

WAYS TO IMPROVE FINANCIAL STABILITY THROUGH ASSET QUALITY AND LIQUIDITY MANAGEMENT IN COMMERCIAL BANKS.

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Abstract: *This article examines the role of asset quality and liquidity management in ensuring and strengthening the financial stability of commercial banks. Effective management of banking assets and liquidity is considered one of the key factors influencing the sustainability, profitability, and resilience of banks against financial risks. The study analyzes the impact of non-performing loans, asset portfolio quality, liquidity ratios, and asset-liability management practices on the overall financial stability of commercial banks. Based on theoretical approaches and practical experiences, the paper identifies major challenges in asset quality and liquidity management and proposes recommendations aimed at enhancing financial stability. The findings indicate that maintaining high-quality assets and an adequate level of liquidity contributes significantly to improving the operational efficiency and long-term sustainability of commercial banks.*

Keywords: *Commercial banks; financial stability; asset quality; liquidity management; non-performing loans; asset-liability management; banking risks; liquidity ratios; financial sustainability; risk management.*

In the modern banking system, ensuring and maintaining financial stability has become one of the primary objectives of commercial banks. Financial stability reflects a bank's ability to perform its core functions efficiently, withstand internal and external shocks, and maintain public confidence in the financial system. In an increasingly competitive and uncertain economic environment, the quality of bank assets and the effectiveness of liquidity management play a crucial role in determining the overall stability and sustainability of commercial banks.

Asset quality is one of the most important indicators of a bank's financial soundness, as it directly affects profitability, capital adequacy, and risk exposure. A deterioration in asset quality, particularly due to an increase in non-performing loans, can significantly weaken a bank's financial position and increase the likelihood of financial distress. Therefore, commercial banks need to implement effective credit risk assessment, monitoring, and asset management strategies to maintain a healthy asset portfolio.

Liquidity management is another critical component of financial stability. Banks must maintain sufficient liquidity to meet their short-term obligations and customer demands while optimizing the use of available financial resources. Ineffective liquidity management may lead to liquidity shortages, increased funding costs, and potential

disruptions in banking operations. Consequently, balancing liquidity and profitability remains a key challenge for commercial banks.

This study aims to examine the relationship between asset quality, liquidity management, and financial stability in commercial banks. The research analyzes the theoretical foundations of asset and liquidity management, evaluates their impact on financial performance and stability, and proposes practical recommendations for improving financial resilience. The findings of this study may contribute to the development of more effective banking policies and risk management practices aimed at strengthening the financial stability of commercial banks.

Theoretical Foundations of Financial Stability in Commercial Banks

Financial stability is one of the key indicators of the effectiveness and sustainability of commercial banks. A financially stable bank is capable of fulfilling its obligations, maintaining profitability, managing risks efficiently, and withstanding adverse economic conditions. The stability of commercial banks depends on various internal and external factors, among which asset quality and liquidity management play a central role.

Asset quality reflects the level of risk associated with a bank's assets, particularly its loan portfolio. High-quality assets generate stable income and contribute to the overall financial soundness of a bank. Conversely, poor asset quality increases credit risk and may negatively affect profitability and capital adequacy. Liquidity management ensures that banks have sufficient funds available to meet their short-term obligations while maintaining efficient resource allocation.

The Impact of Asset Quality on Financial Stability

Asset quality is commonly assessed through indicators such as the ratio of non-performing loans (NPLs), loan loss provisions, and the structure of the asset portfolio. An increase in NPLs reduces interest income, raises provisioning expenses, and weakens a bank's financial position.

The main factors affecting asset quality include:

- Ineffective credit risk assessment;
- Economic downturns and macroeconomic instability;
- Weak borrower monitoring systems;
- Concentration of loans in high-risk sectors;
- Inadequate collateral management practices.

To improve asset quality, commercial banks should strengthen credit analysis procedures, diversify their loan portfolios, enhance borrower monitoring systems, and implement advanced risk management techniques. The application of modern data analytics and credit scoring models can also contribute to reducing credit risk and improving asset performance.

The Role of Liquidity Management in Strengthening Financial Stability

Liquidity management refers to the process of ensuring that a bank has adequate liquid resources to meet its financial obligations when they become due. Maintaining optimal liquidity levels is essential for preserving public confidence and preventing financial distress.

Key liquidity indicators include:

- Liquidity Coverage Ratio (LCR);
- Net Stable Funding Ratio (NSFR);
- Loan-to-Deposit Ratio (LDR);
- Cash and liquid assets ratios.

Insufficient liquidity may force banks to obtain expensive short-term funding or sell assets at unfavorable prices. On the other hand, excessive liquidity may reduce profitability due to underutilized resources. Therefore, banks must balance liquidity and profitability through effective asset-liability management (ALM).

Asset-Liability Management as a Tool for Financial Stability

Asset-Liability Management (ALM) is an integrated approach aimed at managing financial risks arising from mismatches between assets and liabilities. Effective ALM helps banks maintain adequate liquidity, optimize profitability, and reduce exposure to interest rate and market risks.

The main objectives of ALM include:

- Managing liquidity risk;
- Controlling interest rate risk;
- Maintaining capital adequacy;
- Optimizing the structure of assets and liabilities;
- Supporting long-term financial sustainability.

Modern commercial banks increasingly utilize stress testing, scenario analysis, and risk modeling techniques to strengthen their ALM frameworks and improve resilience against economic shocks.

Recommendations for Enhancing Financial Stability through Asset Quality and Liquidity Management

To strengthen financial stability, commercial banks should focus on the following measures:

Improving credit risk assessment and monitoring systems.

Reducing the volume of non-performing loans through proactive loan management.

Diversifying loan portfolios across sectors and customer groups.

Strengthening liquidity risk management in accordance with international standards such as Basel III.

Implementing advanced digital technologies and data-driven decision-making tools.

Conducting regular stress testing and scenario analysis.

Enhancing asset-liability management practices to ensure a balance between liquidity and profitability.

Effective implementation of these measures will contribute to stronger financial resilience, improved risk management, and sustainable growth of commercial banks in a rapidly changing financial environment.

The financial stability of commercial banks is a fundamental prerequisite for the sustainable development of the banking sector and the overall economy. In the context of increasing financial risks, economic uncertainty, and growing competition, maintaining strong asset quality and effective liquidity management has become more important than ever.

The study has shown that asset quality significantly influences the financial performance and stability of commercial banks. A high level of non-performing loans weakens profitability, increases credit risk, and negatively affects capital adequacy. Therefore, improving credit risk assessment, strengthening borrower monitoring mechanisms, and diversifying loan portfolios are essential measures for maintaining a healthy asset structure.

The analysis also highlights the crucial role of liquidity management in ensuring the ability of banks to meet their short-term obligations and withstand unexpected financial shocks. Maintaining an optimal level of liquidity not only enhances operational efficiency but also strengthens public confidence in the banking system. The implementation of internationally recognized liquidity standards, including Basel III requirements, contributes to improving the resilience of commercial banks.

Furthermore, effective asset-liability management serves as an important tool for balancing profitability and risk while supporting long-term financial sustainability. The use of modern risk management techniques, stress testing, and digital technologies can significantly improve the decision-making process and enhance financial stability.

In conclusion, strengthening asset quality and improving liquidity management are among the most effective ways to enhance the financial stability of commercial banks. The adoption of comprehensive risk management practices and modern banking technologies will enable commercial banks to operate more efficiently, remain competitive, and achieve sustainable growth in an evolving financial environment.

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