Risks to the Forecast

Similarly to previous forecasts, this Macroeconomic Forecast is based on a **“no-event” scenario.** On the one hand, this scenario anticipates no escalation of the situation in the euro zone during the forecast horizon. On the other hand, neither does it expect any fundamental positive breakthrough in resolving these problems. In this scenario, therefore, it is not necessary to make speculative assumptions about specific events and their timing, extent, and consequences.

In comparison to the Forecast from July 2012, the presumed scenario yields lower macroeconomic dynamics with approximately equal downside risks.

Short-term external risks have diminished in comparison with the previous forecast. The possibility of intervention by the ECB on the secondary government bonds market as part of the new Outright Monetary Transactions (OMTs) programme, initiation of the ESM long-term bailout fund and a certain shift in resolving the problems of the Spanish banking sector (see Chapter A.1) helped to calm the situation in the euro zone. The risk that a country or systematically important institution might collapse due to insufficient liquidity is relatively low. The exception is Greece, whose resources for financing deficit and debt repayment could run out in Q4. We anticipate, however, that Greece will manage to reach an agreement with the “Troika”, and international creditors will ultimately release another tranche of financial aid.

From a medium-term perspective, however, the situation is much more serious.

The euro zone as a whole has already entered into recession, and the economic situation in the peripheral countries is very bad. According to the European Commission’s estimates, the total economic decline in Greece for 2007–2012 could reach 19%, which unequivocally fits the definition of a depression (for comparison, the transformation decline in the Czech Republic reached ca 12% of GDP in the early 1990s). Over the recession in Portugal that is thus far 7 quarters long, GDP has cumulatively decreased by 4.5%. Italy has been in recession since Q3 2011 (aggregate decrease in GDP by 2.6%), as have Cyprus (decrease of 2.3%) and Spain (decrease of 1.3%). Moreover, it is not realistic to expect the situation in these countries to improve in the foreseeable future. The deep economic slump connected to the rise in unemployment inevitably brings with it social and political unrest.

Although those measures taken (e.g. initiation of ESM and OMTs) may lead to a temporary calming of financial markets, at the same time they expand the risks for the financing countries. The deepening of European integration, which would enable the removal of at least some shortcomings of the current institutional arrangement, is certainly not a short-term undertaking. Moreover, it is necessary to expect that member states will probably not altogether positively accept this process. The effects of structural policies that would raise the presently insufficient level of competitiveness of problem countries and thus help resolve the current problems can also only take effect after a considerable period of time.

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 reveals the **internal risks within the Czech economy**. As compared to the July forecast, the risks of political instability and difficulty of predicting the business environment have been markedly highlighted. As of the end-October, economic entities still did not know what VAT rates will be valid from the beginning of 2013 or whether pension reform will be initiated. (This Forecast is based on the assumptions of VAT rate increases to 15% and 21% and implementation of pension reform, in accordance with the original budgetary documentation.) It is also still uncertain whether the laws regulating the reform of direct taxes and payments will be effective from the beginning of 2014.

Such uncertainty surely does not contribute to improving the very low 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 behind those of neighbouring countries.

Overall, it can be stated that **in the medium term** the **significant downside risks** to the scenario under consideration will **remain high.**