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Analysis of the Current Situation of Liquidity Risk Management in China's Commercial Banks and the Proposed Countermeasures

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Abstract: This paper discusses in depth the importance of liquidity risk management in commercial banks and the challenges it faces at a time of accelerated global economic integration. Financial globalization not only brings unprecedented development opportunities for the banking industry, but also exposes it to more complex and volatile liquidity risks. As an important part of the financial system, the sound operation of commercial banks is crucial for maintaining financial stability and healthy economic development. The article focuses on the current situation of liquidity risk management in Chinese commercial banks and reveals the core issues of weakening deposit base and loan expansion aggravating liquidity pressure through detailed analysis. Subsequently, a combination of literature review and case studies is used to analyze the dual impact of macroeconomic fluctuations and micro-management deficiencies on liquidity risk. Ultimately, the study concludes by emphasizing the key roles of the improvement of the government regulatory system and fintech in optimizing the asset and liability structure of banks and enhancing the efficacy of risk management, which together safeguard the sound operation of the financial system and the sustained and healthy development of the economy.

Keywords: commercial banks, liquidity risk, risk management, Internet finance.

1. Introduction

As an important part of the financial system, the sound operation of commercial banks is crucial to maintaining financial stability and healthy economic development. Liquidity risk is one of the main risks faced by commercial banks, and its management has always been the focus of attention of major banks in their operations. In 2018, the Liquidity Risk Management Measures for Commercial Banks issued by China's CBRC provided a specific definition of liquidity risk: when commercial banks are fulfilling their obligations to settle their liabilities and interest or maintain normal operations, they are not able to raise funds in a timely manner at a reasonable cost and within a controllable range. The risk faced by a bank as a result of its inability to raise funds in a timely manner and within a reasonable and controllable cost range. Liquidity risk not only affects the safety of the bank's own operations, but may also trigger systemic risk, impacting the entire financial system and the economy. In the context of financial globalization, accelerated financial innovation and economic cycle fluctuations, the study of liquidity risk management of commercial banks is of great theoretical and

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practical significance, this paper will analyze the current situation of liquidity risk management of Chinese commercial banks and put forward countermeasures from multiple perspectives.

2. Current situation of liquidity risk management of Chinese commercial banks

From the point of view of China's liquidity supervision history, China's banking industry has long been in an environment of overall liquidity adequacy and moderation, and the importance of liquidity risk supervision is weak, but the phases of bank liquidity risk events continue to appear, such as, the ‘money shortage’ event in 2013 and the takeover of Baoshang Bank and Jinzhou Bank in 2019, which has provided an opportunity for China's financial institutions to enhance the management of liquidity risk. The 'money shortage' incident in 2013 and the subsequent takeover and restructuring of Baoshang Bank and Jinzhou Bank in 2019 have served as a wake-up call for financial institutions in China to prioritize their liquidity management[1]. In recent years, China's commercial banks have improved their liquidity risk management, but the overall awareness still needs to be strengthened, as some banks continue to prioritize meeting regulatory targets over enhancing their management capabilities. The liquidity gap exists objectively, requiring banks to strengthen risk management to cope with the potential pressure. At the same time, high capital leverage ratios, a single form of assets (especially a high proportion of loans and poor liquidity), low credit asset quality and a rising proportion of liquid liabilities have increased the complexity and challenges of liquidity management. Banks need to pay attention to these factors in order to ensure the stability of their funding sources and the safety of their operations.

2.1. Problems

With the rise of Internet finance and the enhancement of residents' awareness of financial management, a large amount of funds have flowed from the traditional banking system to money market funds and Internet financial products. These products have attracted a large amount of funds with their high liquidity and relatively high yields, leading to the erosion of the deposit base of commercial banks. The development of financial technology has changed the speed and pattern of capital flows, making the traditional liquidity management method based on the law of large numbers no longer applicable [2]. Third-party payment platforms need to maintain a high proportion of liquidity to cope with the instantaneous demand for a large number of payments, which poses new challenges and requirements for the liquidity management of the entire financial system. Meanwhile, in order to support the development of the real economy, commercial banks have continued to increase the volume of loan disbursements, especially small and medium-sized enterprise (SME) loans and personal consumption loans, etc. Data from the General Administration of Financial Supervision showed that as of the end of the second quarter of 2024, the balance of loans used by banking financial institutions for micro and small enterprises (including loans to small and micro enterprises, loans to individual industrial and commercial households, and loans to owners of small and micro enterprises) amounted to RMB 78 trillion. Of this total, the balance of loans specifically designated for inclusive micro and small enterprises with a single-family credit amount of RMB 10 million yuan or less reached RMB 32 trillion. This represents a significant year-on-year increase of 17.1 percent. Furthermore, there has been notable growth in personal consumption loans among several banks. For instance, Bank of Communications experienced an impressive 86.25 percent year-on-year increase in personal consumption loans in 2023. Under the dual role of ‘deposit moving’ and loan expansion, there is an obvious gap between the liquidity supply and demand of commercial banks, resulting in the need for banks to make up for the liquidity gap through borrowing, bond issuance, etc., which increases the financing cost and liquidity risk.

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2.2. Causes of the problem

2.2.1. Macro factors

The liquidity risk faced by commercial banks is significantly affected by multiple factors at the macro level. Firstly, the disorderly fluctuation of the financial market environment and the inconsistency of the financial and economic cycles have intensified the operating pressure on commercial banks, especially when the actual profit and loss within the bank cannot be synchronized with the book profit, highlighting the complexity of liquidity management. In addition, the interest rate market reform, as a key factor, has made the level of interest rates determined by market supply and demand, which not only profoundly affects the financial management and financing behaviours of residents and enterprises, but also indirectly plays a role in the liquidity position of commercial banks. When the market interest rate changes, it may impact the balance between the supply and demand of funds in banks, thereby triggering liquidity risk[3]. Furthermore, the implementation of monetary policy also has a direct impact on the liquidity of commercial banks. A loose policy helps to increase market liquidity and reduce bank risk, while tightening the policy may lead to banks facing difficulties in accessing funds and increasing the risk of chain default. Finally, it is important not to overlook the effectiveness of external regulation, as it serves as a crucial guarantee for maintaining financial market stability and reducing liquidity risk.

2.2.2. Micro factors

From the micro level, the liquidity risk of commercial banks mainly originates from their internal management system and business operations. First of all, some banks are confronted with the issue of an inadequate liquidity risk management system, characterized by a deficient management framework and unclear delineation of job responsibilities, all of which constitute potential liquidity risk hazards. Secondly, irrational asset allocation structure is also one of the factors. For example, having too high a proportion of loans and low asset quality can lead to difficulties for banks in meeting the liquidity needs of funds in a timely manner when faced with them, thus exacerbating the liquidity risk. Insufficient technology is also a major challenge in the liquidity risk management of commercial banks. Some banks excessively rely on manual empirical judgment in risk assessment and lack the support of an accurate data analysis system, leading to a negative impact on the accuracy and timeliness of risk assessment, which is especially obvious in small and medium-sized banks[4].

3. Suggestions for liquidity risk supervision of commercial banks

While financial technology has the potential to drive innovation within commercial banks, its current level of application remains limited. In the short term, the negative impact of financial technology, such as technology integration risk and market uncertainty, is often perceived to outweigh the positive benefits, resulting in a rise in liquidity risk of commercial banks[5]. In the future, with the development of financial technology, especially the application of big data, artificial intelligence and other technologies, commercial banks can predict and manage liquidity risk more accurately. For instance, by building an intelligent risk control system banks can monitor the liquidity situation in real-time and adjust the asset and liability structure in a timely manner to cope with potential risks. In addition, with the continuous development of the capital market and the increasing improvement of the financial market, commercial banks can reduce the dependence on a single source of funds through diversified financing channels to improve the flexibility of liquidity management. Meanwhile, the improved market environment also provides more investment opportunities and risk management tools for banks.

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3.1. Government Sector

The Measures for Liquidity Risk Management of Commercial Banks implemented in 2018 established a number of supervisory indicators, such as the liquidity coverage ratio, to strengthen liquidity risk management. However, relying on these intuitive indicators alone is no longer sufficient [6].

The study emphasizes the importance of considering non-intuitive indicators such as the liquidity gap and the degree of financial deepening in order to obtain a more comprehensive understanding of a bank's liquidity health, which provide valuable insights that contribute to a more holistic assessment of a bank's overall financial stability. Therefore, it is recommended that regulators pay more attention to such indicators on an existing basis in order to build a more comprehensive risk monitoring system to ensure that commercial banks can effectively respond to potential liquidity risks and safeguard the stability and security of the financial system. Faced with the differences of different commercial banks, the CBRC needs to implement differentiated supervision and customize the supervisory indicators based on factors such as asset size, business scope and customer types. At the same time, in view of the policy risks associated with macroeconomic and financial reforms and openness, it is recommended that the legislative process be accelerated, a financial stability coordination mechanism be constructed that encompasses multiple parties, and the powers and responsibilities of the supervisory authorities and the co-operative governance mechanism be clarified, so as to effectively manage and cope with risks[7].

3.2. Banks themselves

Firstly, it is recommended that a reserve of high-quality liquid assets be reasonably established, the efficiency of asset use be improved by building up the asset structure in a hierarchical manner, and the adequacy of reserve assets be ensured[8]. On the asset side, asset diversity should be increased, the proportion of loans should be reduced, and the proportion of bonds and other financial instruments should be raised. On the liability side, it is necessary to reduce demand deposit dependence, implement differentiated liability pricing strategies, and flexibly use active liability instruments such as peer-to-peer lending, bond issuance and central bank borrowing to effectively manage liquidity risk and enhance the bank's overall liquidity level.

Research shows that commercial banks with better internal control quality have relatively lower liquidity risk[9]. In order to enhance the liquidity risk management capability of commercial banks, it is recommended to build a comprehensive set of internal control mechanisms, including the implementation of a multi-dimensional and real-time liquidity monitoring system, the improvement of liquidity risk stress testing based on scenario simulation and quantitative analysis, and the deepening of the early warning mechanism for liquidity risk. These measures will serve to enhance banks' ability to identify, assess and respond to potential liquidity risks, ensuring that they maintain sound operations in a complex and volatile market environment[10].

4. Conclusion

In summary, as the cornerstone of the financial system, the liquidity risk management of commercial banks plays a crucial role in maintaining financial stability and healthy economic development. Currently, although Chinese commercial banks have made some progress in liquidity risk management, they still face many challenges, including erosion of the deposit base, the gap between liquidity supply and demand brought about by loan expansion, and multiple risk factors at the macro and micro levels. With the development of fintech and the changing market environment, commercial banks are facing both challenges and new development opportunities. Therefore, the government should further improve the supervisory system, introduce more non-intuitive indicators, implement

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differentiated supervision, and accelerate the legislative process to build a financial stability coordination mechanism. At the same time, commercial banks themselves need to strengthen their internal controls, optimize their asset and liability structures, enhance their liquidity reserves and improve their risk management capabilities with the help of financial technology. Through the dual role of government supervision and the banks' own efforts, the liquidity risk management level of commercial banks can be effectively improved to ensure that they maintain sound operation in the complex and volatile market environment, contributing to the stability of the financial system and the high-quality development of the economy.

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