



REUTERS/KEVIN LAMARQUE

KEY POLITICAL RISKS TO WATCH IN THE UNITED STATES

The U.S. political landscape changed with the congressional and state elections in early November when President Barack Obama's Democratic Party took a beating from the Republicans.

POLITICAL GRIDLOCK

Republicans take control of the House of Representatives on Jan. 5 but with Democrats still in charge in the Senate, political gridlock is very possible.

WHAT TO WATCH:

- **Fights are shaping up** over spending as funding for government operations runs out in February, giving conservative Republicans backed by the Tea Party movement the chance to make cuts. They plan to hold back cash for programs like implementation of Obama's healthcare reform, highway funds, national parks and scientific research. This will be resisted by the Democrat-controlled Senate.

- **Republicans will** try to chip away at Obama's healthcare plan but the best chance of overturning it may be in the courts. There are a series of legal challenges to the reform, one of which might end up in the Supreme Court toward the end of 2011.

- **The stock market** is traditionally no big fan of political gridlock. On average, the S&P 500 index rises only two percent a year when the president's party controls only one of the chambers in Congress, according to Standard & Poor's Equity Research. ■



New House of Representatives members of the 112th Congress pose on House steps of the U.S. Capitol in Washington, November 19, 2010.
REUTERS/LARRY DOWNIN



President Obama signed into law a bill extending Bush-era tax cuts and other benefits based on a deal he brokered with Republicans that angered liberals. December 17, 2010.
REUTERS/JIM YOUNG

BUDGET DEFICIT

The U.S. budget deficit was at a near-record \$1.29 trillion in fiscal year 2010. This was a central issue at the elections, with deep popular concern about the growing national debt. Republicans favor spending cuts to close the fiscal gaps but Democrats are not keen on austerity measures, at least until the economic recovery picks up more pace.

WHAT TO WATCH:

- **Congress will** again have to raise the U.S. government's debt limit, a potential flashpoint between the two parties. The debt ceiling was last increased in February

to \$14.3 trillion but the Treasury Department expects to bump into the existing debt limit in the first or second quarter of 2011. It can delay by discontinuing issuance of some types of debt, but eventually the limit will have to be raised. Deficit hawks have vowed to take a stand when the time comes and demand spending cuts from the Obama administration in exchange for their support of raising the limit. Failing to raise the ceiling would roil world debt markets.

- **Obama has called** for a reform of the tax code in 2011 that broadens the tax base and lowers corporate tax rates. ■



President of China Hu Jintao (C) arrives in advance of his participation in the nuclear security summit in Washington, called by U.S. President Barack Obama, at Andrews Air Force Base, Maryland. April 12, 2010. **REUTERS/JONATHAN ERNST**



Former Alaska governor Sarah Palin has not announced whether she will run in 2012. October 23, 2010. **REUTERS/SCOTT AUDETTE**

USA-CHINA RELATIONS

Disruption to U.S. relations with China can move bonds, currencies, stocks and commodities globally. Beijing is the biggest single holder of U.S. Treasuries, with around \$900 billion. Some in Washington have long feared that China could dump the bonds because of a political dispute, say over Taiwan, bringing prices tumbling down. But that would be counterproductive to China and is seen as unlikely.

WHAT TO WATCH:

- **The tone of a visit to Washington** by Chinese President Hu Jintao in January. China is keen for Hu to be feted with the trappings of a full state visit. Deficits, the yuan currency and the U.S. Fed's quantitative easing will top the economic agenda.
- **Any attempt to revive a bill in the Senate** to punish Beijing for not revaluing the yuan is a big deal for foreign exchange and bonds.

U.S. companies with most to benefit from a stronger yuan include Caterpillar, Alcoa and General Electric, but they also stand to lose from any tit-for-tat trade fight with Beijing. A yuan revaluation might stimulate Chinese demand for commodities but that could be offset by reduced export competitiveness.

- **Political and military tensions** like the crisis in North Korea and whether a harder line by Washington against Pyongyang will upset China. Taiwan lingers as a potential flashpoint in China's relations with Washington but trade ties between the island and Beijing have improved.
- **Friction between multinationals and the Chinese government** after Google and Beijing locked horns over the Internet giant's search engine in 2010. That dispute is over but companies like GE, Siemens and BASF have also complained of the tough investment climate in China. ■

PRESIDENTIAL ELECTION APPROACHES

Possible Republican rivals to Obama at the 2012 presidential election have already started to emerge.

WHAT TO WATCH:

- **Whether Obama** will take a more centrist approach than he has done in his first two years in office as he seeks to court independent voters. His recent tax deal with Republicans suggest this is likely. He is unlikely to push any big legislation like the financial regulation reform or healthcare overhaul that upset conservatives in 2010.
- **Feasible Republican hopefuls** include Mitt Romney, Mike Huckabee and Newt Gingrich but all eyes are on Sarah Palin, the 2008 vice presidential candidate who has yet to say whether she will run. Building campaign war chests and frequent visits to the key elections states of Iowa and New Hampshire are early signs of a presidential run. ■



Iranian university students clash with the police outside the British embassy in Tehran. The protestors claimed that the U.S. and Britain are involved in the bomb blast which killed an Iranian nuclear scientist.
November 29, 2010.

REUTERS/MORTEZA NIKOUBAZI

TENSIONS WITH IRAN

The United States has taken the lead in pushing Iran to come clean about its nuclear program, resulting in both U.N. Security Council sanctions to curb Tehran's nuclear and missile activities and tougher U.S. and European Union measures to cut investment from Iran.

Tehran agreed to return to negotiations in December with the big powers to discuss its nuclear program, and another round of talks is expected in Istanbul in January.

But Western diplomats are dubious that Iran will address concerns about its nuclear program, which they fear is aimed at producing atomic weapons but which Tehran says is purely for peaceful purposes.

WHAT TO WATCH:

● **Next steps in nuclear talks.** EU foreign

policy chief Catherine Ashton is taking the lead, but there is no indication that even a basic agenda for future talks has been agreed. Iran has pulled out of previous negotiations over its nuclear program and any move by Tehran to abandon the talks could herald new international sanctions.

● **Sanctions busting.** U.S. officials say the current sanctions are taking a toll on Iran's economy, and have vowed to ensure they are enforced. A growing number of Western-based oil and financial firms are severing their links with the country, and Chinese energy firms have also been slowing their Iran-related work. But concerns remain about how far China's aggressive state-backed firms, as well as Turkish financial institutions, may comply.

● **How Israel reacts.** Israeli Prime Minister

Benjamin Netanyahu has described Iran as a threat to the Jewish state. Israeli jets in 1981 bombed an Iraqi nuclear reactor it viewed as a threat and in 2007 it destroyed a Syrian facility that U.S. intelligence reports describe as a nuclear reactor intended to produce bomb fuel. Israel could attempt a similar attack on Iran if it feared it was close to producing a bomb, threatening a wider regional war.

● **Iranian politics.** Washington was caught by surprise in 2009 when Iran's opposition movement led huge protest rallies after President Mahmoud Ahmadinejad's contested re-election. Any fresh outbreak of anti-government protests could thrust the United States into confrontation with Tehran.

COVER PHOTO: U.S. President Barack Obama holds a post-election news conference in the East Room of the White House in Washington, November 3, 2010. REUTERS/KEVIN LAMARQUE

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