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Price Dynamics & Inflation and Macroeconomics Expectations





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Introduction

Complementing the Central Bank of Kuwait's (CBK) series of quarterly reports being published since November 2022, this 10th edition (June 2025) is titled "**Price Dynamics & Inflation and Macroeconomics Expectations**". The first section reviews the price dynamics and inflation expectations, while the second section addresses the definition of Macroeconomics and related concepts, economic growth and business cycles in the short term, sustainable long-term economic growth, and the role of CBK in the national macroeconomy.

Price dynamics and societal expectations regarding inflation are among the most prominent factors influencing the macroeconomic environment, as they have direct repercussions on spending, saving, and investment decisions, whether by individuals or businesses. These expectations are influenced by the phases of economic activity a country undergoes, known as the business cycle. This phenomenon is characterized by periods of prosperity and expansion, followed by a slowdown or contraction, followed by a return to growth.

Understanding such changes is not limited to specialists but it helps every individual, family, and business in making more informed and proactive financial decisions. The business cycle affects many aspects, including job opportunities (employment), unemployment (unemployment rate), prices (inflation rate), interest rates, and savings or investment decisions. Therefore, it is important to understand the stages of the business cycle and the drivers of positive and decelerated economic performance. Economic activity is not limited to short cycles but includes what is known as Sustainable Economic Growth, which reflects a country's ability to achieve sustained prosperity over time. This growth depends on structural factors that represent the true foundation of economic progress, such as productivity, education, innovation, and technology.

Price Dynamics and Inflation Expectations



Price dynamics is the study and analysis of how prices change over time, as well as the factors that may influence these changes. It also includes a close examination of how supply and demand interact, as well as a range of economic, social, and political factors that influence market price determination. The importance of price dynamics lies in facilitating decision-making, guiding investment, avoiding risks, improving performance, and supporting relevant government decisions.

I. Price Dynamics and Impact on Macroeconomic Stability and Growth

Price dynamics is a central concept associated with macroeconomic dimensions, as its effects are clearly reflected in both inflation expectations and macroeconomic stability and growth. From an inflation perspective, price levels in the economy are influenced by inflation expectations, which are defined as the perceptions and expectations of households, businesses, and investors regarding the pace of future price increases. While the actual inflation rate does not depend only on direct economic factors, it is partially influenced by the expectations of economic sectors in terms of future price trends. These expectations play a key role in directing spending and investment decisions and pricing of goods and services, thus being a key factor in understanding how inflation evolves over time, and estimating its future trends.

From a macroeconomic perspective, Price Dynamics play a fundamental role in influencing the balance between aggregate supply and demand, and the behavior of various economic sectors, including households, businesses, and investors. Price stability is also a key condition for enhancing the effectiveness of macroeconomic policies, whether monetary or fiscal, thereby reducing uncertainty and providing a clearer and more confident economic environment for households, businesses, and investors. This, in turn, achieves macroeconomic stability, which is a key pillar for achieving sustainable economic growth and encouraging long-term investment.

II. The Importance of Inflation Expectations for Various Economic Sectors

Inflation expectations and stability in society influence, to some extent, the economic decisions made by households (such as spending and saving decisions), businesses (such as wage and price decisions), and investors (such as decisions to purchase government bonds). They also influence actual inflation levels. This can be summarized as follows:

1

Household Sector



Inflation expectations directly influence household spending and saving decisions. When households expect prices to rise in the upcoming period, they tend to purchase goods and services, leading to a hike in the aggregate demand¹. Conversely, savings rates decline because the real value of money saved declines when the inflation rate rises. Expectations may also influence borrowing decisions, as households prefer to borrow when inflation is expected to increase to benefit from interest rates before they rise.

2

Corporate Sector



Inflation expectations lead to changes in companies' pricing, wage, storage, and investment strategies. When companies anticipate rising prices, they often preemptively raise their product prices to maintain their profit margins. Labor and unions demand wage increases to counter the rising cost of living². Companies may also increase their stocks of raw materials to avoid paying higher prices later, a behavior known as "precautionary buying". On the investment front, companies may postpone some investments if they anticipate an unstable inflationary environment, or they may reassess their production cost structure in light of expected changes in input prices.

3

Investment Decisions



Inflation and the related expectations play a crucial role in assessing investors' sentiment, particularly in bond, stock, and real estate markets. For instance, there is a multidimensional relationship between inflation and bond markets. On the one hand, inflation can erode the value of bond investments, as the purchasing power of fixed interest payments declines over time. On the other hand, bond yields tend to rise when inflation expectations increase, as investors demand higher compensation for the risk of losing purchasing power. Likewise, when investors expect inflation to increase, they shy away from fixed-income assets such as government bonds, because the real return (i.e. after deducting inflation) becomes less attractive³. Instead, they shift toward real assets such as real estate or stocks linked to inflation-resistant sectors (such as commodities and energy)⁴.

Therefore, if the Consumer Price Index is estimated to rise, e.g. by 3% over the next year, companies will raise their prices by at least 3%, labor unions will demand equivalent pay increases, and households will increase spending rather than saving. Investors' appetite to purchasing government bonds will decline because higher inflation would reduce the real value of the return.

In general, inflation expectations may not be consistent across segments of the economy (households, businesses, and financial markets) due to different transactions and priorities. Because these expectations influence consumption and investment decisions, which in turn may affect prices and wages, finding the best way to provide a better anchored information for people's views on inflation is an important consideration for policymakers and central banks.



III. Central Banks and Inflation Expectations

In the literature, the concept of “Anchored Inflation Expectations” refers to long-term expectations regarding inflation. Average expectations are close to the central bank target level, and long-term expectations are not affected by temporary changes in the actual inflation rate. Expectations are also not dispersed among individuals⁵. There are a number of mechanisms for tracking inflation expectations, including consumer and business surveys, economists' forecasts, and inflation-linked financial instruments⁶. If the central bank is expected to achieve the target inflation rate that attains economic stability, the household and business sectors will react less when inflation temporarily rises above that level (for example, when global oil prices increase) or temporarily falls below it (for example, during a recession). Consequently, the effectiveness of monetary policy will be enhanced in ensuring that inflation remains at the target level, facilitating the central bank efforts to fulfill its commitments related to price stability.

Therefore, central banks pay great attention to inflation expectations in society and ensuring that long-term inflation expectations remain close to target levels. This is for a number of reasons, the most important of which are: (1) These expectations represent a key indicator of the credibility and independence of the central banks' policies; (2) Inflation expectations are important for the transmission of monetary policy decisions across various economic sectors (households, corporate and investment sectors, and financial markets); and (3) Inflation expectations are generally viewed as important in influencing short-term inflation dynamics. Monetary policy plays an important role in ensuring the stability of inflation expectations across various economic sectors and horizons⁷. To ensure that long-term inflation expectations remain close to target levels, central banks **strengthen governance decision** by⁸:



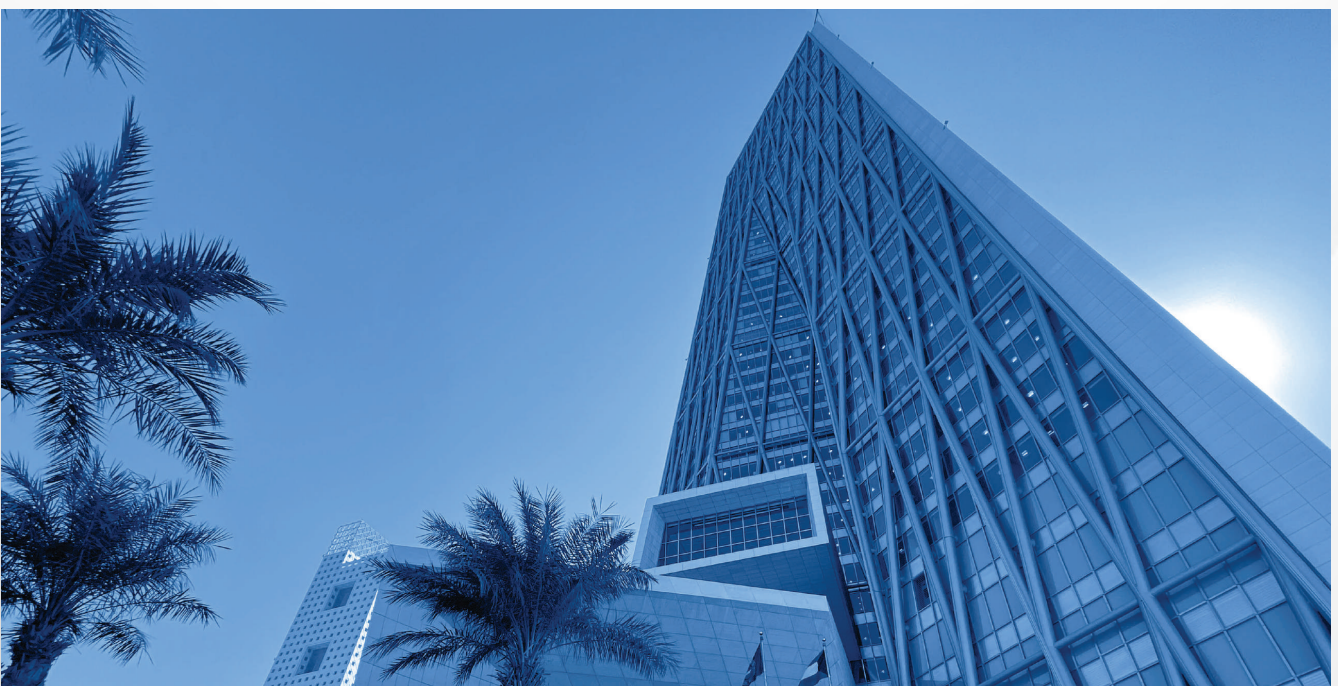
Enhancing transparency and communication regarding the central bank decisions: This is achieved by issuing a clear and direct press release following monetary policy meetings that includes the monetary policy framework, objectives, and decisions taken, along with the explanations associated with those decisions.

2

Enhancing multi-channel communication: Using press conferences, official websites, digital media, and social media platforms to reach various segments of society. Research from international institutions and organizations—such as the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) —indicates that the media plays a crucial role in conveying central bank messages to the public, which influences inflation expectations.

Based on the above, when clear information about future inflation trends is unavailable, or when central banks' disclosures are insufficient, individuals typically develop their price expectations based on the past experiences with inflation. Conversely, some rely on what is known as forward-looking forecasts, i.e. expectations based on broader data, including current and expected economic conditions, as well as central banks' decisions and statements. Central banks would promote this type of forecasting by enhancing transparency, independence, and credibility of their monetary policy and continuously clarifying their procedures and objectives. More transparency in central bank communication, means more people will be able to understand its policies, which contributes to more stable inflation expectations, and strengthens the role of official communication channels as a primary source of information.

The more clarity in central banks' communication, the greater the ability of individuals to understand their policies, resulting in more stable inflation expectations and enhanced communication channels as a primary source of information.





Section Two

Definition of Macroeconomics and its Related Basic Concepts

Macroeconomics is the branch of economics that studies and analyzes aggregate economic activity. It studies a country's overall economic performance and the concepts that determine the economic well-being of society as a whole. A country's overall economic performance is important not only in and of itself, but also because it impacts the lives of all individuals. Macroeconomics is linked to a set of fundamental concepts that affect the lives of individuals. The primary task of macroeconomics is to study the causes of changes in the performance of government authorities and the central bank in improving macroeconomic performance. These concepts are⁹:

**Unemployment
rate**

Inflation rate

Productivity

1

Unemployment rate



Computed by the rate of the unemployed (unemployed individuals are willing to work and actively seeking employment but classified as unemployed) divided by the total labor force in society (the number of employed and unemployed). The higher the unemployment rate, the more difficult it is for an individual to find a job. Unemployment negatively impacts individuals in several ways, most notably through loss of income and difficulty meeting basic needs, leading to a decline in the standard of living. Unemployment also causes anxiety and psychological and social instability.

2

Inflation rate



The inflation rate is the percentage increase in the average general price level in an economy. High inflation rate means that prices, on average, are rising at an accelerated pace, while low inflation rate means that prices, on average, are rising at a slower pace. Zero inflation rate means that prices remain stable. A high inflation rate harms individuals' savings, hinders decision-making, and exacerbates uncertainty (see the 2nd Issue "**Inflation, Monetary Policy, and Sustainable Finance**", issued by CBK in February 2023).

3

Productivity



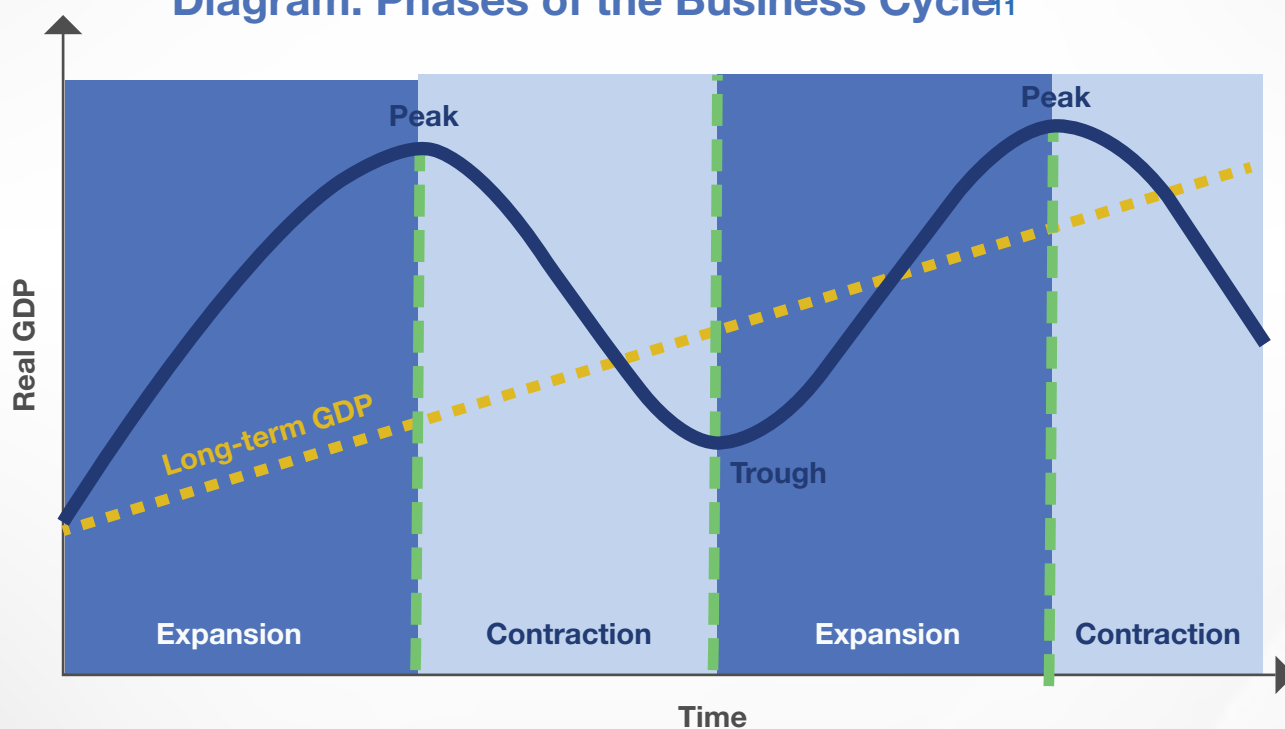
The average output per working hour (GDP per Working Hour). The faster a country's overall productivity growth rate, the easier it will be for every individual in society to improve their standard of living. The country, in turn, will be able to build more housing, hospitals, and schools, and maintain infrastructure and roads, enabling it to achieve long-term growth.

Gross Domestic Product (GDP) is a measure that can be studied by examining changes in the three key concepts:

I. Business Cycles and Their Phases in the Short Term

Business cycles refer to the recurring fluctuations in GDP around its usual long-term growth rate. In other words, they are the fluctuations in a country's economic activity over time, usually measured by changes in real GDP. Business cycles are usually accompanied by changes in productivity levels, unemployment rates, and inflation rates. These cycles recur in the short term, but their duration, frequency, and intensity are unknown and change each time¹⁰. Business cycles go through four main phases:

Diagram: Phases of the Business Cycle¹¹



- 1. Expansion:** growth in GDP, and drop in the unemployment rate. As the economic expansion continues, the rate of inflation may accelerate. The early part of the expansion phase may also be called the "recovery phase".
- 2. Peak:** Real GDP reaches the peak (highest level) of the business cycle.

- 3. Contraction or recession:** Drop in the economy's real GDP, and growth in the unemployment rate. As the contraction continues, inflationary pressures subside. The subsequent phase of the slowdown is called "recession"
- 4. Trough:** Real GDP went down to the lowest level of the business cycle. If the trough is very low, it is called "depression". This is a state of very low GDP, accompanied by an increase in unemployment rate and decreased inflation.

An Overview of Macroeconomic Activity During Business cycles in the Short Term¹²

Economic Expansion Stage

Increasing Demand: Households spend more on goods and services.

Increasing Production: Businesses respond to rising demand by increasing their production of goods and services.

Increasing Wages: Businesses offer higher wages to attract and retain workers to meet the increased demand.

Declining Unemployment: Businesses hire more workers to increase production, reducing the number of unemployed.

Increasing Inflation: Increased spending leads to a gradual rise in prices.

Economic Slowdown Stage

Decreasing Demand: Households spend less on goods and services due to caution or weak income.

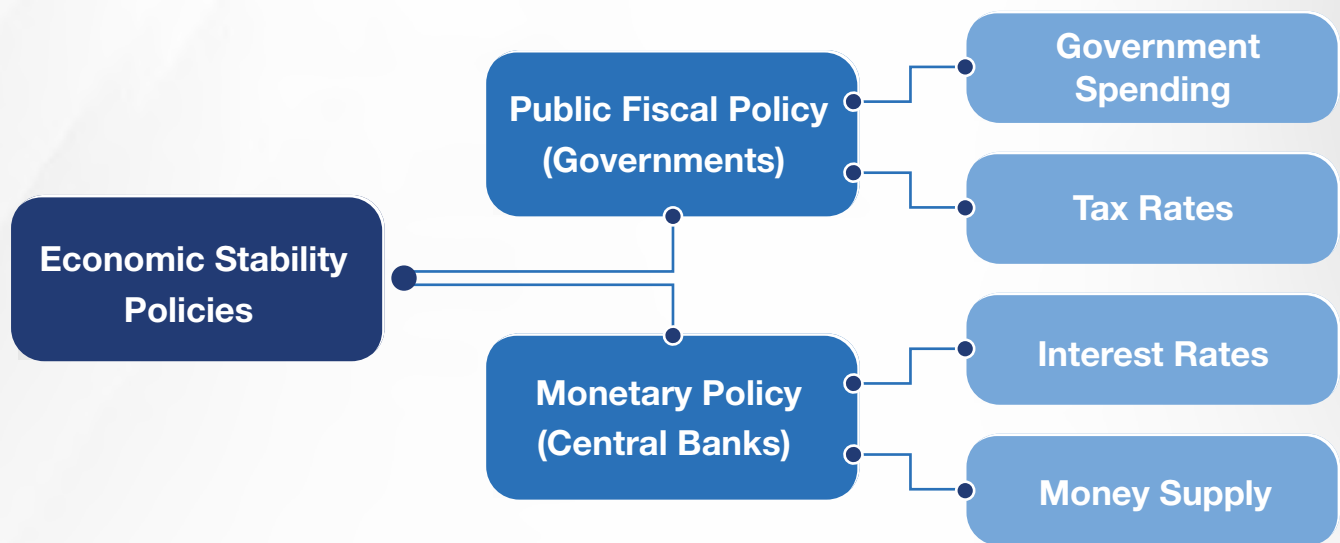
Declining Production: Businesses reduce their production of goods and services due to declining demand.

Decreasing Wages: Wage growth slows and may even decline in some sectors.

Increasing Unemployment: Businesses cut back on hiring, increasing the number of unemployed.

Decreasing Inflation: Prices fall due to weak household and business spending.

II. Stabilization Policies: The Role of Government Authorities and Central Banks



Stabilization or macroeconomic policies, are aimed at maintaining macroeconomic stability by reducing fluctuations in business cycles, such as ¹³:

1. Fiscal Policy: Fiscal policy relates to government decisions on spending and taxation to influence macroeconomics.

Monetary Policy: Monetary policy relates to central bank decisions on interest rates and the money supply to achieve stability in the general price level and push towards economic growth. In this regard, the approaches of governments and central banks differ according to the stages of the business cycle, as follows:

Stabilization Policies Throughout the Business Cycle Stages ¹⁴

Economic Expansion Stage

The government adopts a **Contractionary Fiscal Policy** by reducing or containing government spending (reducing government purchases of goods and services) and increasing taxes. This results in a decline in aggregate demand and a decline in economic activity, which in turn leads to a decline in employment rates and inflation rates deceleration.

The central bank adopts a **Tight or Contractionary Monetary Policy to contain high inflation rates and ensure stability in the general price level** by raising interest rates, which raises borrowing costs and, consequently, reduces household and business spending. This results in a decline in aggregate demand and economic activity, which in turn leads to a decline in employment rates and the containment of high inflation rates.

Economic Slowdown Stage

The government adopts an **Expansionary Fiscal Policy** by increasing government spending (enhancing government purchases of goods and services) and reducing taxes. This results in an increase in aggregate demand and economic activity, which in turn leads to higher employment rates and higher prices.

The central bank adopts an **Accommodative or Expansionary Monetary Policy to stimulate economic activity and boost employment rates** by lowering interest rates, which lowers borrowing costs and, consequently, increases household and business spending. This results in an increase in aggregate demand and economic activity, which in turn leads to increased employment rates and maintaining the inflation rate at target levels.



In this regard, CBK is responsible for formulating and implementing monetary policy, and regulating and supervising the banking system. CBK commenced its duties on April 1, 1969, seeking to achieve its primary objectives stipulated in Article (15) of the Law No. 32 of 1968, which include: exercising the privilege of issuing currency on behalf of the State; ensuring the stability of the Kuwaiti currency and its free conversion into other foreign currencies; directing credit policy to facilitate economic and social progress and increase national income; supervising the banking system in the

State of Kuwait; performing the function of the government's banker; and providing financial advice to the government¹⁵. CBK adopts an exchange rate system based on pegging the Kuwaiti dinar (KWD) to an undisclosed basket of major currencies that reflects the structure of trade and financial relations in the State of Kuwait. The exchange rate system is one of the fundamental pillars of maintaining price stability.

This system demonstrates a high degree of flexibility, allowing it to mitigate the impact of exchange rate fluctuations on the domestic economy while maintaining the stability of the purchasing power of the KWD. This prudent approach has contained inflation rates for many years, despite external challenges, by mitigating the impact of import price shocks and achieving a high degree of credibility in monetary policy. Therefore, the policies pursued by CBK have effectively consolidated the stability of the KWD exchange rate through a package of prudent measures and effective tools aimed at enhancing confidence in the national currency and maintaining its stability against foreign currencies. This has positively impacted the country's monetary, financial, and macroeconomic stability. This has been emphasized by international organizations and global credit rating agencies, as follows:

1

The final statement issued by the IMF mission regarding 2024 Article IV consultation with the State of Kuwait, dated October 10, 2024, affirmed that the country's KWD exchange rate peg to an "undisclosed" basket of currencies remains an appropriate monetary policy framework. IMF experts noted that CBK's monetary policy has maintained low and stable inflation rates for many years. Maintaining this successful monetary policy record requires preserving CBK's independence.

2

On 07 June 2024, Standard & Poor's affirmed Kuwait's sovereign credit rating at "A+" with a stable outlook. Regarding monetary and exchange rate policy, the KWD is expected to remain pegged to an undisclosed weighted basket of currencies, and Kuwait's exchange rate arrangements maintain a strong anchored monetary policy. Inflation remains below levels seen in many emerging market and advanced economies. This is partially due to significant government support and CBK's monetary policy.

III. The Path of the Long-Term Economic Growth

Building a strong economy is not only achieved by facing short-term fluctuations. It also requires a long-term strategic vision that focuses on enhancing productivity, investing in capital and human resources, promoting innovation, and adopting modern technology. **Long-term economic growth** is defined as a sustained increase in real GDP over time¹⁶. Another definition is that long-term growth is the increase in real GDP per capita over time¹⁷. There are a number of **variables and factors that influence long-term macroeconomic growth, including**¹⁸ :

Productivity

It is defined in Section One as the average output per work hour. Productivity measures how effectively a country utilizes its capital and labor, to produce goods and services.

Physical Capital

Physical capital includes tangible assets such as factories and machinery, which are used in the production process. The accumulation of this type of capital enhances the economy's productive capacity.

Human Capital

Human capital relates to the level of education, skills, and experience of the workforce. Investing in education and training is one of the factors that enhances individual productivity and, consequently, promotes long-term economic growth.

Technology

The adoption of new technologies is one of the most important factors in long-term economic growth, as it enables a country to produce more goods and services using the same number of resources, enhancing the productivity and competitiveness of the economy. However, the impact of technology varies from one country to another, depending on the size of investments in research and development, the quality of human capital, and the availability of supporting infrastructure.

Savings

Savings are the portion of income that's not spent and is set aside for future use.

- At the individual level, saving provides financial security and the ability to plan for future needs. However, the impact of saving goes beyond personal finance, as it plays a fundamental role in macroeconomics. Individuals deposit their money in banks and financial institutions, which use these funds to finance businesses and entrepreneurs. This cycle creates capital that fuels economic activities, such as infrastructure projects, industrial development, and technological innovation. Essentially, savings are the foundation for financing investment and productive projects that drive economic growth.

Other Factors

Other factors that ensure sustainable economic growth include the adoption of sound macroeconomic policies—both fiscal and monetary—which stabilize inflation and consolidate public finances. This, in turn, leads to enhanced investment and sustainable economic growth.¹⁹ Another factor is the strength of institutions—such as the adoption of property rights, effective legal frameworks, and robust financial markets—which are essential for economic stability, encourage investment and innovation, and, consequently, achieve sustainable economic growth.²⁰

Conclusion

Price dynamics and inflation expectations are pivotal factors in understanding the behavior of individuals and firms, as they directly impact spending, saving, and investment decisions, and the effectiveness of economic policies. Stable expectations enhance the ability of monetary policies to achieve their objectives efficiently. In this context, macroeconomics constitutes a fundamental framework for understanding the functioning of the national economy as a whole, by tracking indicators such as productivity, unemployment rates, inflation rates, and economic growth. The importance of this framework is evident in the short term through the analysis of business cycles, as responding to periods of expansion and contraction requires the adoption of flexible and effective economic policies. In the long term, achieving sustainable economic growth requires continuous investment in human capital, technology, and productivity enhancement, along with strong and effective economic institutions that ensure stability and support opportunities for sustainable progress.

Key Local Economic, Financial, and Banking Developments

As part of CBK's ongoing monitoring of all economic and monetary variables and indicators in international markets, geopolitical developments, global trade prospects, and their impact on global economic conditions and their repercussions on the performance of the local economy, and in light of the policy responses imposed by these developments and their repercussions according to the requirements and circumstances of each economy, taking into account the nature of our local economy, CBK affirms that the current discount rate of 4.0% is appropriate for the prevailing economic, monetary, and banking conditions at the present stage, both domestically and internationally, while taking into account the role that other economic policies, including public spending policy, can play in driving economic growth.

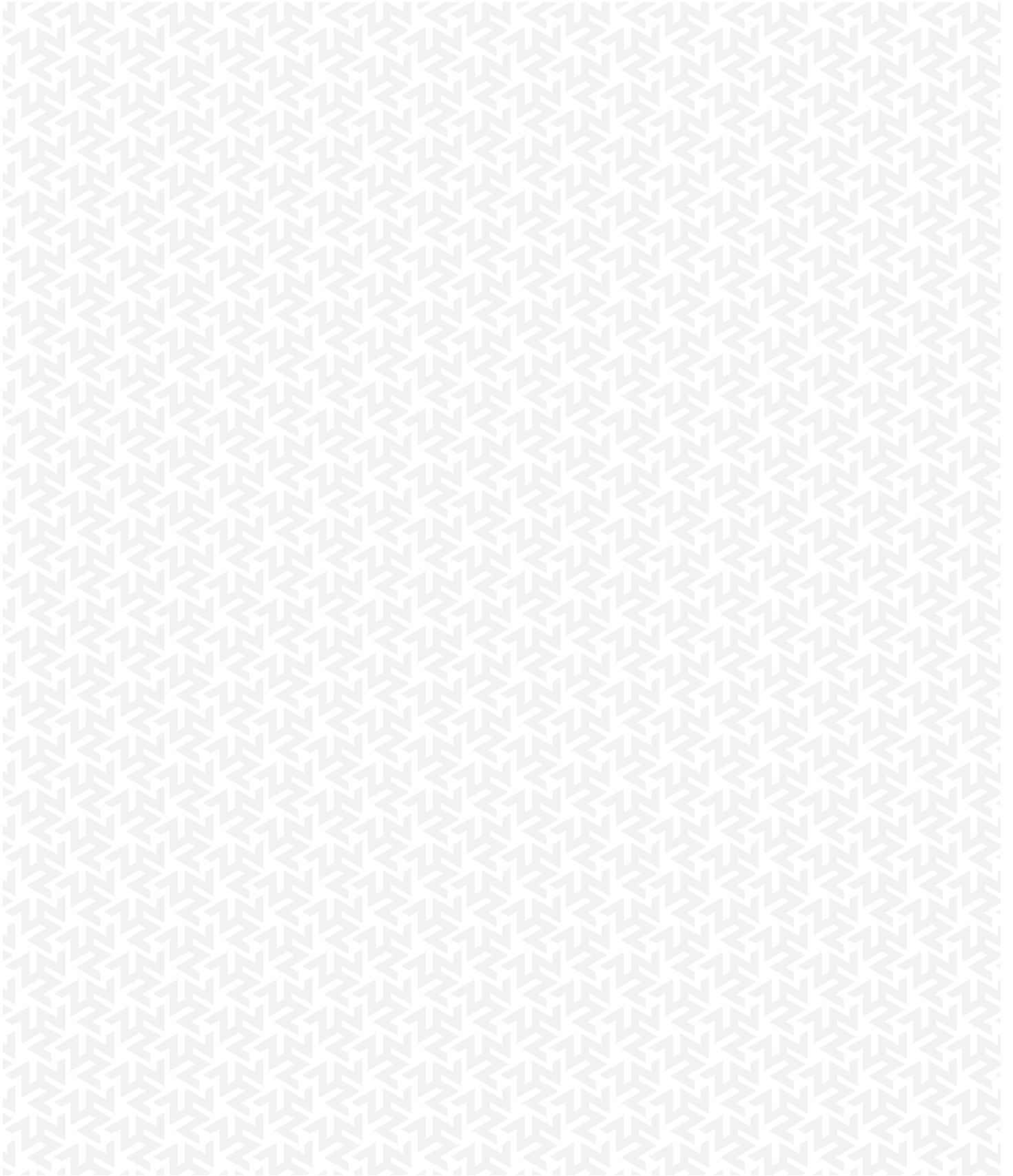
CBK also affirms its continued commitment to employing a gradual and balanced approach to achieve its objectives aimed at maintaining monetary and financial stability and promoting sustainable growth. It also reaffirms its continued commitment and tireless efforts to maintain the attractiveness and competitiveness of the KWD as a reliable and rewarding savings vehicle for local savings.

Within macroeconomic indicators, data revealed a slowdown in the inflation rate from its peak of 4.71% in April 2022 to 2.25% in April 2025, and **a continued relative stability of KWD exchange rate against major currencies**. At the level of monetary and banking indicators, resident deposits in the banking system recorded an annual growth of 6.0% at the end of April 2025. Private sector deposits in KWD accounted for 95.3% of total private sector deposits at the end of April 2025. Resident credit facilities also recorded an annual growth of 5.7% at the end of April 2025.

Therefore, CBK continues to emphasize its continued vigilance in monitoring developments in the local economic, monetary, and banking conditions, as well as interest rate trends on major currencies. It also stands ready to take action using various appropriate tools and measures to maintain the attractiveness of the national currency as a vehicle for local savings, thus consolidating the supportive environment for improving economic performance on a sustainable basis and fostering monetary and financial stability in the country.

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