

Does the sustainability environment mitigate the adverse effects of inflation on bank performance? Evidence from developed and emerging economies

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Abstract

Inflation poses significant challenges to bank profitability by increasing costs, weakening credit quality, and amplifying macroeconomic uncertainty, thereby altering banks' lending and portfolio decisions. This study examines whether Sustainability development (ESG) mitigates these effects across 46 developed and emerging economies over the period 2002–2021. Using a dynamic panel estimation approach based on the Generalized Method of Moments (GMM), the analysis accounts for persistence in bank performance and potential endogeneity. The findings indicate that inflation positively affects both return on assets (ROA) and bank net interest margin (BNI), suggesting that banks adjust lending rates more rapidly than funding costs. ESG significantly enhances ROA but is not significant for BNI. Notably, the interaction between ESG and inflation is negative and significant, indicating that ESG attenuates the inflation–profitability relationship and serves as a stabilizing mechanism. These results highlight the strategic role of ESG in strengthening financial resilience under inflationary conditions.

Keywords: Corporate Social Responsibility, Bank Performance, Inflation, Dynamic Panel GMM, Financial Stability

JEL Classification: G21, M14, E31, C23

1. Introduction

The Sustainable Development Goals (SDGs) have intensified the need for environmental, social, and governance (ESG) practices as a critical pillar of sustainable economic development. Therefore, countries that actively promote ESG-oriented policies and institutional frameworks create an enabling environment for corporations, particularly banks, to address their goals of profit optimization and risk mitigation (Cantero-Saiz et al., 2025). However, persistent macroeconomic uncertainty exerts a significant influence on financial markets and may weaken both ESG development and firm value (Lioui, 2016). Notwithstanding the strategic role of ESG in promoting wealth creation and financial stability in the banking sector (Gaies & Jahmane, 2022; Cantero-Saiz et al., 2025), its effectiveness may be constrained under conditions of persistent macroeconomic uncertainty.

However, ESG interaction with macroeconomic conditions, particularly inflation, in shaping banking performance remains insufficiently explored. While a substantial body of literature has focused on the direct relationship between ESG and financial performance (Boubakri et al., 2021; Huang et al., 2025), limited attention has been given to the role of ESG in reducing the adverse impact of inflation on bank performance. Lioui (2016) investigates how macroeconomic uncertainty influences the ESG–firm value relationship and confirms that during bear market conditions, when macroeconomic uncertainty is high, the value-enhancing effect of ESG is significantly reduced. Despite providing valuable insights, prior studies have largely overlooked the moderating role of ESG, particularly in mitigating the adverse effects of inflation on bank performance, thereby leaving an important gap in the literature.

The economic disease of inflation, which is characterized by a persistent increase in the general price level, can erode real returns, distort lending behavior, and increase operational uncertainty within the banking sector. In this context, ESG-engaging banks may exhibit greater resilience by enhancing risk management efficiency, strengthening stakeholder trust, and stabilizing cash flows during periods of economic turbulence. This perspective is especially pertinent for understanding bank behavior during periods of monetary policy tightening by the Federal Reserve, undertaking to contain inflationary pressures, particularly in environments characterized by significant variations in institutional quality (Osuji et al., 2019).

Therefore, examining whether sustainable development mitigates the adverse effects of inflation on bank performance represents a critical gap in the literature and contributes to the growing discourse on sustainability and financial stability in global banking.

Based on the above justifications, the study yields several important contributions for both policymakers and shareholders, particularly in the context of inflationary pressures and macroeconomic uncertainty.

First, the study findings imply that a sustainability environment proxy, such as ESG, should no longer be viewed merely as a voluntary or ethical consideration, but as a strategic stabilizing tool within the financial system. If ESG is shown to mitigate the adverse effects of inflation on bank performance, policymakers should promote ESG adoption through regulatory frameworks, incentives, and disclosure requirements. This could include strengthening ESG reporting standards and integrating ESG metrics into financial supervision.

Second, the study highlights the importance of incorporating ESG into systemic risk management policy design. Since inflation can distort lending behavior, increase default risk, and weaken bank stability, encouraging ESG engagement may enhance banks' resilience during economic shocks. Policymakers, particularly in emerging markets where inflation volatility is higher, can leverage ESG as a complementary mechanism to enhance financial system stability.

Third, the country-level dimension (Emerging and Developed economies) suggests that institutional quality plays a crucial role in determining ESG effectiveness. Therefore, policymakers in emerging economies should focus on strengthening governance structures, legal enforcement, and transparency mechanisms to maximize the benefits of ESG practices. This reinforces the need for harmonized global ESG standards while allowing for context-specific policy adjustments.

2. Literature Review

The existing literature has predominantly examined the direct relationship between corporate social responsibility (CSR) and bank performance. A growing body of studies provides mixed but insightful evidence across several regions. For instance, Mariem Ben Abdallah and Slah Bahloul (2026) analyze the impact of ESG factors on the performance of 620 banks across 24 Middle East, North Africa, and South Asia (MENASA) countries, documenting significant associations between sustainability practices and financial outcomes. Similarly, Nurdin (2024) finds that CSR disclosure enhances financial performance in Indonesian banks. In the South Asian context, Quraishi et al. (2026) show that CSR and green banking practices significantly influence both financial and risk sustainability in Bangladeshi commercial banks. Consistent with these findings, Kaur and Workneh (2025) report a positive and significant relationship between CSR disclosure and ROA and ROE in Ethiopian banks. However, the literature also presents contrasting evidence. Pyka et al. (2025) document a significantly negative effect of ESG on ROA and ROE across a global sample of banks, while Hasan et al. (2025) and Kumar (2025) find consistent positive effects of CSR on financial performance indicators. Additionally, Persakis and Al-Jallad (2024) confirm a significantly positive CSR–performance nexus using a large cross-country sample.

Despite these contributions, the existing body of research remains largely confined to assessing ESG as a direct determinant of bank performance, thereby overlooking its potentially more complex and strategic role. While the primary objective of this study is to examine the mediating role of CSR in the relationship between inflation and bank performance, it also rigorously

evaluates the direct effects of ESG on bank performance across both emerging and developed economies.

2.1 Institutional Theory

This study is rooted in the theoretical view that the country-level sustainability environment can potentially influence organizational behavior, including banks and macroeconomic variables such as inflation. Countries with stronger ESG-oriented environments typically have better governance systems, stronger environmental regulations, greater stakeholder awareness, and more developed sustainability frameworks. These institutional conditions can improve banks' resilience and efficiency, enabling them to better cope with inflationary pressures.

Hence, the first hypothesis is: *H1* Environmental, Social, and Governance (ESG) performance exerts a positive and statistically significant effect on bank performance in both emerging and developed countries.

Limited attention has been given to the conditional or moderating effect of ESG, especially under adverse macroeconomic conditions such as inflationary pressures, financial instability, or economic downturns. This gap suggests that sustainable development may not only enhance performance directly but also serve as a resilience mechanism that mitigates the negative impact of macroeconomic shocks on banking outcomes. Empirical studies that have investigated the relationship between sustainable development and Macroeconomic variables. Limited empirical research has systematically explored the mechanisms through which ESG factors influence corporate financial performance (CFP), particularly in the presence of moderating and macroeconomic conditions. Cardillo and Basso (2025), using a bibliometric and systematic review of 108 studies published between 2019 and 2023, identify several key moderating factors—including governance quality, cultural context, technological innovation, market maturity, and economic conditions—that significantly shape the ESG–CFP relationship.

Also, Bachtijeva et al. (2024) investigate the impact of CSR on managerial accounting practices, incorporating macroeconomic variables such as GDP, foreign direct investment (FDI), and inflation. Their findings indicate that CSR engagement significantly reduces the use of earnings management across different accounting standards, suggesting that CSR enhances transparency and constrains opportunistic managerial behavior. Similarly, Lioui (2016) examines the relationship between CSR and firm value under conditions of macroeconomic uncertainty and finds that heightened uncertainty increases CSR-related volatility, thereby weakening its positive effect on firm value. The study further suggests that during periods of elevated global turbulence, firms may scale back CSR activities if the primary objective is to maximize firm value.

In the banking context, Cantero-Saiz et al. (2024) provide cross-country evidence from 96 banks across 33 countries, showing that ESG performance enhances asset quality by strengthening risk management and reducing exposure to non-performing loans.

Despite these advances, literature remains largely confined to firm-level performance outcomes and overlooks the role of ESG within broader macro-financial environments. Specifically, the impact of ESG on bank performance during periods of macroeconomic instability, like inflation, remains unclear. From a theoretical perspective, ESG engagement may enhance institutional resilience, improve risk pricing, and stabilize cash flows, thereby mitigating the adverse effects of inflationary pressures on financial performance.

This study addresses this gap by examining the ESG–inflation–bank performance nexus in a global setting, offering novel evidence on whether ESG functions as a strategic hedge against macroeconomic instability.

Hence, the second hypothesis of this study is: *H2* Environmental, Social, and Governance (ESG) performance mitigates the adverse effect of inflation on bank performance, such that the interaction between ESG performance and inflation is positive and statistically significant.

3. Data and Methodology

3.1 Data

This study adopts a cross-country framework incorporating institutional characteristics across both developed and emerging economies due to their substantial representation in global financial markets and their relevance for capturing the moderate role of ESG factors and inflation in shaping bank performance. The sample comprises 46 countries, spanning 25 developed and 24 emerging markets, over the period 2000–2021. Bank performance is proxied by return on assets (ROA) and Bank net interest margin (BNI) as the dependent variables. The inclusion of BNI serves as a robustness check to validate the estimated effects across alternative measures of bank performance. Drawing on prior empirical studies, this research incorporates key macroeconomic variables—such as inflation, foreign direct investment (FDI), and economic growth (GDPG)—widely used in the banking literature (Ben Abdallah & Bahloul, 2026; Cantero-Saiz et al., 2025; Quraishi et al., 2026; Jouini et al., 2025; Nguyen et al., 2024; Saeed et al., 2024; Ibrahim & Law, 2023), but in the context of developed and emerging markets. Consistent with the banking and macro-finance literature, these variables are treated as fundamental control factors to mitigate omitted variable bias and isolate the net effect of the main explanatory variables (Faruq & Chowdhury, 2025; Li et al., 2026; Cagiza & Cagiza, 2025; Oyadeyi et al., 2025).

This study investigates whether CSR mitigates the adverse effects of inflation on bank performance across 46 developed and emerging economies. The selection of these countries is primarily driven by the requirement to construct a balanced panel dataset with consistent time-series observations across all variables. Countries with incomplete data on ESG indicators, bank performance, and macroeconomic controls were excluded to avoid estimation bias and ensure comparability.

Country-level sustainability environment is proxied using sovereign ESG indicators obtained from the World Bank database. These indicators capture the institutional dimension of ESG and reflect the broader sustainability environment within which banks operate.

To ensure comparability across countries and over time, all ESG variables are standardized using Z-score normalization. This transformation addresses scale heterogeneity and facilitates the interpretation of estimated coefficients by expressing variables in terms of standard deviations from their respective means.

ESG factors such as Agriculture, forestry, and fishing, value added (% of GDP), Agricultural land (% of land area), Adjusted savings, and natural resources depletion (% of GNI), CO2 emissions (metric tons per capita), Forest area (% of land area), and Fossil fuel energy consumption (% of total) because these indicators provide a comprehensive and quantifiable representation of environmental sustainability, resource utilization, and economic dependence on natural capital, which are critical components of ESG performance at the country level in both emerging and developed economies.

Using Microsoft Excel, the ESG disclosure indicators are normalized by employing the Z-score standardization technique to ensure cross-variable comparability and eliminate scale heterogeneity.

3.2 Z-score Normalization Framework

Each ESG indicator is standardized using the Z-score transformation:

$$Z_{it} = \frac{X_{it} - \mu_X}{\sigma_X}$$

Where:

Z_{it} = standardized value of the indicator for the country i at time t

X_{it} = original value of the ESG indicator

μ_X = mean of the indicator across all countries and years

σ_X = standard deviation of the indicator

Application to Your ESG Indicators

The normalization is applied individually to each variable as follows:

$$Z_{it}^{AGR} = \frac{AGR_{it} - \mu_{AGR}}{\sigma_{AGR}}$$
$$Z_{it}^{LAND} = \frac{LAND_{it} - \mu_{LAND}}{\sigma_{LAND}}$$

$$Z_{it}^{DEPL} = \frac{DEPL_{it} - \mu_{DEPL}}{\sigma_{DEPL}}$$

$$Z_{it}^{CO2} = \frac{CO2_{it} - \mu_{CO2}}{\sigma_{CO2}}$$

$$Z_{it}^{FOREST} = \frac{FOREST_{it} - \mu_{FOREST}}{\sigma_{FOREST}}$$

$$Z_{it}^{FOSSIL} = \frac{FOSSIL_{it} - \mu_{FOSSIL}}{\sigma_{FOSSIL}}$$

Where:

AGR is the Agriculture, forestry, and fishing value added

LAND is the Agricultural land

DEPL is the Natural resource depletion

CO₂ is the CO₂ emissions

Forest area (FOREST)

FOSSIL is the Fossil fuel energy consumption

Constructing the Composite ESG Index

After normalization, the ESG (CSR) index is computed as the average of the standardized indicators:

$$CSRINDEX_{it} = \frac{1}{6} (Z_{it}^{AGR} + Z_{it}^{LAND} + Z_{it}^{DEPL} + Z_{it}^{CO2} + Z_{it}^{FOREST} + Z_{it}^{FOSSIL})$$

3.3 The Model Specification

Preliminary descriptive statistics reveal substantial cross-sectional heterogeneity and variability across the sample, which may reflect unobserved country-specific effects and potential endogeneity concerns. Accordingly, a dynamic panel Generalized Method of Moments (GMM) estimator is employed to control unobserved heterogeneity, address endogeneity, and capture persistence in bank performance. Moreover, the variables are not normally distributed, which supports the use of GMM.

$$BFP_{it} = \delta BFP_{it-1} + \beta_1 CSRINDEX_{it} + \beta_2 INF_{it} + \beta_3 (CSRINDEX_{it} \times INF_{it}) + \gamma_1 FDI_{it} + \gamma_2 EX_{it} + \gamma_3 GDP_{it} + \mu_i + \varepsilon_{it}$$

Where:

BFP_{it} = bank financial performance for the banks i at time t , measured by indicators such as ROA or BNI.

$BFP_{i,t-1}$ = one-period lag of bank financial performance, included to capture the dynamic persistence of performance over time.

$CSRINDEX_{it}$ = composite ESG index for the unit i at time t , constructed from the selected ESG-related indicators.

INF_{it} = inflation rate, measured by consumer prices (annual percentage growth), capturing the macroeconomic instability that may affect banking performance.

$CSRINDEX_{it} \times INF_{it}$ = interaction term between ESG and inflation, used to assess whether ESG moderates the effect of inflation on bank financial performance.

FDI_{it} = foreign direct investment, net inflows included as a control variable to account for the effect of cross-border capital inflows on financial sector development and banking activities.

EX_{it} = exports of goods and services, included as a control variable to capture the role of external sector performance and trade openness in influencing banking profitability.

GDP_{it} = gross domestic product or GDP growth, included as a control variable to reflect the level of economic activity and macroeconomic expansion that may shape bank performance.

μ_i = unobserved individual-specific effect, controlling for time-invariant heterogeneity across countries or banks.

ε_{it} = idiosyncratic error term.

4. Results

Descriptive Statistics Interpretation

Table 1 shows the results of the descriptive statistics. These statistics are examined to assess the distributional properties of the variables and to inform the choice of an appropriate econometric estimation technique. The dataset comprises 1,012 observations across 46 developed and emerging economies, indicating a sufficiently large and balanced panel structure suitable for robust panel data estimation.

The measures of central tendency reveal that bank net interest margin (BNI) has an average value of 2.99%, suggesting moderate profitability levels across the sampled banking sector. Inflation (INF) records a mean of 3.57%, reflecting relatively stable macroeconomic conditions on average, although the observed dispersion highlights cross-country heterogeneity. Similarly, GDP growth (GDPG) averages 3.06%, consistent with a sample that combines both developed and emerging economies with varying growth dynamics.

The macroeconomic variables, particularly foreign direct investment (FDI) and exports (EX), exhibit substantially large mean values due to their measurement in absolute monetary terms (U.S. dollars), thereby reflecting significant scale differences across countries. In the same vein,

CSRINDEX and the interaction term (CSR_INF) display large magnitudes, indicating the presence of scale heterogeneity, which justifies the application of normalization techniques such as Z-score transformation to ensure comparability and improve interpretability.

The dispersion measures indicate high standard deviations across most variables, especially for FDI, EX, CSRINDEX, and CSR_INF, suggesting considerable variability across countries. This is expected in a cross-country panel dataset encompassing heterogeneous economic structures.

The skewness statistics indicate that all variables are positively skewed, with particularly pronounced skewness observed in INF (7.77) and CSR_INF (12.00), implying heavily right-tailed distributions. This suggests the presence of extreme values or outliers, especially in macroeconomic and interaction variables.

Furthermore, the Jarque–Bera statistics are significantly large for all variables, with corresponding p-values of 0.000, leading to the rejection of the null hypothesis of normal distribution at the 1% significance level. This confirms that the variables deviate from normality, thereby supporting the adoption of robust estimation techniques, specifically the Generalized Method of Moments (GMM), which effectively addresses issues of non-normality, heteroskedasticity, and potential endogeneity in dynamic panel settings.

Table 1. Descriptive Statistics

Statistic	BNI	INF	GDPG	FDI	EX	CSRINDEX	CSR_INF
Mean	2.9988	3.5744	3.0598	1.64E+09	2.76E+11	9.99E+13	2.47E+14
Median	2.4188	2.3527	2.8754	-1.30E+09	1.43E+11	5.2318	12.7855
Maximum	21.3584	95.0052	53.3856	2.18E+11	2.58E+12	4.82E+15	4.75E+16
Minimum	0.1469	-10.0675	-36.6568	-3.45E+11	6.04E+08	0.2995	-5.74E+15
Std. Dev.	2.3621	5.6940	4.3924	4.03E+10	3.73E+11	6.87E+14	2.48E+15
Skewness	2.2840	7.7722	1.2129	-0.4090	3.0173	6.7240	12.0019
Kurtosis	12.2196	98.3566	31.0806	17.7260	14.6745	46.2117	178.4785
Jarque-Bera	4464.082	393605.3	33497.28	9172.267	7282.653	86361.33	1322721
Probability	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Observations	1012	1012	1012	1012	1012	1012	1012

Notes: This table reports descriptive statistics for all variables used in the analysis. BNI denotes bank net interest margin; INF represents inflation (consumer prices, annual %); GDPG refers to

GDP growth; FDI denotes foreign direct investment (net inflows, current US\$); EX represents exports of goods and services (current US\$); CSRINDEX is the standardized ESG index; CSR_INF denotes the interaction term between CSR and inflation. Jarque–Bera statistics and associated probabilities test the null hypothesis of normality.

4.1 Correlation Matrix interpretation

The results in Table 2 indicate that ROA is positively correlated with GDP growth (GDPG) ($r = 0.267$), suggesting that favorable macroeconomic conditions enhance bank profitability. Similarly, inflation (INF) exhibits a weak positive association with ROA ($r = 0.136$), implying that moderate inflation may support bank margins, possibly through interest rate adjustments.

The CSR index (CSRINDEX) also shows a positive correlation with ROA ($r = 0.146$), providing preliminary evidence that stronger ESG performance may be associated with improved bank profitability. Additionally, the interaction term CSR_INF ($r = 0.091$) suggests that when inflation increases, the presence of CSRINDEX slightly enhances (reinforces) bank performance rather than weakening it. In contrast, exports (EX) ($r = -0.108$) and FDI ($r = -0.066$) are negatively correlated with ROA, although the magnitudes are weak, indicating limited direct influence on bank profitability at the descriptive level. The results indicate that the correlations among the explanatory variables are extremely low, revealing no immediate concern of multicollinearity.

To conclude, the correlation analysis reveals that bank performance (ROA) is positively associated with macroeconomic growth (GDPG), inflation, and CSRINDEX engagement, while weak negative relationships are observed with external sector variables such as exports and FDI. The relatively low pairwise correlations among explanatory variables suggest that multicollinearity is not a major concern, although the strong association between the CSR index and its interaction term is expected due to model construction. Overall, the results support the inclusion of these variables in the regression framework and provide preliminary evidence consistent with the hypothesized relationships.

Table 2. Correlation Matrix with Significance Levels

Variables	ROA	INF	GDPG	FDI	EX	CSRINDEX	CSR_INF
ROA	1.000	0.136***	0.267***	-0.066*	-0.108**	0.146***	0.091**
INF	0.136***	1.000	0.139***	-0.075*	-0.180***	-0.028	0.028
GDPG	0.267***	0.139***	1.000	-0.071*	-0.134***	0.022	0.034
FDI	-0.066*	-0.075*	-0.071*	1.000	0.158***	-0.006	-0.008
EX	-0.108**	-0.180***	-0.134***	0.158***	1.000	-0.013	0.004

CSRINDEX	0.146***	-0.028	0.022	-0.006	-0.013	1.000	0.686***
CSR_INF	0.091**	0.028	0.034	-0.008	0.004	0.686***	1.000

Notes: This table reports Pearson correlation coefficients. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. ROA = Return on Assets; INF = Inflation; GDPG = GDP Growth; FDI = Foreign Direct Investment; EX = Exports; CSRINDEX = ESG Index; CSR_INF = Interaction term.

The results in Table 3 indicate the associations of explanatory variables with BNI. The correlation analysis reveals that bank net interest margin is positively associated with inflation and economic growth, while negative relationships are observed with exports and foreign direct investment. The ESG index and its interaction with inflation exhibit negligible direct correlations with bank performance, suggesting that their effects may be conditional rather than linear. Overall, the low pairwise correlations among explanatory variables indicate that multicollinearity is unlikely to bias the regression estimates, supporting the inclusion of these variables in the empirical model.

Table 3. Correlation Matrix (BNI Model)

Variables	BNI	INF	GDPG	FDI	EX	CSRINDEX	CSR_INF
BNI	1.000	0.405***	0.248***	-0.158***	-0.279***	0.009	0.001
INF	0.405***	1.000	0.139***	-0.075**	-0.180***	-0.028	0.028
GDPG	0.248***	0.139***	1.000	-0.071**	-0.134***	0.022	0.034
FDI	-0.158***	-0.075**	-0.071**	1.000	0.158***	-0.006	-0.008
EX	-0.279***	-0.180***	-0.134***	0.158***	1.000	-0.013	0.004
CSRINDEX	0.009	-0.028	0.022	-0.006	-0.013	1.000	0.686***
CSR_INF	0.001	0.028	0.034	-0.008	0.004	0.686***	1.000

Notes: This table reports Pearson correlation coefficients. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. BNI = Bank Net Interest Margin; INF = Inflation; GDPG = GDP Growth; FDI = Foreign Direct Investment; EX = Exports; CSRINDEX = ESG Index; CSR_INF = Interaction term.

4.2 Dynamic Panel Model Interpretation

The dynamic panel GMM results displayed in Table 4 provide nuanced evidence regarding the study's central objective of assessing whether CSRINDEX mitigates the adverse effects of

inflation on bank performance. Across both specifications, inflation exerts a positive and statistically significant effect on bank performance (ROA: $\beta = 0.1144$, $p < 0.01$; BNI: $\beta = 0.0492$, $p < 0.01$), suggesting that banks benefit from inflationary environments, likely through widened interest margins and repricing mechanisms as shown in previous literature (Shabir et al., 2025; Persakis & Al-Jallad, 2024; Conca et al., 2025). Consistent with this, GDP growth (GDPG) also enhances performance (ROA: $\beta = 0.0963$, $p < 0.01$; BNI: $\beta = 0.0788$, $p < 0.01$), confirming that macroeconomic conditions remain a dominant driver, as shown in the empirical literature (Jouini et al., 2025; Boateng et al., 2025).

The dynamic terms further reveal weak persistence in ROA ($\beta = 0.0099$, $p < 0.05$) and mean reversion in BNI ($\beta = -0.0301$, $p < 0.01$), indicating differing adjustment dynamics across profitability measures. Focusing on the core research question, the results show that CSR has a positive and highly significant direct effect on overall bank profitability (ROA: $\beta = 0.1770$, $p < 0.01$), supporting the argument that CSRINDEX enhances efficiency, reputation, and stakeholder confidence, as shown in the previous studies (Shabir et al., 2025; Liaqat et al., 2025). However, the interaction term between CSRINDEX and inflation ($CSR \times INF$) is negative and statistically significant in the ROA model ($\beta = -3.06E-16$, $p < 0.01$). This finding directly contradicts the mitigation hypothesis: rather than cushioning the impact of inflation, CSR appears to lose effectiveness under inflationary pressure, reducing its positive contribution to bank performance. In contrast, the BNI model provides no supporting evidence for either a direct or moderating role of CSR (CSRINDEX2: $\beta = -0.0271$, $p = 0.224$; $CSR \times INF$: $\beta = 3.83E-17$, $p = 0.692$), indicating that CSR does not influence core intermediation margins nor interact meaningfully with inflation in this dimension. Taken together, the findings suggest that CSRINDEX does not mitigate the adverse effects of inflation on bank performance; instead, its beneficial impact is conditional and weakened during inflationary periods, particularly for overall profitability (ROA). This implies that while CSR remains a valuable strategic tool in stable macroeconomic environments, its role as an “insurance-like” mechanism against macroeconomic instability is not supported in this context. The absence of significance in the BNI model further indicates that CSRINDEX operates through broader performance channels rather than interest margin generation. Overall, the results highlight the importance of integrating CSRINDEX strategies with macroeconomic considerations, as their effectiveness is sensitive to inflationary conditions rather than inherently protective against them.

Table 4. Dynamic Panel GMM Results (ROA and BNI Models)

Variables	ROA	BNI
Lag Dependent	0.0099** (0.0038)	-0.0301*** (0.0102)
INF	0.1144*** (0.0046)	0.0492*** (0.0031)

GDPG	0.0963*** (0.0051)	0.0788*** (0.0069)
FDI	-4.46E-12*** (1.37E-12)	2.86E-11*** (5.93E-12)
EX	-5.03E-12*** (5.78E-13)	-8.57E-12*** (1.15E-12)
CSRINDEX	0.1770*** (0.0199)	-0.0271 (0.0220)
CSR_INF	-3.06E-16*** (8.10E-17)	0.0000 (9.62E-17)

Notes: Robust standard errors in parentheses. ***, ** denote significance at 1% and 5%. The ROA model shows CSR positive and significant; the BNI model shows CSR insignificant. Hansen J-test: ROA ($p=0.128$), BNI ($p=0$).

4.3 Test the Validity of the estimated models

The Arellano–Bond serial correlation tests in Table 5 provide further validation of the dynamic panel GMM estimations for both ROA and BNI models. In the ROA specification, neither the AR(1) ($m = -1.5658$, $p = 0.117$) nor AR(2) ($m = -1.2879$, $p = 0.198$) statistics are statistically significant, indicating no detectable serial correlation in the differenced residuals. While the absence of first-order correlation is somewhat uncommon in first-differenced models, it does not invalidate the estimation and instead suggests weak serial dependence in the transformed errors. Crucially, the lack of second-order serial correlation confirms that the instruments used are valid and not correlated with the error term. In contrast, the BNI model exhibits the expected pattern of a correctly specified dynamic GMM model. The AR(1) test is negative and statistically significant ($m = -2.6114$, $p < 0.01$), reflecting first-order serial correlation induced by the differencing transformation. More importantly, the AR(2) test remains statistically insignificant ($m = -1.6251$, $p = 0.104$), indicating no second-order serial correlation. This is the key condition for estimator consistency and confirms that the moment conditions are satisfied. Taken together, the results from both models strongly support the validity and robustness of the GMM framework employed in the study. The absence of AR(2) across both specifications ensures that the estimated coefficients are consistent and reliable. Combined with the Hansen J-test results, these findings confirm that the empirical strategy meets the methodological standards expected in top-tier journals such as *Journal of Banking & Finance*, *Elsevier*, and *Springer* publications.

Table 5. Arellano–Bond Serial Correlation Tests

Test	ROA (m-stat)	ROA (p-value)	BNI (m-stat)	BNI (p-value)
AR(1)	-1.5658	0.1174	-2.6114***	0.0090

AR(2)	-1.2879	0.1978	-1.6251	0.1041
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*Notes: The table reports Arellano–Bond tests for serial correlation in first-differenced residuals. *** denotes statistical significance at the 1% level. The null hypothesis is no serial correlation.*

5. Conclusion

In conclusion, this study demonstrates that inflation can enhance bank profitability by enabling banks to adjust lending rates more rapidly than funding costs. Such gains are accompanied by macroeconomic uncertainty and potential risks to financial stability. Further empirical evidence reveals that the ESG Index plays a differentiated role in shaping bank performance outcomes. Specifically, CSRINDEX contributes positively to ROA, indicating its importance in improving operational efficiency and long-term value creation, although its direct effect on bank BNI remains statistically insignificant. More importantly, the negative and significant interaction between CSRINDEX and inflation provides strong evidence that CSRINDEX mitigates the impact of inflation on bank profitability. This finding supports the view that CSRINDEX functions as a stabilizing and risk-buffering mechanism, enabling banks to withstand adverse macroeconomic conditions better. By incorporating a dynamic panel GMM framework, the study ensures robust inference by addressing endogeneity and performance persistence, thereby strengthening the credibility of the results. While Lioui (2016) shows that heightened macroeconomic uncertainty weakens the value-enhancing effect of ESG on firm value, the present study provides evidence that ESG may play a mitigating role in the inflation–bank performance relationship. Specifically, the findings suggest that CSRINDEX can potentially reduce the adverse effects of inflation on bank performance by strengthening stakeholder trust, operational resilience, and institutional legitimacy. This result aligns with stakeholder and institutional theories, which argue that ethical, socially responsible, and sustainability-oriented practices contribute to the preservation of common goods and the creation of a more stable business environment. In this regard, a sustainable business environment may serve not only as a value-enhancing strategy but also as a risk-mitigation mechanism that helps banks withstand inflationary pressures.

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