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For Immediate Release

Eurasia Group President Ian Bremmer Announces Top Risks and Red Herrings for 2009

NEW YORK, 5 January 2009 — Eurasia Group President Ian Bremmer announced the firm's annual *Top Risks* in a note to clients today. *Top Risks* identifies the year's key geopolitical areas to watch for global investors and market participants. According to Dr. Bremmer, underlying the risks in 2009 are two important structural forces: (1) more state intervention in the global economy and (2) more reactive and poorly coordinated intervention.

Highest on the list of *Top Risks* is the US Congress. The global impact of the US response to the financial crisis will be far reaching and the Democratic-led Congress, which is cohesive and shares the collective sense that the executive branch overstepped its policymaking authority in recent years, will exert policy leadership with long-lasting consequences for business and the economy.

The following is a summary of Eurasia Group's *Top Risks* for 2009. A copy of the full note by Dr. Bremmer is included at the end of this release.

1 — US financial regulation and the rise of Congress: A stronger Congress is likely to be more assertive in driving the US economic policy agenda, with three broad areas to watch: (1) legislative and regulatory changes in the financial industry; (2) direct government involvement/control over economic enterprises; and (3) fiscal policies meant to spur economic growth. The degree to which political populism plays a role in the response to the financial crisis will have a host of unintended consequences.

2 — South Asia security: The security environment in India, Pakistan, and Afghanistan will deteriorate significantly, and the US and Europe will find themselves more directly involved in conflicts in all three states, with little benefit to show for it by the end of 2009.

3 — Iran/Israel: Iran is expected to have the capacity to develop a nuclear bomb (if it so chooses) by the end of the year. While the likelihood of US strikes against Iran has diminished considerably, 2009 is the critical year for conflict (both direct and through proxies) between Iran and Israel.

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4 — **Russia:** The challenges of the financial crisis are likely to produce increased social unrest in Russia—with nearly zero state tolerance for dissent. Given that the Barack Obama administration will probably not keep quiet during a crackdown in Russia, relations between Russia and the US, as well as Russia's relations with some European nations, are likely to continue to deteriorate. Russia will be a troublemaker in international affairs, though military intervention in Ukraine or a direct conflict over Georgia, NATO enlargement, and missile defense are unlikely.

5 — **Iraq:** The Iraqi government will face a series of political tests that will determine its ability to keep the country united and move it toward stability. President Obama will face pressure to fulfill his promise to withdraw US combat troops within 16 months, but he may have to revise his timetable. The looming prospects of US withdrawal, combined with provincial and the parliamentary elections, will expose Iraq to high risks of renewed unrest, while the unresolved dispute over the oil-rich city of Kirkuk will remain a source of long-term volatility.

6 — **Venezuela:** President Hugo Chavez's plan for a referendum to reform the constitution and abolish term limits is unlikely to succeed. Faced with defeat, Chavez is likely to take an increasingly authoritarian approach, which will raise social and political turmoil domestically.

7 — **Mexico:** Rising violence and corruption scandals associated with narco-trafficking will continue to raise questions about the government's strategy against organized crime. However, growing public concerns will not affect political stability or the government's increasingly aggressive efforts to weaken the drug cartels.

8 — **Ukraine:** Direct military conflict with Russia is unlikely, but battles between Prime Minister Yulia Tymoshenko and President Viktor Yushchenko will continue to divide the government and complicate attempts to deal with the country's economic crisis. Growing unemployment, falling wages, and anger at politicians will increase the risk of social unrest in major cities.

9 — **Turkey:** The fight between secularists—in the judiciary, military, and industry—and the Islamists in government is becoming a serious obstacle to economic advancement and Ankara's bid for EU membership.

10 — **South Africa:** The African National Congress is likely to keep a majority in parliament and Jacob Zuma should prevail as the country's next president. Uncertainty over the government's macroeconomic approach, however, may lead to market pessimism, and the outcome of Zuma's corruption case could pose further challenges.

In addition to *Top Risks*, Ian Bremmer identified three *Red Herrings*, which are the issues that Eurasia Group believes will not be sources of geopolitical instability during 2009. These include social unrest in China; political instability in the Persian Gulf; and major global climate change initiatives.

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From 6 to 16 January, Eurasia Group will release a series of in-depth outlooks focusing on each of the *Top Risks* and the *Red Herrings*. For more information, please contact Ms. Alex Lloyd at 646-291-4036 or media@eurasiagroup.net.

[Start of note by Dr. Ian Bremmer]

It's not hard to paint a negative outlook as we begin 2009, given the political instabilities that naturally emerge from such a serious global economic downturn. But underlying the market volatility over the coming months will be two important structural forces, an understanding of which should provide useful context for a year with unprecedented levels of political risk.

First, we'll see more state intervention in the global economy. Second, that intervention will be both reactive and uncoordinated by a series of local, regional, and national political actors who have decidedly non-global (and in many cases non-market) views of the cost/benefit equations that attend their policy decisions. In short, politics will drive the global economy more directly, and more inefficiently, in the coming year than at any point since World War II.

With that, the top risks for 2009. And to end on a more positive note, a few red herrings.

1 — Congress

Political risks have historically been most important for economic outcomes in emerging markets, but that's not so this year. The current financial crisis has created an unprecedented space for government interference in economic affairs within developed states, as well. Nowhere is that more true than in Washington.

The most far-reaching reactions to the global financial crisis—the biggest stimulus packages and the policy decisions with the most important economic implications—will come from the US government. The incoming Obama administration, which has enjoyed an 80% approval rating during the transition, has been welcomed with both enormous relief and enthusiasm. Knowing the range of serious problems that await him, President-elect Obama has eschewed ideology (and, in many cases, his most committed loyalists) and hired the best advisors available. On the domestic side, the incoming Obama team is not just solid, it's cohesive. Larry Summers and his friends and protégés are a crew of pro-globalization free-traders and centrist technocrats who will take a problem-solving perspective on the crisis. (On foreign policy, Obama fields just as much talent, but not nearly as much of a team. It's a separate point, though... a challenge in places like China, Russia, and—in the headlines right now—the Middle East peace process; that's really a problem for later, not for 2009).

Congress is a different matter. I would make the point that Obama actually got more of a democratic majority in Congress than is good for him. On Capitol Hill, we also have much more cohesion—and a collective sense that the executive branch of government has seriously overstepped its policymaking authority in recent years. A strongly Democratic (and much more

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ideologically progressive) Congress will feel the need to respond decisively to the unprecedented nature of the financial crisis to show that it's doing something. In short, Congress will move from a position of stalling administration-led legislation to attempting to exert actual policy leadership. The last time we had serious financial crises, a considerably less cohesive Congress both over-legislated and over-regulated, resulting in, among other things, the Sarbanes-Oxley act. This time around, we're likely to see a series of hearings and populist policies that favor consumers over producers, as well as congressional "showboating" on initiatives related to solving the financial crisis.

There are three broad areas to watch. First, we can expect financial industry legislative and regulatory changes—oversight and supervision for credit rating agencies; revision of bankruptcy laws; new regulation of complex financial products and non-traditional financial institutions; and, most importantly, reform of financial regulatory agencies.

Second will be direct government involvement/control over economic enterprises—and in financial institutions given an increase in US holdings; a "car czar"; the criminalization of company failures, hearings/investigations/special prosecutors for underperforming enterprises; and increased scrutiny of energy companies.

Third will be the fiscal policies meant to spur economic growth—implementation of the second half of the tarp package, new infrastructure stimulus, and additional spending to ensure congressional support.

By the end of 2009, the critical question will be whether the White House or Congress will have driven most of the lasting domestic economic policy agenda. In even the most optimistic assessment, a combination of economic crisis and a stronger Congress means that the balance is likely to tilt considerably from where it has been over the past decade, making the rise of the US Congress the world's top risk in 2009.

2 — South Asia security

The security environment in India, Pakistan, and Afghanistan will deteriorate significantly over the coming year, and the United States and Europe will find themselves more directly involved in conflicts in all three states, with little benefit to show for it, by the end of 2009. The Asian subcontinent would have reached number two on this list even without Pakistani troops massing along the Indian-Pakistani border. The locus of the world's terrorism/security risks has been moving steadily eastward over the past decade—from Israel/Lebanon to Iraq/Iran and now to Afghanistan/Pakistan/India. An increase in Islamic radicalism, given the brittleness of local political institutions and a serious economic downturn, is a growing risk for a number of countries around the world (Algeria, Egypt, Somalia, and Yemen being a few worth particular focus). But nothing comes close to South Asia. Pakistan's problems are creating spillover effects in Afghanistan and India; and responses from both countries (and from the United States) will exacerbate Pakistan's political instability and increase security tensions across the region.

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Perhaps the biggest risk of all—a major terrorist attack inside the United States—is more likely to come from terrorists operating out of Pakistan/Afghanistan than from anywhere else.

In Pakistan, the weakness of the Pakistan People's Party (PPP)-led coalition government and infighting within the military have made it difficult to focus on an already problematic challenge—growing radicalism in the federally administered tribal areas and the northwest frontier province. Both areas are effectively stateless, and terrorist organizations with international ambitions have been growing in strength there. And while Pakistan's military is reasonably cohesive, they have weak counterinsurgency capability and limited willingness to fight what they consider a losing struggle in the regions... especially with a floundering domestic economy creating more dissent and dislocation among the lower and middle classes. As Pakistan's efforts fall short, the United States will increase unilateral operations in the region, stretching US military capacity and provoking stronger anti-American sentiment locally. That, in turn, will further undermine the stability of the Pakistani government and increase support among local radicals for terrorist attacks that directly target the United States.

In Afghanistan, President Hamid Karzai has lost nearly all ability to govern—locals often dismiss him as the "mayor of Kabul." Corruption and mismanagement is rife, and the international coalition hasn't made much of a dent in terms of governance or economic development (helped little by the lack of policy coordination of an increasingly large number of regional actors on the ground—Pakistan, India, China, Russia, Iran). In short, Afghanistan is now a failed state. American and British government officials privately admit they've given up hope for a political solution with the present Afghan leadership. That's meant a change in strategy—increasingly working with tribal leaders and negotiating with the Taliban by proxy. The shift might lead to some progress in the long term, but local mistrust and a lack of foreign credibility will take years to reverse. To make an analogy with Iraq, we're still in the Jerry Bremer phase... and a ways from the troop surge. For the coming year, we'll see a strengthening of local radicals and the Talibanization of Afghanistan and parts of Pakistan.

We'll also see greater spillover into India, where the horrific attacks in Mumbai have sparked political clashes with Pakistan, but very little institutional capacity to deal with the problem. The silver lining is that the risk of direct military conflict between the two countries remains low, but tensions will be high and the security risk is real—slowing foreign direct investment and infrastructure buildup in a country that seriously needs it.

For the entire region, 2009 will see a spike in political risk—and a downward trajectory in underlying political stability and economic promise.

3 — Iran/Israel

The likelihood of the United States launching strikes against Iran has diminished considerably over the past two years, due both to internal policy wrangling between Vice President Dick Cheney and others within the Bush administration and the election of Barack Obama as

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president. But 2009 is the critical year for conflict (both direct and through proxies) between Iran and Israel.

A few key points here. Despite credible international political pressure over the coming months, Iran's nuclear program will proceed apace. Barring direct military action, Iran will likely have the capacity to develop a nuclear bomb (if it so chooses) by the end of the year (probably the beginning of fourth quarter). The Obama administration will try to engage Tehran diplomatically. When that fails, it will continue sanctions, including a focus on shutting down suspect Iranian state accounts and financial transactions—an effort that will sting in a low oil price environment.

Ultimately, that's it for the Washington strategy. The United States (and its European allies) are privately prepared to deal with a nuclear-capable Iran. The Israeli government isn't, and is under much greater domestic pressure to take action. That's particularly true with the entire Israeli political spectrum having tacked to the right in recent months, the labor party essentially disintegrating, and the strong possibility that Likud leader Benjamin Netanyahu will become the next prime minister.

At the very least, Israel will provoke conflict through a stronger focus on national security in this heightened threat environment. Overreaction in Gaza over the past weeks is one example, a display designed in part to demonstrate seriousness of intent to the Iranian government. But Iranian overreaction is equally likely, with enhanced political and military support from Tehran for proxies in the Palestinian territories and Lebanon.

Iran will hold its own presidential election in June. The country's hardliners are critically unpopular on the economy, but they're much stronger on national security, geopolitics, and the nuclear issue, giving them all the motivation they need to take a strong stance in reacting to real and perceived Israeli slights. This would include support for Hizbullah and Hamas strikes into Israeli territory. We could also see Iranian harassment of US warships in the Strait of Hormuz and the fomenting of instability in the south of Iraq.

All of this means that the period around Iranian elections will be particularly dangerous. There's a reasonable possibility of actual Israeli military strikes, but the prospects of a much broader set of Iran/Israel inspired and/or instigated regional conflicts will also be highest in this timeframe. The key takeaway is that in 2009, the Iran risk and the Israel/Palestine/Lebanon risk have become inextricably linked.

Another silver lining: If we can get through 2009 without direct military conflict, the risk premium will decrease significantly. Iran won't quite become another North Korea (given the instability and economic importance of the neighborhood), but the dynamic is similar. Either there's a deal cut with a then tacitly accepted nuclear-capable Iran or there isn't. But the United States will play a less dominant regional role, and the Gulf Cooperation Council will begin to

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integrate a nuclear Iran that they have to learn to live with. Either way, barring military strikes, 2010 is lower risk.

4 — Russia

We enter 2009 with Russia in play in a way we haven't seen in decades. The relevant comparison isn't 1998, when the Russians engaged in default and devaluation but remained within the bounds of their existing political and economic system (as Lenin said, two steps forward, one step back). The history to consider is 1989—as key aspects of the Russian system could change for the worse.

Russian Prime Minister Vladimir Putin certainly isn't a risk taker. The carefully managed "transition" to President Dmitry Medvedev and the extension of presidential terms to six years underscore that Putin prefers to leave as little as possible to chance. That's more ominously obvious in the recent tightening of laws on treason.

With oil prices well below what the Russians can afford, but Putin's (and Medvedev's) popularity still high, the initial moves have been to consolidate power. Yet despite no organized political opposition to speak of, we're still starting to see social unrest. For the first time in years, there have been widespread demonstrations in Russia—in 30 cities, following the imposition of import duties on used cars. We're likely to see much more turbulence in 2009, as factories providing employment for entire cities are shuttered. That's a sort of suffering that Russians are certainly used to, but only in the context of a very different kind of political system.

Where could this go? There will be near-zero state tolerance for dissent. And the strongest level of anti-Americanism (and, in many quarters, of broader xenophobia) of any significant emerging market in the world, creates the potential to make security a serious concern—and possibly lead to unrest that disrupts supply chains. The Obama administration is unlikely to quietly tolerate a crackdown, and will put plenty of focus on human rights and democracy. So American and some European nations' relations with Russia will continue to deteriorate over the course of 2009 (with the Germans, who are more dependent on the Russians economically and, to some extent, politically, playing the role of wild card).

Support within the Kremlin for better relations with the west will also diminish. The real question is how far that actually goes. So does Deputy Prime Minister Alexei Kudrin remain strong, get scapegoated, or actually get fired? Are Western-leaning oligarchs brought under tighter scrutiny and economic control... or forced out completely? And, most fundamentally, to what degree are the Russians prepared to go back to soviet-style authoritarianism? At worst, it's conceivable that western organizations of all sorts (media, NGOs, and corporates) will be, to varying degrees, seen as increasingly unwelcome within the country.

I don't expect such serious risks on the foreign policy side. Russia has achieved its principal objectives in Georgia, at least for now, and we'll see less direct conflict over NATO enlargement

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and missile defense as the West takes a breath and reassesses both issues. Nor will we see Russian tanks in Ukraine. The Russians are too connected into the Ukrainian economy and have too much to lose... though Russian minorities in Ukraine—a majority in Crimea—could see some violence and make headlines. (More on that later.) Nevertheless, Russia will be a troublemaker in international relations—if a more unpredictable and opportunistic one than in 2008. As the latest gas cutoff to Ukraine shows, the Kremlin puts realpolitik and national interests first. "Market discipline" in the aftermath of Georgia did not prevent Moscow from again turning off the tap to Ukraine, and more instances of bare-knuckles foreign policy are likely in 2009.

5 — Iraq

Frankly, Iraq at number five is a good news story. With about 140,000 American troops remaining on the ground and no serious evolution of the Iraqi political model, it's a testament to the relative improvements of security that Iraq has managed to claw its way away from a risk that keeps the world on edge.

The real concern at this point is the politics, not the security situation. Barring external shock (from, say, an attack on Iran or Turkish intervention in the Kurdish north), the present level of stability in Iraq is sustainable, given the existing troop presence. The real question is whether and for how long the United States can maintain a commitment to significant force levels. Obama has already pledged to remove all US combat troops from Iraq within 16 months... and has gotten serious pushback from some American generals who worry that a politically driven withdrawal timetable will be inadequate for real security objectives.

Given the unpopularity (and the human and economic cost) of the deployment, Obama will have a difficult time resisting pressure to begin withdrawing significant numbers of troops in 2009 and, more importantly, announcing a specific timetable for more. That will lead to a political realignment in Iraq. Extremist Shia factions in Baghdad and the south will be emboldened, tensions between Kurds and Arabs over the demarcation of the Kurdish regional government and its energy resources will intensify, and it will be increasingly politically dangerous for Prime Minister Nouri al Maliki and the central government in Baghdad to be seen working with the US.

A potential US withdrawal from Iraqi cities by June 2009 would create new opportunities for armed militias, and those that have recently adopted a low profile will resurface and vie for greater influence. This heightens the risk of renewed intra-Shia violence, especially between Moqtada al Sadr's Mahdi Army and the Badr Brigades of the Supreme Islamic Iraqi council (SIIC). The provincial elections that the Iraqi government hopes to hold on 31 January already expose the country to intra-Shia friction, which the central government will have a hard time suppressing. Consequently, actual implementation of this proposed timetable will be challenging, and American intervention will continue to be critical for maintaining present levels of stability.

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All of this uncertainty will have an impact on the energy sector. Concerns about risks of violence and the US commitment to security, in addition to ambiguous oil contract terms, will undermine the willingness of most international oil companies to commit significant resources to long-term service contracts that would raise Iraqi oil production. Most fundamentally, without a federal system with clear political and economic prerogatives granted to provincial authorities, the central government will remain unable to provide the necessary political, legal, and security guarantees to protect sustainable economic development in the country.

6 — Venezuela

President Hugo Chavez has made a habit of miscalculation over the years, but this may be the big one. His plans for a referendum in the coming month to reform the Venezuelan constitution and abolish term limits (which would allow Chavez to run again for the presidency in 2012) show little likelihood of success. Then the Venezuelan president will have a real political fight on his hands.

It's an understandable risk for Chavez, who has juiced public spending to unsustainable levels in recent months. He understands that his approval is only likely to fall with his country's economic slowdown, declining oil reserves, and spiraling inflation. But Chavez is more Musharraf than Mugabe. He doesn't have the domestic political capital to secure his position.

A defeat in the referendum is the most likely outcome (with the president unable to either mobilize sufficient support for an honest victory, or subvert the process sufficiently to cook the ballot); and Chavez will be hard-pressed to accept the result. Instead, in an effort to keep himself in place, Chavez will likely take an increasingly authoritarian approach...including the widespread use of force to maintain control. This, in turn, will create deeper divisions within the military, national assembly, and bureaucracy; will mobilize what has otherwise been a divided political opposition; and create significant social discontent. As Chavez's support wanes, his staying power will be open to question—an opportunity for Venezuela long term, but not for 2009.

7 — Mexico

While Colombia's President Alvaro Uribe has effectively won his country's war against the drug cartels, the same can't be said of Mexico's President Felipe Calderon. The security situation there has worsened and is almost certain to deteriorate further over the course of 2009. Well armed and well financed narco-criminals have effectively declared war on the state of Mexico—increasingly singling out elected government officials, bureaucrats, and the armed forces and police for their attacks. As the government continues to rely on the military to go after the drug lords, the bloodshed will continue.

One concern is that the fight expands toward the civilian population at large and against US targets. As aid and resources sent to Mexico by Washington increase, the United States has been seen as helping the fight against the cartels. Such a shift could spill over into a broader conflict.

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In recent months, there have been plots against US targets—including one against the US embassy—that were broken up by counterterrorist efforts. It wouldn't be wise to assume that this good fortune will last.

For all the state's public security woes, President Calderon's popularity has remained relatively stable. Unlike with the economic troubles Mexico is experiencing, the president is actually seen as making a difference on the national security front. This is something the government intends to play up as July's midterm congressional elections draw near.

8 — Ukraine

As I mentioned, Ukraine isn't likely to spur the kind of direct military conflict we saw last August in Georgia. But it merits a slot in our top risks because of the government's inability to deal effectively with the severe challenges posed by the current financial crisis and economic downturn—and one certainly not helped by its volatile relationship with Moscow.

Ukraine's vulnerability stems from some hard economic realities—sharply falling demand for Ukrainian exports (particularly steel); heavy private-sector borrowing in foreign currency; a big gas price dispute with Moscow; and a currency (the hryvnia) under enormous pressure. In that context, Ukraine desperately needs a government that can make coherent anti-crisis decisions, including adhering to IMF fiscal austerity criteria. Kyiv is very far from that—it's burdened by infighting between Prime Minister Yulia Tymoshenko and President Viktor Yushchenko, as well as strong opposition from pro-Moscow Viktor Yanukovich and his Regions of Ukraine party.

Presidential elections coming next year—in which all three leaders hope to run—loom as a more important factor in decision-making than the current economic crisis. So while the government may be able to come together to make last minute anti-crisis decisions (for example, managing to pass an imperfect 2009 budget last week), it's not functioning effectively on a day-to-day basis.

For this year, the key risk is that the Ukrainian population will become increasingly restive in the face of power grabs and political bickering—particularly in the industrialized (and more pro-Russian) southeast, where most layoffs will occur. Russia's role in all of this is important. Despite the cutoff of gas supply, the two sides should eventually agree on a higher price for 2009. But that won't resolve the underlying conflict. Of all the countries affected by Russia's trend toward Eurasianism, Ukraine is at the forefront. With an extremely weak government, Ukraine's internal political tensions will be increasingly exacerbated by conflicting loyalties within the population—a much more pro-NATO western Ukraine and a pro-Russian (and in many cases ethnically Russian) population in the southeast and Crimea. If the country plunges into serious crisis—widespread social unrest, currency collapse, ineffective government, inability to pay gas bills to Russia, major companies defaulting on loans—then Moscow could intervene in the domestic political scene to support a government that is likely to be much more pro-Moscow and less EU- (and certainly less NATO-) oriented. In short, it's not a country I'd be betting on in the near term.

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9 — Turkey

Speaking of internal distractions, Turkey is essentially defining the problem. The country has all sorts of factors in its favor—a diversified economy, strong demographics, an extremely favorable trade route geography, and solid ties with both western countries and its Middle Eastern neighbors. Yet the fight pitting secularists in the judiciary, military, and industry against Islamists in government is becoming a serious obstacle to economic advancement. And the AK party leadership, feeling that it increasingly carries the weight of popular support on its side, is unwilling to compromise—instead, casting out potential dissent from within the party (and losing critical bureaucratic competence as a result). To make matters worse, the AK party has long lost its reformist spirit and has embraced a more nationalist attitude, making it more difficult to find a solution to the thorny Kurdish question.

In the context of all that, the international front is also becoming more strained. Growing euro-skepticism in Turkey and rising anti-Turkey feelings in Europe further complicate Ankara's already troubled bid for EU membership. Turkey-US relations could suffer significantly if President Obama decides to fulfill his electoral pledge to approve the Armenian genocide resolution, a step that would seriously inflame the Turkish government and public opinion. An early US withdrawal from Iraq would also raise fears in Ankara concerning the aspirations of the Kurdish leaders in northern Iraq and the fight against the PKK.

In short, it's a bad time for Turkey to try to pull itself out of an economic downturn. And in 2009 at least, the internal fighting is likely to get worse before it gets better. The positive spin is that we're not likely to see a spillover of conflict beyond Turkey's borders. In Turkey's case, at least, misery doesn't like company.

10 — South Africa

Rounding out the top risks for 2009 is South Africa. Upcoming elections will dominate the news, but it's more political context than electoral results that will cause concern. It's pretty clear that the African National Congress (ANC) will keep its majority in parliament, though the emergence of a new splinter party will reduce its numbers. In principal, that's not a bad development; popular concerns over the ANC's abuse of power should be reduced accordingly. But the transition is going to be hard on the ANC leadership—with South Africa's legislators having to accept the need to cooperate with political opponents, rather than using political influence to force would-be dissidents into line. The initial reaction is likely to be a lack of patience and tolerance, undermining public confidence in South Africa's political institutions...and providing little comfort to investors.

Jacob Zuma's election as president is pretty much a done deal. The worry is similar to what the world initially feared with Brazilian President Lula a decade ago—Zuma defeated Thabo Mbeki with support from communists and trade unionists, creating a general skittishness around a Zuma government's macroeconomic approach. Investors will read the worst into any changes. I'm more optimistic than most on the eventual policy decisions, but the early signs are almost certain

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to be more interventionist, with wider social welfare benefits and broader budget deficits. Especially if Finance Minister Trevor Manuel isn't reappointed (which could easily happen whether or not Zuma wants to stick with him), the market reaction is likely to be strongly negative.

And then there's Zuma's corruption case, which, depending on the outcome of an appeal judgment next week, could still wind its way through the court system. If Zuma as sitting president is ultimately found guilty, there will be specific challenges. But the judicial process itself will continue to be polarizing and possibly undermine confidence in the courts and in South Africa's rule of law. In short, while none of the actual political outcomes spell disaster in South Africa, the country's institutions will struggle to manage the volatility of the coming year.

Red herrings

China

Probably the most surprising exclusion from the list of top risks is destabilizing social unrest in China. Demonstrations have erupted across the country, reflecting public anger over a startling diversity of heart-wrenching issues—from infants dying from poisoned milk to schoolchildren crushed to death inside shoddily constructed schools during the Sichuan earthquake to all kinds of economic dislocations. Yet nationalism and pride in the Chinese system remain more intense than at any time since I started traveling to China. The urban population sees the developing economic downturn as largely the result of western misdeeds and, more broadly, a failure of the Western free-market system. If anything, they believe that it's Chinese overreliance on the West that needs to change. The overwhelming majority of China's demonstrations remain localized, while national sentiment is almost purely pro-Beijing and pro-China on a global stage.

However benign the near-term political environment, the Chinese government isn't taking much for granted. It is doing everything possible to stimulate growth in the near-term and building an unrivaled government capacity to restrain social dissent. All of this is creating serious problems for the longer term—most critically on the environmental front, but also in terms of employment for highly skilled labor. These problems, in turn, create their own complex feedback patterns—the accelerating consolidation of state owned enterprises will create a less fractured industrial landscape. And provincial governments will use the opportunity to start the painful adjustment from manufacturing to a service-oriented economy.

If there's a serious baseline (and growing) risk, it's the ability to maintain a semblance of equal footing—and longer-term viability/profitability—for western corporations investing in China... and, accordingly, keeping the politics out of the US/China relationship. But for 2009, the key point is that China is an enormous, dynamic economy with more flexibility than people expect, and it's likely to emerge in better shape than most of the world's emerging markets.

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The Persian Gulf

Despite serious deterioration in oil prices and a major hit in portfolio investments from the global market slowdown, all the attendant concerns of rampant radicalism, and the potential for violence in Iraq, Iran, and in Israel and its neighbors, political stability in the Persian Gulf remains extremely high.

Saudi Arabia, which has budgeted for a much lower oil price and has taken significant steps toward economic reform, will remain among the most stable Gulf States. King Abdullah has built a store of support among his people, which helps the kingdom weather a relative downturn (and to be clear, it's indeed relative—Saudis are still doing reasonably well).

The same is true for Qatar, Oman, and the United Arab Emirates, where even Dubai's vulnerability is shored up by the political capital and capacity of Abu Dhabi to intervene and provide the necessary financial backing. The internal dynamics of UAE politics will change dramatically, and Abu Dhabi will have a clear say in Dubai's development strategy; but this shouldn't have a negative impact on the country's political stability.

The big story in 2009 is likely to be the increasing political cohesiveness of the region. Saudi-Qatari relations, long on the rocks, are improving and will facilitate increasing economic cooperation. We are also likely to see improved political coordination on Iraq and on regional stability...possibly even including a softening of relations with Iran, if Iran's June elections produce a new president. How the United States manages to square that with a desire to keep the dollar as the world's reserve currency will strain relations in the region—with the Saudi relationship being the one to watch.

Climate change

It's happening, as fast as you can say drowning polar bears. But despite all the commitment to cap and trade, all the policymakers in the developed world ready to make a difference, and the big meeting planned for Copenhagen, we're going to see almost no serious policy movement this year.

The Obama administration clearly has folks that want to move on this issue (both in terms of incoming Energy Secretary Steven Chu and the new energy czar Carol Browner, to say nothing of the sense of invigoration at the environmental protection agency), but not this year—too many other priorities, too much need to bail out industry without increasing input costs, and gas prices are at five-year lows already anyway. Even if we see movement on cap and trade and a post-Kyoto agreement, cost containment mechanisms will ensure that carbon prices are suppressed.

Meanwhile, European coordination is decreasing in the context of responses to the financial crisis, and 2020 emission cap commitments have already been reduced from 30% to 20%. Again, the end result will be depressed carbon prices.

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Emerging markets will have an even harder time prioritizing, especially China, given its efforts to stimulate growth. (If there's going to be any near-term support from reduced Chinese emissions, it'll come from growth destruction, not cleaner energy policies.) Collapsing energy prices mean that climate change policy as an energy security tool will also take a back seat.

The pieces are clearly in place for climate change policy to become an enormous driver for global markets. But not this year.

* * *

If I wanted to be exhaustive, I'd add places like North Korea and Taiwan to the red herrings list; and I'd talk about the continued political and economic resilience of Brazil. But I think these points are generally well understood and accepted. So I leave them for a later note.

Meanwhile, we'll be putting out a series of longer pieces—and conference calls—covering each of these risks (and red herrings) over the coming two weeks. And I'll be on an opening conference call to kick it all off a little later today.

Before I close, I would like to express my deep appreciation to you for your support. I'm immensely grateful for the outpouring of folks that have helped all of us at Eurasia Group continue the work that we share with you today. I hope we're making a difference in what's shaping up to be a rather troubling year.

[End of note]

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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