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RISKS TO WATCH EMERGING EUROPE

Euro zone debt worries, the survival of IMF deals in elections, protests, leadership dynamics in Russia and internal divisions in Turkey could all affect emerging Europe investors in 2011. However, for many, most risks are not from within the region at all but from the more established economies of Western Europe as they struggle to contain the euro zone debt crisis. The key issues will be whether the euro zone's most troubled states - particularly Greece, Ireland, Portugal, Italy and Spain - can make tough spending cuts and placate bond markets and whether the bloc can make wider reforms.

HERE IS A SUMMARY OF THE POLITICAL RISKS TO WATCH IN EMERGING EUROPE

WESTERN EUROPE'S WOES

If Western Europe does sink back towards recession, a knock-on effect on exports from emerging Europe could have a marked impact on economies and assets.

At a summit in December, EU states agreed to create a crisis fund from 2013 - but some market players still worry there may not be enough money to bail out countries such as Spain or Portugal if they need it.

What to watch:

- Any renewed crisis in Greece, Ireland or elsewhere will likely have a knock-on market impact in the emerging EU, possibly again raising worries over the most troubled states such as Hungary.
- Any broader reform of EU treaties, bailout regimes or bond haircuts will have a particular impact on accession states such as Poland, the Czech Republic and Baltics.

IMF AND AUSTERITY

Emerging European countries were amongst the first hit by the financial crisis in 2008, forcing many to turn to the International Monetary Fund and EU for bailouts that often brought with them harsh austerity measures.

While some countries - such as Latvia - earned plaudits from Brussels and the IMF for taking the harsh medicine, Hungary's new Fidesz government is walking a more unconventional path prompting the collapse of its deal. That has disturbed investors who worry the pattern might be repeated elsewhere in the region.

Hungary says it must regain its financial independence. It has not yet released full details of its structural reforms. Fiscal measures so far have included special taxes on banks and some corporate sectors and what pension funds described as an effective renationalisation of mandatory private pension schemes.

The government is also poised to change the central bank law, aiming to pack the Monetary Council with its own candidates next March when the mandates of four out of seven members expire.



Hungary's Prime Minister Viktor Orban. Reuters/Bernadett Szabo

Other countries such as Romania are continuing to push forward with their IMF deals - although like their counterparts in Western Europe they face an almost inevitable uptick in strikes, protests and other civil unrest as well as mounting strains within governments.

What to watch:

- Action by ratings agencies against Hungary or further "unconventional measures" by the government there could unsettle markets across the wider region. Any perceived movement back towards the IMF consensus would be taken well.
- The failure of another IMF deal could hit markets across the region.

ELECTIONS AND PROTESTS

Latvia's ruling coalition performed relatively well in elections in 2010, proving that austerity measures might not always prove electorally toxic. But in other emerging EU countries, the pressure of spending cuts is pressuring coalitions, sometimes to the brink of destruction.

Romania's government narrowly survived no-confidence

KEY DATES

May 2011

Latvia due to hold election for president.

June 2011

Election in Turkey. Erdogan expected to win third term of single-party rule.

December 2011

Parliamentary election in Russia.

2012

Russia to hold presidential election.

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votes over planned cuts, with political uncertainty repeatedly knocking asset prices. In the Czech Republic, ties between the three coalition parties have been strained after they did badly in upper house elections. Further tension between the parties could undermine investor confidence and make budget approval, pension and health reforms even more difficult.

In Hungary, Fidesz has a two-thirds majority together with its Christian Democrat allies and has used that clout widely, stripping the Constitutional Court of its jurisdiction over matters related to state finances.

Some analysts describe it as an attack on democratic checks and balances but the government looks set to push ahead with plans for a new constitution next year.

What to watch:

- Signs of coalition strains in any emerging European country with an IMF programme would almost certainly worry markets. Romania probably looks most in focus, with centrist Prime Minister Emil Boc likely facing repeated bids to topple him and spark a full-blown political crisis.
- As in Western Europe, particularly widespread protests could also grab investor attention, especially if they were seen blocking or reversing reforms outright.

RUSSIA - OIL AND LEADERSHIP



In Russia, all eyes will be on the leadership dynamic between Prime Minister Vladimir Putin (left) and President Dmitry Medvedev in the run-up to the presidential elections in 2012 in which both could potentially stand. Putin is by far the dominant member of what Russian officials call the ruling "tandem" - with

leaked US diplomatic cables from WikiLeaks describing the younger Medvedev as "Robin" to Putin's "Batman".

Most analysts expect Putin to return to the Kremlin in 2012 and believe Russia will be stable while he is in control, although in the longer term some investors have worries over such reliance on an individual. Putin himself says he and Medvedev will make a decision closer to 2012 as to who is to stand. Some clarity could emerge after 2011 parliamentary elections.

The world's biggest energy producer, Russia is heavily reliant on oil and gas exports and any sustained fall in the price of benchmark Urals crude below the budgeted average of \$75 per barrel would hit hard, and potentially undermine Putin. But prices moving higher could strengthen Moscow's hand and drive heightened investor enthusiasm.

What to watch:

- Clarity on presidential election plans, although a formal statement is unlikely until closer to the time. Any real signs of discord between Putin and Medvedev could provoke a constitutional crisis and unnerve investors.
- Progress against corruption, described by Western executives as the biggest barrier to business in Russia.

TURKEY - ELECTIONS AND TENSIONS

Turkish Prime Minister Tayyip Erdogan (right) is widely tipped to win a third consecutive term of single party rule in national elections in June 2011, helped by strong economic growth but with a religious/secular divide a potential flashpoint.

Opponents of Erdogan's AK Party accuses it of having a hidden long-term Islamic agenda, with long-running strains between the government and secular military aggravated by a high profile court cases against military officers accused of plotting a coup.

A debate over the use of religious headscarves - a delicate subject that cuts to the heart of national identity - has also resurfaced after the Higher Education Board ordered Istanbul University to stop excluding students wearing them.

Opponents of the headscarf ban say it is a violation of individual freedom, while supporters say it is vital to Turkey's secular principles.

What to watch:

- Comments from the new armed forces chief General Isik Kosaner as trials start over the so-called 2003 "Sledgehammer" plot to destabilise Erdogan and pave the way for military intervention.
- Any government moves to ease the headscarf ban or attempts to rewrite the constitution.
- Relations with the United States - which have become increasingly strained over Turkey's deteriorating relationship with Israel and the European Union, hobbled by wrangling over the divided island of Cyprus.



RUSSIA'S STATE ASSETS SALE

Russia announced plans to privatise stakes in some of its largest government-owned companies

(the size of the stake to be sold is in brackets)

SHIPPING, TRANSPORT

SCF
SOVCOMFLOT
State-owned shipping giant
(25%)

RZD
RUSSIAN RAILWAYS
National rail network
(25%)

AEROFLOT
Russian flagship airline
(12%, est.)

ENERGY

ROSNEFT
Russia's largest oil producer
(15%)

FSK
Federal electricity grid company
(circa 28%)

RUSHYDRO
Largest hydroelectric power producer
(c.9%)

FINANCIAL SECTOR

VTB
Russia's second-biggest bank
(10%)

SBERBANK
Country's biggest lender bank
(9%)

AIZhK
State-owned mortgage agency
(c.49%)

ROSSELKHOZ BANK
Farm industry lender
(c.49%)

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