

## Risks to the Forecast

Future development of the Czech economy through the forecast horizon will depend almost exclusively on developments in the euro zone and on the domestic economy's ability to withstand this situation. Since publication of the Macroeconomic Forecast in October 2011, there has been no substantial forward motion in resolving the euro zone's debt crisis and the situation is no clearer today.

The perception of the problems in Greece and its solvency has significantly deteriorated. The large economies in the south of the euro zone, especially Italy, also give rise to concerns. The ability of political representatives to effectively resolve this situation was reflected in the decrease of most euro zone countries' ratings. The anxiety on financial markets and deepening shortfall in liquidity, on the other hand, were mitigated by extraordinary measures from the ECB.

Given the widespread anxiety, this Macroeconomic Forecast is based on a **"no-event" scenario**, which, as with other current macroeconomic forecasts, brings a slight deterioration of the expected development.

According to this scenario, the debt crisis will not escalate considerably, but neither will the political leadership manage to find a credible solution to the problems that the euro zone is currently facing. The debt crisis could thus extend beyond the forecast horizon, and the potential subsequent recovery could be very slow.

The adopted "no-event" scenario is not necessarily the most likely scenario for future development. In any other scenario, however, we would have to make

presumptions not only about what specific events may or may not occur, but also about their timing. Such approach is too restrictive and even speculative for the purposes of the Macroeconomic Forecast.

Nevertheless, there are **significant downside risks** for the scenario under consideration, at least over the short-term horizon. The main risks include:

- managed or unmanaged default of a euro zone country,
- one of the large euro zone countries needing to accept aid,
- a threat to the stability of the euro zone's banking sector,
- a deeper recession in Germany, and
- one or several countries leaving the euro zone.

Any of these events could occur in isolation or in any combination with the other events.

As regards the debt crisis, the Czech Republic is not a high-risk country. Financial markets have faith in the trajectory of fiscal consolidation, as reflected by low yields on government bonds. Its financial sector is stable, liquid and well capitalised. Due to the economy's considerable openness, however, any possible negative external shocks are very likely to have significant impact. In the current situation, therefore, not even the possibility of another recession similar to that from the turn of 2008 and 2009 can be ruled out.

An adequate fiscal policy response to this situation should be an effort to maintain the trajectory of fiscal consolidation even in unfavourable conditions.