Risks to the Forecast

Economic recovery went on also in the second quarter of 2014. Real GDP increased by 0.3% QoQ, following the quarterly growth of 0.6% in the first quarter of 2014. The slowdown in growth was likely due to the one-off and temporary factors that stimulated the economy in the first quarter (low statistical base, exceptionally mild winter, better drawdown of the EU funds and a positive impact of monetary policy on the growth of exports), as pointed out in the previous forecast.

Gross value added, which unlike GDP does not include indirect taxes and subsidies, increased by 0.5% QoQ in the second quarter. It thus surpassed the previous high from the third quarter of 2008.

We still believe that further recovery of the economy will be rather gradual. A conservative estimate of the developments in the remaining part of this year led to the forecast for real GDP growth in 2014 being revised down from 2.7% to 2.4%. The main reason for this change in the forecast is a downward revision of economic growth in the previous quarters in connection with the transition to the new standard ESA 2010 (see Box C.1). The forecast for the next year remains unchanged at 2.5%.

However, there is a substantial change in GDP composition by end use. The pickup in domestic demand is surprisingly strong, which holds true especially for gross capital formation. Moreover, domestic demand will be supported by a significant fiscal stimulus in the next year.

On the contrary, the deteriorating situation in the external environment led to a considerable downward revision of the forecast for growth in some of the major trade partner countries. This is reflected in the expected contribution of foreign trade to GDP growth, which is virtually zero. As a result, economic growth should be driven exclusively by domestic demand.

Taking into account these changes, we regard the risks to the forecast as roughly balanced.

The uncertainty regarding future developments in the external environment has increased substantially.

As for the developments in the economies of our main trading partners, the data for the second quarter were disappointing, especially in the case of a stagnation of the euro area and a drop of the German economy. Moreover, economic sentiment indicators do not point to an improvement of the situation (see Chapter A.1). Although we think that this was rather a one-off wobble, we assume that economic growth in many states of the EU will be very slow in the upcoming quarters.

The situation in eastern Ukraine has escalated in the period following the publication of the last forecast, and the EU and Russia imposed mutual sanctions. The direct impact of these sanctions on the Czech economy should be negligible (unlikely more than 0.1% of GDP). The indirect effects, however, could be more serious. They might include a reduction in trade with Russia in goods that are not subject to the sanctions, or lower intermediate exports to countries for which Russia is a more important trading partner. Besides that, there is a risk of a further escalation of the conflict, which might trigger another round of sanctions and counter-sanctions with greater economic consequences.

Another geopolitical risk is the ongoing war in Syria and Iraq, which could have an effect not only on the price of oil, but also on the security in Europe.

Situation in the troubled countries on the periphery of the euro area has been gradually calming down further (see Chapter A.1). The decline in yields on the government bond markets points to a certain improvement in the overall situation, but important fundamental factors, e.g. high indebtedness of (not only) the government sector and the true state of banks‘ balance sheets still being unclear, remain unfavourable. In this regard, the publication of the results of the comprehensive assessment of European banks will be important.

The situation within the Czech economy is also subject to risks in both directions. Compared with the previous Forecast, however, we think that the risks to the downside are less significant.

As for final consumption expenditure of households, the question remains what will be the households‘ behaviour under the conditions of high registered unemployment and a relatively low dynamics of real disposable income.

Future development of fixed investment will be influenced by an effort to draw down as much money from the EU funds as possible, relaxation of the restriction on investment of the government sector, resumption of inflow of foreign direct investment, and the extent to which confidence of the private sector will have an effect on actual investment activity. Each of these factors entails sizeable risks, both positive and negative.