West Science Interdisciplinary Studies
Vol. 02, No. 10, October and 2024: pp. 2029-2040

Analysis of the Impact of Liquidity Policy and Economic Fluctuations on Asset and Wealth Management in the Banking Sector in Indonesia

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ABSTRACT

This study analyzes the impact of liquidity policy and economic fluctuations on asset and wealth management in the Indonesian banking sector. Utilizing a quantitative approach, data were collected from 150 banking professionals through a structured questionnaire and analyzed using Structural Equation Modeling (SEM) with Partial Least Squares (PLS) version 3. The results demonstrate that economic fluctuations significantly impact both asset and wealth management, with a stronger influence on wealth management. Liquidity policy also plays a crucial role in improving asset and wealth management practices, though its impact is moderate compared to economic fluctuations. These findings suggest that banks must adopt robust liquidity management and risk mitigation strategies to navigate periods of economic uncertainty and optimize asset and wealth management practices. The study provides important insights for banking professionals and policymakers aiming to enhance financial stability and operational efficiency in the banking sector.

Keywords: *Liquidity Policy, Economic Fluctuations, Asset Management, Wealth Management, Banking Sector*

1. INTRODUCTION

The banking sector is crucial for economic stability and development, especially in emerging economies like Indonesia. Banks manage assets and wealth, ensuring liquidity and resilience against economic fluctuations. Effective asset management supports stability and growth during uncertainties. Liquidity policies, which involve managing cash and liquid assets to meet short-term obligations, are key to this stability, particularly when facing inflation and interest rate changes. Banks also play a vital role in mobilizing savings and allocating capital to drive economic growth [1], [2]. In developing countries, banking development fosters financial inclusion and progress [2]. Managing non-performing assets (NPAs) is essential for profitability and stability [3], while regulatory frameworks help banks withstand economic fluctuations [4]. Liquidity policies enable banks to adapt to economic cycles and maintain stability [1].

The Indonesian banking industry has grown significantly but faces challenges in balancing liquidity and asset management amid economic fluctuations. Liquidity, measured by the Loan to Deposit Ratio (LDR), positively impacts profitability, highlighting the need for effective liquidity management, while non-performing loans (NPLs) negatively affect profitability, emphasizing the importance of credit risk management [5]. Macroeconomic factors like GDP growth negatively impact return on assets (ROA), while inflation positively influences bank performance [6], [7]. Sustainability practices in asset management indirectly enhance bank value, with increasing commitment to sustainable finance [8]. The sector must remain vigilant to global uncertainties, which could impact performance and stability [7]. Strategic asset and liquidity management is vital for sustainable growth [9]. However, the relationship between liquidity policy, economic fluctuations,

and asset and wealth management in Indonesia's banking sector has not been sufficiently explored, which leaves a gap in the understanding of how these factors interact.

Liquidity policies in Indonesia's banking sector are vital for maintaining stability during economic fluctuations by ensuring sufficient liquid assets to meet short-term liabilities, though they can limit long-term, higher-yield investments, affecting profitability. Increasing the Liquidity Coverage Ratio (LCR) often leads to reduced credit distribution as banks prioritize liquidity [10], while the Capital Adequacy Ratio (CAR) does not significantly impact credit growth, showing strong bank capital [10]. Liquidity risk positively influences profitability, moderated by CAR, with a nonlinear relationship between profitability and liquid asset holdings, suggesting an optimal liquidity level for profit maximization [11], [12]. FinTech, especially peer-to-peer lending, increases credit risk, particularly in smaller banks, emphasizing the need for tailored financial frameworks [10], [13]. To balance liquidity and profitability, banks must optimize liquid asset holdings and adopt tailored liquidity management strategies based on economic conditions and bank types [12], [14].

By addressing this gap, the study contributes to a broader understanding of how banks can strengthen their financial resilience and improve asset and wealth management practices amidst dynamic economic conditions. The research objectives are threefold: first, to analyze the impact of liquidity policy on asset and wealth management in Indonesia's banking sector; second, to examine the effect of economic fluctuations on asset and wealth management; and third, to explore how banks can optimize asset and wealth management practices to navigate periods of economic uncertainty.

2. LITERATURE REVIEW

2.1 Liquidity Policy in the Banking Sector

Liquidity policy is a critical component of bank management, ensuring that banks can meet their short-term obligations and maintain financial stability. Effective liquidity management involves balancing liquid assets to meet withdrawal demands and regulatory requirements, such as those outlined in the Basel III Accords, which emphasize liquidity coverage ratios (LCR) to prevent bank runs and ensure stability during financial stress. Larger banks have more access to liquid funds through interbank lending, while smaller banks may rely more on customer deposits. Liquidity is crucial for a bank's solvency, and a loss of liquidity can lead to insolvency [10]. Liquidity hoarding can reduce systemic risk, particularly in larger banks and developed countries, although policymakers must balance liquidity creation for growth with stability [15]. Liquidity risk is influenced by both bank-specific factors and macroeconomic variables like GDP and inflation, making effective liquidity risk management essential to avoid financial losses and bank failures [16]. Additionally, banks with different business models face varying LCR effectiveness, with precautionary liquidity buffers helping to mitigate these differences [17], [18].

2.2 Economic Fluctuations and Their Impact on Banking

Economic fluctuations greatly impact the banking sector by influencing credit risk, interest rate spreads, and financial stability. Systemic risks during economic uncertainty, such as inflation and exchange rate volatility, often lead to increased borrower defaults, raising non-performing loans (NPLs) and straining banks' liquidity and asset management [19]. Interest rate volatility further complicates financial planning, as rising

rates increase market risks, affecting banks' profitability and stock returns, as seen in the case of Silicon Valley Bank [20], [21]. Inflation and monetary policy also significantly affect bank profitability, particularly in regions like Africa and the Middle East, where they influence return on assets and equity, highlighting the need for robust credit risk management [22]. Additionally, political and economic risks, such as corruption, can destabilize banks, but financial inclusion and competition among banks can promote stability, mitigating these risks [19], [23].

2.3 Asset and Wealth Management in Banking

Asset and wealth management are essential to banking operations, optimizing resource allocation to generate returns while minimizing risks. Asset management focuses on overseeing loans, investments, and liquid assets to maintain profitability, especially during economic instability. Wealth management serves high-net-worth individuals and institutional clients, offering portfolio management and investment advisory services. During downturns, both shift from growth strategies to capital preservation. Effective asset management aligns with ISO55000 standards to reduce costs and risks [24]. Asset Liability Management (ALM), managed by the ALCO, balances assets and liabilities, particularly in Islamic banking [25]. Wealth management also incorporates philanthropy and personalized investment strategies to balance financial goals with social impact [26], [27].

2.4 The Relationship Between Liquidity Policy, Economic Fluctuations, and Asset and Wealth Management

Liquidity policy, economic fluctuations, and asset and wealth management are tightly connected, with liquidity policies stabilizing banks during instability. Banks with robust liquidity management navigate fluctuations better, deploying liquid assets without risking solvency [28]. Economic fluctuations influence asset strategies, with aggressive moves during growth and conservative shifts during downturns. In vulnerable economies like Indonesia, banks with strong liquidity reserves and flexible asset management outperform during crises. Economic policy uncertainty (EPU) impacts liquidity creation globally, with different effects in developed and developing nations [28]. Indian banks hoard liquidity, especially larger ones with higher credit risk [29]. In South Asia, a concave relationship between profitability and liquid assets indicates an optimal liquidity level [12]. Banks increase liquidity reserves and focus on low-risk assets like government bonds during downturns [30], and Indonesian banks with strong liquidity perform well in crises [31].

Gaps in the Literature

While substantial research exists on liquidity policy, economic fluctuations, and asset and wealth management individually, there is limited literature that directly examines the interplay between these factors in the Indonesian banking sector. Most existing studies focus on Western banking systems, with few addressing emerging economies like Indonesia. Additionally, the role of economic fluctuations in shaping the relationship between liquidity policy and asset management in the Indonesian context remains underexplored. This study aims to address this gap by examining the impact of

liquidity policy and economic fluctuations on asset and wealth management in Indonesia's banking sector.

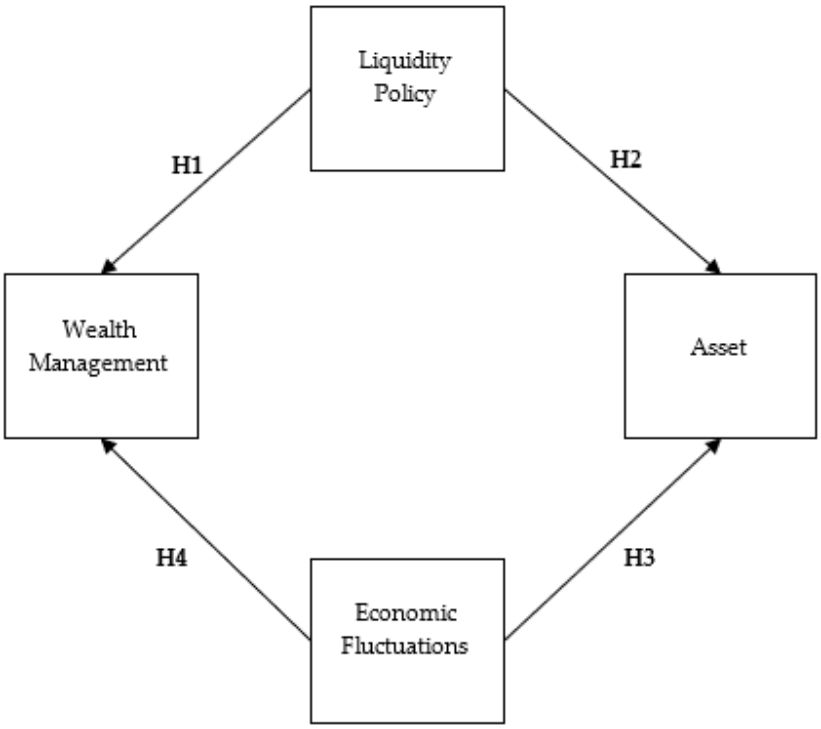

Figure 1. Conceptual Framework

3. METHODS

3.1 Research Design

The research design for this study is quantitative and explanatory, aiming to test hypotheses and examine the cause-and-effect relationships between liquidity policy, economic fluctuations, and asset and wealth management in Indonesia's banking sector. Quantitative research is appropriate for this study because it allows for the measurement of relationships between variables through statistical analysis. The study also adopts a cross-sectional design, where data were collected at a single point in time to analyze the current practices of banks regarding liquidity management and asset and wealth management in the face of economic fluctuations.

3.2 Population and Sample

The population for this study consists of professionals working in Indonesia's banking sector, particularly those involved in liquidity management, asset management, and wealth management. This includes banking executives, financial managers, risk managers, and wealth management professionals from both private and state-owned banks. To ensure the representativeness of the sample, purposive sampling was employed to select respondents with direct experience and knowledge related to the study variables. A total of 150 respondents were chosen, a sample size deemed sufficient for SEM-PLS analysis, which typically requires 100 to 200 observations depending on model complexity (Hair et al., 2017). Respondents were selected based on their expertise in asset and wealth management, liquidity policy, and exposure to economic fluctuations in the banking sector.

3.3 Data Collection Method

Data were collected using a structured questionnaire designed to capture the perceptions of banking professionals regarding liquidity policy, economic fluctuations, and asset and wealth management. The questionnaire was distributed online and via email to ensure broad accessibility across various banking institutions in Indonesia. It was divided into two main sections: demographic information and variable measurement. The demographic section gathered details about the respondents' job roles, years of experience, and the type of bank they work for (e.g., private, state-owned, or international). The second section focused on measuring the independent and dependent variables, including liquidity policy, economic fluctuations, and asset and wealth management.

3.4 Data Analysis Techniques

Data analysis was performed using Structural Equation Modeling with Partial Least Squares (SEM-PLS) version 3, a multivariate analysis technique suitable for examining relationships between latent variables through multiple indicators. This method was chosen for its ability to handle complex models, small-to-moderate sample sizes, and its flexibility in assessing relationships between multiple independent and dependent variables. The analysis followed several steps: first, a conceptual model was developed with liquidity policy and economic fluctuations as independent variables and asset and wealth management as the dependent variable. The measurement model was then assessed for reliability and validity using Cronbach's alpha, composite reliability, average variance extracted (AVE), and the Fornell-Larcker criterion to ensure internal consistency and validity (Hair et al., 2017). After confirming the measurement model, the structural model was tested by estimating path coefficients to evaluate the strength and significance of relationships, using bootstrapping with 5,000 subsamples to generate t-statistics and p-values. Model fit was assessed through R-squared values and the Stone-Geisser Q-square test to confirm predictive relevance (Chin, 1998). Finally, hypothesis testing was conducted to determine whether liquidity policy and economic fluctuations significantly impact asset and wealth management in the banking sector.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

The descriptive statistics provide an overview of the respondents' demographic characteristics and summarize their perceptions regarding liquidity policy, economic fluctuations, and asset and wealth management. Among the 150 respondents, 65% were senior banking professionals, while 35% were middle management employees involved in asset, wealth, and liquidity management. The respondents represented both state-owned (60%) and private banks (40%), with an average of 12 years of experience in the banking sector, indicating a well-experienced sample. Regarding the variables, the mean score for liquidity policy was 4.23, showing a strong belief in the effectiveness of liquidity management practices in their institutions. Economic fluctuations received a mean score of 3.79, indicating moderate concerns about the effects of economic instability, including currency volatility and interest rate changes. Asset and wealth management scored an average of 4.15, suggesting that banks are actively managing portfolios and client wealth to mitigate risks and optimize returns amid economic challenges.

4.2 Measurement Model Discussion

In assessing the measurement model, key indicators of reliability and validity are examined, including factor loadings, Cronbach's alpha, composite reliability (CR), and average variance extracted (AVE). These metrics ensure that the constructs used in this study are measured reliably and accurately. The measurement model was evaluated for four main variables: Impact of Liquidity Policy, Economic Fluctuations, Asset Management, and Wealth Management.

Table 1. Measurement Model

Variable	Code	Loading Factor	Cronbach's Alpha	Composite Reliability	Average Variant Extracted
Impact of Liquidity Policy	ILP.1	0.874	0.900	0.937	0.833
	ILP.2	0.944			
	ILP.3	0.919			
Economic Fluctuations	EFL.1	0.730	0.823	0.883	0.655
	EFL.2	0.810			
	EFL.3	0.820			
	EFL.4	0.870			
Asset	AST.1	0.882	0.837	0.902	0.754
	AST.2	0.856			
	AST.3	0.867			
Wealth Management	WEM.1	0.776	0.864	0.901	0.647
	WEM.2	0.838			
	WEM.3	0.826			
	WEM.4	0.800			
	WEM.5	0.779			

Source: Data Processing Results (2024)

All constructs in the model have loading factors above the acceptable threshold of 0.70, indicating good indicator reliability. The Cronbach's alpha values for all constructs exceed 0.7, demonstrating strong internal consistency across all variables. Composite reliability (CR) values are greater than 0.80 for all constructs, further confirming the reliability of the measurement model. Additionally, the AVE values for all variables surpass 0.50, ensuring good convergent validity, meaning that the indicators adequately explain the variance in their respective constructs. The overall assessment of the measurement model confirms that it has good reliability and validity, with constructs appropriately measured by their indicators. Discriminant validity was assessed using the Fornell-Larcker criterion, where the square root of the AVE for each construct was greater than its correlations with other constructs, establishing sufficient discriminant validity.

Table 2. Discriminant Validity

	AST	EFL	ILP	WEM
Asset	0.868			
Economic Fluctuations	0.719	0.809		
Impact of Liquidity Policy	0.676	0.762	0.813	
Wealth Management	0.794	0.747	0.686	0.804

Source: Data Processing Results (2024)

The analysis demonstrates that the square roots of the AVEs for all constructs are greater than their correlations with other constructs, indicating good discriminant validity across the model. This means that each construct is measuring a unique aspect of the phenomena under investigation, and the indicators for one construct do not overlap with those of another.

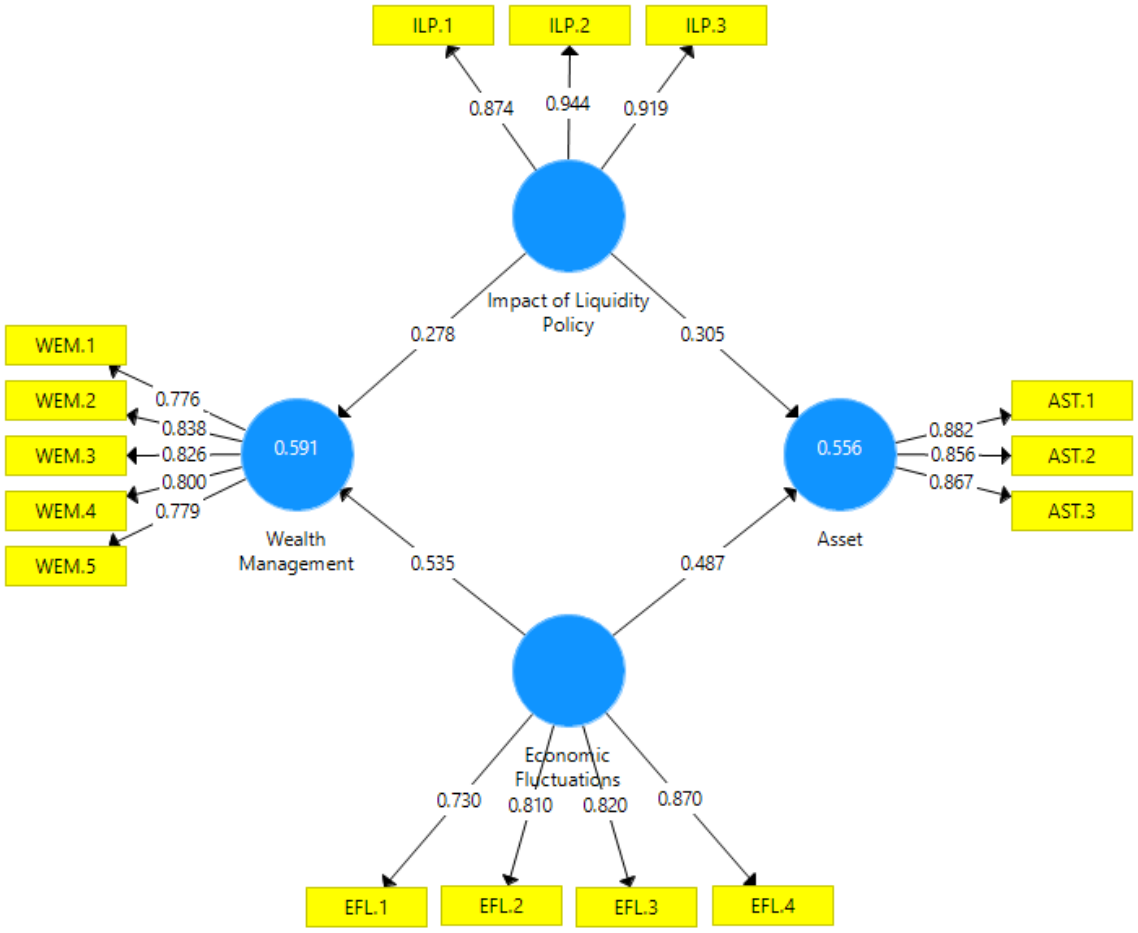

Figure 2. Model Results

Source: Data Processed by Researchers, 2024

4.3 Model Fit

Model fit indices assess how well the proposed structural model represents the data. A well-fitting model is critical to ensure that the theoretical relationships hypothesized between constructs align with the actual data. In this study, various model fit indices are used to evaluate the fit of both the Saturated Model and the Estimated Model. These indices include the Standardized Root Mean Square Residual (SRMR), d_ULS, d_G, Chi-Square, and Normed Fit Index (NFI).

Table 3. Model Fit Results Test

	Saturated Model	Estimated Model
SRMR	0.081	0.098
d_ULS	0.796	1.147
d_G	0.478	0.556
Chi-Square	315.724	343.075
NFI	0.768	0.748

Source: Process Data Analysis (2024)

The Standardized Root Mean Square Residual (SRMR) is a goodness-of-fit measure that quantifies the difference between observed and predicted correlations, with lower values indicating better fit. For this study, the SRMR for the Saturated Model is 0.081, close to the 0.08 threshold, indicating near-acceptable fit, while the Estimated Model SRMR is slightly higher at 0.098, suggesting a weaker but reasonable fit. The d_ULS (Squared Euclidean Distance) for the Saturated

Model is 0.796, indicating good fit, whereas for the Estimated Model, it increases to 1.147, showing some deterioration in fit. The d_G (Geodesic Distance) values are low for both models, with 0.478 for the Saturated Model and 0.556 for the Estimated Model, reflecting reasonably good fit. The Chi-Square values are 315.724 for the Saturated Model and 343.075 for the Estimated Model, showing a slight increase, but the test's sensitivity to sample size means the results should be interpreted cautiously. Finally, the Normed Fit Index (NFI) values are 0.768 for the Saturated Model and 0.748 for the Estimated Model, both below the recommended threshold of 0.90, suggesting moderate fit. However, these values are acceptable for exploratory research, particularly for complex models involving latent variables.

Table 4. Coefficient Model

	R Square	Q2
Asset	0.556	0.549
Wealth Management	0.591	0.584

Source: Data Processing Results (2024)

The R-Square (R^2) values measure the proportion of variance in the dependent variables "Asset Management" and "Wealth Management" explained by the independent variables, liquidity policy and economic fluctuations. For Asset Management, the R^2 value is 0.556, indicating that 55.6% of the variance is explained by the independent variables, suggesting a moderate explanatory power, though other factors may also influence asset management. For Wealth Management, the R^2 value is slightly higher at 0.591, showing that 59.1% of the variance is explained by the same independent variables, reflecting a stronger influence. According to Chin (1998), R^2 values of 0.556 and 0.591 indicate moderate-to-strong explanatory power, suitable for complex relationships in the banking sector. The Q-Square (Q^2) values, which assess the predictive relevance of the model, show high predictive power for both Asset Management (Q^2 = 0.549) and Wealth Management (Q^2 = 0.584). These values indicate that the model can accurately predict new data points and reinforce the importance of liquidity policy and economic fluctuations in shaping asset and wealth management strategies in banks. According to Hair et al. (2017), Q^2 values above zero suggest strong predictive relevance, with both constructs exceeding 0.50, indicating a high level of predictive capability in the model.

4.4 Hypothesis Testing

In structural equation modeling (SEM-PLS), hypothesis testing evaluates the significance of relationships between independent and dependent variables. Key outputs such as the Original Sample (O), Sample Mean (M), Standard Deviation (STDEV), T-Statistics, and P-Values help determine whether the hypothesized relationships are statistically significant. In this study, the relationships between Economic Fluctuations and Liquidity Policy on Asset Management and Wealth Management were assessed. The significance of these relationships is determined by T-statistics greater than 1.96 and P-values less than 0.05, indicating that the relationships are statistically significant.

Table 5. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics	P Values
Economic Fluctuations -> Asset	0.487	0.481	0.108	4.504	0.000
Economic Fluctuations -> Wealth Management	0.535	0.531	0.101	5.314	0.000
Impact of Liquidity Policy -> Asset	0.305	0.318	0.118	2.597	0.001

Impact of Liquidity Policy -> Wealth Management	0.278	0.289	0.116	2.405	0.004

Source: Process Data Analysis (2024)

The study's hypothesis testing reveals that all four relationships between Economic Fluctuations, Liquidity Policy, Asset Management, and Wealth Management are positive and statistically significant. For Economic Fluctuations and Asset Management, the Original Sample (O) is 0.487, with a T-statistic of 4.504 and a P-value of 0.000, indicating a strong positive impact, as economic fluctuations prompt adjustments in asset management strategies (Claessens & Kose, 2013). Similarly, the relationship between Economic Fluctuations and Wealth Management shows a higher impact with an O of 0.535, a T-statistic of 5.314, and a P-value of 0.000, emphasizing the importance of economic factors in wealth management decisions. The impact of Liquidity Policy on Asset Management is also significant, with an O of 0.305, a T-statistic of 2.597, and a P-value of 0.001, suggesting that effective liquidity management enhances asset management by balancing liquid and long-term assets. Lastly, Liquidity Policy's influence on Wealth Management, with an O of 0.278, a T-statistic of 2.405, and a P-value of 0.004, underscores its role in ensuring flexibility in wealth management, although the effect is slightly lower than on asset management. All four relationships are supported by the data, with T-statistics exceeding 1.96 and P-values below 0.05.

Discussion

The results of this study provide significant insights into the relationships between liquidity policy, economic fluctuations, and the effectiveness of asset and wealth management in the banking sector in Indonesia. In this section, we discuss the implications of the findings, relate them to existing literature, and explore their practical significance for both banking institutions and policymakers.

The Impact of Economic Fluctuations on Asset and Wealth Management

The analysis demonstrates that economic fluctuations have a strong and statistically significant positive impact on both asset management and wealth management in Indonesian banks, with T-statistics of 4.504 and 5.314, respectively, indicating significant adjustments in banking strategies in response to external economic conditions. Economic fluctuations explain a substantial portion of the variance in these practices, confirming their robustness. This aligns with existing literature, such as Claessens and Kose (2013), which emphasizes how banks adapt to economic instability, including inflation, interest rate changes, and exchange rate volatility, to reduce risk exposure [32]. The strong impact on wealth management (O = 0.535) highlights the importance of managing client assets with a focus on wealth preservation and risk mitigation during economic downturns [28], [33]. Similarly, the significant effect on asset management (O = 0.487) underscores the need for banks to adjust their investment portfolios and asset allocation strategies in response to market conditions, consistent with Minsky's (1986) theory that economic instability increases financial risk, prompting more conservative asset management approaches to protect liquidity and profitability.

The Role of Liquidity Policy in Asset and Wealth Management

The results highlight the critical role of liquidity policy in shaping asset and wealth management practices, with a positive and statistically significant impact on both asset management (O = 0.305, T = 2.597, P = 0.001) and wealth management (O = 0.278, T = 2.405, P = 0.004), though its effect is somewhat weaker than that of economic fluctuations. This underscores the importance of robust liquidity management in ensuring bank stability[12], especially during economic uncertainty. As Berger and Bouwman (2009) suggest, effective liquidity policies enable banks to maintain sufficient liquid assets to meet short-term obligations while managing long-term investments and client portfolios. In this study, the impact of liquidity policy on asset management (O = 0.305) indicates that banks with strong liquidity strategies can better manage their assets, balancing

immediate cash flow needs and long-term goals [28], [29]. Similarly, the positive effect of liquidity policy on wealth management (O = 0.278) emphasizes the role of liquidity in providing flexibility and stability for managing clients' wealth, particularly during volatile economic periods. This aligns with Diamond and Rajan's (2005) argument that liquidity is vital for maintaining trust among depositors and investors, especially in times of economic stress.

Interaction Between Liquidity Policy and Economic Fluctuations

Although this study does not explicitly examine the interaction effects between liquidity policy and economic fluctuations, the findings suggest that both factors work together to influence asset and wealth management [28]. In times of economic instability, liquidity policy acts as a safeguard, allowing banks to respond to market changes more effectively. This is particularly important in the Indonesian banking context, where fluctuations in global commodity prices, interest rates, and exchange rates can have pronounced effects on banking operations [29].

The combined effect of these two factors emphasizes the need for banks to adopt a holistic approach to risk management, integrating both liquidity and economic considerations into their asset and wealth management strategies. By doing so, banks can maintain financial stability, optimize returns, and protect client wealth during volatile market conditions[34].

Practical Implications for Banks

The findings of this study have several practical implications for banking institutions in Indonesia:

1. Banks should prioritize enhancing their liquidity management frameworks to ensure they are well-prepared for economic fluctuations. Maintaining sufficient liquid assets will allow banks to meet short-term obligations while optimizing long-term asset allocation.
2. Economic fluctuations have a significant impact on both asset and wealth management. Banks must continuously monitor economic indicators and adjust their strategies accordingly. This could include adopting more conservative asset management practices during periods of instability or diversifying investment portfolios to hedge against economic risks.
3. Given the strong impact of economic fluctuations on wealth management, banks should focus on offering flexible and risk-resilient wealth management solutions to their clients. This could include advising clients on how to protect their wealth during economic downturns, while still seeking opportunities for growth in less volatile markets.
4. Banks should integrate liquidity policy with their economic risk monitoring frameworks to ensure a comprehensive approach to managing both internal liquidity needs and external market risks. This will enhance their ability to maintain profitability and stability during periods of economic uncertainty.

Policy Implications

For policymakers and regulators, these findings highlight the importance of maintaining and enforcing liquidity regulations in the banking sector. Liquidity policy acts as a buffer during periods of economic stress, and its proper implementation is crucial for financial stability. Regulatory bodies should ensure that banks adhere to liquidity requirements and encourage practices that align with the broader economic conditions.

Moreover, policymakers should focus on creating a stable economic environment that reduces the volatility and uncertainty banks face. By fostering economic stability, the risks associated with managing assets and wealth in fluctuating markets can be minimized, thus enhancing the overall stability of the banking sector.

CONCLUSION

This research provides valuable insights into how liquidity policy and economic fluctuations influence asset and wealth management in the banking sector of Indonesia. The findings show that economic fluctuations have a significant positive impact on both asset and wealth management, with wealth management being more sensitive to changes in external economic conditions. Meanwhile, liquidity policy also plays a critical role, providing banks with the necessary flexibility to manage their assets and wealth effectively, especially during volatile periods.

For banking institutions, the results underscore the importance of strengthening liquidity management frameworks and continuously monitoring economic indicators to adapt their strategies accordingly. Policymakers must ensure that liquidity regulations are enforced to maintain the stability of the banking sector during times of economic uncertainty.

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