EXECUTIVE SUMMARY

The first half of 2026 was characterised by a challenging external macro-financial environment, amid elevated geopolitical tensions, persistent trade-policy uncertainty (TPU) and renewed volatility in commodity and financial markets. Nevertheless, the global economy remained resilient. Euro area activity was also better than expected at the beginning of 2026, although growth remained modest. Renewed inflationary pressures, fiscal sustainability concerns and political uncertainty in some economies contributed to financial-market volatility, while stretched valuations in certain market segments increased the risk of abrupt repricing.

Against this backdrop, Malta's economy and financial system remained resilient. Economic growth remained robust in the first half of 2026, supported by domestic demand, favourable labour market conditions and continued strength in tourism-related services. At the same time, inflation moderated to 2.0% by mid-year. Public and private-sector balance sheets remained broadly sound, with the government debt-to-gross domestic product (GDP) ratio comfortably below the Treaty reference value. Corporate indebtedness was below the euro area average, while aggregate household balance sheets remained supported by substantial financial wealth and savings. However, these household financial buffers may not be evenly distributed, leaving more highly indebted or financially constrained households more vulnerable to adverse shocks.

Housing market activity remained buoyant, with domestic house prices increasing further and mortgage lending continuing to grow strongly. The combination of such dynamics coupled with increasing household leverage warrants continued monitoring, particularly given banks' significant exposures to mortgages and property-related corporate lending. Borrower-based measures and prudent lending standards help mitigate borrower vulnerabilities, while the sectoral Systemic Risk Buffer (sSyRB) strengthens banks' loss-absorbing capacity. Nonetheless, the concentration of bank lending in property-related activities remains a structural vulnerability that could amplify the impact of a deterioration in domestic economic conditions or an adverse housing-market correction.

The banking sector continued to report strong capital and liquidity positions, sound asset quality and generally solid profitability. Core domestic banks expanded their balance sheets through higher customer lending and sovereign bond holdings, while non-performing loans (NPLs) declined further. Profitability remained broadly stable, although higher operating costs weighed on the banks' cost-efficiency. Non-core domestic banks' balance sheet continued to contract but retained comfortable capital and liquidity buffers and reported improved profitability. Some forward-looking credit-risk indicators for this category weakened, while investment portfolios shifted towards foreign corporate bonds and an increased share of speculative-grade and unrated securities. International banks expanded strongly and recorded improved asset quality and profitability, although some institutions remained exposed to concentrated sovereign holdings in their home jurisdictions and to higher-risk consumer lending segments.

Stress-test results continued to support the banking sector's overall resilience in terms of both solvency and liquidity. In particular, liquidity assessments indicated that, at the aggregate level, all three bank categories retained sufficient liquidity and stable funding buffers under the adverse scenarios considered, although a few individual institutions showed greater sensitivity to certain hypothetical shocks by scenario design. The interest-rate risk in the banking book (IRRBB) assessment, which seeks to quantify the impact of different interest-rate shock scenarios on banks' solvency, indicated that banks can absorb the materialisation of such shocks. This resilience continues to be supported by banks' relatively high share of instruments measured at amortised cost (AMC). Results vary across banks, reflecting the composition of their balance sheets.

The domestically relevant non-bank financial sector also remained broadly resilient. Domestically relevant insurance companies continued to expand and remained well capitalised, with broadly adequate liquidity across both life and non-life segments. Profitability developments were mixed, with life insurers reporting weaker profits despite improved underwriting performance, while non-life insurers benefited from stronger investment returns even as claims increased faster than premia. Domestically relevant investment funds

recorded only modest asset growth. These funds continued to be characterised by very low leverage, substantial holdings of liquid assets and robust aggregate redemption coverage, although liquidity buffers moderated and operating profitability weakened. Despite an improvement in the credit quality of their bond portfolios, increased equity exposures, material holdings of speculative-grade and unrated bonds leave the sector exposed to market repricing and redemption pressures, with links to domestic households and financial institutions providing possible channels of domestic contagion.

Looking ahead, Malta is expected to maintain robust economic growth, but risks to financial stability remain tilted to the downside. A further escalation of geopolitical tensions, a broadening of the recent energy and commodity-price shocks could weigh on import prices and foreign demand, as well as related disruptions to global trade could weaken economic activity and place pressure on sovereigns', corporates' and households' balance sheets. A further tightening of financial conditions and possible abrupt corrections in certain financial-market segments exhibiting stretched valuations represent additional sources of downside risk. These cyclical risks may be compounded by structural vulnerabilities arising from concentration and interconnectedness, reliance on critical third-party service providers, and growing operational, cyber, artificial intelligence (AI)-related and climate-related risks. Continued vigilance, together with sound risk management and adequate capital and liquidity buffers, therefore remains important to preserve the resilience of Malta's financial system.

The report is also complemented by five analytical boxes and two special features. Box 1 examines the extent to which residential property purchases in Malta are associated with mortgage financing from domestic banks, offering insights into how credit conditions, monetary policy and macroprudential measures may transmit to the housing market. Box 2 examines the relationship between cyclical systemic risk and downside risks to bank profitability, while Box 3 assesses the cost of equity (CoE) of Maltese banks and examines the extent to which it varies across institutions and over time. Box 4 assesses the significance of catastrophe risk for domestically relevant non-life insurers, focusing on its contribution to the Solvency Capital Requirement (SCR) under the Solvency II framework. Box 5 examines the role of stablecoins within Malta's licensed crypto-asset service providers (CASPs), assessing their relative importance, currency composition and concentration across reporting entities. Special Feature A uses TARGET2-Malta transaction data to quantify the potential liquidity effects of hypothetical cyber-related payment disruptions and their propagation through the payment network. Finally, Special Feature B presents a sensitivity analysis of the Redemption Coverage Ratio (RCR), providing a forward-looking assessment of the resilience of domestically relevant investment funds sector to redemption pressures at both fund and aggregate levels.