



RISKS TO WATCH MIDDLE EAST

Tension over Iran's nuclear programme and instability in Yemen will again weigh on the Middle East in 2011. Uncertainty about possible power transitions in Saudi Arabia and Egypt is also deepening. Iran has agreed to meet big powers again in January after resuming talks on its disputed nuclear programme in December after a gap of more than a year. But it insists its right to uranium enrichment is non-negotiable and no deal is in sight.

HERE IS A SUMMARY OF THE KEY POLITICAL RISKS TO WATCH IN THE MIDDLE EAST

IRAN: NUCLEAR ROW RUMBLES ON

The United States and Israel do not rule out military action if sanctions-backed diplomacy fails to resolve the row, but U.S. Defense Secretary Robert Gates says this would only delay Iran's pursuit of nuclear arms. Tehran denies seeking such weapons.

President Mahmoud Ahmadinejad (right) fired his foreign minister in December, showing he retains the whip hand in Iran's political infighting - and the support of Supreme Leader Ayatollah Ali Khamenei. But many lawmakers fret that the president is accumulating too much power and trampling parliament's role.

The economy could become Ahmadinejad's Achilles' heel. The price of fuel rose four-fold on Dec. 19 as part of long-delayed plans to phase out costly fuel and food subsidies. That could boost inflation now running at about 10 percent. The economy is already under strain from tougher international sanctions that have hit the energy and financial sectors - complicating the Oil Ministry's quest for investments worth \$25 billion a year it says it needs to prevent vital crude exports from drying up.

Cutting the subsidies, which cost the state about \$100 billion a year, may make economic sense, but is politically risky. The leadership is determined to prevent any repeat of the turmoil that followed the disputed 2009 presidential election and deepened rifts among the Islamic Republic's ruling elite.

Istanbul will host the next nuclear talks in late January, with European Union foreign policy chief Catherine Ashton representing the United States, China, Russia, Britain, France and Germany.

What to watch:

- Any breakthrough in Iran's talks with big powers.
- Possible unrest as food and fuel subsidy cuts bite.
- Power struggle between president and parliament.

IRAQ'S LONG WAIT FOR A GOVERNMENT

Parliament approved a new Iraqi government on Dec. 21,



nine months after an inconclusive election left politics in limbo and delayed investments to rebuild the country after years of war. Lawmakers endorsed Shi'ite Prime Minister Nuri al-Maliki's cabinet list in a vote that last-minute haggling over posts had delayed by one day, highlighting the ethnic and sectarian divides that bedevil Iraq. Maliki has yet to fill some posts, including sensitive ministries such as defence and interior.

Maliki formed the cabinet following a Nov. 10 accord between Sunni, Shi'ite and Kurdish blocs that put him on track for a second term and secured the participation of Iyad Allawi's Sunni-backed Iraqiya bloc, the largest in parliament, allaying fears of a slide back into sectarian violence. Since the U.S. military formally ended combat operations at the end of August, insurgent attacks have continued, albeit far below the levels of 2006-07.

While 50,000 U.S. soldiers remain before a full pullout by end-2011, a perception Washington has in effect disengaged could fuel internal conflict and outside meddling.

Energy projects signed with firms such as BP and Lukoil that could more than quadruple oil output capacity in seven years are moving ahead slowly. But non-oil investors remain wary. Iraqis, plagued by power cuts, unemployment and insecurity 7-1/2 years after the U.S.-led war that toppled Saddam Hussein, have looked

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on impatiently as their politicians bickered. Some fear postwar Iraq is turning into an Islamic state, citing attacks on minority Christians and actions by authorities, hardline clerics and local vigilantes to enforce morals.

What to watch:

- Further wrangling over cabinet posts.
- Any surge in ethnic or sectarian violence.
- Any Iraqi request for U.S. troops to stay beyond 2011.

YEMEN, A PERFECT STORM

Yemen, beset by crushing poverty that fuels violence by southern secessionists and northern rebels, has become a haven for al Qaeda militants intent on striking beyond its borders. Its global image took a fresh hit in October when two U.S.-addressed parcel bombs sent from Yemen were intercepted in Britain and Dubai. The Yemen-based al Qaeda in the Arabian Peninsula (AQAP), which was also behind the failed bombing of a U.S.-bound plane on Christmas Day, 2009, claimed responsibility.

In April, a suicide bomber tried to assassinate the British ambassador to Yemen and militants have attacked several state targets in the south, including a raid on an intelligence headquarters in Aden which killed 11 people.

Western nations and neighbouring Saudi Arabia fear AQAP is turning Yemen into a launchpad for attacks in the region and beyond. Washington has stepped up training, intelligence and military aid to Yemeni forces, helping them stage raids on militant hideouts, some of which have also killed civilians.

A leaked U.S. diplomatic cable showed the United States was itself launching air strikes on al Qaeda targets in Yemen, whose government had agreed to keep this a secret. "We'll continue saying the bombs are ours, not yours," President Ali Abdullah Saleh (right) was quoted as saying in the Jan. 2, 2009, memo.

Worries about instability and corruption have deterred major foreign investment in Yemen beyond the oil industry. Nearly a third of the workforce is out of a job. More than 40 percent of Yemen's fast-expanding population of 23 million live on under \$2 a day. Oil output is dwindling and a water crisis is worsening. However, Yemen has won IMF praise for economic reforms in 2010 that included imposing a sales tax, eliminating most customs exemptions and reducing wasteful fuel subsidies.

What to watch:

- More AQAP attacks, public backlash against U.S. role.
- Worsening violence in south, renewed conflict in north.
- Unrest over economic grievances.

SAUDI ARABIA'S AGEING ROYALS

With King Abdullah, aged about 87, in New York for medical treatment since Nov. 22, concerns about any transition of power in the world's biggest oil exporter have surfaced again. Crown Prince Sultan, also an ailing octogenarian, rushed home from abroad when the king left. Next in line for the throne may be Interior Minister

Prince Nayef, a conservative who could slow Abdullah's gradual reforms in the austere Sunni Muslim kingdom.

Nayef, about 76, became second deputy prime minister in 2009, putting him in charge when both Abdullah and Sultan are absent. Any leadership wobbles in Saudi Arabia, a vital U.S. ally, would attract concern for any impact on global oil supplies or on politics in the Gulf and the wider Middle East.

Abdullah has set up an "allegiance council" of sons and grandsons of the kingdom's founder, Abdul-Aziz Ibn Saud, to regulate the succession, but this remains untested. So far only sons of Ibn Saud have become king, ruling with the assent of hardline clerics. A score of sons survive, mostly in their 70s and 80s. Senior jobs have yet to pass to the next generation, but younger princes are jockeying for position.

If they came into play, potential candidates include Nayef's son Mohammed, who as anti-terror chief was targeted by an al Qaeda suicide bomber in 2009. Another contender among Ibn Saud's grandsons is Sultan's son Khaled, assistant defence minister.

A big challenge for the kingdom is to create jobs, housing and opportunities for a growing population of 18 million Saudis, two-thirds of whom are under 30. Offering young Saudis a future might help keep them away from Islamic militancy. Most of those who attacked the United States on Sept. 11, 2001, were Saudis.

What to watch:

- The health and capacity of senior royal family members.
- Any promotions for grandsons of Ibn Saud.
- Fate of reforms to education and judicial systems.

EGYPT'S PRESIDENTIAL GUESSING GAME

Hosni Mubarak, 82, has kept Egyptians guessing whether he will seek another six-year term in 2011, lever his son Gamal into power or settle on some other successor. If the stifling of almost all opposition in the Nov. 28 parliamentary election is any guide, Egyptians can expect no genuine say in the choice of ruler.

He has no designated successor and, despite gallbladder surgery in March, has given no hint he plans to step down. Speculation is rife that he might try to hand power to Gamal, 46, a businessman-turned politician whose cabinet allies have driven liberalising economic reforms. Both men deny considering any such transition. Gamal has no military pedigree, a possible hurdle in a nation ruled since 1952 by ex-officers.

Egypt expects the economy to grow 7 percent in the next financial year, up from a forecast 6 percent. Inflation has tumbled but it remains above 10 percent. Food inflation is still above 20 percent, worsening hardship for the two-fifths of Egyptians who live on less than \$2 a day.

What to watch:

- Mubarak's health ahead of presidential vote in late 2011.
- Any popular unrest over the cost of living.
- Any sign of Islamists and other opposition groups unifying.

