1. MACROPRUDENTIAL RISK ASSESSMENT AND POLICY RESPONSE

1.1 Macroprudential risk assessment

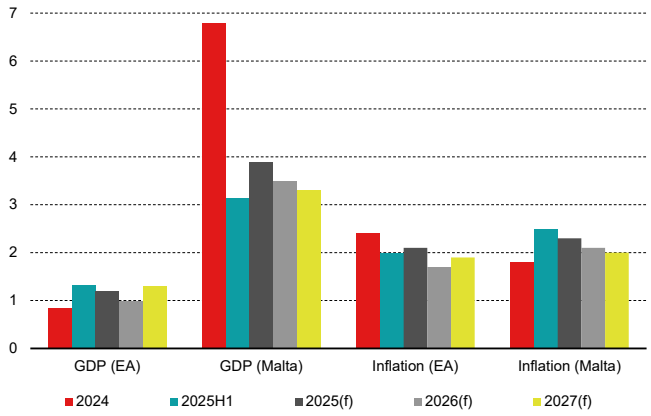
The elevated geopolitical tensions observed during 2024 persisted into the first half of 2025, driven primarily by dynamics related to the announcement of new tariffs by the US administration. These developments intensified financial market volatility, with asset prices remaining acutely sensitive to trade-related news, capable of triggering abrupt adverse movements. However, sentiment partially improved by the recent trade agreements, including the US-China tariff truce and the US-EU tariff deal, which helped reduce uncertainty in the latter part of the period. Meanwhile, conflicts persisted and, in some cases, intensified further, adding more stress to the euro area financial system. Nonetheless, the domestic and euro area financial sector maintained strong capital and liquidity buffers. Bank profitability remained healthy, although this has declined following a reversal of the tight monetary policy stance. Domestic credit flows remained heavily concentrated in property-related sectors, reinforcing concentration risks, though overall asset quality has thus far remained robust.

1.1.1 Vulnerabilities outside the financial system

Euro area economic activity expanded at a somewhat stronger pace than anticipated, although growth remained modest at 1.3% year-on-year in the first half of 2025 (see Chart 1.1).[1,2] This outturn was largely driven by a temporary front-loading of exports in the first quarter of this year, ahead of the higher tariffs introduced by the US administration, while private consumption and investment also contributed positively.[3] In Malta, GDP growth eased to 3.1% in the same half, driven mainly by domestic demand. Inflation dynamics diverged between Malta and the euro area. While in Malta, stronger food and tourism-related services price pressures lifted inflation to 2.5% by June 2025, in the euro area, several factors contributed to push down inflation to 2.0% in the first half of the year.[4] These include lower energy prices, weaker external demand, moderate wage growth and a stronger euro.[5]

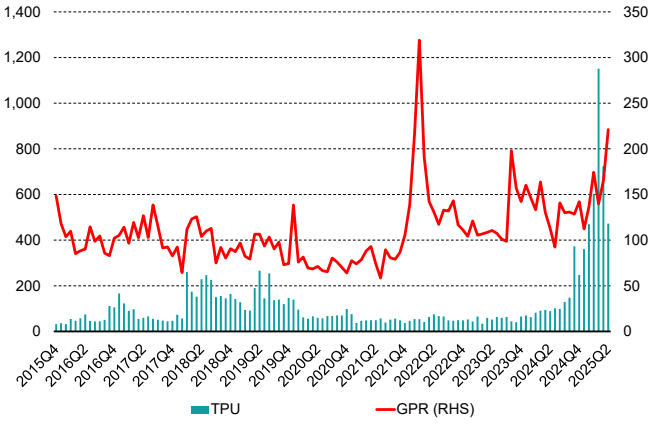
Tariffs surged across major economies in the first half of the year, as the US administration imposed steep duties, particularly targeting imports from China, Brazil, Mexico and Canada. As a result, the trade policy uncertainty (TPU) index spiked in April of this year, before retreating

Chart 1.1
ECONOMIC GROWTH AND INFLATION DEVELOPMENTS
(annual growth rate; per cent)



Sources: Eurostat; ECB; Central Bank of Malta.
Note: GDP and inflation figures for 2025 onwards represent forecasts.

Chart 1.2
TRADE POLICY UNCERTAINTY & GEOPOLITICAL RISK INDEX



Sources: "The Economic Effects of Trade Policy Uncertainty" and "Measuring Geopolitical Risk", Caldara et al., (2020, 2021).

[1] Economic growth figures refer to four-quarter moving sum.
[2] Source: Eurostat, ECB staff macroeconomic projections for the euro area – September 2025.
[3] European Central Bank, *Economic Bulletin,* 5/2025.
[4] Central Bank of Malta, *Economic update*, 7/2025.
[5] *Economic Bulletin,* 2/2025.

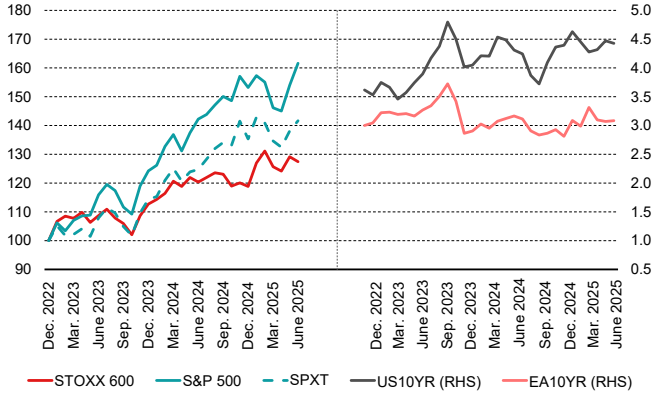
somewhat as a tariff truce was agreed between the United States and China (see Chart 1.2). Such moderation in trade uncertainty was also aided by another tariff agreement between the United States and EU on a 15% tariff on most EU-origin goods entering the United States. Despite these positive developments, the geopolitical risk index (GPR) trended further upwards due to the persistent war between Russia and Ukraine, and the conflict in Gaza until the first half of 2025, which continued to undermine economic growth prospects across the globe.

By end June 2025, major equity indices were higher than in 2024, with the STOXX 600 rising by 7.2% in the first half of 2025, whilst the S&P 500 went up by 5.5% (see Chart 1.3). This uptrend was supported by the ongoing bullish sentiment, mainly driven by strong corporate earnings and heightened investor optimism around the expected US Federal Reserve rate cuts. Nonetheless, markets experienced a short-lived but sharp sell-off in April, triggered by the US import duties mentioned above, before recovering as a truce and bilateral agreements were reached. Although the technology sector in the United States remained a solid driver to this upturn in financial markets, spearheaded by the AI boom, the SPXT also recorded notable growth. EU financial markets performed well, mainly led by the financial sector, especially banks and the defence sector. The performance of the latter sector was boosted by the recent drive by governments, particularly within NATO, to increase defence spending in response to heightened geopolitical tensions. Despite the over-stretched equity prices, the ongoing bullish sentiment is expected to linger due to ongoing tailwinds, such as a weaker dollar, lower trade uncertainty and expected easing in US monetary policy. Bond market developments were somewhat muted, with the US ten-year bond yield edging higher to 4.43% whilst the EU ten-year bond yield increased to 3.08%. In general, liquidity conditions in both the euro area and US sovereign bond markets remained resilient, even during the sell-off in April. Looking ahead, sovereign bond yields are expected to remain high, driven by investors' concerns over high public debt and elevated geopolitical uncertainty including the more recent political crisis in France.

Euro area government debt-to-GDP ratio rose to 88.2% in June 2025, up from 87.2% as at end 2024. If government debt sustainability is challenged further, it may also limit governments' spending on other important structural challenges such as climate change, ageing population, and digitalisation. Debt sustainability is further exacerbated by the higher interest burden, despite the lower policy rates, mainly due to the average maturity of new sovereign debt and the refinancing of maturing debt previously issued at much lower rates.[6] Domestically, the government debt-to-GDP ratio stood at 46.9% in June 2025, suggesting a more sustainable position domestically than in other euro area countries.

Euro area corporates' debt sustainability is characterised by two counteracting forces. Although financing conditions have improved considerably due to the ongoing monetary policy easing, the weak economic growth prospects could potentially harm their financial position and revenue growth generation. The potential of further trade conflicts could also worsen euro area corporates' financial position, especially in those sectors that are heavily reliant on global trade such as the manufacturing sector. Notwithstanding, the euro area corporate debt-to-GDP ratio remained stable at 66.6%. Domestically, the improvement in corporates' financial position persisted with the related consolidated debt-to-GDP ratio improving to 60.8%. This is corroborated by the low domestic corporate leverage ratio of 21.9%, which is also lower than the 25.7% for euro area corporates.

Chart 1.3
FINANCIAL MARKET DEVELOPMENTS
(Index, Dec-2022 = 100; per cent)

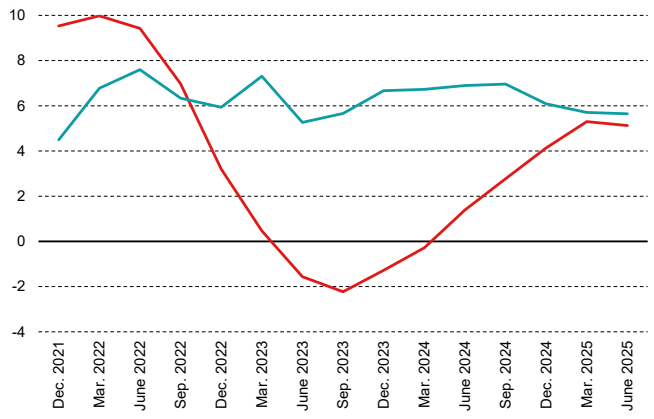


Sources: Investing.com; ECB.
Note: SPXT is a US-listed ETF tracking the S&P 500 excluding information technology companies, including software, technology hardware and equipment, and semiconductor companies.

[6] Global Debt Report 2025, OECD Publishing, March 2025.

The euro area household sector remained resilient buttressed by improving financing conditions and debt servicing capacity, driven by robust growth in real disposable incomes. This largely reflected the decline in inflation coupled with strong labour market developments as overall employment levels reached historic highs. Nonetheless, the ongoing trade policy negotiations create an uncertain economic outlook which may encourage households to save more. Domestically, the household sector remained resilient with the household debt-to-GDP ratio standing at 47.9%, lower than the 51.0% in the euro area. At the same time, the domestic household leverage ratio continued an upward trajectory. At 23.2%, household leverage stood only marginally higher than that of euro area counterparts which stood at 23.1%.

Chart 1.4
RRE PRICES
(per cent; year-on-year growth)



Source: Eurostat.

The euro area residential real estate (RRE) market is recovering strongly, on the back of easing financing conditions, with demand for mortgages picking up, as shown in the euro area Bank Lending Survey results. On the supply side, RRE investment growth moderated while construction costs increased further, adding upward pressures on property prices. Indeed, euro area house prices increased by 5.1% in June 2025 (see Chart 1.4). While activity in the euro area commercial real estate (CRE) market remained subdued, this too showed signs of recovery, on the back of easing financing conditions, though structural factors such as remote working practices are expected to keep demand for offices bleak. Domestically, the RRE cycle remained resilient, supported by a sustained growth in RRE prices of 5.6%. Although, the number of deeds decreased marginally by 0.8%, promises of sale agreement rose by 2.9%, suggesting the resilience of the local property market and sustained investor confidence.[7]

1.1.2 Vulnerabilities within the financial system

Euro area banks' profitability stabilised at healthy levels with a return on assets (ROA) of 0.75% in June 2025.[8] NII remained an important component for these banks' gross income generation, but tighter margins and muted loan volume growth has led to its share in overall net operating income to drop by almost 3 percentage points to 57.5%. The slowdown in NII was compensated by higher non-interest income. Higher operating expenses also contributed negatively to profitability. However, the cost-to-income ratio remained stable at 52.4%. Banks in the euro area continued to operate with strong capital and liquidity buffers with a total capital ratio of 20.4% and LCR and NSFR of 161.6% and 127.2%, respectively. Asset quality also remained healthy, reflected by the low NPL ratio of 1.8%.

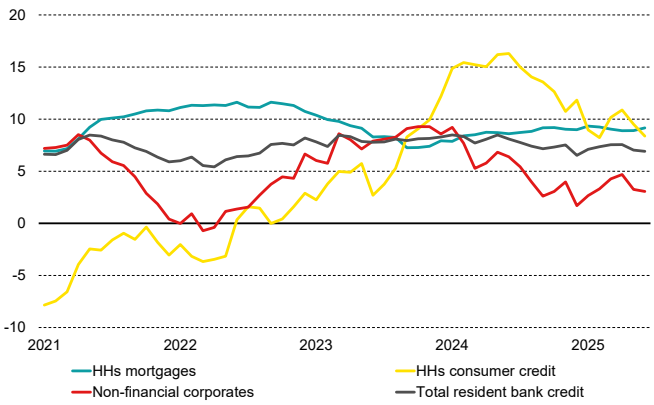
Domestically, banks are seeing reduced profits with the ROA declining by 0.2 percentage points to 0.5%. This reflected weaker profits by the core domestic banks and higher losses by international banks, mainly the branches of foreign banks.[9] In contrast, non-core domestic banks posted slight improvements in their profitability. For core domestic banks, lower NII and higher operating costs weighed on the results, while international banks reported losses due to higher non-interest expenses and lower non-interest income.

Resident credit remained sturdy, growing by 6.9% year-on-year in June 2025 (see Chart 1.5). Resident mortgages continued to drive growth, rising by 9.2% and accounting for almost 55% of resident bank credit. Despite retreating somewhat, resident consumer credit growth remained strong, increasing annually by

[7] Growth rates in value of deeds and promise of sale agreements refers to first six months of 2025 over the same period in the previous year.
[8] EBA risk dashboard 2025Q2.
[9] Profits data refers to the four-quarter moving sum.

8.4% in June 2025. Growth in credit to resident NFCs also edged higher after a brief slowdown late last year, to reach 3.1% in June 2025, mainly concentrated in property-related sectors. The construction, real estate and accommodation sectors together grew by 8.1%. Such sustained expansion in lending to the property sector reinforced the concerns over concentration risks in domestic banks' loan books. Despite this, asset quality of these banks' loan books remained healthy, with an NPL ratio of just 1.9%. In addition, domestic banks' capital and liquidity positions remained strong, with a total capital ratio of 27.4%, while the LCR and NSFR stood at 394.3% and 178.3%, respectively.

Chart 1.5
ANNUAL RESIDENT CREDIT GROWTH RATE
(per cent)



Source: Central Bank of Malta.
Note: A break in series was reported in May 2017 with regards to HH consumer credit due to a reclassification exercise.

The euro area insurance sector remained resilient supported by strong growth in premia and well-capitalised balance sheets.[10] As of June 2025, the median Solvency Capital Requirement (SCR) coverage ratios stood at 231.4% for the life sector and 212.2% for the non-life, reflecting robust capital buffers. Profitability benefited from stronger non-life underwriting, while life investment returns remained stable. Liquidity declined slightly, with the median Liquid Assets Ratio falling to 46% of total assets. Domestic life insurers mirrored euro area trends, with growth driven by higher demand for 'insurance with profit participation' products, although underwriting gains were partly offset by increased contract servicing and reinsurance costs. Capital buffers were strong, with an SCR ratio of 268.3%, well above the euro area median. Non-life insurers also performed well, with premia rising robustly, particularly in property insurance. The combined ratio stood at 72.3%, significantly below the euro area median of 95.1%, indicating efficient underwriting. By June 2025, non-life insurers retained solid capital positions, with an SCR ratio of 243%. Liquidity across both sectors remained broadly aligned with the euro area, with a median Liquid Assets Ratio of 43%.

In the first half of 2025, euro area investment funds expanded by 1.8%, with growth remaining limited as declines in securities issued outside the euro area offset gains in euro area instruments.[11] Leverage in the sector remained elevated at 109.5%, broadly unchanged from end-2024. Market developments led to EU high-yield funds to experience notable outflows, while flows into sovereign bonds and money market funds increased as investors reallocated to safer assets.[12] Concurrently, domestically-relevant investment funds recorded a marginal 0.7% growth in assets, reflecting mixed market conditions, as declines in equities and investment fund units offset gains in fixed-income holdings, despite the bullish sentiment in broader equity markets. Liquidity conditions weakened moderately with the Liquid Assets Ratio declining to 58.2% in June 2025, largely reflecting lower exposures to sovereign debt securities, as the levels of cash and deposits remained broadly unchanged. The lower liquid assets also resulted to the Redemption Coverage Ratio (RCR) to decrease slightly, from 3.0 times to 2.9 times. Still, both indicators remain at prudent levels by historical standards. Leverage increased somewhat, with the AUM-to-NAV ratio remaining significantly below that of euro area peers and consistent with a conservative risk profile. Although remaining positive, profitability declined due to an increase in expenses.

1.1.3 Risk outlook

Looking ahead, the intensification of protectionist policies, including higher tariffs and other trade-distorting measures, may have adverse impacts on the euro area economy, particularly for the manufacturing and export-oriented sectors. Such risk is amplified by the appreciation of the euro against the dollar, further hurting

[10] See EIOPA risk dashboard, October 2025.
[11] Source: ECB Data Portal.
[12] European Systemic Risk Board (ESRB), EU Non-bank Financial Intermediation Risk Monitor 2025, September 2025.

euro area exports. Heightened geopolitical uncertainty, amplified by regional conflicts and the political crisis in France, add to downside risks. Indeed, despite trade agreements, the situation remains very fluid, particularly between the largest world economies China and the United States. Meanwhile, the situation in the Middle East remains highly volatile. Despite a ceasefire agreement, the political environment continues to be unstable.

Against this backdrop, the euro area economy is expected to grow by 1.2% in 2025, retreating to 1.0% in 2026 before recovering to 1.3% in 2027.[13] Meanwhile, labour market conditions remained strong which should support economic growth. These developments are supported by improvements in households' purchasing power and enhanced credit affordability, reflecting the cumulative impact of earlier interest rate reductions. Inflation is expected to bottom out at 1.7% in 2026, before edging up to 1.9% a year later.

Domestically, economic growth is expected to moderate to 3.9% in 2025 and moderate further to 3.5% and 3.3% in 2026 and 2027, respectively. Private consumption is expected to remain the main engine of economic growth, with net exports also contributing positively but to a much lesser extent.[14] Inflation is expected to follow a downward trend to converge to 2% by 2027.

On the financial side, euro area banks' profitability is likely to ease somewhat in 2025, mainly due to lower NII as monetary policy is easing, whilst cost-of-risk marginally improved. Similarly, in Malta, banks' profitability has softened, mainly due to lower NII, a trend which is expected to persist. Resident lending remains heavily concentrated in property-related sectors, heightening concentration risks in banks' loan portfolios. Nevertheless, the strength of the domestic economy and labour market are likely to sustain momentum in the property market.

The incidence and sophistication of cyberattacks are expected to rise further. Losses by EU banks from information technology-related risks increased sharply to around €6.5 billion in 2024, from €2.8 billion a year earlier. This surge reflected the growing number of banks which experienced at least one successful cyberattack.[15] Against a backdrop of heightened geopolitical tensions, state-sponsored cyberattacks could pose risks to critical infrastructure and financial stability.[16] Emerging technologies, including artificial intelligence (AI), may also introduce new operational and systemic risks alongside potential efficiency gains. While adoption remains uneven across sectors, ongoing regulatory developments and legal considerations could influence the pace and nature of integration.

Additional risks stem from the expansion of crypto-assets and stablecoins, which may pose challenges through volatility and contagion, potentially creating runs on reserve assets. This could potentially transmit stress into the traditional financial system, particularly if such instruments gain traction in payments and settlements. Climate-related risks also continue to threaten financial stability and could amplify systemic vulnerabilities and challenge the effectiveness of traditional risk management frameworks. Despite the relaxation of climate-related disclosures, banks should therefore continue strengthening their due diligence and climate stress testing, while limiting exposures to vulnerable sectors.

The insurance sector faces a cautious outlook. Market volatility, rising cost of claims, and climate-related events are likely to weigh on both investment and underwriting performance. Cyber risks remain an emerging vulnerability, with insurers increasingly exposed to the same digital threats affecting the broader financial system. As insurers expand their digital footprint and adopt AI-driven tools, they must also enhance cyber resilience and adapt underwriting models to account for evolving risks. Similarly, the investment fund sector is expected to navigate a challenging environment. Global equity volatility and uncertainty over international interest rates continue to weigh on investor sentiment. Portfolio managers are likely to maintain a cautious stance, limiting exposure to interest-rate risk in fixed income while retaining flexibility to respond to shifts in policy expectations. Balancing short-term volatility with longer-term opportunities in equities will be key. Domestically, Malta's stable macroeconomic environment provides a supportive backdrop. Liquidity and redemption buffers remain adequate though narrower than before, and are likely to stabilise around current levels, underpinned by the sector's conservative risk profile and low leverage.

[13] Eurosystem staff macroeconomic projections for the euro area, September 2025.
[14] Central Bank of Malta, *Outlook for Maltese economy*, 2025:3.
[15] Risk assessment report of the European Banking Authority, June 2025.
[16] European Central Bank, *Financial Stability Review*, Box 1: Cyber threats to financial stability in a complex geopolitical landscape, May 2025.

Table 1.1
SUMMARY OF RISKS

Main vulnerabilities and risks to financial stability		Risk assessment and Outlook (2025H1)
Vulnerabilities outside the financial system		
Geopolitical uncertainties	Geopolitical risks were dominated by escalating trade tensions, particularly due to new U.S. tariffs that intensified global protectionist trends. While some trade agreements were concluded, significant risks persist. Within the euro area, political uncertainty in France, is also contributing to instability. These developments maintain fragility in financial markets.	⟷
Inflationary pressures	Inflation in Malta edged higher due to international food prices and demand for tourism-related services. However, current projections show that it is expected to decelerate to around 2% by 2027. Across the euro area, price pressures have moderated somewhat stabilising at around 2%, prompting the ECB to keep interest rates stable in recent months. Although tail-end risks remain, risks to inflation are broadly balanced.	⟷
Reassessment in risk premia	Financial markets stood near all-time highs, despite persistent concerns over stretched valuations. This environment increases the likelihood of volatile episodes, which could trigger abrupt sectoral sell-offs. Sovereign bond yields remained elevated, reflecting underlying geopolitical tensions and growing concerns over public debt sustainability.	↑
Euro area economic activity and public debt sustainability	Economic growth in the euro area remained subdued, which may prompt governments to adopt more expansionary fiscal measures to stimulate activity. This, combined with the expected rise in defence expenditures and elevated bond yields, could place additional strain on public debt sustainability, already under significant pressure.	↑
Domestic macroeconomic activity and public debt sustainability	Amidst a volatile external environment, the Maltese economy, while moderating, continued to exhibit resilience, supported by robust domestic demand and a buoyant tourism sector. Although government debt as a share of GDP remains well below that of the euro area, the fiscal deficit is projected to hover around 3% in 2026.	⟷
Real estate market developments	The RRE market in Malta remained strong, with property price growth still robust though gradually moderating, now more in line with the euro area average which has recently gained momentum. Malta's property market continues to be supported by a resilient economy, a healthy labour market, and strong tourism activity. Household financial conditions remain broadly benign, contributing to sustained demand. In contrast, activity in the domestic CRE market, particularly in the office segment, remained subdued.	⟷
Vulnerabilities within the financial system		
Developments in mortgage lending	Resident mortgage lending in Malta remained strong, growing at 9.2%, reflecting robust developments in the domestic RRE market. This was accompanied by a positive household credit gap, raising concerns about potential excessive lending to the sector. Nonetheless, cautious underwriting standards by banks, along with targeted macroprudential measures provide a critical safeguard against the build-up of systemic vulnerabilities.	⟷
Developments in NFC lending	After decelerating somewhat in 2024, resident NFC lending rebounded in the first half of 2025. This was primarily driven by robust credit growth to property-related sectors, including construction, real estate, and accommodation, which also contributed to the positive sectoral credit gaps.	↑
Concentration in sectoral lending	Concentration risks in the loan books of the Maltese banking sector have intensified, with resident mortgages and loans to the construction, real estate, and accommodation sectors now accounting for almost three-quarters of their resident lending portfolio. This marks an increase of around 5 percentage points over the past five years heightening vulnerability to cyclical downturns and sector-specific shocks.	↑
Credit quality of the loan portfolio	Credit quality remained healthy, supported by declining NPL ratios in both mortgage and NFC lending, as well as lower forbearance ratios. However, the rise in Stage 2 loans, up by approximately 10% in the first half of the year, may signal emerging pressures on asset quality, warranting close monitoring going forward.	↑
Developments related to net income	Diverging profit developments were observed across segments of Maltese banking sector. Non-core domestic banks reported a slight increase in profits, while core domestic banks experienced a decline. Nevertheless, the ROA of core domestic banks remained stronger than that of their EU peers and well above pre-pandemic levels. In contrast, international banks operating in Malta reported higher losses. Looking ahead, profit levels are expected to moderate further, as the lower interest rate environment continues to exert downward pressure on NII.	↑ ** Increase in risk due to lower income*
Liquidity developments	The liquidity position of domestic banks remained ample. This was compounded by strong deposit growth. Moreover, cost of funding for banks eased further supported by the lower interest rate environment.	⟷
Operational risk	The rapid digitalisation of the financial system has boosted efficiency but also increased avenues of vulnerabilities related to operational risks. This includes increased probability of cyber threats, data breaches, and technical failures. However, operational risk weights as a share of assets remained largely stable domestically.	⟷
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.	↓
Domestically-relevant investment funds	Domestically-relevant investment funds saw marginal asset growth amid mixed market conditions and heightened volatility. Leverage rose slightly but remained contained, while liquidity weakened due to declining cash holdings. Cross-sector interconnectedness stayed strong, and profits remained elevated. Overall, the environment was marked by persistent euro area macroeconomic and geopolitical uncertainty. Looking ahead, continued market volatility and tighter financial conditions with low cash buffers could challenge liquidity management and weigh on asset valuations.	↑
Cross-cutting risks		
Climate and nature-related risks	Although traditionally viewed as long-term challenges, transition, physical, and nature-related risks are gaining increased prominence in both policy and market discussions. Physical risk, particularly extreme weather events, are especially disruptive. Recent studies highlight that Malta's economy is among the most vulnerable in the European Union to extreme weather events	

Risk level: Limited | Moderate | Elevated

Risk direction: Increased ↑ | Stable ⟷ | Decreased ↓

1.2 Macroprudential regulatory developments

This section reports the main developments in macroprudential policy measures during the first half of 2025.

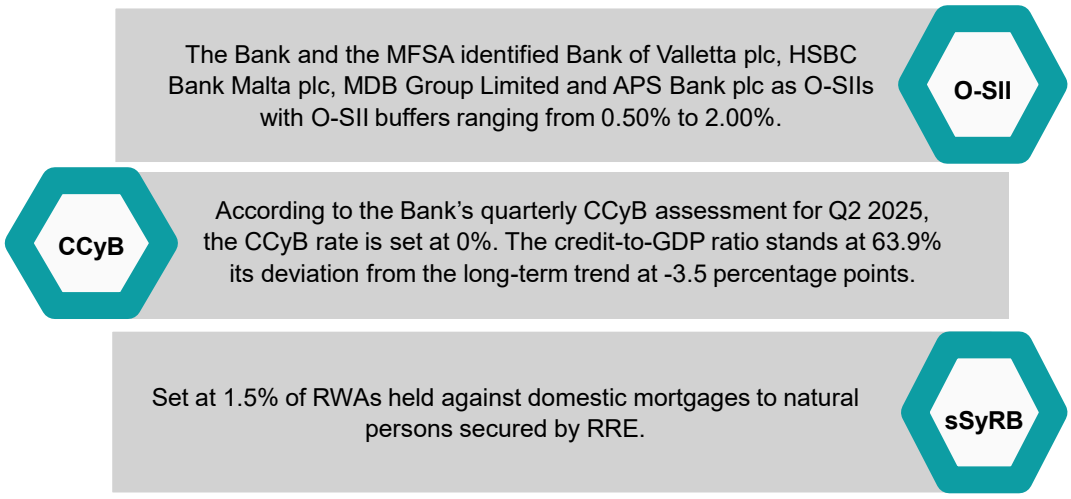
1.2.1 Capital-based macroprudential measures

As part of its macroprudential tool kit, the Central Bank of Malta applies capital-based macroprudential measures, amongst others, to preserve the stability of the Maltese financial system. These measures strengthen the resilience of financial institutions by addressing systemic risks and limit any potential losses in case of adverse economic shocks. Figure 1.1 presents the macroprudential capital buffers that are currently applicable to domestic banks.[17]

Extension of Sectoral Systemic Risk Buffer

On 11 April 2025, the CBM launched a restricted consultation on the proposed extension of the Sectoral Systemic Risk Buffer (sSyRB) through the Malta Bankers Association (MBA). The consultation period ended on 9 May 2025 and written feedback was received from seven credit institutions through the MBA. Given that the proposed extension of the sSyRB coincides with the entry into force of Capital Requirements Regulation and Directive (CRR3/CRD6), as part of the consultation, the Bank requested specific data from credit institutions to assess the impact of the CRR3 new risk weight treatment on bank capital adequacy, the buffer calibration and how changes in CRR3 affected macroprudential space. From the Bank's estimations, it is deemed that the proposed 1.5% capital buffer rate is adequate and commensurate with the Bank's policy targets. Results show that on aggregate, management buffers remain over 2%, which is sufficient even after allocating a portion for the sSyRB. This finding also holds for the core domestic banks, which represent the category mainly affected by the measure. The extension of this buffer is subject to a formal notification process with the ECB and ESRB, as well as final endorsement by the Joint Financial Stability Board. This buffer will be applicable from June 2026 and applies to all credit institutions in Malta that engage in domestic credit activity, at the highest consolidation level. Regular review of the underlying risks being addressed by the sSyRB will take place which in turn will assess the adequacy or otherwise of the buffer.

Figure 1.1
MACROPRUDENTIAL CAPITAL BUFFERS HELD BY BANKS AS AT END OF JUNE 2025



Source: Central Bank of Malta.

[17] The Going Concern Capital Stack for banks includes the following components: the Pillar 1 Requirement, the Pillar 2 Requirement, the Combined Buffer Requirements – which comprise the Capital Conservation Buffer extended by the Countercyclical Capital Buffer (CCyB), Systemic Risk Buffer, and the Other Systemically Important Institutions (O-SIIs) Buffer as applicable – as well as the Pillar 2 Guidance. In addition, banks must also meet the Leverage Ratio Requirement. A detailed overview of the regulatory requirements applicable to banks can be found in Box 2 of the Interim Financial Stability Report 2023 (FSR).

O-SII Buffers

During the first half of 2025, the Bank ran the O-SII buffer exercise to determine whether the banks identified as O-SIIs remained as such, together with the corresponding buffer rates. The scores and the respective buffer rates of those institutions identified as O-SIIs, are provided in Table 1.2 and no changes, other than in the scores, were reported when compared to the preceding exercise. Following discussions with the ECB and ESRB, the respective banks have been bilaterally informed. The results are published in the CBM-MFSA Statement of Decision with buffer rates applicable from January 2026.

Table 1.2
LIST OF IDENTIFIED O-SIIs FOR 2026, CORRESPONDING O-SII SCORES AND EFFECTIVE BUFFER RATES

Institution	Size	Importance	Complexity	Intercon-nectedness	Total	Fully loaded buffer rate
APS Bank plc	182	523	17	74	796	0.50%[1]
Bank of Valletta plc	661	1,682	165	341	2,848	2.00%
HSBC Bank Malta plc	308	901	99	123	1,431	1.25%[2]
MDB Group Limited	222	209	493	340	1,264	1.00%

Source: Central Bank of Malta.

[1] APS Bank plc is currently following transitory provisions as outlined in the statement of decision until it reaches the fully loaded O-SII buffer rate in 2026 as shown in the table above.

[2] HSBC Bank Malta plc qualifies for the provisions of Article 131(8) of CRD, which results in the capping of its 1.50% O-SII buffer rate to 1.25%.

1.2.2 Borrower-based measures

CBM Directive No. 16 on borrower-based measures (BBMs) has now entered its sixth year in force. While no amendments were introduced during the past year, the Bank continues to maintain a proactive stance in monitoring the domestic RRE market. This vigilance ensures that the Directive remains aligned with evolving market dynamics and continues to support financial stability.

In 2025, banks submitted the results of their compliance audits referring to activities conducted during the 2024 financial year, in accordance with the requirements set out in Directive No. 16. Notably, this year marked the implementation of an external audit exercise for the second time, providing an independent evaluation of banks' adherence to the Directive. Overall, external auditors observed that banks were adhering to the provisions of the Directive, complementing internal analyses where compliance is assessed on the basis of hard data. This initiative strengthens the regulatory framework by enhancing transparency and reinforcing the credibility of internal compliance mechanisms. The Bank remains committed to reviewing the Directive as needed, ensuring it remains fit for purpose in a changing financial landscape.

1.2.3 Other measures

Voluntary Reciprocation

No new reciprocation measures were introduced during the first half of 2025. Moreover, the CBM maintained its existing stance of non-reciprocation with respect to previously identified measures eligible for reciprocation.

Identification of material third countries

In line with the ESRB Recommendation ESRB/2015/1, which pertains to the recognition and setting of CCyB rates for exposures to third countries, the Central Bank of Malta conducts an annual exercise to identify third countries to which the domestic banking sector has material exposure. The Bank also monitors potential risks to financial stability arising from excessive credit growth in these countries.

The annual review for the identification of material third countries (M3C) has concluded that, for the period from Q2 2025 to Q2 2026, the United Arab Emirates (UAE) and the United Kingdom (UK) remain the M3C for Malta. This confirms that the list of M3C is unchanged from the previous year.

Other developments

The CRR3, entered into force in January 2025. The Regulation *inter alia* introduced more granular requirements for the calculation of RWAs. From a macroprudential perspective, these changes enhanced risk sensitivity, ensuring that capital levels more accurately reflected underlying risks, thereby strengthening the capital base and supporting financial stability, particularly during periods of market stress. More information on how CRR3 impacted MT credit institutions' RWA, can be found in Box 1.

BOX 1: IMPACT OF CRR3 ON MALTESE BANKS' RISK WEIGHTS[1]

Introduction

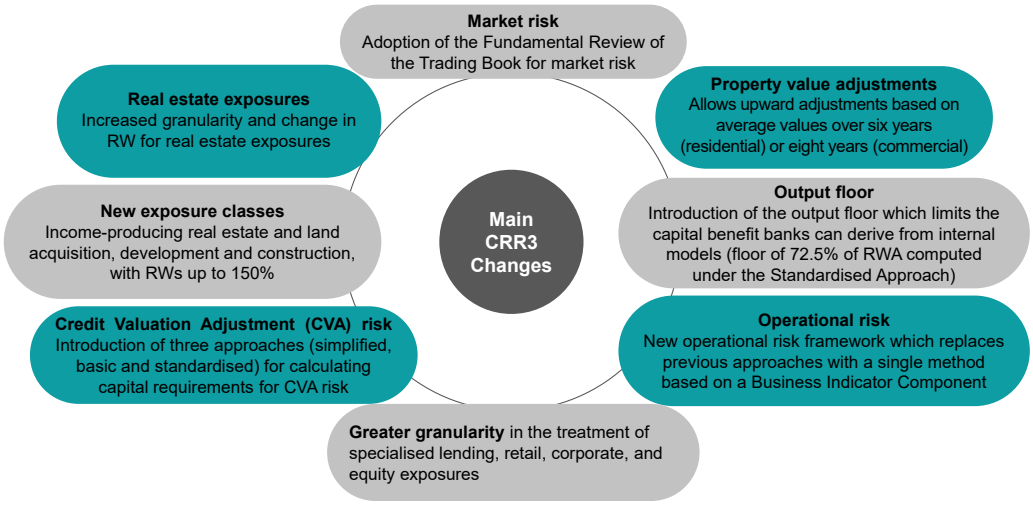
On 1 January 2025, the revised CRR3 came into effect as part of the EU legislative landscape, marking a pivotal step in finalising the Basel III reforms. These changes aim to strengthen the resilience of the banking sector via, *inter alia*, updates in supervisory reporting requirements, revised approaches to market and operational risk, as well as refinements on how banks quantify their capital requirements, particularly for credit risk.

Against this backdrop, the purpose of this boxed article is to explore in greater depth the changes in RWA reported by banks in the calculation of capital requirements, focusing on credit and operational risk. The analysis evaluates differences in impact across banks attributed to the new rules. In particular, the analysis aims to evaluate the impact on the overall capital position by measuring the extent to which risk weights (RWs) have shifted relative to total assets.[2] A key focus is to determine whether these updates have materially affected banks' capital levels. This examination is especially relevant in the context of macroprudential policy space, and in light of potential refinements or the introduction of new macroprudential tools.

Overview

Figure 1a below outlines the key changes to the revised Regulation, in particular those of direct relevance to the revised quantification of capital. For the purposes of this summary, the focus is limited to selected regulatory changes with direct implications for financial stability. Broader reforms, such as those concerning Environmental, Social and Governance (ESG) risk, data architecture, and reporting frameworks, are not addressed here but remain critical components of the overall CRR3 package.

Figure 1a
MAIN CHANGES EMANATING FROM CRR3



[1] Prepared by Ms Dominique Tanti, Principal Economist within Macroprudential Policy, Stress Testing and Research Department. The author would like to thank Ms Christine Balzan, Head; Mr David Stephen Law; Mr Pedro Polvora, Principal Economist and Mr Alan Cassar, Chief Officer Financial Stability and Statistics Division, for their valuable suggestions.

[2] The impact on RWs is calculated as a ratio of RWA to Total Assets of the total domestic banking system and is referred to as the effective RW or risk density.

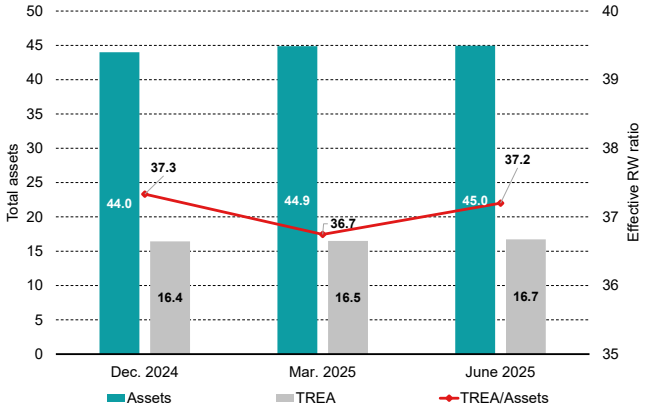
Credit risk remains the main source of risk for domestic banks in Malta and consequently, the majority of their RWA are held against such risk. In light of this, the following section will underscore this development by outlining quantitatively the impact of CRR3 comparing data for December 2024 (CRR2) with June 2025 (CRR3). Furthermore, the analysis is conducted at the consolidated level (rather than solo level) to ensure consistency with capital ratio calculations.

Deep dive into changes to the effective RWs

Overall effective RW decreased slightly with a heterogeneous impact across risk classes.

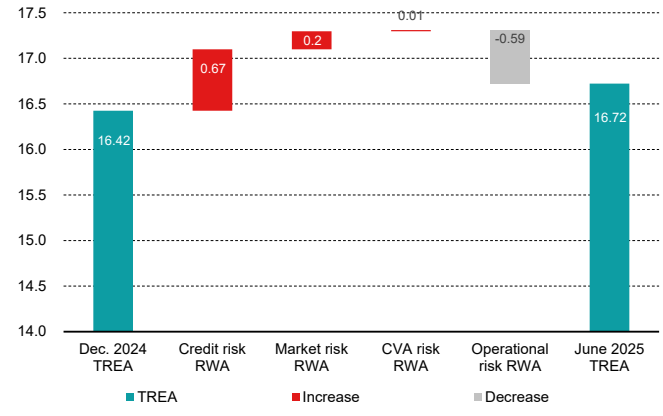
Chart 1a illustrates a consistent upward trend in both Total Assets and the Total Risk Exposure Amount (TREA); also referred to as RWA, for Maltese banks over the observed period. This reflects continued expansion in the sector's balance sheet and associated risk exposures. Concurrently, the RWA-to-Assets ratio – depicted by the line graph – declined modestly from 37.3% in December 2024 to 36.7% in March 2025, before stabilizing at 37.2% in June 2025. This marginal decrease in the ratio suggests a slight reduction in overall risk density, primarily attributable to asset growth marginally outpacing the increase in risk-weighted exposures. Indeed, upon further investigating the evolution in TREA specifically within key risk categories, this overall movement is the result of offsetting shifts across the risk classes as seen in Chart 1b. The composition of these changes highlights a rebalancing of risk (given by changes in corresponding RWs) within the sector, with rising credit and market exposures partially offset by reduced operational risk.

Chart 1a
DEC. 2024 TO JUNE 2025 – EVOLUTION OF BANK ASSETS AND RISK EXPOSURE RATIO
(EUR billions; per cent)



Source: Central Bank of Malta

Chart 1b
DECOMPOSITION OF TREA CHANGES BY RISK CLASS – TOTAL BANKING SECTOR
(Eur billions)

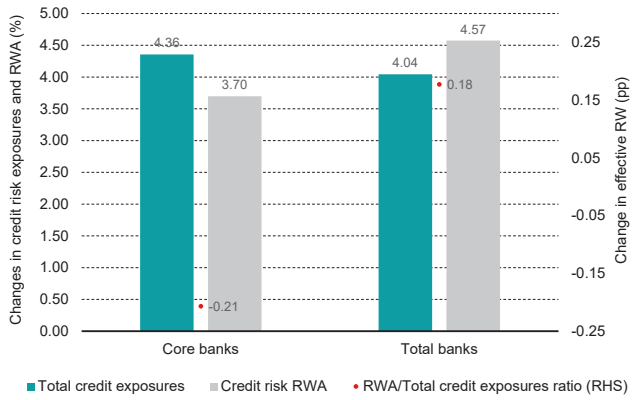


Source: Central Bank of Malta.

Change in RWA for credit risk

Given that credit risk and operational risk are the principal drivers of changes in TREA, a more granular analysis of the underlying factors for both core and total banks, is warranted. In this context, Chart 1c provides a breakdown of the evolution in Credit Risk RWA by examining the changes in total credit exposures, RWA held against Credit Risk, and the resulting effective RW. This comparative view helps to isolate to the extent possible, the impact of portfolio shifts and regulatory adjustments on credit risk metrics from other developments.

Chart 1c
DEC. 2024 TO JUNE 2025 CHANGES IN CREDIT RISK EXPOSURES AND RWA, AND THEIR RATIO
(per cent; percentage points)



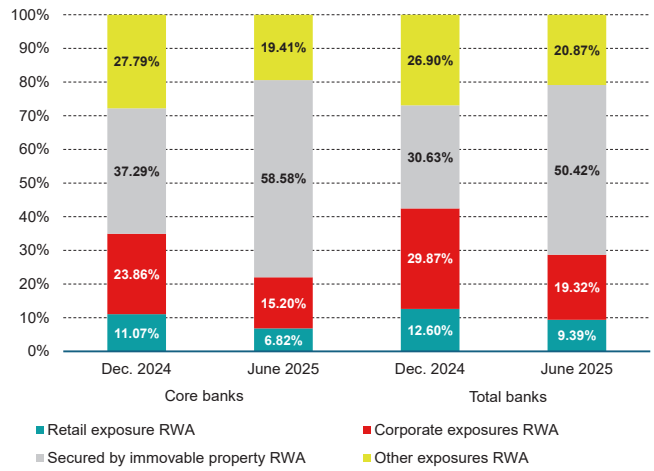
Source: Central Bank of Malta.

As outlined in Chart 1c, while core banks registered a drop of 0.21 percentage points in the effective RW, total banks recorded an increase in 0.18 percentage points.

Figure 1b below goes a step further and provides a detailed breakdown of the evolution in the composition of credit risk across key exposure classes for domestic banks, comparing the regulatory periods prior to and following the implementation of CRR3 (i.e. December 2024 vs. June 2025). This

Figure 1b
DEEP DIVE IN THE EVOLUTION OF CREDIT RISK ACROSS KEY EXPOSURE CLASSES

DEC. 2024-JUNE 2025 SHARES OF CREDIT RWA, BY EXPOSURE TYPE



Core banks
Secured by Immovable property exposure class –

- ⬆ Eur 2.58bln in RWA

Decomposed into:

- ⬆ Eur 1.57bln via assets
- ⬆ Eur 1.01bln via effective RW

Total banks
Secured by Immovable property exposure class –

- ⬆ Eur 3.00bln in RWA

Decomposed into:

- ⬆ Eur 1.79bln via assets
- ⬆ Eur 1.20bln via effective RW

breakdown aims to identify shifts within these exposure classes and uncover the underlying factors driving changes in RWA held against credit risk.[3]

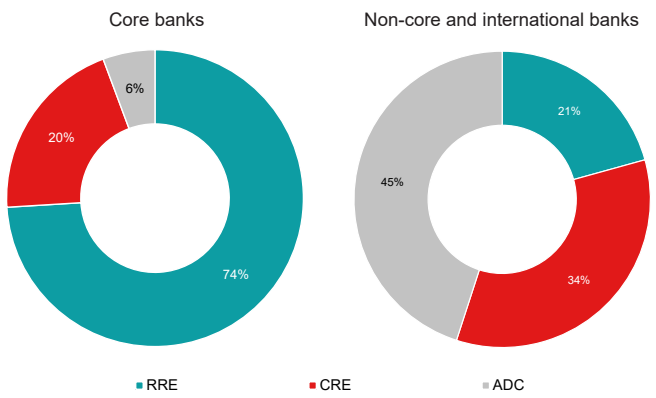
A notable development is the significant increase in the share of risk-weighted exposures classified as *secured by immovable property* (SIP), observed across both core and total banks. This shift is primarily attributable to two factors:

1. **Reclassification of exposures:** The enhanced granularity introduced under CRR3 has led to the reclassification of certain exposures which are now classified under SIP. This includes the classification of exposures previously reported under the *retail and corporate* categories, as well as items classified under the *SIP* new sub-classification of *Land Acquisition, Development, and Construction* (ADC).

2. **Changes in RWs:** CRR3 has also introduced revised RWs for RRE and CRE exposures, as well as a new classification for ADC. For core banks, this has resulted in a higher effective RW for loans secured by immovable property. This is mainly because a significant portion of RRE loans, have loan-to-value (LTV) ratios between 55% and 70%, which now attract RWs of 75% or 100%, (depending on the counterparty), compared to the previous uniform weight of 35%. Similarly, CRE loans with LTVs below 50% now carry a RW of 60%, up from 50%. Moreover, CRR3 has introduced a new exposure category – income producing real estate (IPRE) – which carries significantly higher RWs. Under this classification, RRE exposures may attract RWs of up to 105%, while CRE exposures may be subject to RWs of up to 110%.

   These changes have collectively contributed to an increase in the RWA for the SIP exposure class for core banks by €2.58 billion (see Chart 1d). When considering the entire banking system, this increase rises slightly to €3.00 billion. As illustrated in the pie charts below, the primary factor driving the increase in RWA for non-core and international banks differs from that of core banks. For the former institutions, the inclusion of ADC exposures, which carry a RW of up to 150%, is the main contributor. ADC exposures now account for approximately 45% of total exposures within this class for non-core and international banks. This shift has resulted in a reclassification from the previously assigned exposure class, *'items associated with particularly high risk'*.

Chart 1d
SHARE OF SECURED BY IMMOVABLE PROPERTY EXPOSURES
(per cent)



Source: Central Bank of Malta.

[3] The relative contributions to changes in the effective RW were estimated using a Fisher decomposition which attributes the relative change in RW density to the proportional contributions of changes in RWAs and total assets. This is done by expressing the density as a multiplicative function and isolating each component's effect through log-differentiation.

Table 1a summarises the impact of reclassification of exposures and changes in RWs on the overall RWA pertaining to credit risk for core banks.

Between December 2024, and June 2025, total RWA for credit risk increased modestly from €11.01 billion to €11.41 billion, a net rise of €0.4 billion. This increase was primarily driven by a €0.48 billion positive contribution from asset growth, which more than offset a €0.07 billion negative contribution from declining effective RWs.

A notable shift occurred within the SIP category, where RWA rose significantly from €4.10 billion to €6.69 billion. This increase was supported by both a reallocation of exposures from the retail and corporate segments and a rise in the effective RW for the SIP class. The SIP category alone contributed €1.01 billion via RWs and €1.57 billion via asset growth.

Conversely, the retail and corporate exposure classes experienced declines in RWA, largely due to the above-mentioned asset reallocation. While both categories showed small positive contributions from RWs (+€0.02 billion and +€0.26 billion, respectively), these were outweighed by substantial negative contributions from asset reductions (−€0.46 billion and −€1.15 billion, respectively).

The “Others” category, which accounts for over half of total credit exposures, also saw a decline in RWA – from €3.06 billion to €2.22 billion. This was primarily driven by a significant drop in effective RW (−€0.83 billion), as a result of the shift of ADC exposures (carrying a 150% RW) from the ‘others’ exposure class to the SIP, offsetting the positive contribution of the effective RW in the retail, corporate, and SIP on their corresponding RWA class.

Overall, the observed changes in RWA reflect a combination of compositional shifts and asset reclassifications, particularly the contraction in the ‘others’ category (which consists of over 50% of total credit exposures) and which thus played a key role in the observed change in the system’s aggregate credit risk profile over the period.

Table 1a
EXPOSURE COMPOSITION AND RWA ANALYSIS FOR CORE BANKS – DEC. 2024 VS JUNE 2025

Per cent; EUR billions

	Dec. 2024	June 2025	Dec. 2024	June 2025		
Exposure Class	Share of total credit exposures	Share of total credit exposures	RWA	RWA	Relative contribution from RW[2]	Relative contribution from total assets[2]
Retail	5.0%	3.0%	1.22	0.78	0.02	-0.46
Corporate	9.7%	5.4%	2.63	1.73	0.26	-1.15
SIP[1]	30.3%	39.1%	4.10	6.69	1.01	1.57
Others[3]	55.0%	52.5%	3.06	2.22	-0.83	-0.01
Overall	100.0%	100.0%	11.01	11.41	-0.07	0.48

Source: Central bank of Malta.

[1] SIP is referring to Secured by Immovable Property Exposures

[2] RW Effect and Asset Effect represent the relative contributions (in billions) to the change in RWA based on the Fisher decomposition. Positive values indicate a positive contribution towards the RWA change.

[3] The largely dominant factor in the reduction of effective RW is the reclassification of ADC exposures from the high-risk class (under the 'others' category) to SIP. These carry a 150% RW and in Dec. 2024 had accounted for 28% of the 'others' RWA albeit accounting for only 3% of 'others' assets. Excluding this reclassification, the 'others' category (consisting of over 70% of its exposures with central government and institutions) would have remained with very similar RWA and total assets (given that RWs remained similar) between December 2024 and June 2025.

RWA held against operational risk

As observed above, a decline in RWA for operational risk was observed between December 2024 and June 2025. As outlined earlier, the implementation of CRR3 introduced a new methodology which replaces all previously used approaches.[4]

Under CRR3, a single Standardised Approach is applicable to all institutions. This new framework is based on the Business Indicator Component (BIC), which is computed from financial statement data including interest income, fee income, and trading income.[5] The BIC is then mapped to one of three regulatory buckets, each with a corresponding coefficient:

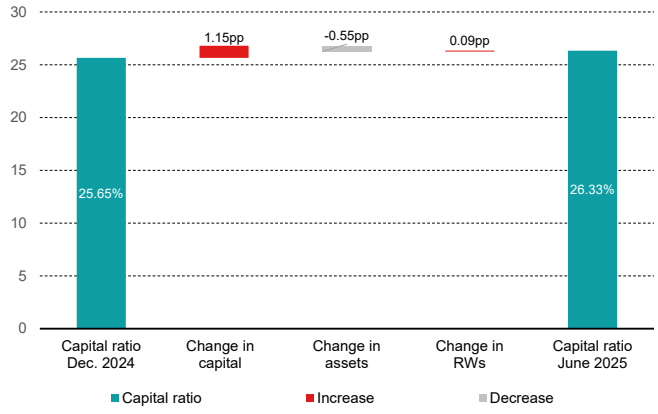
- 12% for BIC ≤ €1 billion
- 15% for BIC between €1 billion and €30 billion
- 18% for BIC > €30 billion

A comparative analysis of data from December 2024 to June 2025 reveals that, despite a 6.28% increase in the sector-wide BIC, the own funds requirement for operational risk fell by 27% over the period. This reflects a dual effect: an 8% increase in RWAs due to the higher indicator base component, offset by a 35% reduction resulting from the lower regulatory coefficient. The majority of banks fell within scope of the 12% bucket, as opposed to their previous position falling within the 15% category. As a result of these developments, operational risk RWAs registered a net decline.

An analysis into the banks' capital ratio

Chart 1e decomposes the sources of change in the capital ratio following the introduction of the new CRR3 provision. This decomposition therefore reflects changes in capital, total assets, and RWs.[6] The biggest contribution stems from the increase in capital, which led to a 1.15 percentage points rise in the capital ratio.[7] Conversely, the growth in total assets exerted downward pressure on the ratio, resulting in a negative contribution of -0.55 percentage points. Lastly, when isolating the effect of changes in RWs – excluding other balance

Chart 1e
CHANGE IN CAPITAL, ASSETS AND RWs IMPACTING BANKS' CAPITAL RATIO – TOTAL BANKING SECTOR
(per cent; percentage points)



Source: Central Bank of Malta.

[4] The previous approaches include: the Basic Indicator Approach (BIA), which applied a flat 15% regulatory coefficient, the Standardised Approach, which segmented activities by business lines with coefficients ranging from 12% to 18%, depending on the associated risk level; the Advanced Measurement Approach (AMA). In Malta, the majority of banks had adopted the BIA, whilst only a few followed the Standardised Approach. To note that under the BIA approach, the relevant indicator comprises of the sum of NII, net fee and commission income, trading result, and other operating income.

[5] Under the BIC approach, the relevant indicator comprises of the three-year average of Interest, lease, and dividend income, Services income and Financial income.

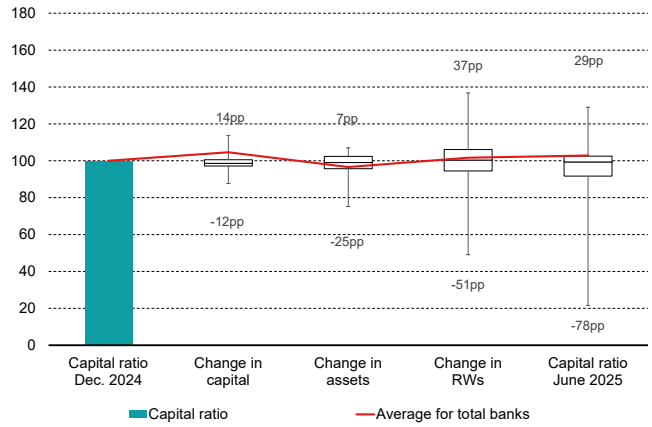
[6] The relative contributions to changes in the capital ratio were estimated using a first-order Taylor expansion, which linearly approximates the capital ratio as a function of capital, total assets, and RWs by computing the partial derivatives with respect to each variable and multiplying them by their respective changes.

[7] Main driver behind the increase in capital is issuance of Tier 2 instruments (in the form of bonds, tier 2 notes and subordinated loan) amounting to 195 million, registering an increase of 36% over December 2024.

sheet movements – these declined slightly, thereby contributing positively to the capital ratio by 0.09 percentage points.

The impact on domestic banks has been heterogenous. As illustrated in Chart 1f, on average, changes in capital contributed positively, with quite a narrow dispersion among banks; however, the impact on RWs was quite varied, indicating substantial differences in risk profile recalibrations. This divergence helps explain the overall neutral impact on RWs for total banks.

Chart 1f
BOX PLOT OF CHANGES TO BANKS' CAPITAL RATIO
(Index: Capital Ratio Dec. 2024=100, percentage points)



Source: Central Bank of Malta.

Banks remain with solid capital buffers

Banks' voluntary capital buffers remained robust, increasing on average by 0.87 percentage points – from 5.90% to 6.77%. This improvement reflects two key drivers: an increase in banks' capital levels and a reduction in overall RWs stemming from changes introduced under CRR3.

Concluding remarks

The implementation of CRR3 has introduced a more granular and risk-sensitive framework for calculating capital requirements, particularly under the Standardised Approach for credit risk, among other topical developments. These refinements are expected to enhance the responsiveness of capital metrics to underlying risk changes and improve comparability across institutions.

The impact of CRR3 has been heterogeneous across banks, reflecting differences in portfolio composition, business models, and exposure to ADC-type lending. Credit risk exposures, particularly exposures under SIP exposure class have nonetheless increased considerably, driven by: (i) reclassification of exposures from the retail and corporate categories to the SIP class; (ii) the introduction of the ADC exposure class, now included within the immovable property category and subject to higher RWs (up to 150%).

This shift, together with the revised RW treatment for real estate exposures under CRR3, has significantly elevated the RWA for the immovable property class, particularly among non-core banks. These developments are relevant for the upcoming extension of the sSyRB, which will be targeting this newly classified category for immovable property.

Even though the RWs within the SIP class have increased and contributed positively to the increase in RWA for its own class, its impact on overall credit risk effective RW has been partly offset by the reclassification of exposures from higher RW exposure classes (namely retail and corporate classes) to those attracting lower RWs. Furthermore, the drop in the effective RW for the "Others" category, which accounts for over half of total credit exposures, helped in offsetting the positive contribution of the effective RW in the retail, corporate, and SIP on their corresponding RWA class, thus leading to a negative effective RW for total credit risk.

Nonetheless, while the overall effective credit RW has declined for core banks and increased slightly for total banks, the overall impact on Maltese banks' capital ratios and voluntary buffers has been muted, with voluntary buffers remaining strong.

From a strategic perspective, the CRR3 amendments are expected to support banks in continuing to maintain adequate capital levels, particularly in the face of emerging sectoral or niche risks. The enhanced risk sensitivity of the framework should enable more timely and targeted supervisory responses, thereby contributing to the overall resilience of the financial system.