

The Effect Of Term Deposits On Bank Liquidity

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Abstract

The main objective of the study was to investigate the effect of term deposits on the Liquidity of Mitayen cooperatives credit union Cameroon. The study was quantitative and qualitative in nature. Data was collected through primary and secondary data. The sample size was made up of 80 respondents that were randomly selected from the financial institution. The primary data was collected using close-ended questionnaires with the main objective being structured in the questionnaires. The study made use of descriptive statistics to present data. The data were analyzed using correlation analysis and the use of alpha coefficient of 0.05 to test the significant relationship. It was discovered that term deposits have a negative effect on the liquidity of the financial institution. The alternate hypothesis was rejected while the null hypothesis was accepted. It was recommended that the management of the financial institution diversify investments into the stock market in order to raise sustainable liquidity for its operations.

INTRODUCTION

The global financial crisis reveals some problems associated with the liquidity of many financial institutions. It is commonly said that the backbone of every economy depends on its financial institutions. This is because these financial institutions serve as providers of money and other financial assets to the economy. Also, they act as employment opportunities for many peoples. Again, they enhance and promote economic growth and development in the country.

During the recent financial crisis in the CEMAC ZONE, many banks run out of cash in order to adequately perform their functions profitably. Some raised funds with large discounts in order to encourage depositors and debtors of loans. This crisis coupled with the recent Anglophone crisis in Cameroon slowed down the turnover of many businesses. As a result, the profit level fell. This downturn in the economy affected many financial institutions in the Anglophone regions of Cameroon which depended on the regular savings of many business entrepreneurs. Thus, some financial institutions have started revisiting their governance policies as a medium to accumulate their liquidity risk exposures. The Central bank of Cameroon (BEAC), since its independence, and in the year 2010, formulated excellent policies in order to revamp the deficiencies in Cameroon's financial institutions (Aaron,2008). More recently, was the formulation of sustainable economic policies in order to revamp the economic crisis in the country. It is an obvious fact that banks profit is of great importance. Over the years, many banks have adopted several approaches in order to solve liquidity risks faced by the banks. Among return on investment, return on assets and net interest margins, liquidity management is the most widely and commonly used approach to solve liquidity risk exposures in the banking industry(Aaron,2005). With this in mind, liquidity management is very crucial for the effective standardization of liquidity regulations in the banking sector.

Mistakes in bank liquidity planning and implementation can affect banking operations. This might exhibit long-term operations in the economy. Profitability does not translate to liquidity in all cases. Thus, liquidity should be managed in order to obtain an operational level. That is a level that avoids shortages and excesses of liquidity (Bassis Joel,2010). Liquidity management plays a significant role in the overall performance of the banking sector. Bank managers must be sensitive to identify, measure and control liquidity risk scenarios in the bank. This is because a mismatch in the assets and liabilities of the bank may affect the liquidity position of the bank(Daniel,2017). Many banks have high investments in illiquid assets but are tied up in loans. Some banks despite having lots of assets faced the challenges of sudden withdrawal of cash and thus, fall out of liquidity(Edem,2012). This has been identified as the major cause of bank failure in Island bank in Nigeria in the year 2008. The research aims to investigate the relationship between term deposits and liquidity in Mitayen cooperatives credit union Cameroon.

Statement of the Research Problem

In recent times, micro-banks improved their profit by providing a variety of products such as deposits, credit cards, investment and insurance programs. If a financial institution cannot effectively provide liquidity for its short-term and long-term investments, its reputation can be damaged. Term deposit is a type of savings that has a fixed return within a period. Term deposits can serve as a source of liquidity to the financial institution. If the rate of return on the term deposit is raised, it encourages more customers to invest in term deposits and that increases the liquidity. The liquidity of any bank enables the bank to be able to perform its operations successfully, with its main objectives being achieved (Elobeke,2017). Paul Dragos, (2013), in his study of bank liquidity and term deposit, listed four key factors to support these views. Firstly, bank liquidity builds a strong reputation for society. Secondly, a bank with

adequate liquidity satisfies customers' requirements. Thirdly, liquidity enables the bank to plan adequately. Fourthly, there would be more investments in many projects by the bank.

In Mitayen cooperative credit union, term deposit has an annual rate of return that is between 3.5% to 5.5%. This rate of return on term deposit is small to encourage savings or customers opening savings account.

Research Objective

The main objective of the study is to investigate the relationship between term deposits and the liquidity of Mitayen cooperatives credit union.

Hypothesis of the Research

On the basis of the research objective of the study, the null and alternate hypotheses would be made.

H1: There is a positive significant effect of term deposits on the liquidity at Mitayen cooperatives credit union

H2: There is a negative significant effect of term deposits on the liquidity at Mitayen cooperatives credit union.

Significance of the Research

This study identifies coping strategies for liquidity improvement in the financial institution. The discussions of liquidity strategies improving liquidity would help to revamp the liquidity problem in the financial institution. These new strategies would be; the issuing of bonds, investing in the financial market, retail deposits, and banking reserves with commercial banks.

Secondly, this study would enable the financial institution to identify and establish key responsibilities for management on how to make financial policies on term deposits. It would help the management of the institution to plan and monitor the progress of term deposits in the institution. Term deposit can attract high liquidity if properly and effectively control and evaluated.

The study would help management to implement strategies to motivate customers to desire the term deposit services of the institution.

Also, the research would help the bank to build and sustain a strong relationship with its clients and other stakeholders. New products would be designed to attract customers. The interest rates on term deposits would be favorable to attract customers earnings per share would increase to attract investors in the financial institution.

Literature Review

Bank Liquidity refers to the condition of the bank asset (liquid asset). It involves making money from bank transactions and being able to invest. Liquid assets can be easily moved from place to place. Let us define the term liquidity as it relates to banking. First, it's the property of an asset which includes that which can be converted into money quickly, with low transaction costs. Money is the only perfect liquid. Stocks and other assets however cannot be fully desirable as liquid. The problem with the financial market is the loss of liquidity that occurs from an exchange of financial assets (Robert Waldmann, 2009). Similarly, the other believes that liquidity is a property of an asset which indicates that a larger amount of it can be converted into money quickly at a price close to its current price (Waldmann, 2009). Hence, when an asset becomes illiquid, the bank becomes unable to meet its financial obligation.

The liquidity trap is a situation in which conventional policy loses all transactions. Banks affected by the global financial crisis took measures to maintain liquidity (Mike Shedock, 2008). Lack of liquidity occurs when the economy is stagnant, the nominal interest rate is close to zero, and the monetary authority is unable to stimulate economic growth via monetary and fiscal policy (Milton, 1969). In order to remedy the liquidity trap, other policy measures are suggested by the central bank, the central bank has set up a high rate of increase in the monetary base, and provides liquidity in the economy so as to achieve the goal (Hiro Ito, 2009) the bank can raise liquidity by investing in profitable projects in the public. In

this way, both the public and the bank absorb liquidity that can foster economic growth and development.

It's important for us to discuss on the different sources of liquidity in the bank. Banks are concerned on whether humans will have enough funds to pay their loans and interest at the appointed time. Liquidity is the main function of a bank's profitability. The more profitable a bank is, the more cash is available to keep the bank liquid. Also, the rate at which accounts receivable and inventory are converted to cash, is an important factor to create enough liquidity in the bank. Banks can collect their accounts earlier than another credit in order to have cash at hand. This means it has enough cash flow to invest (Paul, 2008).

Another essential factor to liquidity is the indication of the liquidity ratio of current assets to current liabilities. When a bank has a higher ratio of current assets and liabilities, the bank would be more liquid. This means that the bank has received more monies from loans. The sales of a bank's products like a credit card, promissory notes, bills of exchange, etc in the money market can equally act as a reliable source of liquidity to the bank.

Banks can involve in investments in the stock exchange market as a means of raising money. Despite its long-term nature, a portfolio is an essential factor in generating liquidity in a bank (Drehman and Chikolaou, 2009). To sum up this area, a bank's ability to absorb and create liquidity, a concise view is that a high bank capital enables the bank to absorb risk and create liquidity. Liquidity creation exposes the bank to risk. At the same time, the more liquidity, the more the bank tries to dispose of liquid assets in order to satisfy customers' demands for cash withdrawal and credit (Diamond, 1983). The higher the capital ratio, the higher the ability of the bank to create liquidity. We refer to this set of theories as the "risk absorption hypothesis" (Diamond, 1983).

Liquidity risk for a bank is especially prevalent as it is easy for a bank to lose its liquidity because depositors can withdraw funds when they choose.

In addition to depositors, banks faced another way in which their cash reserves can be strained by fulfilling obligations to companies. These companies have previously established loan commitments called credit lines that can be borrowed from the bank when needed (Strahan, 2007).

Historically, runs on banks have shown certain bank predisposition of liquidity risk and the severity of impact this risk can have on the economy. Risks of liquidity are mostly tied to the nature of the bank. Thus, the inability of the bank to meet its financial obligations is a liquidity risk (Brendan, 2010). The banking industry faces different types of liquidity risk; they are interest rate risk, market risk, exchange rate risk, credit risk and financial risk. All these different types of liquidity risk affect the liquidity position of the bank.

Credit risk is a risk that a borrower will default in any type of debt by failing to perform his own part of the obligation. It is the first of replacing cash flow when the borrower defaults. Credit risk is the potential financial loss as a result of the failure of a customer to honor in full the terms of a loan or contract.

Market risk is that which occurs when the totality of the market underlying asset falls due in the market. A bank's market risk exposures are determined by both volatilities of underline risk factors and the sensitivity of the bank's portfolio to movements in those risk factors (Daniel Bassey, 2017).

Interest rate risk stems from timing differences in the maturity of fixed rates and the repricing of the floating rates of bank assets, liabilities and off-balance sheet positions. The basic tool used to measure repricing risk is duration. This assumes a parallel shift in the yield curve. Also, mismatch is repricing exposes the bank to risk deriving from changes in the slope and shape of the yield curve. When interest rate changes, unexpected changes occur in the cash flows and earnings spread among assets and liabilities. Thus, interest rate risk is the

potential loss in a bank's earnings or value due to changes in interest rates (Daniel Bassey, 2017).

Exchange rate risk is a form of credit risks such as the default of the counterpart to foreign exchange rate and fair zone-related settlement risk. Foreign exchange rate risk is incurring losses due to changes in the exchange rate. The loss of earnings may occur due to a mismatch between the value of assets and that of capital liabilities dominated in foreign currencies.

Foreign exchange risk is comprised of transaction risk (the price-based impact of exchange rate changes on foreign variables and foreign payables), economic risk (effects of exchange rate on firm's long-term competitive position) and revaluation risk (arises when a bank's foreign exchange position is revalued in domestic currency and financial reporting).

The events of recent years have demonstrated that the availability of liquidity in financial institutions is a major problem. This is because it has led to an increase in awareness of the importance of developing models of liquidity provisions in the financial market. Models of liquidity and liquidity crisis provide very different predictions. There are short-term and long-term models of liquidity geared towards the solving of emergencies in liquidity crisis events. Both the liquidity providers and liquidity seekers are important in a liquidity model.

The price of liquidity and the elasticity of its supply are central to the model. But to determine these factors requires closing the model by taking a stronger stance on the characteristics of liquidity sources (Charles and Gale, 2009). When a bank sector is large so that liquidity demands have an impact on the price of liquidity provided by households, additional factors come into consideration. In particular, an essential role is played by the relative cost of moving liquid assets to the banking sector. Our analysis emphasizes that once the familiar results that banks tend to under-provide various sources of liquidity, it is no longer obvious that the result is liquidity (Bhatta Chrya, 1987).

There are both internal and external features of a liquidity model. Internally, there is a trade-off between the bank raising liquidity ex-ante and ex-poste asserts. This also contrasts with the setup by Diamond (1983) who said that the initial objective of the bank was to make a profit. Thus, the bank has faced three constraints in raising liquidity internally. They are the borrowing constraint. In this constraint, as the bank date on the returns of its projects is only imperfectly attachable, banks may not be able to raise enough liquidity to continue their projects. Assets sales help to reduce the constraint via transfer of ownership and management. This allows in generating more cash at the expense of efficiencies since projects specific skills are lost. The next constraint is the aggregate liquidity constraint. Since banks without liquidity needs can turn as investors of liquidity, it can lead to the abandonment of projects. Adequate liquidity in the banking sector is determined by the total borrowing capacity of the banking sector or by liquidity via investors.

It is also good to be clear about sources of external liquidity. This arises via the prices of liquidity at date 1. The total availability of liquidity at date 1 is the net financing within the banking sector (Diamond, 1983). The third constraint of raising liquidity can be binding; causing assets sales by raising the cost of liquidity. At the same time, the costs of the sales of the asset becomes less binding. The next effect is determined by the relatively deadweight losses from raising liquidity. The cost of raising liquidity at date 0 is relatively higher than at date 1. Holding liquidity within the financial system will increase the ability of the financial system to generate more liquidity at the intermediate date (Allen and Gale 2004).

Reviewing the term deposit as a variable in the study, we will offer a definition and in-depth explanation about the concept. A term deposit is a fixed-term investment that includes the deposit of money into an account at a financial institution. Term deposit investments usually carry short-term maturities ranging from one month to a few years and will have varying levels of required minimum deposits.

The investor must understand when buying a term deposit that they can withdraw their funds only after the term ends. In some cases, the account holder may allow the investor early termination or withdrawal if they give several days of notification. Also, there will be a penalty assessed for early termination. Examples of term deposits include certificates of deposit (CDs) and time deposits (James Cheng, 2004). A term deposit is a type of deposit account held at a financial institution where money is locked up for some set period of time. Term deposits are usually short-term deposits with maturities ranging from one month to a few years. Typically, term deposits offer higher interest rates than traditional liquid savings accounts, whereby customers can withdraw their money at any time. When an account holder deposits funds at a bank, the bank can use that money to lend to other consumers or businesses. In return for the right to use these funds for lending, they will pay the depositor compensation in the form of interest on the account balance. With most deposit accounts of this nature, the owner may withdraw their money at any time. This makes it difficult for the bank to know ahead of time how much they may lend at any given time (Paola, 2007). To overcome this problem, banks offer term deposit accounts. A customer will deposit or invest in one of these accounts, agreeing not to withdraw their funds for a fixed period in return for a higher rate of interest paid on the account. The interest earned on a term deposit account is slightly higher than that paid on standard savings or interest-bearing checking accounts. The increased rate is because access to the money is limited for the timeframe of the term deposit. Term deposits are an extremely safe investment and are therefore very appealing to conservative, low-risk investors. The financial instruments are sold by banks, thrift institutions, and credit unions

How term deposit works is a vital element in this discussion. Term deposits work in the interest of both the customers and the financial institution in question. If a customer places money in a term deposit, the bank can invest the money in other financial products that pay a higher rate of return (RoR) than what the bank is paying the customer for the use of their funds (Dragos, 2017). The bank can

also lend the money out to its other clients, thereby receiving a higher interest rate from the borrowers as compared to what the bank is paying in interest for the term deposit. For example, a lender may offer a 2% rate for term deposits with a two-year maturity. The funds deposited are then structured as loans to borrowers who are charged 7% in interest on those notes. This difference in rates means that the bank makes a net 5% return. The spread between the rate the bank pays its customers for deposits and the rate it charges its borrowers is called net interest margin. Net interest margin is a profitability metric for banks (Ahmed, 2003). Banks are businesses, as such, they want to pay the lowest rate possible for term deposits and charge a much higher rate to borrowers for loans. This practice increases their margins or profitability. However, there is a balance the bank needs to maintain. If it pays too little interest, it won't attract new investors into the term deposit accounts. Also, if they charge too high of a rate on loans, it won't attract new borrowers.

In periods of rising interest rates, consumers are more likely to purchase term deposits since the increased cost of borrowing makes savings more attractive. Also, with higher market interest rates, the financial institution will need to offer the investor a higher rate of interest, so the investor also earns more. When interest rates decrease, consumers are encouraged to borrow and spend more, thereby stimulating the economy. In a low-interest-rate environment, demand for term deposits can decrease since investors can typically find alternative investment vehicles that pay a higher rate (Bake, 2012). Typically, interest rates should be proportional to the time until maturity, and the minimum amount of principal lent to the credit union or bank. In other words, a six-month term deposit will likely pay a lower interest rate than a two-year term deposit. Investors not only receive a higher rate for locking up their money with the bank for extended periods, but also should earn a higher rate for large deposits. For example, a jumbo CD, which is a term deposit above \$100,000, will receive a higher interest rate than a \$1,000 Certificate of Deposits.

Based on the advantages of term deposits, Term deposits offer a fixed rate of interest over the life of the investment. Term deposits are risk-free, safe investments since they're either backed by the finance law of the economy. Various maturities allow investors to stagger end dates to create an investment ladder. Term deposits have a low minimum deposit amount. Term deposits pay higher rates for larger initial deposit amounts (Chen,2004).

Methodology

The study is qualitative and quantitative in nature. The study uses primary and secondary sources to

collect data. The primary data was obtained through questionnaires in a given sample of 80 respondents within the financial institution. The respondents were selected randomly and taking into consideration that financial data requires someone with adequate knowledge in the institution. The data were presented using descriptive statistics and analyzed using regression analysis and the use of an alpha coefficient of 0.05 to determine the significance level.

Data presentation

Table 4.1 Respondent Rate

Options	Frequencies	Percentages (%)
Administered questionnaires	80	100%
Returned Questionnaires	74	92.5%
Unanswered questionnaires	6	7.5%
Questionnaires analyzed	74	100%

Source: Field Work (2020)

Demographic Information

The background information of the respondents was very important in this study because it gives the accuracy of information to be analyzed. The

studied variables greatly depended on demographic information. The background information was to draw the respondents' gender, marital status, age, level of education and the relationship they have with the credit union.

Table 4.2: Gender Distribution

Options	Frequencies	Percentage (%)
Males	40	54.05%
Females	34	45.95%
Total	74	100

Source: Field Work (2020)

Table 4.5: Age Distribution

Options	frequency	percentage
45-55	15	28.27%
35-45	40	54.25%
25-35	13	17.57%
10-25	10	8.11%
Total	74	100%

Source: From field Work (2020)

Table 4.6: Distribution of Relationship

Option	frequency	percentage
Staff	7	9.46%
Board members	10	13.01%
Donors	2	2.70%
Contributors	55	74.32%
Total	74	100%

Source: From Field Work (2020)

Assessing the Effect of Term Deposit on the Liquidity of Mitayen cooperative credit union.

The objective of the study was to investigate the relationship between term deposits and the

liquidity of MITCCUL. Under this topic, there are three questions in the form of interest rate, number of depositors and the type of term deposit.

Table 4.7: Responses on assessing the effects of term deposits on the liquidity of Mitccul.

Items	SA	%	A	%	SD	%	D	%	Total	%
Mitccul has a high interest rate on term deposit	1	1.4%	3	4.1%	42	57%	28	38%	74	100%
There are many depositors in Mitccul	3	4.1%	6	8.1%	40	54%	25	34%	74	100%

Only term deposit certificate with small nominal value is bought by customers	38	51%	20	27%	8	11%	6	8%	74	100%
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Source: From Field Work (2020)

As seen on table 4.7 above, an examination on the impact of term deposits on the liquidity of the Mitayen cooperatives credit union, you will see that 57% of the respondents strongly disagreed that the interest rate is high on term deposits in the CBCDF. In the same light, 38% of the respondents disagreed that the interest rate on term deposits is high in CBCDF. On the other hand, 1.4% strongly agreed that the interest rate on term deposits is high. This was supported by 4.1% of respondents who agreed that the interest rate on term deposits is high.

Also, 54% of the respondents strongly disagreed that there are many depositors in CBCDF. This was supported by 34% of the respondents who disagreed that there are many depositors in the financial institution. On the other hand, 4.1% of the respondents strongly agreed to the option while 8.1% agreed to that option.

Furthermore, 51% of the respondents strongly agree that only term deposit certificates with small nominal value is bought in the CBCDF. 27% of the respondents agreed that only term deposit certificate with small nominal value is bought in the F.I. On the other hand, 11% of the respondents strongly disagreed that only term deposit with small nominal value is bought by customers in the CBCDF. This was supported by 8% of respondents who disagreed with the option.

In a nutshell, we realized that the interest rate is low on term deposit in the financial institution. This has resulted in low depositors in the F.I., who purchased only term deposits with small nominal value. This means that term deposit has not contributed to improving the liquidity of the F.I.

Regression Analysis

Table 4.10: Presentation of Regression Results

NO. of Obs				74
F (4, 74)				16.34
Prob > F				0.0000
R- squared				0.6110
Adj R- square				0.5789
Test variables	coef	Std. Err,	T statistics	p> t
term deposits	.5658	.2590	1.15	0.342
Donations	.4784	.1639	3.451	0.005

staff contributions	-.1564	.1724	1.102	0.367
investment	.2564	.2724	1.062	0.367
Constant	17.253	3.3092	5.21	0.000

Source: Field software program, 2020

Findings

From the collection of data to the presentation of the data to the regression analysis, we found out that term deposit has a negative significant effect on the liquidity of the financial institution.

Conclusion and Recommendation

In conclusion, a term deposit is reliable means of finance and investment as the bank could raise money for their investment through term deposits. Since Mitayen cannot fully raise funds through term deposits, it is recommended that the finance manager encourage customers to invest in term deposits by raising the rate of return on term deposit accounts. Giving customers opportunities to hold shares and a term deposit in the financial institution would add value to liquidity. Effective liquidity management and term deposit management is required to plan, control, and monitor progress on customers' savings as well monitoring the liquidity level of the institution.

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