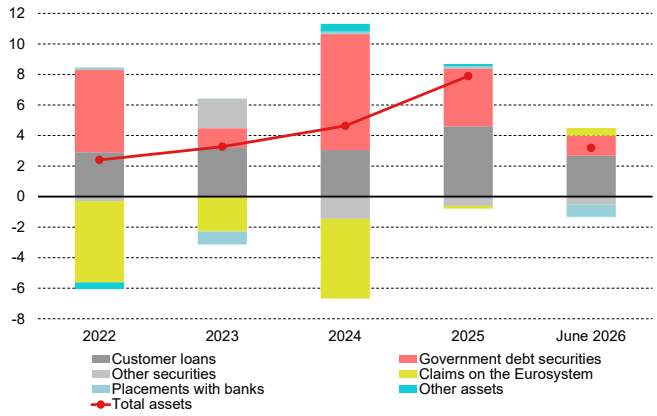
2. DEVELOPMENTS IN THE BANKING SECTOR

2.1 Core domestic banks

The balance sheet of the core domestic banks continued to expand during the first half of 2026, with their total assets increasing by 3.2% and reaching the equivalent of almost 135% of GDP (see Chart 2.1). This category of banks continued to exhibit sound financial fundamentals, supported by sound asset quality, broadly stable profitability, and capital and liquidity buffers that remained well above regulatory requirements despite some moderation during the reviewed period.

Chart 2.1
CONTRIBUTION TO BALANCE SHEET GROWTH – CORE DOMESTIC BANKS
(percentage points)



Source: Central Bank of Malta.

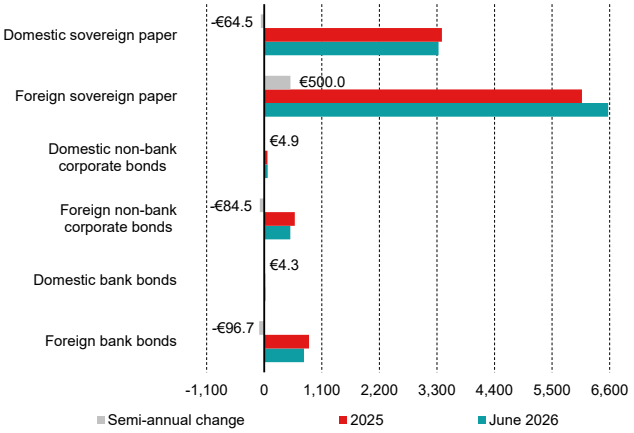
Asset growth was driven primarily by customer lending and higher sovereign bond holdings. In addition, claims on the Eurosystem increased by 7.0%, reversing the declining trend observed in recent years, although these remained limited in terms of their share of total assets. By contrast, interbank placements and non-sovereign debt securities decreased.

2.1.1 Securities portfolio

The core domestic banks' securities portfolio expanded by 2.3% during the first half of 2026, to account for 34.3% of total assets. Growth was driven primarily by debt securities, which increased further by 2.4%, while equity holdings remained relatively stable at a share of just 1.4% of these banks' balance sheets.

The increase in debt securities reflected higher holdings of foreign sovereign paper, which rose by 8.2%. These holdings accounted for 58.4% of overall debt securities (see Chart 2.2). Exposures remained concentrated in other European jurisdictions, with the increase mostly driven by exposures to France, Austria and the Netherlands, among others. By contrast, holdings of domestic sovereign paper declined by 1.9%, although these continued to account for almost 30% of total debt securities. Moreover, the latest decline reflects concentrated portfolio adjustments rather than a broad-based reduction across the banking sector. Collectively, sovereign securities increased their share from 86.2% to 88.0%. The continued preference for sovereign bonds may reflect their role in meeting liquidity management needs and regulatory requirements, as well as the relatively attractive risk-return characteristics of certain sovereign securities. Together, the bonds of foreign banks and corporates accounted for around 11% of total debt securities held by core domestic banks.

Chart 2.2
BOND PORTFOLIO – CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

Meanwhile, holdings of domestic bank and corporate bonds increased, although they continued to represent only a small share of the overall portfolio. Corporate bond exposures were concentrated in transportation firms, oil and gas producers and beverage companies.

The credit profile of the securities portfolio deteriorated slightly, although investment-grade assets continued to account for the large majority of holdings, consistent with the historical investment profile of core domestic banks. Low-rated debt securities rose by 27.8%, with their share increasing by 1.0 percentage point to 4.8% in June 2026.[1] Meanwhile, medium and high-rated bonds also increased, albeit to a lesser extent, up by 1.9% and 0.7%, respectively. Although the shares of medium and high-rated bonds declined slightly, these continued to account for the bulk of the bond portfolio, representing 56.1% and 37.9%, respectively. In addition, unrated and speculative bonds fell by 3.0% and represented only 1.2% of the bond portfolio.

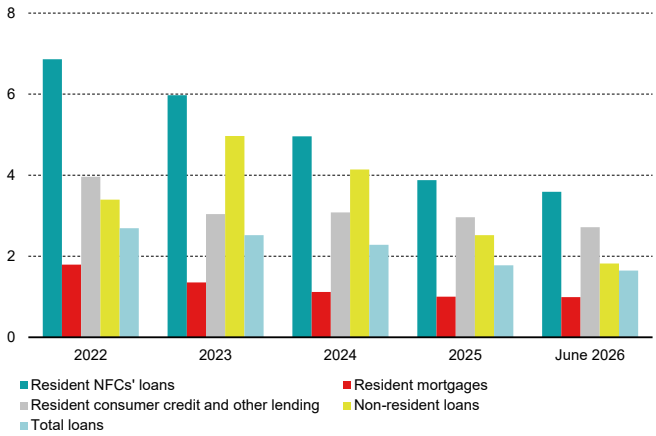
2.1.2 Loan portfolio

The customer loan book continued to expand during the first half of 2026, growing by 5.3% and accounting for just over half of these banks' balance sheets. Growth stemmed almost entirely from resident lending, which rose by 5.3% and represented around 97% of the customer loan book, while non-resident lending remained limited despite increasing by 5.5%.

The increase in resident lending extended beyond mortgage and property-related activities, although these remained the principal drivers of loan growth. Mortgages increased by 5.0% in the first half of the year, accounting for 56.4% of outstanding resident customer loans. Resident NFC lending also expanded strongly, up by 5.7%, with property-related activities accounting for just over three-quarters of this increase.[2] As a result, property-related NFC lending represented 54.8% of resident NFC loans by June 2026. Credit to other corporate sectors also strengthened, including wholesale and retail trade, as well as the non-bank financial sector. Resident consumer credit and other household lending likewise increased by 3.8%, largely reflecting loans granted to purchase goods and services.

Taken together, households and NFCs continued to underpin the expansion in core domestic banks' credit, accounting for over 93% of outstanding resident lending. The sustained pace and broader sectoral distribution of credit growth may contribute to a build-up of cyclical vulnerabilities over time. At the same time, the concentration of lending in mortgage and property-related NFC lending warrants continued monitoring as it could amplify the impact of adverse developments in the property market or a broader deterioration in domestic economic conditions.

Chart 2.3
NPL RATIOS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

2.1.3 Credit quality

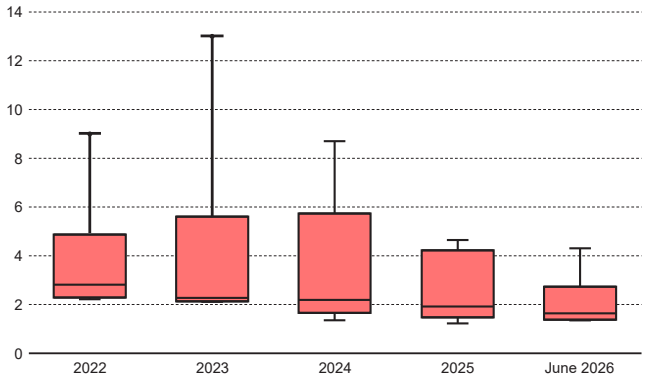
Asset quality continued to improve during the first half of 2026, with the overall NPL ratio edging further downwards by 0.1 percentage point to 1.6%. This reflected both a continued expansion in lending and a 3.7% reduction in the stock of NPLs (see Chart 2.3). The improvement was also evident across institutions, with the median NPL ratio declining

[1] Investment-grade bonds rated AA- or higher are classified as high-rated, those rated A- to A+ as medium-rated, while those rated BBB- to BBB+ as low-rated.

[2] Property-related NFC sectors refer to firms operating in construction and real estate activities, as well as accommodation and food services activities.

further and the interquartile range narrowing slightly, indicating greater convergence among banks at comparatively low NPL ratios (see Chart 2.4). Excluding Eurosystem placements, the NPL ratio also decreased by 0.2 percentage points to 1.9%.

Chart 2.4
OVERALL NPL RATIO – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.
Note: The central line within each box represents the median NPL ratio, while the lower and upper edges of the box correspond to the 25th and 75th percentiles, respectively. The whiskers extend to the minimum and maximum values observed in the distribution.

The decline in NPLs was observed across most borrower segments, although the largest contribution stemmed from non-resident exposures. Non-residents' NPLs declined by more than one third, lowering the corresponding NPL ratio from 2.5% in 2025 to 1.8% in June 2026. This mainly reflected the absence of NPLs among non-bank financial entities, together with an improvement in household NPLs, particularly within the mortgage segment.

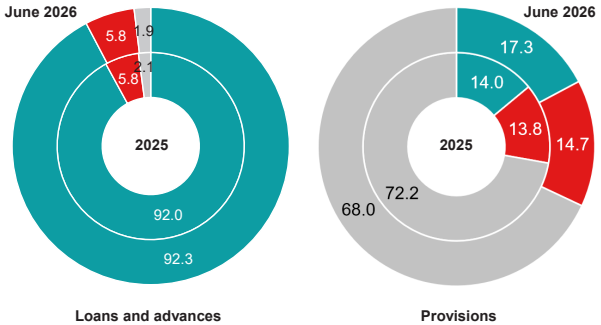
The resident NPL ratio declined marginally to 1.6%, reflecting improvements across all major loan categories. The most pronounced reduction was again recorded among non-bank financial entities, with their NPL ratio declining from 0.5% in 2025 to 0.2% following a substantial reduction in NPLs. Resident NFC NPLs also declined, resulting in a 0.3 percentage point reduction in the corresponding NPL ratio, to 3.6%. This improvement was driven primarily by firms operating in the construction and real estate sectors, followed by the health and social work sector. Nevertheless, non-performing corporate exposures remained concentrated in the construction and real estate sectors, and the accommodation and food services sector, reflecting their significant share within the overall NFC loan portfolio. Collectively, the NPL ratio of these sectors declined by 0.6 percentage points to 3.7%.

Asset quality also improved within the resident household segment. Consumer credit NPLs declined, reducing the corresponding NPL ratio by 0.2 percentage points to 2.7%. Although mortgage NPLs increased by 3.5%, growth in mortgage lending was faster, and reduced the corresponding NPL ratio to just 1.0%.

The reduction in NPLs was mirrored by a decline in Stage 3 loans. By contrast, Stage 2 loans increased by 4.2%, reflecting developments within the NFC portfolio. However, their share in total lending remained unchanged at 5.8%, as Stage 1 loans also expanded (see Chart 2.5).

Overall provisions declined by 2.7%, reflecting lower Stage 3 provisioning, partly offset by higher provisions for Stage 1 and Stage 2 loans. Nevertheless, the coverage ratio improved slightly, increasing by 0.5 percentage points to 46.8%, supported by the substantial reduction in NPLs.

Chart 2.5
STAGE ALLOCATION OF LOANS AND ADVANCES AND PROVISIONS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

Forborne loans contracted further, down by 4.9% in the first six months of 2026. This reflected lower non-performing exposures subject to forbearance measures. As a result, the overall forbearance ratio declined by 0.2 percentage point to just 1.8% in June 2026, consistent with the generally sound asset quality observed across this segment of banks.

2.1.4 Funding and liquidity

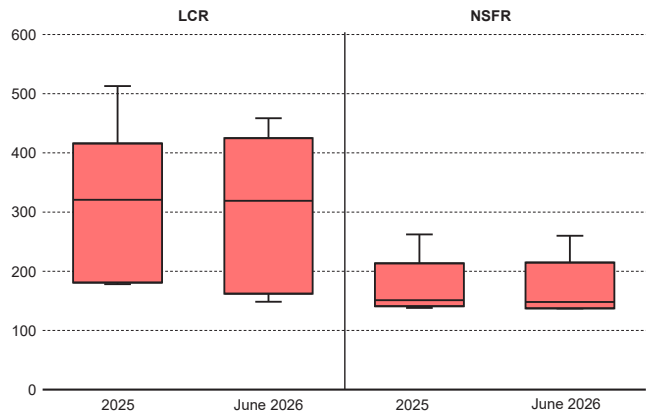
Customer deposits, which financed over 80% of these banks' balance sheets, expanded by 2.2%. The increase was entirely attributable to resident customers, whose deposits grew by 2.4% compared with December 2025, while non-resident deposits contracted by 1.0%. Within the resident segment, households continued to account for the largest share of deposit growth, increasing by 3.5% and representing almost three-quarters of total resident customer deposits. Resident NFC deposits also increased, albeit modestly, rising by 0.5%, largely driven by firms operating in the wholesale and retail trade, and construction and real estate sectors. As customer lending grew faster than deposits, the customer loans-to-deposits ratio increased by 1.8 percentage points to 62.1%. Nevertheless, it remained substantially below the euro area average of 106.3%, highlighting these banks' continued reliance on customer deposits as their primary source of funding.[3]

The decline in the remuneration offered on time deposits may have reduced their relative attractiveness, with the weighted average interest rate (WAIR) falling from 1.9% in December 2025 to 1.7% in June 2026. Consequently, time deposits fell by 2.5%, driven mainly by household deposits with maturities of up to six months, while demand and savings deposits increased by 2.9%. These developments suggest some reallocation in depositors' preferences towards more liquid deposit products amid lower returns on time deposits. Consequently, demand and savings deposits represented 87.3% of total deposits by mid-2026.

Alternative funding sources, including wholesale and Eurosystem funding, continued to represent only a marginal share of total liabilities. During the first half of 2026, the liquidity coverage ratio (LCR) declined by 5.9 percentage points to 369%, while remaining comfortably above the regulatory minimum. The drop primarily reflected a more pronounced rise in net liquidity outflows than in high-quality liquid assets (HQLA). At the same time, HQLA rose by 3.1%, mainly driven by higher sovereign bond holdings and central bank reserves. The net stable funding ratio (NSFR) also continued to signal a robust long-term funding position, standing at 186.8%, marginally below the 188.3% recorded in December 2025.

The distribution of liquidity ratios across banks continued to point to a comfortable liquidity position. The LCR remained characterised by a high median level but a relatively wide interquartile range, indicating some variation in liquidity buffers across individual banks, despite all banks remaining above the regulatory threshold (see Chart 2.6). By contrast, the NSFR displayed lower dispersion, suggesting broadly similar funding structures and stable funding positions across these banks.

Chart 2.6
LIQUIDITY RATIOS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.
Note: The minimum requirement of LCR and NSFR ratios is 100%.

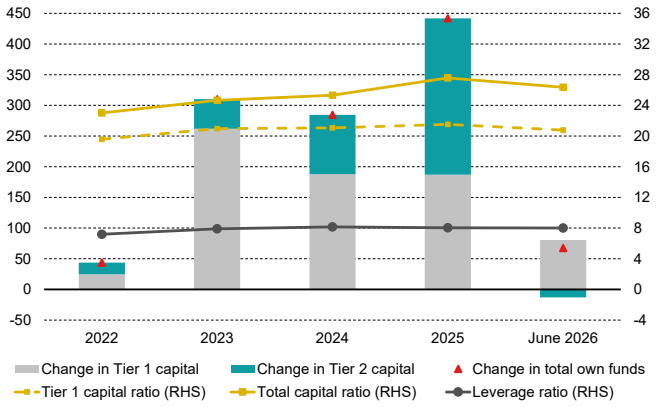
2.1.5 Capital and leverage

The capital position of core domestic banks remained strong, with the total capital ratio standing at

[3] Source: EBA Risk Dashboard 2026Q2.

26.3%, despite decreasing by 1.3 percentage points compared with end-2025 (see Chart 2.7). This decline reflected growth in RWA, which outpaced the increase in own funds. RWA increased by 6.7%, driven primarily by credit risk exposures, which accounted for 90.5% of total RWA. This partly reflected continued growth in customer lending, including to NFCs operating in property-related activities. Market risk exposures also increased, although they continued to account for only 0.1% of total RWA, while operational risk exposures declined slightly. Consequently, the ratio of RWA to total assets increased by 1.3 percentage points to 40.1% in June 2026, indicating a modest rise in the overall risk intensity of the banks' balance sheets.

Chart 2.7
CHANGE IN TOTAL OWN FUNDS, CAPITAL AND LEVERAGE RATIO – CORE DOMESTIC BANKS
(EUR millions; per cent)



Source: Central Bank of Malta.

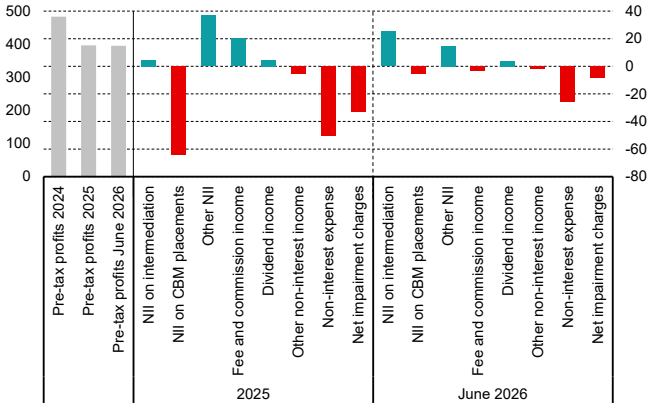
Meanwhile, own funds increased by 1.9%, supported mainly by higher retained earnings, although this was partly offset by a decline in Tier 2 capital. Concurrently, the leverage ratio remained stable at 8.0%, comfortably above the minimum regulatory requirement, providing additional comfort regarding the banks' capacity to absorb potential losses.

2.1.6 Profitability

Profitability remained broadly stable in the first half of the year, as a modest increase in NII was largely offset by higher operating costs, resulting in a marginal 0.3% decline in pre-tax profits.[4] Post-tax return on equity (ROE) dropped slightly to 8.7% whilst ROA remained broadly unchanged at 0.8% in June 2026. While ROE remained below the euro area average of 11.3%, the ROA was in line with that of other euro area banks.[5]

NII increased by 4.9% and continued to account for more than three-quarters of gross income. Growth was largely driven by higher NII from intermediation activities, which increased by around 5%, supported by continued expansion in mortgage lending volumes as the related WAIR remained unchanged at 2.4%. NII from other components also increased by about 8%, reflecting higher sovereign bond holdings and the still elevated yield environment (see Chart 2.8). By contrast, NII from Eurosystem placements declined by 11.3%, driven

Chart 2.8
MAIN CONTRIBUTORS TO PROFITS – CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.
Note: Grey bars indicate pre-tax profits in absolute amounts. Teal (positive) and red (negative) bars indicate annual and semi-annual changes in profit components.

[4] Pre-tax profits refer to a four-quarter moving sum of the reported quarterly flows.
[5] See footnote 3.

by the lower average deposit facility rate in the first half of 2026 compared with the corresponding period of 2025.

Meanwhile, operating expenses increased by 4.8%, largely reflecting higher staff and other administrative costs, particularly those related to information technology, advertising, marketing and communication. In addition, reversals of net impairment charges were lower than those recorded at end-2025. Non-interest income declined marginally by 0.5%, as lower fee and commission income, weaker trading income, non-trading losses, and reduced foreign exchange income exceeded the increase in dividend income.

As operating costs grew slightly faster than gross income, cost efficiency weakened during the review period. Consequently, the operating cost-to-income ratio increased by 0.7 percentage points to 58.9% in June 2026, remaining above the euro area average of 51.5%.[6]

2.1.7 Risk outlook

Looking ahead, core domestic banks' profitability is expected to remain supported by balance sheet growth and income from intermediation activities, particularly if lending growth continues to be underpinned by favourable property market conditions. However, rising operating expenses may weigh on earnings and partly offset these positive developments.

While asset quality remains sound, the increase in Stage 2 loans warrants continued monitoring, particularly in an environment characterised by heightened geopolitical uncertainty, trade tensions and energy market volatility. These developments could affect external demand, supply chains and firms' operating costs, with possible implications for debt-servicing capacity and banks' credit risk.

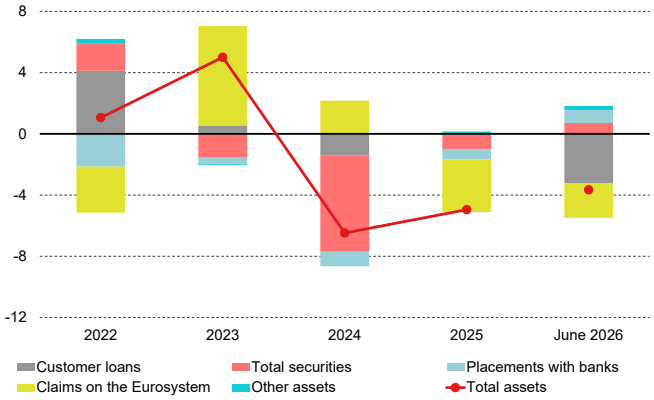
At the same time, the strong pace of credit growth, together with the continued broadening of lending across sectors warrants close monitoring. While asset-quality indicators remained sound, these developments could contribute to the emergence of cyclical vulnerabilities over time. The sector's continued concentration in mortgage and property-related lending remains another structural feature requiring continued attention.

Nevertheless, stress-test exercises conducted by the Bank indicate that core domestic banks have adequate capacity to absorb the shocks considered under the respective scenarios, supported by strong capital buffers, ample liquidity and sound asset quality.

2.2 Non-core domestic banks

The balance sheet of the non-core domestic banks, which has been contracting for the past three years, fell by 3.7% during the first half of 2026, with total assets standing at €3.1 billion, equivalent to around 12% of GDP. This reduction reflected lower customer lending and reduced placements with the Eurosystem, partly offset by increases in inter-bank claims, securities holdings and other assets (see Chart 2.9).[7] Notwithstanding the contraction in business volumes, this category of banks maintained strong capital and liquidity buffers, while profitability strengthened and asset quality remained broadly stable.

Chart 2.9
CONTRIBUTION TO ASSETS GROWTH – NON-CORE DOMESTIC BANKS
(percentage points)



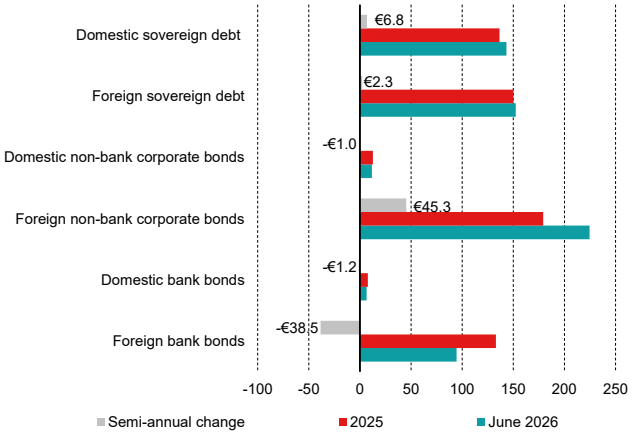
Source: Central Bank of Malta.
Note: June 2026 figures refer to growth over end 2025.

[6] See footnote 3.
[7] Increase in other assets mainly reflected cash in transit, receivables and customer suspense accounts, although these continued to represent a relatively small share of the overall balance sheet.

2.2.1 Securities portfolio

Non-core domestic banks' total securities portfolio grew by 2.9% during the first half of 2026, accounting for 26.4% of total assets. Growth was driven by increases in both debt securities and equities. Debt securities increased by 2.2% and continued to represent the largest component of these banks' securities portfolio, accounting for almost 78% of holdings. The increase in debt securities was primarily driven by a 25% rise in foreign corporate bond holdings, mainly comprising securities issued by investment companies (see Chart 2.10). As a result, the share of non-bank corporate bonds in the debt securities portfolio rose by 6.3 percentage points to 37.3%. Holdings of sovereign paper also contributed positively, increasing by 3.2%, and remained the largest component of the debt securities portfolio. By contrast, holdings of bank bonds, predominantly issued by foreign institutions, declined by around 28%, reducing their share of total debt securities by 6.8 percentage points to 16.0%.

Chart 2.10
BOND PORTFOLIO – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

These changes in the bond portfolio composition were accompanied by some weakening in the credit quality profile of their debt securities holdings. High-rated debt securities contracted by almost a fifth, largely reflecting a reduction in foreign government bond holdings, with the decline concentrated in a single bank. As a result, the share of highly rated securities in total debt securities fell from 27.5% in December 2025 to 21.9% in June 2026. Medium-rated bonds rose modestly by 1.7%, with high and medium-rated bonds together continuing to account for almost three-quarters of the portfolio. In contrast, the share of low-rated bonds declined to 4.6% of the overall debt securities portfolio, while the combined share of speculative-grade and unrated securities increased from 16.2% to 22.4%. Taken together, the increase in foreign corporate bond holdings, particularly speculative-grade and unrated instruments, alongside lower Eurosystem placements, is consistent with a reallocation towards higher-yielding assets during the review period.

Equity holdings increased by 5.3%, bringing their share of the overall securities portfolio to around 22%. This growth was mainly driven by one bank's direct equity investments in subsidiaries, with such investments accounting for around 96% of the total equity exposures.

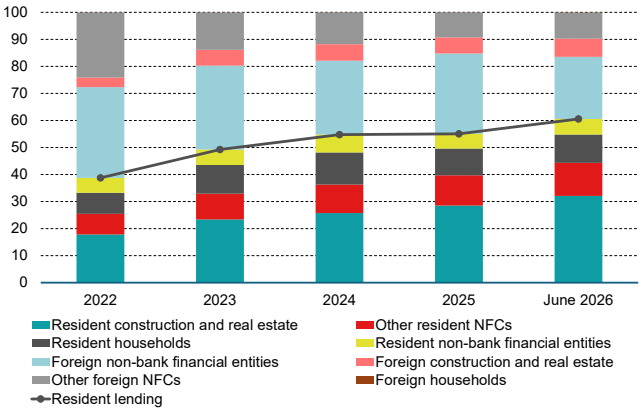
2.2.2 Loan portfolio

The customer loan portfolio of these banks contracted further in the first half of the year, driven entirely by a 19.1% decline in non-resident lending. This decline was driven by one bank, while the remaining banks collectively reported an increase. This primarily reflected a 28.8% reduction in lending extended to foreign non-bank financial entities. Lending to foreign NFCs also edged down mainly owing to lower exposures to the public administration and defence sector and, to a lesser extent, the manufacturing sector and the professional, scientific and technical activities sector. The drop was partly offset by higher loans for the wholesale and retail trade sector.

By contrast, resident customer loans increased by 1.3%, raising their share of total customer loans by 5.5 percentage points to 60.6% (see Chart 2.11). Nevertheless, these banks continued to have a limited presence in the domestic retail market, with their lending to residents accounting for just 4.0% of total resident customer

loans. The increase was entirely driven by lending to NFCs, particularly those operating in the construction and real estate sectors, which together accounted for more than half of total resident lending by these banks. This highlights the continued importance of property-related sectors within these banks' domestic lending portfolios, while also contributing to concentration risk in their loan portfolios. Meanwhile, lending to resident households and non-bank financial entities declined by 2.9% and 2.2%, respectively.

Chart 2.11
DISTRIBUTION OF RESIDENT LOANS AND NON-RESIDENT LOANS – NON-CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

2.2.3 Credit quality

The quality of these banks' loan portfolio remained broadly sound, with the NPL ratio unchanged at 1.3% in June 2026. Excluding Eurosystem placements, however, the NPL ratio edged up to 2.2% from 2.1% in December 2025, reflecting a sharper decline in loans and advances than in NPLs, which fell by 3.4% over the period.

Developments across borrower segments were mixed. The household NPL ratio rose by 0.4 percentage points to 1.1%, reflecting weaker credit performance within the mortgage portfolio. More specifically, the overall mortgage NPL ratio increased from 1.4% in December 2025 to 2.7% in June 2026, driven mainly by developments in the resident mortgage portfolio of one bank. While resident mortgages declined by 3.3%, the associated NPLs rose substantially, partly reflecting the relatively small size of the underlying portfolio. By contrast, the overall NFC NPL ratio improved by 0.2 percentage points to 3.5%. This reflected strong lending growth to NFCs, which more than offset the rise in NPLs among resident NFCs, notably those operating in real estate activities. In contrast, NPLs among NBFIs fell by more than half, contributing to the overall decline in NPLs.

The reduction in NPLs translated into a decline in Stage 3 loans, which fell by 3.5% to account for just 2.1% of total loans. By contrast, Stage 2 loans increased by more than a third, particularly from NFC exposures, raising their share to 6.4%. This points to some deterioration in forward-looking credit risk assessments despite the continued low level of NPLs.

In line with lower NPLs, provisions declined by almost 10% in the first half of the year, largely reflecting lower Stage 3 provisioning. Consequently, the share of Stage 3 provisions in overall provisions fell by 2.4 percentage points to 64.4%. Stage 2 provisions also declined, accounting for 16.4% of total provisions, while Stage 1 provisions increased by 6.9%, raising their share to 19.2%. As provisions fell more rapidly than NPLs, the coverage ratio declined by 5.5 percentage points to 76.1% in June 2026.

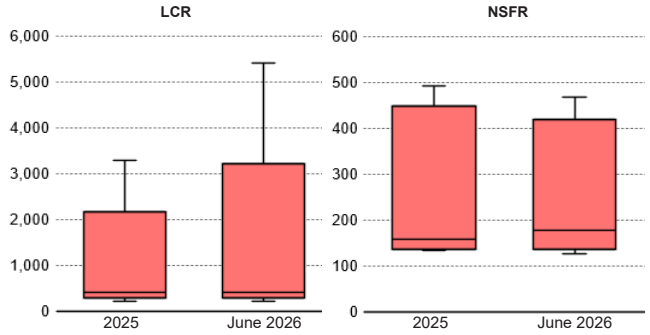
The forbearance ratio increased from 1.9% in December 2025 to 2.2% in June 2026. This rise was entirely attributable to higher performing exposures subject to forbearance measures, which accounted for 70.1% of all forborne loans.

2.2.4 Funding and liquidity

In line with the contraction in the non-core domestic banks' balance sheets, customer deposits declined by almost 6%, albeit still financing just over three-quarters of total assets. This drop was driven mainly by a 9.1% decline in non-resident deposits, partially reflecting lower deposits sourced through online platforms. The overall decline stemmed primarily from lower savings deposits, although term deposits also declined, albeit to a much lower extent.

Resident customer deposits also edged down by 0.9%, largely reflecting lower deposits held by private NFCs. This was partly offset by a 5.7% increase in household deposits, which accounted for around 54% of resident customer deposits. The decrease in resident deposits was driven by time deposits, as withdrawable on-demand deposits increased. Although interest rates on deposits declined, they remained above those offered by core domestic banks. Despite the contraction in resident deposits, their share in total customer deposits increased by 2.1 percentage points to almost 42%, reflecting the larger drop in non-resident deposits. Nevertheless, resident deposits held with non-core banks accounted for only 3.5% of the total resident customer deposits across the domestic banking system.

Chart 2.12
LIQUIDITY RATIOS – NON-CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.
Note: The minimum requirement of LCR and NSFR ratios is 100%. Merkanti Bank Ltd was excluded from the LCR chart, as it is currently in the process of surrendering its licence.The central line within each box represents the median LCR and NSFR ratios, while the lower and upper edges of the box correspond to the 25th and 75th percentiles, respectively. The whiskers extend to the minimum and maximum values observed in the distribution.

Interbank funding declined by 4.8%, with its share of total assets standing at just 2.9%. By contrast, Eurosystem funding rose by 1.6%, reflecting higher participation in MROs, and three-month longer-term refinancing operations (LTROs), although it remained limited at 2.3% of total assets by end-June 2026.

The liquidity position strengthened during the first half of 2026, with the LCR increasing to 402.4%. The ratio remained substantially above the regulatory minimum, with even the lowest reported ratio standing at a comfortable level of around 220%, despite considerable variation across institutions (see Chart 2.12). This improvement was primarily driven by lower net liquidity outflows, partly offset by a 7.1% decline in HQLA, reflecting lower holdings of withdrawable central bank reserves and other central bank assets. Meanwhile, the NSFR declined by 3.0 percentage points to 169.4%. Despite this moderation, all institutions remained comfortably above regulatory requirements, with ratios ranging between 125.4% and 466.9%.

2.2.5 Capital and leverage

Total own funds decreased by 1.3%, reflecting a reduction in Tier 1 capital primarily due to lower accumulated other comprehensive income, and lower retained earnings. Meanwhile, RWAs fell by 0.2%, in part reflecting the winding down of operations at one bank. The drop in RWA mainly reflected lower operational risk exposures, which accounted for 8.3% of total RWA in June 2026. Credit risk exposures also fell marginally by 0.1%, although they continued to represent the vast majority of RWA at 89.5%.

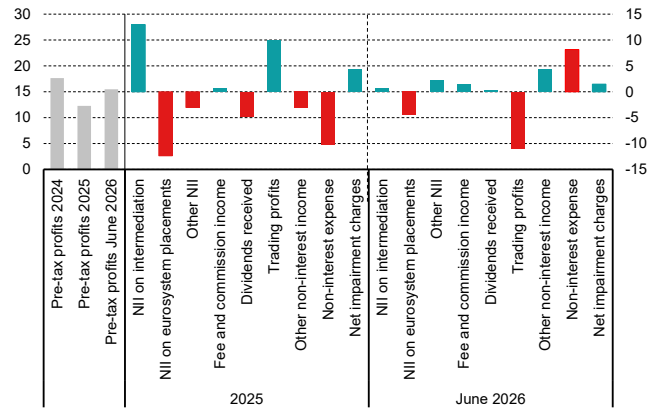
As a result of the decline in own funds, both the total capital ratio and the Tier 1 capital ratio edged down, while remaining at comfortable levels of 22.2% and 19.9%, respectively. Meanwhile, the ratio of RWA to total assets increased by 2.0 percentage points to 60.9%, mainly reflecting the contraction in overall assets. The leverage ratio improved to 11.6%, well above regulatory requirements and indicating substantial capacity to absorb potential losses.

2.2.6 Profitability

On a four-quarter moving-sum basis, pre-tax profits increased by more than a quarter between December 2025 and June 2026. As a result, post-tax ROE and ROA stood at 1.7% and 0.2%, respectively. This improvement was driven primarily by a 10.7% drop in non-interest expenses, particularly operating expenses, following

one-off currency revaluation losses reported in 2025 (see Chart 2.13). In addition, net impairment charges declined considerably during the review period.

Chart 2.13
MAIN CONTRIBUTORS TO PROFITS – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.
Note: Grey bars indicate pre-tax profits in absolute amounts. Teal (positive) and red (negative) bars indicate annual and semi-annual changes in profit components.

These favourable developments were partly offset by a 7.1% decline in gross income. This mainly reflected a 16.9% reduction in non-interest income, driven by trading losses. NII also contracted by 2.6%, although its share of total gross income rose by 3.4 percentage points to 71.6%. The decline in NII was entirely driven by lower income earned on Eurosystem placements, which fell by 22.3%, owing to a reduction in such holdings. By contrast, income from other interest-generating activities increased. NII from intermediation activities increased by 2.1%, as interest expenses on customer deposits, particularly those held by households and NFCs, declined at a faster pace than interest income on loans. This largely reflected lower deposit volumes and liability repricing at lower interest rates, which reduced funding costs more than the decline in interest income associated with lower non-resident lending. Other NII also increased by 30.5%, supported by higher debt securities holdings and still elevated bond yields, with part of the increase associated with unrated instruments.

Against this backdrop, operating costs declined more rapidly than income, resulting in improved cost efficiency. Consequently, the cost-to-income ratio fell by 3.3 percentage points to 81.0% in June 2026.

2.2.7 Risk outlook

The outlook for non-core domestic banks remains challenging, reflecting elevated global economic uncertainty and the characteristics of their specific business models. The continued contraction in balance sheets, alongside lower customer lending, deposits and Eurosystem placements, suggests that pressures on business volumes may persist over the period ahead.

While credit quality indicators remain broadly favourable, developments in some indicators warrant continued monitoring. In particular, the increase in Stage 2 loans, the decline in the coverage ratio and the higher forbearance ratio point to some weakening in selected credit risk metrics, despite the NPL ratio remaining low. In addition, the growing exposure to resident borrowers within the construction and real estate sectors could increase impairment risks should economic conditions weaken or borrowers' repayment capacity come under pressure.

Market and concentration risks may have risen, reflecting the shift towards foreign corporate bonds and the greater share of speculative and unrated securities within investment portfolios. These developments occurred against a backdrop of heightened market volatility and increased uncertainty surrounding the global economic outlook, which could increase the sensitivity of lower-rated and unrated debt securities to adverse market repricing.

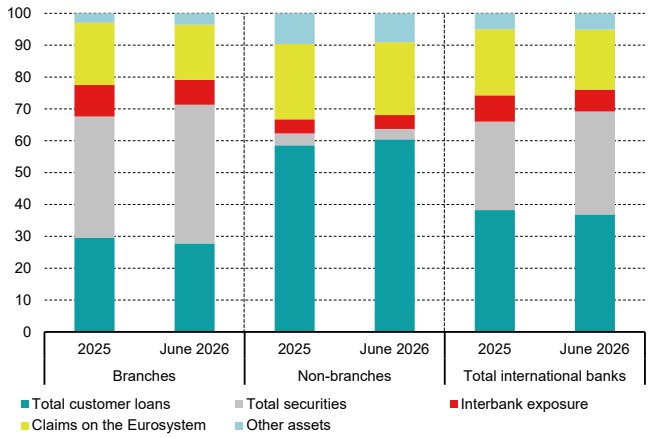
Overall, the non-core domestic banks remain resilient, supported by sound capital and liquidity positions. However, while profitability improved, earnings remain relatively modest and continue to be supported partly by lower operating costs and impairment charges. Looking ahead, profitability may face headwinds from lower gross income and potentially volatile trading income. Consequently, the sector's outlook remains subject to

downside risks, particularly if economic conditions deteriorate or geopolitical uncertainty intensifies.

2.3. International banks

International banks' balance sheets expanded by 10.6% in the first half of 2026, reversing the contraction recorded in the previous year. As a result, these banks' total assets increased to about 49.4% of GDP. Growth was mainly driven by the branches of foreign banks, which recorded a 14.2% increase in total assets, compared to a more modest growth rate of 2.1% among the non-branches. Despite this expansion, the sector continued to exhibit strong capital and liquidity positions, supported by improving profitability and sound asset quality.

Chart 2.14
COMPOSITION OF ASSETS – INTERNATIONAL BANKS
(per cent)



Source: Central Bank of Malta.

The increase in assets stemmed predominantly from higher debt securities holdings, particularly Turkish sovereign bonds held by the branches, which continued to offer attractive yields amid Turkey's elevated inflation and interest rates. Customer loans also rose, albeit at a more moderate pace than total assets, resulting in a lower share (see Chart 2.14). At the same time, placements with the Eurosystem remained broadly stable, while interbank exposures declined, reflecting lower holdings by branches.

2.3.1 The securities portfolio

The securities portfolio of international banks increased by more than a quarter over the first six months of 2026, raising its share of total assets to almost one-third. This growth remained largely driven by branches, whose securities holdings increased to 43.5% of total assets, up by 5.4 percentage points from end 2025. By contrast, the share held by non-branches declined to just 3.3%, mainly reflecting lower investment in debt securities, and, to lower extent, equity holdings.

Foreign government bonds remained the dominant asset class in the securities portfolio, accounting for 86.7% of total securities holdings, compared with 85.5% in 2025. This mainly reflected further investments in Turkish sovereign bonds by branches, which continued to offer comparatively high returns. Holdings of bonds issued by foreign non-bank corporates also rose markedly, up by more than three-quarters, with the expansion exclusively driven by branches. These securities were primarily issued by diversified financial companies and, to a lesser extent, investment companies.[8] By contrast, holdings of MFI bonds grew by a more moderate 3.9%, accounting for 8.5% of the overall securities portfolio. Meanwhile, holdings of Malta Government Stocks (MGSs), which were held exclusively by non-branches, remained broadly unchanged and continued to represent only a marginal share of the portfolio.

The bond portfolio remained heavily concentrated in unrated and speculative-grade investments, largely reflecting the branches' sizable exposure to Turkish sovereign securities. The remainder was invested in medium-rated bonds, held exclusively by the non-branches. The non-performing securities ratio stood at 0.8%, marginally lower than the 0.9% six months earlier.

2.3.2 Loan portfolio

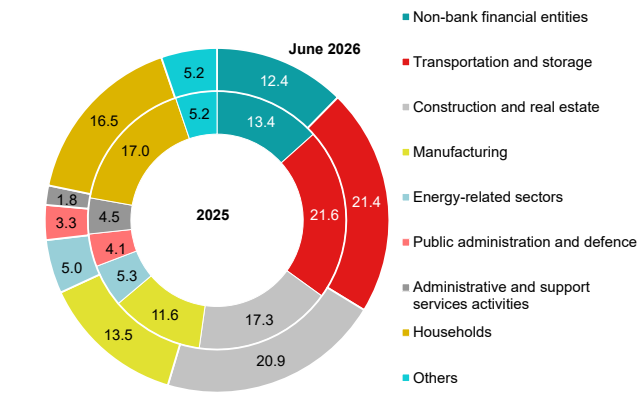
In the six months to June 2026, the customer loan portfolio of international banks expanded by 6.6%, to account for 36.9% of their total assets. Growth was recorded across both the branches and non-branches,

[8] Diversified financial companies refer to NBFIs engaged in a range of financial activities, such as investment management, financing, leasing and other financial services.

with lending increasing by 7.6% and 5.4%, respectively.

NFC lending remained the main driver of customer loan growth, accounting for almost 95% of the overall increase in customer loans. Lending to NFCs grew by 8.9%, raising their share in total customer loans to 71.1%. Growth was concentrated in the construction and real estate, manufacturing, as well as the transportation and storage sectors. Higher loans in these sectors offset declines in others, particularly in the sector comprising administrative and support service activities (see Chart 2.15). Consumer credit rose by 3.4% on the back of higher lending by the non-branches and accounted for 16.5% of total customer loans. By contrast, lending to non-bank financial entities declined by 1.6%, as lower lending by branches outweighed the increase recorded by the non-branches.

Chart 2.15
CUSTOMER LOANS BY SECTOR – INTERNATIONAL BANKS
(per cent)



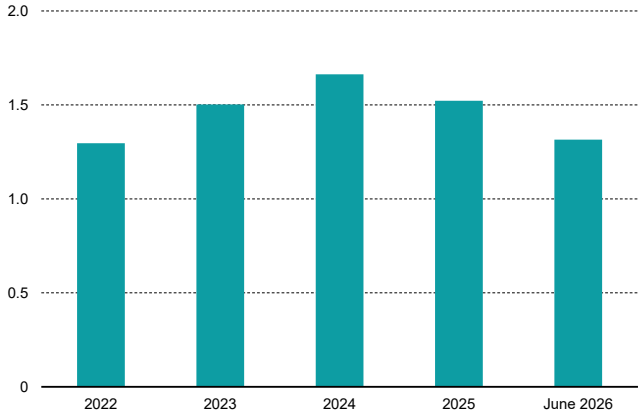
Source: Central Bank of Malta.

Interbank placements contracted by 7.8%, reducing their share to 6.9% of total assets in June 2026. This decline was exclusively attributable to branches and mainly reflected a sharp reduction in placements with related banks, which fell by almost two-thirds. Consequently, the share of related bank exposures in overall interbank placements declined to 19.1%. This was partly offset by higher placements with unrelated banks, whose share increased to 80.9%, pointing to a notable shift in the composition of interbank exposures.

2.3.3 Credit quality

Asset quality strengthened further during the first six months of 2026, with the NPL ratio declining by 0.2 percentage points to 1.3% (see Chart 2.16). This was largely driven by an 8.3% drop in NPLs, mainly reflecting positive developments in the consumer credit portfolio, with write-offs by one bank making only a marginal contribution. As a result, the household NPL ratio fell from 13.6% to 11.8%. Nevertheless, the ratio remained elevated, solely reflecting the specialised payday lending activities undertaken by a small number of institutions. NPLs within the NFC portfolio also declined, with the corresponding NPL ratio remaining low at just 0.3%. In line with the overall improvement, the dispersion of NPL ratios across international banks narrowed somewhat but remained relatively wide. Excluding Eurosystem placements, the NPL ratio declined further by 0.5 percentage points to 1.9%, reflecting the faster growth in loans and advances excluding Eurosystem placements.

Chart 2.16
OVERALL NPL RATIO – INTERNATIONAL BANKS
(per cent)

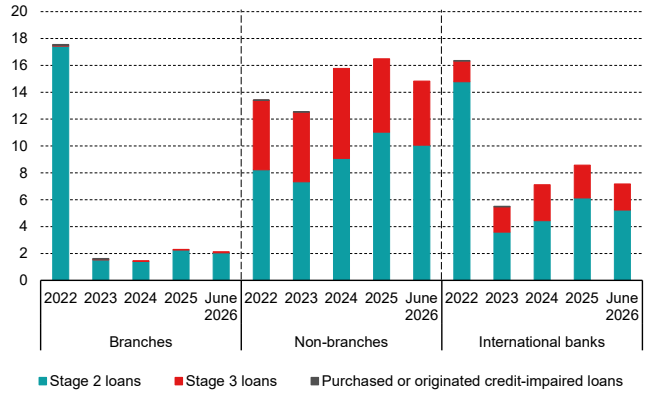


Source: Central Bank of Malta.

The strengthening in asset quality was also reflected in lower Stage

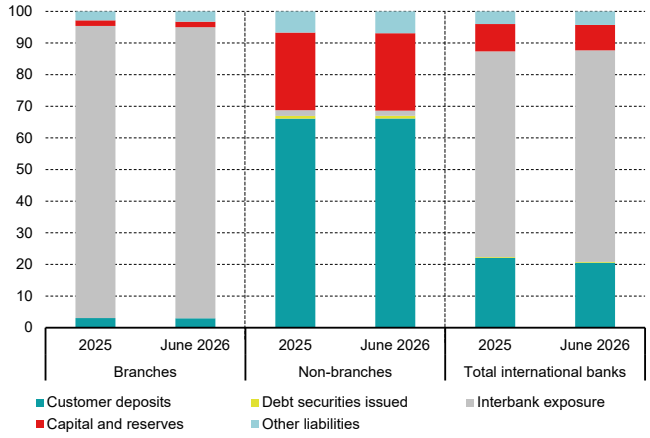
2 and Stage 3 exposures (see Chart 2.17). Provisions associated with these stages fell accordingly, although higher Stage 1 provisions resulted in overall provisions remaining broadly unchanged. Consequently, the coverage ratio strengthened from 101.2% in 2025 to 110.2% in June 2026, indicating that NPLs remained fully covered at the aggregate level. Meanwhile, the forbearance ratio improved slightly, declining from 2.3% to 2.1% during the first six months of 2026. This improvement was exclusively driven by a reduction in performing loans with forbearance measures, which nevertheless continued to account for most of the forborne loans. By contrast, non-performing forborne loans rose, albeit from a low base.

Chart 2.17
SHARES OF HIGHER CREDIT RISK LOANS – INTERNATIONAL BANKS
(per cent)



Source: Central Bank of Malta.
Note: Shares are calculated on the total portfolio of loans excluding placements. When considering Stage 1 loans, the shares would add up to 100%.

Chart 2.18
SOURCES OF FUNDING – INTERNATIONAL BANKS
(per cent)



Source: Central Bank of Malta.

2.3.4 Funding and liquidity

International banks continued to rely heavily on interbank funding, which accounted for around two-thirds of assets in June 2026 (see Chart 2.18). This largely reflected the business model of branches, whose balance sheet growth was mainly financed through increased intragroup funding and, to a much lesser extent, through foreign customer deposits. By contrast, non-branches remained predominantly funded through customer deposits, mainly sourced from non-resident non-bank financial entities and households, with growth in these deposits underpinning their balance sheet expansion.

Customer deposits for the whole segment increased by 3.1% during the first half of 2026. Growth was driven primarily by deposits from households and, to a lower extent, private NFCs, which rose by 8.0% and 9.2%, respectively. These accounted for 50.2% and 16.7% of the deposit base, respectively. Meanwhile, deposits from non-bank financial entities fell by 6.2%, accounting for around a third of customer deposits. The overall increase reflected growth in both withdrawable-on-demand and term deposits, with the latter accounting for 54.4% of total customer deposits.

Other funding sources also increased during the period under review, reflecting higher profits earned in the current financial year by one of the branches, as well as a rise in capital and reserves of non-branches. Debt securities issued by non-branches also increased, though they remained a negligible source of funding, accounting for just 0.2% of total assets.

The liquidity position of the non-branches strengthened during the first half of 2026. The LCR increased to 324.9% in June 2026, standing comfortably above the regulatory threshold. Similarly, the NSFR rose from 129.7% in 2025 to 132.4% in June 2026, pointing to a sustained surplus of stable funding.

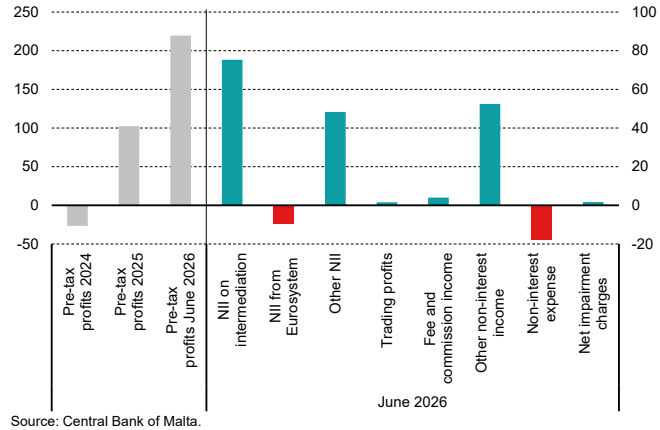
2.3.5 Capital and leverage

International banks maintained a strong capital position during the first half of 2026. The total capital ratio increased by 0.5 percentage points to 35.2% as own funds rose by 2.3%, supported by higher Tier 1 capital. RWA rose by 1.1%, reflecting higher credit and operational risk exposures. This was partly offset by a decline in market risk exposures following a reduction in net long commodity positions. Consequently, the ratio of risk-weighted assets to total assets edged down by 0.3 percentage points to 75.6%, suggesting a marginal improvement in the sector's overall risk profile. The leverage ratio for the non-branches remained broadly unchanged at a comfortable 24.1%, well above the regulatory minimum.

2.3.6 Profitability

The profitability of international banks strengthened markedly during the four-quarter to June 2026, with pre-tax profits more than doubling compared to 2025 (see Chart 2.19). As a result, the post-tax ROA increased from 0.9% in 2025 to 2.0% six months later. The improvement was driven primarily by the branches, although subsidiaries and stand-alone banks also reported stronger results, reflecting higher operating income.

Chart 2.19
MAIN CONTRIBUTORS TO PROFITS – INTERNATIONAL BANKS
(EUR millions)



Source: Central Bank of Malta.
Note: Grey bars indicate pre-tax profits in absolute amounts. Teal (positive) and red (negative) bars indicate yearly contribution to the change in profits.

The increase in profitability was mainly underpinned by higher NII. Income generated from non-intermediation activities rose by more than three-fifths, driven mainly by returns on branches' holdings of high-yield Turkish government bonds. At the same time, income from intermediation activities increased by almost one-fifth, more than offsetting a 7.2% decline in income from Eurosystem placements. Non-interest income also increased significantly, rising by 57.9% as favourable movements in foreign exchange valuations reported by the branches led to valuation gains compared with losses recorded in 2025. Higher net fees and commission income, together with stronger trading profits among non-branches, further supported overall earnings.

Non-interest expenses rose by 10.9%, reflecting higher staff and administrative costs, particularly among non-branches. Nevertheless, revenue growth outpaced the increase in expenses, resulting in an improvement in operational efficiency. As a result, the cost-to-income ratio declined from 52.4% in 2025 to 36.6% in June 2026. Profitability was further supported by a 1.7% reduction in net impairment charges during the period under review.

2.3.7 Risk outlook

The risk outlook for international banks remains broadly stable, underpinned by strong capital and liquidity buffers, improving profitability, and continued strengthening in asset quality. The overall decline in NPLs further supports the sector's resilience, although heightened geopolitical and macroeconomic uncertainty continues to pose downside risks.

Branches remain particularly exposed to developments in their respective home jurisdictions through their concentrated holdings of sovereign securities. While these exposures have benefitted from the relatively high yields and have supported profitability in recent periods, they expose a subset of institutions to shifts in economic conditions, sovereign risk perceptions, and financial market developments in those jurisdictions. In addition, a small number of institutions remain exposed to consumer lending segments that may be more sensitive to adverse economic conditions, labour market developments and borrower repayment capacity, warranting continued monitoring despite the recent improvement in asset quality.

Going forward, maintaining diversified earnings streams and prudent risk management practices will remain important in safeguarding the sector's resilience to external shocks.

BOX 3: MEASURING THE COST OF EQUITY OF MALTESE BANKS[1]

Introduction

The CoE reflects the return that shareholders require to hold a bank's equity. From a financial stability perspective, a persistently elevated CoE may increase the cost of raising capital. This can potentially constrain banks' capacity to expand lending or rebuild capital buffers following periods of stress. However, the CoE is not directly observable, and its estimation is particularly challenging in Malta's small and relatively illiquid equity market.

This box presents market-based CoE estimates for domestic banks listed on the Malta Stock Exchange (MSE) using a range of capital asset pricing models (CAPMs). The analysis considers three listed core-banks and one non-core bank. It then examines the relationship between these estimates and bank-specific characteristics, including asset quality, capitalisation, funding structure and bank size, to derive indicative CoE measures for other non-listed domestic banks. Since the CoE of banks is not directly observable, the resulting measures are sensitive to the model specification adopted. Hence, the results presented should be interpreted as indicative model-based estimates rather than as precise measure of banks' actual required ROE.

Market-based cost of equity estimates

The market-based analysis uses monthly equity returns for listed core and non-core banks from January 2018 to May 2026. Estimating the CoE of Maltese banks is particularly challenging owing to the small and less liquid domestic equity market, in which individual bank share prices may not always closely reflect broader market developments. Hence, changes in share prices do not always reflect closely with broader market developments, making estimates based on any single model potentially unreliable. To address this limitation, the analysis considers several alternative capital asset pricing approaches rather than relying on one model.

Capital asset-pricing frameworks

The starting point of this analysis is the standard CAPM, estimated from excess bank returns:

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_i(R_{m,t} - R_{f,t}) + \varepsilon_{i,t} \quad (1)$$

where $R_{i,t}$ is the monthly ROE of bank i, $R_{m,t}$ is the market return and $R_{f,t}$ is the risk-free rate. The estimated beta measures the sensitivity of the bank's equity return to market movements.

The corresponding CoE is constructed as:

$$k_{i,t} = R_{f,t} + CRP_{(MT,t)} + \beta_{i,t} \times ERP \quad (2)$$

where $k_{i,t}$ denotes the estimated CoE, $R_{f,t}$ is proxied by the German Bund ten-year yield and $CRP_{(MT,t)}$ is Malta's country-risk premium measured using the Malta–Germany sovereign yield spread. The ERP denotes Malta's mature-market equity risk premium (ERP), derived according to Damodaran (2013).[2] This decomposition allows the headline estimate to vary with the risk-free rate, country risk (as measured by the sovereign yield spread) and the bank's exposure to systematic equity-market risk.

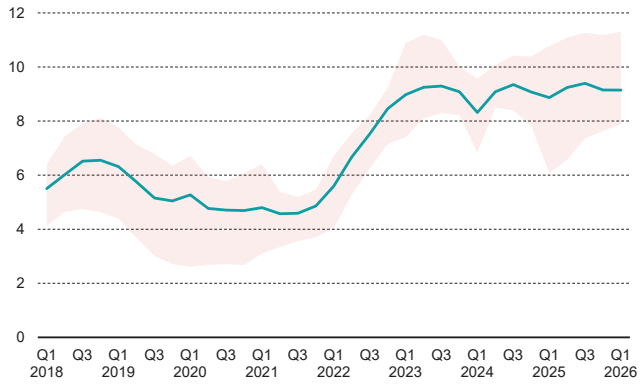
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[1] Written by Ms Sarah Vella, Principal Research Economist within the Macroprudential Policy, Stress Testing and Research Department and Doctoral Researcher at Universitat de Barcelona and University of St Andrews. The author would like to thank Governor Alexander Demarco, Deputy Governors Rita Schembri and Oliver Bonello, Ms Amy Camilleri, Mr Alan Cassar, Dr Aaron G. Grech, Ms Christine Balzan and Mr Pedro Polvora for their helpful inputs and valuable suggestions.

[2] Damodaran, Aswath (2013), "Equity risk premiums (ERP): Determinants, estimation and implications — the 2012 edition."*In Managing and measuring risk: Emerging global standards and regulations after the financial crisis*, pp. 343–455, World Scientific.

After estimating the baseline CAPM, a range of alternative CAPMs are estimated separately for each bank to allow for time variation in market sensitivity, additional sources of systematic risk and to cater for banks' different business models. These include rolling and shrunk rolling CAPM models, Constant Conditional Correlation and Dynamic Conditional Correlation (DCC) models, as well as richer Fama–French (1993) and sovereign-credit specifications.[3] Each model is then evaluated for each bank based on statistical performance, economic plausibility and stability.[4] The three highest-ranked models for each bank are then combined to obtain a more robust headline estimate. This approach follows the principle that there is considerable volatility surrounding any individual estimate of the CoE.

Chart 3a
MARKET-BASED AVERAGE CoE ESTIMATES
(percentage)



Source: Central Bank of Malta calculations.
Notes: The series represents the average of the three highest CoE estimates implied by the various asset-pricing models for each selected banks. The shaded region represents the minimum-to-maximum range of these three bank-level models across the selected banks.

Across banks and time, the resulting estimates based on the three best performing models per bank, range from approximately 4% to 9% (see Chart 3a). More recently, CoE has increased across listed banks, reaching an average of around 9% by March 2026, above the respective historical averages. These developments appear to be largely driven primarily by changes in the risk-free rate and the market risk premium. During 2019–2021, declining risk-free rates and lower estimated market betas contributed to lower required returns. The sharp increase during 2022–2023 is mainly associated with higher risk-free rates amid rising inflation expectations and tighter monetary conditions in key advanced economies. Overall, the results indicate that interest-rate developments are particularly important in driving the initial post-2022 increase in CoE, while greater estimated exposure to systematic equity-market risk subsequently helped sustain model-implied elevated required returns. During 2024–2025, for example, higher estimated market betas partly offset the downward impact of declining risk-free rates and country-risk premia.

Extending the analysis to unlisted banks

Following Altavilla et al. (2021), the analysis is extended to three unlisted banks because the absence of share-price data prevents direct market-based estimation.[5] However, their CoE remains relevant for loan pricing and shareholders' required returns. Regressing listed banks' estimates on their fundamentals provides a basis for inferring this otherwise unobservable funding cost for unlisted banks. In Malta, unlisted banks operate within both the core and non-core domestic

[3] Fama, Eugene F. and Kenneth R. French (1993), "Common risk factors in the returns on stocks and bonds."*Journal of Financial Economics*, 33, pp. 3–56.

[4] Model selection follows a four-step procedure. First, specifications are screened for economic plausibility, requiring an economically meaningful market beta and limited incidence of CoE floor binding. Second, model stability is assessed based on the stability of parameter estimates. For DCC models, conditional-correlation dynamics are considered. Third, eligible models are ranked according to the correlation between realised and fitted bank returns, with higher correlations indicating better statistical fit. Finally, the three highest-ranked specifications are retained for each bank. The headline CoE is calculated as their equal-weighted average.

[5] Altavilla, Carlo, Paul Bochmann, Jeroen De Ryck, Ana-Maria Dumitru, Maciej Grodzicki, Heinrich Kick, Cecilia Melo Fernandes, Jonas Mosthaf, Charles O'Donnell, and Spyros Palligkinis (2021), "*Measuring the cost of equity of euro area banks.*" ECB Occasional Paper.

banking groups, but still play a role in credit provision and deposit-taking.[6] Their inclusion therefore provides a broader and more comprehensive assessment of the CoE underpinning domestic financial intermediation activities.

A comparison of customer deposits-to-non-interbank loan ratios helps to assess the similarity of the funding structures of both listed and unlisted banks. This comparison informs and supports the application of the fundamentals-CoE relationship estimated for listed banks to unlisted banks. Customer deposits are substantial when compared to non-interbank lending both for unlisted banks and listed banks. Over 2018Q1–2026Q1, the average customer deposits-to-non-interbank loans ratio of unlisted banks is 109.5%, compared with 144.3% for listed banks. Although the average ratio is lower for unlisted banks, the difference is not statistically significant.[7] These averages indicate that customer deposits exceed non-interbank loans on average for both listed and unlisted banks in the sample. This common feature provides further support for applying the fundamentals-CoE relationship estimated for listed banks to unlisted banks.

To extend the analysis to the unlisted domestic banks, the market-based estimates derived for listed banks are regressed against their fundamentals as shown in equation (3).

$$CoE_{i,t} = \alpha + \beta_1 NPL_{i,t} + \beta_2 CET1_{i,t} + \beta_3 (Deposits/Loans)_{i,t} + \beta_4 \ln(Assets)_{i,t} + \tau_t + \varepsilon_{i,t} \quad (3)$$

The dependent variable is the quarterly average of the top-three headline market-based cost of equity ($CoE_{i,t}$) for listed banks.[8] The explanatory variables capture asset quality (the NPL ratio), common equity tier 1 (CET1) ratio, funding structure (customer deposits relative to loans) and bank size (the logarithm of total assets). The specification also includes time fixed effects (τ_t) to capture common developments across banks.

Overall, the estimates identify asset quality and funding structure as the balance-sheet characteristics most clearly associated with banks' CoE. A higher NPL ratio is associated with a higher estimated CoE, consistent with investors requiring greater compensation when asset quality is weaker. Moreover, a higher customer-deposits-to-loans ratio is associated with a lower CoE, suggesting that a more deposit-based funding structure, which tends to be stable, may be viewed favourably by investors. The coefficient on the CET1 is negative, as expected, but is not statistically significant in the preferred specification, consistent with the range of results by Altavilla et al. (2021). Bank size enters positively and significantly in this baseline regression. However, given the small number of listed banks and the sensitivity of the results to the size measures used, the coefficient should be interpreted with caution. Bank size should be interpreted primarily as a control variable and should not be viewed as a structural determinant of the CoE.[9]

Model-implied estimates for unlisted banks broadly mirror the trend observed for listed banks, although asset quality and stable deposit funding help contain differences across institutions. Applying the coefficients reported in Table 3a to the balance-sheet characteristics of unlisted banks produces estimated costs of equity ranging from approximately 4% to 10% over the sample period

[6] See Central Bank of Malta, *Financial Stability Report 2025*, Chapter 2: "Developments in the banking sector".

[7] A two-sided t-test does not reject equal mean ratios for listed and unlisted banks at the 5% significance level so there is no strong evidence of difference between the groups ($p = 0.08$).

[8] This approach is inspired by the model-averaging framework of Altavilla et al. (2021). The authors average ten models including five factor models and five implied CoE models requiring analysts' earnings and profitability forecasts. Given the smaller set of factor models available for each bank, the headline CoE per bank is calculated as the equal-weighted average of the three highest-ranked eligible models.

[9] The results reported in the Table 3a are robust to alternative specifications of bank size, including the use of a relative-size measure based on banks' assets. Robustness checks also include retained earnings relative to loans and an extended 2014–2026 sample allowing for a structural break in 2018 due to a break in the data series. The extended specification retains the variables in the main model and additionally includes retained earnings relative to loans and ROA.

Table 3a
BANK-FUNDAMENTALS DETERMINANTS OF CoE

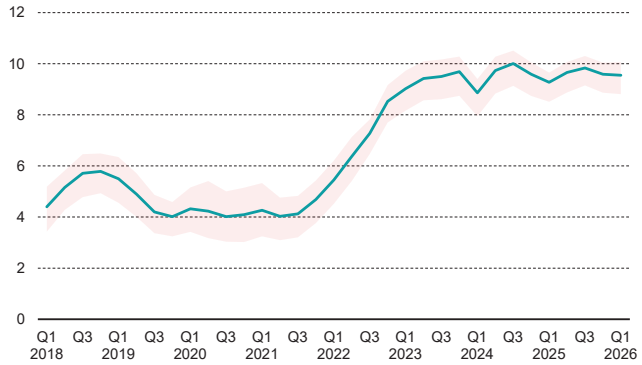
Percentage points

Economic group	Variable	Coefficient	Statistical significance
Asset quality	NPL ratio	+0.1030***	p < 0.01
Capitalisation	CET1 ratio	−0.0450	Not statistically significant
Funding structure	Customer deposits / loans	−0.0133***	p < 0.01
Bank size	Log assets	+1.2285***	p < 0.01

Source: Central Bank of Malta calculations.
Note: Pooled OLS with quarter fixed effects, 2018Q1–2026Q1; Driscoll–Kraay standard errors with four quarterly lags (to allow for heteroskedasticity, serial correlation and cross-sectional dependence);
*** denotes p < 0.01.

(see Chart 3b). The estimated cost of equity range for unlisted banks is broadly comparable to that of listed banks. This similarity may partly reflect the composition of the unlisted bank sample, which includes banks with business models broadly comparable to those of the studied listed banks. The average estimated CoE increased markedly during 2022-2023, reflecting the common upward trend observed for listed banks and captured by the time fixed effects in equation (3). Changes in bank fundamentals help explain differences across institutions. Declining NPL ratios generally exerted downward pressure during 2022–2024, while subsequent increases contributed positively for some banks. Changes in customer deposits relative to loans also moderated the estimated CoE in several periods, particularly towards the end of the sample. However, this contribution was not uniform across all banks. Capitalisation effects were generally smaller, while changes in bank size mostly contributed positively. Overall, these patterns are consistent with business models in which sound asset quality and substantial reliance on customer deposits may help to contain credit and refinancing risks. This moderated the estimated CoE for both listed and unlisted banks where the funding structure is broadly similar. Stronger CET1 ratios may provide an additional mitigating influence, although their contribution in the decompositions is generally smaller.

Chart 3b
UNLISTED BANKS: AVERAGE CoE ESTIMATES BASED ON BANK FUNDAMENTALS
(percentage)



Source: Central Bank of Malta calculations.
Notes: The series represents the average of the three highest CoE estimates implied by the various asset-pricing models for each selected banks. The shaded region shows the minimum-to-maximum range of the bank-level cost-of-equity average estimates.

Among listed banks, asset quality and funding composition are the main bank-specific contributors to year-on-year movements in the estimated CoE. Over 2019Q1–2026Q1, the NPL ratio accounts for 42.5% of average absolute contributions, followed by the customer deposits-to-loans ratio at 35.2%. Bank size and CET1 play smaller roles, accounting for 12.5% and 9.8%, respectively.

Among unlisted banks, changes in bank size and asset quality make the largest bank-specific contributions to year-on-year movements in the estimated CoE. Over the same period, log assets account for

35.4% of average absolute contributions, followed by the NPL ratio at 30.5%. The customer deposits-to-loans ratio contributes a further 21.9%, while CET1 accounts for the smallest share, at 12.2%.[10]

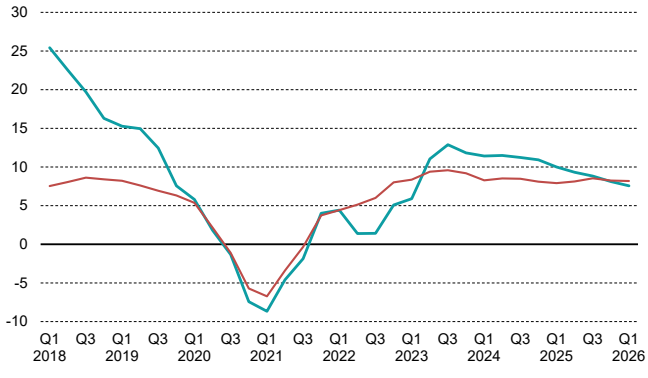
By 2026Q1, the increase moderated, with the average estimated CoE stabilising around 9% when all seven banks are weighted equally. This level falls within the range reported by many European banks. The EBA's June 2026 Risk Assessment Report indicates that approximately one-third of surveyed banks estimated their CoE at between 8% and 10%, while around 40% reported estimates between 10% and 12%.[11] The model-based estimate for Maltese banks therefore appears broadly comparable with European benchmarks, although differences in methodology, reference periods and bank characteristics make this comparison indicative.[12]

These results should not be interpreted as the actual CoE faced by unlisted banks. Rather, these represent model-implied estimates of the CoE on the assumption that unlisted banks would behave the same as listed banks, if such banks were publicly listed on the MSE. The estimates are therefore conditional on the model specification and should be interpreted with appropriate caution.

Bank profitability

For most banks in the sample, average profitability exceeded the estimated return required by shareholders, although the results varied across institutions and over time. Comparing each bank's ROE with its respective estimated CoE provides an indication of whether it generated returns sufficient to meet shareholders' required return.[13] Over 2018–2026, average ROE of approximately 8.02% exceeded the corresponding average CoE at 5.76% for the six core banks (see Chart 3c).[14] Five of the six core banks registered higher ROE than their respective CoE average over 2018–2026. Indeed, this does not imply that these banks maintained a positive gap throughout the period, as some experienced episodes in which ROE fell below their estimated CoE. Assessing the results at bank level therefore provides a more representative picture than comparing aggregate sample averages, which would be disproportionately affected by these negative observations.

Chart 3c
CORE BANKS: FUNDAMENTAL-BASED CoE VS PROFITABILITY
(percentage)



Source: Central Bank of Malta calculations.
Note: The sample contains the six Maltese core banks. Average RoE and CoE are calculated as asset-weighted averages of the corresponding bank-level measures.

Conclusion

Overall, the results point to a marked increase in Maltese banks' CoE after 2021, followed by stabilisation in early 2026. At the same time, the analysis emphasises that no single asset-pricing specification is sufficient to estimate the

[10] For each fundamental, the average size of its contribution to the year-on-year change in CoE across common time quarters and banks in each group is averaged, treating increases and decreases equally. This average is expressed as a percentage of the combined averages for all four fundamentals. Banks receive equal weight and the common time effect is excluded.
[11] European Banking Authority (2026), *Risk Assessment Report – June 2026*, Section 5, "Profitability".
[12] Only two banks are similar across this study's sample and the EBA report.
[13] ROE is calculated as the sum of quarterly profits over the latest four quarters divided by the simple average of total equity at the current quarter-end and the previous December year-end, multiplied by 100. The December balance provides a consistent calendar-year reference point. Alternative denominator averaging conventions yield very similar ratios.
[14] Average ROE and CoE are calculated as asset-weighted averages of the corresponding bank-level measures.

CoE of Maltese banks in a small and relatively illiquid market. Combining the best-performing asset-pricing specifications provides a more robust market-based measure. This approach shows that CoE increased but stabilised towards the start of 2026. The analysis further suggests that asset quality and funding structure are important correlates of the market-based estimated CoE for Maltese banks.

Against this backdrop, future work could extend the analyses to the cost of debt. This would provide a more comprehensive understanding of the factors influencing banks' funding cost and capital structures, while also capturing the role of creditors' risk perceptions and broader funding conditions.