Risks to the Forecast

In Q4 2013, **real GDP grew** by 1.8% QoQ. To a great extent, however, this result was positively influenced by **one-off factors**, in particular by stockpiling cigarette tax stamps before an increase in the excise tax on cigarettes as of 1 January 2014. In contrast, this factor should dampen economic growth in the following quarters.

A more realistic view of the course of economic recovery is provided by **real gross value added**[1], which increased by 0.8% QoQ in Q4 2013. Even though this is a very promising result, we still assume that **economic recovery** will continue at a more or less **gradual rate**. So far, growth has been almost exclusively driven by manufacturing; other sectors are mostly in stagnation. Intensity of the recovery is still uncertain and will depend on whether the recovery spreads to other sectors as well. Therefore, the central scenario of the Macroeconomic Forecast is **rather more conservative** in comparison with other forecasts for the Czech economy (see Chapter D).

The risks of the scenario are considered to be more or less balanced.

As far as the **external environment** is concerned, one can emphasise a **positive risk** that the developed economies may grow more quickly than the central scenario assumes.

Even though on the global scale the euro zone will probably remain the slowest growing region, the chances are that the **recovery of the export-oriented economies of Germany** and some other main trading partners of the Czech Republic may be **stronger**. This may be the direction in which the positive confidence indicators in these countries point (see Chapter A.1).

On the other hand, a new **negative risk** has arisen in geopolitical developments **in Eastern Europe**. In spite of its recent increase, Czech export exposure to the problem area remains relatively small – Russia accounted for 3.7% of Czech exports in 2013 and Ukraine for 1.0%. However, any eventual escalation of the tensions or even military action in this region could lead to disruption of crude oil or natural gas supplies to Central Europe. However, we believe that such development is not in the interest of any of the parties involved.

The situation in the troubled countries on the euro zone periphery has gradually, at least from the short--term perspective, **calmed**. Macroeconomic indicators and development on the government bond markets suggest that any major upheavals in the affected countries on the euro zone periphery are, for the time being, unlikely. However, unfavourable fundamental factors – very high level of government sector debt and unclear situation regarding the quality of bank assets – still remain. Therefore, much will depend on results of the tests of banking sector resilience to be published by the ECB in November 2014 at the latest (see Chapter A.1).

Amid instability of economic and legal environment, the 5-year period of alternating recessions and weak growth led to an increase in risk aversion of both households and firms, which now remains **a negative risk within the Czech economy**

Regarding **household consumption**, we are therefore far from certain if the considerable improvement in the consumer confidence indicator (see Chapter B.2) will be reflected in a change in household behaviour, which has been cautious so far. A strong argument against exaggerated optimism is registered unemployment being near its historical maximum, low creation of new jobs and a decrease in households' real disposable income in 2013.

Real **gross fixed capital formation** is at the bottom of the investment cycle after a very deep fall lasting for more than 5 years. To a great extent, future development will be influenced by the necessity to draw down as much EU funds from the 2007–2013 financial perspective as possible before the end of 2015. The ability to utilize such funds represents both an upside and downside risk to the relatively prudent scenario of the forecast. A non-negligible risk is also the efficiency of capital allocation, given the likely effort to draw down funds "at any cost" and the possibility that economically more meaningful projects with a higher multiplier effect, which cannot be cofinanced from the EU funds, will be crowded out.

The use of the exchange rate as an additional monetary policy instrument of the CNB (see Chapter A.3) has considerably changed the economic policy setting. Current experience shows that the market has adjusted to the CNB commitment without the necessity of other interventions, and that the CZK/EUR exchange rate is relatively stable. Uncertainty still persists, however, regarding the date and way of discontinuing this instrument and the switch to the standard regime of monetary policy.

[1] GVA, unlike GDP, does not include taxes and subsidies on products.