

LIQUIDITY MANAGING A CURRENT JOB OF BANKING MANAGEMENT

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Abstract:

A credit institution liquidity managing, concerns on currency flows and operative funding needs, for customer satisfaction. Correlating bank liabilities and assets reflects the overall picture of the liquidity situation. The purpose of an efficient management of bank liquidity is to ensure the normal course of banking intermediation, to protect the interests of customers on one side and of the shareholders on the other side. Through an efficient bank liquidity management, are ensured reserve requirements and especially reasonable banking capacity of deposits reimbursement to customers, correlated with period in which they are or there are not returned to the credit institution, investments in the loans and other assets.

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1. Introduction

Liquidity is a feature of banking assets which expresses their ability to be converted quickly into cash or account currency. Liquidity position is determined as the difference between total assets and total liabilities on each maturity band.

Management of liquidity position is a daily activity of tracking intrabanking and interbanking cash flow that can be influenced by various risks. Risk exposure is monitored through a culture of risk, calculating various indicators of liquidity.

In this respect, banks calculate their liquidity indicator on maturity bands. It is calculated as the ratio of actual liquidity and liquidity required on each maturity band. Bands are up to one month, between one and three months, between 3 and 6 months, between 6 and 12 months and 12 months. Lower limit of liquidity indicator is 1.

When recording a surplus of liquidity in any of maturity bands, except the last one, this will add to the amount of liquidity effective for the next maturity band.

Effective liquidity is determined by summing, for each maturity band, of the assets, of received commitments highlighted. And the necessary liquidity is determined by summing, for each maturity band, liabilities, given commitments highlighted.

By monitoring liquidity risk, can be daily fulfilled deposit holders requests on their total or partial liquidation and can be made all payments ordered by the holders of bank accounts.

So, liquidity managing of a credit institution is achieved through many forms that correlate asset position of bank liabilities. Firstly, by managing bank liabilities, that which allows credit institutions to maintain liabilities on the same maturity bands without making changes in the structure and volume of assets held.

And secondly by managing assets on the same maturity bands and by combined management of balance sheet assets and liabilities

2. The need for liquidity of credit institutions

The need for liquidity is determined by the current obligations that credit institutions must make to its customers, as a financial intermediary.

Estimating this need is usually based on the term of eligibility on bank obligations. Thus appears, liquidity risk that is itself the expression of probability of loss financing capacity of credit institutions.

Credit institution management continuously monitors three types of bank liquidity needs: current (short term), long-term and cyclical. On long term, bank profitability may be negative affected if the bank has too many portfolios in liquid financial assets above its needs. On the other hand, too small liquidity can create financial problems, especially for small banks and generate even bankruptcy of a credit institution.

Generally credit institutions, financial banks groups, constantly monitors their asset position and liabilities on important groups of maturity.

Bank liquidity expresses the bank's ability to finance current operations, as a matter of management of assets and liabilities that have varying degrees of liquidity [1]

On European monetary system, bank liquidity rules, overlapping on requirements regarding minimum reserves, mainly used as an instrument of monetary policy.

To compensate the liquidity needs of the banking financial groups, to support a sustainable process of lending and to harmonize reserve requirements with European Central Bank standards, on the first months of the year, in Romania was taken financial policy measures. National Bank of Romania Board, decided in January this year, reducing minimum reserve requirement ratios in domestic credit institutions on 12 percent from 15 percent. And decrease of minimum reserve requirement ratios in foreign currency at 18% from 20%. Also, the central bank decided to lower the monetary policy interest at 3.75% per year from 4.0%. Interest rate on lending facility (Lombard) fell to a level of 6.75 percent per year from 7.0 percent. And the interest rate on the deposit facility fell to 0.75% on year in January.

Then, in February of this year the central bank decided to lower the monetary policy interest at 3.50%. Interest rate on lending facility (Lombard) has decreased at 6.50%. And the interest rate on the deposit facility will be 0.50% for the same period. NBR also decided continued proper management of liquidity in the banking system and maintain current levels of minimum reserve requirement ratios in lei and foreign currency of credit institutions.

Gradual adjustment of overall monetary conditions aimed maintaining price stability on the medium term corresponding to a stationary annual target of 2.5 percent. All these monetary policy measures shows that the National Bank of Romania decided to continue adequate management of liquidity in the banking system [2].

More money on the monetary market, as a result of improved liquidity conditions, contribute to a positive trend of lending in local currency or foreign currency.

Thus, central bank refunded to credit institutions some of their own money, hold at the central bank in reserve requirements and these as "NBR recommendations" should be used with discernment, especially for investments in Romania.

But at the first sight, some of the branches in Romania of banking financial groups rushed to repay debts to parent banks and then setting out measures of relaxation of credit conditions. In previous years, the central bank gave signals for banks with foreign capital to invest in Romania mobilized deposits money but financial banking groups had an entirely different monetary strategy

Specifically, according to the National Bank of Austria [3], only the last two years, Austrian banks (which hold about 30% of the Romanian banking system assets and about 20% of the share capital) have decreased by over 4 billion exposure in our country. Per all Romanian banking system, amounts would have been even higher than in the absence of "*Vienna Agreements*", which basically forced major foreign banking financial groups to maintain yet at reasonable levels, exposure in Romania

But after the current decisions of central bank, Austrian banks would have to regain confidence in Romanian customers. For example, the Romanian Commercial Bank, a member of Erste Group, the most important Austrian financial group in Romania, after escaping of the state burden aid of 1.2 billion euros received from Austrian government for helping Erste to exceed the toughest period of financial crisis, may now reconsider lending standards and boost lending especially for SMEs, with attractive prices at banking products.

These monetary policy measures are come on a "lack of liquidity" in the system, although bank deposits of individuals and companies amounted to 315 billion lei (71 billion euros) at the end of last year, with about 11 billion lei over level in September 2013, according to the Deposit Guarantee Fund. Savings [4] increased by the end of year, after on the first part of 2013 the stock of deposits was constant: about 305 billion lei. The increase of savings was due to deposits in lei, while foreign currency deposits recorded a setback amid low interest rates and exchange rate stability. Savings in lei were about 169 billion lei (plus 14 billion lei on September). Currency deposits decreased by the equivalent of 600 million euros and have come to 32.6 billion.

Basically, by the monetary policy central bank intervened at three levels, namely by reducing the monetary policy rate, the minimum reserve those for the domestic and foreign currency. Statistical estimates show that reducing reserve requirements *for lei* were issued in the market, only in January of 2014, about 3.5 billion lei, while those *for currency*- 400 million euro. Associated with a reduced interest rate monetary policy, this money would be reflected in lending various projects in the real economy. Only that boosting growth through effective lending will see in the next period after they become eligible projects financed from EU funds. And when credit institutions will help companies with the necessary co-financing by lending.

Was past, however, at relaunching of credit activities with attractive prices?

By observation money market, only price of loans in domestic currency appears to be lower, especially on mortgage loans. While some banks have indicated that they descended active interest rate, not all credit institutions allow themselves for now, this fact.

Why? For the fact that some credit institutions is facing with liquidity problems [5]. And generally, from creditors clearly appears lack of credibility in local customers, underperforming loans increased to 25% of total money market liabilities in Romania. By comparison, underperforming loans are only 17-18% in Hungary and Slovenia and below 10% in Austria, Czech Republic, Poland, Slovakia and Croatia. The general trend of deterioration of the loan portfolio in 2013 was visible especially in Romania, Hungary and Slovenia.

Specialists from FMI at Bucharest, recommended National Bank to maintain in a prudent line the monetary policy, because they considered that any liquidities issued by the central bank would not get into credit, but will be used by the financial banking groups to prepay of credit lines from outside, resulting an additional pressure on the exchange course.

After less than two months since beginning of the year and there are credit institutions that face liquidity problems and can not constitute *minimum reserves*.

For credit institutions with insufficient reserves shall apply penalty interest which exceed a few percentage points the interest rate applied to operations "day-to-day" money market. For this, starting with January 24 to February 23, 2014, the penalty rate for deficits of reserve requirements in domestic currency was 10.25% per year [6]

3. Details of minimum reserve requirements

Although some countries such as Canada, Switzerland, Australia have gave up of required reserves, in the EU their establishment by credit institutions is mandatory.

Calculation of reserves that are required to credit institutions, are established by them according to procedures issued by the central bank the state. There are some differences with regard to the calculation of the reserve from one country to another.

In some countries the reserves are not remunerated, while in other cases only part of the reserves are remunerated, having regard to bank obligation to use these reserves for lending to the state.

In Romania, the National Bank pays an interest on required reserves. Interest rate is at least at the level of average interest rate at demand deposits by banks. NBR policy respects the recommendations of the European Central Bank to regulate money supply in the economy. Romania's alignment with European standards in terms of minimum reserves shall be made in an interval well-determined.

Minimum reserve requirements generally have the following characteristics:

- are determined by the monetary authority rules depending on the structure of bank deposits being executed by credit institutions
- are an additional risk factor for credit institutions as are established according to the objectives of the monetary policy of the state to control the money supply;
- can be used to cover an increase in demand for the liquidation of bank deposits.

In this respect, the policy of minimum reserve in the EU requires credit institutions to constitute at the state central bank, on remunerated or low-paid accounts of minimum share of funds raised. There are two monetary policy situations:

- A) when there is a increase in the rate required reserves when the domestic currency needs of banks is increased because they have to increase the amount of reserves held in accounts at the central bank of the state. In this case reduce the immediate liquidity of credit institutions which may lead to cash problems. Can be operative days when credit institutions will be forced to seek refinancing from the central bank or borrow through the money market.
- B) the reserve ratio decreases as happened in early January this year in Romania, the reserves of credit institutions and central currency will decrease, increasing their liquidity by enabling them to meet the needs of central currency resulting from the current activity.

In other news, leading monetary and credit policy depending on the intended purpose, central bank changes amount of minimum reserves, namely:

- a) when following a reduction of liquidity, a excess of money from circulation and the volume of loans, increasing reserve ratio requirements.
- b) when monetary policy promotes development lending activity and promoting credit role for economic development will proceed to the reduction of the minimum reserve rate.

By procedures concerning required reserves, in order to regulate the money supply in the economy, the central bank conducted a number of explanations for terms like: calculation base observation period, period of application [7]. In accordance with these terms are established reserve requirements *limits*.

"*The basis of calculation* is determined as the average of daily balances of liabilities. It is constitutes based on the average, during the observation of the liabilities of the banks' balance sheets. And same, from the aggregate balance sheet of the credit cooperative networks, drawn up by the central credit cooperatives on which the reserve ratio is applied;

Observation Period is the period for determining the base. This period is between 24 the previous month and to 23 the current month.

Application period is the interval of time during which must be maintained in accounts at the National Bank of Romania's level of reserve requirements. It is the interval between the 24th of the current month and 23 the next month.

Lower limit the reserves is the minimum daily balance of the account where remained the minimum reserves, level from which credit institutions can not make payments, and is calculated by applying a percentage to the projected level of required reserves for the period of application.

The limit provided of required reserves is the average daily balance that bank must it calculate and record in the account where maintained reserves, lei or foreign currency are.

The calculated limit of minimum reserves is the product of the base and the reserve ratio.

Effective limit of reserves is the average daily balance of the bank account registered in who maintains minimum reserves on period of application. Determination of the average daily balance is made taking into account the number of calendar days in the period of application.

Maximum limit as referred reserves is the maximum daily balance of the account where the minimum reserves are maintained and calculated by applying a percentage to the projected level of required reserves for the period of application. Depending on banking risks appear surpluses or deficits of reserve requirements.

Reserve deficiency is the negative difference between the effective level and predicted level of the minimum reserves.

On first calculation of the minimum reserves, in the calculation base were found only local currency deposits created by businesses at banks. Then they entered into the calculation of reserve requirements and foreign currency deposits attracted from individuals and to establish the possibility of holding reserves to foreign currency deposits in national currency or in foreign currency (EUR and USD).

In Romania decreasing minimum reserve requirements has reduced credit institutions costs, relaxing the pressures on the interest rate of term deposits. Thus decreasing minimum reserve requirements determines of reduction credits rate extended by banks, but with lower amplitude than the reduction rate on revived term deposits

4. Managing bank liquidity

Credit institutions are very cautious in granting loans and are concerned to ensure liquidity. Bank liquidity management is one of the most important functions in management activity. In this regard banking legislation provides that „credit institutions should organize their entire business in accordance with the rules of sound and prudent banking practices” [8].

The main activity of bank management is to monitor risks and meet the needs of bank liquidity. As intermediaries of temporarily available funds, credit institutions accumulate financial resources on different maturity periods. This is reflected in investments with a maturity terms similar structure, corresponding to each strategy of bank financial groups.

As has been observed, especially during the financial crisis, financial banking groups were faced with periods when was registered deficits of current liquidity. But, in the global business strategy of each bank, the situation could be controlled through their insurance policies necessary funding and liquidity risk management

Managing banking risks ensure that liquidity required compensating the expected and unexpected fluctuations, recorded in the cash flow. The normal course of banking business provides also when deposits or withdrawals own system resources are reducing and when are increasing of loan portfolio by allocating additional funds. This is due to managerial skills on the management of liquidity.

Liquidity can be predicted by a credit institution's ability to secure funds either by increasing funds or by immediate conversion of assets into cash in very short time and at low prices. Costs of ensure bank liquidity are dependent both on market conditions and the level of risk embedded by active and passive interest rate in credit institution activity. Maintaining external levels too high or too low, of liquidity, will lead either to higher costs and registered of reduced profitability, and may even lead to financial loss, or may cause abrupt discontinuation in institution's activity.

Managing bank liquidity is determined both by proper management of *monetary position* and the management of *the liquidity position*;

By monetary positions are aimed the value of liquid assets at a time.

First, *monetary position management* means framing in the minimum *reserve requirements*, which we have presented above. Then identify all significant transactions affecting money in current account with the central bank and performing all operations necessary for contrary to influence of the transactions on monetary position.

Liquidity position is determined as the difference between the amount of liquid assets and volatile liabilities.

As we mentioned liquidity position is calculated on *maturity band*, as a difference between liquid assets and volatile liabilities and may exist following situations:

a) negative liquidity position, means that liquid assets are insufficient to meet full compliance of obligations , so that resort to immediate sources such as:

- loans on the interbank market;
- premature liquidation of assets in the portfolio;
- loans from the central bank.

b) positive liquidity is position means that resources exceeds the necessary . In this case the excess over the permitted limit is placed on short-term interbank deposits form.

For more accurate determination of the liquidity position will be scored on the first maturity band at book value all liabilities with maturity of sight. Among them include: refinancing loans from the National Bank of Romania, the amounts of correspondent accounts of credit institutions, credit institutions' deposits redeemable at notice, loans from overnight received of credit institutions, amounts of repos on overnight credit institutions. Also on the first maturity band will record : securities lent on overnight credit institutions, loans on a day to day

financial institutions , amounts of repos on overnight with customers, titles lent from one day to another customer and amounts on account settlement on securities operations [9] .

Must be followed daily as, the customer deposits, customer deposits redeemable at notice and amounts of accounts payable of customers to be placed on the first maturity band at a value adjusted up to 40% of book value.

5. Conclusions

One of the most important tasks of credit institution management is to estimate and properly cover bank liquidity needs.

For as banks are able to fully satisfy and at the agreed deadlines their clients commitments, managers will managing liquidity through operative schedules. But, outputs and inputs of cash availability that are developed by each bank's interbank settlements do not fall sometimes their predictions, which may lead to different variations and a certain consequences.

So, it is important that credit institutions oversee their daily assets exposure to risk and estimate their liquidity position.

To estimate the liquidity position credit institutions management may establish:

- or an aggressive policy of Quickly growth on loan volume towards deposits volume. And so therefore an additional need on long-term liquidity and may reduce by decrease the margin of liquidity or by borrowing;

- or an slower borrowing activity than establishment of deposits volume. And thus, resulting an extra long term liquidity that can be used to increase liquidity margin or refinancing banking investment.

In conclusion, maintaining an uncorrelated limit too high or too low of liquidity, may be leading, either to higher costs and reduced profitability registration or possibly to financial losses, or may cause business disruption bank and bankruptcy. Thus, management of credit institutions must achieve efficient liquidity risk management, particularly through quantitative measures for assessing the short and long term of liquidity position. Monitoring risk exposure to ensure of liquidity has a significant impact on financing strategies of bank balance sheet structure, especially in times of financial crisis.

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