

Risks to the Forecast

Recently, the Czech economy has been very volatile. A deep and surprising QoQ decline in GDP of 1.3% in Q1 2013 was followed by an increase of 0.6% in Q2 2013. **Under such volatile conditions forecasting future development is very difficult; nonetheless, the MoF's forecast is, in accordance with its role, rather conservative.**

GDP growth in Q2 2013 was partially influenced by compensation of unfavourable one-off circumstances from the previous quarter (reactions of economic agents to a change in excise taxes on tobacco and cigarettes, bad weather); however, the analysis of gross value added, which is not influenced by tax changes, indicates that the economy probably emerged from recession in Q2 2013. Even so, the sustainability and intensity of recovery are highly uncertain.

For 2014, the central scenario of this Macroeconomic Forecast expects a YoY growth of real GDP of 1.3%, with equal contribution of domestic and foreign demand. **We consider the risks of this development to be moreless balanced.**

The most important **negative economic risk** related to the **external environment** is, in our view, the still unresolved crisis in the euro zone. From the short-term perspective, one can say that the situation has become calmer and major upheavals are not very likely. However, this does not mean that the risk of a possible

escalation in the euro zone crisis can be entirely ruled out (for more details see Chapter A.1).

On the other hand, given the possibility that the **recovery of the German economy** could be **stronger** than in the central scenario of the forecast, **positive risk** can also be accented. The correlation coefficient of cyclical components of GDP¹ of Germany and the Czech Republic reaches, without any lag, nearly 85% for the period starting in 2000. The Czech economy is thus extremely synchronized with its German counterpart. Any change in the cyclical development of the Federal Republic of Germany is therefore also reflected in cyclical development in the Czech Republic.

The biggest negative domestic risk is the risk of political instability. At the time of preparing this forecast, the results of the early election to the Chamber of Deputies were not known. Much will depend on how quickly the future government will be formed after the election and how strong and stable it will be. Neither is it possible to forecast the economic policy of the future government.

Economic sentiment is still low, though the business cycle indicators show an improvement in all examined segments, even to a lesser extent in construction. This could pose a **positive risk** of a more dynamic recovery than that expected in the central scenario.

¹ The cyclical component of GDP is derived from a time series adjusted for the influence of seasons and working days using the Hodrick-Prescott filter.