EXECUTIVE SUMMARY

Malta's financial sector continued to perform strongly during the first half of 2025, despite a challenging global environment marked by persistent geopolitical tensions. Although Malta's economic growth moderated to 3.1% in the first half of 2025, it still outperformed that of the euro area, largely driven by domestic demand. While euro area inflation continued its downward trajectory, Malta's inflation rate experienced a slight uptick, largely due to rising prices for food and tourism-related services.

In line with euro area trends, the domestic banking system remained resilient, buttressed by ample capital and liquidity buffers. Overall profitability declined, primarily due to reduced net interest income among core domestic banks. At the same time, international banks reported a deterioration in profits, with the foreign branches posting losses, driven by higher non-interest expenses and lower non-interest income. Core domestic banks remained highly profitable, with profitability rates exceeding the EU average. Nonetheless, profitability may moderate further should monetary policy easing continue. Such an effect is expected to be partly mitigated by elevated bond yields, limited pass-through of loan rates, and a persistently low cost of funding. Credit growth remained robust, driven primarily by resident mortgage lending and property-related loans to non-financial corporations. While this supported economic activity, it is also increasing concentration risk within banks' loan books. Nonetheless, asset quality remained sound, with drops in the non-performing loan (NPL) ratio, and adequate provisioning levels. However, increases in Stage 2 loans could signal early signs of potential credit deterioration.

The strong capital and liquidity stance was confirmed via the Bank's stress test results. During the six months under review, the observed NPL ratios for all three loan categories, namely mortgages, non-financial corporates (NFCs) and consumer credit, kept below those projected in end-2024. Liquidity stress tests also confirmed the institutions' resilience across three distinct liquidity metrics, namely persistent deposit withdrawals, liquidity coverage ratios (LCRs) and net stable funding ratios (NSFRs). In addition, interest rate risk assessments showed that upward rate shocks would strengthen capital positions, whereas downward rate scenarios would have only a limited negative impact, keeping all banks comfortably above their capital requirements. These results underscore the continued soundness of the domestic banking system, with some exceptions identified in isolated cases under exceptionally severe conditions.

The non-bank financial sector in Malta recorded moderate growth in the first half of 2025, broadly in line with euro area developments. Life insurers experienced increased demand for products featuring profit participation. However, the positive impact of this demand was partially offset by higher servicing and reinsurance costs. Non-life insurers performed well, particularly in property insurance, supported by efficient underwriting. Investment funds posted marginal growth, mainly driven by fixed-income gains, while equity markets' volatility weighed on performance. Liquidity conditions in both insurance firms and investment funds weakened moderately, largely due to reduced sovereign holdings, though buffers remained robust compared to their respective euro area peers. Profitability improved across the two sectors, driven by stronger underwriting for the non-life insurance sector and higher investment income for life insurers. At the same time investment funds recorded increased interest and dividend income and reductions in operating costs.

The Report also features four boxed articles. Box 1 analyses the impact of the EU's implementation of Capital Requirements Regulation 3 (CRR3) on banks' risk-weighted assets (RWAs). Box 2 introduces a credit risk-based clustering approach for the Maltese banking sector, offering insights into how credit risk interconnectedness could contribute to systemic risk. Box 3 examines payment transactions within Malta's financial system, providing an overview of evolving payment channels and systemic implications. Finally, Box 4 explores the relationship between economic growth and insurance premia, highlighting how macroeconomic trends influence the insurance sector.