BANK ANALYSIS

CAMELS – Liquidity

A bank´s liquidity measures its ability to pay for current obligations, hence efficiently meeting present and future cash flow needs without adversely affecting daily operations.

Sound banking operations and monitoring systems are preconditions to ensure sufficient solvency on an ongoing basis. – A mid-size financial institution unable meeting its short-term obligations may not only go out of business within merely hours or days, but could actually even endanger the entirety of a national banking system. Therefore, liquidity planning and monitoring is a major focus point of any banking operation.

Naturally, cash and investments – as long as made in a liquid, efficient market - are the most liquid assets of a bank. As a matter of fact, adequate liquidity means that an institution has sufficient funds currently available or can obtain such easily and swiftly: This can be done by either rising funds or by monetizing assets at a reasonable cost.

Liquidity requirements have to be constantly monitored and anticipated through sophisticated planning tools, including cash flow needs for funding loan demand, share withdrawals, or the payment of liabilities (including deposit withdrawals) and expenses (including interest as well as staff or else). – At the same time, merely hoarding excess funds may point towards an inadequate or inefficient liquidity management, as yields earned on the basis of such a strategy will by all means only be meagre.

Now, banks generate foremost income by mobilizing short-term deposits at relatively lower interest rates, and lending or investing these funds long-term at relatively higher rates. This makes banks so particularly vulnerable in regards to matching all of the following: Lending as well as borrowing interest rates, but even more so: deposits and other liabilities on the passive side of the balance sheet and loans and securities on the active side of the balance sheet.

In regards to funding, history indicates that deposits, even though having only extremely short maturities, have proven as a very sticky, and therefore stable, source of funding. Quite on the opposite, interbank funding and other short- to medium-term funding tools, such as repos, have proven as rather fickle, especially during market disturbances. In any case, the funding sources of a financial institution should ideally be widely diversified not only across numerous investor clusters but also in regards to instruments as well as terms, such as maturities. Therefore, contingency planning to meet unanticipated events or handle periods of excess liquidity, is utmost important. Whereby such planning has to extend to and include off-balance sheet obligations, such as guarantees or stand-by commitments.

To ensure banks having sufficient liquidity in the course of market instabilities, the Basel III Regime introduced a number of liquidity minimum benchmarks: Among others, nowadays banks have to permanently hold highly liquid assets of an amount equivalent to the expected net cash requirements over a period of 30 days. Assets qualifying for this purpose are only cash and a set of selected frequently traded and highly rated government bonds.

LIQUIDITY

TOTAL CUSTOMER DEPOSITS | TOTAL ASSETS
TOTAL LOANS | TOTAL CUSTOMER DEPOSITS
LIQUIDITY | TOTAL ASSETS
GOVERNMENT SECURITIES | TOTAL ASSETS
LIQUIDITY | DEMAND DEPOSITS