick up slightly before moderating reflecting the impact of the Middle East conflict, with risks to the outlook tilted to the upside.

The share of government debt in GDP rose but remained well below the euro area average and the Maastricht criteria threshold. Concurrently, the financial position of private business firms and households in Malta remained broadly sound, bolstered by sustained economic growth and favourable labour market conditions. Nonetheless, overall leverage within the household segment increased with some pockets of potential vulnerabilities at the tail end of the distribution.

The domestic banking system remained resilient, supported by strong capital, ample liquidity buffers and further improvement in asset quality. The latter reflected historically low non-performing loan ratios coupled with strong coverage levels. Notwithstanding this, increases in Stage 2 loans could signal a potential deterioration in credit quality going forward. Aggregate profitability increased only marginally, but the return-on-assets (ROA) remained broadly in line with EU averages. These developments reflected a recovery in profitability of international banks, while profitability eased among both core and non-core domestic banks amid weaker net interest income (NII) and higher operating costs. Credit growth strengthened further, driven primarily by continued robust mortgage lending and a strong and increasingly broad-based pick-up in lending to non-financial companies, although growth remained more pronounced in property-related sectors. While this supported economic activity, it also contributed to a further build-up of concentration risks within banks' loan portfolios, with elevated exposure to property-related lending and emerging signs of a potential cyclical risk build-up.

The Bank's macro-stress test results continue to confirm banks' resilience under both the baseline and adverse scenarios. In the baseline scenario, banks' profitability is supported by interest income, and capital ratios remain comfortably above the supervisory requirements. The adverse scenario assumes a sharp deterioration in the macro-financial environment, driven by an escalation of geopolitical tensions and trade fragmentation. This, in turn, weakens foreign demand, raises energy and commodity prices, and tightens financial conditions. Under the severe scenario, solvency levels deteriorate, but the results indicate that aggregate buffers remain sufficient for the financial system to absorb such shock. Liquidity and interest-rate sensitivity exercises likewise indicate that banks retain ample capacity to withstand funding pressures and rate shocks.

The domestic non-bank financial sector continued to expand, supported by both the insurance and investment funds sectors. The domestically relevant insurance sector recorded strong balance sheet growth, with the most pronounced expansion observed among the non-life insurers. Premia related to non-life insurance were driven primarily by property insurance, which together with motor and health accounted for most of the premia written. Growth in the life segment was meanwhile driven by index-linked (IL) and unit-linked (UL) products, reflecting increased interest in demand for products combining protection and investment returns. While overall profitability remained strong, it moderated in the life segment but strengthened in non-life insurance. Both sectors maintained robust capital buffers, while liquidity conditions remained broadly in line with the euro area average, driven by strong liquidity within the life segment.

Despite periods of elevated volatility amid heightened global market uncertainty, the investment funds sector recorded moderate growth, supported by strong overall returns. Portfolio allocation continued to shift gradually towards equities and units in investment funds, although bonds remained the dominant asset class. Profitability weakened slightly as the rise in expenses outweighed the increase in revenues. Liquidity positions remained at sustainable levels, although they declined over the year. Portfolio positioning continued

to tilt towards a shorter modified duration, reflecting a cautious stance amid heightened market uncertainty, leaving the sector well-positioned to absorb evolving market risks.

Operational vulnerabilities, including cyber-related risks, continued to gain relevance amid rapid digitalisation and heightened geopolitical tensions, while climate-related risks and other novel risk drivers, including those linked to artificial intelligence (AI), also became more important for financial stability given their potential to amplify shocks across the financial system.

The Report also includes six thematic articles. Box 1 introduces a financial stability risk heatmap designed to support the early identification and prioritisation of emerging systemic risks for macroprudential policy purposes, while Box 2 presents the results from the 2025 Bank Lending Survey (BLS). Box 3 presents the results from the Systemic Risk Perceptions Survey (SRPS) conducted by the Bank among 11 domestic banks, capturing key risks affecting the banking sector. Box 4 examines the evolution of banks' sovereign investment holdings over time, highlighting changes in portfolio composition, while Box 5 discusses a refinement to the credit risk module of the macro stress testing (MST) framework, via a more direct modelling of probabilities of default based on macro-financial variables. Finally, the Special Feature presents a preliminary analysis of TARGET2 transaction data and discusses their potential use for detecting cyber-related sources of risk.