

For Immediate Release

US-China relations #1 global political risk in 2010

Eurasia Group President Ian Bremmer and Head of Research David Gordon announce Top Risks and Red Herrings for 2010

NEW YORK, 4 January 2010 — Eurasia Group President Ian Bremmer and Head of Research David Gordon announced the firm's annual Top Risks in a note to clients today. Top Risks identifies the upcoming year's key geopolitical areas to watch for global investors and market participants. According to the report, 2010 is likely to be much more turbulent geopolitically than 2009, when the world was preoccupied with coping with the global financial crisis, but saw no big geopolitical crisis.

Dr. Bremmer and Dr. Gordon write, "with the world now coming out of recession, the risks are starting to shift to the challenges created by the emergence of a new global order – developed vs. developing states, the old unipolar system vs. the emerging non-polar one, and the old dominant globalized system of regulated free market capitalism vs. the growing strength of state capitalism."

Highest on the list of Top Risks is where all three of these trends converge: US-China relations. Despite the fact that both countries understand their mutual interdependence and want to have a good relationship, there are a series of issues brewing that will increase friction this year.

The following is a summary of Eurasia Group's Top Risks for 2010. Please visit <http://eurasiagroup.net/pages/top-risks> for the complete report.

1 — US-China relations: High US unemployment and strong Chinese growth will exacerbate tensions in the world's most important bilateral relationship in 2010. For Beijing, economic partnership with the US looks a lot less attractive than it did just a couple of years ago. Meanwhile, the US will be disappointed when China fails to demonstrate more (and more responsible) global leadership on key issues like climate change, nuclear non-proliferation, international trade, cyber-security and armed conflicts around the world. As US mid-term elections approach in November, we'll see more intense politicizing of exchange rate policy; investment policy tensions both in the US and in China; China-bashing when President Obama pushes cap-and-trade in the senate; growing trade tensions (especially on steel); and issues involving cyber-security.

2 — Iran: Post-election domestic pressures are intensifying, Tehran has lost considerable influence regionally, and internationally, Iran faces a new round of UN sanctions. The Iranian regime looks increasingly like a cornered, wounded animal. In 2010, it's likely to act like one.

3 — European fiscal divergence: We'll see a blurring of the distinction between "mature" and "emerging" markets in the Eurozone this year. Fiscal policy coordination has been eroding for some time, and member state political processes are highly uneven. Greece, Ireland, Spain, Portugal and Italy in particular face complex fiscal challenges and consequent policy changes will have far-reaching implications.

4 — US financial regulation: There's not as much domestic policy risk coming from the US this year, but financial regulation is a key exception. The reform package will be more far-reaching than anything we've seen since the Great Depression, and there is a high likelihood it will pass. Upcoming mid-term elections will encourage populist approaches, and despite congressional awareness of the risks of over-regulation and taxation of the financial sector, domestic political interests will be at odds with the need for effective reform.

5 — Japan: Sweeping political change has transformed Japan from a one-party state to a zero-party state. The country may be set to continue with the post-Koizumi era succession of weak governments, but this time without the benefit of a strong unified bureaucracy to guide policy and with a much more worrisome economic situation. An anti-big business approach threatens financial confidence, deepening economic woes.

6 — Climate change: The Copenhagen outcome makes it even less likely that the US congress will pass cap-and-trade legislation in 2010. It is now also more likely that individual countries will move to "nationally appropriate" mitigation measures, creating a greater challenge for international coordination. And the lack of an international framework will complicate compliance efforts by multinational corporations that have carbon footprints in dozens of countries at once.

7 — Brazil: The country stands to gain from a strong rebound in growth over the course of 2010, but Brazil's newfound economic abundance will lead to a drop in the quality of economic policymaking both on macroeconomic policy and, to a much greater extent, through leaning more heavily on state-owned enterprises. As a result, 2010 will be marked by growing investor concern on both macro and sectoral policy as the October presidential election draws near.

8 — India-Pakistan (no, not Afghanistan): The decision by Pakistan to go after terrorists domestically provides Islamic extremists with powerful incentives to expand asymmetric attacks on Pakistan's urban centers and to try to reignite Indian-Pakistani conflict. India's counterterrorism capability remains vulnerable and any new attacks would put serious pressure on India to take a tougher line on Pakistan. The US troop surge in Afghanistan will help the US delay tougher strategic decisions there until 2011, but there are serious factors pushing the Indian and Pakistani Governments back toward confrontation.

9 — Eastern Europe, elections & unemployment: High unemployment is a critical issue in many economies, but as a political risk it's most worrisome in Eastern Europe, where several upcoming elections increase the likelihood of instability. Incumbent

governments in Ukraine, Hungary and Latvia in particular will be increasingly sensitive to domestic economic and social constituencies, and tempted by protectionist, nativist, and populist policy options. Candidates will seek to channel the frustration and anger of the unemployed, which bodes poorly for markets and financial stability.

10 — Turkey: Country risk is hitting Turkey from just about every side. Domestically, the increasingly unpopular AK party is embroiled in fights with the judiciary, industrialists and the military. The AKP's overture to Turkey's Kurdish population failed, and the Kurdish region in Iraq is unsettled. Internationally, Turkey will drift further away from Europe and seek broader engagement with Syria and Iran. The EU accession process won't be fatally undermined in 2010, but it's unlikely to see much progress.

In addition to Top Risks, Dr. Bremmer and Dr. Gordon identify four Red Herrings, issues that Eurasia Group believes will not be sources of geopolitical instability in 2010. These include "the US and British financial centers, the death of which have been greatly exaggerated; Iraq, where investment and new oil will be a much bigger story than security risks; the Persian Gulf, which we generally like quite a bit (Dubai's problems notwithstanding); and the dollar, where really slow and steady-ish still wins the race."

Contact:

Ms. Alex Lloyd, Director of Communications
+1 646.291.4036 | media@eurasiagroup.net

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Eurasia Group is the world's leading global political risk research and consulting firm. Since 1998, we have helped clients make informed business decisions in countries where understanding the political landscape is critical. Our research analysts are trained social scientists with post-graduate degrees, extensive professional experience, and a diverse range of language capabilities. Headquartered in New York, we also have offices in Washington and London, as well as a vast network of experts around the world.

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