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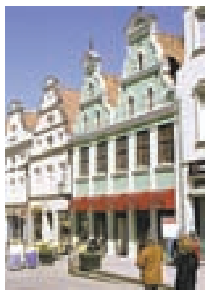

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■ **Rumors about Lehman** are the focus of the SEC's investigation into potential market manipulation in the U.S. Page 19

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■ **Danone and Wahaha** appear to be headed for a breakup of their partnership as they look beyond a longtime feud. Page 6

■ **Euro-zone money growth** eased in June amid slowing credit growth, removing one motivation for the ECB to raise interest rates. Page 22

■ **Alcatel-Lucent's services** division is expanding while growth in fixed- and mobile-phone equipment has been sluggish. Page 3

Markets

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11370.69	+21.41	+0.19
Nasdaq	2310.53	+30.42	+1.33
DJ Stoxx 600	281.76	-0.45	-0.16
FTSE 100	5352.6	-9.7	-0.18
DAX	6436.71	-3.99	-0.06
CAC 40	4377.18	+29.19	+0.67
Euro	$1.5675	+0.0002	+0.01
Nymex crude	$123.26	-2.23	-1.78

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World-Wide

Sen. Obama wooed Europe and the Middle East last week with calls for a major transformation of U.S. foreign policy, but his extensive courting of Israel and its political leadership served as a signal to some in the Arab-Israeli peace process that the Illinois senator might not be as neutral a political broker as they had originally anticipated. Page 1

■ **Abbas said Egypt** will resume mediation talks between Fatah and Hamas, two days after a car bomb killed six people in Gaza and prompted tit-for-tat arrests.

■ **West Bank homes** go without water for hours, and sometimes days, because of a shortage, the Palestinian Water Authority says.

■ **Iraq's provincial elections** are unlikely to be held this year, a top lawmaker said, because of an impasse with Kurdish leaders.

■ **Greek and Turkish** Cypriot leaders plan to start talks on Sept. 3, sparking hopes of ending the island's 34-year division.

■ **Storms and floods** in the Carpathian Mountains killed 13 in Ukraine and five in Romania. Thousands were evacuated and more than 300 Ukrainian towns and villages were without power.

■ **With the Olympics set** to open in 11 days, organizers said competition and training venues were completed, but journalists questioned Beijing's compliance with other promises. Page 9

■ **An appeal was filed** by Radovan Karadzic's defense team to stop Serbia from extraditing the ex-Bosnian Serb leader to the U.N. war-crimes tribunal.

■ **Spain jailed** seven people on charges of belonging to a militant cell of the Basque separatist group ETA believed responsible for recent bomb attacks.

■ **A high alert was declared** in India's cities after a string of bombs in Ahmedabad killed dozens and wounded more than 150 Saturday. Page 32

■ **Two consecutive explosions** in Istanbul killed at least eight people and injured two dozen.

■ **The owner of a ferry** that sank in the Red Sea, killing more than 1,000 Egyptians, was acquitted of criminal charges.

■ **Carlos Sastre of Spain** won the Tour de France.

Editorial & Opinion

Brown on the ropes

Labour doesn't have a mandate for another elected premier. Review & Outlook. Page 11

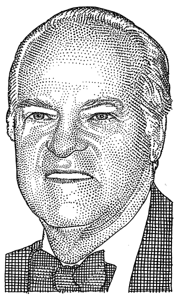
KKR moves to go public

IPO will value firm at up to $15 billion; grim time in market

By Dennis K. Berman

Kohlberg Kravis Roberts & Co. will soon be a publicly traded company, as the venerable private-equity firm prepares a transaction that will list it on the New York Stock Exchange and could value it at between $12 billion and $15 billion, people familiar with the matter say.

KKR, founded by Henry Kravis and George Roberts, is plunging into the public markets at a dark time for private fund managers, who generally make the bulk of their income buying and selling companies. The credit markets have largely closed on such deals, making funding hard to get and drying up the pipeline of fees that they create. What is more, the vintage of transactions from 2006 and 2007—a furiously busy period for the whole buyout industry—is widely regarded as overleveraged and overpriced.



Henry Kravis

In finally moving to the public markets—having filed papers more than a year ago—KKR is asking investors to believe in both the firm's past and its future.

Indeed, KKR has proved itself a consistent performer since its founding 32 years ago, delivering an average annual return of 26%. While some deals, notably its historic takeover of RJR Nabisco, yielded meager returns, KKR has showed it could navigate through good times and bad. But now investors must trust KKR's acumen in other investing arenas, where it has little or no track record.

Part of KKR's plans include bigger investments in infrastructure and real estate, mezzanine debt investing and old-fashioned stock picking. The hope is to transform KKR into a broad asset manager, anchored but not exclusively controlled by the private-equity earnings.

This was also the mission of **Blackstone Group** LP, which went public in the summer of 2007 just as the credit markets were cresting. So far Blackstone shares have performed poorly, as investors fret about the strength of the firm's earnings stream. Blackstone shares began trading on June 22, 2007, and closed that day at $35.06 on the New York Stock Exchange. Since then, the shares have fallen $18.05, or 51%, to $17.01. Blackstone shares trade at

Please turn to back page

Obama sends mixed signals on trip abroad

By Jay Solomon

CHICAGO—Barack Obama wooed Europe and the Middle East last week with calls for a major transformation of U.S. foreign policy, pledging to withdraw American soldiers from Iraq while building closer trans-Atlantic ties.

But the Democratic presidential candidate's 10-day, eight-nation trip also hinted at the potential limitations on his campaign to reorient America's overseas strategy, should he be elected in November. A number of European and Arab analysts said such shortcomings could risk alienating the very people the presumptive Democratic presidential candidate has inspired most in the U.S. and globally during his presidential campaign. "The Arab Street definitely prefers the Democrat to become the next American president," said Radna Habib, a Jordan-based political analyst who tracked Sen. Obama's visit to Amman. "But they're still pessimistic about the U.S. perception of Muslims and Arabs."

Barack Obama

Sen. Obama, in an interview Saturday en route to Chicago from London, said he had learned on the overseas tour that "people were more optimistic about our ability to solve [the Arab-Israeli] problem and how important it is to addressing broader problems in the region."

"If we can solve the Palestinian question," he added, "I think it will be much easier for moderate Arab states and leadership to ally strongly with us in our policies towards Iran."

Still, Sen. Obama's extensive

Please turn to back page

Banks' status still shaky despite recent stock rally

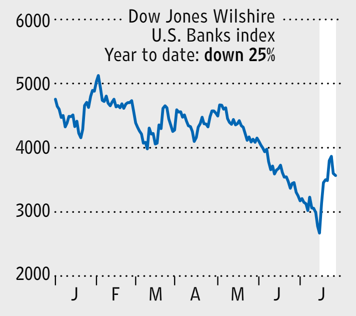
By E.S. Browning

Every few months since the credit crisis began a year ago, bank stocks have rallied on hopes that the worst is over. They did it again, loudly, a few days ago. But there are signs that it may be too soon to sound the all-clear.

The rebound this time was impressive. From their July 15 low through Wednesday, U.S. bank stocks surged 45% according to the Dow Jones Wilshire bank index. Even after giving back some gains late in the week, the prices of some financial stocks have doubled from their July lows.

Still, the hardest-hit, such as **Washington Mutual**, **National City** and **Fannie Mae**, remain down 80% or more from their 2007 highs.

These sudden surges typically happen when stocks have fallen so drastically that short-term investors see the opportunity to cash in on a bounce. A government move to clamp down on short-selling, making it harder for investors to bet on stock declines, was a big catalyst for the recovery this time.



If longer-term investors decide the worst is over and start buying, this sudden recovery can mark the end of a bear market. If the longer-term investors stay away, the stock

Please turn to back page

LEADING THE NEWS

Brazil agrees to a compromise at WTO summit

By John W. Miller

GENEVA—European Union and U.S. trade negotiators achieved a minor breakthrough at the World Trade Organization summit, persuading Brazil to accept a compromise proposal on agricultural and industrial goods.

The Latin American country Friday accepted some tariff cuts on goods like cars and chemicals in exchange for a $14.5 billion cap on U.S. farm subsidies, down from $15 billion three days earlier. Those are key points of contention in the seven-year-old Doha Round of world-trade talks.

A final resolution remains far from certain. China, India, South Africa, Argentina and many others remain opposed to the compromise proposal, drawn up by WTO chief Pascal Lamy Friday in a last-ditch attempt to save the talks. And there are still dozens of unresolved issues on the table.

The negotiations began last Monday and quickly turned into a marathon session of ill-tempered bargaining. "The biggest concern we have is that a handful of large emerging markets threaten this round for the rest of us," said U.S. Trade Representative Susan Schwab.

In particular, India's industry-and-commerce minister, Kamal Nath, has proved inflexible on the key EU and U.S. demand that he accept cuts in tariffs on industrial goods like cars and chemicals.

But Brazil's acceptance of Mr. Lamy's proposal could unlock the tension in the talks, say analysts. Brazil and India had previously forged an iron pact of resistance to Western demands on industrial tariffs. "The talks had foundered for days and were on the verge of collapsing, so this is important," says Paul Blustein, a trade analyst at the Brookings Institution.

Banks feel heat of U.S. housing bill

Lenders must agree to take partial loss for program to work

By Damian Paletta

WASHINGTON—The housing rescue bill passed by the U.S. Senate Saturday hasn't even been signed into law, but top Democrats already are putting pressure on regulators and bankers to try to make sure a major program to prevent foreclosures doesn't fall flat.

For struggling U.S. homeowners, the success or failure of the program—which would let roughly 400,000 owners refinance into affordable, government-backed loans—depends largely on bankers' willingness to take a partial loss on the loans and to reduce the amount of money borrowers owe.

Bankers say they will do it, but it isn't clear how many loans they might be willing to restructure.

"I absolutely do believe that there will be more principal reductions," Michael Gross, **Bank of America** Corp.'s managing director for loss mitigation, mortgage, home-equity and insurance services, told a congressional panel Friday.

If successful, the program could put a dent in the rising foreclosure figures as interest rates on adjustable-rate loans continue to increase while house prices in many areas slip. RealtyTrac Inc. reported last week that 739,714 homeowners received foreclosure warnings and other related notices in the second quarter.

Experts say the program's eventual participation could rise dramatically if home prices continue to drop—which could put more pressure on lenders to offer borrowers more assistance. Lawmakers are already pressing regulators and lenders to prepare now so the program can begin without delay when it goes into effect Oct. 1.

The Senate approved the bill 72-13 after the House of Representatives passed it Wednesday in a 272-152 vote. Minutes after the Senate vote, Senate Banking Committee Chairman Christopher Dodd (D., Conn.) called for a prompt meeting with the Federal Reserve, the Department of Housing and Urban Development, and other regulators to determine the quickest way to get the program up and running.

House Financial Services Committee Chairman Barney Frank (D., Mass.) on Friday asked lenders to hold off on foreclosures until Oct. 1 if it is possible the borrower would qualify for the government program. He threatened legislation if loan servicers and investors don't work together to help avert foreclosures.

Taking a loss on a loan by writing down the principal owed is one of the least desirable options for loan servicers. They typically prefer to either lower the interest rate or extend the life of the loan—from 30 years, for example, to 40 years.

"The real problem is going to be, just like with every program out there, are the banks going to take this seriously?" said Rebecca Case-Grammatico, a staff attorney at the Empire Justice Center in Rochester, N.Y., who advises clients facing foreclosure. "And if they don't, we're in the same position we've been in all along."

Whether banks embrace the program could mean the difference between foreclosure and homeownership for people like Kimberly Cox, 37 years old, who lives with her family in a house in New Boston, Mich. Ms. Cox refinanced the $254,000 mortgage on her house three years ago into a mortgage that had a flat interest rate for the first two years and then switched to an adjustable rate. When rates reset a year ago, her monthly payments jumped from $2,100 to $2,800.

The program will be run by the Federal Housing Administration and will insure to $300 billion in refinanced 30-year, fixed-rate loans. The mortgages can't be for more than 90% of the home's newly appraised value. For mortgages that exceed the value of the home, the lender would have to voluntarily write down the principal to the qualifying level. If the home goes up in value, the borrower must share newly created equity with the FHA.

The program will begin Oct. 1 and sunset on Sept. 30, 2011. Borrowers won't be able to qualify if they have intentionally defaulted on their loans or if they have a debt-to-income ratio of less than 31% as of March 1.

Karen Yule, a retired schoolteacher and counselor in Denver, hopes the program could help her save her two-story townhouse from foreclosure. She consolidated two mortgages on the home into one loan through a refinancing several years ago.

Her new adjustable-rate loan gave her multiple options each month, and she typically paid the lowest amount. Recently, her loan servicer told her she could no longer pay the lower amount she had been paying—$1,200—and her payments doubled to $2,400, well above what she was able to pay. She has tried to move into a more affordable loan, but there is a hefty prepaymentpenalty if she moves out of her current loan before next year.

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.

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INDEX TO PEOPLE

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

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

LEADING THE NEWS

Alcatel's services expand

Company shifts focus because core business likely to stay sluggish

BY LEILA ABBOUD

Since **Alcatel-Lucent** was formed in a trans-Atlantic merger two years ago, the telecom-equipment maker has struggled with eroding profit and intensifying competition. It has lost more than half of its market capitalization.

But one bright spot is likely to be included when the company reports second-quarter results Tuesday: Alcatel-Lucent's services division, which nearly doubled in size last year to provide €3.2 billion ($5.02 billion) of the company's €17.8 billion in annual revenue.

The services division is under the spotlight because growth in the company's core business—fixed- and mobile-phone equipment—is likely to remain sluggish. Most of the revenue from Alcatel-Lucent's services unit comes from managing telecom operators' networks, including operating mobile towers and introducing digital-TV services.

But Alcatel-Lucent is also branching out to serve new kinds of clients—hospitals, police departments and utility companies, among others—to help them build private networks in highly specialized environments. For example, Alcatel-Lucent is working on a project for the U.K. Highways Agency that is aimed at modernizing communications systems on highways in order to better manage traffic flow.

Alcatel-Lucent has helped French electricity-grid operator RTE to lay a fiber-optic communications network on top of its high-voltage power lines. Far under the Alps, Alcatel-Lucent is building a communications network in what will be, upon completion, the world's longest tunnel, the 36-mile-long Gothard Base tunnel between Switzerland and Italy.

Alcatel-Lucent's push into new areas is an effort to offset slowing growth in its core business of selling equipment to the world's telecom operators. It also wants to differentiate itself from low-cost Asian manufacturers, such as China's Huawei Technologies Co. and ZTE Corp., which are increasingly commoditizing telecom equipment such as broadband routers and telephone switches.

The transformation from equipment maker to service provider is also happening at **Telefon AB L.M. Ericsson** and **Nokia Siemens Networks**. Unlike Alcatel-Lucent, however, those two rival companies have decided to stick to the telecom arena—not only developing but also managing and maintaining the networks of big operators like France Télécom SA or Telefonica SA.

"We target the telecom operators because that is where our expertise lies," said Jan Frykhammar, Ericsson's head of global services. "It also helps us to gain better leverage with our customers and create synergies."

In becoming service providers, telecom-equipment makers are taking a page out of the handbook of technology companies such as **International Business Machines** Corp. and **Hewlett-Packard** Co. IBM, the iconic computer hardware manufacturer, has refocused on consulting and information-technology services, which now account for the majority of its sales.

"The way the telecom-equipment business is changing is very similar to the way the information-technology sector changed," says Andy Williams, who heads Alcatel-Lucent's service business after spending many years at IBM. "We're just about five to eight years behind" the information tech industry.

The change of direction won't be easy for Alcatel-Lucent, which is suddenly facing new types of customers, many of whom know little about communications. Mr. Williams says it will take between three and five years to see whether the strategy will actually help Alcatel-Lucent ride out the telecom industry's difficult predicament.

Some are cautious about whether the services strategy will pay off for telecom-equipment makers. Rod Hall, an analyst for J.P. Morgan, questions whether managing telecom operators' networks "is really an attractive business."

"Margins are low and the tasks they are given can turn out to be more complex and costly than expected," said Mr. Hall, who has an "overweight" rating on Alcatel-Lucent. But Mr. Hall said he was intrigued by some creative steps Alcatel-Lucent had taken to address these problems, such as a joint venture it signed with Indian telecom operator Reliance in which both sides have an economic stake in the outcome of outsourcing deal.

Indeed, Michael Fabian, head of the nontelecom part of Alcatel-Lucent's service division, said he recently negotiated a five-year contract to help New Zealand's electricity grid operator modernize its infrastructure. When it came time to finalize the deal, the client didn't haggle over price, recalled Mr. Fabian.

"They were more interesting in making sure the technology would be fail-safe even over 50 years," he says. Alcatel-Lucent signed a €150 million contract with the grid operator, TransPower Ltd. TransPower didn't return phone calls seeking comment.

Alcatel-Lucent

The **Gotthard Tunnel** is being constructed under the Alps between Switzerland and Italy.

CORPORATE NEWS

AUTOMOBILES

Daimler is in talks to buy 42% of Russia's Kamaz


Kamaz

GERMAN auto maker **Daimler** AG said it is in exclusive talks with **Troika Dialog** about acquiring a 42% stake in truck maker OAO **Kamaz**, as it seeks to expand in the growing Russian market. Daimler, the world's biggest truck maker by sales, said the deal would combine its technological expertise Kamaz's production facilities, sales structures and Russian network. Kamaz is Russia's leading heavy-duty truck maker, selling more than 53,000 trucks last year, Daimler said. It has annual revenue of $3.8 billion.

Investment company Troika Dialog holds 54% of Kamaz and the Russian state has a 38% stake.

—Hilde Arends

INFORMATION TECHNOLOGY

Capgemini will acquire unit of KPN's Getronics


JexOpen

FRENCH information-technology services company **Capgemini** said it will pay €255 million ($400 million) for a unit of **KPN** NV's Getronics subsidiary, bolstering its position in the Dutch public sector.

The acquisition of the business-application unit, which generated revenue of €297 million, will add 5% to Capgemini's net profit in 2009, said Chief Financial Officer Nicolas Dufourcq.

Pending approval by regulators, Capgemini said it expects to close the deal for Getronics PinkRoccade Business Application Services BV by year end.

—Jethro Mullen

MUSIC

Rolling Stones leave EMI and sign with Universal


Kevin Mazur/AFP/Getty Images

THE ROLLING Stones confirmed their long-expected defection from record label EMI Group Ltd. to **Vivendi** SA's Universal Music Group, the latest in a string of departures by major acts from the music company.

People close to the situation said the deal gives Universal the right to distribute, for about five years, Stones albums released since 1971, and to release two or three new albums. The departure had been expected since January, when the band and Universal said that label would release the soundtrack to Martin Scorsese's concert film "Shine a Light."

—Ethan Smith

U.S. buyers snub diesel

Rising gas prices block campaign from European car makers

By Christoph Rauwald

EUROPEAN auto makers' efforts to persuade more Americans to buy cars with diesel engines are turning into an uphill battle due to rising prices at the pumps.

German manufacturers **Volkswagen** AG, **Daimler** AG and **BMW** AG have launched initiatives to make diesel cars more popular in the U.S. as they bet Americans will eventually overcome the perception that diesel engines are loud, smelly and polluting. But their plans appear to be stalling on the back of soaring oil prices.

"The recent price hike is a major blow for the companies' initial plans to offer more cars with diesel engines in the U.S.," said Global Insight analyst Roman Mathyssek. He said more-focused marketing efforts along with the diesel engine's superior fuel efficiency still might be able to win over American customers, if the price for diesel eases again.

Less than 5% of the cars on the road in the U.S. have diesel engines. That compares with about 55% in Western Europe.

"As far as diesel is concerned, I've become more skeptical. There's not much happening in the U.S.," said Karl-Thomas Neumann, an executive board member of auto-supplier Continental AG.

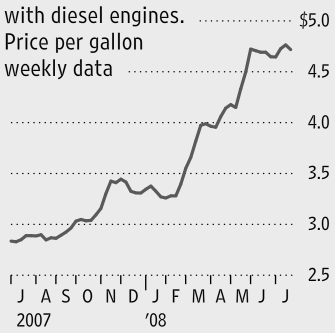
Crude oil for September delivery fell $2.23, or 1.8%, to $123.26 a barrel on the New York Mercantile Exchange on Friday, up 60% from 52 weeks ago.

According to the U.S. Energy Information Administration, the average price per gallon for diesel fuel rose $1.88 over the past 12 months to $4.73 as of July 7, compared with a rise of $1.13 to $4.11 for regular gasoline. Since September 2004, the price of diesel fuel in the U.S. has been higher than the price of regular gasoline amid rising demand for diesel fuel in China, Europe and the U.S., which increased pressure on the tight global-refining capacity.

Pressure at the pump

Diesel-fuel-price rises make it more difficult to sell cars with diesel engines.

Price per gallon weekly data



Note: data through July 21

Source: U.S. Energy Information Administration

Additionally, the transition to low-sulfur diesel fuel in the U.S. has pushed up production as well as distribution costs, and the federal excise tax on diesel fuel is six cents higher per gallon, at 24.4 cents, than the tax on regular gasoline.

Volkswagen, Daimler and BMW, which invested heavily in the development of modern diesel engines, said the fuel economy of diesel engines, especially on longer journeys, is superior compared with a hybrid car. Hybrid cars are powered by an electric engine combined with a conventional combustion engine, which leads to lower fuel consumption, particularly in urban traffic. But for highway travel, hybrids depend on their combustion engines.

Charlie Freese, **General Motors** Corp.'s director of diesel engines, said the business case for diesels in the U.S. has sagged under the high cost for that fuel. "As far as the economic justification for buying a diesel, it's just not there for many people."

He said hybrid-electric vehicles make sense in many cases in the U.S., especially for people who drive mostly in congestion. Heavier vehicles such as trucks, which need a lot of power, are an ideal fit for diesel.

GM will begin offering lighter versions of its pickup trucks with diesel engines in 2010. It already has several heavier-duty trucks available with diesel engines. Mr. Freese declined to say whether the company will bring diesel-powered passenger cars to the U.S. market.

Despite the sharp increase in fuel prices, European auto makers are determined to persevere with their diesel plans in the U.S. for now.

Volkswagen Chief Executive Martin Winterkorn said he still sees significant potential for diesel cars in the U.S. "We've received great feedback from our dealers on our diesel models," Mr. Winterkorn said.

That sentiment was echoed by BMW. "There are a couple of different issues that pushed the price for diesel up in the U.S., but there's still very clearly a logic behind launching diesel in the U.S.," BMW executive board member Ian Robertson said.

"We'll stick to our plans....We don't expect the recent trend to continue. The price gap between diesel and gasoline will narrow again," Mr. Robertson said. BMW later this year plans to launch cars with diesel engines under the BluePerformance label.

Daimler shares that assessment. "We monitor the diesel price in the U.S. very closely, and the circumstances could be better, indeed," said Daimler spokesman Christoph Horn.

"Diesel has been a success for us in the U.S. as demand is rising, and there is no sign so far that this trend would reverse," he said, adding that diesel cars already account for about 25% of the M-Class vehicles the company sells in the U.S., even though no major marketing effort has been made.

Mercedes-Benz sold around 5,500 cars with diesel engines in the U.S. in the first five months of the year, compared with roughly 4,500 in the same period last year. Overall, Mercedes-Benz sold 99,703 cars in the U.S. in the January-to-May period.

Mercedes-Benz sells diesel versions of its M-, R- and GL-Class models in 45 states and is rolling out a new diesel-engine generation, dubbed BlueTec, for sale in all 50 states in the fall.

Daimler promotes BlueTec as the world's cleanest diesel engine, using filters and traps to reduce soot and nitrogen-oxide emissions.

—John Stoll contributed to this article.

Scania shows profit gain but demand is uneven

By Ola Kinnander

STOCKHOLM—Swedish truck maker **Scania** AB reported a 51% jump in second-quarter net profit, benefiting from strong demand in Russia, Latin America and Asia.

Net rose to 3.04 billion Swedish kronor ($503.7 million) from 2.01 billion kronor a year earlier. Revenue increased 14% to 23.89 billion kronor.

Shares in Scania on Friday rose 4.75 kronor, or 5.5%, to 91.25 kronor, outperforming the broader Stockholm market, which rose 0.1%.

Order bookings, an indicator of future sales, fell 25% in the quarter. Scania said high oil prices, greater uncertainty about economic developments and long lead times have made customers more cautious.

"The long-term outlook remains good, but recent developments in various markets in Europe make it difficult to give an outlook for 2009," said Chief Executive Leif Östling, adding that earnings will be higher in 2008 than in 2007.

Scania's earnings and sales numbers were "fantastic," but its order intake continues to decline and its outlook is uncertain, said Michael Andersson, an analyst at Evli Bank.

Hampus Engellau at Handelsbanken Capital Markets said the 25% decline in order intake was better than the 34% drop he had expected. "Overall it was a pretty good report," he said.

Orders booked from Western Europe fell 48%, with the slowdown especially big in the U.K., Spain and the Netherlands. Scania's market share for heavy trucks in the U.K., its second-biggest market after Brazil, fell to 16.1% in the first half from 16.5% a year ago, even as truck registrations in the U.K. rose 45%.

DAILY SHARE PRICE

Scania AB

On the Stockholm Stock Exchange

Friday's close:

91.25 Swedish kronor, up 5.5%

Year-to-date change: **down 37%**

Source: Thomson Reuters Datastream

In Central and Eastern Europe, orders fell 35%. Latin American order bookings were up 45%, and in Asia the bookings rose 36%. Scania also lost market share for heavy trucks in Brazil in the first half, seeing a decline to 19.1% from 24.2%.

Scania said it is working to boost its presence in the Middle East. During the second half, it plans to begin operations at a new plant in Dubai.

"We are continuing to expand our technical capacity to an annual rate of 90,000 vehicles towards year-end 2008 and 100,000 by the end of 2009," Mr. Östling said.

GE realigns with eye toward sale

By Lauren Pollock

General Electric Co. realigned its operations into four segments, including two infrastructure groups, from six, anticipating the sale or spinoff of its appliances, lighting and industrial divisions.

The move appears to rule out additional major portfolio divestitures that some observers have been calling for, such as the sale of NBC Universal or its health-care division.

Chief Executive Jeffrey Immelt said two weeks ago that the restructuring was likely.

The conglomerate will reorganize its operations into Technology Infrastructure, Energy Infrastructure, GE Capital and NBC Universal.

GE, which earlier this month posted a 5.8% drop in second-quarter net income, said the moves are intended to simplify the company.

CORPORATE NEWS

Honda's net accelerates

Demand offsets costs of commodities, yen; rough road ahead?

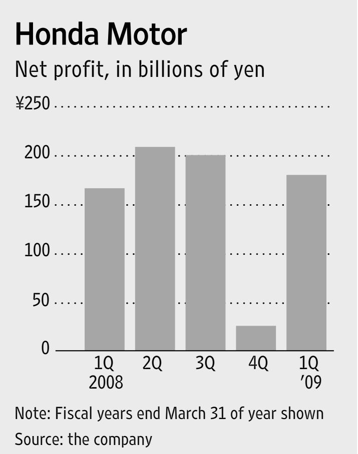
By John Murphy

TOKYO—**Honda Motor** Co. posted a surprise 8.1% increase in net profit for its fiscal first quarter as strong demand for its fuel-sipping vehicles in the U.S. and increased sales to emerging markets helped offset the impact of higher raw-materials costs and a stronger yen.

Though Japan's No. 2 auto maker by sales volume behind Toyota Motor Corp. beat analysts' expectations, the company is still bracing for a tough year amid a global economic slowdown. Honda trimmed its global auto-sales forecast to 4.08 million from 4.14 million because of projected auto-sales declines in North America, Asia and Europe.

Honda's results stand in stark contrast with the latest earnings from other global auto makers. Ford Motor Co. reported an $8.7 billion loss for the second quarter and outlined measures to revamp its North American operations. Daimler AG Thursday said its second-quarter net profit dropped 26%.

Honda posted net profit in the quarter ended June 30 of 179.61 billion yen ($1.67 billion), compared with 166.12 billion yen a year earlier. Revenue fell 2.2% to 2.867 trillion yen because of the rising strength of




2008 Honda Civic Sedan
Wieck

the yen against the dollar, which diminished the value of overseas earnings. The net profit beat analysts' mean forecast of 131.35 billion yen, compiled by Thomson Reuters.

During the same period, Honda sold 962,000 automobiles, up 1.7% from a year earlier, as sales increased to China and Brazil. Its North American auto sales slipped 1.1% to 460,000 for the quarter.

Still, analysts say Honda has clear advantages over its Japanese rivals in the U.S., the world's largest car market, as drivers flock to its fuel-efficient models like the Civic amid rising gasoline prices.

Toyota and Nissan Motor Co., as well as U.S. auto makers, are feeling the pinch of sluggish demand for their lineups of gas-guzzling trucks and sport-utility vehicles. Honda, with a more modest offering of larger vehicles, has been less affected by this market shift. This month, it said it would cut production of its Odyssey minivan and Pilot SUV in the U.S. while seeking to meet rising demand for its smaller passenger cars.

For January to June, as the overall U.S. auto market shrank by 10%, Honda's sales increased 4.1% while Toyota's sales slipped 6.8% and Nissan's fell 2.4%, according to Autodata Corp. Nissan will release earnings this week, and Toyota will report earnings Aug. 7.

Honda, however, still has a pessimistic outlook for the fiscal year ending March 31, 2009, and projects an 18% fall in net profit to 490 billion yen. The car maker says a stronger yen and rising commodity prices for materials needed to build cars will both weigh down earnings.

The company initially expected higher steel and other material costs to cut its operating profit by 740 billion yen this fiscal year. But now it anticipates these costs will reduce operating profit by an additional 125 billion yen, Honda Executive Vice President Koichi Kondo said at a press conference.

—Yoshio Takahashi contributed to this article.

In race for sales in U.S., Honda is making gains

By John D. Stoll

U.S. auto makers on Friday will report vehicle sales for July, and another substantial decline is expected. In the battle for top spot, **Toyota Motor** Corp. is nipping at the heels of longtime leader **General Motors** Corp. But GM has been propping up sales with heavy incentives, which should enable the company to remain No. 1, at least for now.

The more telling development this week and in the months ahead, however, could be the race for No. 3. **Honda Motor** Co. is the only major car company that guessed right on gasoline prices and geared up in the past few years to sell small cars. The Big Three and Toyota all put their bets on trucks.

Since gasoline prices climbed to $4 a gallon, U.S. consumers have turned away from Detroit's truck and heavy-vehicle lines in favor of passenger cars, especially models with four-cylinder engines, Honda's specialty. Toyota, too, has been forced to temporarily idle truck plants and overhaul its manufacturing plans.

Honda's sales, meanwhile, have surged. In June, it passed **Chrysler** LLC to become the fourth-largest auto maker in the U.S. for that month. In July, it will likely beat Chrysler again and edge closer to the No. 3 player, **Ford Motor** Co.

In June, Honda's market share was 12%, fewer than three percentage points behind Ford's 14.6%, according to Autodata Corp. Ford expects its share to decline in the second half, too. A year ago, the two were separated by nearly seven percentage points.

Over the first half of 2008, Honda sold nearly 100,000 more passenger cars than Ford, and it is poised to gain more ground. A new plant that Honda has been building in Greensburg, Ind., is set to start production in September, making the Civic compact. In 2009, the plant could crank out up to 200,000 Civics, just as Americans are flocking to the vehicle. It was the top-selling model in the U.S. in May.

For the last several years, Honda has worked to build a green image with consumers while turning out small cars with style and flair—a formula that appeals to Americans on many levels, from concerns about global warming to fuel prices to foreign-oil imports.

"This is the legacy they have decided to cultivate and it's turned out to be the single silver bullet that is needed," said Michael Bernacchi, a marketing professor at the University of Detroit. "Their Web site speaks to it, their products speak to it and they use every opportunity to sell the fact they are the greenest car around."

UBS suspends executive in U.S.

By Liz Rappaport

UBS AG suspended David Shulman, the Swiss bank's head of fixed income in the U.S. and global head of municipal securities, according to people familiar with the matter.

The suspension comes as state and federal investigations have heated up into sales and marketing of auction-rate securities by UBS and other Wall Street firms. Mr. Shulman ran the auction-rate-securities business at UBS.

The office of New York state Attorney General Andrew Cuomo last week followed Massachusetts state securities officials by filing a civil-fraud lawsuit against UBS regarding its sales of auction-rate securities. Neither has charged any individual, though Massachusetts named Mr. Shulman as a figure who helped to direct UBS's efforts.

A UBS spokeswoman confirmed the firm placed an employee on administrative leave. The suspension occurred in mid-July.

Mr. Shulman is cooperating fully with UBS as it works through these matters, a spokesman for Mr. Shulman said.

Both New York and Massachusetts suits allege that UBS and its executives knew the auction-rate-securities market was collapsing last year and early this year, and didn't disclose the problems to investors. Instead, the suits allege, the firm marketed the securities to institutional and retail investors through its sales forces to clean their own inventories of the investments.

According to the Massachusetts case, Mr. Shulman helped to direct those sales. The case names several other UBS employees and made public reams of their emails.

A spokeswoman said UBS is frustrated by the cases because the firm is working to help its clients holding auction-rate securities. She said the firm doesn't believe any of its employees acted illegally, but some might have used poor judgment. She also said UBS will defend itself against any charges.

After encouraging UBS-affiliated financial advisers to increase their efforts to sell auction-rate securities to retail investors starting in August, the Massachusetts complaint said, Mr. Shulman, head of Fixed Income Americas at UBS, also sold much of his personal holdings in the instruments.

The New York lawsuit alleges that in all, top UBS executives sold $21 million of their own auction-rate securities as the market fell into deeper turmoil.

Auction-rate securities—issued by municipalities, student-loan companies, charitable organizations and others—are long-term securities that Wall Street engineered to have short-term features.

Lufthansa ground workers set to strike

Associated Press

FRANKFURT—**Lufthansa** AG, Germany's biggest airline, faces a major strike by ground crews and others this week after the union said Friday that its members voted overwhelmingly to support a massive walkout.

The ver.di union, which represents some 52,000 Lufthansa workers, said nearly 91% of its members voted for the strike in two weeks of balloting that came after talks with the airline collapsed July 10.

Ver.di had sought a pay rise of 9.8% this year, and rejected a Lufthansa offer of 6.7% spread through February 2010, plus a one-time bonus payment.

Ver.di said the strike could start Monday and would affect all areas: catering, Lufthansa Cargo, and maintenance and repair staff at Lufthansa Technik. A strike could also affect cabin and check-in personnel, but to a lesser extent.

"Lufthansa is one of the most profitable airlines in the world," said Erhard Ott, ver.di's national director. He added that he expects "a significantly better" offer from the company, without specifying how much higher. He also said he was expecting open-ended and time-defined strikes from different divisions and locations.

Lufthansa spokeswoman Claudia Lange said she couldn't comment on the number of flights that could be affected, but said the company was preparing for the worst. Lufthansa will have to see when and where the walkouts unfold before it can determine how its domestic and international flights, including long-haul destinations to Asia, the Middle East and the Americas, are affected, she said.

"We'll try to offer as many flights as possible, and limit the effects of a strike as much as possible," she said.

Chrysler will no longer offer leases through finance arm

By Neal E. Boudette And John D. Stoll

DETROIT—In a sign that the woes afflicting Detroit and Wall Street are starting to feed on one another, Chrysler LLC said Friday it will no longer offer auto leases through its lending arm, a move that couldfurther crimp the car maker's sales.

The move by Chrysler Financial, previously reported on the Web site of The Wall Street Journal, comes as the finance unit has been scrambling to borrow fresh money amid tight credit markets. It also underscores how weak sales are starting to undermine the financing arrangements that underpin American car sales.

For years, auto makers have offered leases as a way of getting customers into new vehicles with attractive monthly payments. Since leasing customers essentially rent vehicles for just two or three years, their monthly payments are typically lower than they would be if buyers took out loans to buy their cars outright.

But leases pose a big risk for finance units such as Chrysler Financial. These operations need to borrow billions of dollars, because they buy and own the vehicles to be leased. After the leases expire, they sell them at used-car auctions—hopefully at a profit.

The Big Three auto makers and their financing units have been piling up increasing losses in recent quarters stemming from leases, mainly as a result of falling resale values on trucks and sports-utility vehicles leased a few years ago. With the rise of gasoline prices to $4 a gallon, used pickups and SUVs sell for much less than the auto makers had expected.

On Thursday, Ford Motor Co. took a write-down of $2.1 billion related to unprofitable lease deals made by Ford Motor Credit.

Spokeswomen for Ford Motor Credit and for GMAC LLC, the auto-finance unit jointly owned by General Motors Corp. and Cerberus Capital Management LP, declined to comment on whether their companies would scale back their lease offerings. In 4 p.m. composite trading on the New York Stock Exchange, Ford was down 1.17% at $5.05 a share, and GM fell 8.46% to $11.90.

Detroit's Big Three and some other auto makers are suffering from a downturn in U.S. auto sales and a consumer shift from trucks to more fuel-efficient cars. Chrysler's U.S. vehicle sales have fallen 22% in the first half of 2008

In a bid to pump up sales, GM announced new deals Friday in which a limited number of customers will be allowed to buy new vehicles at the discounted prices it normally reserves only for its employees.

Chrysler's decision stems from trouble facing its finance unit at both the borrowing and selling ends of the lease business.

For the past few weeks, Chrysler Financial has been trying to persuade more than 20 banks to renew a $30 billion credit facility—backed by car loans, leases and loans to dealers. The facility was issued by the auto-finance company last year when it was carved out of the former DaimlerChrysler AG.

But so far it has been unable to do so at attractive interest rates, both because of the jittery state of potential lenders and Chrysler's own uncertain financial situation.

—Jeff Bennett and Liz Rappaport contributed to this article.

Infineon plans job cuts

Chip maker reports widening of net loss; Qimonda is a weight

By Archibald Preuschat

FRANKFURT—Chip maker **Infineon Technologies** AG of Germany posted a wider fiscal third-quarter net loss Friday, weighed down by unprofitable memory-chip unit Qimonda AG, and said it plans to cut 3,000 jobs as part of a restructuring program.

"The job cuts can't be avoided," said Chief Executive Peter Bauer, citing market conditions, the weakness of the U.S. dollar against the euro and the necessity of reorganizing the company.

The cuts, scheduled to take place in Infineon's next fiscal year, should result in savings of at least €200 million ($314 million) annually, the company said. The savings Infineon wants to achieve are higher than expected, said Sal. Oppenheim analyst Juergen Wagner.

Infineon has roughly 43,000 employees world-wide, including about 13,500 Qimonda employees.

Note: fiscal year ends Sept. 30
Source: the company

Infineon's fiscal fourth quarter ending Sept. 30 will be significantly affected by charges related to the cost-cutting program, the company said. Mr. Bauer declined to give details on the charges.

Infineon posted a net loss in the quarter ended June 30 of €592 million, compared with a year-earlier loss of €197 million.

The latest results included a write-down of €411 million related to Infineon's 77.5% stake in Qimonda. Infineon already wrote down €1 billion on its Qimonda stake in the second quarter. Mr. Bauer reiterated that Infineon wants to cut its Qimonda stake to below 50% by early 2009.

Revenue rose 1.8% to €1.03 billion from €1.01 billion.

The company's two core businesses showed mixed results. The automotive, industrial and multimarket division reported a profit, while the communication-solution unit remained unprofitable.

Infineon said it expects revenue in the current quarter to increase by a mid-single-digit percentage from the fiscal third quarter, while earnings before interest and taxes are expected to be stable or to decline slightly from the previous quarter.

Sal. Oppenheim's Mr. Wagner said Infineon's dependency on its automotive, industrial and multimarket unit was also cause for concern, given the weak performance of the automotive sector right now.

Infineon shares rose 5.3% to €5.08.

Higher prices lift Danone net 34%

By Geraldine Amiel

Groupe Danone SA posted a 34% rise in first-half net profit as the company managed to offset a drop in volume with price increases. The French dairy, water and baby-food company also upgraded its full-year margin forecast.

First-half net profit was €879 million ($1.38 billion), compared with €656 million a year earlier. Revenue jumped 18% to €7.69 billion.

For the second quarter, revenue also rose 18%, to €3.93 billion, despite a tough consumer environment. Fresh-dairy sales were up 8.7%, the company said.

Sales at the water division slipped 0.8% in the second quarter on an organic basis, which excludes currency fluctuations and any effect from integrating Dutch baby food company Numico. Danone blamed the drop in volume on what co-Chief Operating Officer Emmanuel Faber called a "perfect storm." In Europe, he said, most notably in France, Spain and the U.K., bad weather, combined with port and transportation strikes, dented sales.

Better weather so far in the third quarter could improve the figures, Danone's Chief Financial Officer Pierre-Andre Terisse said.

Danone reiterated that it expects full-year revenue to grow between 8% and 10%. It also raised the outlook for its operating margin, saying it now expects growth between 0.4 and 0.5 percentage point, up from its previous forecast of "at least" 0.3 percentage point.

Danone Chief Executive Franck Riboud said the company is boosting margins by reacting quickly in markets where it sees weakness and by accelerating innovation to keep its competitive advantage.

The company's free-cash flow this year also is likely to beat its target, said Mr. Faber. Danone predicts its full-year free-cash flow to reach between 7% and 8% of sales.

The integration of Numico, which Danone bought last year, "is doing great," said Mr. Faber, adding that he is confident it will deliver planned cost synergies of €45 million. Of these, €20 million were delivered in the first half, he said.

The optimistic forecast boosted Danone shares 7.7% Friday to €48.29 in Paris trading.

Motorola reorganizes mobility unit

By Sara Silver

Motorola Inc. is reorganizing its second-largest business unit, home and networks mobility, into three distinct businesses, a step that could make it easier for Motorola to sell some of the businesses in the future.

The changes, outlined in a memo to employees last week, come ahead of Motorola's quarterly report on Thursday. The Illinois-based telecom-equipment maker is expected to report on plans to split itself into two companies, separating its troubled cellphone unit from the rest of Motorola, the home and networks mobility unit and its public-safety radios division.

Home and networks mobility, with revenue of $2.4 billion in the first quarter, supplies telecom carriers and cable companies with the equipment to provide voice, broadband and TV services. Until now it had been organized as an array of businesses, making cable set-top boxes, modems, cable infrastructure and network gear to carry voice and data signals.

The reorganization aligns these businesses into three distinct units. One unit will include the cable set-top boxes operation as well as other equipment for digital video, Internet-based video and modems. It will be led by John Burke, who currently oversees the cable set-top business, the world's largest by sales.

The company's networks-gear business will be divided in two. One unit, cellular networks, will focus on traditional wireless equipment sold to telecom carriers and be led by Fred Wright. The other, broadband access solutions, will focus on next-generation technologies including WiMax and LTE, which have so far produced little revenue. This unit will be led by Dan Moloney, head of home and networks mobility, until a permanent leader is announced.

Dan Coombes, who was senior vice president for wireless broadband systems, will become an adviser to Mr. Moloney.

Coming at a time when Motorola is contemplating various restructuring options for the entire company, the reorganization could pave the way for Motorola to keep the cellphone business and spin off or sell other pieces, one analyst said. "This opens the way for a reverse spinoff, in which everything but the handset business is sold," said Ittai Kidron, analyst at Oppenheimer & Co.

The memo to employees noted that "these changes are not a reaction to Motorola's separation plans or a cost-cutting measure." The memo said "it's time to position our business for continued success over the next five years."

A Motorola spokeswoman said the reorganization "will ensure that Home & Networks Mobility remains agile, focused and ideally aligned to realize its growth potential."

Danone, Wahaha appear likely to part amid feud

By James T. Areddy

SHANGHAI—An escalating dispute between **Groupe Danone** SA and **Hangzhou Wahaha Group** Co. over China's largest soft-drinks empire looks increasingly as though it could result in a breakup of their 12-year-old partnership, one of the country's most prominent foreign joint ventures.

The disagreement has hurt both Paris-based Danone and Wahaha, which has headquarters in the city of Hangzhou just west of Shanghai. And each has taken recent steps to look past the relationship, including hiring separate investment advisers to estimate a value for the business.


Zong Qinghou

Wahaha founder Zong Qinghou, at a meeting with journalists this month, called for a speedy "divorce." Danone executives, meanwhile, have played down the importance of Wahaha to their company's bottom line, while highlighting new operations in China, such as a baby-food business.

Since it broke into public view in early 2007, the Danone-Wahaha fight for control over one of China's most iconic brands and valuable consumer-product franchises has come to symbolize how bad cross-cultural business relationships can get.

Twists and turns in the case have offered executives at other companies a rare opportunity to study how a business dispute might play out in the world's fastest-growing major economy. Other executives "are paying keen attention to the process, not only the outcome," says Teng Bingsheng, a professor of strategic management at Beijing's Cheung Kong Graduate School of Business.

At stake is the business of making and selling of bottled water, tea and fruit drinks under the name Wahaha, a more familiar brand for many Chinese than Coca-Cola. The Chinese and French parties came together in 1996 when Mr. Zong agreed to make his Wahaha drinks in joint ventures with Danone to speed the business's expansion. Danone owned 51%, but involved itself little in Mr. Zong's operations, an arrangement that for years seemed to work.

Today, Mr. Zong controls a number of Wahaha factories outside the joint venture. Danone says that is a breach of their original agreement, while Mr. Zong says Danone initially condoned the setup. Danone has contended Mr. Zong's "parallel" operations cost it $25 million in lost revenue each month.

Each side says it remains committed to a successful Wahaha business, and the products remain as popular as ever. Wahaha and Danone both say they trust a Swedish arbitration process planned for January. Yet, the two sides also increasingly play down the likelihood of an amicable settlement.

Legal developments in China, Los Angeles, Stockholm, Samoa and the British Virgin Islands have periodically appeared to signal a possible victor, only to see the dispute drag on. Even pressure last year from the French and Chinese presidents produced little more than a short-lived truce.

Indeed, the tussle has turned increasingly nasty: Each company has heaped scorn on the other and leaked information to the news media—and Danone says it has assisted U.S. tax authorities investigating Mr. Zong, whose family owns a house in California. Danone also sued Mr. Zong's wife and daughter last year in the U.S., alleging that they helped him gain profits from Wahaha ventures that Danone was entitled to receive. Danone says a court backed its request for freezes on Zong-family controlled offshore bank accounts. Mr. Zong says his family denies Danone's allegations and is contesting the suit.

At a fancy dinner he hosted for reporters in Hangzhou this month, Mr. Zong stressed that the two sides are heading for "divorce." The effusive 62-year-old said Danone should exit China "in a decent way" by selling its share of the business ventures to Wahaha or a third party.

One big hurdle: The two sides are billions of dollars apart in valuing the ventures, he said.

Danone says legal efforts in various jurisdictions bar it from commenting on key aspects of the relationship. But the company has taken steps that suggest it is ready to part ways with Wahaha—as it has already done with two other joint ventures in China in the past year. For instance, Danone has hired **J.P. Morgan Chase** & Co. to help it value the Wahaha operations, according to a Danone spokesman.

In mid-2007, Danone changed the way it accounts for its Wahaha interests in its financial statements, presenting them as investments rather than core subsidiaries. That makes it hard to see whether Danone is suffering financially because of the fight, but makes the businesses look more like salable assets. In 2006, the last year the French company broke out numbers, China accounted for 11% of Danone's €14 billion ($22 billion) in global sales, and was its third-biggest market after France and Spain.

In April, relying in part on receipts from Danone detailing Mr. Zong's earnings from their business, U.S. tax authorities hit Mr. Zong with a $19.48 million assessment for back taxes and penalties for 2001, according to documents seen by The Wall Street Journal from a lawsuit Mr. Zong filed against the Internal Revenue Service contesting the assessment on July 14 in U.S. Tax Court in Los Angeles. The documents suggest Mr. Zong earned more than $40 million outside of China in 2001, even as he reported income closer to $50,000.

Mr. Zong says he is "astonished" anyone would think he owes U.S. taxes, although he concedes to steps that often make a person subject to such assessments, including working in the U.S. occasionally in the 1990s and getting approved for permanent residence. When asked about his tax situation, Mr. Zong says Danone "cheated" him, but said his recent payment of back taxes and penalties to Chinese authorities would offset U.S. assessments.

Danone says it merely responded to a U.S. government request in the case. "They asked us to provide some assistance," says Randall Lewis, associate general counsel for Danone Asia based in Shanghai. Mr. Lewis said it is corporate policy to cooperate with government requests, and that most of the information it provided to tax authorities is publicly available.

CORPORATE NEWS

Sanofi-Aventis sets offer for U.K. vaccine supplier

Bid of $548.4 million for Acambis is part of new industry push

By David Pearson

Sanofi-Aventis SA of France launched a friendly takeover offer for U.K. vaccines maker **Acambis** PLC, valued at about £276 million ($548.4 million).

The offer is the latest evidence of Big Pharma's growing interest in vaccines, which are experiencing stronger sales growth than other kinds of prescription medicines. Acambis recently won a 10-year contract with the U.S. government to supply its licensed smallpox vaccine.

Sanofi's vaccines unit, Sanofi Pasteur Holding, is offering 190 pence ($3.78) a share, a 65% premium to Acambis's share price of 115 pence at the close of business July 24, the last day the shares traded, as well as on the share price in the past 50 trading days.

Sanofi Pasteur and Acambis have collaborated for more than 10 years, and Acambis is partnered with Sanofi Pasteur in projects to develop and market vaccines against Japanese encephalitis, dengue and West Nile virus.

Invesco Asset Management and **Goldman Sachs International**, which together hold about 42% of Acambis, have confirmed their intent to support the offer, Sanofi said.

Among its other projects, Acambis also has early stage proprietary programs targeting potentially significant markets in the fields of clostridium difficile, influenza and genital herpes.

Sanofi-Aventis "quite liked what we had in Acambis," Acambis Chief Executive Ian Garland said, referring to the pipeline of experimental vaccines that the company is developing outside the partnership with the French drug maker.

Potential Bayer blockbuster clears a key Europe panel

By Richard Breum
And Allison Connolly

FRANKFURT—**Bayer AG** said it is a step closer to approval for its next potential blockbuster drug, after receiving a positive opinion from European regulators for Xarelto, an anticoagulant.

Xarelto is the most important drug in Bayer's pipeline, and the company said it expects the drug to garner more than €2 billion, or about $3 billion, in annual sales. Analysts predict the drug could eventually bring in as much as €5 billion a year.

The German company is seeking marketing approval for the drug in more than 10 countries, including China. It also plans to submit a regulatory filing in the U.S., where the drug would be marketed by Bayer's partner, **Johnson & Johnson**.

The drug received the green light Friday from the European Medicines Agency's Committee for Medicinal Products for Human Use. The recommendation comes just nine months after the company submitted its application, which is relatively fast, noted Bayer HealthCare executive-committee member Kemal Malik, who heads product development.

The drug still needs to receive marketing approval from the European Commission before it can be sold. The commission, the European Union's executive arm, normally follows the committee's recommendation. A decision should come within a few months, Bayer said.

Xarelto, which was developed jointly with J&J, initially will be used to prevent blood clots in patients undergoing hip- and knee-replacement surgery. The company plans to seek approval for other uses, including the prevention of strokes in atrial-fibrillation patients and for the secondary prevention of acute coronary syndrome.

With the European approval, Bayer hopes to have the drug on the market by year's end. It would compete with **Boehringer Ingelheim**'s antithrombosis drug Dabigatran and **Sanofi-Aventis** SA's Lovenox.

State Bank of India's net profit rose 15% in fiscal first quarter

By John Satish Kumar

MUMBAI—State Bank of India said its unconsolidated net profit for the fiscal first quarter rose 15% from a year earlier, aided by a one-off tax gain that slightly offset mark-to-market losses of 16.57 billion rupees ($393 million).

Most Indian banks are reporting mark-to-market losses on their bond and equity portfolios because of rising interest rates and adverse equity market conditions.

The state-owned bank, India's largest bank by assets, said unconsolidated net profit for the quarter ended June 30 rose to 16.41 billion rupees from 14.26 billion rupees a year earlier.

Net profit was helped by a one-time refund of 2.47 billion rupees, which went toward tax provisioning in last fiscal year's first quarter.

Unconsolidated total income rose 32% to 162.03 billion rupees from 122.29 billion rupees a year earlier.

The mark-to-market loss included a loss of 7.84 billion rupees on securities issued by the federal government on its rights issue.

Rival **ICICI Bank** Ltd. said Saturday its net profit in the fiscal first quarter fell 6.1% from a year earlier, dragged by mark-to-market losses of 5.94 billion rupees on its trading and securities portfolio.

The New York-listed bank said net profit in the quarter ended June 30 fell to 7.28 billion rupees from 7.75 billion rupees.

GLOBAL BUSINESS BRIEFS

Belgacom

Net profit declines 4.1%; full-year revenue outlook cut

Belgacom, Belgium's biggest telecommunications company, posted a 4.1% drop in second-quarter net profit and lowered its full-year revenue outlook in light of the economic downturn. In a move designed to support the share price, the company also said it will use part of its €336 million ($527 million) spare cash to buy back shares valued at €200 million. Net profit fell to €235 million from €245 million a year earlier, while revenue was down 2% to €1.49 billion from €1.52 billion. The Brussels-based company said it now expects full-year revenue to fall around 2%, compared with its previous forecast of a decline of "up to 1%." The lowered outlook, coming after crosstown rival Mobistar SA Thursday raised its expectations, sent shares in Belgacom down 6.9%.

Volkswagen AG

German car maker Audi, the premium division of **Volkswagen** AG, reported a 36% rise in first-half net profit due to lower sales costs, and said it expects full-year profit to increase as model launches and revamps will boost second-half sales. Net profit rose to €907 million ($1.42 billion) from €668 million a year earlier. Revenue was flat at €17.4 billion. Chief Financial Officer Axel Strotbek said the company booked financial income of €510 million, mostly from currency and raw-material hedging deals. The auto maker delivered more than 516,000 cars to customers, up 1.4% from a year earlier, fueled by demand in the Asian-Pacific region and Eastern Europe. In the U.S., Audi saw a slight drop in first-half sales to 45,024 as the financial crisis and escalating fuel prices hit the market.

Inmarsat PLC

SkyTerra Communications Inc. and its largest shareholder, **Harbinger Capital Partners Funds**, on Friday said they will make a takeover offer for **Inmarsat** PLC—just four days after the U.K. satellite-communications company said talks had ended. SkyTerra and Harbinger said they intend to make a bid for Inmarsat, but that they would try to get regulatory approval first, since that process is likely to take 18 months. Any tie-up would require approval from a raft of regulators, most notably in the U.S., where SkyTerra's Mobile Satellite Ventures holds mobile licenses that are used primarily for public safety, security, fleet management and asset tracking. Inmarsat said it remains confident of its standalone prospects but will consider any offer that would maximize value for its shareholders.

Cie. de Saint-Gobain SA

French building-materials company **Cie. de Saint-Gobain** SA said it would slash 6,000 jobs, about 3% of its work force, as part of a €435 million ($682.9 million) cost-cutting plan to adapt to worsening global economic conditions. Saint-Gobain, a leading supplier of glass to the automotive and building industries, said 4,000 of the jobs would be cut by year end, accounting for most of this year's €300 million cost savings. A spokeswoman said that this year 1,550 jobs would be cut in the U.S., 1,100 in the U.K. and 270 in Spain. In the rest of Europe, cuts will be made by ending temporary work contracts, implementing a hiring freeze and not replacing departing employees, she added. Saint-Gobain employs about 210,000 people world-wide.

Samsung Electronics Co.

Pressures emerged during the second quarter for **Samsung Electronics** Co.'s cellphone and flat-panel businesses, the units that have delivered healthy profit over the past year as its chip business slumped. The development, together with a delay in the expected recovery of the chip business that executives announced Friday along with quarterly results, created more negative sentiment among investors. Shares of Samsung, which had already fallen 20% since mid-May, dropped another 6.2% on the Korea Stock Exchange. Though Samsung remains one of the most profitable companies in high tech, its results announcement showed that it is also falling victim to the global economic slowdown. Full-year net profit is likely to be around $8 billion, about average since 2002.

Fortune Brands Inc.

Fortune Brands Inc. posted a 41% decline in second-quarter profit as the company announced a nearly 5% dividend increase, its latest move to return value to shareholders after failing earlier this year to buy the parent of Absolut vodka. The Deerfield, Ill., firm reported net income of $136 million, or 88 cents a share, down from $232 million, or $1.48 a share, a year ago. Net sales fell 8.3% to $2.1 billion. Fortune boosted its quarterly dividend to 44 cents from 42 cents. In March, Fortune Brands lost the auction for Swedish distiller Vin & Sprit, which ows Absolut, to French drinks giant Pernod Ricard SA, which shelled out $8.3 billion. Following the loss, the company authorized the repurchase of a 10% equity stake in the Beam Global sprits business held by Vin & Sprit.

Vattenfall Europe AG

German utility Vattenfall Europe AG said it is looking for investors for its ultrahigh-power-transmission network. Vattenfall Europe, a unit of the Swedish **Vattenfall Group**, said it will sell the network because of a political debate in Europe on ownership of ultrahigh-voltage grids. The European Commission, the European Union's executive arm, wants a full separation of energy-production and distribution assets to promote competition. Vattenfall Europe is the second of Germany's four transmission-grid operators to put its grid assets up for sale. In February, **E.On** AG proposed to sell its German power-transmission network and some of its German power-plant assets to settle two EU antitrust cases. The operators of the other two grids, **RWE** AG and **EnBW Energie Baden Württemberg** AG, said they will keep their grids.

Alitalia SpA

The board of Italy's **Alitalia** SpA held an emergency three-hour meeting Saturday to discuss the nearly bankrupt airline's options and consider possible future developments while it waits for adviser **Intesa Sanpaolo** to present its rescue plan, a person familiar with the matter said. No decisions were made, the person said, and the company didn't issue a statement after the meeting. The airline is being kept afloat by a bridge loan of €300 million ($471 million) issued by the Italian government May 5, and the company is burning more than €2 million in cash per day. The carrier gave Intesa Sanpaolo a mandate to study a possible rescue plan in June after merger talks with French carrier **Air France-KLM** collapsed.

Roche Holding AG

Roche Holding AG's drug Actemra appears effective at treating rheumatoid arthritis, a disease that can destroy joints and causes chronic pain for patients, the U.S. Food and Drug Administration said. The drug appears effective for treating patients with moderate to severely active rheumatoid arthritis, but has been linked to serious infections, malignancies and other problems, according to documents posted on the FDA's Web site. A panel of outside medical experts will meet Tuesday to discuss whether the benefits of Actemra outweigh the risks, and whether the drug should be approved. The FDA doesn't have to follow its panels' advice, but generally does.

Edison SpA

Edison SpA, one of Italy's biggest power and natural-gas companies by volume, said first-half net profit fell 60%, hit by higher taxes following a new government levy, and weaker gas operations. Net profit dropped to €102 million ($160.1 million) from €256 million a year earlier, even though net revenue was up 27% to €5.46 billion. Gross operating profit fell 11% to €809 million from €904 million. Edison blamed the decline on the Italian government's so-called Robin Hood tax. Excluding the resulting €101 million in taxes and a €40 million provision for a tax dispute, profit would have been "similar" to last year, said Chief Executive Umberto Quadrino.

Yahoo Japan Corp.

Yahoo Japan Corp.'s results Friday showed that while profit growth was sustained in the April-June quarter, the Internet-service company began feeling the effects of slowing economic and corporate earnings growth in Japan. The company, affiliated with Softbank Corp. and Yahoo Inc., said net profit in its fiscal first quarter ended in June rose 18% from a year earlier to 19.16 billion yen ($177.6 million), in line with its forecast. Sales rose 16% to 65.56 billion yen. But the company also said the economy was more sluggish than anticipated, and revenue from display advertising, paid search advertising and recruiting service was "slow" in the quarter.

Sinosteel Corp.

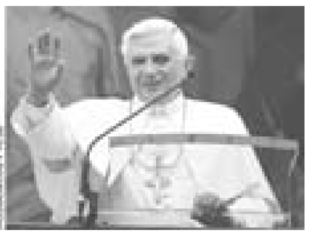
Sinosteel Corp. extended again its bid of 1.36 billion Australian dollars for Midwest Corp., this time to Aug. 25, hoping to build on its stake. Sinosteel said it had a relevant interest in 54.16% of Midwest shares, down slightly from 54.81% last week. It needs 90% of the company's shares for compulsory acquisition under Australian takeover law and to delist the company from the stock exchange. Sinosteel won a controlling stake in Midwest earlier this month after a 10-month battle with Murchison Metal Ltd. for the shares, marking the first successful hostile foreign acquisition by a Chinese company. But Murchison has vowed that it won't sell its 10% stake in Midwest.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

VATICAN

Dissident Catholics urge end to birth-control ban



MORE THAN 50 dissident Catholic groups have written an open letter asking Pope Benedict XVI, left, to lift the Church's ban on birth control.

In an ad in the Italian daily Corriere della Sera, the groups said the Church's ban on artificial birth control has had "catastrophic effects."

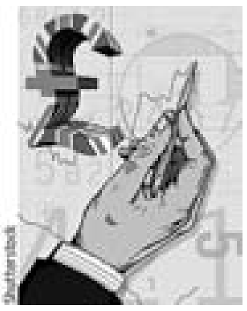
The Vatican spokesman, the Rev. Federico Lombardi, said the accusation was "clearly unfounded."

The groups published their appeal on the 40th anniversary of "Humanae Vitae," or "On Human Life"—the document issued by Pope Paul VI that prohibits Catholics from using artificial contraception.

—Associated Press

U.K.

Slowing economic growth pressures Brown further



THE BRITISH economic growth slowed to 0.2% in the second quarter and fell to 1.6% from a year earlier, joining a lost by-election and rising inflationary pressures on Prime Minister Gordon Brown's list of political woes.

Data from the Office of National Statistics showed that the U.K.'s quarterly growth was the weakest in more than three years. The annual growth rate hasn't been weaker than 1.6% since the start of 1993.

Late last week, Mr. Brown's governing Labour Party was defeated in a Scottish by-election by the Scottish National Party. The district was traditionally one of the safest Labour seats in the country.

—Roundup

JAPAN

June core inflation grew at fastest pace in 15 years

JAPANESE core inflation grew at its fastest pace in more than 15 years in June, due largely to rising energy and food prices, making the nation's already uncertain economic-growth prospects even murkier.

The Ministry of Internal Affairs and Communications said the core consumer-price index, which excludes fresh-food prices, rose 1.9% from a year earlier.

The reading marked the ninth straight month of gains and was the fastest rise since January 1998. Discounting the impact of a rise in the consumption tax in 1997, it was the sharpest year-to-year growth since December 1992.

—Tomoyuki Tachikawa

Is it a recession if output doesn't shrink?

Times may be tough in U.S., but GDP has yet to decline

BY SUDEEP REDDY

HOUSE PRICES are tumbling in the U.S., the job market is faltering, gasoline is almost $1 a liter and financial markets are struggling through their worst shock in decades.

This must be a recession, right?

Maybe, maybe not. The U.S. economy is expanding. It is likely to show a growth rate of more than 2% at an annual rate when the government Thursday gives its first estimate of the second-quarter performance.

The continued growth raises a key question: Could this be the first U.S. recession without a decline in economic output?

The nation's gross domestic product—its total output of goods and services—expanded at a 1% pace in the first quarter, reflecting a rise in exports because of the declining dollar. The growth defied predictions from some economists that a contraction would begin during the period.

The figures indicate a recession under the most common definition—two straight quarters of declining GDP—didn't occur in the first half of this year, though the government could, of course, revise the data later.

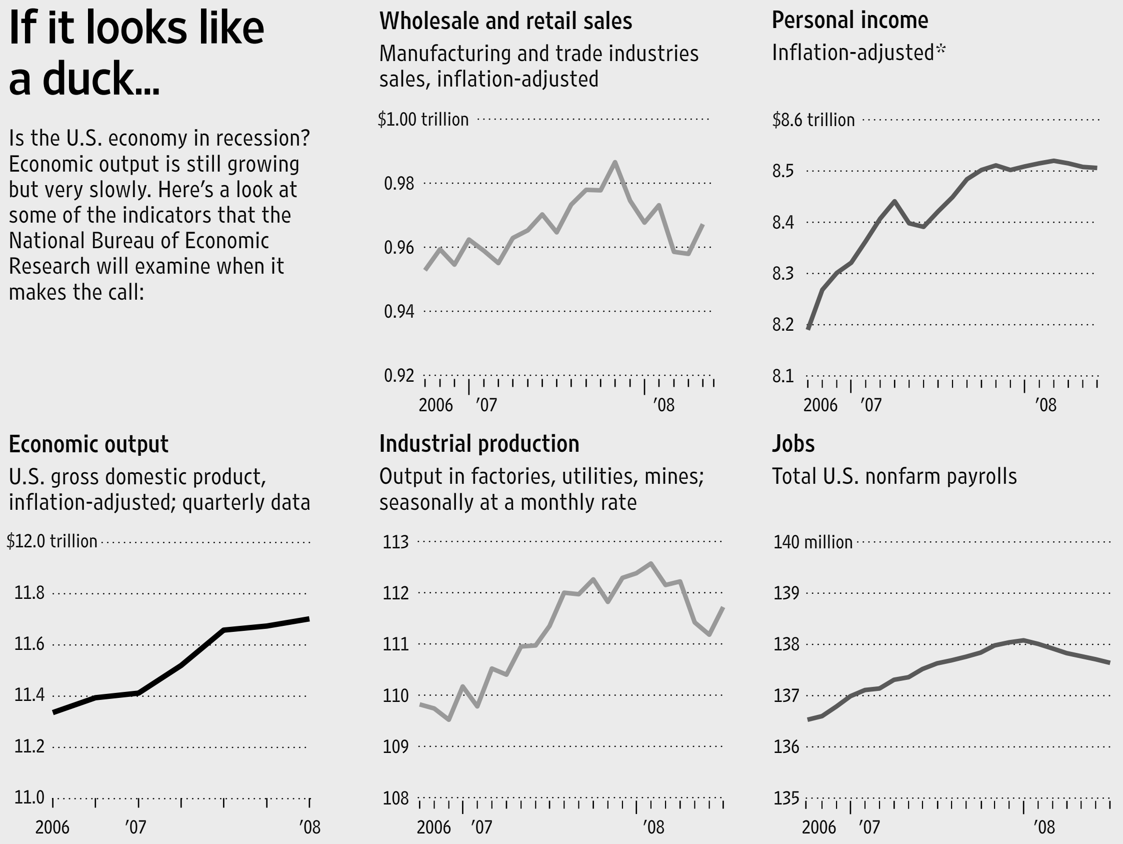
But the nonprofit National Bureau of Economic Research, which decides whether the U.S. has slipped into a recession, looks for "a significant decline in economic activity spread across the economy, lasting more than a few months."

Those gauges include GDP, incomes, employment, industrial output and retail and manufacturing sales, says the NBER's seven-member Business Cycle Dating Committee, which is composed mostly of economists from academic institutions. The panel can declare a recession, even if GDP remains positive, based on other measures.

Most of those gauges have been especially weak in recent months and some are in outright decline. The job market, for instance, has been contracting all year and the government on Friday is expected to report that payrolls dropped in July, the seventh consecutive monthly decline.

If it looks like a duck...

Is the U.S. economy in recession? Economic output is still growing but very slowly. Here's a look at some of the indicators that the National Bureau of Economic Research will examine when it makes the call:



*Less transfers, or income for which no services are performed, such as net insurance payments and government social payments

Note: Series are adjusted for inflation are in chained 2000 dollars; sales, income and GDP data are at seasonally adjusted annual rates

Sources: U.S. Commerce Department (GDP, sales, income); St. Louis Federal Reserve (industrial production); U.S. Labor Department (payrolls)

Boosting the economy are continued productivity gains. When employers get more from each worker, output can rise even as the number of jobs declines. But the productivity gains may not last long enough to keep growth positive.

"At the moment, we're sort of skimming along," with the economy expanding slowly because of the boost from economic-stimulus checks and strong exports, says Jeffrey Frankel, a Harvard professor and committee member.

In the past three decades, he says, the economy several times has threatened to slip into a recession but instead has managed to muddle through. But with the latest episode, he says, "this seems like a bigger set of adverse circumstances than that."

The economic data that have been reported provide "very strong confirmation of a recessionlike shortfall in employment and flatness in real output," says Robert Hall, a Stanford University economist who has led the recession-dating discussions for three decades. Still, the job market is declining only moderately and "the bottom hasn't fallen out of employment yet."

The committee has several options: Call the latest period a recession, even if GDP grew, citing the decline in employment and the other key gauges. Or it could do nothing—not declare a recession—and let the last year go down in history as a slowdown caused by a bone-chilling financial crisis.

Or, if GDP declines late this year or early next year, the committee could backdate the start of the recession to January, when employment started declining. That would make the downturn the longest since the 1981-82 recession. The panel also could declare a shorter recession, even without a negative GDP quarter.

Members say they aren't sure whether they will classify the current economy as in a recession. "It's hard for me to imagine doing so without a single negative quarter," says Mr. Frankel.

Committee member Victor Zarnowitz says the downturn in the job market "is not alone enough, but it already tilts the weight toward a recession." Mr. Zarnowitz, an economist at the Conference Board, a research group, who has been with the NBER since 1952, says a decline in GDP would give him "considerably more confidence that the whole thing is in decline."

Harvard professor Martin Feldstein, president of the NBER until this month, says the nation has been "sliding into a recession" since January, when many monthly statistics peaked. But a GDP decline isn't necessary "if there is enough other evidence that the economy is contracting," Mr. Feldstein says.

Some economists say GDP will begin to decline before the end of this year, as the impact of the government's $110 billion in stimulus checks passes and other problems—shrinking payrolls, higher inflation, restrained wages and tighter credit—reassert themselves.

"We are unwinding a 20-year credit cycle" that took off in the past six years, says Merrill Lynch economist David Rosenberg, who believes a recession started in January. "We are unwinding the biggest housing bubble of all time....This economy is straddling the zero line, and it's precarious."

Most recessions since World War II have been preceded by an increase in oil prices. While the price of oil has moderated in recent weeks, it is still far above the level of a year ago, and exacting deep pain on consumers and businesses.

The NBER panel committee won't be making the decision of whether the economy is in a recession anytime soon. The group, which started conferring by email about the question of recession when employment began declining, stands firm in its decision not to rush ahead with a recession call despite commentary in the financial markets and the press.

"We take our time," says Mr. Hall, the NBER committee chair. "We like to get things right."

Morgan Stanley economists, who predicted a recession earlier in the year, are still predicting a downturn—and now say it will start in the fourth quarter and continue into early 2009.

Today's peculiar environment may be a result of a flattening of the business cycle, says Morgan Stanley economist David Greenlaw. He says companies are better able to navigate the economy's ups and downs because of better technology and forecasting abilities. Also, the decline of manufacturing makes the economy less subject to sharp adjustments of inventories.

ECONOMY & POLITICS

Set for Games, China is still under scrutiny

Pollution, censorship are issues as officials say they are ready

By Geoffrey A. Fowler, Mei Fong And Loretta Chao

BEIJING—Organizers of the Beijing Olympics said they had met the commitments they made to host the Summer Games, even as they face mounting criticism over media access, Internet censorship and air quality.

Thousands of athletes, journalists and spectators have begun to pour into the city for the Games, which start in 11 days. When it bid to host the Olympics, Beijing made a series of promises to prepare the city for the international spotlight, including improving infrastructure, cleaning up pollution and opening up to foreign media coverage.

At a Sunday press conference to discuss Beijing's commitments, Tan Xuxiang, deputy director of the Beijing Municipal Planning Commission, said that the 37 competition and 56 training venues for the Games had been completed and were "ready for the world." But journalists pressed with questions about Beijing's compliance with other promises.

While roughly 20,000 journalists have been accredited to cover the Games, some report that they aren't able to work with the freedom they are accustomed to. Last week, Chinese police clashed with reporters from Hong Kong at a chaotic, last-minute sale of Olympics tickets. At least one reporter was detained by police, and video of the incidents showed uniformed police aggressively questioning, and in some cases shoving or hitting, several reporters. The incident was called a "wanton violation of press freedom" by the Hong Kong Journalists Association.

Sun Weijia, director of the Media Operations Department of the Beijing organizing committee, didn't address the incidents at the Sunday news conference, but he said that Beijing had "created a very good and very free regulation environment."

China has also poured enormous resources into security to protect against possible terrorist attacks, as well as political protests, during the Games. On Friday, a U.S. terrorism-monitoring company released a video it obtained from a group calling itself the Turkistan Islamic Party threatening to carry out attacks during the Olympics and claiming responsibility for recent deadly explosions in China.

The exact identity of the group isn't clear, but it appears to be linked to Uighurs, a Muslim ethnic group in China's western Xinjiang region that has long chafed under Chinese rule. Some independent experts questioned the group's claims of responsibility, however, and Chinese security officials quickly dismissed them, telling China's state-run Xinhua news agency that they had no evidence to indicate the explosions were the act of terrorist groups.

The most visible challenge for China's Olympics organizers remains pollution. A thick haze cloaked the city as organizers opened the Olympic Village on Sunday, and the "Bird's Nest" national stadium was barely visible from the highway nearby. Despite stringent measures put in place on July 20 to restrict the number of cars on the road, pollution levels for Thursday through Sunday all hit Level 3, or "slightly polluted," which is still on the higher end of the pollution scale and above China's national standard.

Du Shaozhong, vice director of Beijing Municipal Environmental Protection Bureau, said the moist and stagnant weather in Beijing in recent days has been "not very favorable for the control of pollutants."

He also said it wasn't possible to judge pollution levels based solely on visibility, or by comparing one day to another. "For nine straight years, the air quality in Beijing has been improving," he said.

Mr. Du said he was "confident" that Beijing also would be able to meet its commitment to satisfy World Health Organization standards for four major pollutants in August and that Beijing would "take tougher control measures to guarantee the air quality" in "extreme weather conditions."

"It shall be finally tested by the Games," he said.

Another media issue for the Games is access to the Internet, which the Chinese government often filters to remove political and pornographic content. In an April interview, International Olympic Committee President Jacques Rogge said that he had been assured by Beijing that there "will be absolutely no censorship on the Internet" for accredited journalists.

But on Internet connections provided at Beijing's newly opened Main Press Center, a hub of activity for journalists covering the Games, more than a dozen Web sites are inaccessible, including those for accredited media organizations Apple Daily—Hong Kong's second-largest circulation newspaper—and the British Broadcasting Corp.'s Chinese language service. Other inaccessible sites include aid organization Oxfam Hong Kong, the Chinese-language version of Wikipedia and the personal Web site of Chinese actor Andy Lau.

Asked about these sites at the news conference, Mr. Sun said he hadn't heard of such issues and emphasized that "Internet access is not a problem." Confronted later by several journalists with similar experiences at the media center, Mr. Sun said he would look into the issue.

The incidents at last week's ticket sales have raised questions about both media freedom and China's overall readiness for the huge crowds expected during the games. At least 400,000 foreigners are expected to attend, as well as hundreds of thousands of Chinese from outside Beijing.

The scuffles with reporters broke out when Beijing sold the last round of some 820,000 tickets for Olympics events. The sale had been long planned, but police were caught off guard by the large numbers of prospective buyers.

A report by Xinhua news agency said that at its peak, the crowd of ticket buyers near the main Olympic venues numbered more than 30,000 people. The report said that a combination of heat and long wait times made people "emotional" and that more police officers had to be deployed to the scene as the crowds became rowdy. It said that some of the reporters "from China and overseas" tried to enter a "forbidden area."

An official of the Beijing Public Security Bureau said Friday the bureau wasn't aware of the events.

One journalist, Felix Wong, a photographer with Hong Kong's South China Morning Post, was detained Friday while covering a scuffle that broke out when crowds swarmed a ticketing office, according to Mr. Wong. Xinhua said Mr. Wong had broken through a barricade and kicked a police officer in the groin.

Mr. Wong, in a telephone interview, said he was pushed by a police officer and may have accidentally kicked him in response. Mr. Wong said he was detained for about six hours.

The South China Morning Post issued a statement saying, "We believe Felix was just trying to do his job as a photojournalist. Both journalists and policemen, as well as the tens of thousands of Beijingers who queued up for the tickets, were victims of the relevant authorities' failure to make proper arrangements for the orderly sale of tickets."

In a separate incident, footage from Hong Kong's Television Broadcasts Ltd. that was posted on the YouTube Web site showed a mob scene at the Olympic area, where massive crowds were pushed back by police officers. The video then showed a police line trying to herd journalists back from filming the scene. A police officer then slipped under the police tape and lunged at a reporter who wouldn't budge, shoving him to the ground.

Another video, posted Thursday by the Hong Kong-based Network of the World, appears to show police moving in to break up a fight and then asking to see the identification of journalists covering the action. "What media are you from?" a police officer asked repeatedly of the reporters. One answered, "I'm from Hong Kong," to which the officer replied, "Well, you're from Hong Kong, but you're in Beijing, and you must follow the laws of Beijing."

Francis Moriarty, a spokesman for the Foreign Correspondents' Club in Hong Kong, said the organization would meet to discuss the incidents.

"We always view cases of interference with seriousness, especially now given the promises made to reporters that they would have freedom of coverage during the Games. I hope this is a one-off," he said.

—Kersten Zhang, Gao Sen and Jason Leow contributed to this article.

Beijing National Stadium was blanketed with thick smog Sunday.

McCain meets with Dalai Lama

By **Elizabeth Holmes** *in Denver,* **John D. McKinnon** *in Washington and* **Jason Dean** *in Beijing*

With the Beijing Olympics starting soon, U.S. Sen. John McCain brought China to the forefront of the foreign-policy debate Friday by meeting with the Dalai Lama.

Despite a recent focus on Europe and the Middle East because of Sen. Barack Obama's overseas trip to those regions, China is likely to dominate the news coverage in the coming weeks as the Games get under way.

Sen. McCain, the Republican presidential contender, sat down with the exiled Tibetan spiritual and political leader in Aspen, Colo., to discuss "issues of mutual concern," a McCain aide said, including talks between the Dalai Lama and China, as well as how "the international community can best support the Dalai Lama in his efforts."

After the meeting with the Dalai Lama, Sen. McCain offered tough criticisms of China and urged its leaders to show more progress in addressing political grievances.

"The U.S. welcomes good relations with China, but it does no service to the Chinese government and certainly no service to the people of China for the U.S. and other democracies to pretend that the suppression of rights in China doesn't concern us," Sen. McCain said.

Over the years, activists have turned the Dalai Lama into a symbol not just of the struggle for Tibetan autonomy but, more broadly, of political and human rights in China. Especially given the timing, Sen. McCain's meeting is a strong show of sympathy for critics of the Chinese regime at a time when the world's attention is focused on the country.

Most voters see China as more of an adversary than an ally, according to The Wall Street Journal/NBC News poll released this week—the survey showed 54% think of China as a foe, while only 23% view it as a friend—even though a clear majority, 63%, believe President George W. Bush should attend the Aug. 8 opening ceremonies of the Olympics, while only a quarter said he shouldn't. Sen. McCain's meeting with the Dalai Lama appears to be partly an effort to inoculate himself from the criticism Mr. Bush is likely to get from human-rights activists.

Sen. Obama, the presumptive Democratic presidential candidate, has spoken with the Dalai Lama twice in recent months, a campaign aide said. He talked by phone with the Dalai Lama in April, at the height of the Chinese government's crackdown on Tibet, and met with him in Sen. Obama's role on the Senate Foreign Relations Committee. Sen. Obama also has expressed a willingness to meet with the spiritual leader one-on-one.

China's government strongly objects to foreign leaders meeting with the Dalai Lama, who Beijing insists wants to wrest Tibet from Chinese control. In the past year, Beijing has publicly lashed out at Canadian Prime Minister Stephen Harper and German Chancellor Angela Merkel for hosting him. When Mr. Bush met privately at the White House with the Dalai Lama in October, a Chinese government spokesman blasted the meeting as "gross interference in China's internal affairs."

—Jay Solomon in Paris contributed to this article.

Sen. John McCain met with **the Dalai Lama**, a move that could spur Chinese ire.

India's deficit is a danger to its economy

New state spending may boost inflation, prevent investment

BY JACKIE RANGE

THE OUTLOOK

NEW DELHI—India's slowing economy is beginning to show another big crack: A growing government deficit that could hurt much-needed investment in India's ramshackle infrastructure, boost inflation and undermine growth.

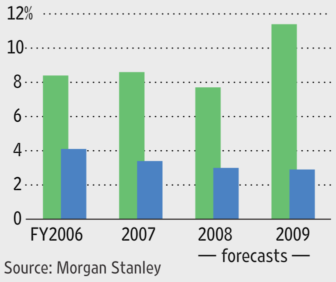
A hefty list of expenditures is at the root of India's fiscal woes, especially a once-a-decade salary increase that Standard & Poor's estimates could mean pay increases of as much as 40% for 2.9 million central government employees. Were the government to approve the full amount, the ratings agency figures it could cost as much as the equivalent of 2.4% of gross domestic product. State governments are likely to follow suit.

Oil prices also are jacking up government costs. New Delhi is issuing bonds equivalent to 3.6% of GDP to oil and fertilizer companies to partially compensate them for selling their products domestically at lower-than-global prices. While some fuel prices were increased in June, India's domestic fuel prices still significantly lag global ones.

Then there is politics. The Congress party, which leads India's fragile governing coalition, is expected to loosen the purse strings before a general election that must happen by May. It already won approval of a debt-cancellation package for many of India's impoverished farmers.

Big spender

India's consolidated fiscal deficit as a percentage of gross domestic product



Source: Morgan Stanley

Overall, Morgan Stanley predicts, India's fiscal deficit—including central, state and so-called "off-budget" items—will rise to 11.4% of GDP in the fiscal year ending March 31, up from an estimated 7.7% in the previous year.

The spending increase is likely to play out in a number of ways that will harm the Indian economy, which has been growing robustly in spite of sporadic instability such as last week's bomb blasts in Bangalore and Ahmedabad. It may give another boost to inflation, which is already running at an annual rate of more than 11%. And that could prompt the central bank to continue to raise interest rates, or take other measures to try to keep inflation in check. Along with some other negative factors, the result is that India's growth is likely to ease to between 7% and 7.5% this fiscal year, many economists estimate, down from 9.1% the previous year.

The higher spending is also bound to hurt India's efforts to deal with some long-term problems, including modernizing its decrepit ports, roads, power systems, airports and telecommunications infrastructure over the next five years. Among the projects that could be delayed is an infrastructure-development program, Bharat Nirman, to improve drinking water, electricity, roads, telephones and irrigation in rural areas. Many economists say that India needs to improve its infrastructure to sustain rapid economic growth.

In the 1990s, India also faced a growing fiscal deficit. Then, too, a key factor was the once-every-decade rise in government pay packages. In the subsequent drive to bring down the deficit, infrastructure spending was curtailed, which especially hurt manufacturers. It was easier for the government to cut back on building roads, hospitals and schools than on government-employee pay or interest payments.

Infrastructure has been neglected for so long that the Indian government figures it needs as much as $500 billion in spending over the next several years to equip the country properly. The government hopes to provide much of the money, with the rest coming from private funding. But, "government finances are not in good shape, which does not augur well for increasing investment rates dramatically," according to a Goldman Sachs report.

"India's infrastructure is way behind the rest of the world," said Shiksha Bhatia, a 26-year-old human resources executive at Google Inc. in Gurgaon, near New Delhi. "Roads are not well-built and full of potholes, especially the rural areas," and "power cuts make people's lives miserable." Fans or air conditioning are essential in India's sweltering summer heat.

Businesses also suffer. Pramod Bhasin, president and chief executive of Genpact Ltd., in Gurgaon, which runs call centers around the country, said his company must provide its own transportation, power, security and education for its employees. As the outsourcing sector expands outside the major cities, he said, India will require "better regional airports [and] better social infrastructure that invites middle and senior management to move and live" there.

The worsening fiscal situation could affect the nation's creditworthiness, and the borrowing prospects of some of its most important companies. Ratings agency Fitch recently changed its view on the outlook for a key rating of Indian debt to negative from stable, saying its move was "based on a considerable deterioration in the central government's fiscal position."

Lehman Brothers Asian sovereign credit analyst Yang-Myung Hong said that ratings agencies aren't likely to rush to downgrade India's sovereign debt. But if the fiscal situation and inflation worsens appreciably, he said, "we could actually see the ratings get additional negative pressure."

A downgrading of India's sovereign-debt rating could hurt commercial banks, including **ICICI Bank** Ltd., the country's largest private-sector bank, said Mr. Hong, "because they are pretty much linked to the sovereign rating."

More broadly, Indian companies could face higher interest rates at home, because government efforts to finance its deficit could swamp the bond market, analysts warn. That could especially affect industrial enterprises looking to finance large capital projects.

—Vibhuti Agarwal contributed to this article.