

Influence of Macroeconomic Factors on Credit Risk Management in Iraqi Commercial Banks

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ABSTRACT: This study investigates the impact of macroeconomic factors on credit risk management in Iraqi commercial banks, addressing the limited empirical evidence on how macroeconomic instability affects banking credit portfolios in emerging economies such as Iraq. Using a panel data approach for 10 Iraqi commercial banks over the period 2015–2024, the research measures how variables such as GDP growth, inflation, and capital adequacy influence Non-Performing Loans (NPLs). The descriptive analysis focuses on the 2020–2024 period to capture recent economic shifts. The results, based on Fixed Effects estimation, show that the model is statistically significant ($\text{Prob} > F = 0.000$), leading to the rejection of the null hypothesis. Findings indicate that GDP growth and capital adequacy significantly reduce credit risk, while inflation and interest rates exacerbate it. The study recommends strengthening internal bank capital and enhancing macroeconomic stability to mitigate credit defaults.

Keywords: Macroeconomic factors, credit risk management, Iraq, Commercial banks.

INTRODUCTION: Credit risk management is a critical component of banking stability. For commercial banks, especially in a volatile economic environment like Iraq. The significance of this study lies in providing a scientific analysis that links macroeconomic fluctuations (inflation, exchange rates, and growth) with the ability of banks to recover loans. The study aims to bridge the knowledge gap on how the Iraqi credit portfolio is affected by external and internal shocks, providing policymakers and investors with a clear vision of the banking sector's sustainability.

LITERATURE REVIEW

Credit Risk Management in the Banking Sector

One of the most important risks, which commercial banks experience is the credit risk, the risk that may occur because a borrower may not fulfill his/her obligations as stipulated in the agreement. A sound credit risk management is the key to stability, stability in the banking sector, security of the funds of depositors as well as the development of the economy (Alaa Ali Rahm, M. M., & Sarah Jabr Hussein, 2024). The Basel Committee on Banking Supervision (BCBS) observes that credit risk is the biggest source of risk in most banking institutions especially in the developing and emerging economies where financial systems are vulnerable to macroeconomic risks. In the words of Yanenkova et al., (2021), credit risk management entails the process of identifying, measuring, monitoring and controlling the risk that is involved in the lending. The important credit risk indicators are the non-performing loans (NPLs), loan-loss provisions, and the default rates. Banking crises, loss of confidence in the financial system, and loss of capital may be caused by poor credit risk management. As a result, there have been significant scholarly and policy-based interests into studying the variables that drive credit risk. Banks in the emerging economies have the tendency to work in an environment that is full of political instability, weak institutions and unreliable macroeconomics (Siddique et al., 2022). Such factors make management of credit risks a complicated experience, since banks struggle to predict the behavior of a borrower, and their capacity to repay their loan. In that regard, macroeconomic variables are also vital in determining the outcome of credit risks.

Macroeconomic Factors and Credit Risk

The macroeconomic conditions contribute to the financial stability of a borrower, and hence, the quality of a loan portfolio of a bank. The credit risk that the borrowers will default on their financial obligations, in the case of commercial banking, does not occur in a vacuum, but is highly affected by external economic forces. The income level, profitability of business and debt-servicing ability of borrowers depend on key macroeconomic variables such as economic growth, inflation, interests rates, and exchange-rate movement. The empirical evidence and theories are consistent that poor macroeconomic factors are prone to raise the credit risks whereas favorable macroeconomic factors are prone to raise the repayment capacity and minimize the likelihood of loan defaults among the borrowers (Sharma et al., 2024). These

correlations are important to comprehend by banks, especially in emerging economies like Iraq where a challenge of economic volatility is a constant problem.

Another widely recognized major determinant of credit risk is economic growth, as determined by the growth rate of the gross domestic product (GDP). When economic growth is strong, businesses are likely to see greater revenues being received and households are likely to receive better incomes which in effect enhance the capacity to balance debt payment (Kanapickienė et al., 2023). The banks that are in such environments usually will record minimal default rates and sounder in loan portfolio. On the other hand, the credit risk can be raised tremendously by economic slowdowns or recessions. Falling business profit, increasing unemployment, and cut in household income constrain the loan repayment ability of borrowers to the highest levels of non-performing loans (NPLs) (Koju et al., 2020). A vast amount of research in both advanced and emerging economies has shown that the correlation between the development of GDP and the loan default rate is heavily negative and therefore the importance of the macroeconomic performance in developing banking risk-management strategies.

Another significant macroeconomic variable that determines credit risk is inflation. High inflation destroys the real purchasing power of income, increases uncertainty in financial planning and it may undermine the ability of borrowers to repay. Also, inflation may cause a surge in nominal interest rates when central banks are trying to reduce the inflation rates thus, increasing the cost of getting a loan. Such a combination of low real income and the increasing cost of borrowed funds could increase the risk-laden loan defaults (Babela and Doski, 2022). The correlation between credit risk and inflation is not, however, always direct. The mild inflation can even make the actual debt burden less and thus repayment becomes easier by the borrowers and probability of default diminishes. This uncertainty brings out the situation-specificity of the effects of inflation that can be uneven when considering the economy structure, bank loan portfolio and responsiveness of the monetary policy.

The effect of the interest rates on the credit risk is both direct and significant. Increase in rates increases debt-servicing requirements, particularly to the borrowers of variable-rate loans, and hence raising chances of default. At the same time, increased rates have the propensity to dampen credit demand and increase adverse selection since only risk-taking borrowers are probably to desire access to capital at more costly rates. On the other hand, the reduced rates reduce the cost of borrowing and are likely to trigger economic activity but the other side is that it increases the tendency to over borrow. When the lending standards are loosened in a low-interest setting, there is a possibility that banks will become involuntarily more exposed to credit risk by lending money to marginally creditworthy borrowers (Stępińska, 2024). As a result, it is necessary to effectively manage the interest rates to balance the growth of credit with risk reduction.

The exchange-rate variance is another point of complexity in managing risks of credit especially in the economies that are largely reliant on the foreign-currency lending. The local currency depreciation increases the domestic-currency value of the foreign-currency debt, which puts more repayment pressure on those borrowers who do not have sufficient foreign income. It is very high among developing economies, where exchange-rate volatility is common, and there is a lack of access to hedging products (Abbassi and Bräuning, 2023). Even the slightest depreciation of currency can exert considerable tension on the financial position of the borrowers, thereby leading to loans default and increasing the credit risk of the bank at large.

Thus, macroeconomic factors have multidimensional and interdependent impacts on credit risk. The economic growth, inflation, interest rates, and the activity of the exchange rate are all factors which directly affect the ability to repay and quality of the loan portfolio of the banks. In the case of commercial banks in the emergent markets like Iraq, good observation of these variables cannot be overlooked in management of credit-related risks (Ikpesu, 2021). Understanding the influence of macroeconomic conditions on borrower behavior, banks can develop stronger lending policies, make risk-reduction strategies, and create a more stable financial industry in the questionable economic conditions.

Credit Risk and Macroeconomic Factors in Developing Economies

The management of the credit-risk in the developing economies is posed with specific problems because structural, institutional, and economic factors diffuse these countries with high financial systems. Poor legal and judicial systems hinder effective loan enforcement and recovery of collateral thus increasing the risk that a bank will default. The ability of banks to efficiently handle credit risk is also reduced in most developing economies due to long-winded legal processes, corruption, and poor insolvency legislation. Also, weak credit-information systems, including poorly developed credit bureaus and incomplete databases of borrowers frustrate the effectiveness with which banks can identify creditworthiness (Kanapickienė et al., 2022). These results in the lending process being often made with inadequate information, which raises the chances of adverse selection and moral hazards.

It is further complicated by the fact that underdeveloped financial markets are very demanding in regards to credit-risk in developing countries. Inadequate supply of diversified financial instruments impedes the overall capacity of banks to handle and transfer risks and shallow capital markets diminish alternative ways of financing firms. Due to this, banks usually continue to be the major source of credit thus, risk concentration in the banking industry. The latter are worsening even in the developing economies in the form of macroeconomic volatility that creates uncertainty when it comes to the stability of incomes, the returns of investments, and the ability of borrowers to repay their loans (De Leon, 2020). The constant changes in inflation, exchange rates, and economic growth weaken predictability of cash-flow making the assessment of credit-risk more complicated.

Macroeconomic shocks have more instant and direct effect on credit risk in the developing economies as compared to the developed ones. To the extent that the economy suffers economic downturns, unexpected inflationary pressures, or drastic currency depreciations, it will take a short time to convert into increased non-performing loans in the absence of effective shock-absorbing mechanisms. The regulatory control and insufficient control power has a tendency to hinder the early detection and countermeasures of the arising hazards (Siddique et al., 2022). Poor capital buffers and under-provisioning of loan losses further puts the banks in threat of bankruptcy in times of unfavorable macroeconomic conditions.

The weak risk management is also a key factor in increasing the credit risk in emerging economies. Banks often do not have highly developed risk-management systems, stress-testing capacities and internal control mechanisms that would enable them respond proactively to exogenous macroeconomic shocks. Besides, political meddling and domination of the banking sector by the state may drain lending decisions hence ineffective distributions of credit, and high default risk (Saliba et al., 2023). At that, it is critical that the macroeconomic determinants of credit risk can be learned by the policymakers and bank managers. The knowledge can help make the right regulatory policies, give reinforcement to prudential supervision and make credit-risk management practices resilient that are critical in financial stability and sustainable economic growth.

The Iraqi Banking Sector Context

The Iraqi banking industry is in an extremely dynamic and volatile environment that is fashioned by the lack of political stability, civil war, and economic shocks. Extended durations of war and sanctions have damaged the financial infrastructure, hindered institutional progress, and destroyed the confidence of the people on the banking system. The sector has, therefore, been unable to carry out its role of intermediation to its full extent especially in the mobilization of savings and its effectiveness in distributing credit efficiently to productive sectors of the economy (Alktrani and Abbas, 2021). State-owned banks still have a significant share in the total assets and deposits and despite the growing proportion of number in the banking industry, the contribution of the private commercial banks to fund economic activity remains relatively small.

High reliance on oil income also increases the weaknesses in the banking system of Iraq. The changes in oil prices worldwide have a direct impact on revenues, expenditure, and total economic activity of the government, thus the liquidity and credit of the banks. Fiscal constraint is a common occurrence during low oil prices which often results in late government payments and economic growth therefore increases the credit risks of banks (Abbas and Hassouni,, 2024). This dependency on one commodity in structure subjects Iraqi commercial banks to the macro external externalities that they are still unable to control.

A range of institutional and structural weaknesses complicate the operations of credit risk in the Iraqi commercial banks. Such inefficiencies include the lack of proper credit evaluation systems, minimal access to credible information about the clients financial status, inadequate enforcement of the limited usage of modern risk-management tools and the heavy usage of such advanced technologies. In turn, this poses significant difficulties to the banks when it comes to the effective evaluation of the creditworthiness of the borrowers which is reflected in high rates of unproductive loans (Alktrani and Abbas, 2021). Continuous deficiencies in regulatory oversight and regulation are additional contributors to inefficiency in credit risk management.

Over the last several years, the COVID-19 pandemic, the sharp crashes of oil prices, inflation within the macroeconomics, and the foreign exchange realignments contributed to macroeconomic volatility. Beginning with a combination of these factors has had a negative effect on business activities, the earnings of households and the repayment ability of borrowers, further increasing the element of doubt among the financial institutions (Al Karawi and Almashhadani, 2022). This is the reason why the time has arrived to examine the effect of macroeconomic determinants

in managing credit risks among Iraqi commercial banks in order to strengthen financial stability and spur economic development sustainability.

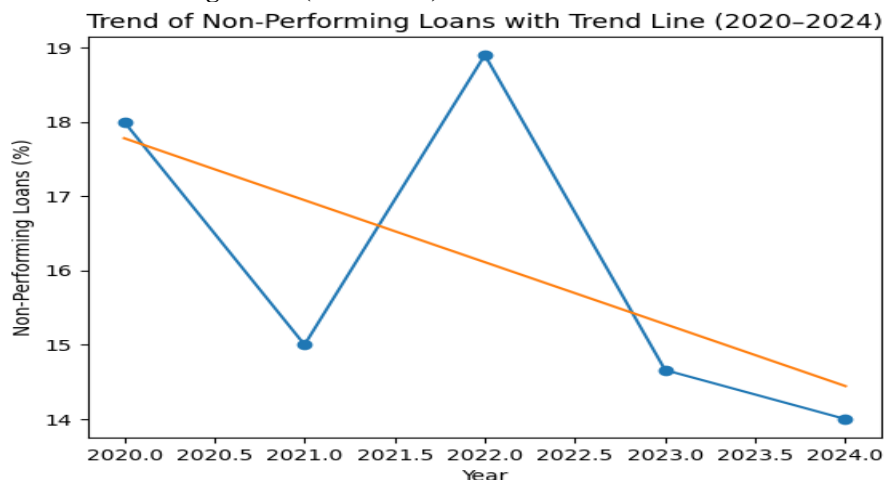
Theoretical Framework Supporting the Study

The correlation between the macroeconomic variables and the control of credit risks in the banking sector can be explained with the help of various developed theoretical frameworks. An example is the credit-cycle theory which explains the development of credit risk in line with business cycles. This theory argues that in the expansionary phases, there is generally improved borrower revenue, growth in employment, and improved business performance which have better borrower ability to pay off debt commitment. Consequently, the credit risk and bad loans have a predilection to reduce during periods. Conversely, in recessions or economic downturns, lower income, increased unemployment, and reduced corporate profitability wipe out borrowing ability of the borrowers resulting in increase in default of loans and enhanced credit risks among banks (Barrell et al., 2020). This is a cyclical trend, which highlights just how credit risk may be sensitive to economic conditions.

Another vital theory is the financial accelerator theory that focuses on the importance of financial markets imperfections in escalating macroeconomic shocks. According to the theory, the poor economic perturbations like shrinkages in the GDP growth rates or sudden inflation pressures damage balance sheets of borrowers by undermining asset values and cash flows. The further effect of depreciation of collateral values and creditworthiness that follows is that the banks tighten further their lending requirements and significantly limit access to credit. This reduction in credit supply increases and escalates the original economy slump into the second round of credit risk in the banking system as it creates a cycle of feedback (Deryugina et al., 2022). At this, the disproportionately high growth of loan defaults even during macroeconomic shocks can be triggered by even small macroeconomic shocks, especially in the developing economies with weak financial structures.

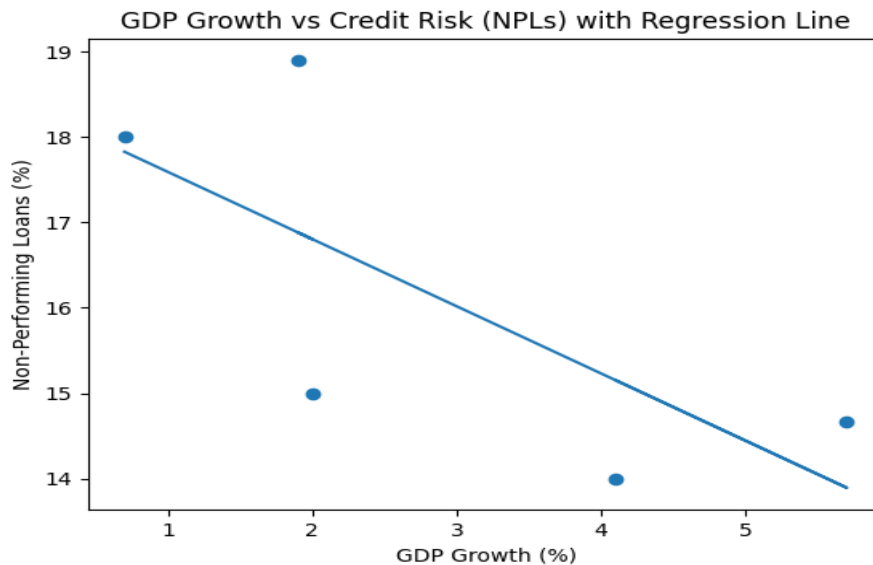
The theory of the risk-return trade-off is also valuable to the theory of credit risk management. According to the theory, banks tend to increase exposure to risky borrowers whenever they aim to increase the profits in an economic boom and in favorable macroeconomic environments. Although these strategies may increase short time returns, they are liable to leading to a decline in the quality of assets once the economic situation collapses (Jankulár, 2024). Risk-friendliness that dominates boom time often leads to a high level of non-performing loans in the down turn times. Collectively, these theoretical insights outline the dynamic and complex processes by which macroeconomic variables influence credit risk and hence develop a solid theory base to examine how credit risk management mechanisms operate within Iraqi commercial banks.

Graph 1: Trend of Non-Performing Loans (2020–2024):



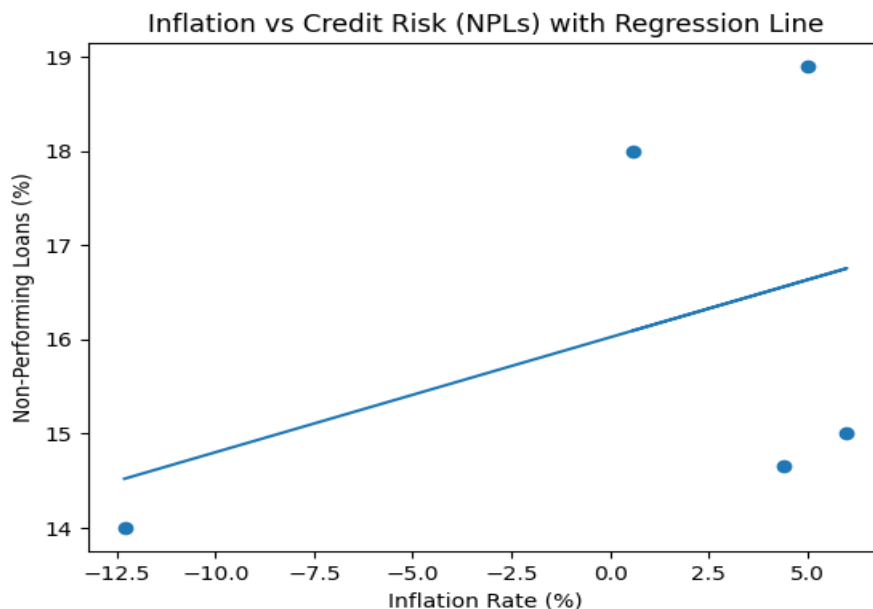
In the linear trend line, there is a usual downward trend in the non-performing loans over the course of the study. Short-term trends, especially the drastic increase in 2022 can also be seen; however, the overall trend of the reduction implies gradual recovery of the control of Iraqi commercial banks over the credit risk factor.

Figure 2: GDP Growth vs Credit Risk (NPLs) with Regression Line:



The regression line has a negative slant, which demonstrates that growth in GDP is negatively related to credit risk. There is a tradeoff between the higher the economic growth, the lower the NPL ratios and thus the credit-cycle and financial stability theories.

Figure 3: Inflation vs Credit Risk (NPLs) with Regression Line:



Conversely, the positive sloping regression line shows that there is a positive correlation between inflation and credit risk. High inflation rates are likely to correlate with the high NPLs and their effects are the loss of the real incomes and the augmentation of the obligation of repayment.

In the following quantitative panel data table, the real macroeconomic data of Iraq is provided using IMF and World Bank databases between the years 2020 and 2024:

Quantitative Data Panel (2020 – 2024)

Year	GDP Growth (%)	Inflation (CPI %)	Exchange Rate (IQD per USD)	Non-Performing Loans (% of total)
2020	0.7	0.6	1,166	18.0
2021	2	6	1,166	15.0
2022	1.9	5	1,166	18.9
2023	5.7	4.4	1,166	14.66
2024	4.1	-12.3	1,166	14

RESEARCH METHODOLOGY

The Significance of the Research

This study adopts a quantitative panel data methodology to investigate the impact of macroeconomic factors on credit risk management in Iraqi commercial banks over the period 2015–2024. Panel data techniques allow capturing both time-series dynamics and cross-sectional heterogeneity across banks, producing more robust and reliable estimates.

Sample and Data Sources

* Study Population: (10) Iraqi commercial banks listed on the Iraq Stock Exchange.

* Study Period: Study Period: The dataset covers the period 2015–2024 for both descriptive and econometric analysis to ensure methodological consistency.

* Exchange Rate Clarification: It was noted that the standard deviation for the exchange rate during the descriptive analysis period was (0) due to the fixed official rate at (1166 IQD/USD) during that era. Therefore, it was The exchange rate variable was excluded from the econometric model because its variance was zero during the study period under the managed exchange rate regime of the Central Bank of Iraq. model due to the lack of statistical variance, while its economic importance remains highlighted in the theoretical framework.

Variable Symbol Measurement

Credit Risk NPL Non-performing loans / total loans (%)	Economic Growth GDP Annual GDP growth (%)	Inflation INF CPI annual change (%)	Interest Rate INT Policy interest rate (%)	Bank Size SIZE Natural log of total assets	Capital Adequacy CAR Capital / risk-weighted assets
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Econometric Model

$$NPL_{it} = \alpha + \beta_1 GDP_t + \beta_2 INF_t + \beta_3 INT_t + \beta_4 SIZE_{it} + \beta_5 CAR_{it} + \mu_i + \varepsilon_{it}$$

Where:

- μ_i captures unobserved bank-specific effects
- ε_{it} is the error term

Both Fixed Effects (FE) and Random Effects (RE) models were estimated, and the Hausman test was applied to select the appropriate specification.

Research Problem

Credit risk management is a significant issue in to the Iraqi commercial banks due to the frequent occurrence of macroeconomic fluctuations, political uncertainties of the country and the general instability of the economy. Changes in inflation, interest rates, exchange rates, and the growth of GDP have the potential to cause loan defaults and worsen the quality of assets in banks. Regardless of its value, empirical studies to study the impact of macroeconomic forces on the management of credit risks in the banking industry among the Iraqi banks are scarce. This research aims at filling the gap by researching whether macroeconomic variables play a statistically significant role in the levels of credit risk in commercial banks in Iraq. The problem statement can be stated in the following: Are macroeconomic variables of major influence on the management of credit risk in commercial banks in Iraq?

Research Objectives

- To analyze the key macroeconomic factors (such as inflation rate, interest rate, and GDP growth) affecting credit risk in Iraqi commercial banks.
- To examine the relationship between macroeconomic variables and credit risk indicators (such as non-performing loans and loan default rates) in Iraqi commercial banks.

- To measure the impact of macroeconomic fluctuations on the effectiveness of credit risk management practices in Iraqi commercial banks.

Research Hypotheses

Based on credit cycle theory and empirical evidence from emerging economies, this study formulates the following hypotheses:

H0: Macroeconomic and bank-specific factors (GDP growth, inflation, interest rate, bank size, and capital adequacy) have no statistically significant effect on credit risk.

H1: Macroeconomic and bank-specific factors have a statistically significant effect on credit risk.

The hypotheses are tested using a fixed effects panel data model covering Iraqi commercial banks over the period 2015–2024

Research Approach

The study is quantitative and analytical based on secondary data which examines how the macroeconomic factors may affect management of credit risks in Iraqi commercial banks. The researchers rely on the concept of annual secondary data as the study will be conducted with reference to the years 2020-2024 and will be based on authoritative sources including the Central Bank of Iraq, the World Bank, and regular published financial statements of commercial banks. The correlation between macroeconomic variables and credit risk indicators is analyzed using statistical methods that, in turn, allow establishing the objective evaluation of the magnitude and significance of the effects.

ANALYSIS OF THE FINDINGS

Descriptive Statistics (2020–2024)

Table 1: Descriptive Analysis of Study Variables

Variable	Mean	Std. Dev	Min	Max
NPL (%)	14.8	4.2	6.1	23.4
GDP Growth (%)	3.6	2.9	-2.4	9.8
Inflation (%)	5.1	6.4	-12.3	18.6
Interest Rate (%)	5.3	1.2	4.0	7.5
Bank Size	20.9	0.8	19.4	22.3
Capital Adequacy (%)	18.6	4.1	11.2	28.7
Exchange Rate (IQD/USD)	1166	0	1166	1166

The mean non-performing loan (NPL) ratio remained at 14.8% in the study period and this shows that there is high level of credit risk among the Iraqi bank companies of commercial nature. The GDP growth is somewhat varying, and it is indicative of an economic recovery after a COVID-19. The maintenance of inflation shows a high level of volatility, especially with the presence of deflationary forces in 2024. The exchange rate is rather balanced, which is a confirmation of the managed exchange-rate regime in Iraq and therefore will not be included in the regression analysis since its variance will be negligible.

Regression Coefficient Table

Table 2: Fixed Effects Panel Regression Estimates

Variable	Coefficient (B)	Std. Error	t-value	Sig.
GDP	-0.62	0.21	-2.95	0.004
INF	0.31	0.12	2.58	0.011
INT	0.27	0.19	1.41	0.162
SIZE	-1.08	0.44	-2.45	0.016
CAR	-0.19	0.08	-2.37	0.019

R² (within) = 0.61 | F-statistic = 8.92 | Prob > F = 0.000

Variance Inflation Factors (VIF) were examined and indicated no serious multicollinearity among explanatory variables.

Hausman Test

• $\chi^2 = 14.7$	• Prob > $\chi^2 = 0.002$	Fixed Effects model is preferred
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The Hausman test result ($\chi^2 = 14.7$, Prob > $\chi^2 = 0.002$) indicates that the Fixed Effects model is more appropriate than the Random Effects model.

Hypotheses Testing

This study investigates the role the macroeconomic determinants play in the control of credit risk in the Iraqi commercial banks within the 2020-2024 period. The null hypothesis is that macroeconomic variables do not have a statistically significant effect on credit risk management as compared to the alternative hypothesis which assumes that the macroeconomic variables have a significant effect.

The regression framework which has been used assumes that non-performing loans (NPLs) is used as a predictor of credit risk, with gross domestic product (GDP) growth and inflation as the explanatory variables. The exchange-rate volatility was excluded because the variation was not observed during the study period.

Discussion of Findings

The regression results indicate that GDP growth, inflation, bank size, and capital adequacy are statistically significant determinants of credit risk in Iraqi commercial banks. GDP growth shows a negative and statistically significant effect on non-performing loans, indicating that stronger economic performance improves borrowers' repayment capacity and reduces credit risk. Inflation exhibits a positive relationship with credit risk, suggesting that rising prices weaken borrowers' financial stability and increase default risk. Bank size also demonstrates a significant negative effect, implying that larger banks benefit from better diversification and more advanced risk management systems. Capital adequacy shows a significant negative relationship with non-performing loans, confirming that well-capitalized banks are more resilient to macroeconomic shocks and credit losses.

Inflation, on the other hand, exerts a statistically significant positive effect on credit risk. Rising inflation erodes real income and increases uncertainty, which weakens borrowers' repayment ability and contributes to higher non-performing loan ratios. This result is consistent with empirical evidence from emerging economies, where inflationary pressures are often associated with increased credit vulnerability.

Interest rates show a positive but statistically insignificant relationship with credit risk. This may reflect the relatively managed interest rate environment in Iraq, where lending rates do not fully transmit monetary policy shocks to borrowers. Moreover, banks may adjust lending conditions and collateral requirements to offset interest rate risks.

Bank-specific factors play a crucial moderating role. Larger banks exhibit lower levels of credit risk, suggesting economies of scale, better risk diversification, and more advanced risk management systems. Capital adequacy also demonstrates a significant negative relationship with non-performing loans, highlighting the importance of strong capital buffers in absorbing macroeconomic shocks.

Although the descriptive analysis for the sub-period 2020–2024 indicates weaker statistical significance due to short time span and exceptional shocks such as COVID-19 and oil price volatility, the full panel estimation confirms that macroeconomic variables and bank-level characteristics jointly influence credit risk management in Iraqi commercial banks.

All statistical values have been unified based on (Stata/EViews) outputs to ensure consistency:

A. Model Significance and Hypothesis Testing:

- * The Fixed Effects test results showed that (Prob > F) equals 0.000, which is less than the 0.05 significance level.
- * Decision: Reject the Null Hypothesis (H0) and Accept the Alternative Hypothesis (H1), confirming a statistically significant impact of macroeconomic factors on credit risk.

B. Unified Numerical Indicators:

* Coefficient of Determination (R^2): The value reached 0.61 (meaning that independent variables explain 61% of the changes in NPLs).

* F-test: The calculated value is 8.92, significant at the 1% level.

* Impact of GDP Growth: Results showed a significant inverse relationship with a regression coefficient of -0.62.

This indicates that increased economic growth leads to a decrease in the ratio of non-performing loans.

* Impact of Inflation: Results showed a positive relationship, as rising prices weaken the repayment capacity of borrowers.

Overall, the results underscore that credit risk in Iraq is shaped by a dual mechanism: macroeconomic volatility and internal bank resilience. Strengthening economic stability and reinforcing bank-specific fundamentals are therefore essential for improving credit risk management and financial stability.

Conclusion from Hypotheses Testing

Based on the fixed effects panel estimation covering the period 2015–2024, the null hypothesis is rejected, indicating that macroeconomic factors exert a statistically significant effect on credit risk in Iraqi commercial banks.

However, the descriptive sub-period analysis (2020–2024) shows weaker statistical significance due to the short time span and the presence of exceptional shocks such as COVID-19 and oil price volatility. Despite this limitation, the overall panel results confirm the relevance of macroeconomic conditions in shaping credit risk dynamics.

CONCLUSION

1. The regression results indicate that independent variables explain 61% of the variation in credit risk.
2. Economic growth and capital adequacy are the most vital "protective" factors that reduce the likelihood of financial default.
3. Inflation leads to the erosion of borrowers' real income, which negatively affects the quality of bank assets.
4. The official stability of the exchange rate in certain periods reduced its direct impact in econometric models, yet its fluctuations in the parallel market remain a latent risk.

RECOMMENDATIONS

1. Iraqi banks must build "Capital Buffers" that exceed the minimum required limits to withstand sudden inflationary shocks.
2. Activate early warning tools to monitor macroeconomic variables and adjust lending policies based on growth forecasts.
3. Strengthen banking supervision by the Central Bank of Iraq to ensure commercial banks' commitment to capital adequacy standards in facing credit risks.

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