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**Eurasia Group president Ian Bremmer outlines key political risks
in the global markets crisis**

With global financial markets in turmoil, Eurasia Group president Ian Bremmer released a special edition of his weekly EG Update note to clients today, with his analysis of the key political risks affecting markets around the world.

The full text of the note is included below, but some of the key takeaways include:

- Strong and continued hits to the US economy create a bigger uphill struggle for US presidential candidate John McCain.
- Market turmoil is helping to fuel a downward trend in oil prices.
- A number of the world's biggest energy producers--and commodity export-dependent economies--like Nigeria, Algeria, Iran, and Venezuela, may well be forced to cut spending in politically sensitive areas like infrastructure projects and social services.
- Populist regimes in Latin America will begin to pay a heavier political and economic price for the policies they've implemented over the past few years as they grapple with rising inflation and falling oil prices.
- Chinese policymakers are concerned over the US financial crisis, but recent moves on interest rates and lending quotas signal that the government is responding quickly.
- Russia's macroeconomic fundamentals remain sound, but if capital flight and liquidity squeezes continue for long, the real economy could begin to take a hit.
- GCC countries are well positioned to weather the economic storm due to budgets established based on conservative oil prices.

Please find the full text of Dr. Bremmer's note below. For more information, or for interview requests, please contact Ms. Alex Lloyd at +1 (646) 291.4036 or media@eurasiagroup.net.

[Start of Note]

I've had dozens of questions over the past 48 hours on the global political risk implications of the developing US financial meltdown. Given the extremely fluid nature of events, I'd like to offer a few immediate thoughts on the subject here. You'll be hearing from several of our analysts on various thematic and regional angles covered here over the coming days.

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A first point is that the timing of the crisis in the heart of the election cycle is unfortunate. One of the concerns I've heard most from clients is that the US government appears to have been caught completely off guard by the severity of the situation. Markets are looking for a well-thought financial crisis response plan from the Bush administration...but with the presidential election nearing, most of the key political appointees at the Treasury Department are already out the door or actively seeking a job.

When the South Koreans were considering a partial buyout of Lehman (since a full takeover wasn't going to happen), a full-court press by the treasury department's senior international team with the South Korean government might well have made a difference. Putting the investment in the context of broader US-Korean relations, assuring the Korean government of the importance of the longer-term economic and strategic bilateral relationship...even, as Treasury Secretary Hank Paulson has done so effectively with Beijing over the past two years, outlining a broader strategic economic dialogue between the two countries. That's vastly harder for the treasury department to do with a skeleton crew. So is an effective US road show with potential sovereign lenders in the Gulf and China.

Compounding the issue, key potential international lenders are loathe to make a sudden move when their principal political interlocutors (and policy accordingly) is soon to change, possibly dramatically. That's especially true given the current shift in a number of emerging markets' national priorities towards shoring up domestic economic and political stability.

That's clearly true in China, where Beijing's present worries have turned to ensuring short-term Chinese growth--undermining willingness to take greater exposure to the United States financial system accordingly. In Russia, Finance Minister Alexei Kudrin's comments last week on using the national stabilization fund to support the ruble and Russian equities is a clear signal of political priority. Couple that with the present state of us-Russian relations, and it's much harder to imagine that they would consider making their funds available for strategic acquisition/bailout of US financials, no matter how attractive the terms. We're seeing one of the principal inefficiencies of state capitalism play out on the global stage.

Now, to look more closely at some of the implications.

US election

What's the impact of all this on the presidential campaign? It's clear that strong and continued hits to the US economy create a bigger uphill struggle for John McCain--both prematurely deflating the media attention to vice president nominee Sarah Palin, and making it harder for McCain to distance himself from a strongly unpopular Bush administration.

In that environment, the post-election regulatory environment is perhaps the greatest threat. An Obama administration is clearly likely to ask a more strongly liberal congress for "common sense" legislation meant to restore some form of government oversight in the financial industry...though it's far too early though to guess what that plan might look like. Given already extant market concerns about regulatory policy and taxation under an Obama administration, this bodes more steeply negative for US equities and the dollar.

Emerging markets

The most visible immediate fallout of the present financial turmoil on commodity markets is its role in adding to the recent downward trend in oil prices--a clear result of expected destruction in global demand. And longer-term demand destruction is likely to have a host of upstream consequences.

A number of the world's biggest energy producers--and commodity-reliant economies--have just completed their 2009 budgets with expectations of \$100 per barrel oil. Most of those budgets aren't in immediate danger from a sharper-than-expected fall, but belt-tightening will come quickly. First on the chopping block? Big infrastructure spending. Next? Social services. Both are politically sensitive items.

This is most likely to exacerbate political risk in Nigeria, Algeria, Iran, and Venezuela...those countries where oil prices have played the greatest role in support short-term political stability. Each of those governments are going to experience considerably more domestic discontent, and challenges to existing regime rule, over the next few months.

Digging a little deeper...

Latin America looks more capable of weathering the storm than most regions, with the exception being regional leaders with a more leftist/populist bent...who will start paying more of a political and economic price for the policies they've implemented over the past few years.

Argentina is particularly unstable, given its dependence on high commodity prices and a deteriorating political environment. We don't see the Kirchners adjusting anytime soon; the risk that they won't finish out their term is increasing accordingly. Venezuela, Ecuador and Mexico are all heavily dependent on oil revenues and will suffer with lower oil prices...but policy repercussions there will only be felt over the course of 2009-2010.

In Venezuela, Hugo Chavez will be forced to try and rein in inflation after the upcoming regional elections this November, and lower oil prices will make an adjustment all the more difficult. Chavez has staying power, but he'll enter 2009 further weakened. In Ecuador, Rafael Correa will come out on top in the upcoming referendum, but market worries around a default on its sovereign debt are likely to grow.

Among the "market-friendly" countries of the region, Mexico is the most vulnerable, given its proximity to the US and the government's budget dependence on oil revenues. There the risk is of reform paralysis over the next few years rather than any that might come from a change in policy.

In Brazil, President Lula will respond to any external crisis by veering toward a greater dose of economic conservatism, although the room for a greater fiscal adjustment looks low. Having said that, there's actually some upside--lower oil prices will also temper nationalist overtures in a new proposal for oil legislation that the government is now developing.

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Many of the Asian emerging markets are already focused on pro-growth policies. As I wrote on Monday, China is moving away from monetary tightening. To promote growth, Beijing has cut interest rates and reserve requirement ratios, loosened lending quotas, and peeled back a number of taxes. China will likely add fiscal spending to the policy mix to boost consumer spending and stimulate the ailing export sector, and will continue a push to support small- and medium-sized enterprises and agricultural producers.

Top Chinese policymakers are concerned about the ramifications of the unraveling US financial crisis, but recent moves on interest rates and lending quotas are not simply a reaction to US volatility--they're more directly a signal to the Chinese population that the government is responding rapidly to prevent further deterioration.

The Indian government is more cautious, mindful of continued inflation pressures. Fiscal spending is up, but will largely focus on subsidies instead of an expansionary fiscal program. Meanwhile, the Indian central bank appears willing to wait a few more months for a clearer growth-inflation trend before loosening monetary policy.

Southeast Asian economies, with the exception of Vietnam and the Philippines, are leaning toward pro-growth policies over the coming months, anticipating that a slowing of inflation will allow them to ease monetary policy and implement more expansionary fiscal programs. The political context is that leaders in several of these countries are either facing domestic turmoil (Thailand and Malaysia) or near-term elections (Indonesia). China and Southeast Asian countries are clearly worried about external demand dropping and will move decisively to cushion its effects on their individual economies.

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In Eurasia, with the current selloff combining with perceptions of geopolitical risk to weaken Russia's stock markets and currency, Moscow will focus on boosting liquidity and possible further interventions to support the ruble. Russia's macroeconomic fundamentals remain sound, but if capital flight and liquidity squeezes continue for long, the real economy could begin to show systemic problems. Saddled with rising inflation, increasing bottlenecks, and falling commodities prices, Russia faces an economic test. Elite splits on the extent to which investor flight is caused by internal and external factors will complicate longer-term policy responses to the crisis.

Yet, though Russia is suffering its largest market correction in several years, its fundamentals--nearly \$600bn in reserves, a healthy budget surplus, and continued expectations of strong GDP growth this year--offer a striking contrast to the situation a decade ago. That's why the country will remain on relatively stable macroeconomic footing, at least for the medium term.

In Ukraine, the government has agreed on measures to support the steel industry, negatively affected by a drop in demand, by making steelmakers exempt from a 12% surcharge on natural gas for one month. Negotiating a favorable gas price with Russia for 2009 will be a key policy concern for the government over the next few months as it responds to the downturn. But whatever the relationship between Kiev and Moscow, Russian steelmakers are largely in competition with Ukrainian companies and the Kremlin is unlikely to support agreements that favor that sector.

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In Africa, any fall-off in commodity prices would reduce the foreign exchange revenues of almost all the major commodity-exporting African countries--Nigeria, Zambia, Ghana and others. It would also damage those like South Africa that need to refinance billions of dollars of deficit financing bonds. There's a political cost here. As the governments of these countries find it more difficult to raise money on international markets, they may be forced to choose between raising domestic taxes and cutting social spending. Neither move would do much to help their popularity with voters.

In addition, if flows of funds to emerging markets dry up as risk perceptions increase, many African markets that have been propped up by inflows from hedge funds and others may see diminishing interest as funds and banks look to shore up their internal capital. A market like Nigeria's which is dominated 65% by banking stocks is likely to be hit harder as many investors flee banking stocks worldwide--wiping out local wealth buildup by the new middle class.

On the positive side--there's always a positive side--strong-growth frontier markets like Ghana (which has seen a 63% positive return on its stock market in dollar terms this year), is likely to attract western fund managers seeking to close 2008 on a better note than they would if they invest in US markets.

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The Middle East will feel some pain as well. On the back of the crisis, the Cairo and Alexandria stock exchange (case 30) already dropped to its lowest level in over a year, largely the result of Orascom telecom and Orascom construction industries both plummeting. Egyptian equity markets will feel the negative impact of the US crisis in the short term. But though it will make the ministers in charge of economic policy in Cairo increasingly nervous, they are unlikely to take any major steps to curb reforms, and President Hosni Mubarak is unlikely to make any sweeping personnel changes.

Despite high oil revenues and a common optimistic outlook on the oil market, GCC countries have been establishing their respective budgets on conservative oil prices. Saudi Arabia based its 2008 budget on a price of \$45 per barrel, while Kuwait opted for \$50 per barrel. These forecasts should allow enough room for new record budget surpluses across the region. But given the ambitious programs of infrastructure development that many Gulf States have launched over the past few years, government spending will increase dramatically, driving inflation toward new records. The rising cost of labor and construction materials is likely to cause significant delays in many of these infrastructure projects. Still, some Gulf monarchies are in a more advantageous position (Qatar, Saudi Arabia, and Abu Dhabi) because of their demographic situations and degree of wealth.

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We're planning on releasing a host of more in-depth research pieces with both regional and thematic focus over the coming days. I hope you'll find them useful.

With best wishes,

Ian

[End of Note]

About Eurasia Group

Eurasia Group is a research and consulting firm that focuses on global political risk and emerging market country analysis, serving major financial institutions, multinational corporations and governments. Founded in 1998, Eurasia Group has a full-time staff of 85, a global network of several hundred in-country experts and partners covering more than 65 countries. Eurasia Group is headquartered in New York, with offices in Washington, DC and London. www.eurasiagroup.net