THE WALL STREET JOURNAL.

WSJ.com

Dow Jones Newswires

EUROPE

DOW JONES A News Corporation Company

VOL. XXVI NO. 113 FRIDAY - SUNDAY, JULY 11 - 13, 2008

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Russians are coming—to buy pricey U.S. property

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Business & Finance

Fortis directors scheduled a special meeting Friday to discuss investor anger with management's plan to raise $13 billion in capital. The board was expected to make a decision on the status of Chief Executive Jean-Paul Votron, in a possible leadership shake-up. Page 1

■ **The options for** shoring up U.S. mortgage giants Fannie Mae and Freddie Mac aren't looking attractive. Page 1

■ **Bernanke called** market turmoil "ongoing," and Paulson decried the state of Fannie Mae and Freddie Mac in testimony to U.S. lawmakers. Page 8

■ **The Bank of England kept** its key interest rate at 5% amid fears of a U.K. recession even as inflation rises. Page 2

■ **The FTSE 100 index came** close to joining Europe's bear-market club on a bad day for retailers. U.S. stocks rebounded on a chemical-sector deal. Pages 15, 16

■ **Economists are split** over whether the Fed should focus more on growth or on inflation, the latest Wall Street Journal forecasting survey found. Page 3

■ **Sinosteel completed** corporate China's first hostile acquisition overseas by gaining control of Australia's Midwest. Page 7

■ **Dow Chemical agreed to buy** U.S. rival Rohm & Haas Co. for $15.3 billion. Page 6

■ **Novartis will acquire** all of Speedel to gain control of blood-pressure drug Tekturna. Page 5

■ **Toyota will revamp** its U.S. manufacturing operations as demand for more fuel-efficient models grows. Page 6

■ **General Electric** plans to spin off its entire Consumer & Industrial division, rather than just its appliances unit. Page 6

■ **Russia may dethrone** Germany as Europe's top car market as a growing middle class attracts foreign marques such as Ford and Renault. Page 2

■ **U.S. retailers generally beat** forecasts for June sales. Page 5

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11229.02	+81.58	+0.73
Nasdaq	2257.85	+22.96	+1.03
DJ Stoxx 600	277.95	-5.95	-2.10
FTSE 100	5406.8	-122.8	-2.22
DAX	6305.00	-81.46	-1.28
CAC 40	4231.56	-108.10	-2.49
Euro	$1.5793	+0.0065	+0.41
Nymex crude	$141.65	+5.60	+4.12

Money & Investing > Page 15

World-Wide

Iran test-fired more long-range missiles in exercises designed to show it can defend itself against any U.S. or Israeli attack, Iranian state television said. Rice warned that the U.S. will not back down in the face of threats against Israel. French oil company Total said political conditions weren't right for investment in Iran.

■ **Turkish police caught** a fugitive suspected of taking part in an attack on the U.S. Consulate in Istanbul, and four other suspects were detained. Officials are investigating whether one of three gunmen killed in the attack had al Qaeda links.

■ **France's Sarkozy defended** his decision to attend the Olympics' opening but chastised Beijing over pressure to drop his plans to meet the Dalai Lama.

■ **India's prime minister** will announce a parliamentary confidence vote Friday that will determine his government's fate and the future of a U.S. nuclear deal.

■ **Six-nation talks** on North Korea's nuclear disarmament resumed in Beijing, focusing on efforts to verify Pyongyang's declaration of its atomic materials.

■ **Britain's Defense Ministry** agreed to pay nearly $6 million to settle a case alleging torture and abuse of 10 Iraqi civilians.

■ **A Dutch court ruled** it has no jurisdiction in a civil suit against the U.N. by survivors of the 1995 Srebrenica massacre in Bosnia.

■ **Nigeria's main militant group** said it would resume attacks in the oil-rich delta region, abandoning a two-week-old cease-fire.

■ **Zimbabwean government** and opposition officials met in South Africa to try to find a way out of the country's crisis.

■ **The EU high court,** settling a Belgian dispute, ruled employers can be found guilty of ethnic discrimination, even if no one files charges against them.

■ **Prosecutors sought** a seven-year prison term for Samsung ex-Chairman Lee Kun-hee as they ended a trial for alleged tax fraud and breach of trust. Page 7

■ **Bush signed** a measure that expands U.S. government spy powers and grants immunity to telecom companies, following its Senate passage. Page 8

EDITORIAL & OPINION

Missile defense

Iran's saber rattling should be a wake-up call to Europe. Review & Outlook. Page 10

Fortis CEO's fate at stake as investor unrest grows

Board seeks to cool anger at leadership over capital-raising

By Carrick Mollenkamp, Dana Cimilluca And Nicolas Parasie

Fortis NV's board is considering shaking up leadership in an effort to assuage investors in the big European bank, possibly ousting its chief executive.

The directors scheduled a special meeting Friday to discuss investor anger with management's plan to raise capital and was expected to make a decision on the status of Chief Executive Jean-Paul Votron.

For Mr. Votron, the situation would mark a sharp comedown from a few weeks ago, when he said he had board support. It also would mark a big change from a year ago, when he was taking part in the $101 billion acquisition of Dutch rival ABN Amro NV, the largest bank deal ever; some investors have questioned the high price Fortis paid for its part of ABN.

Mr. Votron could still keep his job. Should he depart, he would join a growing list of executives at U.S. and European banks, such as Citi-

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Associated Press

The status of **Fortis Chief Executive Jean-Paul Votron** is expected to be discussed at Friday's board meeting amid investor concern over a $13.06 billion capital-raising.

U.S. considers options to bolster Fannie, Freddie

By James R. Hagerty And Gregory Zuckerman

As the swooning stock prices of U.S. mortgage giants **Fannie Mae** and **Freddie Mac** force government officials to consider game plans for shoring up these pillars of the American housing market, the options aren't looking attractive, setting up what might be a messy end game.

In late trading on the New York Stock Exchange, Freddie's stock was down 23% to $7.94, and Fannie's was down 15% to $13.05. The shares are under pressure in large part because investors worry that the companies will need to raise huge amounts of capital to cover losses stemming from rising defaults on home mortgages. The new shares sold to raise that money would dilute the value of existing stock, leaving the existing shares less desirable.

Investors also fret that if the government has to rescue Fannie or Freddie, there may be little value remaining for the current shareholders.

Fannie and Freddie, little known to most Americans, are suddenly

Please turn to back page

Sharing the pain

Rising defaults and falling home prices hit mortgage insurers 20

Rich nations invest in farms of poor ones

By **Tom Wright** *in Jakarta,* **Mariam Fam** *in Cairo and* **Patrick Barta** *in Bangkok*

Emerging nations are trying to cash in on the global food crisis by getting big importers of crops to effectively lease their farmlands—a new trend that is already sparking complaints from farmers in some countries who are concerned about their own food supplies.

The latest example: A plan by the Indonesian government to develop a Kuwait-sized farming tract in the remote province of Papua to grow rice, sugar cane and soybeans. Promoters of the project have met with Saudi investors in the hopes of receiving hundreds of millions of dollars in return for dedicating part of the crops to the Middle East nation.

Saudi Arabia and other Gulf nations are scouring the globe for agricultural investments to lock in supplies of key crops like wheat, corn and rice, much as countries like China have invested billions of dollars to secure a steady stream of oil from around the globe.

There is a big risk in the new trend. Nations such as Indonesia have had to contend with protests at home as food prices have risen

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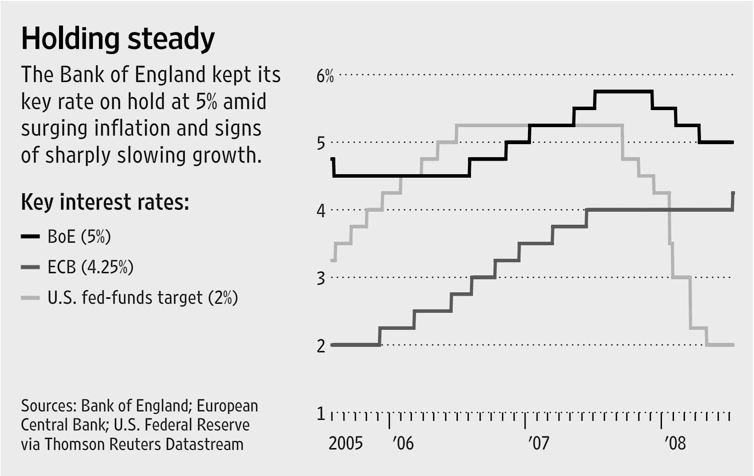
THE WALL STREET JOURNAL.

LEADING THE NEWS



U.K. recession fears rise as key rate stays at 5%

By Joellen Perry

Concerns about a serious economic slowdown across Western Europe mounted Thursday as the Bank of England kept its key rate on hold amid increasing fears the British economy could slip into recession even as inflation rises.

As expected, Britain's central bank kept its key interest rate steady at 5%. Its nine-member Monetary Policy Committee released no statement explaining the decision, as is typical when rates don't change. But dismal U.K. housing-market data Thursday bolstered economists' expectations that the central bank will lower the rate later this year or next. U.K. mortgage lender HBOS PLC said house prices fell 2% in June from May and 6.1% from last year, the largest annual decrease since March 1993.

Grim economic news also hit the European continent, where French and Italian industrial production fell far more than expected in May, adding to increasing evidence that the euro zone's manufacturing sector is struggling with the effects of high energy prices, the strong currency and faltering demand. French industrial output fell 2.6% in May from April, the largest decline in more than three years. Economists expect the euro-zone-wide industrial-production figure, due Monday, to slip sharply.

Inflation concerns prompted European Central Bank policy makers to raise their key rate on July 3 to a seven-year high of 4.25%, but increasing signs of a sharp slowdown have tempered expectations that the rate could rise again this year. Many economists predict a second-quarter contraction in the 15-nation euro-zone economy. The ECB's monthly bulletin, released Thursday, reiterated policy makers' contention that growth will slow moderately as high inflation persists.

In the U.K., rising unemployment, slumping consumer and business confidence and widespread expectations that house prices will fall further are stoking fears the economy will slip into recession in the second half. Financial-market turmoil means mortgage-interest rates are rising sharply despite the central bank's three-quarter-percentage-point rate cuts since December. Consumer confidence hit its lowest level in more than four years in June, according to the Nationwide Building Society, while a recent survey from the British Chamber of Commerce found a "serious risk" of recession in the U.K. this year.

Soaring inflation means British policy makers have limited scope to support economic growth with further interest-rate cuts.

—Luca Di Leo in Rome contributed to this article.

CORRECTIONS & AMPLIFICATIONS

Some issuers of auction-rate securities have had to pay high penalty rates if auctions to reset their interest rates failed. A Money & Investing page article Thursday incorrectly said investors were stuck paying high penalty rates.

Macau's casinos generated $3.71 billion in gambling revenue during the first three months of this year, more than their counterparts in the Las Vegas Strip and Atlantic City, N.J., combined. An article Wednesday incorrectly said Macau's casinos generate more gambling revenue than their counterparts in Las Vegas and Atlantic City combined.

An article about volunteer tourists in the July 4 Weekend Journal carried the wrong credit for a photo of a children's book party in Laos. The photo was from Peter Ferraro, not Stay Another Day.

Russia's car market booms

Rising middle class lures foreign makers; German lead at risk

By Will Bland

MOSCOW—Russia is poised to overtake Germany this year to become Europe's largest automotive market by vehicles sold, auditor PricewaterhouseCoopers LLC said.

The surging price of oil has revitalized the country's economy, providing many Russians the means to buy foreign-made cars. Meanwhile, rising fuel costs have made car ownership more expensive in Europe and the U.S., where sales are stagnating.

Car sales in Russia rose 41% in the first half of 2008 to 1.65 million, with a total value of $33.8 billion, PwC said in a report, citing figures from the country's customs service and a trade group. The auditor said that the figure is larger than the number of new-car registrations in Germany, but that Russia's total includes used imported cars.

"If the market growth remains at the same level in the second half of the year, sales in Russia will exceed sales in Germany," PwC said.

The auditor estimates that Russians will buy as many as 3.8 million new cars in 2008. Industry association VDA expects 3.2 million new cars to be sold in Germany this year.

Russia has become a priority market for major car makers in recent years.

Russia has become a priority market for major car makers in recent years. **Volkswagen** AG of Germany and **PSA Peugeot-Citroën** SA of France are the latest auto makers to open factories in Russia and to take advantage of tax exemptions on locally assembled cars.

Russia's emerging middle classes have been snapping up cars such as **Ford Motor** Co.'s Focus and **Renault** SA's Logan. Each model had sales of more than 30,000 vehicles since January.

Russians' rising spending power has let foreign car makers increase their sales at the expense of less costly Russian brands, such as the Lada, owned by OAO **Avtovaz**. That company, Russia's largest car maker by sales, sold a 25% stake to Renault for $1 billion last year.

Russians bought 1.1 million foreign cars in the first half of the year, up 47% from a year earlier, according to the Association of European Businesses. In June, Russians bought 202,309 foreign vehicles, up 44% from a year earlier. The figures include the sales of foreign-branded cars produced in Russia. Of the top five best-selling models in the first half, three are locally produced.

—Elena Murina contributed to this article.

INDEX TO PEOPLE

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

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

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.

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.

Editeur responsable: Daniel Hertzberg M-17936-2003

LEADING THE NEWS

Which direction will Fed next take rates?

Survey finds division on whether to target growth or inflation

By Justin Lahart

With the U.S. economy weak and prices rising, economists are deeply divided over whether the Federal Reserve should focus more on fostering growth or keeping inflation in check, according to the latest Wall Street Journal forecasting survey.

Of the 53 economists surveyed, 22 said the U.S. central bank should be more concerned by economic weakness than by inflation, while 21 said inflation should be the greater concern. The rest said the risks were balanced or declined to answer.

"The damage from letting inflation percolate and remain in the system will trigger an even bigger economic slump down the road," said Alliance Bernstein economist Joseph Carson.

With oil and food costs pinching pocketbooks and profits, surveys of consumers and businesses are registering a rise in inflation expectations, something Mr. Carson worries could lead to prices continuing to spiral higher. On average, the economists in the survey predicted that consumer prices will rise 4% this year, up from the 2.3% they were expecting at the beginning of the year.

But Lehman Brothers economist Ethan Harris argued that the housing downturn and fragile capital markets make a weakening economy the more pressing concern. While inflation expectations are rising, surveys also show that workers don't expect wage increases. That means it is unlikely the wage-price inflationary spiral of the 1970s—when wages rose in response to higher inflation, helping fuel further price rises—will occur, he said.

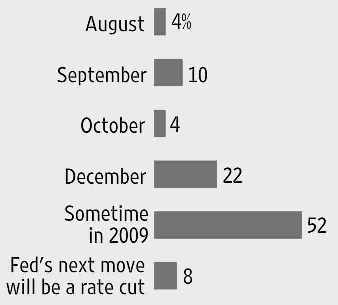
"The average person is saying, 'I'm worried about inflation because I can't get a wage increase,' " Mr. Harris said. "It's not, 'I'm worried about inflation and therefore I'm going to ask my boss for a raise.' "

The conflicting views on what the Fed should focus on reflect differing perspectives on where the economy is headed. Most of the economists who say that economic weakness is the bigger threat think a recession is under way. Those who think inflation is the main worry don't think a recession has begun and, on average, say the odds are just over 50-50 that one will occur.

The Fed's dilemma

Economists are divided over what the U.S. Federal Reserve's focus should be:

When will the Federal Reserve raise interest rates?



Source: WSJ survey

Many of the economists surveyed have increased their estimates for second-quarter growth. That reflects a bigger-than-expected increase in consumption because of the economic-stimulus checks sent out by the government in recent months. On average, respondents believe U.S. gross domestic product grew a 1.4% annual rate in the second quarter, up from the 0.5% they forecast in June. But fewer than one in five economists said that the stimulus package prevented a recession; most said it merely delayed one, or had no effect at all.

"The stimulus package has softened the downturn, but will not change the ultimate outcome," said Goldman Sachs economist Jan Hatzius.

Indeed, for the second half, the economists predict slower growth than they forecast last month, and they also project higher unemployment, bigger job losses and a steeper decline in housing prices. Most economists don't think that a second stimulus package, something that Sen. Barack Obama has called for in his presidential campaign, would be very helpful, and a handful think it would be damaging.

"The economy needs to grow on its own or endure recession," said Western Carolina University and Parsec Financial Management economist James Smith.

The economists who are more worried about inflation gave lower marks to Fed Chairman Ben Bernanke than did those concerned primarily about economic growth. They gave higher marks to European Central Bank President Jean-Claude Trichet, who has voiced much more concern over higher prices than Mr. Bernanke has.

"Central banks need to consistently strive for price stability," said Decision Economics economist Allen Sinai, who gave Mr. Trichet a grade of 90 out of 100, compared with 70 for Mr. Bernanke.

Overall, the average forecast for the Fed's target interest rate at year end crept higher, rising to 2.11% from 2.03% in last month's survey. Still, while the number of economists expecting an increase rose, most expect the Fed will keep its key overnight rate at 2% for the remainder of the year and not increase it until next year.

Cathay to seize chance to expand

By Bruce Stanley

HONG KONG—**Cathay Pacific Airways** Ltd. plans to strengthen its presence in the lucrative Middle East air market and stick by its previous expansion efforts in the Pacific and India, even as it contends with rising fuel prices that threaten to saddle the airline with its first annual loss in a decade.

In an interview, Chief Executive Tony Tyler said he sees opportunities for his carrier to grab business from rivals, particularly from U.S. carriers flying between North America and Asia, who are paring back as oil prices hit the industry worldwide.

"Despite all the dire forecasts of gloom and doom in the world economy and so on, we're not seeing—yet—any real sign of that," he said. "What we are facing at the moment is a cost problem, not a revenue problem."

At the same time, he acknowledged industry conditions could limit expansion efforts. "There are opportunities, but it's not going to be easy to make profitable use of them in the short term. It's more about consolidating our market share," Mr. Tyler said.

Cathay—historically well run and a bellwether for the Asian market—is adding more fuel-efficient aircraft such as the Boeing 777-300ER to its fleet to expand service on routes where it sees a high potential for profit. It plans, for example, to add flights in October to three destinations in the Persian Gulf—Dubai, Bahrain and Riyadh, Saudi Arabia.

The airline has increased its aircraft capacity on trans-Pacific routes by 37% since the start of this year, and its passenger traffic on these routes has grown by 33% over the same period, Mr. Tyler said. At the same time, cash-strapped U.S. carriers including **Northwest Airlines** Corp. and **UAL** Corp.'s United Airlines are scaling back flights or delaying planned service between the U.S. and China.

"Now is the time to go in there and capture market share, so that when the U.S. economy strengthens again, we'll be in a great position to feed the whole Cathay Pacific network," he said.

Cathay has ramped up service to India. The airline and its Dragonair unit fly 35 times a week to India, up from eight weekly flights in December.

It also is raising fares for first- and business-class passengers on most of its routes to and from Hong Kong. The fare increases, ranging from 3% to 15%, will take effect starting Friday. But the airline concedes it runs the risk of driving away customers, particularly as the economy weakens in much of the developed world.

"Fares have to go up," said Mr. Tyler, 52 years old. "The amount people have to pay to travel has to climb. The unknown question is, what impact will that have on traffic demand?"

The cost of jet fuel accounts for 49% of Cathay's total operating costs, up from 39% 12 months ago. Fuel surcharges have failed to keep pace, offsetting only $3 of every $10 of this increase, and Cathay is hedging fewer of its fuel requirements this year compared with 2007. As a result, the Hong Kong carrier issued a profit warning last week for only the second time in its 62-year history.

Investment bank Cazenove said in a July 3 research note that the airline stands to post a loss of 1.6 billion Hong Kong dollars (US$205 million) this year because of higher fuel bills. Cathay plans Aug. 6 to announce its financial results for the first six months of the year. Mr. Tyler declined to give a forecast.

Cathay is in a better position than many of its counterparts to tough out the new hardships. Its balance sheet and brand are strong, it has a loyal base of high-margin corporate customers and its vast international network serves high-volume destinations. It also has the strongest network in China of any airline based outside the Chinese mainland.

Cathay last month ordered its pilots to fly slower to burn less fuel. Its flights now take an average of four minutes longer, enough to save "several million U.S. dollars" over the remainder of this year but not so much slower that passengers might miss connecting flights, Mr. Tyler said.

Cathay also could ground some aircraft if the potential savings justify such a drastic step, but Mr. Tyler draws the line at the idea of delaying deliveries of new aircraft. "It's always very expensive to defer deliveries. Manufacturers can hold your feet to the fire, and they tend to do that," he said.

Flight path

Cathay Pacific CEO Tony Tyler hopes to keep the company in the black despite high fuel prices

Source: the company Photo: AFP

Capital outlays by chip firms set for further drop

By Melissa Korn

Capital spending by semiconductor companies is expected to drop more than previously anticipated this year amid continued economic uncertainty and "significant" oversupply in certain memory segments, according to a report by Gartner Inc.

The technology market-research firm sees the spending contracting 22% in 2008 to $48.2 billion. That's an even bleaker view than Gartner forecast back in April, when it projected a 20% decline for the year.

The new report also reflects a more cautious growth outlook in 2009.

Gartner said memory is the only major area where revenue is projected to decline in 2008—down 3% to $57 billion amid plunging prices—and overall semiconductor revenue is expected to grow 4.6% to $286.5 billion for the year. Still, most segments will expand only modestly. As a result, semiconductor producers are paring back spending to counter economic uncertainty.

"While our forecast for overall semiconductor-industry revenue shows a mild increase consistent with prior years, it is achieved at the cost of major reductions in capital spending to bring capacity more in line with overall demand," the report states.

All segments' capital spending is projected to decline in the double digits this year, led by a 32% drop in memory. Dynamic random access memory spending is seen slumping 40.5% while NAND flash is projected to fall 19%.

Even though Gartner expects capital-spending growth to return next year, it trimmed its forecast to 7.6% and admitted the new figure was subject to change.

CORPORATE NEWS

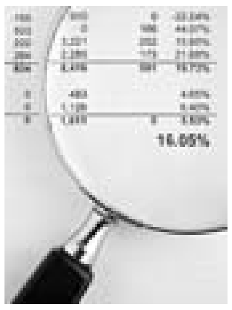
AIRLINES

Lufthansa, labor union fail to reach wage accord

WAGE TALKS between German flagship airline **Deutsche Lufthansa** AG and union Ver.di failed, a Lufthansa spokeswoman said. The union, which represents ground workers and cabin crew, called on its members to vote on a potential strike. Ver.di spokesman Harald Reutter said he expected members to be willing to strike and that the decision should be made this month. The union seeks a 9.8% pay increase, while Lufthansa has so far proposed 4.6%, with an additional 2.1% raise as of July 1, 2009. The union argued that this offer compensates only for inflation, without accounting for productivity increases and employees' contribution to earnings growth. *—Kirsten Bienk*

AGRICULTURE

Grain traders, distributors targeted by antitrust raids



ANTITRUST officials said they raided the offices of grain traders and distributors in two unnamed European Union countries.

The European Commission, the EU's regulatory arm, said it suspects collusion in the market for cereals and other agricultural products. U.S. food company Cargill Inc. said its offices in Italy were raided and that it was cooperating with investigators.

The EC recently said that prices for foodstuffs are rising faster than prices for agricultural goods, prompting concerns about price-gouging. The commission said it will study evidence obtained during its raids. *—Adam Cohen*

ENTERTAINMENT

EU high court rebukes Sony-Bertelsmann ruling

EUROPE'S highest court ruled a lower court was wrong to overturn the European Commission's initial approval of the Sony BMG joint venture.

The Court of First Instance "committed errors of law" when it concluded in 2006 that the commission's approval process was beset by "manifest errors," the European Court of Justice said. The deal itself is unaffected by the ruling: The commission, the EU's executive arm, re-examined the merger after the lower-court ruling and cleared it.

The case involves a dispute between an association of independent music publishers and **Sony** Corp. and **Bertelsmann** AG. *—Mike Gordon*

Live Nation banks on heft

CEO Rapino targets artists with history; 'everything is up'

By Ethan Smith

BOSS TALK

LIVE NATION Inc.'s chief executive, Michael Rapino, has spent much of the past three years reorienting the world's largest concert promoter, paring away businesses like theater and television production and expanding music-related activities.

The company owns or operates 155 concert venues world-wide, including San Francisco's Fillmore, London's Wembley Arena and the House of Blues nightclub chain, and it reported revenue of nearly $4.2 billion in 2007 from staging 28,000 concerts in 18 countries. But largely because of the high cost of paying star performers, it had an $11.8 million loss for the year.

Last fall, seeking new, related businesses with meatier profit margins, Live Nation started making high-profile "360 deals" with such megastars as Jay-Z, Madonna, Shakira and and the Canadian rock band Nickelback. Under the deals, it agreed to make rich upfront payments—$150 million to Jay-Z and $120 million to Madonna, for example—in exchange for financial participation in virtually all aspects of their careers, from concert tickets and recorded-music sales to image licensing.

Mr. Rapino, 43 years old, worked his way up the ranks of Clear Channel Entertainment. Shortly before parent **Clear Channel Communications** Inc. spun off the unit in 2005 and renamed it Live Nation, he became chief executive. He later brought in his former mentor, Michael Cohl—the promoter who effectively turned concert promotion into a global business when he staged the Rolling Stones' world-wide Steel Wheels tour in 1989—as chairman.

Live Nation's huge deals have attracted scrutiny. Many competing executives in the music business consider them overvalued, and the company's stock price is down more than 50% since Madonna was signed in October. In June, a rift over how quickly to sign more big stars led to the departure of Mr. Cohl, who advocated accelerating the strategy.

Mr. Rapino says the company's high-priced contracts are widely misunderstood and that hedging higher-risk businesses like CD sales against more profitable ones like endorsement deals is a smart move. And he insists that over the 10-year lifetime of most of these deals, the artists in question will generate far more revenue from ticket sales and endorsement deals than Live Nation paid them initially.

The company also has acquired Signatures Network Inc. and Trunk Ltd., which manufacture memorabilia like T-shirts, along with Musictoday LLC, which manages fan clubs and online stores for musicians. And it is preparing to sever ties with Ticketmaster next year and launch its own ticketing service.

Excerpts from an interview with Mr. Rapino:

WSJ: *The numbers on your 360 deals have been eye-popping, particularly in an industry where everything seems to be shrinking.*

RAPINO: We're already paying big advances to these global artists. To get a world tour for Bon Jovi, Celine Dion, the Police, this is a sizable number that we would guarantee the artist. So it wasn't hard for us to say, "Well, we know their 15-year history. We can project their future." That's why in our model we need the artist that has the history.

When you strip it all down, it was just taking global touring to the next level.

WSJ: *You've attracted a lot of attention for expanding into businesses beyond the traditional concert promoter's role of booking and marketing concerts.*

RAPINO: Three years ago, we were really just a promoter and a venue operator. When Tom Petty came to town we just made money from the ticket. Now, we don't just do one thing for them but sometimes six or seven. For Tom Petty, Signatures is doing his tour merchandise. So when you buy the T-shirt in the hallway, we're participating. Then we're also doing his Web site, or at least his fan-club Web site. Then with Musictoday, we're also the fulfillment store on the performer's e-commerce site.

And the best part about all this: Every one of these businesses we enter is higher margin than the concert business. So I'm in the lowest business; everything is up.

WSJ: *You can't get a volume discount booking concerts?*

RAPINO: I always joke when I meet investors that whatever they learned in business school about how "scale means the cost of goods goes down" does not apply to the concert business. Scale gives you a different advantage. It doesn't say you can buy Aerosmith for less. It says you can pay Aerosmith more and be competitive because your scale has so many revenue pools to capture.

The only given I know is that in the future artists, athletes and movie stars are not going to make less. So we looked at that and said, "OK, how do you build a model that can be a leadership model?" We can afford to pay Aerosmith more than anyone else, and make a higher return.

WSJ: B*ut in some cases you're paying a big number to maintain the status quo. For some artists, you were already doing their merchandise, their tours.*

RAPINO: Everybody makes this big assumption that U2 and Madonna were going to continue to work just for us. The biggest cost of my business is competition—promoters bidding against each other to get a tour. We had no belief that if we did nothing that we would have just continually got the U2 tour for 10 years, and/or anywhere near the same economics. We got the Madonna 2014 tour at 2008 prices.

WSJ: *What's to stop Madonna from saying, "I don't like the 2008 prices now that it's 2014. I want to renegotiate for 2014 prices"?*

RAPINO: Madonna and these artists don't get paid in 2014 unless they perform. It's not like Madonna's living off the signing bonus we gave her in 2007 in 2014. We have a contractual deal that has a very structured schedule of payments for certain rights. We project that Madonna will gross over $1 billion in this 10 years. She's working to generate the $1 billion, not the $100 million schedule that we're going to pay her over time. That's just the appetizer.

WSJ: *Madonna was the first artist with whom you signed a recorded-music deal. You've now got three more. Are you building a record label?*

RAPINO: We have no desire to be in the record business. We are not going to be [talent scouts], we're not going to produce records.

If and when the new model requires us to help distribute those rights for the artist as part of the 10-year package, then we absolutely believe there's value in distributing that music without all the infrastructure costs of being in the business.

WSJ: *Can you make that work at the $17 million an album you're paying Madonna?*

RAPINO: We have always said that Madonna is the most expensive deal we did because it was the first deal, to break the model. And every deal after that would be sizably better. With Madonna, we have somewhere around a 9% [operating cash flow] margin. That's double the 4% I'm making now.

WSJ: *What can you tell us about your plans for your ticketing business, which you're launching in 2009?*

RAPINO: If there's anything that has been underplayed and overshadowed, there is one reason you should buy our stock or you should watch our company: It's because we are entering the ticketing business next year. We think that is 90% of the equation on why our business model comes together.

We are spending immense amounts of time on dynamic pricing for airlines and hotels. We think there's a way that the artist can make more money but the consumer can pay less money if we can sell more tickets.

Misha Gravenor/Live Nation

Live Nation Chief Executive **Michael Rapino** says the company's high-priced contracts for music artists are widely misunderstood.

CORPORATE NEWS

Sony may try global ads

Agencies will battle to create a campaign for Bravia televisions

By Aaron O. Patrick and Yukari Iwatani Kane

Fallon Worldwide

Sony is considering launching a **global advertising campaign** for Bravia televisions. Fallon Worldwide handles its European ads.

Sony Corp., aiming to sharply boost sales of its Bravia flat-screen television this year, is wrestling with a difficult decision. Should it appoint the midsize ad agency that helped make Bravia famous in Europe, Fallon Worldwide, to lead a global ad campaign?

ADVERTISING

In some ways, the decision should be a slam dunk. Fallon's lavish, attention-getting ads for Bravia, shown primarily in Europe, are credited with helping boost Bravia's market share. One, three years ago, showed thousands of colored balls bouncing down a San Francisco street. In 2006, Fallon sprayed 15,000 gallons of paint onto a housing estate for a spot called "Paint." A more recent ad showed Play-Doh bunnies morphing into a giant rabbit in downtown New York.

But Fallon has only a few offices around the world, making it possibly ill-equipped to lead a global campaign. And the idea of having a single agency prepare ads for every part of the world runs counter to Sony's traditional way of letting its regional divisions and subsidiaries hire their own agencies to run separate ads.

Even so, in line with Sony Chief Executive Howard Stringer's effort to break down barriers between regions, the Tokyo-based electronics giant plans a global shootout of agencies this month to consider just such an appointment, according to five people familiar with the situation. Each of the company's operating regions will send a team to Tokyo with ideas for Bravia ads from their own ad agencies. Sony marketing and electronics executives will decide whether one region's ideas are good enough to be used globally.

Howard Stringer

Aside from Fallon, which has the Bravia account in Europe, agencies participating in the shootout include **WPP Group** PLC's Berlin Cameron United; **Crispin Porter + Bogusky**, of Miami and Boulder, Colo.; and the agency **180**, according to a person familiar with the situation. The Los Angeles office of 180 handles the Bravia account in the U.S. The winning agency won't handle all of Bravia's international business, as regional ads will continue to run. And it will be up to the regional companies to decide whether to use the global spots, so there is no guarantee the spots will be used everywhere in the world, said a person familiar with the details.

A spokeswoman says Sony's global marketing divisions are working in a "unified way" to promote Bravia televisions. "Sony is working to get the maximum value out of its marketing activities," she said.

For Fallon's London agency—regarded as one of the hottest in Europe—the account review is a chance to extend its profile globally. Missing out would be a blow to the **Publicis Groupe**-owned firm. After a string of awards and account wins, expectations of Fallon are high. Fallon London's chairman, Laurence Green, declined to comment. A decision is expected at the end of July or beginning of August, according to a person familiar with the situation.

Sony's decision to consider a global campaign highlights a longstanding debate among multinational companies: whether it is better to make ads that can run anywhere in the world or to tailor spots for regional sensibilities.

Novartis to buy Speedel, control hypertension drug

By Anita Greil And Jeanne Whalen

Novartis AG said it plans to buy the rest of **Speedel Holding** AG for about 907 million Swiss francs ($881.5 million), giving Novartis full control of a blood-pressure medication the small drug company helped develop.

In a two-step process, Novartis, which previously held 9.7% of Speedel, said it paid 130 francs a share to buy an additional 51.7% from five shareholders, including Speedel Chief Executive Alice Huxley. Now, Novartis plans to buy the remaining shares in a mandatory public offer at the same price. That represents a 94% premium to Speedel's 67.10 franc closing price Wednesday.

The acquisition will give control of the blood-pressure drug Tekturna to Novartis, which has hopes of turning the medication into a blockbuster, though it has gotten off to a slow start since its launch in the U.S. last year.

By acquiring Speedel, Novartis will put an end to the sometimes fractious relationship it has had with the smaller company. Novartis sells Tekturna world-wide and pays Speedel fees from the sales; last year, Speedel said Novartis wasn't paying it all it was due. Novartis said it was fully complying with their partnership deal. Later, Speedel said the dispute was resolved.

Birgit Kulhoff, pharmaceutical analyst in Zurich with Swiss private bank Rahn & Bodmer, said the acquisition is a good deal for Novartis. "Just by no longer having to pay license fees [to Speedel], Novartis will soon recoup the acquisition costs," she said. Speedel also has several other cardiovascular drugs in development.

In a statement Wednesday, Dr. Huxley said: "In light of the currently very challenging environment for Speedel, i.e. the upcoming financing needs and the depressed market sentiment, I have agreed to a solution which promises a solid fundament for the future of Speedel."

Both companies are based in Basel, Switzerland.

Japan to help manufacturers with TV-screen technology

By Yukari Iwatani Kane

TOKYO—The Japanese government said it is working with **Sony** Corp., **Sharp** Corp. and other electronics manufacturers to jointly develop a promising next-generation television technology, the latest effort to retain the competitiveness of Japan's electronics makers in an increasingly cutthroat industry.

The companies will develop large organic light-emitting-diode panels, or OLED, which use chemicals that can emit light, eliminating the need for the backlight used in conventional liquid crystal display sets. That means TV sets using this technology can be thinner and show crisper images with less energy.

OLED currently is used mostly in small displays for mobile phones, digital cameras and handheld television sets, but electronics manufacturers are racing to develop large OLED displays that can be mass-produced at a relatively reasonable cost for big, flat-panel TV sets.

Though it is still a new technology, Texas-based market research firm DisplaySearch expects OLED displays to grow into a $5.3 billion market by 2015 from $497.4 million in 2007. Sony became the world's first manufacturer to start selling an OLED TV set last year, but it is small at 11 inches and is priced at about $2,500. The set, made in small quantities and sold in Japan and the U.S., remains the only OLED set on the market.

Industry executives believe OLED TV sets one day will become as affordable as LCD televisions are now, but given that no company has yet figured out a way to mass produce large-sized OLED sets, they admit that such a future is still far off. Existing LCD and plasma TV sets have just recently become affordable for average consumers even though they have been in the market for years.

By initiating a joint research effort by 11 Japanese companies including materials and parts suppliers, the government is hoping to speed up development and to give Japanese electronics companies an edge. In addition to Sony and Sharp, a joint venture between **Toshiba** Corp. and **Matsushita Electric Industrial** Co. is participating.

Japanese companies have long been global leaders in the electronics industry, but they are struggling to compete against aggressive rivals such as Samsung Electronics Co. and LG Electronics Inc., both of South Korea.

The Japanese government's involvement in industry isn't new. The Ministry of Economy, Trade and Industry, under which the joint effort is being conducted, has been looking for ways to retain influence even as Japanese industries continue to be deregulated.

The ministry played a key role in guiding Japan's auto and electronics companies in the decades after World War II, as they turned into global leaders. But in recent years, it has lost its traditional role as a planner of industrial and trade policies and is now active in areas such as environment-friendly technologies and consumer protection.

The effectiveness of past efforts has been questionable. About five years ago, the government created a joint-development company called Future Vision to develop large, low-cost liquid-crystal-display TV sets at a time when manufacturers were struggling with the issue, but the company produced few results. A big impediment was the reluctance of manufacturers to share core technology that would allow them to differentiate themselves from rivals.

For the current project, the government says it plans to commit 3.5 billion yen ($32.8 million) over five years, a sum that people in the industry say is too small to make a difference, given the billions of dollars that OLED development would require.

The project aims to make it possible to mass-produce 40-inch or bigger TV sets by the second half of 2010.

Rebate checks aid U.S. retail sales

By Nicholas Casey, Gary McWilliams And Kevin Kingsbury

Many retailers beat expectations for June sales as U.S. tax-rebate checks continued to trickle in last month, with **Wal-Mart Stores** Inc. reporting its biggest same-store-sales increase in years. But apparel chains have yet to show similar improvements.

Wal-Mart's U.S. same-store sales for the five weeks ended July 4 rose 5.8%, the highest monthly rate of growth since May 2004, as Americans went bargain-hunting in its stores. The world's largest retailer by revenue said results in all of its market groups rose for the first time in two years.

Revenue was up nearly 12% to $39.94 billion, compared with $35.81 billion a year ago. The company also raised its profit estimate for the fiscal second quarter to a range of 82 cents a share to 84 cents, up from a range of 78 cents to 81 cents.

The Bentonville, Ark., retailer has shifted from building new stores to improving existing locations, and boosting advertising using a new value theme. A Wal-Mart spokesman said that customer visits, which had been declining for most of last year, increased "significantly." The company didn't disclose traffic figures.

Other discounters showed gains as well. **Costco Wholesale** Corp. reported a 9% rise in June same-store sales. Growth in the U.S. was 9%, with higher gasoline prices making up four percentage points of the gain. The increase internationally was 11%, or 8% excluding benefits from the weaker dollar. Smaller competitor **BJ's Wholesale Club** Inc. had a nearly 17% jump, half of which was thanks to gasoline sales. **Target** Corp. was the exception, again reporting weak results and generating just a 0.4% rise in same-store sales.

The industry is bracing for more difficult times, as the National Retail Federation estimates that 80% of tax-credit checks have been spent. Far less carryover is expected for July. "We have to keep in mind this is a short-term fix," said Scott Krugman, a spokesman for the National Retail Federation. "I don't think the retail industry is going to have sustained strength until other economic indicators change."

Indeed, many apparel chains continued to falter, though the June results appeared slightly better than analysts expected. The month saw a 0.8% drop in same-store sales, according to the Thomson Reuters Same Store Sales Index, thanks largely to a 7% slide at **Gap** Inc., the segment's biggest firm. Old Navy struggled with a 10% decline. The chain posted a 25% plunge in May.

Limited Brands Inc., which also has seen sales weaken significantly in recent months, reported a bigger-than-expected 9% drop for June. **Abercrombie & Fitch** Co. said last month's same-store sales fell 3%.

Late Wednesday, teen retailers **Zumiez** Inc. and **Hot Topic** Inc. posted weakened sales, though Hot Topic's 0.3% same-store-sales decline was narrower than expected and Zumiez's 3.4% drop was bigger than anticipated.

Some bright spots included **Aeropostale** Inc., whose same-store sales climbed 12%, and **Buckle** Inc. with an impressive 29% surge—both gains attributed to innovative marketing and merchandising. Mr. Krugman of the National Retail Federation said the results may indicate that there will be "some hope for the back-to-school" season, a critical time for the industry. He added that some parents may be saving tax-rebate money for use later in the summer.

Department stores, which also have been struggling, are anticipated to post a composite 2.6% decline. **J.C. Penney** Co., the company with the biggest sector weighting in the group, had projected a mid-single-digit decrease for June.

Holding back the segment's performance will be **Nordstrom** Inc. with a 22% drop, but its comparisons are skewed because it began its semiannual sale in May this year. That resulted in the company's May same-store sales rising 11% and the firm projecting a June decline of 18% to 22% at its department stores.

GE to shed entire division

Unit that includes appliances business is set to be spun off

A WSJ News Roundup

General Electric Co., in an effort to recharge its profit growth, plans to spin off its entire Consumer & Industrial division, rather than just appliances.

The GE units involved accounted for roughly $13.3 billion of the Fairfield, Conn., conglomerate's $173 billion in revenue last year, but an even smaller share of its profit, earning $1 billion of the total $22 billion. The biggest component of the unit is GE's well-known appliance business, which the company said in May it would try to sell. The other major pieces are GE's lighting business, which dates to Thomas Edison's invention of the incandescent light bulb in the 19th century, and a smaller electrical-distribution and motor unit.

In May, GE said a sale or spinoff of the $7.2 billion appliances division was one possible result of a strategic review. The company's management has been under pressure to trim its sprawling portfolio, which includes credit cards, aircraft engines and television broadcasting, following a disappointing first-quarter earnings report.

"As we explored our options for appliances, it became clear that the fastest, most-efficient step we could take in completing the transformation of our industrial portfolio would be to focus on a possible spinoff of the entire unit," Chief Executive Jeff Immelt said Thursday.

He said one advantage in keeping the unit together would be to maintain internal efficiencies. The division's various operations have "integrated processes, distribution and backroom operations," he said. "Consumer & Industrial would benefit by keeping a world-class leadership team intact."

GE in April reported an unexpected 5.8% drop in first-quarter net income amid weakness in its financial-services operations and issued a disappointing forecast for the rest of the year. Profit was down at four of six GE divisions, with only infrastructure and NBC logging gains. Second-quarter results were due Friday.

Jeff Immelt

In May, Mr. Immelt said he expected no shortage of suitors for the conglomerate's appliances unit, even as he acknowledged that the timing of a possible sale comes amid a "difficult" economic environment. He also had said GE was seriously considering spinning off the century-old unit instead of selling it outright.

The consumer and industrial division has 50,000 of GE's 300,000 employees.

The company is already trying to auction off its $30 billion credit-card business, though it has been attracting tepid interest as prospective buyers fret that customers of retail chains such as Wal-Mart Stores Inc., J.C. Penney Co. and Lowe's Cos. are having trouble paying their bills.

GE executives have acknowledged difficulties for the card business but have repeatedly said they aim to complete the sale in the fourth quarter. In addition, GE is trying to trim underperforming operations in GE Money, its consumer-finance unit.

Last year, GE shed its underperforming plastics business by selling it to a Saudi Arabian company for $11.6 billion.

In a research note, Robert T. Cornell, an analyst at Lehman Brothers, said the most-recent announcement "shows an accelerated pace of evolution that investors may well prefer over gradually evolving." Mr. Cornell said a spinoff, combined with additional asset sales at GE's consumer-finance unit, could hurt GE's earnings next year. "However the potential upside is a refocused and vital company sooner, a scenario we endorse," he concluded.

Steve Tusa, an analyst for J.P. Morgan Chase said the move was "not a big surprise, and a step in the right direction." But he said the businesses proposed for spinoff are small and face both slackening demand and tough competition. "There's not much value 'unlocked' here—we see no material near term impact on the stock price."

The latest news did little to move GE's stock, which was trading slightly higher Thursday afternoon at $27.33, near the low end of its one-year range of $26.15 to $42.15. The stock had its worst day in decades in April after the company reported the smaller-than-expected first-quarter profit and lowered its outlook for the full year.

Dow Chemical buys Rohm & Haas

By Ana Campoy

Dow Chemical Co. said it is buying specialty-chemical company **Rohm & Haas** Co. for $15.3 billion, marking a major step toward transforming itself into a growth company with fatter margins and steadier earnings.

The chemical company, which had coveted Philadelphia-based Rohm & Haas for years, paid a hefty premium to get it: $78 a share, which is 74% over the closing price of Rohm & Haas's shares Wednesday.

As part of the financing arrangement, **Berkshire Hathaway** Inc. and the **Kuwait Investment Authority** are buying $3 billion and $1 billion in convertible preferred securities, respectively. When the deal closes, Berkshire, which is run by Warren Buffett, will be Dow's largest shareholder.

Dow, based in Midland, Michigan, was one of several bidders for Rohm & Haas, a competition that accounts for the high premium. Germany-based **BASF** AG said it was also interested in buying the company.

Dow Chemical and Rohm & Haas would have had combined revenue of $62.41 billion last year.

Producers of high-tech, high-margin specialty chemicals such as Rohm & Haas "are very rare," Dow Chief Executive Andrew Liveris said in an interview. "We played to win."

The Haas family controls about one-third of Rohm & Haas, which is best-known for its paints and electronics-materials businesses. Raj Gupta, the company's CEO, said the family had been advised earlier this year to diversify its holdings, triggering interest in a group with sales of $8.9 billion in 2007.

Dow shares fell 4.3%, or $1.46 each, to $32.50 in late afternoon trading. Some investors had been expecting Dow to mount a major buyback of its shares rather than make a big purchase that could be difficult to digest in the short run.

Dow, which derives a large chunk of its revenue from thin-margin commodity chemicals, has been trying to expand its specialty-chemicals business for the past few years. Specialty chemicals, which go into products ranging from semiconductors to paint, are generally more profitable for manufacturers.

Some analysts think the $15.3 billion that Dow is paying is too much.

In recent months, the steep rise in oil and natural-gas prices has hammered Dow and other producers, which use the fuels as raw materials for their products. Dow, for example, recently announced sizable price increases across the board as well as production-capacity cuts for several products to deal with the higher energy costs and slowdown in the U.S. economy.

Producers of specialty companies, including Rohm & Haas, haven't been immune from the same problems. Last month, it said it was cutting jobs and reducing some of its operations to deal with higher raw material prices.

In light of these difficulties, some analysts think Dow is paying too much for Rohm & Haas.

"We've got some near-term pain that we need to go through," said Frank Mitsch, a managing director at BB&T Capital Markets. He downgraded his rating on Dow to "hold" from "buy" after the agreement was announced.

After the deal closes, Dow will transfer some of its specialty business to Rohm & Haas, which will keep its name and continue to be based in Philadelphia. Dow expects Rohm & Haas's annual revenue to grow to $13 billion from $8.9 billion in 2007.

The Kuwait Investment Authority's involvement, meanwhile, deepens Dow's connections with the Middle Eastern country, as an arm of its state-owned oil company is creating an $11 billion joint venture including various Dow assets.

Berkshire's role marks the second time in recent months Mr. Buffett is involving his company in financing a buyout. Berkshire is taking a stake in **Wm. Wrigley Jr.** Co. after its acquisition by **Mars** Inc. Berkshire is also providing $4.4 billion of subordinated debt to help finance the Wrigley deal.

—Doug Cameron and David Benoit contributed to this article

Associated Press

The **Toyota Motor** manufacturing plant in Princeton, Ind., where the auto maker produces the Tundra pickup truck and Sequoia SUV.

Toyota alters U.S. plans in drive away from SUVs

By Norihiko Shirouzu

Toyota Motor Corp. will revamp its U.S. manufacturing operations as rising gasoline prices lead to a sudden shift toward fuel-efficient models, a big change from just a few years ago when gas-guzzling sport-utility vehicles ruled the marketplace.

The Japanese company announced a series of moves in the U.S. that include scrapping plans to produce the Highlander crossover SUV in a plant it is building near Tupelo, Miss., starting in mid-2010. Instead, in late 2010, the company will produce the Prius, its fuel-sipping, gasoline-electric hybrid, at that plant.

Previously, Toyota was planning to produce about 120,000 Highlanders a year in Mississippi. It wasn't immediately clear, however, how many Prius cars Toyota plans to produce in Mississippi, or whether it plans to assemble Prius variants.

In addition, Toyota said it will temporarily suspend production of the Tundra pickup truck and Sequoia SUV beginning Aug. 8, citing the declining market for full-size trucks and SUVs. The company plans to resume production in early November, and said it will continue to provide work to employees at the affected factories.

Also as part of the planned move, Toyota is expected to consolidate production of the Tundra at a single site in San Antonio, Texas. Currently, Toyota produces the Tundra at two plants in the U.S., in San Antonio and the other in Princeton, Indiana.

In Indiana, Toyota produces the Tundra and the Sequoia SUV on one assembly line. It plans to produce the Highlander there in fall 2009 after it moves production of the Tundra.

The moves come as Toyota struggles for the first time with the problem that has plagued its U.S. rivals: too much North American manufacturing capacity. With the global credit crunch and soaring gas prices, officials have said that idle capacity in the U.S. exceeds the capacity of an entire assembly plant.

The company is struggling to make money at its two truck plants in the U.S. this year, underscoring the toll slumping sales of trucks and sport-utility vehicles are taking on all auto makers.

—Donna Kardos contributed to this article.

Financial firms see increase in IT spending despite slump

By William M. Bulkeley

Banks and brokerage firms are laying off workers and cutting costs as they struggle with the fallout of the subprime-mortgage crisis, but many are still planning to increase spending on information technology, according to a survey of 200 IT executives by **International Business Machines** Corp.

In a survey conducted last month in cooperation with the Securities Industry and Financial Markets Association, IBM found that 21% of those questioned were planning to increase IT spending by up to 10% this year, and 18% saw increases of more than 10%. Twenty percent of the managers said they expect to cut spending this year, with the balance either not responding or seeing flat spending.

For 2009, 41% predicted budgets would increase, 13% foresaw a decrease, and 28% predicted budgets would be the same, with 18% saying they didn't know.

The responses cover computer, software and services buying. Managers were asked to exclude staffing costs.

If the survey results turn out to reflect actual expenditures, financial firms would be spending more freely than buyers interviewed in broader surveys. Goldman Sachs Group Inc.'s latest IT spending survey, released this week, shows 30% of large companies expect to cut IT capital budgets this year, and only 13% expect increases topping 10%.

Market researchers predict that the U.S. economic slowdown will reduce growth in computer spending, but they don't foresee a contraction. IDC, based in Framingham, Mass., predicts U.S. technology spending will grow 4% this year, slowing from 7% growth last year when the market was $465 billion. The U.S. accounts for about 34% of world-wide tech spending, IDC says.

CORPORATE NEWS

Sinosteel scores an upset

China joins ranks of overseas raiders with Midwest deal

BY LAURA SANTINI AND RICK CAREW

HONG KONG—A Chinese metals trader, by winning a tough battle for control of an Australian iron-ore miner, has managed to pull off corporate China's first successful hostile acquisition of an overseas company.

Thursday, China's **Sinosteel** Corp. bought additional shares in **Midwest** Corp. that brought its stake in the Australian mining company to slightly more than the key threshold of 50%, according to people familiar with the situation, in a transaction that values Midwest at $1.36 billion Australian dollars (US$1.30 billion).

The acquisition is the latest sign of China's growing sophistication at securing resources that will feed the country's explosive economic growth. Sinosteel fended off competing offers from a rival suitor, **Murchison Metals** Ltd. of Australia, and enlisted the aid of Australian regulators in coping with a U.S. hedge fund's efforts to block the deal.

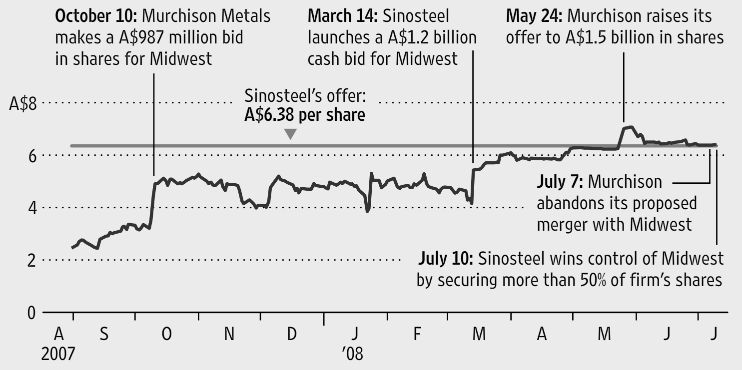
Several previous attempts by China to buy global assets ended in embarrassing defeat. The worst was suffered in 2005 when Chinese oil giant **Cnooc** Ltd.'s $18.5 billion bid for Unocal Corp. of California foundered on political resistance and inability to make quick decisions at key moments.

Earlier this month, in a display of new deal-making skills, an arm of Cnooc secured support for its $2.5 billion bid for **Awilco Offshore** ASA, a Norwegian oil-rig company. By the time the deal was announced, the Cnooc subsidiary had secured the backing of two major Awilco shareholders, which together held 40% of Awilco, plus the recommendation of the company's board.

China's appetite for commodities is pushing its outbound investment figures to new highs. So far this year, Chinese companies have acquired overseas assets valued at a total of $42.6 billion, nearly double what they invested overseas in all of 2007, according to Dealogic data. Natural-resources deals contributed a large chunk of the increase.

Success in Australia

Key dates in the takeover battle for Midwest, and how its stock price reacted:



Sources: Thomson Reuters Datastream; WSJ reporting

Until recently, Chinese companies heading overseas have largely pursued minority stakes in their targets, rather than outright control. In February, **Aluminum Corp. of China** Ltd., known as Chinalco, teamed up with U.S. metals giant **Alcoa** Inc. to buy 9% of **Rio Tinto** for more than $14 billion.

Sinosteel's president, Huang Tianwen, sent a Beijing executive, Wu Hongbin, to Australia to oversee the effort, which unfolded over a period of at least seven months. Mr. Wu's team was given "authority to make day-to-day decisions, and that was a key factor which helped them to win in a very dynamic bidding environment," says Alan Young, managing director of J.P. Morgan & Co., the adviser to Sinosteel. Morgan Stanley advised Midwest.

Sinosteel also reached out to Australian regulators, who blocked U.S. hedge fund **Harbinger Capital Partners** from voting alongside Murchison, which holds 10% of Midwest. Regulators ruled that Harbinger, which owns 20% of Murchison, couldn't act in concert with the company in backing its all-stock offer for Midwest.

Strong global demand for Australian commodities such as iron-ore and coal has fueled the rise of Midwest and a generation of other so-called junior mining companies. For instance, a year ago, Midwest's shares were trading at A$3.30. Thursday, they closed at A$6.40, above the Sinosteel offer of A$6.38 in cash for every Midwest share.

In reaching the threshold that would give it control, Sinosteel dealt a blow to Murchison, which operates an iron-ore mine in Western Australia that neighbors a Midwest asset. Murchison put forth a stock offer for Midwest in October, boosting that bid when Sinosteel entered the race.

Thursday, a Murchison spokesman reiterated the company's pledge not to turn over its own 10% stake in Midwest to Sinosteel. Harbinger also is unlikely to sell its Midwest shares. Since Murchison extended its own bid in May, its shares have tumbled 31%, closing at A$2.80 on Thursday.

Murchison had put forward a so-called reverse-takeover plan—by which its shareholders would have received 0.575 Midwest share for each share of Murchison. In a conference call with shareholders Wednesday night, Murchison sought to reassure investors that it would move ahead with its own iron-ore development project.

While Midwest's board wound up recommending the Sinosteel offer, the company's management previously had championed the possible cost-savings that would have resulted from a combination with Murchison. So far, Midwest's deputy chairman, David Law, has been unwilling to tender his own 13% stake in Midwest to Sinosteel.

However, in recent days, Sinosteel has won over other directors of the company who hold smaller stakes, putting Sinosteel above the 50% threshold, according to a person involved with the deal. Midwest referred calls to an outside public-relations representative, who didn't respond to calls.

Trial ends for Samsung's Lee

BY EVAN RAMSTAD

SEOUL—Prosecutors on Thursday asked for a seven-year prison term for Lee Kun-hee, the former chairman of the **Samsung** conglomerate, as they wrapped up a trial that was far shorter than the high-profile, three-month state investigation into wrongdoing at South Korea's biggest business.

A Seoul Central District Court judge is due to rule on the charges of tax fraud and breach of trust against Mr. Lee next Wednesday. If Mr. Lee is convicted, the judge might also pronounce a sentence at the same time. Under the charges brought against him, the 66-year-old Mr. Lee could receive life in prison, but Korean judges have a long record of leniency with major business executives.

After the charges were brought against him in mid-April, Mr. Lee retired from Samsung, the business empire that his father started 70 years ago and that he had led since 1987.

Mr. Lee has pleaded not guilty to the charges. Still, in several public and court appearances since retiring, Mr. Lee apologized to South Koreans and Samsung employees and accepted blame for wrongdoing at the conglomerate. He did so again during Thursday's hearing, telling the court he was "ashamed" about the charge brought against him in connection with tax. "It's natural for me to take responsibility, whether legally or morally," Mr. Lee said.

Lee Kun-hee

At Thursday's session, his attorneys asked for leniency.

Mr. Lee's trouble began last November when a former Samsung attorney alleged that various affiliated companies created secret bank accounts under employees' names to stash funds used to pay bribes to influential South Koreans, including politicians, judges and prosecutors.

The National Assembly appointed a special prosecutor, whose investigation grabbed local headlines nearly every day from the start of the year until indictments were announced against Mr. Lee and nine other Samsung executives.

The special prosecutor found no evidence of bribery. Instead, he said he discovered that the bank accounts were used to hide 4.5 trillion won, or about $4.5 billion, of Mr. Lee's personal assets, far more than he was known to be worth, and to evade taxes.

—SungHa Park contributed to this article.

GLOBAL BUSINESS BRIEFS

DnB NOR ASA

Net profit drops slightly amid high costs in market

Norwegian bank **DnB NOR** ASA said second-quarter net profit declined slightly, as higher costs and financial-market turmoil combined to offset a rise in net interest income. The Oslo-based bank said net profit fell to 3.23 billion kroner ($631.5 million) from 3.33 billion kroner a year earlier. Net interest income rose 19% to 5.02 billion kroner from 4.22 billion kroner as corporate lending helped offset retail margin pressure. Costs rose 14% to 4.45 billion kroner from 3.9 billion kroner because of international expansion and increased competition in the bank's home market. Amid market turmoil, the bank has benefited from its low-risk credit portfolios as well as Norway's oil-rich economy.

Investor AB

Investor AB, the main investment vehicle of Sweden's Wallenberg family, said it swung to a second-quarter loss, reflecting lower valuations of its key holdings amid falling stock markets and slower growth. The company posted a net loss of 3.52 billion Swedish kronor ($585.7 million), compared with a year-earlier net profit of 19.35 billion kronor. But the loss wasn't as steep as it was in the first quarter, when it hit 8.9 billion kronor. "We believe it is prudent to expect additional quarters characterized by economic weakness and turbulent financial markets," President and Chief Executive Börje Ekholm said.

Associated British Foods PLC

Associated British Foods PLC posted a 24% increase in fiscal-third-quarter revenue and said it expects profits to rise in the second half in all its units except the sugar division. AB Foods said the sales gain for the 16 weeks ended June 21 from the year-earlier period were driven by double-digit growth across its business units. Sales at its discount retailer **Primark Stores** Ltd. increased 14%, largely because of store openings. At the company's sugar business, sales increased 21%, but profit will be hit by the effects of the European Union's cutting of quotas since November 2005.

Telefon AB L.M. Ericsson

A Swedish appeals court upheld a verdict that cleared five current and former executives of wireless-equipment maker **Telefon AB L.M. Ericsson** of tax evasion. The defendants, including Ericsson's former chief strategy officer, were acquitted by a lower court in 2006 of charges that they filed false invoices worth about 3.3 billion Swedish kronor, or about $550 million, to avoid taxation. Prosecutor Lage Carlstrom appealed that verdict, saying it was based on a wrongful application of the law and failed to take key witnesses into account. However, the appeals court in Stockholm said it shared the district court's opinion that the invoices couldn't be deemed false or insufficient enough to claim Ericsson violated accounting laws.

Boeing Co.

Boeing Co. said its second-quarter earnings will include a pretax charge of about $250 million, or 22 cents a share, on delays at its Airborne Early Warning & Control program. Boeing has said it needs additional testing time for the Airborne system, which involves converting 737s into flying radar rooms for the military in a program known as Wedgetail. The program is so named because the radar antenna looks like a wedge-like fin that runs along the top of the fuselage. Boeing expects to deliver the first two aircraft, to Australia, in July 2009, four months later than scheduled. The remaining four aircraft will be delivered in 2010. The company continues to expect 2008 per-share earnings of $5.70 to $5.85, as the 22-cent charge is expected to be offset by strength across the aerospace giant.

StatoilHydro ASA

Norwegian oil company **StatoilHydro** ASA said it will cooperate with U.S. authorities expected to review its South Pars natural-gas project in Iran. "If they want to have further information and to talk to us, we are willing to give it to them," a spokesman said. He said StatoilHydro is "in the final stages" of the project, after which it "has no plans for further investment in Iran." U.S. law bans companies from investing more than $20 million in Iran, but so far the U.S. hasn't prosecuted companies that have apparently violated the Iran Sanctions Act, which aims to force Tehran to abandon uranium enrichment on concerns the uranium could be used for weaponry. StatoilHydro is the development-phase operator for South Pars 6-8.

GfK AG

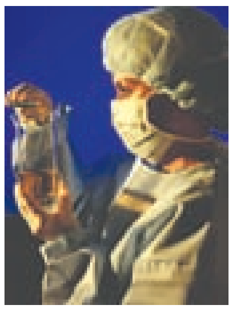
German market-research company **GfK** AG stressed that there was no certainty it would make an offer for British rival **Taylor Nelson Sofres** PLC after calling off an agreed merger. GfK said it was considering such an approach after **WPP Group** PLC, the world's second-largest advertising company behind New York-based Omnicom Group Inc., took its £1.08 billion ($2.14 billion) hostile takeover offer for TNS directly to shareholders. The fight for TNS has become increasingly acrimonious in recent weeks, with the company saying that WPP's continued offers and associated "commentary and innuendo" were an attempt to disrupt its planned deal with GfK. WPP wants to combine TNS with its own Kantar market-research business.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

U.S.

Governments join forces over drug-making plants



The U.S. Food and Drug Administration will join with European Union and Australian authorities to conduct overseas inspections.

The three governments will plan, allocate and conduct inspections of drug-making facilities, according to a U.S. government news release. The inspections initially will focus on makers of ingredients active in drugs, but will expand to other manufacturing facilities if successful.

The FDA has come under criticism for its lack of overseas inspections after a blood thinner, heparin, was contaminated and imported from China this year and linked to more than 80 deaths in the U.S.

—Jared A. Favole

EUROPE

Drug raids in 3 countries find labs, net 16 arrests

SWISS and German police arrested 16 people and uncovered 17 laboratories during hundreds of raids across three countries targeting an alleged synthetic-drugs network, officials in Bern and Munich said. Hundreds of police took part in the coordinated raids at 600 addresses Wednesday in Germany, Austria and Switzerland. They arrested eight people in Germany and eight in Switzerland. Police became suspicious of online orders for the legal chemical GBL, which is found in industrial cleaners but can be used to make the date-rape drug GHB. Most of the orders were placed with a 37-year-old chemical salesman near Munich, who was arrested Wednesday. *—Associated Press*

U.S.

Bill expanding spy powers passes Senate; Bush signs

THE U.S. SENATE approved a measure to expand government spy powers, ending nearly two years of debate.

In a 69-28 vote, the Senate approved a compromise measure that gives conditional immunity to telecommunications companies alleged to have helped spying efforts. The compromise essentially came down to Democrats agreeing to back the immunity provision, which the White House sought, in exchange for more oversight than Republicans wanted. On Thursday, President George W. Bush signed the bill. "This bill will help our intelligence professionals learn who the terrorists are talking to, what they're saying, and what they're planning," he said.*—Siobhan Gorman*

Bernanke, Paulson push for more muscle

Fed, Treasury chiefs testify for revamp of regulatory system

BY BRIAN BLACKSTONE AND MICHAEL CRITTENDEN
Washington

U.S. FEDERAL RESERVE Chairman Ben Bernanke on Thursday told lawmakers that financial-market turmoil is "ongoing" and said efforts should be aimed at returning conditions to normal on Wall Street.

Meanwhile, Treasury Secretary Henry Paulson, also in testimony to the House Financial Services Committee, said mortgage-finance giants **Fannie Mae** and **Freddie Mac** continue to have a vital function.

"They play an important role in our housing markets today and need to continue to play an important role in the future," Mr. Paulson said. He noted that their regulator, the Office of Federal Housing Enterprise Oversight, stressed earlier this week that "they are adequately capitalized." Fannie and Freddie, which represent the backstop of the failing U.S. housing market, have seen their stock prices tumble to 16-year lows this week amid fears about their capital.

Mr. Paulson also said the collapse of Bear Stearns and the continuing market turmoil have "convinced me that we must move much more quickly to update our regulatory structure and improve both market oversight and market discipline."

"It will take additional time to work through challenges. Progress has not come in a straight line, but much has been accomplished," Mr. Paulson said, noting that firms are deleveraging, raising capital and generally improving their financial positions.

Financial institutions shouldn't expect to be bailed out, Mr. Paulson said. "For market discipline to be effective, market participants must not expect that lending from the Fed, or any other government support, is readily available," Mr. Paulson said. "For market discipline to effectively constrain risk, financial institutions must be allowed to fail," he added.

Reuters

U.S. Treasury Secretary **Henry Paulson**, left, and Fed Chairman **Ben Bernanke** testified before the House Financial Services Committee on Thursday.

Mr. Paulson's comments came just two days after Mr. Bernanke said in a speech that the central bank is mulling an extension of its emergency-loan program for investment banks into 2009.

Mr. Bernanke's testimony largely echoed remarks he made Tuesday, laying out a greater Fed role in the oversight of financial markets. He told lawmakers that while an agreement between the Fed and the Securities and Exchange Commission to share information on investment banks is addressing short-term issues, "in the longer term...legislation may be needed to provide a more robust framework for the prudential supervision of investment banks and other large securities dealers."

He cautioned that any overhauls shouldn't "unduly inhibit innovation" or result in a shift of certain risky activities to other institutions.

Meanwhile, "because robust payment and settlement systems are vital for financial stability, the Congress should consider granting the Federal Reserve explicit oversight authority for systematically important payment and settlement systems," he said.

But Mr. Bernanke said the Treasury should have greater responsibilities when it comes to dealing with failed institutions. "Because the resolution of a failing securities firm might have fiscal implications, it would be appropriate for the Treasury to take a leading role in any such process, in consultation with the firm's regulator and other authorities," he said.

Obama stresses economic security in appeal to women

BY AMY CHOZICK

CHICAGO—Barack Obama laid out an economic agenda aimed at working women, his latest effort to attract skeptical voters loyal to former rival Hillary Clinton.

Earlier this week, the Obama campaign said Sen. Clinton's former director of women's outreach, Dana Singiser, had joined the campaign as a senior adviser in charge of outreach to women.

"I don't accept an America where a woman earns less than a man for the same work, or an America that makes women choose between their kids and their careers," Sen. Obama said in a statement.

His "Plan for Economic Security for America's Working Women" includes a repackaging of existing economic ideas such as a tax cut of as much as $1,000 per family that would affect as many as 71 million working women, and new proposals including a required seven days of paid sick leave for an estimated 22 million additional working women as well as more affordable child care.

The likely Democratic presidential nominee will need to win over the female voters who rallied behind Sen. Clinton during the primary. Before claiming the nomination, Sen. Obama showed strong support among affluent whites and African-American voters, but struggled to gain the backing of older and working-class women in some states.

On Feb. 5, Sen. Clinton beat Sen. Obama 53% to 43% among women. She defeated him 60% to 36% among white women, according to exit polls.

Michelle Obama

As the primary season neared a finish in late May, Sen. Obama's popularity among white women had declined. According to a Pew Research Center poll, as many as 39% of Sen. Clinton's female backers said they believed her gender hurt her candidacy, in part because of how she was treated by the media and her rival. Sen. Obama's favorability rating among white women dropped from 58% in March to 43% in May.

More recent polls show Sen. Obama leading among women against likely Republican nominee John McCain. In a Gallup poll conducted June 5-8, 51% of female voters said they prefer Sen. Obama, while 38% prefer Sen. McCain.

Sen. Obama's lead is in part the result of his campaign's recent outreach, including talking more about being the son of a single mother, said Democratic strategist Celinda Lake.

"They still have some weaknesses," Ms. Lake said. "But I think across the board they've been actively targeting women and so far have been quite successful at it."

Sen. Obama is expected to join Sen. Clinton Thursday at a "Women for Obama" breakfast fund-raiser in Manhattan. The candidate's wife, Michelle Obama, is on a two-day swing through the Midwest to hold roundtable discussions with working women. Campaign aides say Mrs. Obama, a mother of two young daughters and a lawyer who worked as a vice president at a Chicago hospital before campaigning full time on behalf of her husband, will be ramping up her event schedule and targeting this core demographic.

"As president Barack will change our politics and change our policies...to ensure that working women no longer have to choose between their kids and their careers," Mrs. Obama said Wednesday.

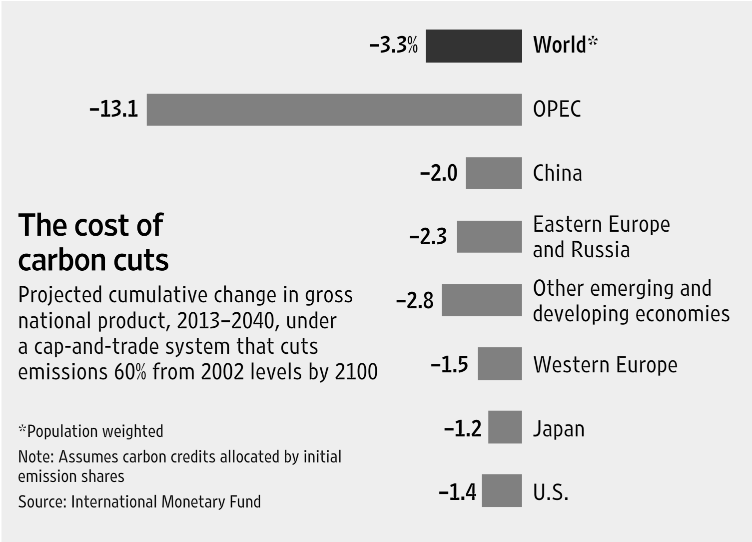
As part of his plan to support working women, Sen. Obama pledges to raise the minimum wage to $9.50 an hour by 2011 from $7.25 an hour in 2009, reduce health-care costs per family by as much as $2,500 and promote equal pay for women.

According to the Bureau of Labor Statistics, women earn 77 cents for every dollar earned by men. The pay gap is greater for minority working women, with Hispanic women earning 53 cents and African-American women 62 cents for every dollar men earn.

What cost climate target?

After G-8 meeting, questions looming over who will pay

By Jeffrey Ball



Leaders of the Group of Eight major industrialized economies, meeting in Japan this week, issued their first long-term target for cutting global-warming emissions. But their pronouncement failed to address the two toughest questions: How will the world do it, and who will pay?

The answer to the money question is clear: Consumers will pay—at the gasoline pump, at the car dealership and on the monthly electric bill. If the campaign against global warming gets serious, it will transform today's esoteric environmental threat into a fundamental pocketbook issue for people from Boston to Beijing.

But how much it will cost and how much it will do for the planet depend on the gritty details of how policy makers decide to attack greenhouse-gas emissions. Those details were in short supply this week, because the diplomats disagree—and because nobody knows.

G-8 leaders on Tuesday set a goal to halve greenhouse-gas emissions by 2050. The most common manmade greenhouse gas, carbon dioxide, is produced whenever fossil fuel—such as oil, natural gas or coal—is burned. Slashing the current level of greenhouse-gas emissions without injuring the global economy would likely require a range of technologies that today are still in the lab.

A separate diplomatic group that met on Wednesday and that included representatives from developing nations declined to endorse even the G-8's broad goal. Fast-growing countries like China and India don't want to commit themselves to an emissions-cut target, saying rich countries should ante up first.

Reaching the G-8's goal would go a long way toward preventing dangerous consequences from global warming but not all the way, according to many scientists. Some have called for even deeper cuts.

Many studies have tried to quantify what this would cost. A United Nations panel, for instance, said last year that reducing greenhouse-gas emissions enough to avoid the worst consequences could cut projected global economic output in 2030 by as much as 3% below the level it would otherwise reach that year.

Whether that is a reasonable price is a matter of debate. But even those who think the cost is worth it admit such studies have two whopping caveats.

The studies assume the world will cut emissions in the most economically rational way. And the studies acknowledge that the cost will hit some countries, companies and consumers harder than others.

The cost is "meaningful, but not devastating, to the economy," says Scott Nyquist, a director and co-head of the energy practice at consulting firm McKinsey & Co., which recently has issued several studies of the cost of curbing emissions. "But the point is, there are individual parts of the world that get hit harder." Consumers in countries—or regions within them—that rely more heavily on coal, for example, would likely face bigger increases in energy prices.

Two hints that consumers will significantly bear the costs of fighting global warming have cropped up in recent weeks.

One came from California, which proposed new rules in late June to cut its greenhouse-gas emissions to 1990 levels by 2020. Among the measures California is considering is a fee of between $10 and $50 per ton of carbon dioxide that is emitted. Translation: a potential increase in the wholesale price of gasoline of between 10 cents and 50 cents per gallon, the state said.

The U.S. Congress also recently acknowledged that it will have to provide financial help for consumers if it is to make cutting greenhouse gases politically feasible.

In early June, the Senate considered and rejected what broadly amounted to a mandatory U.S. version of the G-8's nonbinding global pledge. The bill sought to cut U.S. emissions about 65% from current levels by 2050. Included in the bill was a provision for tax relief for Americans whose bills for coal-fired electricity would rise as a result.

Among the few specifics in the G-8 proposal was for more research and development of new technologies to burn coal more cleanly. Many of the world's biggest economies have huge coal reserves. As energy prices soar, these countries intend to burn more of that coal than ever before.

That suggests the debate over what to do about global warming is about to get a lot more personal for consumers, says Billy Pizer, a senior fellow at Resources for the Future, a Washington think tank that focuses on energy issues. The relatively easy step is setting broad goals for emission cuts decades hence. But whatever progress that represents doesn't answer the stubborn question, he says: "What are we actually going to do?"

Nordic inflation pushes higher

By Joel Sherwood

Inflation has picked up pace in the Nordic region, leaving its already hawkish central banks less room to boost sluggish economies with lower interest rates.

Sweden's consumer-price index rose a higher-than-expected 0.5% on a monthly basis, pushing the annual rate in June to 4.3%—the highest level since November of 1993, figures released Thursday revealed. Last week, Sweden's central bank forecast—while increasing its key rate a quarter percentage point to 4.5%—a 4.1% June on-year rise in the index.

The Riksbank had said last week it sees the need to raise rates "on a couple of occasions" this year to combat surging inflation and inflation expectations. Thursday's data seemed to remove the possibility that slackening economic activity in Sweden would prompt the central bank to backtrack on its aggressive fight against inflation.

"We expect two further hikes from the Riksbank this year," said Dominic Bryant of BNP Paribas.

Inflation continued to accelerate in Norway and Denmark also, data from respective national statistics agencies showed Thursday.

In Norway, the consumer-price index rose on an annual basis to 3.4% in June, from a 3.1% rate in May, still over the Norges Bank's target of a 2.5% inflation rate.

"In all then, the latest data show that inflation has moved further away from the Riksbank's and Norges Bank's targets," said Ben May of Capital Economics. In Denmark, data released Thursday showed that the country's European Union-harmonized index of consumer prices in June rose a higher-than-expected 0.4% on the month and to 4.2% on the year.

The June annual rate is the highest for the index, which national statistics agency Statistics Denmark began measuring in 1996.

Economists say the high rate will likely erode Denmark's competitiveness, which may in turn make the country's economic slowdown worse and longer than expected.

With two consecutive quarters of economic contraction, Denmark has become the first country in the European Union to fall into recession since the credit crisis hit last year.

However, inflation figures weigh little on monetary policy in Denmark, where the country's currency, the krone, is pegged to the euro. Denmark's central bank typically keeps rates in line with European Central Bank rates to stabilize exchange rates, regardless of domestic economic development.

China reports slowdown in June export growth

By Andrew Batson

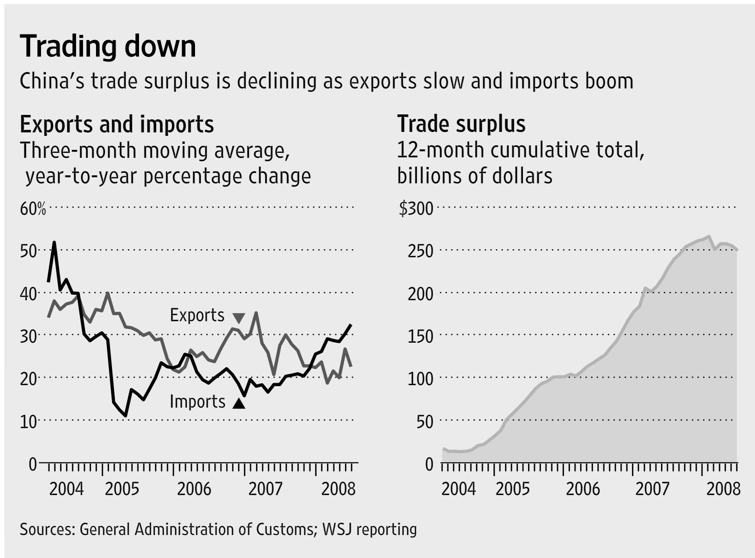
BEIJING—A further slowdown in China's export growth last month could add to domestic political pressure on the government to loosen credit curbs and slow appreciation of the yuan.

Merchandise exports in June rose 18% from a year earlier to $121.53 billion, China's customs agency reported Thursday. That was below most forecasts and significantly slower than the 28% jump recorded in May. Total imports of goods in June, by contrast, jumped 31% from a year earlier to $100.18 billion, shrinking the nation's trade surplus for the month by more than a fifth to $21.35 billion.

Slowing export growth is being caused by both economic weakness in the U.S. and the Chinese currency's appreciation against the dollar, which makes Chinese goods relatively more expensive. China's exports to the U.S. are up action as China continues to confront both high inflation and a slowing global economy. The compromise course of policy this year has been to stop raising interest rates but still try to cool economic activity somewhat by putting limits on bank lending and raising the value of the yuan. But with the currency already up 4.1% against the U.S. dollar in the first quarter and an additional 2.3% in the second quarter, many in China still think that is too much, too fast.

"If you worry about the U.S. market turning down, rising costs at home and hot money inflows, then you say, 'stop' " appreciating the yuan, says Barry Naughton, a long-time observer of the Chinese economy at the University of California, San Diego. "I disagree with this position, but it's perfectly logical."

Mr. Naughton points out that exports are still growing quickly. For the second quarter of 2008, exports were up 22% from a year earlier, in line with growth rates for



just 8.9% so far this year, though shipments to Europe and Asian countries are doing better. Exporters complain that the yuan's rise against the dollar is eating into their revenue as labor and raw-material costs are also increasing.

Thursday's trade figures were issued just days after Premier Wen Jiabao and other top leaders toured different parts of China and made a show of listening to the worries of businesses. Mr. Wen, who visited the eastern coast, "was particularly concerned with the difficulties faced by textile companies," according to the official account. Vice Premier Wang Qishan, who oversees financial policy, was for his part "very concerned with the situation of exporters and the difficulties they face."

Many scholars and analysts interpreted that public show of concern as an indication that the government is shifting priorities to supporting growth, rather than controlling inflation—which has been running at decade-high levels and which officials have called their top priority. Other analysts believe the visits were intended more to reassure the public than to signal a substantive change. A meeting Wednesday of the State Council, China's top government body, discussed the economy but didn't produce any major new policy announcements.

In either case, significant divisions are likely to remain in the government over the proper course of the two previous quarters, though down from the 26% to 28% expansion in early 2007. The bill for imports, however, has steadily risen along with the prices of the raw materials China buys in large quantities. Imports for the quarter were up 32%, accelerating from the 28% gain in the first quarter and the 21% increase for 2007.

With growth in exports slowing while imports are accelerating, it now seems clear that China's trade surplus peaked around the beginning of this year and is set for a gradual decline. China's global trade surplus in goods came in at $57.62 billion for the second quarter, down 13% from a year earlier.

Most economists deem a fall in China's huge trade surplus to be inevitable, and largely desirable. But because exports have contributed a lot to growth in recent years, there is concern that such a decline will be accompanied by a slowdown in the overall economy.

In this debate, China's central bank is believed to favor tougher policies to fight inflation. A commentary in the central bank's newspaper Thursday said that "controlling inflation requires continuing to strengthen and improve macroeconomic control measures"—in other words, that relaxing credit curbs and other restrictions isn't yet warranted. Inflation may have moderated to 7.7% in May from 8.5% in April, the commentator noted, "but the general trend of high inflation has not changed."

REVIEW & OUTLOOK

The Price of Fannie Mae

As opposed to GM or Ford, most Americans have never heard of Fannie Mae and Freddie Mac. Yet the insolvency of either mortgage giant would have far more profound consequences for every American taxpayer than the bankruptcy of those car companies. It's time Americans understood the price they could soon pay for the Beltway's confidence game with these high-risk "government-sponsored enterprises."

These columns have warned about Fannie and Freddie going back to 2002, and our fate has been to climb a wall of denial and hostility. This week reality began to set in. The duo's share prices tanked nearly 20% on Monday on fears that their capital levels may not be adequate. They rallied on Tuesday as their regulator played cheerleader, but they sank again Wednesday to prices in the teens, compared to more than $60 a share last October. Investors are saying that a Bear Stearns-like run on the companies is a real possibility, and they're right.

Hank Paulson

* * *

What Americans need to know is how damaging such a failure would be. This wouldn't merely be a matter of the Federal Reserve guaranteeing $29 billion in dodgy mortgage paper, a la Bear Stearns. Fannie and Freddie are among the largest financial companies in the world. Their liabilities—mortgage-backed securities (MBSs) and other debt—add up to some $5 trillion.

To put that in perspective, consider that total U.S. federal debt is about $9.5 trillion, compared to a total U.S. GDP of $14 trillion. About $5.3 trillion of that debt is held by the public (in the form of Treasury bonds and the like), while $4.2 trillion is intragovernment debt such as Social Security IOUs. This is the liability side of America's federal balance sheet, and its condition influences how much the government can borrow and at what rates.

The liabilities of Fan and Fred are currently not on this U.S. balance sheet. But one danger is a run on the debt of either company, putting pressure on the Treasury and Federal Reserve to publicly guarantee that debt to prevent a systemic financial collapse. In an instant, what has long been an implicit taxpayer guarantee for both companies would be made *explicit*—committing American taxpayers to honoring as much as $5 trillion in new liabilities. U.S. debt held by the public would more than double, and the national balance sheet would look very ugly.

Taxpayers may soon pay for this Beltway-Wall Street creation.

The companies have a stronger liquidity position than Bear, but investors are saying the chance of a collapse is greater than our politicians want to admit. With its share price decline this week, Fannie Mae's market capitalization is down to $15 billion. Yet at the end of the first quarter, the company had $42.7 billion in capital. Investors are saying that as a business Fannie is worth only slightly more than *one-third* of its capital cushion. Fannie's debt is also priced at the highest spreads over Treasurys since 2000—another sign of eroding confidence.

Freddie's market discount from its capital cushion is even worse. Its shares fell nearly 24% Wednesday—to a market cap of some $6.8 billion. Yet its capital, at the end of the first quarter, was $38.3 billion. The message from markets is that both companies are in danger of exhausting their capital and becoming insolvent if home prices keep falling and mortgage losses mount.

Why is there so little Washington or Wall Street alarm about this? Because the politicians and financiers are part of the consensus that has long promoted the growth of Fannie and Freddie. Congress created the companies to spur home ownership and, in return, got an endless stream of campaign contributions and election support. Beltway elites like James Johnson and Jamie Gorelick made tens of millions working there. Wall Street marketed their MBSs to buyers around the world, pitching them as virtually as safe as Treasurys (due to the implicit taxpayer guarantee) but with a higher return. Everybody made a bundle.

The assumption was that the taxpayer guarantee would never have to be honored, just as everyone before the savings and loan debacle thought deposit insurance would rarely have to be paid. But these political bills always come due.

The double irony amid the current credit crunch is that U.S. politicians have been promoting Fannie and Freddie as mortgage saviors even as their risk of insolvency has grown. Chuck Schumer, Chris Dodd and others have encouraged the duo to take on even greater mortgage risk as the housing slump has unfolded. They're the arsonists posing as firemen while putting more dry tinder around the blaze.

So how do Americans get out of this mess? The worst option would be to let the situation erode until the Fed and Treasury panic amid market pressure and issue an explicit taxpayer guarantee. The consequences from putting $5 trillion in liabilities on the federal balance sheet would raise America's borrowing costs and jeopardize the Treasury's AAA credit rating. The dollar could face greater selling pressure, especially if the Fed tried to inflate away this greater debt burden. And all without a single Congressional appropriation or public debate.

Hank Paulson's Treasury is now pressing Congress to move quickly to create a new regulator with greater powers—not least to reassure Fannie and Freddie's borrowers. The question is whether this is too little, too late. Congress is refusing to set a statutory limit on their MBSs, though reducing this business and their debt is the only way to limit taxpayer risk. And under pressure from Congress, the regulator recently *eased* the companies' capital requirements.

* * *

Our own proposal, made months ago, is to require a more honest form of socialism by injecting taxpayer money now into both companies (say, in the form of subordinated debt or preferred stock) to recapitalize them enough to weather the current storm. This would help prevent a U.S. balance sheet debacle, and it would force the politicians to acknowledge the mess they have created. Then as the crisis passed, the taxpayers would at least get something for their money, while regulators could work to unwind Fan and Fred's liabilities and shrink these monsters to a less dangerous size.

This would be real "change" in Washington. Instead, the political class continues to promote the status quo illusion that Fannie and Freddie are risk-free purveyors of the American housing dream. It is one of the great political scandals of our age, and it has unfolded in broad daylight. As usual, the American taxpayer will get stuck with the bill.

Iran's Missile Threat

Talk about timing, perhaps fortuitous. On Tuesday, U.S. Secretary of State Condoleezza Rice was in Prague signing an agreement that's a first step toward protecting Europe from ballistic missile attack. As if on cue, Tehran Wednesday tested nine missiles, including several capable of reaching southern Europe, as well as Israel and U.S. troops stationed in the Middle East. Remind us. Who says Iran isn't a threat?

The chief naysayer is Moscow, which continues to insist that the planned American-led missile defense for Europe is aimed at defeating Russian missiles, not Iranian ones. This was Vladimir Putin's line, and the new Russian President, Dmitry Medvedev, picked it up Wednesday, saying that the antimissile system "deeply distresses" Russia and is a threat to its national security. The Russian Foreign Ministry issued a statement warning that if the system is deployed, "we will be forced to react not with diplomatic, but with military-technical methods." Good to see the Russians haven't lost their subtle touch.

No one in that neighborhood—least of all the Russians—actually believes Iran's missile program is anything but dangerous. Russians talk privately about the Iranian threat, and it's not hard to imagine a scenario whereby Tehran shares a missile—and perhaps a nuclear warhead—with its brother Muslims in Chechnya.

About that defense system: Tehran will soon be able to target Europe.

In any case, Washington's proposed antimissile system for Europe is designed to defend against one or two missiles launched from Iran, not against the thousands of missiles in the Russian arsenal. It would include a tracking radar in the Czech Republic and 10 interceptors in Poland (or perhaps Lithuania, if the Poles can't get their act together). Russia's claim that this highly limited defense poses a threat to its nuclear deterrence is absurd.

Wednesday's tests offered no big surprises about Iran's missile technology, but they are a useful reminder of just how real the Iranian threat is—and how rapidly it is growing. One of the missiles tested was the latest update of the Shahab-3, which has a range of about 1,250 miles.

Replace the payload with a lighter one—say, a nuclear warhead—and the range gains 1,000 miles. Add a booster and the range can be extended even farther. North Korea did just that with its Taepodong missile, technology that it passed along to Iran. U.S. intelligence estimates that Iran will have a ballistic missile capable of reaching New York or Washington by about 2015.

Iran may already have the capability to target the U.S. with a short-range missile by launching it from a freighter off the East Coast. A few years ago it was observed practicing the launch of Scuds from a barge in the Caspian Sea.

This would be especially troubling if Tehran is developing EMP—electromagnetic pulse—technology. A nuclear weapon detonated a hundred miles over U.S. territory would create an electromagnetic pulse that would virtually shut down the U.S. economy by destroying electronic circuits on the ground.

The proposed "third site" in Europe is part of a rudimentary missile-defense system that the U.S. already has in place for its homeland. It's one of the unsung successes of the Bush Presidency, and the U.S. and its allies are safer for it. Yet few Democrats are willing to acknowledge it. That apparently includes Barack Obama, whose response to Iran's missile tests Wednesday was to call for more direct diplomacy with Tehran, tougher threats of economic sanctions and bigger incentives to behave—all of which Tehran has sneered at numerous times.

Some 30 nations, including North Korea and Syria, have ballistic missiles and their proliferation is sure to continue. The European site is part of the Bush Administration's vision of missile defense with a global reach. Iran's latest missile tests show that Europe needs an antimissile system more than ever.

Comments? The Journal welcomes readers' responses to all articles and editorials. It is important to include your full name, address and telephone number. Please send letters to the editor to: **Letters@WSJ.com**

On Taste

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■ **As his kids** head off to camp, Cameron Stracher remembers an era when summers were spent more simply—and cost a lot less.

■ **"The cool" was** born in a hot New York apartment in 1948, but Tom Nolan says the musicians who changed jazz were inspired by Claude Thornhill's big band.