Risks to the Forecast

The Macroeconomic Forecast is based on a "**no-event**" **scenario**. On the one hand, this scenario anticipates no escalation of the euro zone's debt and banking crises or any other geopolitical event having a significant impact on the Czech economy during the forecast horizon. On the other hand, neither does it expect any crucial breakthrough in resolving the euro zone's problems.

From this perspective, the accepted scenario may seem considerably improbable. In any other scenario, however, it would be necessary to make speculative assumptions about specific events and their timing and extent. We consider such assumptions not to be useful and essentially impossible to formulate.

In comparison to the Forecast from April 2012, the presumed "no-event" scenario yields lower macroeconomic dynamics with even more significant downside risks.

The situation eased following the ECB's extraordinary liquidity operations in December 2011 and February 2012 and the "voluntary" write-off of part of the Greek debt, but this was only temporary. As from May 2012, financial markets refocused their attention on the problematic countries at the euro zone's periphery. Nevertheless, from a short-term perspective, the risk that a country or systematically important institution might collapse due to insufficient liquidity is relatively low.

From a medium-term perspective, however, the situation is much more serious. The euro zone as a whole is teetering on the edge of recession, peripheral countries are already in recession, and there are no serious expectations for the situation to improve in the near future. The situation in Greece clearly fits the definition of depression (total decrease in GDP by more than 10%). GDP has so far decreased by 3.3% versus the previous peak in Portugal, by 1.7% in Italy, and by 1.5% in Cyprus.

Proclamations as to the necessity of supporting growth are not likely to change the situation, as there is no room for fiscal stimulus and the structural policies that could improve the insufficient levels of these countries' competitiveness are all for the long haul.

This reinforces anxiety concerning the economic and political sustainability of, for example, the Greek consolidation strategy. We therefore do not consider it very probable that Greece would be able to repay the provided loans under current conditions. Moreover, developments in Spain confirm that besides the debt crisis of public finances there is also risk of a banking crisis.

The extent of loans provided by the EFSF or the newly forming ESM also increases the risk that the crisis could unfavourably affect creditor countries. The possibility that sooner or later the crisis will escalate is therefore entirely realistic.

Although the Czech Republic shows a roughly similar intensity of fiscal consolidation in comparison with neighbouring countries, it has markedly poorer macroeconomic results. This demonstrates **internal risks within the Czech economy**, and especially the very low, and in most cases still deteriorating, level of confidence in further economic advancement. This concerns not only consumers, but also many segments of the business sector (see Chapter B.2). The low level of confidence leads to more cautious microeconomic decisions and is probably one of the causes for the Czech economy's lagging.

Overall, it can be stated that **in the medium term** the **significant downside risks** to the scenario under consideration have again **increased.**