Risks to the Forecast

Real GDP recorded a **surprisingly strong quarterly growth** of 0.8% in the first quarter of 2014, following a revised growth of 1.5% QoQ in the fourth quarter of 2013. Real gross value added, which does not include indirect taxes and subsidies, increased by more than 1% QoQ in each of these two quarters. Without further comments, these figures on their own illustrate the strength of the recovery in this time period.

It is likely, however, that positive developments in the first quarter of 2014 were, for the large part, due to **one-off or temporary factors**, e.g. low statistical base, exceptionally mild winter, better drawdown of the EU funds and a positive impact of monetary policy on the growth of exports.

Therefore, we still hold the view that further **recovery of the economy** will be rather **gradual** and that the macroeconomic aggregates' dynamics of the fourth quarter of 2013 and the first quarter of 2014 will not repeat itself in the nearest future.

We have revised our forecast for real GDP growth in 2014 up by 1.0 pp to 2.7%, despite a conservative estimate of developments in the remaining part of this year. Economic growth should slow down slightly to 2.5% in 2015.

We regard the scenario risks as roughly balanced.

There is a **positive risk** in **the external environment** that economies of some of the main trading partners of the Czech Republic will, at least in the short-run, grow faster than the central scenario assumes. Results of the indicator model, however, should be treated with some caution. Apart from that, caution is also warranted by June economic sentiment indicators (see Chapter A.1).

On the other hand, one has to emphasize geopolitical risks, considering the developments in Iraq (possible impact on the price of oil) and Ukraine. As at the cut-off date of the Forecast, the situation in eastern Ukraine was unclear. Although severance of trade relations with Russia or Ukraine does not seem to be imminent, the risk of a negative impact of this crisis on the Czech economy still persists.

Situation in the troubled countries on the periphery of the euro area has been gradually **calming down** further. A modest recovery or stabilisation of periphery economies and a decline in yields on the government bond markets point 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. Apart from the results of the comprehensive assessment of European banks (see Chapter A.1), it will be important in this respect whether and how the banks will manage to cover eventual capital shortfalls.

The situation **within the Czech economy** is also subject to risks in both directions.

As far as **private consumption** is concerned, the question remains to what extent will the increase in consumer sentiment indicator (see Chapter B.2) have an effect on households' behaviour under the conditions of high registered unemployment and low dynamics of real disposable income.

Having experienced a big fall over previous years, real **gross fixed capital formation** rebounded after it had hit the bottom of the investment cycle. However, it is unlikely to reach the all-time high of 2008 by the end of the outlook period. Further 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.

It is also necessary to mention the **risk of statistical description of economic reality**. This Macroeconomic Forecast is the last one to be based on the ESA 1995 system of national accounts. In October 2014, there will be a shift to the ESA 2010 standard. This special revision will have an impact on the whole system of national accounts, including the main aggregates: GDP, gross national income and the ratio of government sector debt to GDP. There will be a change not only in the level of individual indicators, but their dynamics (though to a limited extent) is likely to be affected too.