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The Interplay of Liquidity, Credit Risk, and Profitability in the Global Economy

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Abstract

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Liquidity and profitability are two primary indicators for assessing the performance and stability of the banking sector. This study aims to analyze the relationship between liquidity, credit risk, and banking profitability within the context of economic globalization. Globalization has expanded opportunities for financial expansion and diversification of funding sources, yet it has also increased exposure to market risks and exchange rate volatility. Using a historical review of empirical literature, this research highlights that an optimal level of liquidity plays a crucial role in maintaining the balance between fulfilling short-term obligations and achieving sustainable profitability. Conversely, excessive liquidity or high credit risk can reduce financial efficiency and weaken banks competitiveness in the global market. The findings are expected to provide both theoretical and practical contributions to the development of risk management strategies and banking policy formulation in an increasingly dynamic global economy. By emphasizing the interconnectedness of liquidity, credit risk, and profitability, this study underscores the importance of adaptive financial management to sustain banking stability amid global economic integration.

1. Introduction

The stability of the banking system is an essential foundation for achieving a nation's economic equilibrium. In this context, liquidity and profitability are key indicators for assessing bank performance. Liquidity describes a bank's ability to meet short-term obligations through liquid assets, while profitability assesses the bank's effectiveness in generating profit from financial intermediation activities. These two indicators have a dynamic relationship; sufficient liquidity supports operational continuity, but excess liquidity can suppress returns because unproductive funds are not optimally invested (Ghenimi et al., 2017).

In addition to liquidity and profitability, credit risk is an important factor affecting banking stability. This risk arises when debtors fail to meet their obligations, resulting in a decline in interest income and potential capital losses. Amid increasing competition and financial sector liberalization, exposure to credit risk increases, making liquidity management more complex. Abbas et al. (2019) emphasize that the relationship between credit risk, liquidity, and profitability depends not only on internal bank factors, such as capital structure and operational efficiency, but is also influenced by external conditions, including macroeconomic stability and the flow of financial globalization.

Economic globalization has expanded the scope of banking operations and increased integration among international financial systems. Globalization encourages operational efficiency and financial product innovation, thereby contributing to the growth of bank profitability. However, globalization also brings challenges in the form of exchange rate volatility, cross-market dependence, and transnational liquidity risk. Nisar et al. (2018) found that financial globalization encourages diversification and efficiency, but also increases banks' exposure to external shocks that can disrupt systemic stability. Therefore, risk management capability is the main determinant in balancing global expansion and domestic financial resilience.

From the perspective of financial intermediation theory, banks function as critical intermediaries that facilitate the efficient allocation of resources by channeling funds from economic agents who possess surplus capital, such as households, corporations, or institutional investors, to those who require financial resources to support consumption, investment, or business operations. This intermediary role not only enables the mobilization of idle funds within the economy but also contributes to the overall stability and growth of the financial system by reducing information asymmetries, managing risk, and providing mechanisms for liquidity transformation. This role demands efficient liquidity management so that credit channeling remains smooth without sacrificing profitability. Saleh and Abu Afifa (2020) affirm that the effectiveness of simultaneous liquidity and credit risk management is the main determinant of bank financial performance, particularly in developing markets that are vulnerable to external fluctuations.

In addition to internal factors, regulation and macroprudential policies have a significant role in determining the level of financial stability. Strict liquidity supervision policies and increased minimum capital requirements can strengthen banks' resilience to external shocks. However, overly conservative regulation can suppress short-term profitability by limiting investment scope. Anarfo and Abor

(2020) emphasizes that balanced regulation is capable of creating a resilient banking system while encouraging innovation. Thus, the interaction between liquidity, credit risk, profitability, and economic globalization forms a complex reciprocal relationship. Excessive liquidity potentially reduces profitability, while efforts to increase profitability without considering credit risk can threaten bank stability. This research aims to broaden the understanding of the balance between these factors in the context of modern banking, as well as contribute academically to effective risk management strategies in the era of financial globalization. By understanding this complex linkage, banks can formulate policies that support sustainable growth, minimize risk, and maintain the overall stability of the financial system.

2. Literature Review

2.1. The Relationship between Banking Liquidity and Profitability

Liquidity and profitability are two main indicators reflecting the financial health of a bank. Liquidity indicates the bank's ability to meet its short-term obligations, while profitability shows the extent to which the bank can generate income from managed assets. Both have an interdependent relationship, where efficient liquidity management can increase profitability, but excessive liquidity can reduce returns due to idle funds. According to Ghenimi et al. (2017), liquidity that is too low can cause banks difficulty in meeting payment obligations, potentially leading to systemic instability. Conversely, banks with high liquidity reserves tend to be safer but less efficient in optimizing productive assets.

In this context, the balance between liquidity security and profitability is a key challenge for bank management. Wang and Luo (2020) found that banks in the MENA region maintaining moderate liquidity ratios showed better financial performance compared to banks with extreme liquidity levels. This indicates a non-linear relationship between the two variables. Other research by Abbas et al. (2019) affirms that efficient liquidity directly contributes to increased profitability, especially in the post-global crisis period. When market confidence declines, liquidity becomes the main instrument for maintaining operational stability. However, overly cautious management strategies in maintaining liquidity can reduce the bank's ability to seize profitable investment opportunities. Therefore, banks need to establish optimal strategies that consider the balance between risk and return.

2.2. Credit Risk and Its Impact on Profitability

Credit risk arises when customers fail to meet payment obligations on loans granted, directly impacting interest income and bank asset quality. Saleh and Abu Afifa (2020) state that increased credit risk significantly reduces bank profitability, especially in the banking sector of developing countries. The inability to manage credit risk not only reduces income but can also worsen liquidity conditions, as banks must absorb losses and experience a decline in cash flow from interest income. According to Noor et al. (2018), there is a significant negative relationship between the Non-Performing Loans (NPL) Ratio And Bank Profitability. The higher the NPL ratio, the Lower The Return On Assets (ROA) and Return On Equity (ROE), thus suppressing overall financial performance. Conversely, banks implementing effective credit monitoring systems are able to mitigate the negative impact of market fluctuations, maintain financial stability, and preserve long-term profitability.

Research by Al-Kurdi et al. (2019) indicates that good credit risk management practices, including credit portfolio diversification and improved monitoring systems, significantly contribute to the improvement of asset quality and increased bank profitability. However, the implementation of overly strict credit policies can limit the ability to expand business and reduce the bank's competitiveness in the market. Therefore, an adaptive risk management approach is needed, one that considers market dynamics and the risk profile of each banking institution. Such a strategy allows banks to balance risk mitigation with the achievement of optimal financial performance, while also maintaining the sustainable stability of the banking system. Thus, the effectiveness of credit risk management is a determining factor in maintaining bank profitability and liquidity, which in turn plays a crucial role in the overall stability of the financial system.

2.3. Economic Globalization and Its Implications for Banking Stability

The era of globalization brings major changes to the banking industry landscape. Economic globalization expands market access, accelerates cross-border capital flows, and encourages financial innovation (Riswanto, 2021). However, globalization also increases exposure to external risks such as exchange rate fluctuations, capital market volatility, and dependence on the global financial system. Nisar et al. (2018) found that globalization has a positive influence on the efficiency and profitability of banks in developing countries, but the impact depends on the level of readiness of domestic regulation and financial infrastructure. Research by

Koten (2021) indicates that globalization encourages banks to innovate in digital services and expand their global customer base, but also increases systemic risk due to inter-market linkages. Therefore, the ability to adapt to global changes and readiness to face external risks are key factors in maintaining long-term profitability and liquidity.

Furthermore, Ayalew (2021) emphasizes that bank ownership structure also influences how institutions cope with globalization. Banks with foreign ownership tend to have more sophisticated risk management strategies and access to global funding sources, while domestic banks are more vulnerable to external shocks. Thus, the literature shows that economic globalization, credit risk, and liquidity are closely interrelated in affecting bank profitability. To achieve long-term financial stability, banks must manage these three aspects simultaneously, balanced, and based on historical data to be able to adapt to ever-evolving global challenges.

3. Method

The research approach used in this study is the historical study method, which focuses on tracing, interpreting, and analyzing past data and events relevant to the development of the relationship between liquidity, credit risk, profitability, and globalization in the banking sector. This method is used to understand the pattern of inter-variable linkage over a long period and to identify how global economic dynamics influence banking stability and performance. The historical study is carried out through a longitudinal analysis of empirical research results and secondary data from the last five years, published in reputable academic journals from Google

Scholar or Elsevier. The secondary data analyzed include bank financial reports, key financial ratios such as ROA, ROE, Loan-to-Deposit Ratio (LDR), and NPL, as well as macroeconomic indicators such as interest rates, inflation, and GDP growth. This approach provides a comprehensive overview of how changes in global economic conditions affect the relationship between banking liquidity and profitability.

The stages in this historical study method consist of four main steps. First, heuristics, which is the process of collecting secondary data sources from scientific publications and bank financial reports. Second, source criticism, performed to assess the credibility and relevance of the data to the research objective, by only selecting academic publications published within the last five years that possess a high scientific reputation. Third, data interpretation, which is the stage of analyzing the cause-and-effect relationship between the phenomena of liquidity, credit risk, and profitability, considering the variable of economic globalization. Fourth, historiography, which is the compilation of analysis results in the form of an academic narrative explaining the evolution of concepts and practical implications for the modern banking sector.

This method also utilizes descriptive-comparative analysis, which compares research results across regions such as Asia, the Middle East, and Africa to identify common patterns and structural differences in each market. According to Abbas et al. (2019), the historical approach is important for understanding how global financial crises shaped liquidity policies and credit risk management in various countries. Thus, the historical study method in this research provides a strong conceptual foundation for explaining the long-term relationship between liquidity, credit risk, profitability, and economic globalization in banking.

4. Results

The analysis results indicate that the relationship between liquidity, credit risk, profitability, and economic globalization in the banking sector forms a dynamically interdependent linkage. From an operational perspective, adequate liquidity is the main foundation for the continuity of banking activities, while profitability is a key indicator of efficiency and the bank's ability to generate added value through financial intermediation activities. This research finding confirms that achieving a balance between liquidity and profitability often faces challenges, especially due to pressure from credit risk and the increasing complexity of economic globalization.

The literature synthesis indicates a moderate positive relationship between liquidity and profitability, which is non-linear. In other words, increased liquidity will boost profitability only up to a certain point, after which the relationship can reverse. Liquidity that is too high signifies unproductive funds, which subsequently reduces asset efficiency. This finding aligns with Ghenimi et al. (2017), who explained that liquidity is essential in maintaining bank financial stability, but excessive reserves can reduce financial performance because funds are not optimally channeled. Therefore, balanced liquidity management is a crucial strategy for sustaining continuous profitability without sacrificing operational stability.

Credit risk is also proven to have a significant impact on bank profitability. When the level of NPL increases, interest income decreases while provisioning costs rise, thereby suppressing net profit. In the long run, the accumulation of credit risk can affect solvency ratios and reduce investor confidence. Priyadi et al. (2021) emphasize that the effectiveness of credit risk management is the main determinant of profitability, where a robust credit monitoring system can reduce potential losses. Strict credit risk supervision and the application of prudence principles are important elements in maintaining the bank's financial sustainability. Noor et al. (2018) affirm a significant negative relationship between the NPL ratio and profitability; the higher the NPL, the ROA and ROE. Conversely, banks with effective credit monitoring systems are able to mitigate the negative impact of market fluctuations and maintain financial stability.

Good credit risk management practices, such as portfolio diversification and improved monitoring systems, are proven to significantly improve asset quality and increase profitability, as revealed by Al-Kurdi et al. (2019). Nevertheless, the implementation of overly strict credit policies potentially hinders business expansion and reduces competitiveness. Therefore, banks need to implement an adaptive risk management approach, one that considers market dynamics and the risk profile of each institution. This strategy allows banks to balance risk mitigation with the achievement of optimal financial performance so that financial stability can be maintained.

Economic globalization has a dual effect on the banking sector. On the one hand, globalization promotes innovation, efficiency, and market expansion through international financial integration and technological advancements. On the other hand, globalization increases exposure to external risks, including exchange rate fluctuations, global interest rate movements, and cross-country regulatory changes. Nisar et al. (2018) emphasize that globalization strengthens competition in the financial sector, promotes managerial efficiency, but simultaneously increases profitability volatility due to inter-market connectivity. Therefore, the management of liquidity and credit risk needs to be adjusted to global conditions so as not to cause financial imbalance.

The interaction between liquidity and credit risk is simultaneous. When credit risk increases, banks tend to hold more liquid assets as a form of mitigation against potential default. This strategy, although increasing liquidity security, potentially reduces short-term profitability. Oino et al. (2021) state that efficient credit risk management allows banks to optimize assets without sacrificing liquidity stability. Synergy between credit policy and liquidity policy is important to create sustainable financial efficiency. Managerial capacity and internal bank policies also play a significant role in determining the relationship between the main variables. Banks with good risk management systems are able to balance risk exposure and profit achievement, while banks with weak internal supervision tend to face high profitability fluctuations. Anarfo and Abor (2020) affirms that appropriate regulation can strengthen bank stability without hindering profitability if implemented adaptively.

Macroeconomic factors such as inflation, economic growth, and interest rates also moderate the relationship between liquidity and profitability. When economic conditions are stable, increased lending can boost profit, whereas during periods of economic uncertainty, banks restrain credit expansion to reduce the risk of default, ultimately suppressing profitability. In the context of globalization, the digitalization of banking and the integration of cross-country payment systems accelerate fund turnover and change how banks manage liquidity. The use of financial technology (fintech) in risk management and customer service increases efficiency, strengthens the relationship between globalization and profitability, and supports liquidity stability.

Bank profitability cannot be sustained without strong risk management. The higher the exposure to credit and liquidity risk without adequate mitigation, the greater the likelihood the bank will face a decline in profit and public trust. The risk management strategy must be integrative and responsive to global changes. Secondary data analysis from various studies shows that the inter-variable relationship is dynamic and depends on macro conditions and management policies. A bank's success in maintaining profitability amidst globalization is determined by its ability to balance productive and liquid assets, establish credit policies adaptive to market risk, optimize technology for liquidity efficiency, and develop internal supervision systems responsive to global dynamics.

With a historical approach, it can be concluded that the evolution of the global financial system demands banks to adjust liquidity and credit risk management strategies to maintain stable profitability. The interaction of the four main variables liquidity, credit risk, profitability, and economic globalization shows that financial stability depends on internal factors and resilience to changes in the global environment. This research provides a theoretical basis that modern banking must focus on the balance between security and efficiency. Banks overly focused on stability will lose growth opportunities, while those too aggressive in pursuing profit face greater systemic risk. Therefore, the dynamic balance between liquidity, credit risk, and profitability in the era of globalization is key to the sustainability of the banking sector in the future.

Furthermore, the research results show a close linkage between liquidity, credit risk, profitability, and economic globalization in the structure of modern banking finance. Theoretically, this relationship can be explained through the liquidity-profitability trade-off theory, where banks must balance the need for liquidity for stability with efforts to increase profitability through productive investments. Imbalance in liquidity management can cause conflict between short-term and long-term goals. This finding reinforces the view Trad et al. (2017) that liquidity and credit risks have a significant influence on banking stability. Banks with strong risk management are able to minimize the negative impact of market fluctuations and maintain customer trust, in line with the findings Wang and luo (2020) which indicate that effective liquidity management strengthens the cash position while supporting long-term profitability growth.

Economic globalization is proven to be an external factor that accelerates change in the financial system. Global financial integration encourages banks to expand cross-border services and increase competitiveness through digital innovation, but also introduces new risks, including dependence on international capital markets and pressure on liquidity stability. Jumono and Mala (2019) affirm that globalization increases banking efficiency through access to capital and technology, but demands stricter risk supervision to avoid systemic vulnerability.

From a managerial perspective, a bank's success in maintaining profitability depends on an integrated risk management strategy. Banks must be capable of anticipating external changes by adjusting asset and liability structures adaptively. Oino et al. (2021) state that banks with good credit risk assessment systems can minimize potential losses without sacrificing profitability. The balance between risk exposure and investment strategy is key to maintaining financial performance. From a policy perspective, regulation implemented by financial authorities needs to consider the balance between systemic stability and operational flexibility, as overly strict liquidity policies suppress profit margins, while excessive deregulation increases systemic risk. Thus, an adaptive risk-based policy approach is needed to maintain the stability of the banking sector amid the continuously evolving global dynamics.

5. Discussion

The research results reveal a complex linkage between liquidity, credit risk, profitability, and economic globalization in the structure of modern banking finance. Conceptually, this relationship can be explained through the liquidity-profitability trade-off theory, which emphasizes the need for banks to balance the requirement of maintaining liquidity to ensure operational stability with efforts to increase profitability through productive investments. Imbalance in liquidity management often leads to conflicts between short-term goals, such as stability, and long-term goals, namely profit enhancement.

This finding reinforces the argument of Trad et al. (2017) which asserts that liquidity risk and credit risk have a significant impact on banking stability. Banks that implement risk management effectively are able to minimize the negative impact of market fluctuations and maintain customer trust, thus preserving operational performance. These results are also consistent with the research by Wang and Luo (2020), which shows that good liquidity management not only strengthens the cash position but also supports sustainable profitability growth.

Economic globalization emerges as an external factor accelerating the transformation of the financial system. Global financial integration encourages banks to expand the scope of cross-border services and increase competitiveness through the adoption of digital innovation. However, globalization also creates new risks, including dependence on international capital markets and pressure on liquidity stability. Jumono and Mala (2019) emphasize that globalization increases banking efficiency through access to capital and technology, but demands stricter risk supervision to avoid systemic vulnerability that could disrupt profitability. In the managerial sphere, this research affirms that a bank's success in maintaining sustainable profitability heavily depends on the implementation of integrated risk management strategies. Banks need to be able to anticipate changes in external conditions by adaptively adjusting their asset and liability structures.

Oino et al. (2021) show that banks with effective credit risk assessment systems can minimize potential losses without having to sacrifice profitability levels. This affirms the importance of balancing risk exposure and investment strategy to maintain the stability of financial performance. From a policy perspective, the findings of this research indicate that regulation implemented by financial authorities must be designed to balance systemic stability and operational flexibility. Overly strict liquidity policies potentially suppress profit margins, while excessive deregulation increases systemic risk. Therefore, an adaptive and risk-based policy approach is needed, capable of maintaining the stability of the banking sector while allowing financial institutions to respond effectively to global dynamics. With an integrated strategy, banks can maintain sustainable profitability performance while facing the risk challenges arising from the global economic environment.

6. Conclusion

This research affirms that liquidity, credit risk, profitability, and economic globalization are four interconnected elements that determine the sustainability of the banking sector. Liquidity plays a crucial role in maintaining a bank's ability to meet short-term obligations, while profitability reflects performance and operational efficiency. However, the relationship between the two is dynamic liquidity that is too high can reduce efficiency, while liquidity that is too low increases the risk of default.

The synthesis results indicate that credit risk has a strong negative influence on bank profitability, while globalization acts as an external factor that expands opportunities but also increases the complexity of risk. Global market integration accelerates innovation and efficiency, but also increases vulnerability to international economic fluctuations. Therefore, adaptive risk management strategies and balanced supervision policies are key in maintaining financial stability. This research affirms that a bank's success in the era of globalization is determined not only by its ability to generate profit but also by its effectiveness in managing risk and maintaining liquidity balance. Banks capable of strategically combining security and efficiency aspects will be more resilient to global changes and able to maintain long-term profitability. Thus, an integrative approach to liquidity, credit risk, and profitability becomes the main foundation for building a resilient and competitive banking system in the global economic era.

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