

Annual Forecast 2012 by Stratfor

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There are periods when the international system undergoes radical shifts in a short time. The last such period was 1989-1991. During that time, the Soviet empire collapsed. The Japanese economic miracle ended. The Maastricht Treaty creating contemporary Europe was signed. Tiananmen Square defined China as a market economy dominated by an unchallenged Communist Party, and so on. Fundamental components of the international system shifted radically, changing the rules for the next 20 years.

We are in a similar cycle, one that began in 2008 and is still playing out. In this period, the European Union has stopped functioning as it did five years ago and has yet to see its new form defined. China has moved into a difficult social and economic phase, with the global recession severely affecting its export-oriented economy and its products increasingly uncompetitive due to inflation. The U.S. withdrawal from Iraq has created opportunities for an Iranian assertion of power that could change the balance of power in the region. The simultaneous shifts in Europe, China and the Middle East open the door to a new international framework replacing the one created in 1989-1991.

Our forecast for 2012 is framed by the idea that we are in the midst of what we might call a generational shift in the way the world works. The processes are still under way, and we will therefore have to consider the future of Europe, China and the Middle East in some detail before drawing a conclusion. The 2012 forecast is unique in that it is not a forecast for one year in a succession of years, all basically framed by the same realities. Rather, it is a year in which the individual forecasts point to a new generational reality and a redefinition of how the world works.

2012 may not be the conclusion of this transformative process. Neither was 1991 the conclusion. However, just as 1991 was the year in which it became clear that the old world of the Cold War no longer functioned, 2012 is the year in which it will become clear that the Post-Cold War world has come to an end, being replaced by changed players and changed dynamics.

Europe

The European Union and eurozone will survive 2012, and Europe's financial crisis will stabilize, at least temporarily. However, Stratfor expects Europe to continue its long, painful slide into deepening recession. We expect accelerating capital flight out of peripheral European countries as investors in Europe and farther afield lose confidence in the European system. We expect financial support measures to be withdrawn on occasion to maintain pressure on governments to implement fiscal reforms, which will lead to financial scares.

However, the driving force behind developments in Europe in 2012 will be political, not economic. Germany, seeing an opportunity in the ongoing financial crisis, is using its superior financial and economic position to attempt to alter the eurozone's structure to its advantage. The core of this "reform" effort is to hardwire tight financial controls into as many European states as possible, both in a new intergovernmental treaty and in each state's national constitution. Normally, we would predict failure for such an effort: Sacrificing budgetary authority to an outside power would be the most dramatic sacrifice of state sovereignty yet in the European experiment -- a sacrifice that most European governments would strongly resist. However, the Germans have six key advantages in 2012.

First, there are very few scheduled electoral contests, so the general populace of most European states will not be consulted on the exercise. Of the eurozone states, only France, Slovakia and Slovenia face scheduled national elections. Out of these three, France is by far the most critical: The Franco-German partnership is the core of the European system, and any serious breach between the two would herald the end of the European Union. If Germany is to compromise on its efforts for anyone, it will be for France, and if France needs another country in order to secure its own position in Europe, it needs Germany. Consequently, the two have chosen to collaborate rather than compete thus far, and we expect their partnership to survive the year. Luckily for the German effort, French elections will be at the very beginning of the ratification process, so any possible modifications to the German plan will come early.

Second, Germany only needs the approval of the 17 eurozone states -- rather than the 27 members of the full European Union -- to forward its plan with credibility. That the United Kingdom has already opted out is inconvenient for those seeking a pan-European process, but it does not derail the German effort.

Third, the process of approving a treaty such as this will take significant time, and some aspects of the reform process can be pushed back. European leaders are expected to sign the new treaty in March, and the rest of the year and some of 2013 will be used to seek ratification by individual countries. Amending national constitutions to satisfy Germany will be the bitterest part of the process, but much of that can be put off until 2013, and judgment by European institutions over how the revision process was handled comes still later. Such delays allow political leaders the option of pushing back the most politically risky portions of the process for months or years.

Fourth, the Germans are willing to apply significant pressure. Nearly all EU states count Germany as the largest destination for their exports, and such exports are critical for local employment. In 2011, Germany used its superior economic and financial position as leverage to

help ease the elected leaderships of Greece and Italy out of office, replacing them with unelected former EU bureaucrats who are now working to implement aspects of the German program. Similar pressures could be brought to bear against additional states in 2012.

Those most likely to clash with Germany are Ireland, Finland, the Netherlands and Spain. Ireland wants the terms of its bailout program to be softened and is threatening a national referendum that could derail the ratification process. Finland's laws require parliamentary approval by a two-thirds majority for some aspects of ratification. The normally pro-European government of the Netherlands is a weak coalition that can only rule with the support of other parties, one of which is strongly euroskeptic. Spain must attempt the most painful austerity efforts of any non-bailout state if the reform process is to have credibility -- and it must do so amid record-high unemployment and a shrinking economy. Also, if Greece decides to hold new elections in 2012, European stakeholders will attempt to ensure that the new government in Athens does not end its collaboration with the European Central Bank (ECB), European Commission and International Monetary Fund. None of these issues will force an automatic confrontation, but all will have to be managed to ensure successful ratification, and the Germans have demonstrated that they have many tools with which to compel other governments.

Fifth, the Europeans are scared, which makes them willing to do things they would not normally do -- such as implementing austerity and ratifying treaties they dislike. Agreeing to sacrifice sovereignty in principle to maintain the European economic system in practice will seem a reasonable trade. The real political crisis will not come until the sacrifice of sovereignty moves from the realm of theory to application, but that will not occur in 2012. In many ways, the political pliability of European governments now is all about staving off unbearable economic catastrophe for another day.

The economic deferment of that pain is the sixth German advantage. Here, the primary player is the ECB. The financial crisis has two aspects: Over-indebted European governments are lurching toward defaults that would collapse the European system, and European banks (the largest purchasers of European government debt) are broadly insolvent -- their collapse would similarly break apart the European system. In December, the ECB indicated that it was willing to put up 20 billion euros (\$28 billion) a week for sovereign bond purchases on secondary markets to support struggling eurozone governments, while extending low-interest, long-term liquidity loans to European banks in unlimited volumes. The bond program is large enough to potentially purchase three-fourths of all expected eurozone government debt issuances for 2012, while the first day of the loan program extended 490 billion euros in fresh credit to ailing banks.

Together these two measures make a eurozone financial meltdown highly unlikely in 2012, but they will greatly degrade European competitiveness and efficiency. That will be a problem for another time, though. For now, ECB actions are buying economic and political breathing room: economic in that austerity efforts can be somewhat softer than they would otherwise need to be, and political in that there is a feeling that Germany is willing to compromise somewhat on the issues of budgetary discipline today in order to achieve its broader goals of budgetary control tomorrow. Therefore, while the financial support is not exactly buying good will from other European states, it is certainly buying time.

As the ratification process proceeds, European hostility toward Germany and Brussels will increase. Internationally, the key theme will be states attempting to protect themselves from what they see as a growing -- and unwelcome -- German intrusion into their internal affairs. At the national level, the deepening recession will translate into general anger toward the government's announced austerity measures. The relative dearth of elections will deny that anger its normal release valve of centrist opposition parties, emboldening nationalist and extremist movements and leading to social unrest.

Political and financial turbulence will persist within this framework as Germany negotiates the new treaty with other eurozone countries. Though the core of these negotiations is a highly contentious abdication of national fiscal sovereignty, Europe is highly likely to adopt the new treaty since a perceived failure would dramatically accelerate the collapse of EU political structures and implementation will not happen in 2012.

Former Soviet Union

Russia's Challenges

In 2012, the Kremlin will face numerous challenges: social unrest, restructuring Russia's political makeup (both inside and outside of the Kremlin) and major economic shifts due to the crisis in Europe. The social unrest seen at the end of 2011 will continue festering throughout the presidential elections in 2012. Kremlin chief Vladimir Putin will have to reshape the political landscape from one dominated by his party to one that accounts for the increasing support for the nationalists and a new class of young, liberal activists. Simultaneously, Putin will restructure his inner circle of Kremlin loyalists, who have allowed infighting to divert their attention from their roles in tackling Russia's social unrest and financial problems. None of this will significantly diminish Putin's authority. The Kremlin will also have to adjust its economy in 2012 to accommodate changes in previous plans involving billions of dollars in investments from Europe in some of Russia's most strategic sectors. The crisis in Europe means any such investments will be significantly reduced, so the Kremlin will have to restructure the economic plans for its modernization and privatization programs and fund many of the projects itself. Putin will be able to navigate through these obstacles, though they will take up much of the Kremlin's attention. None of these factors will fundamentally change Russia's direction either domestically or in its foreign policy.

Russian Resurgence

Russia will continue building its influence in its former Soviet periphery in 2012, particularly by institutionalizing its relationships with many former Soviet states. Russia will build upon its Customs Union with Belarus and Kazakhstan as it evolves into the Common Economic Space (CES). This larger institution will allow the scope of Russia's influence over Minsk and Astana, as well as new member countries such as Kyrgyzstan and possibly Tajikistan, to expand from the economic sphere into politics and security as Moscow lays the groundwork for the eventual formation of the Eurasian Union, which it is hoping to start around 2015.

As Ukraine's chances to grow closer to the European Union decrease, Kiev will realize that Moscow is the only outside power it can turn to. Russia will be able to take advantage of Ukraine's inability to maneuver and will gain access to strategic Ukrainian assets, possibly including minority control in its natural gas transit system. However, Ukraine will continue to resist the institutionalization of Russia's influence via the CES by maintaining a degree of cooperation with the West.

In the Baltic countries -- which, unlike other former Soviet states, are committed members of NATO and the European Union -- Russia's ultimate goal is to neutralize the countries' pro-Western and anti-Russian policies, a goal it will make progress toward in Latvia in 2012. It will face setbacks in Lithuania, but Lithuania will not be able to seriously challenge Russia's maneuvers in the region because of ongoing difficulties for its primary supporters: NATO and the European Union.

Russia and the West

Russia will continue managing various crises with the West -- mainly the United States and NATO -- while shaping its relationships in Europe. Moscow and Washington will continue their standoff over ballistic missile defense and U.S. support for Central Europe, and Moscow will react to the ongoing row by increasing security pressure on Central Europe and bolstering its economic presence in the region. Russia will use these crises as an opportunity to deepen divisions among the Europeans, between the Europeans and the United States, and within NATO while promoting the perception that Russia is being forced to act aggressively. The security situation will become tenser, and Russia will attempt to push these crises with the United States to the brink without actually rupturing relations -- a difficult balance.

Russia will also use the financial and political crises in Europe to bolster its influence in strategic countries and sectors. Moscow and Berlin will continue their close relationship, especially in economic matters and security, but Russia will focus more on Central Europe in areas of security and energy and in picking up assets. There is no real counter to Russia in Europe, as the Europeans will be absorbed with domestic and EU issues. But this does not mean Russia has a free pass, as it must still manage the domestic effects of its neighbors' crisis.

Central Asia

Numerous factors will undermine Central Asia's stability in 2012, but they will not lead to a major breaking point in the region this year. Protests over deteriorating economic conditions will occur throughout the region, particularly in Kazakhstan, though these will be contained to the region and will not result in overly disruptive violence. Serious issues in Kazakhstan's banking sector could lead to a financial crisis, though the government will be able to manage the difficulties and contain it during 2012 by using the oil revenues it has saved up.

The more pressing problem is the rising Islamist militancy in the region. Sporadic attacks will continue in Kazakhstan, and Kyrgyzstan, Tajikistan and Uzbekistan could see an increase in attacks. However, these attacks will not achieve their strategic goal of overthrowing regimes or coalesce into a transnational movement capable of destabilizing the region. In addition to these

security tensions, looming successions for the longtime leaders in Kazakhstan and Uzbekistan will create political tensions, but barring the death of either leader, no major political upheavals are expected.

Middle East

Iran and the Saudi Dilemma

Iran's efforts to expand its influence will be the primary issue for the Middle East in 2012. The U.S. military withdrawal from Iraq has rendered Iran the pre-eminent military power in the Persian Gulf, but Tehran cannot count on the United States being as constrained beyond this year, and Turkey, Iran's natural regional counterweight, is rising steadily, albeit slowly. Iran's efforts to consolidate and extend its regional influence must therefore accelerate this year before its window of opportunity closes. Iran will still be operating under heavy constraints, however, and will therefore be unable to fundamentally alter the politics of the region in its favor.

Iran's regional expansion will be felt most deeply by Saudi Arabia. The Saudi royals now doubt that the United States has the ability or the willingness to fully guarantee Riyadh's interests. Adding to Saudi Arabia's vulnerabilities, the Gulf Cooperation Council states fear that if Iran is not contained within Iraq, it will exploit continued Shiite unrest in Bahrain and in Saudi Arabia's Shia-concentrated, oil-rich Eastern Province. In 2012, Saudi Arabia will lead efforts to shore up and consolidate the defenses of Gulf Cooperation Council members to try to ward off the threat posed by Iran, but such efforts will not be a sufficient replacement for the United States and the role it plays as a security guarantor. A critical part of Iran's regional agenda for the year will be to force Riyadh into an accommodation that benefits Iran and allows Saudi Arabia some reprieve. This could lead to temporary truces between the two adversaries, but given Iran's constraints and limited timetable, Saudi Arabia is more likely to stay committed to the U.S. security framework in the region -- for lack of better options.

Turmoil in Iraq and Syria

The effects of Iran's expansion efforts will be most visible in Iraq and Syria. In Iraq, Iran's main challenge is to consolidate Shiite power among several competing groups. As Iraq's fractured Shiite leadership tries to solidify its influence with Iranian support, Iraq's Sunni and Kurdish factions increasingly will be put on the defensive. This ethno-sectarian struggle and the security vacuum created by the U.S. withdrawal will degrade Iraq's overall security conditions. Meanwhile, Turkey will attempt to contain the spread of Iranian influence in northern Iraq by building up political, economic, military and intelligence assets.

In Syria, the ultimate goal of Saudi Arabia, Turkey and the United States will be to disrupt Iran's Shiite arc of influence by trying to crack Syrian President Bashar al Assad's regime. However, without direct foreign military intervention, the Syrian regime is unlikely to collapse. Al Assad will continue to struggle in trying to stamp out domestic unrest. The regime's limited options to deal with the crisis will force Syria to further rely on Iran for support, which will allow Tehran to reinforce its presence in the Mediterranean.

Stratfor cannot rule out the remote possibility that the al Assad clan will be coerced into a political exit. Such an outcome would risk inciting a sectarian struggle within the regime. Iran's goal is for Syria to maintain a regime -- regardless of who leads it -- that will remain favorable to Iranian interests, but Iran's ability to influence the situation is limited, and finding a replacement to hold the regime together will be difficult. It should be noted that the battle for Syria cannot take place without spilling over into Lebanon. In that regard, Lebanon faces a difficult year as proxy battles intensify between Iran and Saudi Arabia in the Levant.

Turkey's Struggles

Overwhelmed by instability in its periphery, Turkey will continue to face significant challenges to its regional ascendancy. Despite its rhetoric, Turkey will not undertake significant overt military action in Syria unless the United States leads the intervention -- a scenario Stratfor regards as improbable -- though it will continue efforts to mold an opposition in Syria and counterbalance Iranian influence in Iraq. Ankara will thus work to maintain a decent bilateral relationship with Tehran despite growing tensions between the two. Economic conditions in Europe will slow Turkey's economic growth, Kurdish militancy in Turkey will remain a significant threat, and concerns over Turkish Prime Minister Recep Tayyip Erdogan's health could turn the government's focus inward as it tries to work through a contentious set of proposed constitutional changes. On the foreign policy front, Turkey will try to influence the rise of political Islamists, particularly in Egypt and Syria, but Ankara's own constraints will prevent it from taking meaningful steps in that regard.

Egypt's Political Transition

Egypt's turbulent political transition likely will give rise to a parliament with a significant Islamist presence, thereby complicating the ruling military elite's hold on power. However, the democratic transition will be a partial one at best; the country's fractious opposition and impotent parliament will continue to suffer from internal divisions and will be unable to overrule the military on issues of national strategic importance. Thus, the military will remain the de facto authority of the state.

Concerns over the country's struggling economy will outweigh the military's concerns over its political opposition. Egypt's preoccupation with its economic and political issues will undermine its ability to patrol its Sinai buffer, leading to increased tensions with Israel. However, both sides will continue to maintain the peace treaty that has been the foundation of Israeli-Egyptian relations for the past generation.

The Hamas Agenda

Hamas will take advantage of the slowly growing political clout of Islamists throughout the region in hopes of presenting itself to neighboring Arab governments and the West as a pragmatic and reconcilable political alternative to Fatah. These moves will help protect Hamas from the potential regime crisis in Syria (where its politburo is based) and bolster its relationships with Egypt, Jordan and Saudi Arabia. At the same time, Hamas will be on alert for

tactical opportunities to undermine security in the Sinai Peninsula with the hope of creating a crisis between Egypt and Israel.

Egypt's preoccupations and Hamas' expanded room to maneuver will incentivize the Jordanian leadership to strengthen its ties with Hamas. It will also allow Jordan to manage its own unrest by building more credibility among Islamists, leverage its relations with Fatah and keep a tab on Hamas' actions as the Jordanian monarchs adjust to changing regional dynamics.

East Asia

Three things will shape events in East Asia: China's response to the economic crisis and possible social turmoil amid a leadership transition; the European Union's debt crisis and economic slowdown sapping demand for East Asia's exports; and regional interaction with the U.S. re-engagement in the Asia-Pacific region.

The 2008 financial crisis exposed the inherent weaknesses of the Chinese economy, which, like its East Asian powerhouse predecessors, largely was based on a growth model driven by exports and government-led investment. While Beijing had been aware for some time of the need to shift toward a more balanced economic model, the continued slump in Europe and fears of another global slowdown have forced the government to face the challenges of economic restructuring now, rather than constantly staving them off. Even in the best of times, the redirection of an economy the size of China's would be difficult, but the pressure for change comes amid a leadership transition, when Beijing is particularly sensitive to any disruptions. With the politburo lineup changing in October and the new state leaders taking office in early 2013, the Communist Party of China (CPC) is focused on maintaining social stability to preserve the legacy of the outgoing leadership and solidify the legitimacy of the incoming leadership.

A rapid drop in economic growth poses a serious threat to China in 2012; a modest slowdown is widely expected this year due to the weakening export sector, a slump in the real estate market, and investment and risks to the banking system. Beijing is betting the decline will remain at a manageable level -- at least for a year of transition. The sharp drop in demand from Europe will harm the export sector in particular, with growth likely reduced to single digits. This declining external demand will threaten the already weakened export-oriented manufacturing industry, which has experienced rising costs in labor, raw materials and utilities as well as appreciating currency on top of its already thin-to-nonexistent profit margins. China will seek to compensate in part by refocusing on exports to the United States and expanding in emerging markets in Southeast Asia, Latin America or Africa, though this will not fully make up for the drop-off from Europe. Moreover, growing trade protectionism because of the economic downturn and political considerations -- especially the upcoming U.S. election season -- will likely put Chinese manufacturers at the center of trade frictions, making their position even more vulnerable. Beijing will employ traditional tools including targeted credit, tax reductions and direct subsidies to mitigate the risks of rising unemployment and bankruptcy in the financially strained manufacturing sector.

While Beijing knows that rolling out another massive fiscal stimulus and bank loans as it did in 2008-2009 is unsustainable and would put the economy at risk, it sees few other short-term

options and thus will use government-led investment to sustain growth in 2012. Beijing will resume and launch a number of large infrastructure projects even at the expense of overcapacity and lack of productivity. However, accounting for around 10 percent of gross domestic product and a quarter of fixed investment, the decline in the real estate sector due to Beijing's tightening measures since 2010 represents one of the largest threats to Beijing's effort to stabilize growth. With affordable housing projects -- Beijing's plan to offset the negative consequences from falling real estate prices and weakening investment -- unlikely to reach their designated goal, Beijing may have to selectively relax its real estate tightening policy in 2012 while trying to avoid overcompensating by causing a sharp market rebound or property price inflation. The ruling Communist Party had promised it would bring these issues under control; its failure to do so could undermine the Party's credibility.

The continued high-level credit boom combined with the need to work out nonperforming loans (NPL) from the 2008-2009 stimulus will bring China into heightened NPL risk. The actual NPL ratio may rise as high as 8-12 percent in the next few years. At least 4.6 trillion yuan (\$729 billion) out of a government-estimated local debt of 10.7 trillion yuan is set to mature within two years, and Beijing expects 2.5 trillion to 3 trillion yuan of the total risk to turn sour. The NPL risk, the 2.1 trillion-yuan debt from investment in the railway system and the massive informal lending from the shadow banking system that grew significantly during Beijing's credit tightening pose a systemic risk to the banking sector. Beijing may have to take some pre-emptive actions, such as refinancing measures or capital injections, in 2012 to ensure Chinese banks are able to maintain confidence in China's financial system. China's leaders, faced with near-term stabilizing options and long-term deep reforms, will choose the former, postponing the crisis but amplifying it when it becomes unavoidable in the future.

Given the economic uncertainty and political sensitivity surrounding the leadership transition, political elites in Beijing will attempt consensus at the highest levels. As it learned from the Tiananmen Square incident, CPC factional infighting exploited at a sensitive time is a serious risk, and we expect to see measures to ensure ideological and cultural control throughout the Party and down through the rest of society. Meanwhile, the priority to ensure a smooth transition means Beijing will be much less tolerant of actions that could spread instability, though Beijing is also cultivating pre-emptive methods for social control, such as community-level management or providing carefully controlled outlets for expressing grievances to better manage the country's social frustration, which will likely be exacerbated by the deteriorating economic situation.

Internationally, China will continue to accelerate its resource acquisition and outward investment strategy. As domestic problems mount, China may use external disputes to ease public dissatisfaction. Anticipating U.S. economic and trade pressure due to the electoral season and strategic encroachment in China's periphery, Beijing will focus its attention on reducing miscalculation and stressing interdependence in its relations with Washington while clarifying its response to the U.S. engagement. Meanwhile, China will balance nationalistic initiatives with maintaining neighborly relations -- particularly with the South China Sea claimant countries, India and Japan -- and countering perceived moves by the United States to constrain China's economic influence in the region and lines of supply. The South China Sea claimant countries, including Malaysia, the Philippines and Vietnam, will respond by accelerating their military purchases, taking advantage of the U.S. re-engagement efforts to hedge against China.

Most Asian countries -- which showed a strong economic recovery throughout 2010 and early 2011 -- will experience reduced growth amid the global economic slowdown. As the most important economic partner to many countries, China will increase its economic assistance and trade to Association of Southeast Asian Nations countries to leverage its influence. Beijing hopes to again project economic power in the region through aid, the import of consumer goods, currency swaps and regional trade agreements, but Beijing's role may also face challenges by renewed interest from other nations -- for example, the United States and Japan.

The death of North Korean leader Kim Jong Il has increased uncertainty on the Korean Peninsula. The first six months of the year will be critical as the unity of the regime is tested amid the leadership transfer. The leadership structure between civilian and military elements was established in recent years to strengthen the role of the Workers' Party of Korea as one of the pillars of power and to rebalance the military's role, but the process was not yet complete at the time of Kim's death. North Korean leaders are unlikely to fundamentally change the direction of Pyongyang's foreign policy in the near term. Their attention initially will be focused internally, and they will seek to avoid any sudden shift in policy that could destabilize the regime or significantly increase foreign pressure. China will look to make a push to ensure even greater influence on the Korean Peninsula during the transition period. In addition, bilateral discussions with the United States on resuming the six-party nuclear talks were showing progress before Kim's death, and Pyongyang is likely to restart these discussions sometime during the year.

South Asia

The U.S.-led campaign in Afghanistan will not maintain sufficient force levels long enough to militarily defeat the Taliban -- and their various factions -- or pacify the country. But the Taliban will not be in a position to drive the United States and its allies from the country by force. Force structure choices must be made in 2012 to define the war effort through 2014, but the United States and its allies will continue to combat the Taliban in 2012 even as Afghan forces increasingly bear the brunt of the war effort. The United States will continue to consider a political accommodation with the Taliban, but such accommodation is unlikely to be reached this year.

The most important development in South Asia is Pakistan's ongoing political evolution. While other states, including Iran, are interested in shaping the future political landscape of Afghanistan, Pakistan continues to be at the heart of the Afghan war. As such, U.S.-Pakistani tensions will intensify in 2012 as the United States reaches an understanding with Pakistan, which will have to deal with the situation in the region after the United States leaves. Political, religious, ethnic and ideological tensions will intensify inside the country, and these will affect Pakistan, Afghanistan and U.S.-Pakistani relations moving forward.

Latin America

Mexico

Through the first half of 2012, Mexico will be enmeshed in campaigning for its July 1 presidential election. The country faces the possible end of what will be 12 years of rule by the

National Action Party (PAN). Faced with public condemnation of rising violence, the PAN has lost a great deal of credibility over the past five years, something likely to benefit the Institutional Revolutionary Party and the newly unified Revolutionary Democratic Party. We expect no major legislative action under the administration of outgoing President Felipe Calderon as the three main parties compete for public approval. The new president takes office Dec. 1, meaning most of the new administration's major policy moves will not occur until 2013.

Regardless of any change in party, Mexico's underlying challenges will remain. The country's drug war rages on, with Los Zetas having consolidated control over most of Mexico's eastern coastal transportation corridor and the Sinaloa cartel having done the same in the west. Both cartels have a significant, growing presence in Central America and relations with South American organized crime. We expect the cartels to intensify their efforts to extend control over regional supply chains in 2012, although the Mexican cartels will remain dependent on relationships with local organized crime in other transit and producing countries. Despite significant territorial control in Mexico by Sinaloa and Los Zetas, numerous smaller criminal entities are still struggling for access to key transport hubs such as Acapulco. Meanwhile, the two main cartels will continue to attack each other in critical transit cities such as Veracruz and Guadalajara.

Continued inter-cartel competition among Mexico's diverse criminal groups will prevent any kind of alliance between Los Zetas and Sinaloa that allows them to abandon violence in favor of more profitable smuggling conditions. Similarly, the government faces severe constraints on its counter-cartel activities. It cannot afford to be seen publicly backing away from attempts to rein in violence. At the same time, any significant uptick in military offensives against the cartels carries the risk of intensifying the violence. The government will therefore attempt to emphasize social and economic policies while maintaining its current, high-tempo counter-cartel strategy.

Brazil

Brazil will spend 2012 focused on mitigating shocks to trade and capital flows from the crisis in Europe. However, with only 10 percent of Brazil's gross domestic product dependent on exports, Brazil is much less vulnerable than many other developing countries. In politics, Brazil will remain focused on trying to strike a balance between growth and inflation during the expected slowdown with judicious fiscal outlays and monetary expansion. Brazil will thus remain primarily focused on domestic issues through 2012. Trade protectionism will play a strong role in efforts to shield vulnerable industries. With global trade slowing, China will look for alternative export markets; these two trends will drive increased bilateral tensions between China and Brazil over the next year. Key Brazilian domestic issues will include ongoing city and border security initiatives; social welfare programs; infrastructure construction; and the development of, and politics surrounding, Brazil's petroleum reserves.

Venezuela

Uncertainty surrounding the health of Venezuelan President Hugo Chavez makes it difficult to forecast the precise direction of Venezuelan politics in 2012. There will certainly be continued speculation about a potential successor from the Chavista elite, and growing dissatisfaction with

the status quo among Chavez's base will be a prominent political force. Meanwhile, the political opposition parties -- which at this point appear prepared to unite behind a single candidate to be selected in February -- will make their most credible play for power in a decade. Under these conditions, the 2012 election will serve as a disruptor of Venezuelan politics. While the exact details of the outcome are unpredictable, 2012 will likely see some sort of power transition away from Chavez.

Regardless of who holds power at the end of the year, 2012 will continue to be characterized by growing domestic economic uncertainty, periodic infrastructure failure and poor distribution of basic goods. Dissatisfaction with these and other socio-economic issues will drive further protests, but the majority of political action will be centered on the election.

Cuba

Cuba's slow and cautious transitional measures can be expected to continue in 2012. Key reforms such as making credit and private property available to individuals are under way, and similar reforms, including attempts to loosen travel restrictions, can be expected in the next year. Cuba's ultimate international challenge is to balance the liberalization demands of the United States with its need for subsidized Venezuelan oil. A sudden disruption of these shipments is unlikely, but a political shift in Venezuela could force Cuba to reach out to the United States as a much more powerful -- but also more politically invasive -- economic partner.

Sub-Saharan Africa

Somalia

In 2012, a containment strategy will solidify against Somali jihadists -- both the transnationalist group al Shabaab and its nationalist rival, the Somali Islamic Emirate. This strategy will have three elements. The first will feature African Mission in Somalia (AMISOM) forces consolidating their presence in Mogadishu. These forces include peacekeepers from Uganda, Burundi and Djibouti, and additional forces from Sierra Leone will be deployed soon.

In the second part of the strategy, Kenyan troops will strengthen the cordon along the Kenyan border with southern Somalia. The 4,000 Kenyan troops there, nominally part of AMISOM, will hold territory and interdict Somali jihadists moving about the area. Lastly, Ethiopian forces will fortify a cordon along Ethiopia's border with central Somalia, also attempting to hold the territory and interdict jihadists.

To deny the Somali militias propaganda material, AMISOM, the Kenyans and the Ethiopians will not push deep into Somali territory to engage the jihadists. Instead, local militias employing guerrilla tactics will fight the jihadists within the containment zone. The combined efforts will successfully disrupt the jihadists' lines of supply, but they will not bring about their defeat. The United States will continue covert action in the Somali theater. U.S. special operations forces and unmanned aerial vehicles will collect and share intelligence with the Somali government and its allies. Additionally, U.S. forces in East Africa and the Horn of Africa will remain poised to strike high-value Somali jihadists or senior al Qaeda targets, should the opportunity arise.

Nigeria

Nigeria will see sustained militant violence in its northern region. Aggrieved political elites in the north, believing the government of President Goodluck Jonathan stole political power from them, will seek to use the Boko Haram militant group to their advantage. As part of their campaign to regain political power in 2015 national elections, these northern politicians will provide Boko Haram with arms and funding while protecting it politically.

This will enable the group to carry out frequent attacks on Nigerian government and civilian targets in its core area of operations in the country's northeast and northwest. Boko Haram will also conduct operations in the Nigerian capital of Abuja, but these will be rare. Boko Haram's statements will be jihadist and fierce, but the nature of its support will prevent it from carrying out attacks that would trigger an international response and result in a loss of leverage for northern Nigeria's political elite, such as transnational operations or attacks against foreign political or commercial facilities in Nigeria.

The Niger Delta in the south will also see a slow but steady return to militant violence. Though the Jonathan administration has stated that it will serve only from 2011 to 2015, divisions will start to emerge within the Jonathan camp over whether a single term is sufficient. Like their peers in northern Nigeria, political elites in the Niger Delta region, including Jonathan, will start reactivating alliances with regional militant groups such as the Movement for the Emancipation of the Niger Delta (MEND).

Attacks by MEND or other Niger Delta militants in 2012 will be infrequent and ultimately will not threaten oil production. However, they will form the basis for a counter-campaign by the Niger Delta political elite to demand political patronage while the region's elite decides whether to run for the ruling party's nomination for the presidency in the next elections.

Sudan

Domestic opposition in Sudan and South Sudan will prevent both governments from signing a legally binding oil revenue-sharing accord. Instead, they will accept the continuation of ad hoc agreements regarding the distribution of oil revenues. Additionally, U.N. peacekeepers will maintain their deployments in South Sudan and Darfur to respond to border clashes between militias on both sides of the Sudan-South Sudan border. It will take much of the year, but Khartoum and Juba will settle into an informal understanding over border demarcation.

South Africa

South Africa will remain focused on internal rivalries that will inhibit its ability to consolidate its influence in the southern African region. The ruling African National Congress (ANC) will contend with internal rivalries as it moves toward a leadership convention and election in December 2012. South African President Jacob Zuma will be working to secure a second term as ANC president, a post that would effectively make him the party's candidate for South African president in 2014 elections. Simultaneously, the Zuma camp will work to ensure that no rival faction in the ANC gains enough momentum to challenge Zuma.

