

Abstract

The primary objective of this study is to investigate the paradoxical phenomenon where low funding liquidity risk does not enhance bank stability, but rather diminishes it. Drawing upon the theoretical predictions of Acharya and Naqvi (2012), banks with abundant funding liquidity are posited to face lower funding liquidity risk, thereby incentivizing them to engage in increased risk-taking behavior. To empirically test this hypothesis, the study employs the system generalized method of moments (SGMM) technique using data from 86 conventional commercial banks operating in Indonesia over the period from 2014 to 2021. The research findings demonstrate that abundant funding liquidity, proxied by the ratio of deposits to total assets, exerts a positive and significant influence on bank risk-taking. This implies that banks with higher funding liquidity are more inclined to undertake riskier activities. Furthermore, the study examines the moderating effects of the Covid-19 crisis and bank size on the relationship between funding liquidity and bank risk-taking. During the Covid-19 crisis period, banks facing low funding liquidity risk exhibit a moral hazard by increasing their risk-taking behavior. Additionally, the study highlights the significant role played by bank size in influencing the relationship between funding liquidity and bank risk-taking. Larger banks demonstrate greater prudence in risk-taking when confronted with abundant funding liquidity. The findings have noteworthy implications for policymakers and regulators in comprehending the potential risks associated with funding liquidity and the necessity for appropriate measures to uphold financial stability within the banking sector.

Keywords: funding liquidity, bank risk-taking, Covid-19 crisis, bank size, commercial banks, system-GMM method