THE WALL STREET JOURNAL.
EUROPE
DOW JONES Newswires
DOW JONES A NEWS CORPORATION COMPANY
VOL. XXVI NO. 148
FRIDAY - SUNDAY, AUGUST 29 - 31, 2008

For information or to subscribe, visit www.services.wsje.com or call +32-2-741-1414 — Albania Lk 370.00 - Austria €3 - Belgium €2.90 - Croatia HRK 20 - Czech Republic Kc 110 - Denmark Dkr 22 - Finland €3.20 - France €2.90
Germany €3 - Greece €2.90 - Hungary Ft 530 - Ireland (Rep.) €2.90 - Italy €2.90 - Lebanon L£ 4000 - Luxembourg €2.90 - Morocco Dh 24 - Netherlands €2.90 - Norway Nkr 27 - Poland Zl 10.50 - Portugal €3 - Slovakia Sk 100/€3.32 - Spain €2.90
Sweden kr 27 - Switzerland SF 4.80 - Syria S£ 150 - Turkey YTL 4.25 - U.S. Military (Eur) $2 - United Kingdom £1.40

Taking on the granite peaks of the High Tatras

WEEKEND JOURNAL | PAGES W6-W7

Aston Martin touts new car's price tag: $1.8 million

CORPORATE NEWS | PAGE 4

What's News—

Business & Finance

Berlusconi rekindled Air France-KLM's interest in Alitalia as part of a new plan to revive the Italian state-controlled carrier under which the potentially profitable parts of its operations would be merged with Italian airline Air One. Page 28

■ **China and Iraq** reached an oilfield development deal, the first major foreign contract struck with the Iraqi government since the 2003 U.S.-led invasion. Page 1

■ **Energy supplies** are better ahead of Tropical Storm Gustav than during 2005's Katrina. Oil prices settled at $115.59, down $2.56. Pages 15, 16

■ **Spanish home sales** fell 29.6% in June as mortgage approvals skidded, signaling pressure on the home-building industry. Page 2

■ **The U.K. economy** may be slowing more quickly than thought, as the sluggish pace of retail-sales growth shows. Page 8

■ **Euro-zone growth slowed** in August, adding to evidence of a possible recession. The EuroCOIN indicator fell to its lowest since mid-2003. Page 8

■ **The U.S. revised GDP** in the second quarter to a 3.3% annual rate, above the 1.9% gain originally reported. Page 8

■ **U.S. stocks gained** on the strong GDP reading and a turnaround in energy prices. Shares in Europe rebounded. Page 16

■ **Boeing delivered** another contract offer to its largest union as it tries to avoid a strike. The union votes Wednesday. Page 3

■ **Crédit Agricole and Natixis** posted weak second-quarter results, hit by big write-downs related to the credit crisis. Page 15

■ **Diageo eked out** a 2% increase in full-year earnings and said growth of alcoholic-drink sales could be slower. Page 5

■ **Bertelsmann might reduce** its stake in broadcaster RTL to raise capital for future acquisitions in television. Page 5

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11715.18	+212.67	+1.85
Nasdaq	2411.64	+29.18	+1.22
DJ Stoxx 600	287.21	+3.96	+1.40
FTSE 100	5601.2	+73.1	+1.32
DAX	6420.54	+99.51	+1.57
CAC 40	4461.49	+88.41	+2.02
Euro	$1.4723	+0.0016	+0.11
Nymex crude	$115.59	-2.56	-2.17

Money & Investing > Page 15

World-Wide

The U.S. has put "under review" bilateral talks with Russia focused on missile defense and nuclear disarmament as part of a broader re-evaluation, escalating its response to Moscow's actions in Georgia. The EU's ex-communist countries want an EU summit to show Russia it will pay a price for actions in Georgia. Page 1

■ **Obama prepared** to accept the Democratic nomination as the first African-American presidential choice of a major U.S. party. Bill Clinton gave his full endorsement. Pages 9, 12, 13

■ **A suicide bomber attacked** a police van in northwest Pakistan, killing at least 11 people. Lawyers mounted protests over the government's reluctance to reinstate fired judges. Page 27

■ **A Swiss judge** who investigated Pakistani presidential candidate Zardari for alleged money laundering said he is disappointed the case was dropped.

■ **U.S. forces arrested** a top Shiite official in Iraq's government suspected of involvement in a June bombing that killed four Americans and six Iraqis.

■ **U.S.-led coalition** and Afghan forces killed over 100 militants in a four-day battle in southern Afghanistan, the coalition said.

■ **India's prime minister** unveiled a relief package for about two million people left homeless by floods in Bihar state. Page 27

■ **Three British men** questioned about an online threat to assassinate Prime Minister Gordon Brown have been charged with terror offenses, police said.

■ **Southeast Asian nations** reached free-trade deals with India, Australia and New Zealand and aimed to seal an investment pact with China. Page 20

■ **Antigovernment protesters** continued to occupy the Thai prime minister's compound Thursday night, defying a court order.

■ **Hindu mobs ransacked** a church and clashed with Christian villagers, hundreds of whom have fled their homes, in Orissa state in eastern India.

■ **A U.N. refugee-agency official** kidnapped in Somalia in June was freed by his abductors.

EDITORIAL & OPINION

Plus ça change

Surprise, surprise: North Korea is still not coming clean about its nuclear program. Page 10

U.S. considers scrapping nuclear talks with Russia

Invasion of Georgia leads Bush to review policies on Moscow

BY JAY SOLOMON AND GREGORY L. WHITE

WASHINGTON—The Bush administration, escalating its response to Russia's actions in Georgia, has placed "under review" bilateral talks focused on missile defense and nuclear weapons disarmament that were tentatively scheduled for mid-September.

The discussions, involving senior State Department and Pentagon officials and their Russian counterparts, are part of a broader strategic dialogue that Washington and Moscow have pursued under President George W. Bush, aimed at forging closer cooperation. But as a result of the Georgia conflict, Mr. Bush has called for a review of all U.S. engagement with Russia, U.S. officials said.

AFP

South Ossetian women **receive humanitarian aid** in Georgia.

The White House said Thursday that it was considering pulling its support for a nuclear-cooperation agreement with Russia, which would have opened America's nuclear industry to Russian companies. And Bush administration officials said they are also considering joining Europe in enacting economic sanctions against

Please turn to back page

EU is divided over best actions to punish Russia

The former communist countries of the European Union want next week's EU summit to show Russia it will pay a price for its military intervention in Georgia, but the organization is struggling to find meaningful sanctions it can agree on.

In a test of unity for the 27-nation union, EU leaders meeting Monday in Brussels are expected to repeat criticisms of the intervention and to reject Moscow's decision to recognize the independence claims of Georgia's two separatist territories, South Ossetia and Abkhazia.

By **Marcus Walker** *in Berlin,* **Alessandra Galloni** *in Paris and* **Guy Chazan** *in London*

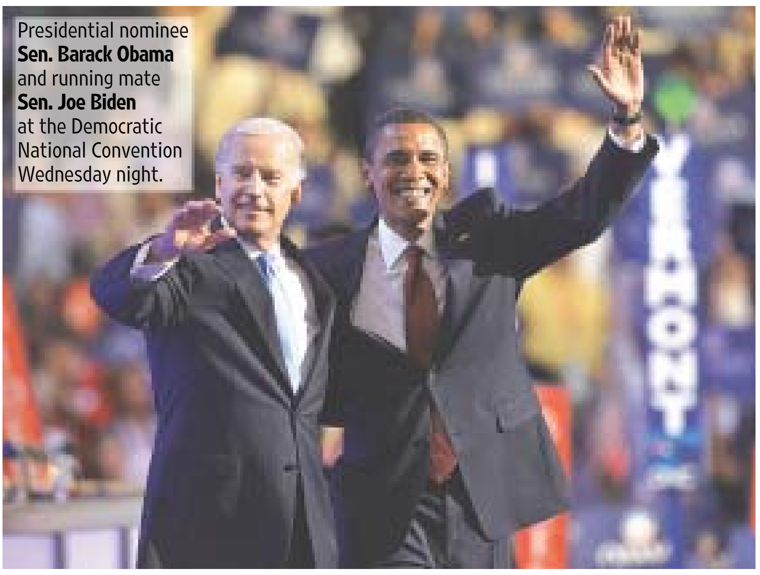
They could also postpone negotiations with Russia on a new partnership agreement with the EU, diplomats say, though little more concrete action is likely to emerge. That is mainly because Western European countries fear that breaking off economic or political ties with Russia could hurt them more than Moscow. "We don't want to give [Russia] the stick with which to beat us," one French diplomat said.

Poland, Estonia, Latvia and other former communist-bloc members say they are looking for a tougher approach in the wake of Russia's Aug. 8 invasion and continued occupation of Georgian territory. Russia says it intervened to protect its citizens in South Ossetia from a Georgian attack.

Among proposals that some Eastern European countries want to discuss: making it harder for Russian officials and businesspeople to get

Please turn to back page

Tail winds and turbulence for U.S. democrats



Presidential nominee **Sen. Barack Obama** and running mate **Sen. Joe Biden** at the Democratic National Convention Wednesday night.

Associated Press

■ Obama accepts the Democratic nod 9

■ Bill Clinton offers full-throated support 12

■ Go to WSJ.com for more coverage of the convention.

China reaches $3 billion deal to develop oil field in Iraq

BY GINA CHON

BAGHDAD—China clinched a deal to develop an oil field in southeastern Iraq, marking the first major foreign oil contract struck with the Iraqi government since the 2003 U.S.-led invasion.

The agreement, which revives a deal struck between Beijing and the Saddam Hussein regime, calls for an investment of about $3 billion. But the development agreement is a limited, technical-services contract, far less lucrative that the accord originally envisioned in a 1997 deal between Baghdad and **China National Petroleum** Co.

Legislation that would govern bigger foreign deals is bogged down in the Iraqi Parliament. And separate negotiations between Baghdad and a handful of Western companies for other, technical pacts have faltered. That makes the Chinese deal the most significant foreign-investment commitment in Iraq's vast but creaking oil industry in years.

The contract is to develop the al-Ahdab oil field in Wasit province. It extends for 20 years after produc-

Please turn to page 27

Toyota lowers sales target

Emerging markets fail to pick up slack of a sputtering U.S.

BY JOHN MURPHY

TOKYO—**Toyota Motor** Corp. delayed its plans to become the world's first auto maker to sell more than 10 million vehicles annually, the latest sign that global auto makers are bracing for a long slowdown as robust sales to developing markets fail to offset losses in the crumbling U.S. market.

The Japanese auto maker, which is closing in on **General Motors** Corp. as the world's largest auto maker by sales volume, said Thursday that it aims to sell 9.7 million vehicles next year, backpedaling from the target of 10.4 million vehicles it set a year ago.

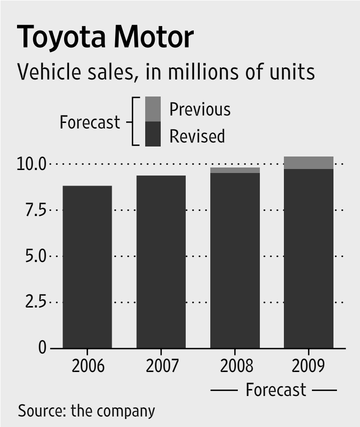
The lower target is a rare setback for Toyota, whose robust sales and profit growth this decade made it appear impervious to the challenges facing other auto makers, particularly the Big Three in Detroit.

It also underscored how the stagnation threatening the auto industry world-wide likely will continue well into next year.

"Things remain nebulous and uncertain," Toyota President Katsuaki Watanabe said.

When Toyota announced the sales target of 10.4 million last August, the company was confident that surging demand for new vehicles in fast-growing markets like China, India and Russia would make up for any softness in the U.S., which was souring amid the subprime crisis.

But the past 12 months have delivered more bad news for the auto industry than anyone imagined, making it difficult for Toyota and other auto makers to use emerging-market sales to offset huge U.S. losses. Sales of big trucks and sport-utility vehicles, once the cornerstone of the U.S. market, have plummeted as gas prices have soared. Prices are up for steel and other materials needed to build cars, eating into profits. Auto makers, including Toyota, are setting aside millions of dollars in leased-vehicle losses as used-car prices plummet.



Source: the company

Toyota last month cut its 2008 global sales forecast by 350,000 units to 9.5 million. Last year, it sold 9.37 million vehicles. Toyota says it expects demand in the U.S. to improve but it doesn't know when it might reach its goal of selling more than 10 million vehicles.

Toyota cut its 2009 sales target for North America to 2.7 million vehicles, down from its original target of 3.1 million. Even as sales of its trucks and SUVs have declined this year, Toyota continues to gain market share in the U.S. because of its lineup of smaller, fuel-efficient vehicles and the weakness of its Detroit rivals. Toyota held 16.8% of the U.S. auto market for January to July, up from 16.3% in the same period last year.

Toyota trimmed its 2009 Europe sales plan to 1.3 million units from 1.45 million. For Asia, the target dropped to 1.75 million from 1.9 million. In the Middle East, South America and other markets, sales projections increased to 1.7 million from 1.55 million.

Mr. Watanabe said that after years of rapid growth, Toyota would use this slower period to restructure its operations: making its production system in the U.S. more nimble to adjust to changing market demands, pushing deeper into the world's emerging markets and developing more hybrid cars and other fuel-efficient vehicles.

Toyota said that early next year it will unveil the next generation of its best-selling Prius hybrid and a new Lexus hybrid, part of its goal of selling one million hybrids a year in the early 2010s. While the focus of Toyota's future growth remains hybrid vehicles, Mr. Watanabe said that by early next decade, it would start producing an electric car, offering a challenge to the plans by Japanese rivals **Nissan Motor** Co. and **Mitsubishi Motors** Corp. to mass-produce electric vehicles in the next two years.

CORRECTIONS & AMPLIFICATIONS

Finn Kydland is a professor of economics at the University of California, Santa Barbara. An Economy & Politics page article on Monday about Nobel Laureates' support for policies to even out the gains from globalization stated incorrectly that Mr. Kydland is at the University of California, Berkeley.

Spanish home sales, mortgage approvals fall

A WSJ NEWS ROUNDUP

MADRID—Spanish home sales and new mortgage approvals fell sharply again in June, signaling continued pressure on Spain's once-flourishing home-building industry that fed the country's decadelong economic boom.

Home sales fell at an annual rate of 29.6% in June, while the number of new mortgages fell 37.7%, data released Thursday by Spain's National Statistics Institute, or INE, showed. In May, annual home sales plunged 34.3%, and the number of new mortgages fell 36.2%.

Spain had been among the euro zone's hottest real-estate markets, but house prices fell for the first time in a decade between April and June as chronic overbuilding and eight-year-high mortgage rates added to the impact of the U.S. subprime credit crunch.

The housing bust also spells bad news for Spanish banks, especially its system of local savings banks, which generate roughly half of the country's lending and deposit-taking. Moody's Investors Service earlier this month cut its ratings on five large and medium-size Spanish savings banks, noting "the rapid deterioration in asset-quality indicators."

Research firm Keefe, Bruyette & Woods Ltd. has raised concerns about several of Spain's commercial banks that have real estate and construction loans making up nearly a fifth of their portfolios. Foreign banks operating there are also taking a hit. When British banking company **Barclays** PLC reported a 35% drop in first-half net income earlier this month, the results included impairment charges of £103 million, or about $190 million, in its Western European retail and commercial business to help cover losses tied to Spain's property and construction markets. The country's banks have also more than doubled their use of the European Central Bank's liquidity facility since the credit crunch began a year ago.

Still, many analysts believe the banks will ultimately whether the storm. Spain's two largest banks, **Banco Santander** SA and **Banco Bilbao Vizcaya Argentaria** SA, are in a relatively good position, analysts say, thanks largely to buoyant earnings from Latin America and other parts of their global operations. And a May report from Fitch Ratings found that Spanish banks have been developing new strategies to capture retail deposits and called their wholesale funds "generally well-diversified."

The fall in housing investment is hampering economic growth in Spain, the fourth-largest economy in the euro zone, with gross domestic product rising 0.1% in the second quarter, compared with the first three months of the year. The government forecasts GDP growth this year of 1.6%, well below the 3.7% growth rate posted in 2007.

Strong economic growth in Spain over the past decade had been supported by surging property and construction markets, though many analysts now expect the country to go into recession in the second half as housing demand collapses.

"It appears unlikely that such a large adjustment in the housing sector combined with rapidly rising unemployment and weakening euro-zone demand can end in anything other than a Spanish recession," BNP Paribas said in a research note.

Spain has been among the euro zone's hottest real-estate markets.

Wednesday, Lehman Brothers said it expects Spain to enter into recession by the end of 2008.

House prices are expected to follow the worsening sales and mortgage figures, with some analysts predicting a depreciation of up to 30% in average property values over the next few years.

"We're not seeing prices fall as sharply in Spain as in the U.K., but that is because the promoters are in no hurry to sell in the current market. But the fall is inevitable and will be hard," said Juan Rodriguez Rey, an economist for Ibersecurities.

Spanish house prices fell 3.9% in July from a year earlier, marking the fifth month of decline, an industry report showed at the beginning of August.

—Sara S. Muñoz contributed to this article.

INDEX TO BUSINESSES

This index of businesses mentioned in today's issue of The Wall Street Journal Europe is intended to include all significant references to companies. First reference to these companies appear in boldface type in all articles except those on page one and the editorial pages.

Aer Lingus 16
Ahold NV 6
Air Berlin 7
Air France-KLM 3,28
Air One 28
Alcatel-Lucent 16
Alitalia 3,28
Allianz SE 17
Ambac Financial Group .16
American International Group 16
AMP Inc. 19
ArcelorMittal 3
Aston Martin.................4
AT&T 9
Austrian Airlines 3
Avdeevka Coke 19
AXA 17
Bain Capital 18
Banco Bilbao Vizcaya Argentaria 2
Banco Popolare 19
Banco Santander (Spain) 2
Banques Populaires 15
Baosteel Group.............3
Barclays 2,16
Belgacom 7
Bertelsmann 5
Bill Heard Enterprises .5
BNP Paribas 15,16
Boeing 3
BP..................................16
British Airways 3
British Midland Airways 3
Caisses d'Epargne 15
Canaccord Adams........19
Canon Inc. 21
Casino Guichard-Perrachon ...6
Caterpillar 7,16
Cerberus Capital Management 5
China Mobile................21
China National Petroleum 1
Chrysler 5
Coca-Cola Co. 16
Crédit Agricole........15,16
Credit Suisse 15
Diageo 5
easyJet 3
Enakievo Steel.............19
Enel 28
Esprit Holdings............21
Eurasian Natural Resources 7
Exxon Mobil 18
Fannie Mae 16,18
Ferrari 4
Fidelity Investments 9
Ford Motor 5
Freddie Mac 16,18
Gaz de France 7
Gazprom 18
General Motors 2,5,7
Genworth Financial 9
GlaxoSmithKline 4
GMAC 5
GMP Securities............19
Goldman Sachs Group.16
Grupo Mexico 20
Heineken.......................5
Henderson Global Investors 19
Henderson Group.........19
Ryanair Holdings 3
HSBC Holdings 21
Iberia Líneas Aéreas de España 3
Ikon Office Solutions ..21
ING 19
Intesa Sanpaolo......17,28
Invesco.........................18
ITV..................................5
JetBlue Airways 3
Jindal Vijayanagar Steel 3
Kazakhmys 7,16
Kentz Group 19
Kohlberg Kravis Roberts 18
Landor Associates.........4
Lazard 15
Lehman Brothers Holdings 18
L'Oréal...........................6
Lufthansa 3,7
MBIA 16
Merrill Lynch 9,15
MGIC Investment 16
Microsoft 26
Mirabaud Securities ...19
Mitsubishi Motors 2
Mitsui Fudosan 21
MTU Aero Engines 16
Natixis....................15,16
Nintendo 26
Nissan Motor 2
Pagani Automobili 4
Pearl Group..................19
Piaggio 28
Posco 3
Procter & Gamble 6
Reed Elsevier 5
Reliance Industries 21
Ricoh 21
Royal Bank of Scotland Group 16
Royal Dutch Shell 16
RTL Group.....................5
Samsung Electronics 5,21
Sanford C. Bernstein ..18
Siemens 3
SN Airholdings 3
Société Générale 15
Sony 4,5,26
Sony BMG Music Entertainment 5
Suez 7
Suez Environnement 7
Sunkar Resources 19
Swiss Life 16
Swiss Life Holding 17
Thomas Cook Group 7
Tiffany......................7,16
Toyota Motor.................2
TPG 18
Transocean..................16
TUI 7
UniCredit................16,19
Valeant Pharmaceuticals International 4
Vedanta Resources......20
Veolia Environnement...7
Vietnam Technological & Commercial Joint Stock Bank 21
Virgin Express Holdings 3
Volkswagen....................4
Woodside Petroleum...21
Zale 16
Zhaikmunai..................19

FREE daily access to WSJ.com

If you bought today's paper from a retail outlet, simply register at:
wsj.com/reg/coupon
or renew at: **wsj.com**
Today's code is: **EUROPE-C-543**

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium
Telephone: 32 2 741 1211 FAX: Business: 32 2 732 1102
News: 32 2 741 1600 Editorial Page: 32 2 735 7562
SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +32 2 741 1414
International freephone: 00 800 9753 2000
E-mail: subs.wsje@dowjones.com Website: www.services.wsje.com
Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.
Registered as a newspaper at the Post Office.
Trademarks appearing herein are used under license from Dow Jones & Co. © 2008 Dow Jones & Company All rights reserved.
Editeur responsable: Daniel Hertzberg M-17936-2003

INDEX TO PEOPLE

This index lists the names of businesspeople and government regulators who receive significant mention in today's Journal.

For more people in the news, visit CareerJournal.com/WhosNews

Agon, Jean-Paul 6
Bailly, Jean-Paul 7
Bellens, Didier 7
Benson, David 18
Boehm, Christian 3
Chaussade, Jean-Louis .. 7
Cheng, Vincent 21
Chu Woosik 5
Chubachi, Ryoji 4
Chung, C.W. 5
Colaninno, Roberto 28
Cole, David 26
Conti, Fulvio 28
Cronje, André 17
Dallavecchia, Enrico 18
Darda, Michael 8
Drevna, Charlie 16
Ferrero, Dominique 15
Fievet, Emmanuel 17
Formica, Andrew 19
Hamamura, Hirokazu ... 26
Heard, Bill Jr. 5
Hirai, Kazuo 26
Hisey, David 18
Jestaedt, Thomas 28
Joon-yang, Chung 3
Joy, Rachael 8
Kang, Daniel 3
Kim, Henry 5
Kowalski, Michael J. 7
Kydland, Finn 2
Lambert, Jerome 3
Lantz, Carl 16
Lee Chang-hyung 3
Levin, Robert 18
Luke, Tim 18
Mangold, Klaus 28
Mansfield, Luke 4
May, Ben 8
Mishr, Hemant 21
Mittal, Lakshmi 17
Mudd, Daniel 18
Napoli, Robert 18
Niculescu, Peter 18
Novachuck, Oleg 7
Ostrowski, Hartmut 5
Owens, Jim 7
Paddock, Duane 5
Parekh, Ashit 21
Parisot, Laurence 17
Passera, Corrado 17
Pottage, John 17
Rabe, Thomas 5
Reid, Dustin 16
Rishton, John 6
Ruland, Heino 16
Sacconaghi, Toni 18
Shauruk, Denis 19
Shaw, Michael 18
Silvia, John 8
Swad, Stephen 18
Tatsukawa, Katsumoto . 26
Walsh, Paul 5
Watanabe, Katsuaki 2
Williams, James 15
Williams, Mark 5
Williams, Michael J. 18
Yates, Roger 19
Yip, Linus 21

Posco forges a better path to iron

Innovative furnace pollutes less and uses lower-cost materials

By Evan Ramstad

Reuters/Newscom

Posco's steel plant in South Korea, above, bypasses the highly polluting ovens used in traditional fabrication.

POHANG, South Korea—Faced with environmental demands and rising costs, some steel companies are reformulating the centuries-old recipe for making the iron used to fabricate steel.

Companies in Europe, Australia and North America have developed processes that skip a high-polluting step in iron's creation, and they are finding steelmakers in Asia and Africa that are willing to gamble on the innovation. But South Korea's **Posco**, the world's third-largest steelmaker, has moved even further from the traditional iron-making blast furnace.

Historically, steel has been made by refining iron in three steps. First, iron ore and coal are heated into materials—sinter and coke, respectively—that can bind easily. Then, they are thrown together in a hot furnace where they combine to become pig iron. Finally, the pig iron is melted further and mixed with other materials into a liquid form of steel, which is then cast in forms or rolls.

Posco, though, has built a furnace that can prepare cheaper types of coal and iron ore to be converted into pig iron without putting them through the highly polluting ovens used in traditional fabrication. It spent more than $2 billion on research to create the process, called Finex, which it co-developed with the predecessor company of Siemens-VAI, now a unit of **Siemens** AG of Germany.

The Siemens unit previously built the Corex iron-making furnace at plants owned by **ArcelorMittal**'s Saldanha Steel in South Africa, **Jindal Vijayanagar Steel** Ltd. in India and **Baosteel Group** Corp. in China. The Corex process eliminated the need for separate coke and sinter processing, and Baosteel, China's largest steelmaker, is now building its second Corex furnace, which is set to start production in 2010.

Posco and Siemens-VAI had planned to build a small demonstration plant using the Corex process, but they decided to take an additional step. While the Corex process can use cheap fine coal, the Finex process is more cost effective, using both fine coal and fine iron ore.

Pursuing the new approach was "the second biggest risk Posco has taken," says Posco's president, Chung Joon-yang, adding that the biggest was the decision to start the company in the late 1960s, when South Korea was still an agrarian backwater.

Steelmakers have experimented with new processes at the iron-making stage for years, chiefly tinkering with the ratio of ingredients in hopes of reducing the use of coke. Most alternatives never made it to market because they consumed too much energy. "If you manage to make it without spending much more energy than the usual process, then you win everything," says Jerome Lambert, technology and environmental manager in the Beijing office of the International Iron and Steel Institute.

The iron created in the Finex furnace can be used in any type of steel, including the high-grade kind used in cars, executives say. Posco says it uses the same inspection and quality-control processes for Finex pig iron that it uses at other blast furnaces. In both cases, the iron must have the same composition, and it is evaluated at both the iron-making and steel-making stages.

Posco's Finex plant, which began operating in May 2007, performed below production targets and above energy-consumption projections for months, in part because of numerous mechanical problems. "In the beginning we were trying lots of things," Lee Chang-hyung, a Posco engineer, says. "Until September, we couldn't reach our daily [production] target. After that, we got it stabilized."

Posco's plant now produces 1.5 million tons of iron a year, or about 6% of the company's steel-making needs. Its operating cost, which doesn't include fixed expenses, is 90% of the cost at its 10 traditional iron-making furnaces, when measured on a comparable output basis. With plans to expand to India and Vietnam, the company has at least six more furnaces on the drawing boards, and executives say they are likely to use the Finex design for them.

"It's a cheaper operation than the normal iron-making furnace and should ultimately allow them to reduce costs," says Daniel Kang, a steel-industry analyst at HSBC Securities in Hong Kong. "It's incremental, but it's a positive increment."

In the past year, cost pressures have grown for steelmakers as they have been forced to accept huge price increases for coking coal and iron ore.

The gap in per-ton prices between coking coal and the cheaper fine coal used in Posco's new furnace has widened to $50 from $15 this year. Recently, Posco also agreed to pay a key supplier 96% more for lump iron ore, the kind used in traditional blast furnaces. By contrast, the price for the iron ore used in its new furnace has risen only 79% from a lower base.

Posco began working with Siemens-VAI on the Finex concept in 1993. Back then, Posco executives were focusing on the long-term prospect of competition from countries such as China, whose economies were rising in South Korea's wake. They realized that the labor and other cost advantages Posco had as it was growing in the 1970s and 1980s wouldn't last.

"We could go two ways. One was to look for totally new businesses. The second one was to go for new technology," Mr. Chung says. "We decided to look at alternative processes."

Even as the economic case for new iron-making techniques is growing, Christian Boehm, a marketing manager at Siemens-VAI, says he is spending more time talking about reduced pollution and other environmental effects with prospective customers.

"Every producer is asked about pollution by the people in their community," he says. "New laws are always coming. China is getting even tougher than Europe on emissions."

Boeing issues final offer to machinists union

By J. Lynn Lunsford

Boeing Co., hoping to smooth a volatile relationship with its largest labor union and avoid a second strike since 2005, delivered its final offer for three-year contract with the International Association of Machinists and Aerospace Workers on Thursday.

Details of the proposed contract weren't immediately available, but a company spokesman said earlier in the day that the company intended to deliver "an outstanding" contract proposal that showed the company's commitment to avoid a work stoppage.

The Chicago aerospace manufacturer's final offer comes much earlier this time than in previous negotiations, which have typically gone down to the wire. Boeing said it wanted to give the 26,800 employees affected by the contract plenty of time to study it with their families over the holiday weekend.

A Boeing spokesman said a news conference would be scheduled on Thursday to explain the key provisions of the proposal. In a statement, the Machinists union said it was "reviewing it line by line to see ALL changes and how they impact our members."

The Machinists are scheduled to vote on the contract Sept. 3. Two-thirds of the members must vote against the proposal for a strike to occur. In 2005, the union struck for 28 days. In 2003, the union rejected the contract but failed to gain enough votes to strike, causing the contract to go into effect by default.

Boeing had been in around-the-clock negotiations with the Machinists union since last Thursday, with both sides initially digging in on hot-button issues such as pensions, health care and job security.

Unions are looking to see whether the company made any new concessions since its last proposal on Tuesday.

In that proposal, the company softened its stance on some key areas and offered to boost monthly pension payments by 11.4% and give machinists raises totaling 9%.

Boeing had sought to move away from a traditional pension plan for newly hired workers, replacing it with a defined-contribution-type plan. But the company removed that proposal from the contract, as well as language that would have allowed Boeing to bring in contract workers to maintain its factories and another proposal that would have split off workers in the company's Wichita, Kan., facilities into a separate bargaining unit.

Nevertheless, union leaders said the offer made on Tuesday didn't go far enough. The union said it had expected the company to offer raises of at least 13%. It said it also was pushing Boeing to back away from language that gave the company greater control over decisions that had once been the purview of the union.

Boeing also insisted on ending medical coverage for those who retire early or are laid off for six years, an issue that Machinists had labeled as a one that would prompt them to call for a strike.

With its aircraft order books so full that some customers must wait as long as five years for deliveries, Boeing can ill afford a strike—especially one that could further delay the rollout of its 787 Dreamliner jet. But Boeing says it is determined to draw the line on big long-term costs that have plagued other large industrial companies.

SN Airholdings stake is discussed by Lufthansa

By Daniel Michaels

BRUSSELS—In another advance for consolidation of Europe's fragmented airline industry, **Deutsche Lufthansa** AG said it is in talks to buy a 45% stake in the parent of Brussels Airlines for €65 million ($96 million).

The planned investment, which includes a capital increase, also would give Lufthansa an option to buy the remaining 55% of the parent, **SN Airholdings** SA, within two years. SN Airholdings, which confirmed the talks, is closely held by Belgian and British investors.

The deal, which still must be approved by both companies' boards and antitrust regulators, comes as other European carriers are seeking scale through link-ups. **British Airways** PLC and Spain's **Iberia Líneas Aéreas de España** SA announced plans last month to merge. The Austrian government is soliciting bids for a minority stake in unprofitable **Austrian Airlines** AG, and the Italian government wants to find a foreign partner for deeply troubled **Alitalia** SpA as part of a restructuring plan now coming together.

Franco-Dutch **Air France-KLM** SA, which held talks to take control of Alitalia that broke off earlier this year, said Thursday it would be interested in taking a minority stake in the Italian carrier alongside local investors if the restructuring moves ahead.

Small carriers are getting hit particularly hard by high fuel prices and dropping passenger demand amid spreading economic weakness. Large carriers such as Lufthansa, Air France-KLM and BA—as well as major budget carriers **Ryanair Holdings** PLC and **easyJet** PLC—have greater financial resources. They are using their market heft to squeeze smaller rivals and build market share.

Lufthansa, one of the world's largest and most profitable airlines, has been acquisitive lately. Earlier this year it announced plans to exercise a longstanding option to buy the rest of closely held **British Midland Airways** Ltd., in which it holds a 30% stake. Terms and timing of the deal haven't been released. In December, Lufthansa bought a 19% stake in New York-based **JetBlue Airways** Inc. for $300 million. And in 2005, Lufthansa bought Swiss International Air Lines.

Brussels Airlines was created in 2002 from the remains of Belgian national carrier Sabena, which was liquidated after the terrorist attacks of Sept. 11, 2001, and the collapse of its main owner, Swissair. Originally called SN Brussels Airlines, the carrier in 2004 merged with **Virgin Express Holdings** PLC, a low-fare carrier started by Richard Branson.

Lufthansa and Brussels Airlines said the Belgian carrier would become an independent company with Lufthansa's aviation group, as is the case with Swiss.

Belgian airlines have long faced difficulty, being squeezed among giant carriers in France, the Netherlands and Germany. But the Brussels market is attractive because Brussels is home to the European Union, the North Atlantic Treaty Organization and the European headquarters of international companies.

SN Airholdings, which is 30%-owned by Virgin Express Holdings and 70% by Belgian companies and regional governments, has been trying to sell Brussels Airlines for many months.

CORPORATE NEWS

PHARMACEUTICALS

Glaxo to join with Valeant to develop epilepsy drug

Associated Press

GLAXOSmithKline PLC is teaming with **Valeant Pharmaceuticals International** of California to make and sell an experimental epilepsy drug, retigabine, in a deal valued at as much as $820 million.

Glaxo will pay upfront $125 million to Valeant and will pay as much as $545 million as retigabine reaches certain development and marketing milestones.

Valeant could receive an additional $150 million as other backup compounds advance in development. The two companies plan to file the drug with regulators in the U.S. and Europe by early 2009.

—Elena Berton

INSURANCE

Liverpool Victoria to buy Highway Insurance Group

MOTOR Insurer Highway Insurance Group PLC agreed to be acquired by mutually owned Liverpool Victoria Friendly Society for £150 million ($275 million). Liverpool Victoria's offer, a 47% premium to the insurer's closing share price Tuesday, follows a series of acquisitions in the past few years which have expanded its insurance operations. Highway sells car insurance to around 600,000 U.K. customers, focusing on specific risks such as vintage or high-performance cars as well as young drivers. Separately, Highway reported first-half pretax profit fell 88% to £1.4 million from £11.8 million a year earlier.

—Elena Berton

ELECTRONICS

Sony introduces new line of flat-panel televisions

Sony

Sony Corp. unveiled new flat-panel LCD television sets that are thinner and display sharper images than before as it gears up for what is expected to be another tough holiday season.

The consumer-electronics maker said it will release four high-end series of larger-screen TV sets that are between 40 inches and 55 inches in the next couple of months.

Sony, which has been losing money in television sets since it missed the industry's transition from traditional sets to flat-panel sets, is under pressure to turn the business profitable this year.

—Yukari Iwatani Kane

The lure of the $1.8 million sticker price

Aston Martin raises the exclusivity bar; the value of scarcity

BY EDWARD TAYLOR

ADVERTISING

ADS FOR THE NEW $1.8 million **Aston Martin** coupe say nothing about the car's top speed or massive horsepower. They play up a different fact: only 77 of the cars will be built.

The British sports-car maker's marketing pitch is a sign of how being fast and powerful is no longer enough for high-end cars. Scarcity and sticker price (the higher the better) are now what provide car makers with bragging rights.

Top-end auto makers have struggled to find a fresh sales pitch since the launch of the Bugatti Veyron in 2005. While that car set a benchmark for power (1,001 horsepower) and speed (faster than 400 kilometers per hour), a growing environmental consciousness and the rise in oil prices have blunted the appeal of pitching a car's speed and acceleration.

"Continuing an arms race among car companies to increase speed feels a bit trite," says Luke Mansfield, head of innovation at **Landor Associates**, a London-based branding and design agency.

Aston Martin, most famous for its association with the James Bond films, has been coy about the particulars of its new car—it hasn't even named the vehicle yet. It has yet to disclose key specs like acceleration and top speed. The car maker says only that the new coupe won't be faster than the Veyron. (Bugatti last week announced that it will launch a limited edition of 150 convertible versions of the Veyron.)

Aston's print ads, which have run in publications including France's Le Figaro and Germany's Handelsblatt, show a dimly lit silhouette of a car, drawing the viewer's eye to the Aston Martin logo instead. The only performance details available are that the car will be made from carbon fiber and aluminum—most of Aston's previous cars have been made from steel and aluminum—and will have a seven-liter V12 engine. The ads direct readers to a Web site, www.one-77.com. The print campaign will run in 16 publications across Europe, Asia, the Middle East and the U.S.

Aston's decision to use scarcity as a main selling point for the new car may be partly out of necessity. Smaller companies like Aston, which makes only 7,000 cars a year, don't have the same resources as Bugatti's parent company, Germany's **Volkswagen** AG, which pumps out 6.2 million cars a year. And building faster cars is expensive: It requires getting approval from the highway authorities in various countries, which in turn requires extensive emissions and crash testing, among other things.

Aston Martin

Aston Martin's sales pitch for its new coupe plays down performance and focuses on ultra-exclusiveness, as the company plans to make only 77 of the vehicles.

While Aston says it doesn't consider the Veyron a competitor, it does appear eager to compete in the same league on price. The Veyron has a sticker price of €1.1 million ($1.6 million) for the standard version versus £1 million (or $1.8 million) for the new Aston Martin. Aston's production run of 77 is a fraction of Bugatti's planned production run of 300 for standard Veyrons.

The $1.8 million is a radically new price point for Aston Martin, whose most expensive car until now has been the DBS, which costs £160,000, or less than $300,000. Some analysts question how Aston, if it makes only 77 of the new coupes, will be able to generate enough revenue to fund the cost of developing an entirely new vehicle. That leads some observers to believe that the company may be planning to build more carbon-fiber and aluminum cars. Aston declined to comment on its plans.

Aston, which Ford sold last year to an investor group led by an international motor-racing entrepreneur backed by a Kuwaiti holding company, says it still hasn't made a final decision on when it will begin production on the new cars, though it could start as early as 2009. The current print campaign is a "way of finding out about Aston's potential in this end of the market," it says.

While Aston Martin is pushing extreme exclusivity, rival auto makers haven't bothered to do the same. Italy's Lamborghini, a unit of Volkswagen, in 2007 launched a "limited edition masterpiece" of 20 Reventon vehicles with a design inspired by the stealth fighter. It avoided ads and instead invited a select group of existing clients to put down €1 million for the car, which mechanically is almost identical to the Murcielago LP640, a vehicle that starts at about €260,000.

Italy's **Pagani Automobili** used a similar approach with its "Cinque," a limited edition of five sports cars tailored for the Asian market and costing €1 million each. **Ferrari**'s limited edition FXX sports car, which is limited to 20 examples costing €1.5 million each, was also offered to existing customers without an ad campaign.

Havas posts profit rise, as Aegis has solid revenue

BY ERICA HERRERO-MARTINEZ AND KATHY SANDLER

LONDON—French media company **Havas** SA Thursday posted a 40% rise in first-half net profit, boosted by winning new accounts and the strong performance of recent acquisitions. Separately, **Aegis Group** PLC, one of the world's biggest ad buyers, reported relatively strong growth in revenue but sounded a note of caution about the second half.

Havas's net profit rose to €49 million ($72.1 million) from €35 million a year earlier. Havas said the euro's rise against the dollar and pound hurt earnings by €46 million compared with the first half of 2007. Last month the company already reported that organic revenue growth, a closely watched figure that strips out the impact of acquisitions and disposals, was 8% in the first half, while revenue was 3.6% higher at €755 million compared with €729 million last year.

At that time, Chief Executive Fernando Rodes Vila said the company was preparing "for a more fragile economic times ahead," but said he was "comfortable about our ability to react." The company achieved net new business valued at €1.13 billion in the first six months of the year.

Revenue was up because of "strong business growth in key markets reflecting new account wins and increased market share," it said. Among the accounts won by Havas in the first half were **Pernod Ricard** SA, **Pfizer** Inc., **Western Union** Co. and **Coca-Cola** Co.

Earlier this year Havas bought U.K. media agency BLM, U.K. entertainment agency Cake, and San Francisco-based digital agency Kadium.

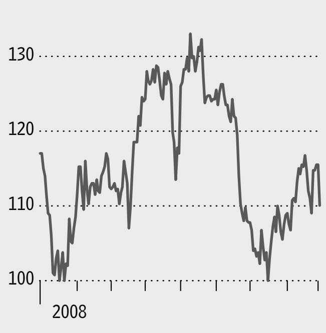
French industrialist Vincent Bolloré is the controlling stockholder of Havas, as well as a 30% shareholder in Aegis. Earlier Thursday Aegis reported better-than-expected first-half results, but the company saw its shares drop about 5% after it, too, gave a cautious outlook for the second half. Unlike at Havas, the strong euro helped Aegis's earnings, pushing sales up substantially, contributing £35.5 million ($65.1 million) to revenue of £607.6 million, up from £499 million the year before.

Aegis, which owns media-buying agency Carat and digital-planning group Isobar, said organic revenue, which strips out acquisitions and currency effects, grew 8.2% in the six months to June 30, ahead of the wider marketing-services sector. Net profit rose 17% to £30 million.

DAILY SHARE PRICE

Aegis

On the London Stock Exchange
Thursday's close: 110, down 4.8%



Source: Thomson Reuters Datastream

Diageo net rises, sales could slide

Company puts focus on pricier spirits; demand for the best

By Aaron O. Patrick

LONDON—**Diageo** PLC eked out a modest increase in full-year net profit and said growth could be slower over the next year, citing the global economic slowdown and higher costs.

Net income at the world's biggest alcoholic-drinks producer by volume rose 2% to £1.52 billion ($2.79 billion) in the fiscal year ended June 30 from £1.49 billion year earlier. Revenue rose 7% to £8.01 billion from £7.48 billion.

Operating profit, which strips out the effect of acquisitions, disposals and currency changes, rose 9%. Operating profit for the current year is expected to grow between 7% and 9% as weaker markets in Europe make it harder to sell more alcohol, the company said. It didn't break out second-half results.

London-based Diageo's strategy is to focus on pricier spirits, which are growing in popularity faster than inexpensive spirits in many places. This year, it bought distribution rights to Ketel One, an upmarket vodka, for $900 million. It also makes Johnnie Walker scotch, Tanqueray gin and Guinness beer, among other brands.

As cloudy economic conditions raise doubts about whether consumers will continue spending, company executives say the relatively low cost of spirits compared to other luxury products—Johnnie Walker scotches sell for $40 to $400 a bottle—make it less likely that consumers will stop buying even as the global economy slows.

"There are still a nucleus of consumers around the world in the top 50 cities who have the means and the desire to consume the best, and that's not going to change," Chief Executive Paul Walsh said at a news conference.

Investors have rewarded this view. Diageo shares are roughly flat over the past year, a good performance amid falling share markets around the world. Diageo shares rose 2.1%, or 20.50 pence, to £10 in London trading Thursday.

The company has avoided some of the cost problems suffered by the beer industry. Most spirits are sold in glass, which hasn't increased in price as much as aluminum, used for beer cans. Dutch brewer **Heineken** NV, for example, reported packaging and food costs rose 24% in its first half, which ended June 30.

Diageo's costs rose just 3% over the past year, although the increase will likely be higher over the next year, the company said.

Samsung Electronics faces tough second half

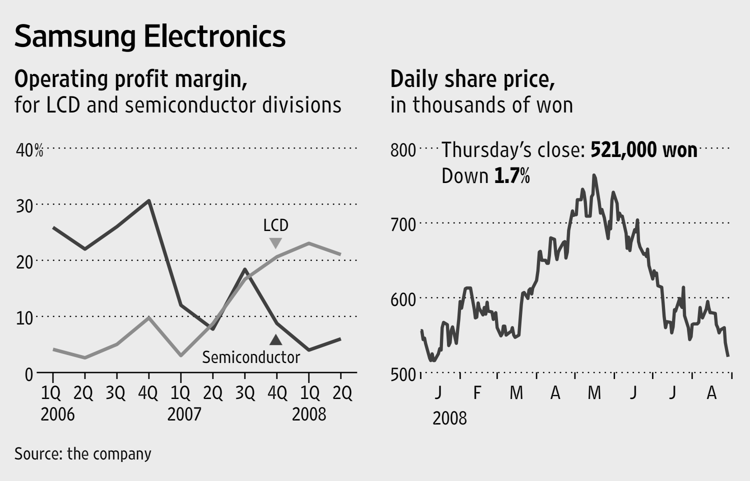
By Evan Ramstad

SEOUL—**Samsung Electronics** Co.'s profit in the third and fourth quarters is shaping up worse than expected and full-year profit will likely be below last year's as weaker global economic conditions damp demand for consumer-electronics products and components, an executive said.

The company isn't experiencing the normal seasonal bump in orders caused by retailers loading up on electronics goods ahead of the holiday season, said the executive, Chu Woosik. "The seasonal gain is being overcome by the macroeconomic weakness," Mr. Chu, Samsung's investor-relations chief, said at an investment conference here.

In addition to slowing sales of consumer products, Samsung is seeing profitability of two big cyclical businesses, memory chips and flat-panel screens, turn downward simultaneously.

Samsung is one of a handful of major producers whose performances are watched by investors as a barometer of the electronics industry's health. The company is the world's largest maker of television sets, memory chips and flat-panel screens by revenue and units, and it is the second-largest maker of cellphones by both measures.



Source: the company

For years, Samsung has been one of the most profitable technology companies in the world. It will remain so this year, though it is now signaling that full-year net profit will be below last year's 7.43 trillion won ($6.85 billion).

Earlier this week, several analysts downgraded performance estimates and share-price targets for Samsung. C.W. Chung, an analyst at Lehman Brothers in Seoul, lowered his estimate for the company's full-year net profit to 6.77 trillion won from 7.9 trillion. Henry Kim, an analyst at Citigroup Global Markets, trimmed his full-year net-profit estimate to 6.97 trillion won from 9.42 trillion won.

Samsung shares climbed sharply from 566,000 won a share at the start of the year to 764,000 won through early Mayas the company appeared to be emerging from a cyclical downturn in the memory-chip business, which was its most profitable area for years.

Its shares tumbled again in late May and through July as fears grew that the memory-chip industry might experience a double dip instead of a recovery. After a brief rally this month, Samsung shares slid this week as analysts signaled more trouble for the chip business. They finished at 521,000 won, down 9,000 won, on Thursday, marking the lowest level since early January.

When the company announced second-quarter results July 25, Mr. Chu and other Samsung executives said memory-chip profit margins were at risk of turning downward again. They also said margins in the flat-panel business would decline because new factories opened by competitors would boost industry supplies.

Now, it is becoming clearer that memory-chip prices and profits are indeed falling again, Mr. Chu said. Also new, he said, is that sales of important end products like TV sets and cellphones aren't turning out as strong as hoped.

"We see the markets in the U.S. and Europe are softening quite a bit, although emerging-market demand seems to be holding quite well," Mr. Chu said.

Bertelsmann may pare RTL stake to fund TV deals

By Mike Esterl

German media giant **Bertelsmann** AG said it could sell part of its stake in publicly traded **RTL Group**, Europe's largest commercial broadcaster, to bankroll future acquisitions in television.

A sale would cut Bertelsmann's stake in RTL to 75% from 90%, and raise about €1.5 billion ($2.2 billion). The proposal highlights efforts by Bertelsmann Chief Executive Hartmut Ostrowski to finance new revenue streams at the privately held media conglomerate, which has been weighed down by debts and slumping sales.

A partial divestment also would reverse earlier efforts by Bertelsmann to buy out RTL's minority shareholders. Europe's largest media company by sales put that effort on hold last December, amid legal uncertainty over so-called squeeze-out laws in Luxembourg, where RTL is based. Squeeze-out rules normally allow anyone who buys 95% of a company's shares to force the remaining shareholders to sell. Uncertainty over the Luxembourg rules, however, threatened to make buying RTL's remaining shares expensive.

In an earnings conference call Thursday, Mr. Ostrowski said he has adopted a "neutral position," meaning that Bertelsmann could seek to acquire all of RTL, or reduce its stake to pay for other acquisitions. He added that Bertelsmann hasn't set a deadline for a decision.

Thomas Rabe, Bertelsmann's chief financial officer, said on the same conference call that the RTL stake could decline to 75% if a partial sale is approved. A company spokesman later added there are no plans to finance a specific acquisition by reducing its majority stake. RTL generated more than one-third of Bertelsmann's revenue and about three-fourths of its operating profit in the first half of this year.

If Bertelsmann does sell a stake in RTL, the money would be reinvested in television broadcasting or production assets, according to people familiar with the company's thinking. The German conglomerate also owns U.S.-based book publisher Random House, media-services unit Arvato and a majority stake in European magazine publisher Gruner + Jahr among its holdings.

Bertelsmann Thursday reported net income of €284 million ($418 million) for the first six months, compared with a loss of €51 million in the year-earlier period, when it was hit with one-off costs. But revenue slipped to €7.64 billion from €7.73 billion, hurt by foreign-exchange effects and the global economic slowdown.

Revenue at RTL, which owns stakes in 44 TV channels and 32 radio stations in 10 countries, declined 0.9% to €2.86 billion, and operating profit fell 3.1% to €494 million over the same period. Traditional broadcasters such as RTL are grappling with weak advertising markets and shifting viewer habits amid increased cable and online offerings.

Since becoming CEO in January, Mr. Ostrowski has moved quickly to restructure Bertelsmann and cut debts after it spent €4.5 billion in 2006 to buy out a minority investor. Last month, Bertelsmann agreed to sell its 50% stake in Sony BMG Music Entertainment to venture partner **Sony** Corp. in a deal that valued the world's No. 2 recorded-music company, behind Vivendi SA's Universal Music Group, at $1.8 billion. It also has begun selling off book, music and DVD membership clubs in several countries.

Now Bertelsmann is scouting for acquisitions. Its Gruner + Jahr unit confirmed last week it had submitted a preliminary bid for Anglo-Dutch publisher **Reed Elsevier**'s trade magazines, which have attracted several suitors and could fetch about £1 billion ($1.8 billion). Mr. Ostrowski also has signaled plans to invest in adult-education services and in Asia, in addition to expanding Bertelsmann's TV and media-services businesses.

Big Three dealers feel the squeeze from credit crisis

By John D. Stoll

The credit crunch squeezing Detroit's Big Three auto makers is now spreading to some of their dealers, adding financial pressure to a group already strained by this year's big drop in auto sales.

The latest and most prominent example is **Bill Heard Enterprises** Inc., one of the largest Chevrolet dealers in the country, with 2007 sales of $2.1 billion. Earlier this month **GMAC** LLC, the financing company partly owned by **General Motors** Corp., stopped doing business with Bill Heard over concerns about financial losses related to the privately owned chain of 14 stores, Bill Heard confirmed through a spokesman.

The weakening credit profiles of GM, **Ford Motor** Co. and **Chrysler** LLC and their finance arms are adding a new challenge for dealers. In the past, GMAC, Chrysler Financial and Ford Motor Credit were key elements in how Detroit pumped up vehicle sales. They typically offered dealers easy credit to help them sell as many cars and trucks as possible, even if they gave away some of their margin to do so.

But now that the car makers and their once-lucrative financing units are racking up losses and struggling to raise funds themselves, they are getting tougher on dealers with weak finances. And since GMAC and Chrysler Financial are both controlled by private-equity group **Cerberus Capital Management** LP, each is now being run to maximize profits, not auto sales.

Tighter credit is "starting to hurt," said Mark Williams who sold a dealership near Cincinnati to Ford earlier this year but still owns two others. "You have less [financing] sources, and the sources you do have today are willing to advance less money," Mr. Williams said.

Other domestic-brand auto dealers around the country are also feeling the pinch. In Sacramento, Calif., Winter Volvo Lincoln Mercury is preparing to close its doors Sept. 2, after 60 years in business. Also in the Sacramento area, Elk Grove Ford closed at the end of June and Great Valley Chrysler Jeep went out of business in May. After suffering a big sales drop in the first few months of 2008, Longhorn Dodge, in Fort Worth, Texas, shut down in May.

"GMAC has changed due to the economic environment, and it has put more strain on the individual dealership," said Duane Paddock, owner of a Chevy dealership near Buffalo, N.Y., and head of the GM dealer council.

GMAC typically provides dealers with subsidized financing for customers as well as low-interest-rate loans to buy the vehicles they hold in inventory on their lots. The loss of financing from GMAC is likely to make it even harder for Bill Heard and other dealers to improve their financial situation. The Chevy dealer has told GM it is now considering selling at least two or three of its stores.

Neither Chief Executive Bill Heard Jr. nor other executives were available to comment. In a statement, a company spokesman said it "is taking actions" to address GMAC's decision. GMAC declined to comment on Bill Heard. A spokeswoman acknowledged that "clearly this is a challenging market environment."

—Kate Linebaugh and Neal E. Boudette contributed to this article.

L'Oréal net profit increases 6.6%

Weakening demand slows sales growth; gross margin falls

By Christina Passariello

PARIS—**L'Oréal** SA Thursday said its first-half net profit rose 6.6%—less than in previous periods—as a flare-up in the price of raw materials and energy wiped out other cost savings.

Net profit at the world's largest cosmetics company by revenue totaled €1.26 billion ($1.85 billion) from €1.18 billion in the first half of 2007. Operating profit increased 3.9% to €1.5 billion. Weakening consumer spending hit L'Oréal's sales growth, which it reported last month inched up 1.6% to €8.65 billion.

Like many consumer-goods companies, including rival **Procter & Gamble** Co., L'Oréal was slammed by higher costs for the ingredients that go into its face creams, shampoos and lipsticks. Unlike its American competitors, though, L'Oréal has also borne the brunt of a robust euro this year. In a statement, Chief Executive Jean-Paul Agon said productivity gains helped offset the rise in commodity prices in a "difficult economic environment."

Pointing to its strict cost control and its strong schedule of new product launches, L'Oréal said it expects full-year earnings per share to grow at least 10%, at constant exchange rates. In the first half, earnings per share rose 12.3% at constant exchange rates. However, last month L'Oréal lowered its full-year sales growth target to 6%, excluding any negative currency impact.

The gross margin at the group behind such brands as Lancôme, Kiehl's and the Body Shop fell to 71% in the first half from 71.5% a year ago. Yet L'Oréal reined in its advertising costs, and the bottom line also benefited from a lower tax rate. L'Oréal typically spends more on advertising in the second half, when it launches new products ahead of the holiday season.

L'Oréal reined in its advertising costs and benefited from a lower tax rate.

L'Oréal's rapid growth in emerging markets such as China, India and Russia has helped compensate for slowing consumer demand for its goods in the U.S. and Europe this year. However, analysts estimate that the newer markets aren't yet as profitable for the company. L'Oréal doesn't break out profits by region.

Hit by slowing economies across Europe, consumers have been shunning more-expensive branded goods in supermarkets and drugstores, such as L'Oréal's Garnier line, in favor of cheaper shampoos and creams from supermarkets' in-house labels.

L'Oréal's share price has fallen nearly 30% since the beginning of the year over concerns about consumer spending and commodity costs.

Knowledge
Understanding

KNOWLEDGE IS VITAL. BUT KNOWLEDGE IS NOTHING WITHOUT UNDERSTANDING.

We all know a humble wine is best enjoyed swiftly and with good humor.
But when you understand enough about wine to store it on its side, even the humblest of wines may develop a measure of true nobility.

That's understanding. That's The Wall Street Journal Europe.

25 YEARS
THE WALL STREET JOURNAL.
1983 EUROPE 2008

SUBSCRIBE FOR 6 MONTHS AT THE SPECIAL PRICE OF € 113

✓Please start my **6-month subscription** to The Wall Street Journal Europe now for only **€113**. That's **66% off** the cover price. Credit card customers will receive a €50 / £30 Amazon gift certificate.

Subscription details

- URL: www.services.wsje.com/media
- E-mail: subs.wsje@dowjones.com
- Phone: +32 2 741 14 14
- Fax: +32 2 741 14 59
- Address: Subscriber Relations, The Wall Street Journal Europe, Blvd Brand Whitlock 87, 1200 Brussels, Belgium.

Your tracking code is HSDEB000E. Always indicate your delivery details, payment preferences and tracking code.

Subscription price*

Eurozone	Switzerland	United Kingdom
€ 113	CHF 176,4	£ 54,6

©2008 Dow Jones & Company, Inc. All rights reserved.

Contact, delivery and payment information

Mr/Mrs/Ms Full Name:
Job Title**:
Delivery Address:
City: Postcode:
Country: Tel:
Email:
Signature: Date:
Credit card no.:
Expiry date:
□ Visa □ Amex □ Eurocard/Mastercard
□ Please invoice me

We may provide your information to third parties, including companies outside of the EU, in order to fulfill your subscription request, process data and provide you with promotional information from WSJE, its affiliates and other carefully selected companies.
□ I do not wish to receive promotional materials from other carefully selected companies.
□ I do not wish to receive promotional materials from WSJE or its affiliates.
* For other currencies, please call us free at 00 800 9753 2000 or +32 2 741 14 14.
** Optional. All other information is required. Failure to provide obligatory information will result in subscription delays. Hand delivery subject to confirmation by local distributor. Offer only open to new subscribers.
Please allow 2 weeks for delivery to commence.

DOWJONES

Grocery owners Ahold and Casino post lower profits

By Stefan Kloet

Supermarket operators **Ahold** NV of the Netherlands and **Casino Guichard-Perrachon** SA of France posted sharp declines in net profit from a year earlier, when earnings were boosted by gains from asset sales.

Amsterdam-based Ahold, which operates the Stop & Shop and Giant-Landover supermarket chains in the U.S. and Albert Heijn in the Netherlands, said net profit for the second quarter, which ended July 13, slumped to €338 million ($497.6 million) from €2.23 billion a year earlier.

A €162 million gain from the divestment of its Dutch supermarket business Schuitema couldn't compare with some €2 billion it booked from the sale of its U.S. Foodservice subsidiary and its operations in Poland last year.

Earlier this month, Ahold reported a 0.8% decline in consolidated net sales to €5.78 billion. The company slimmed down last year by selling its Foodservice business, which supplies food to restaurants and hotels, to a consortium of private-equity investors.

John Rishton

In the second quarter, the retailer had an operating margin of 4.3%, down from 5.1% a year earlier. Ahold said it expects to meet its previous goal of delivering an underlying retail operating margin for 2008 of 4.8% to 5.3%.

Like other European retailers, Ahold is suffering from the rapid rise in food and commodity prices.

"Food inflation in the Netherlands came in the range of 5% to 6% in the second quarter," Chief Executive John Rishton said. "Certainly we did not put that through to customers, and we've been taking that stance in all of our markets."

However, he warned that "as inflation increases, it would be ridiculous to say we will not pass that on to consumers" later this year.

Ahold started a major overhaul of its U.S. operations two years ago in an effort to lure back customers to its stores in the northeast states by permanently lowering prices and ditching temporary product promotions.

Saint-Étienne, France-based supermarket chain Casino reported a 38% drop in first-half net profit despite a 20% rise in sales to €13.81 billion from €11.55 billion. Net profit fell to €229 million from €367 million a year earlier, when €158 million from the sale of businesses in the U.S. and Poland boosted the bottom line.

A 63% jump in international sales offset lackluster demand in France, helped also by the consolidation of the Super de Boer chain in the Netherlands and Almacenes Exito in Colombia.

Casino, with its network of discount and convenience stores, is seen as well positioned as a slowdown in consumption creeps across Europe and consumers seek cheaper goods and fewer nonfood items sold at larger stores.

—A.H. Mooradian and Mimosa Spencer contributed to this article.

CORPORATE NEWS

Suez spinoff logs 14% profit drop on listing costs

By Adam Mitchell

PARIS—**Suez Environnement** said costs related to its spinoff from parent **Suez** SA earlier this year triggered a 14% decline in net profit for the first six months of the year.

Net dropped to €201 million ($295.9 million) from €233 million, as costs of about €19 million linked to Suez Environnement's stock-market debut, as well as a share-distribution program for employees, hurt earnings. Earnings before interest, taxes, depreciation and amortization, or Ebitda, rose to €1.01 billion from €956 million.

In July, the water and waste company reported a 4.4% rise in revenue to €6.03 billion from €5.78 billion, thanks to price increases and new water services as well as the higher value of recycled materials and small acquisitions.

Chief Executive Jean-Louis Chaussade said he still expects full-year net profit to exceed that of 2007. A €500 million tax credit related to old losses and inherited from Suez is expected to translate into a benefit of about €170 million over three years, Mr. Chaussade said. The majority of that sum will make its impact this year, he added.

Suez Environnement also said changes in its tax profile after becoming a separate company would allow it to save an extra €40 million a year, with the first benefits apparent in the second half of 2008.

For the full year, the company wants to reach Ebitda between €2.1 billion and €2.15 billion. It also aims for average annual organic revenue—which excludes the impact of acquisitions—to grow by more than 5% until 2010 and make industrial tuck-in acquisitions that will boost revenue by at least 2%.

Suez Environnement, which made its stock debut July 22, describes itself as a "pure-play" waste and water company. It competes with larger French peer **Veolia Environnement**, which also has energy services and transport divisions.

It was spun off to balance the value of Suez and **Gaz de France** to ensure the French state, which owns most of GdF, has a controlling minority stake in the future GdF-Suez entity. GdF-Suez plans to retain control by means of a shareholders' pact, which includes the 35% stake it still holds in the company.

Marketplace

Realistic graphics

Sony trades guns for cameras in a game players can't win > **Page 26**

GLOBAL BUSINESS BRIEFS

Dassault Aviation

Weak dollar, cooler demand send net profit down 9.2%

Dassault Aviation reported a 9.2% decline in first-half net profit, pulled down by the weak dollar and cooling demand for its Falcon business jets. Net profit dropped to €167 million ($245.8 million) from €184 million a year earlier, while revenue, as the company reported previously, was down 14% to €1.54 billion. Chief Executive Charles Edelstenne said that, stripping out currency fluctuations, revenue would have been 7% higher. Just over 50% of Dassault's costs are in dollars, and the CEO said the company aims to have 70% of its purchasing either in dollars or in low-cost countries to limit currency risks. The builder of civilian and military jets said it booked orders valued at €2.39 billion in the first half, down 21% from €3.03 billion. Orders in the first half included 87 Falcon executive jets, unchanged from a year ago, but only 41% of last year's total of 212.

Thomas Cook Group PLC

Thomas Cook Group PLC's charter airline Condor Flugdienst GmbH has joined talks between TUI Travel PLC's TUIfly and **Deutsche Lufthansa** AG's Germanwings over a three-way merger that would create a national rival to **Air Berlin** PLC. The companies said discussions were at an early stage, that no commercial terms had been agreed to and that there was no certainty of a deal. TUI Travel, a unit of German group **TUI** AG, and Lufthansa have been in talks since the beginning of the year. A combination of the three airlines would create a carrier with 142 aircraft and 30 million annual passengers, putting it ahead of Air Berlin, which carries 28 million passengers each year in its 133 aircraft. Analysts warned the complexity of a three-way deal and antitrust approval could pose challenges.

Aer Lingus PLC

Irish airline **Aer Lingus** PLC swung to a first-half net loss—hit by skyrocketing fuel costs and the weak dollar and sterling—and said it anticipates a full-year loss and a possible "three figure" millions loss in 2009. Previously, Aer Lingus said it would break even in 2008. Ireland's formerly state-run carrier said it posted a net loss of €20.6 million ($30.3 million) compared with a net profit of €6.8 million a year earlier, even though total revenue as well as passenger revenue were up 10% to €632.9 million and €606.2 million respectively. However, fuel costs rose 49% to €172.4 million. The company said it has hedged 70% of its estimated fuel requirement for the rest of the year at $1,137 a ton and 20% for 2009 at $1,165 a ton.

UCB SA

Belgian pharmaceuticals company **UCB** SA said it plans to eliminate 2,000 jobs, or 17% of its work force, in a move to focus on its best-performing businesses. The job cuts should lead to the reallocation of €300 million ($442 million) over the next three years, said the company, funds it will use to strengthen its research in central-nervous-system disorders and immunology diseases. UCB earlier this month reported a 37% drop in its first-half net profit, mainly because the U.S. patent for its Zyrtec allergy drug expired. This declining performance prompted the company to launch its cost-savings program, dubbed Shape. UCB's exclusive U.S. patent for its main product, antiepileptic drug Keppra, will expire in January.

Accor SA

French hotels group **Accor** SA posted a 48% drop in first-half net profit and launched a €75 million ($110 million) cost-savings plan, warning it expects a second-half slowdown and an uncertain environment in 2009. Net profit fell to €310 million from €596 million a year earlier, mainly because of a €255 million decrease in capital gains. Revenue slid 6.2% to €3.77 billion from €4.02 billion, hit by €507 million in asset sales. Accor said that in July revenue per available room—a common measure in the hotels industry—rose 3% in its European upscale and midscale hotels and 1.7% in its European economy hotels, but fell 3% in its U.S. economy hotels. Accor owns more than 4,000 hotels with brands like Ibis, Sofitel, Novotel and Mercure. In total, it has nearly 500,000 rooms in 90 countries.

Impala Platinum Holdings Ltd.

Impala Platinum Holdings Ltd., the world's second-largest producer of the metal after Anglo Platinum Ltd., said fiscal-full-year net profit more than doubled despite a decline in output, lifted by gains from a sale and stronger metals prices. The Johannesburg-based company said production for the coming fiscal year is expected to increase, although costs are expected to be higher and demand for platinum group metals to be dented by the slowdown in world economies. Net profit increased to 17.6 billion rand ($2.3 billion) in the year ended June 30 from 7.23 billion rand the previous year. Revenue rose 19% to 37.62 billion rand. The results were bolstered by the 5.69 billion rand sale of a holding in Aquarius Platinum Ltd. Gross production fell to 1.91 million ounces from a record 2.03 million ounces a year earlier.

Kazakhmys PLC

Kazakh miner **Kazakhmys** PLC posted a 23% drop in first-half net profit and said it would seek to cooperate with **Eurasian Natural Resources** Corp., in which it has a stake of about 25%. "Taking into account that our cooperation could bring some synergy to both companies, I believe we have good ground to build a constructive dialogue," Chief Executive Oleg Novachuck said in a conference call with reporters. Kazakhmys this month raised its stake in ENRC to just more than 25%, but ENRC ruled out a board seat for Kazakhmys. Kazakhmys said net profit fell to $608.4 million from $794.2 million a year earlier, hurt by lower copper-cathode output because of winter weather and rising costs. Revenue grew to $2.84 billion from $2.79 billion.

OAO Vimpel Communications

Russian telecommunications operator OAO **Vimpel Communications** said its second-quarter net profit rose 31%, boosted by the acquisition of Golden Telecom and strong usage growth in its core market. New York-listed VimpelCom, Russia's second-largest operator by customers after OAO **Mobile TeleSystems**, said net profit rose to $470 million from $359 million in the year-earlier period. Revenue grew 52% to $2.61 billion from $1.72 billion as VimpelCom signed up six million new mobile users and existing clients in its core domestic market spent 20% more a month on average. "The increase in revenue was driven by fast organic growth in both our mobile and fixed-line operations as well as by the first full quarter consolidation of Golden Telecom," said Chief Executive Alexander Izosimov.

Caterpillar Inc.

Caterpillar Inc. said it will invest about $100 million to triple production capacity over three years at its unit in China's Shandong province. The U.S. company also will spend $20 million to build the first phase of a research-and-development center in Wuxi, in eastern China. The expansion of Shandong SEM Machinery Co., which manufactures wheel loaders, will begin in 2009. Caterpillar Chief Executive Jim Owens said SEM's employees will increase to 3,000 in 2013 from 1,700 in 2007. The first phase of the R&D center is to be completed by the end of 2009.

Bouygues SA

Construction-to-broadcasting conglomerate **Bouygues** SA said its first-half net profit rose 6.4% and—despite emerging "tensions"—reaffirmed its full-year sales forecast. Net profit increased to €701 million ($1.03 billion) from €659 million a year earlier, as revenue, which the company reported earlier this month, jumped 15% to €15.3 billion. The rise was fueled by a 20% surge in sales at Bouygues's construction division. Property unit Bouygues Immobilier posted a 61% jump in sales, reflecting a carry-over of reservations from 2006 and 2007, while its net profit climbed 45% to €61 million. However, the company noted that reservations in the residential-property segment had dropped 13%, and those for commercial property were down 15%. Bouygues said that "tensions," such as the financial crisis, the slowdown in the property market, soaring commodity prices and the weakness of dollar to the euro, have had only a limited impact on its business performance.

Belgacom SA

The chief executive of Belgium's biggest telecommunications company, state-controlled **Belgacom** SA, has agreed to government demands for a substantial pay cut, paving the way for a renewal of his contract, the Belgian government said. The government asked Didier Bellens to take a cut of about 25% in his annual basic pay of about €1.79 million ($2.64 million). Mr. Bellens has faced sharp criticism from a number of the company's board members over his failure to expand the company beyond the small European country of 10 million people. After Mr. Bellens and Belgacom's board have agreed on the contractual conditions, Minister for State-Owned Companies Inge Vervotte "will submit a draft decree for the renewal of Mr. Bellens's contract," ministry spokeswoman Sabine Pauquay said Thursday.

La Poste

France's La Poste aims to raise as much as €3 billion ($4.42 billion) through a capital increase to finance its development ahead of the opening of the European postal industry to full competition in 2011, the state-controlled mail carrier's chief executive said Thursday. La Poste, which has annual sales of €20.8 billion, plans to launch the capital increase in 2010, via either a sale of a stake in its capital to one or more institutional partners or a public offering of shares to retail investors and employees, Jean-Paul Bailly said at a news conference. La Poste must first negotiate a change in its legal status from state-run enterprise to limited liability company, which is planned by the end of 2009, Mr. Bailly said. La Poste needs approval from the government to go ahead with the plan.

General Motors Corp.

General Motors Corp. will invest more than $200 million in India to build its first plant for car engines. The U.S. auto maker is expanding its manufacturing facilities to take advantage of rising demand in the South Asian country. The factory will be built at Talegaon, near Pune City, in the western state of Maharashtra, General Motors India Pvt. Ltd. said. The auto maker imports engines from South Korea and Australia for its Indian operations and will be able to use the new factory to supply its factories in the local market and overseas.

Baoshan Iron & Steel Co.

Baoshan Iron & Steel Co. said its first-half net profit rose 18% to 9.65 billion yuan ($1.41 billion) from 8.16 billion yuan a year earlier on higher steel prices. The company, the Shanghai-listed unit of **Shanghai Baosteel Group** Corp., China's largest steel producer by capacity, said cost pressures will rise in the second half driven by higher iron-ore prices. Its revenue in the six months ended June 30 was 103.43 billion yuan, up 9.9%. The firm sold 12.39 million metric tons of steel products in the first half, up from 10.83 million tons. Steel-demand growth may slow because of Beijing's macroeconomic tightening measures, Baoshan Iron said. But the company said steep prices will remain stable, because of the increased costs and global inflation.

Tiffany & Co.

Tiffany & Co. doubled its fiscal-second-quarter net income amid a year-ago divestiture charge as the company continued to see strong sales growth in the Asian-Pacific and Europe regions. Asian-Pacific sales jumped 17%, with the weaker dollar contributing seven percentage points to the increase. The upscale jeweler also raised its full-year earnings forecast, but tempered expectations for sales growth. For the quarter ended July 31, the New York-based company reported net income of $80.8 million, or 63 cents a share, up from $40.5 million, or 29 cents a share, a year earlier, when results were hurt by a charge of 17 cents a share related to the planned sale of a Caribbean chain. Net sales rose 11% to $732.4 million.

Brown-Forman Corp.

Brown-Forman Corp. posted a 7% drop in fiscal-first-quarter net income amid a charge related to raw materials needed to produce tequila, sending the company's shares lower. For the quarter ended July 31, the Louisville, Ky., distiller of Jack Daniel's and Southern Comfort reported net income of $88.2 million, or 73 cents a share, down from $95.3 million, or 77 cents a share, a year earlier. The latest results included a 13-cent charge related to an "abnormal" number of agave plants identified during the quarter as dead or dying. Agave is the primary raw material used to make tequila. Net sales from continuing operations rose 7% to $790 million.

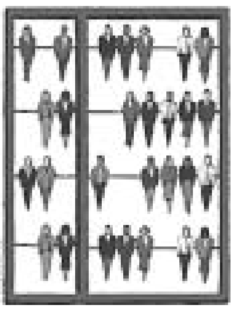
—Compiled from staff and wire service reports.

THE WALL STREET JOURNAL. EUROPE
Executive Travel Program
Guests and clients of 320 leading hotels and car rental agencies receive The Wall Street Journal Europe daily, courtesy of
addictlab.com™ global creative think tank

ECONOMY & POLITICS

GERMANY

Jobless rate falls to 7.6% as labor market improves



GERMANY'S jobs market continued to improve in August, performing better than the long-term average despite the weakening outlook for the country's economy, labor office data showed.

The improvement was mainly based on an increase in employment, as well as labor-market changes, the agency said. The number of unemployed fell by an adjusted 40,000, while the jobless rate fell to 7.6% from a revised 7.7% in July.

"The data support the view that Germany is still in better shape than most other euro-zone economies," said Ben May, European economist at Capital Economics in London. *—Roman Kessler*

JAPAN

Central bank might raise rates as growth improves

JAPAN'S economy might be sluggish, but the central bank is prepared to raise interest rates once it decides the economy is back on a sustainable growth path, according to Miyako Suda, a Bank of Japan policy-board member.

"It may be necessary to take monetary-policy steps once [the central bank is] confident about sustainable growth under price stability," Ms. Suda said Thursday. Still, she said that with the economic outlook "likely to remain uncertain for the time being, the BOJ might need time to thoroughly consider whether [adjusting rates] is the right choice." *—Megumi Fujikawa*

TAIWAN

Boeing gets U.S. contract to sell antiship missiles

THE U.S. government awarded a contract to **Boeing** Co. for the sale of antiship missiles to Taiwan, amid a continuing delay in approval for the sale of another, larger American weapons package to the island.

The sale of the 60 Harpoon air-launch missiles to Taiwan was approved by the Pentagon more than a year ago, but the formal award of the supply contract to Boeing's McDonnell Douglas Corp. unit was included Monday in a broader Pentagon statement about weapons-sales contracts. The statement, posted on a Pentagon Web site, said the Taiwan contract is valued at $89.8 million. *—Jason Dean*

U.K. slump continues

Sluggish retail sales, weak housing prices put a rate cut in view

BY NICHOLAS WINNING
London

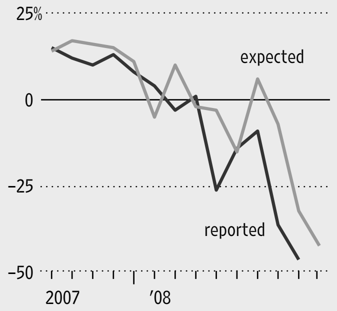
THE U.K. ECONOMY may be slowing even more rapidly than expected, with retail sales growing at their slowest pace in at least 25 years and house prices falling more sharply than at any time since 1990.

Tumbling house prices, slowing wages growth and widespread concerns about job security are taking their toll on consumer spending, the driving force behind the 16-year run of economic growth that ended in the second quarter.

The weak outlook for consumer demand suggests that the Bank of England has few reasons to fear a second round of price increases in response to the earlier surge in oil and food prices, which are now falling. Many economists now expect the central bank to cut its key interest rate before the end of this year.

Retail rout

Balance* of U.K. retail-sales volume, reported and expected



*Difference between the percentage of retailers reporting higher sales compared with a year earlier and those reporting lower sales

Source: CBI

The Confederation of British Industry said Thursday that its main indicator of retail sales volume plunged in August to its weakest level in a quarter century, as poor weather exacerbated the impact of the credit crunch, higher inflation and weak consumer confidence.

According to the business lobby group's Distributive Trades Survey, 60% of respondents said sales in the first half of August were lower than a year ago and 13% said they were up. That dragged the sales volume balance to negative 46 from negative 36 in July, the lowest level since the survey began in 1983.

Sales are unlikely to pick up soon, although consumer confidence did improve slightly in August. Polling organization GfK NOP said the headline measure of sentiment was negative 36 compared with negative 39 in July, an unexpected increase.

That is likely to prove a short-lived bounce, boosted by the U.K.'s largest Olympics-medals haul since 1908.

"This improvement could be down to a number of recent factors, which are mostly of short-term influence, such as cheaper petrol offers, summer holidays happening or just a general feeling of 'things can't get any worse, can they?' " said Rachael Joy, from GfK NOP's consumer confidence team.

The housing market also suffered in August. The Nationwide Building Society said the price of a typical house fell 1.9% from July and 10.5% from the August a year earlier.

Europe's growth slowed in August

By **Paul Hannon** *in London*
and **Monica Houston-Waesch**
in Frankfurt

Economic growth in the 15 countries that use the euro slowed in August, according to a closely-watched survey, adding to evidence the euro-zone economy could slip into recession this year.

Money-supply growth across the bloc slipped in July, reflecting slowing lending growth.

The EuroCOIN indicator of economic growth fell to its lowest since mid-2003, according to the Centre for Economic Policy Research in Brussels. The indicator, closely watched by the European Central Bank, fell in August to 0.17% from 0.34% in July.

The CEPR said the slippage signals that growth is losing momentum in the second half. The euro zone's gross domestic product shrank 0.2% in the second quarter, its first contraction since records began in early 1995, according to official data released this month. Two consecutive quarters of economic contraction generally are considered the measure of a recession.

But ECB policy makers have indicated they won't cut the bank's key interest rate this year given continued concern about inflationary pressures arising from earlier rises in oil and food prices. Most economists believe the ECB won't alter interest rates without several more months of evidence that economies are stalling.

The ECB reported Thursday that a robust pace of money-supply growth in the euro zone decelerated slightly in July, reflecting slowing lending growth to the private sector and a slowdown in economic activity. July broad M3 money supply growth was 9.3% from the same month of last year, below June's 9.5% annual rise and reflecting slower lending growth.

While the ECB is likely to stress that relatively robust lending to nonfinancial corporations signals that the bloc has yet to see signs of a credit crunch, analysts noted that growth in loans for house purchases fell to 4.3%, the lowest since the euro zone's creation. A measure of money supply called M1—which includes currency in circulation and overnight deposits—also fell, suggesting consumer demand in coming months is likely to be weak.

U.S. growth is revised up, but a slowdown is likely

BY KELLY EVANS

The U.S. economy grew much faster than originally thought from April to June, but the pace is expected to slow over the rest of the year.

Gross domestic product grew at a seasonally adjusted 3.3% annual rate during the second quarter, according to the Commerce Department, which originally put growth at a 1.9% pace. The revision, released Thursday, reflects new data showing that exports were even stronger than first estimated and that business inventories weren't depleted as much as thought earlier.

"The U.S. economy has been quite resilient one year into this credit debacle," said Michael Darda, chief economist and director of research at MKM Partners in Greenwich, Conn. But, he said, "with the labor market softening and the credit markets getting more stressed, it's too soon to breathe a sigh of relief."

Separate data released Thursday showed the number of people filing new jobless claims dipped by a seasonally adjusted 10,000 last week but remains at 425,000, a level consistent with past recessions. In addition, the total number of people drawing unemployment benefits in the week ended Aug. 16 rose by 64,000 to more than 3.4 million—the most since November 2003.

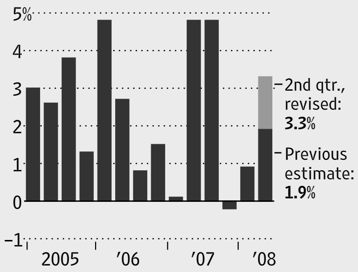
The surprisingly strong economic performance in the second quarter follows a meager 0.9% growth rate in the first quarter and a contraction of 0.2% for the final quarter of last year, the first quarterly decline since the 2001 recession. Many forecasters say GDP could decrease again in the fourth quarter of this year, as global demand for U.S. products slows and the American consumer cuts back on spending.

The report also indicated that inflation remains relatively muted.

A smaller trade gap—due to growing exports and slowing imports—combined to add 3.1 percentage points to the second-quarter GDP growth rate. Global demand for U.S. goods, bolstered by a weak dollar that makes those goods cheaper to customers abroad, has been a crucial source of strength for the economy.

Unexpected growth

Quarterly change in gross domestic product*



*At a seasonally adjusted annual rate

Source: U.S. Commerce Department

"It may be that perhaps exports are finally taking a recognized position as just a regular growth sector of the U.S. economy," said Wachovia Corp. chief economist John Silvia. "To have such a disparity between the domestic economy and its performance and the export sector and its performance is really significant."

Slowing growth in Japan, Europe and the U.K. suggests foreign demand for American goods could fade somewhat in coming months, depressing economic growth in the second half of the year.

U.S. consumer spending, typically the largest driver of economic growth, grew 1.7% from April through June, boosted by the government's economic-stimulus checks. Spending growth contributed 1.24 percentage points to the GDP tally, higher than initially reported but still low by historical standards. As the boost from the stimulus checks fades and labor-market worries persist, consumer spending could decline during the second half of the year for the first time since the 1990-91 recession.

Corporate profits also were weak in the second quarter, the GDP report showed, raising concerns about the employment outlook. Profits were down 7% from the previous year, the worst performance since 2001 and the sixth consecutive quarter of annual declines, according to Global Insight, a Lexington, Mass.-based forecasting firm.

Denver's roar over, Obama faces long road

Election turns close as built-in pluses hit built-in challenges

By Gerald F. Seib
And Christopher Cooper

Associated Press

Barack Obama, seen here speaking at the Democratic National Convention Wednesday, still faces major hurdles as he launches his general election campaign.

DENVER—U.S. Sen. Barack Obama prepared to accept the Democratic Party's nomination Thursday and launch a historic general election campaign in which he will benefit from strong winds blowing at his party's back, yet face challenges and uncertainties no other presidential contender has confronted.

As Sen. Obama leaves the Democratic convention in Denver, his party is enjoying more institutional advantages than at any time in recent history. Voter identification with the party is higher than it has been in years, voter registrations have soared as a result of the vigorous primary campaign earlier this year, the incumbent Republican president is unpopular, and Democrats enjoy a rare advantage over Republicans in campaign cash.

Yet Sen. Obama is, at best, only marginally ahead of presumptive Republican nominee John McCain in national polls.

Among the challenges facing Sen. Obama: winning over more working-class white voters; turning out young voters who say they are for him; identifying the Republican states he can turn Democratic; and, in the eyes of many in his party, shedding some of the cool facade that causes some voters to consider him to be a bit aloof.

"It's a close election now," said David Axelrod, Sen. Obama's chief campaign strategist, just hours before the Illinois senator was scheduled to accept his party's nomination at a giant rally at a Denver stadium, Invesco Field at Mile High. "It will be a close election after the conventions. It probably will be a close election until the end."

The uncertainties about the road ahead arise in no small measure because of the historic firsts that mark the Obama effort. He would be the first African-American presidential nominee in U.S. history, meaning his campaign is likely to explore America's anxieties over race relations.

Sen. Obama also would be the country's first presidential nominee who came of age after the Vietnam War, possibly testing America's readiness for a generational change. And he would be the first presidential nominee since the current campaign-finance system was installed to finance his own general election campaign rather than rely on taxpayer financing.

He was to set another first Thursday night by taking the final night of his nominating convention outdoors to Invesco Field.

At the same time, the McCain camp was working to steal some of the spotlight. Aides said Sen. McCain, whose party starts its own convention on Monday, had chosen his running mate.

There were signs that Sen. McCain intended to unveil his choice Friday morning, in hopes of cutting short the Democrats' afterglow and shifting attention to the Republicans. Such as strategy matters because of the short general-election calendar this year. The November election arrives in just 67 days, and some voters will be casting absentee and mail-in ballots in just 40 days.

To win, the Obama campaign has to change the shape of an Electoral College map that worked to Republicans' advantage the past two elections. The Obama goal is to protect all the states that Sen. John Kerry won for the Democrats in 2004, and then turn a handful of red states carried by Republicans last time into blue-state wins for Sen. Obama.

The Obama campaign says it has set up operations in 18 so-called battleground states. The list includes four states that Democrats won in 2004 but that Sen. McCain will contest because he sees them within reach: Michigan, New Hampshire, Pennsylvania and Wisconsin.

The other states are traditionally Republican states the Obama camp says could turn Democratic. That list includes Alaska, Colorado, Florida, Montana, Nevada, North Carolina, Ohio and Virginia.

In trying to turn such states, Sen. Obama must convince undecided voters that a man just four years out of the Illinois state legislature is ready to be commander in chief. The campaign also needs to address what Democrats consider the key to victory: economic anxieties among middle-class Americans frightened by a global economy, technological change in the workplace and high energy prices.

Those anxieties have made this a year in which "the tectonic plates are moving big-time" in favor of Democrats and their agenda of more active government involvement in the economy, says Sen. Charles Schumer of New York.

To take advantage of those shifts, Sen. Obama will need to tackle several challenges:

- Identify the red states that are his top priorities. If he is to win, he almost certainly have to win at least a few large swing states where he posted poor showings against rival Democratic Sen. Hillary Clinton during the primary season. Those states include many of the traditional political bellwethers: Florida, Michigan, Missouri, Ohio, Pennsylvania and Virginia.

The campaign is competing hard for them all, but ultimately it will have to make some tough choices about which ones warrant precious money and candidate time.

With 32 Obama campaign offices in Florida, 29 in Missouri, 33 in Virginia - even five offices in the deeply Republican state of Alaska — Sen. Obama is making a hard play in a lot of red states and fielding what is likely to become the most comprehensive political operation in American history.

But with the size comes breathtaking expense: The campaign spent a whopping $56 million in July, federal records show, almost twice as much as John Kerry spent on his race during the same month in 2004. "Somebody could make the case that this is a big waste of money," said Joe Trippi, a longtime political adviser, who oversaw the efforts of Democratic candidate John Edwards during the current political cycle. "But for Obama, this organization is probably everything."

- Generate lots of cash: Keeping the wheels on the operation will eat up more than money—it will eat up Sen. Obama's time. While Sen. McCain has opted to take $84.5 million in public financing - and freed himself from fundraising duties after the convention—Sen. Obama has rejected public money and the spending restrictions that accompany them so he won't have such a luxury. Currently, it's not unusual for Sen. Obama to hold four or five fundraising events a week; that will likely ramp up in September. The campaign reckons it needs to raise about $20 million a week during ten weeks beginning in August, and though Sen. Obama has smashed all fundraising records, collecting $390 million in donations through July, posting such cash flow numbers could prove a daunting task even for him. Through 19 months of campaigning, the Obama campaign has raised an average of $5 million a week.

Scott Reed, a longtime Republican political operative, notes that the Obama strategy carries peril if the money doesn't arrive. If Sen. Obama is forced to prune back his ground operation, the resulting headlines could damage him in some states. Meanwhile, he said, Sen. McCain is keeping it close by operating a much more modest, advertising-oriented campaign. "McCain's smart to be putting his money into TV," Mr. Reed said.

- Turn out the youth vote. Sen. Obama has generated the kind of enthusiasm among young voters that brings back memories of Eugene McCarthy's college-student-driven candidacy in 1968 and George McGovern's anti-Vietnam-war campaign in 1972.

In fact, there seems little doubt that young voters, along with African-Americans, are the two most reliable Obama blocs. In the latest Wall Street Journal/NBC News poll, Sen. Obama was preferred over Sen. McCain 55% to 37% among voters aged 18 to 34, by far his strongest showing among any voting bloc. Young voters are far more comfortable with the idea of a President Obama; 65% of those aged 18 to 34 said they were comfortable with that idea, compared to just 48% of those aged 65 and over.

The classic question with young voters, though, is whether they will actually show up at the polls on Election Day. Turnout among young voters ticked up four years ago, yet even with that improvement young voters turned out in lower proportions than any other age group. Data compiled by the nonpartisan group Rock the Vote indicates that turnout among those under age 30 was 49%, compared with 73% of those age 60 to 74.

The dilemma for the Obama campaign is simple: Those voters aged 60 to 74 are a core McCain constituency, and they show up. Those voters under age 30 are a core Obama constituency, and the outcome may well turn on getting them to show up.

- Identify Sen. McCain with President Bush. One thing that became clear from the thousands upon thousands of words that spewed forth from the stage of the Democratic convention was that Democrats are intent on running against the unpopular President Bush as much as against the generally more popular Sen. McCain.

The reasoning isn't hard to fathom. In the latest Journal/NBC News poll, 55% of the voters surveyed had negative feelings about President Bush, while just 33% reported negative feelings about Sen. McCain.

The rhetoric designed to tie Sen. McCain to those Bush numbers won't be subtle. "If you liked the last eight years you should pick John McCain because he'll give you four more years of the same," said David Plouffe, the Obama campaign manager, on Thursday.

Business spending shows U.S. politics are in a new world

By Brody Mullins

DENVER—For the past decade, corporations have showered Republicans with money and attention. But this week's Democratic convention shows how much things have changed.

Corporations sponsored hundreds of cocktail parties, receptions and A-list concerts for Democratic lawmakers, aides and delegates gathered for the convention this week.

With Democrats in control of Congress and Democratic presidential nominee Sen. Barack Obama generating excitement across the country, companies appear to be springing for far fewer parties at the Republican convention next week in Minneapolis.

A list of Democratic convention events compiled by the Washington lobbying firm Quinn Gillespie & Associates LLC is three times as long as one it compiled for the Republican convention.

A separate study by the nonpartisan Campaign Finance Institute shows that 141 companies have donated $160 million to the host committee for the Democratic convention, compared with 80 companies and $100 million for the Republican convention.

Precise figures are impossible to produce because companies aren't required to disclose all of their spending at conventions, and host committees don't report spending at the same time. But nonpartisan watchdogs have been monitoring spending by special interests in Denver. "There certainly seems to be more parties at the Democratic convention than the Republican convention," said Nancy Watzman with the Sunlight Foundation.

A look at the convention schedule underscores that point.

Sunday, **AT&T** Inc. and **Genworth Financial** Inc. threw a party for the moderate Blue Dog Coalition at a club a few blocks from the Democrats' convention hall. Monday, financial-services companies including **Merrill Lynch** & Co., **Fidelity Investments** and the trade association for the mutual-fund industry sponsored a forum on financial literacy with former Democratic Rep. Harold Ford of Tennessee. Later that night, the U.S. Chamber of Commerce was among a dozen corporate backers of a party at Beta nightclub.

Tuesday, the technology industry hosted an evening reception at the Rioja restaurant that was packed with Democratic insiders and corporate lobbyists. Guests nibbled on finger food and mingled with the likes of Oregon Sen. Ron Wyden. The tab was picked up by industry trade groups TechNet, the Consumer Electronics Association and Telecommunications Industry Association.

The attention that businesses are devoting to Democrats at the convention underscores a broader shift in political spending as the Democratic Party increases its power in Washington.

For the first time in at least a decade, corporations are spending more money to elect Democrats this fall than they are on Republicans. Data compiled by the nonpartisan Center for Responsive Politics show that corporations and their political action committees have contributed $115.9 million to Democratic candidates, the Democratic Party and liberal outside political organizations this election cycle, compared with $111.5 million for Republicans. The data don't include donations from individuals.

That gives Democrats a 51% to 49% advantage in corporate money.

Businesses traditionally have given about 66% of their donations to Republicans and 33% to Democrats, according to the center's data. In the last presidential election, corporations spent $178.3 million to help Republicans and $100.1 million to benefit Democrats.

REVIEW & OUTLOOK

Calling Hank Paulson

The good news about the year-old credit crunch is that we are finally getting to the main event, which is the condition of the banking system. The bad news is that U.S. regulators are still trailing events, and prolonging financial trouble and uncertainty in the bargain.

Exhibit A is the revelation by Federal Deposit Insurance Corp. Chairman Sheila Bair that her $45 billion deposit insurance fund may not be adequate to pay off account holders as banks continue to fail. This has been inevitable for months, but neither Ms. Bair nor Treasury wanted to admit the truth in public for obvious political reasons. Yet now we learn that the insurance fund shrank by $7.6 billion in the second quarter, bringing its reserve ratio well below the minimum required by Congress.

Banks are supposed to pay premiums into that fund, with riskier banks paying higher premiums. But for most of the past decade most banks were paying no premiums at all, as bank failures were few and the living was easy. Last year the FDIC started charging again, but bank failures—and insurance payouts—are up sharply.

This has Ms. Bair talking about sharp increases in premiums, with the steepest being levied against the banks that are most in danger—and so most in need of conserving their capital. Ms. Bair cannot be held entirely accountable for this bizarre state of affairs. "Reforms" of the deposit insurance fund in 1996 and again in 2005 required the FDIC to charge banks nothing, or close to it, when they're flush with cash, and to dun them hardest when the tough times hit. The banks themselves also lobbied hard to keep their contributions low in the fat years. Now they're screaming about having to pay more amid a nearly 20% increase in problem loans.

In a report released Tuesday, the FDIC said bank profits are down nearly 90% and loan-loss reserves are soaring—but delinquencies are rising even faster than reserves. The number of banks on the FDIC's trouble list is up to 117 from 90, while the assets represented by those banks tripled to $78.3 billion between March and June. IndyMac wasn't on that list before it failed, and that could cost the FDIC as much as $9 billion more.

How not to reassure bank depositors and credit markets.

Ms. Bair also said she might need to tap the Treasury for short-term financing to maintain "liquidity." But she added that she didn't see any need for longer-term help from the Treasury or taxpayers, despite her growing list of problems and a shrinking pool of potential buyers for the assets the FDIC keeps collecting.

This is not the way to reassure depositors and anyone else amid a credit crunch. As long as the U.S. has federal deposit insurance, by all means let the banks pay for it themselves. But the perverse way that premiums are collected needs to be fixed by Congress—and regulators like Ms. Bair and Treasury Secretary Hank Paulson ought to be saying so.

In the meantime, Ms. Bair could do Americans a favor by making it clear that the FDIC is prepared to meet its obligations to depositors no matter what—and asking Congress for an appropriation to do so. The longer we have to wait for that day, the more jittery people will become watching the insurance fund's balance decline. Taking more money from the most troubled banks only makes more bank failures likely. And taking money from banks that are going to fail anyway, only to pay it back to depositors after the fact—and still coming up short—is merely dumb.

Mr. Paulson could also help if he used some of his own political capital to run interference for Ms. Bair, rather than making her plead poverty in public. One thing we've learned about Mr. Paulson is that for all of his reputation as a tough Wall Street guy, he's not a general who leads his troops up San Juan, er, Capitol Hill. No doubt having to ask Congress for more money for the FDIC is unpleasant, but if he doesn't do it, his successor will have to.

We wouldn't rule out something like the Resolution Trust Corp. that was designed to acquire and dispose of financial assets during the savings and loan meltdown of the early 1990s. That's normally the FDIC's job. But if the losses get too big, that bureaucracy can get overwhelmed. It can also succumb to political pressure not to sell assets quickly, which can prolong the crisis. A case in point is Ms. Bair's attempt to use IndyMac as a kind of social experiment, rewriting most of its delinquent loans to test her theories about how widespread loan modification could make the housing crisis vanish. With the right leader and a mandate to go out of business, a new RTC could contribute to a faster end to the mortgage and banking woes.

The same goes for pulling the trigger on Treasury's new authority to stabilize Fannie Mae and Freddie Mac. Mr. Paulson keeps saying he doesn't want to use that power, hoping that private investors will give the mortgage giants enough cash to spare him from having to make some hard decisions. This may be considered canny politics at Goldman Sachs, but it's a terrible way to govern in a financial mess. Letting Fan and Fred twist in the marketplace has only added to the stress in the credit markets and increased borrowing costs for nearly everyone.

Mr. Paulson gives the impression of wanting desperately to pass these problems along to someone else. If that's true, he should have stayed on Wall Street. His labyrinthine proposal to redesign the financial bureaucracy was a nice thought experiment for the future. But it does nothing to address the immediate task at hand: stabilizing the current financial system.

Pyongyang As Usual

North Korea announced Tuesday that it will halt the disablement of its nuclear facility at Yongbyon in retaliation for what it calls the U.S. failure to abide by its side of the recent disarmament deal. How do you say *plus ça change* in Korean? It's business as usual in Pyongyang, where Kim Jong Il's negotiating habits are nothing if not predictable.

And it was predicted by critics inside and out of the Bush Administration who argued that Pyongyang would find a way to wiggle out of its commitments. Sure enough, as soon as the Olympics were over—so as not to offend its patrons in Beijing—Pyongyang returned to form.

The excuse this time is that Washington hasn't acted quickly enough to remove North Korea from the State Department's list of terror-sponsoring states. But the U.S. promised to do that only if Kim disclosed all of his nuclear program. Pyongyang is now threatening to reactivate its aging reactor at Yongbyon, though that is a sideshow. The real issues are the North's refusal to turn over all of its plutonium, disclose how many nuclear weapons it has and where they are, and come clean on its suspected uranium program. The North is also resisting an intrusive verification regime to prove that it is keeping its word.

Pyongyang isn't likely to return to the table unless the Bush Administration gives in on these issues, and if the past is any guide its threats will grow louder as the U.S. election nears. Most likely, the North will stall until it sees who wins in November and hope it—with the help of the State Department—can get the next President to bend. That's negotiation, North Korea-style.

The Sri Lankan Solution

Sri Lanka's military is two months into a full-on offensive against Tamil Tiger rebels in their northern base. An end finally may be in sight to the war that has roiled the country for a quarter century.

The government claims control of large areas in the region and could soon take the Tiger "capital" at Kilinochchi, an important symbolic victory. The operation, which has made surprisingly fast progress, could be over within six months to a year. But winning the conventional war is only a start to winning the peace.

Colombo is following the pattern it set in 2006 in eastern provinces: launch a major offensive against Tamil fighters, then establish a democratic government. Two eastern elections this year were marred by violence and charges of voter intimidation, but the peace seems to be holding.

The Tigers, a guerrilla fighting force par excellence, won't be easy to subdue. Despite the government's latest progress, there's speculation the Tigers have been holding back their best fighters up to now. Even if the government wins, enough remaining Tigers are likely to fade into the jungle to carry on a guerrilla campaign. The 25-year-old conflict has already claimed more than 100,000 lives, according to the International Crisis Group.

The Tigers finally may be on the run. Then what?

So as the military operation continues, Colombo needs to offer moderate Tamils a political settlement to separate them from the rebels. The government of President Mahinda Rajapakse has long promised to put greater power in the hands of local Tamil politicians in the east and north. So far it hasn't. The east's newly elected local and provincial councils have little power to set economic policies in their areas.

To break the cycle, the government needs to allow the All-Party Representative Committee, a body charged with negotiating a comprehensive devolution plan, to push forward toward an agreement. Colombo could also show good faith by reinstating the independent Constitutional Council that's supposed to oversee important institutions like the Human Rights Commission and the National Police Commission.

Part of the problem is that President Rajapakse lacks the political will to follow through. He rode to power in 2005 on appeals to Sinhalese nationalism. The military solution plays well at the polls, and his coalition won big victories over the weekend in two provincial elections billed as referendums on the government. The political follow-up is more controversial.

Taking the battle to the Tigers in the north is an important step in ending the war. But lasting peace will be built on a political deal with the moderate Tamils left behind when the rebels are gone.

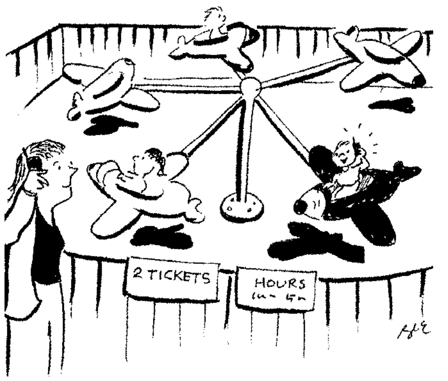
On Taste

Page W9

■ **If John McCain** wants to court America's evangelical voters, Naomi Schaefer Riley says, he could talk more about one of their new favorite causes: adoption.

Pepper . . . and Salt

THE WALL STREET JOURNAL



"Hi, it's me. We just landed."