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Markets

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	8046.42	+494.13	+6.54
Nasdaq	1384.35	+68.23	+5.18
DJ Stoxx 600	182.13	-4.62	-2.47
FTSE 100	3780.96	-94.03	-2.43
DAX	4127.41	-92.79	-2.20
CAC 40	2881.26	-99.16	-3.33
Euro	$1.2498	-0.0037	-0.30
Nymex crude	$49.93	+0.51	+1.03

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World-Wide

Obama is preparing a new plan to stimulate the U.S. economy with over $500 billion in spending and tax cuts, aides and advisers said, far more aggressive than anything envisioned during the campaign. His aides are working with Democratic leaders to have a bill ready for him to sign soon after his inauguration. On Monday, Obama will name part of his economic team. Page 1

■ **France's Socialist Party is** struggling to pick a new leader and mount a comeback as the opposition to Sarkozy. After two days of voting, party members still haven't chosen between two very different candidates. Page 3

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■ **The U.S. military arrested** 14 suspected militants from two groups with alleged links to Iran in raids across Baghdad.

■ **Russia's lower house gave** its final approval to a bill extending the presidential term to six years from four years.

■ **Austria's center-left** Social Democrats and the conservative People's Party agreed to form a governing coalition.

■ **Palestinian President Abbas** said he would call elections early next year if Hamas doesn't open reconciliation talks with him.

■ **Guinea-Bissau's president** survived an attack by renegade soldiers on his home, officials said. At least one guard died.

EDITORIAL & OPINION

Not default swaps' fault

Regulators are determined to find a culprit, but CDS markets aren't the problem. Page 15

Obama's stimulus plan to exceed $500 billion

U.S. president-elect to move aggressively to boost economy

*By **Jonathan Weisman, Jon Hilsenrath** and **Deborah Solomon***

President-elect Barack Obama is crafting a new plan to stimulate the ailing economy with more than $500 billion of federal spending and tax cuts, Obama aides and advisers said Sunday, a far more aggressive initiative than anything envisioned during the election campaign.

His aides are working with Democratic leaders in Congress to have a bill ready for him to sign within days of his Jan. 20 inauguration.

The stimulus work is part of an intensifying effort by Mr. Obama to reassure jittery financial markets that he won't wait two months until moving into the White House to begin filling the policy vacuum that appears to have emerged in the period between his election and President George W. Bush's departure from office.

Monday morning, the president-elect will hold a news conference to introduce part of his economic team and to promise fast action to address the economic and financial crises, aides said. The message will be that "this is an extraordinary time, and extraordinary responses are going to be needed," one aide said.

Mr. Obama will also seek to calm financial institutions by offering explicit assurances that his administration will honor all commitments already made by the Bush administration through the $700 billion Wall Street bailout fund, even if there may be changes to the program down the road. Some borrowers have feared that the Democratic administration might try to renego-

Please turn to page 31

Getty Images

Lawrence Summers, left, will be named Monday as the head of President-elect Barack Obama's National Economic Council.

Banks placed big bets against Morgan Stanley

*By **Susan Pulliam, Liz Rappaport, Aaron Lucchetti, Jenny Strasburg** and **Tom McGinty***

Two days after Lehman Brothers Holdings sought bankruptcy protection, an explosive rumor spread that another big Wall Street firm, **Morgan Stanley**, was on the brink of failure. The chatter on trading desks that Sept. 17 was that **Deutsche Bank** AG had yanked a $25 billion credit line to the firm.

That wasn't true, but it helped trigger a cascade of bearish bets against Morgan Stanley. Chief Executive John Mack complained that profit-hungry traders were sowing panic. Yet he lacked a critical piece of information: Who exactly was behind those damaging trades?

Trading records reviewed by The Wall Street Journal provide a partial answer. It turns out some of the biggest names on Wall Street—**Merrill Lynch** & Co., **Citigroup** Inc., Deutsche Bank and **UBS** AG—were placing large bets against Morgan Stanley, the records indicate.

They did so using complicated financial instruments called credit-default swaps, a form of insurance against credit losses.

A close examination by the Journal of that trading also reveals the swaps played a critical role in magnifying bearish sentiment about Morgan Stanley, in turn prompting traders to bet against the firm's stock by selling it short.

The interplay between swaps trading and short selling accelerated the firm's downward spiral. This account was pieced together from the trading documents and more than six dozen interviews with Wall Street executives, traders, brokers, hedge-fund managers, regulators and investigators.

For years, sales of credit-default swaps were a profit gold mine for Wall Street. But during those tumultuous few days in mid-September, the swaps market turned on Morgan Stanley like a financial Frankenstein's monster. The market became a highly visible barometer of the Panic of 2008, fueling the crisis that ultimately prompted the government to intervene.

Other firms also were trading Morgan Stanley swaps on Sept. 17: **Royal Bank of Canada, Swiss Re,** and hedge funds including **King Street Capital Management** LLC and **Owl Creek Asset Management** LP. Pressure also mounted on another front. There was a surge in "short sales"—bets against the price of Morgan Stanley's stock by large hedge funds including **Third Point** LLC. By day's end, Morgan Stanley's shares were down 24%,

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UBS clients seek amnesty on U.S. taxes

*By **Carrick Mollenkamp** in Zurich and **Evan Perez** in Washington, D.C.*

Wealthy clients of Swiss bank **UBS** AG are coming forward to make amends with tax authorities, in a sign that U.S. efforts to battle offshore tax evasion and dent Switzerland's bank secrecy are having the desired effect.

Moved to take action after a former UBS private banker was indicted and spilled valuable secrets, the UBS clients are hiring tax lawyers and pursuing amnesty through an Internal Revenue Service voluntary disclosure program. The program allows U.S. citizens to avoid criminal prosecution if they acknowledge evasion and agree to pay taxes and penalties. The clients' actions are a boon for the IRS, which lacks the staff to go after about 20,000 U.S. citizens who U.S. authorities say worked with UBS private bankers to avoid taxes.

The moves come as UBS, U.S. authorities and the Swiss government have accelerated talks aimed at releasing data on the offshore accounts of U.S. taxpayers, people familiar with the matter said. Meanwhile, the IRS is considering a na-

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THE WALL STREET JOURNAL.

LEADING THE NEWS

Euro-zone outlook dims for business, jobs, GDP

Purchasing index points to slowdown; rate cut is expected

BY EMMA CHARLTON

LONDON—Fresh data pointed to a sharp downturn in euro-zone business activity and suggested joblessness will accelerate.

In November, the euro-zone composite Purchasing Managers' index dropped to the lowest level in its 10-year history, research group Markit Economics said Friday.

"This is truly awful data—the manufacturing sector has been slammed by dwindling foreign demand alongside weakening domestic demand," said Matthew Sharratt, an economist at Bank of America in London. "What's more, the services sector will be hit just as hard in the months to come, pushing unemployment higher," he said.

The index—which measures private-sector activity in a survey of about 4,500 manufacturing and services businesses across the euro zone—dropped to 39.7 in November from 43.6 a month earlier.

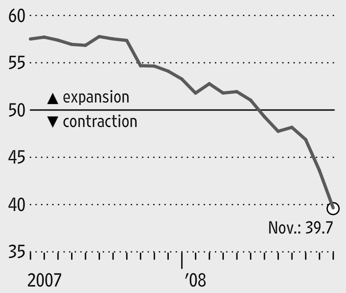
The development makes it almost certain that the euro zone's gross domestic product will contract in the fourth quarter, for a third consecutive quarter of shrinking output.

Adding to the bleak outlook, the German Finance Ministry on Friday issued a forecast that the country's economic downturn will continue into next year and joblessness will rise.

The euro zone's jobless rate held steady in September at 7.5%, according to the EU's statistics agency, but some economists predict the unemployment rate could reach double digits. "Hitting 10% by the end of next year is certainly a very real possibility," said Ben May, an economist at Capital Economics in London.

A new low

Euro zone's composite purchasing managers index - a measure of total private sector activity



Source: Markit Economics

Nevertheless, European Competition Commissioner Neelie Kroes, warned that Europe's politicians must resist illegally subsidizing their struggling car industries in the face of the recession, saying it would only make matters worse.

European car makers have called for €40 billion in loans, but the European Commission, the EU's executive arm, says any aid would have to be targeted and temporary. Germany is considering giving Opel, a unit of **General Motors** Corp., €1 billion in state guarantees for loans that would reduce its borrowing costs.

"Any recession will be shorter and shallower" if trade between European countries can continue without undue state intervention, Ms. Kroes said at a state-aid conference in Brussels.

Friday's economic news bolsters expectations the European Central Bank will cut its key rate again next month, by at least 0.5 percentage point to 2.75%, and could go lower in 2009. The ECB has cut its rate by a full percentage point since October.

"Euro-area monetary policy in my view has enough leeway for further easing if necessary," Bundesbank President and ECB Governing Council Member Axel Weber said Friday in Frankfurt.

Separately, the ECB expanded its operations to help Central European banks gain access to euros amid the squeeze in the markets where banks lend to one another. The ECB said it has set up a €10 billion lending facility for the Polish central bank.

CORRECTIONS & AMPLIFICATIONS

Former Federal Reserve governor Laurence Meyer projects that excluding the impact of potential fiscal stimulus and lower interest rates, output will contract at a 4% annualized rate in the fourth quarter and a 2% rate in the first quarter, and the jobless rate will exceed 8% by the end of 2009. A Money & Investing article on Thursday failed to note that the forecast excludes the impact of fiscal stimulus or rate cuts.

A promotion by eBay Inc.'s PayPal unit to offer holiday online credit lines to customers can't be used on **Amazon.com.** An article in some editions Friday incorrectly said the credit could be used at Amazon.

U.K. economy offers no easy fix

BY ALISTAIR MACDONALD

LONDON—U.K. Treasury Chief Alistair Darling will have to strike a delicate balance Monday when he presents his spending plans. With the economy in deep trouble and people looking to the government for help, his goal will be to offer a crowd-pleasing fiscal boost without prompting investors to run for the exits.

On the world stage, the U.K. has been among the most vocal proponents of relying on government spending to counter economic malaise. But with investors increasingly concerned about the government's ability to balance its budget, it will likely have to settle for a smaller stimulus than the multibillion-dollar packages announced by countries like the U.S., Spain and China.

In his so-called prebudget report, Mr. Darling is likely to predict a sharp but short economic downturn and announce a stimulus package that will be valued at about 1% of annual economic output, people familiar with the matter say. The package is likely to include an extension of income-tax cuts for low-income families announced in May and the acceleration of billions of pounds of large spending projects, for transport in particular.

Gordon Brown

The government is also likely to cut the U.K.'s value-added tax to 15% from the current 17.5% for a period of as long as a year, and postpone a new fuel tax and a planned increase in taxes on small to midsize enterprises.

Prime Minister Gordon Brown also has promised new measures to help small businesses get loans. Efforts could include extending an existing £360 million ($531 million) initiative guaranteeing 75% of the loans of small businesses, among other measures.

"To fail to act now would be not only a failure of economic policy, but a failure of leadership," Mr. Brown plans to say in a speech to business leaders Monday, according to a transcript. Mr. Darling hopes to pay for the stimulus in part through sales of state assets and efficiency gains in government offices, a person familiar with the matter said.

Underscoring the U.K.'s financial challenges, the Treasury said Thursday that the budget deficit more than doubled to £23.3 billion in the seven months ended October, from £9.5 billion in the corresponding period last year. Economists predict the budget deficit will reach 6.5% of annual economic output next year—one of the widest deficits among developed nations.

In a measure of how international investors have lost confidence in the U.K., the pound has fallen by about 25% against the dollar this year and almost 14% against the euro.

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

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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LEADING THE NEWS

Paulson weighs tapping rescue funds again

Market deterioration raises need to initiate confidence measures

BY DEBORAH SOLOMON

WASHINGTON—Treasury Secretary Henry Paulson is considering tapping the second half of the U.S. government's $700 billion financial-industry rescue fund and rolling out new programs in response to worsening market conditions, according to people familiar with the matter.

Treasury is in the middle of deploying the first $350 billion of the Troubled Asset Relief Program, or TARP. It is injecting $250 billion into banks and has invested $40 billion in American International Group Inc., the giant insurer. About $60 billion remains unused, and Mr. Paulson had suggested he wasn't planning to initiate additional spending before he leaves office in two months.

But last week's deterioration in the markets heightened concern at Treasury that it might need to implement additional confidence-boosting measures sooner than later. Officials are now discussing which programs to roll out and when to do so.

The Dow Jones Industrial Average lost 5.3% last week, and credit markets showed fresh signs of additional tightening. Among the hardest hit was banking giant Citigroup, whose share price fell about 60% for the week. The bank's board met

Associated Press

A Treasury spokeswoman said Secretary Henry Paulson **had always planned** to implement new programs when they were ready.

Friday to discuss options for the bank, including selling parts of the company or replacing its chief executive, Vikram Pandit.

Treasury spokeswoman Michele Davis on Sunday said Mr. Paulson had always planned to implement new programs when they were ready and never ruled out tapping the remaining half of the $700 billion fund. "We're looking at a variety of programs to support the market and we'll implement them as soon as they're ready," she said.

It wasn't clear whether, or how much, Citigroup's woes have been a factor driving Treasury's consideration of using more TARP funds.

The selection of Timothy Geithner to be President-elect Barack Obama's Treasury secretary is providing some comfort to Treasury officials that they would be able to move ahead with implementing new programs that wouldn't be derailed after Mr. Obama takes office in January. Mr. Geithner has been a key player in crafting the Bush administration's response to the financial crisis and has backed many of the steps Treasury has taken.

Treasury's immediate focus is on establishing a lending facility with the Federal Reserve, which Mr. Paulson believes will help alleviate strains in the consumer credit market by making more auto loans, student loans and credit cards available.

A person familiar with the planning said Treasury and the Fed have agreed on the structure of such a program, which would encourage investors to buy securities backed by credit cards, auto loans or even mortgages. This person said the agencies are working on operational details, such as whether the Fed should buy assets itself or provide loans to entice private investors to buy securities. Treasury is expected to contribute between $25 billion and $100 billion to the facility.

The program could be announced within a few weeks.

Treasury is continuing to look for a way to prevent more foreclosures, including trying to improve a proposal floated by Federal Deposit Insurance Corp. Chairman Sheila Bair. Democratic lawmakers have been pressuring Mr. Paulson to use some of the $700 billion rescue fund to help homeowners in danger of foreclosure.

Treasury has also been designing another capital-injection program aimed at financial institutions beyond banks, in addition to considering making more money available to banks that have already received a government infusion.

Markets appear to have been spooked by Mr. Paulson's assertion before Congress last week that Treasury wasn't planning to initiate any new capital-injection programs and his indication that he had no plans to tap the remaining $350 billion in TARP funds. There was also concern on Wall Street over Mr. Paulson's decision to forgo buying bad loans and other distressed assets clogging the books of financial institutions, an original intent of TARP.

Mr. Paulson told lawmakers last week that Treasury "concluded it was only prudent to reserve our TARP capacity, maintaining not only our flexibility, but that of the next administration."

Many on Wall Street took that to mean the Bush administration was finished intervening and wouldn't take any further steps to prop up the financial sector. That prompted a barrage of calls to Treasury officials over the past week from market participants angry that the government seemed to be abandoning its plan to craft a broad financial rescue, according to market participants and other people familiar with the calls.

"There was an expectation that there was going to be this substantial intervention, and while that's ultimately going to happen, it's unclear right now what direction it will take," said Alec Phillips, an economic policy analyst with Goldman Sachs. "There's also some concern about whether that next $350 billion will materialize, though it is hard to see Congress rejecting it."

Within Treasury, there is a growing view that the markets may not be able to wait two months until a new administration is installed and that Mr. Paulson may need to take quick, additional steps to alleviate the strains. But even if Treasury were to introduce any new programs, it would likely take weeks before money flows out the door and into the financial sector.

Mr. Phillips said the markets would welcome any additional efforts to ease the current problems.

French Socialists battle to lead party in comeback bid

BY DAVID GAUTHIER-VILLARS

PARIS—France's fractured Socialist Party is struggling to pick a new leader and mount a comeback as the opposition to conservative President Nicolas Sarkozy, even as Mr. Sarkozy has appropriated part of the Socialists' agenda in response to the global financial crisis.

After months of bickering and two days of voting, party members still haven't chosen between two vastly different candidates: Ségolène Royal, the glamorous and more center-leaning politician who lost the presidential election against Mr. Sarkozy last year, and Martine Aubry, a more traditional leftist best known for penning the 1998 law limiting the French workweek to 35 hours.

On Saturday, the Socialist Party said Ms. Aubry had collected 50.02% of some 135,000 votes cast. Ms. Royal's camp refused to concede defeat and asked for a new vote, saying that Ms. Aubry's lead of 42 ballots was too thin to call a winner. Both sides later said there had been errors in the vote count.

The party's departing secretary said he would convene with other party chiefs on Tuesday to examine each side's claims and declare a final verdict.

Whoever wins will face the uphill task of restoring the Socialist Party's credibility at a time when France has moved to the right of the political spectrum.

The party has tried to follow, but has fallen into a political no-man's-land by trying to embrace market economics, alienating far-left voters, while its platform is still steeped in communist rhetoric, which puts off centrists.

Though it's the second-largest French party in terms of supporters after Mr. Sarkozy's UMP, the Socialists have lost the past three presidential elections.

The party hasn't groomed a new generation of leaders. Both Ms. Royal, 55 years old, and Ms. Aubry, 58, graduated from ENA, the elite civil-servant school that produces many of France's top politicians. Both were ministers under the late Socialist President François Mitterrand almost two decades ago.

Mr. Sarkozy has successfully exploited the party's weaknesses. The global financial crisis and the economic recession could have provided a boon to the Socialists, who have long advocated giving the state a bigger role in running the economy.

Yet Mr. Sarkozy has deftly adopted their rhetoric. Declaring that "the state is back," the president over the past few weeks has tried to lead the European Union's response to the financial crisis by supporting state-backed bailouts and rescue packages for banks, industries and consumers. In France, the government has earmarked up to €360 billion to support domestic banks, and announced plans to support key sectors such as the automobile and real estate industries.

Last week, Mr. Sarkozy borrowed another page from the Socialists' textbook when he launched a €20 billion wealth fund aimed at supporting ailing companies and protecting them against foreign predators. "I won't allow any industrial sector to fail," Mr. Sarkozy said in a speech Thursday.

Mr. Sarkozy's response to the financial crisis has won him political points. His approval rating rose eight percentage points in a month to 49% in November, according to a survey by polling agency Ipsos.

Still, Mr. Sarkozy was elected on a platform that urged people to "work more to earn more." In his 18 months in office, he has chipped away at the 35-hour workweek, made it harder for public-sector workers to go on strike and trimmed the number of jobs in France's large state sector—all moves that are anathema to the Socialists. Those changes have met with limited public resistance, partly because Mr. Sarkozy's political rivals haven't shown much muscle.

The prolonged weakness of the Socialists isn't all good news for Mr. Sarkozy. Political analysts say it could give extremist movements a voice just as France is about to slide into economic recession.

Ms. Royal was a relative backbencher when she decided to run for president two years ago. She was mainly known as the domestic partner of departing party secretary François Hollande, with whom she has four children.

Yet her ability to galvanize voters across the country through town-hall meetings won her the party's presidential nomination. Ms. Royal has never been fully accepted by more senior Socialist politicians, commonly known as the "elephants," and remains a divisive figure within the party. She hasn't said whether she will run for president in 2012, but argued the party leader

Associated Press

In the fight to lead **France's Socialist Party**, Ségolène Royal, above, has refused to concede to Martine Aubry. Party leaders said they would name the winner Tuesday.

should be a charismatic figure, and plays up what she calls her "special relationship with people."

Ms. Aubry, the mayor of Lille, in northern France, has said she wants to strengthen the party's tradition and left-wing ideology.

"A party must not rally behind a personality. It must be a group of determined militants," Ms. Aubry said in a recent speech. She has said one of her first steps as party leader would be to rebuild relationships with labor unions.

Ms. Aubry hasn't said whether she would seek to restore the strict 35-hour workweek, which was designed to create jobs by spurring employers to hire more people to share the work.

The Socialist Party has been in a kind of limbo since 2002, when then-Socialist Prime Minister Lionel Jospin didn't advance to the second round of the presidential race. He got fewer votes than both conservative candidate Jacques Chirac and far-right leader Jean-Marie Le Pen. Left with little choice, Socialist voters rallied behind Mr. Chirac.

In 2005, the party suffered a harder blow when its leaders split on whether to support a proposed EU constitution. French people eventually voted "no" and the Socialist Party nearly broke up. As the Socialists have struggled, other fringe parties have risen in France—leaving Mr. Sarkozy's political rivals even more fragmented.

CORPORATE NEWS

GM board, CEO split over bankruptcy

In rare disagreement with Wagoner, directors consider 'all options' as U.S. auto maker struggles to survive

BY JOHN D. STOLL

DETROIT—Members of **General Motors** Corp.'s board of directors are willing to consider "all options" for the ailing auto maker, including an eventual filing for bankruptcy protection, a stance that puts them in rare disagreement with Chairman and Chief Executive Rick Wagoner, people familiar with the matter said.

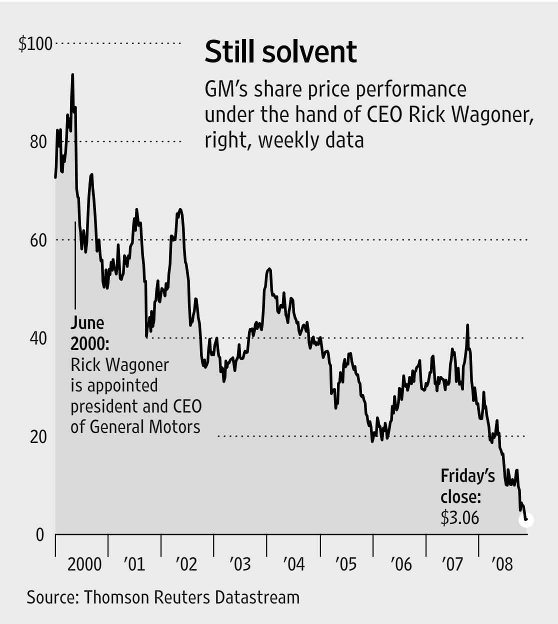
As part of his push to win a federal bailout for the company, Mr. Wagoner told Congress last week that GM management believes bankruptcy protection is not a viable option for the company. Instead, GM is focusing on persuading lawmakers to provide financial help, Mr. Wagoner said.

The board, which in the past has publicly offered Mr. Wagoner its strong support, agrees that seeking government funding is the company's top priority. But it isn't willing to dismiss the possibility of a bankruptcy filing, said people familiar with the thinking of the board's outside directors.

In a statement provided to The Wall Street Journal on Friday, GM said the board had discussed bankruptcy but didn't view it as a "viable solution to the company's liquidity problems." The board "is committed to considering all options in light of circumstances as they may develop." A GM spokesman, Tony Cervone, said that management is considering doing everything in its power to avoid a filing.

GM said Mr. Wagoner declined to be interviewed. Several of GM's board members couldn't be reached for comment on Friday. It is unclear whether the board has hired independent advisers to help it evaluate options it may have to consider.

New signs of tension in the boardroom could complicate the next few weeks for Mr. Wagoner. In the past month, he has had to acknowledge GM is using cash at an alarming rate. Mr. Wagoner said that as soon as January the company could fall short of the minimum levels it needs to stay out of bankruptcy court.



Friday's split represented at least the second time in recent weeks the board has shown a willingness to oppose Mr. Wagoner. This fall, Mr. Wagoner's management team presented a plan to potentially merge with Chrysler LLC. Some directors gave that plan a cold reception, according to people familiar with the meetings. By early November, when GM was set to report deep losses and $6.9 billion in cash outflows for the third quarter, the board encouraged GM management to quit the merger talks and focus solely on its liquidity crisis, these people said.

Of GM's 14 board members, nine have been in place since Mr. Wagoner became chairman in 2003. Many were elected when Mr. Wagoner's mentor and predecessor, Jack Smith, was running the auto maker. Lead director George Fisher, the retired chairman of Eastman Kodak Co., several times in recent years voiced support for Mr. Wagoner as the company racked up billions in losses. Other directors include Phil Laskawy, the retired Chairman of Ernst & Young, who was recently named Chairman of Fannie Mae, and University of North Carolina president Erskine Bowles, who was chief of staff for President Bill Clinton.

On Friday, GM said it is pushing ahead with new cost-cutting measures. It said three plants in the U.S. and one in Ontario, Canada, would extend their normal two-week holiday shut-downs into January. It also said it would close down an Ontario truck plant sooner than it had planned.

GM also confirmed it is ending leases on two of the five remaining corporate jets in its fleet. The move comes after Mr. Wagoner and Detroit's two other auto CEOs were chastised in Congress for flying corporate jets to meetings last week.

Meanwhile, Ford Motor Co. said Friday that it is exploring the sale of its five aircraft.

Mr. Wagoner and the chief executives of Ford and Chrysler LLC were in Washington last week hoping to get $25 billion from the $700 billion fund administered by the Treasury Department for troubled financial institutions, or to persuade Congress to accelerate the release of $25 billion in loans that had already been pledged to Detroit through an Energy Department fuel-efficiency program.

Mr. Wagoner, Ford's Alan Mulally and Chrysler's Robert Nardelli told lawmakers they have been restructuring their companies and need bridge loans to carry them through until the economy recovers. Mr. Wagoner asked the government for $10 billion to $12 billion in immediate funding.

All three expressed concern that a bankruptcy filing by any one of their companies could cause a collapse of the others. Because the companies share suppliers, one maker's failure could bring down the supplier network, they said, impacting one or both of the others. They also point to studies showing that consumers would be unwilling to buy cars from bankrupt auto makers, out of concern that warranties may not be honored or spare parts could become unavailable.

Lawmakers were skeptical that the companies had taken the tough steps to put their companies on the road to profitability. After enduring two days of harsh criticism, the Detroit CEOs were told to come back by Dec. 2 to describe how they would use taxpayer funds to become "viable."

On Friday, House Speaker Nancy Pelosi and Senate Majority Leader Harry Reid said in a letter that auto makers must provide "a forthright, documented assessment" of how much cash they need to become stable for the long term. They also said the companies, if granted loans, must make the government senior to all other creditors, meet fuel-efficiency targets, limit executive pay and offer warrants to allow taxpayers to profit if the companies recover.

—Sharon Terlep, Josh Mitchell and Matthew Dolan contributed to this article.

Pencils? Wall clocks? No cost cuts are too small at GM

BY JOHN D. STOLL AND SHARON TERLEP

Over the past several weeks, engineers and technicians working at **General Motors** Corp.'s sprawling proving grounds west of Detroit started noticing a curiosity: an increasing number of wall clocks had the wrong time, or stopped working altogether.

The reason: As part of a drive to cut $15 billion in costs, GM is no longer keeping the 562 clocks in working order, which will eliminate the expense of replacing and disposing of the clock's batteries and the cost of resetting them twice a year for daylight savings time.

It's not the only new measure GM is taking to save every last nickel. In its Renaissance Center headquarters, employees working late have to climb stairs when navigating its labyrinth of lower floors— the company now stops the escalators at 7 p.m. In designated cleanup areas of certain offices, the company has changed the type of wipe-up towels it buys. In a memo to employees, a staffer explained this will lower GM's "cost per wipe."

Like GM, **Ford Motor** Co. and **Chrysler** LLC are slashing costs. Earlier this month, Ford said it will cut its North American salaried work force by approximately 10%, and is trimming its capital spending, manufacturing, information-technology and advertising costs. GM and Chrysler have both halted or slowed work on new vehicles to cut development expenditures. Neither company held news conferences at the Los Angeles Auto Show last week, a standard function at such shows.

At GM, though, the penny-pinching is visible at the microscopic level, from cheaper pencils to elimination of voice mail in the plants.

This year, GM isn't giving out its "Mark of Excellence" awards to its top-selling dealers. It used to maintain a sizable fleet of cars for reporters to test drive, but has cut that back.

At the same time, GM has felt the heat for cutbacks it hasn't made. Last week Chief Executive Rick Wagoner flew on one of the company's corporate jets to Washington to ask for a bailout from taxpayers, a fact that raised the ire of some lawmakers. "There's a delicious irony in seeing private luxury jets flying into Washington, D.C., and people coming off of them with tin cups in their hands," Rep. Gary Ackerman (D.,N.Y.) said. "It's almost like seeing a guy show up at the soup kitchen in high-hat and tuxedo. ... I mean, couldn't you all have downgraded to first class or jet-pooled or something to get here?"

While Mr. Wagoner was able to travel on the corporate jet, GM has tightened its travel policy for thousands of employees in North America, telling them no air travel is allowed without written approval from senior managers.

Ford and GM scrambled to blunt the public-relations damage. Ford said it was exploring the sale of its five aircraft and GM, which leases the planes, said it had decided to get rid of two of its five remaining jets before last week's hearings. Tom Wilkinson, a spokesman, said GM has eliminated half the workers who staff its Detroit-based hangar and planes.

In view of their companies' dire finances, Mr. Wagoner and the CEOs of Ford and Chrysler were also asked on Capitol Hill last week if they would share in the sacrifice their employees have to make, and cut their salaries to $1. Mr. Wagoner and Ford's Alan Mulally declined. "I think I'm good where I am," said Mr. Mulally. Chrysler's Robert Nardelli said he would accept that, although he isn't paid a salary right now and he likely will be compensated if Chrysler's owner, **Cerberus Capital Management** LP, makes a return on its acquisition of the auto maker.

At GM's metal-fabricating plant in Grand Blanc, Mich., Steve Bean, a union committeeman, said he recently had to tell workers they would have to wait until at least next year to get $270 stipends they were promised in order to buy T-shirts, hats or coats emblazoned with their union local.

In addition, no settlements over grievances will be paid until next year. Grievance settlements are deals the company cuts with the union when a worker feels he or she wasn't properly paid or if the company violated work rules. Hundreds of such grievances are settled each year as a normal course of business.

"Someone might be owed eight hours of pay," he said. "All I can say is, 'If you're owed that money I'll get it to you, but not until Jan. 1—if we're still afloat.' "

Voice mail at most of the company's plants has been eliminated, a move that GM spokesman Tony Sapienza said saved something like "a million" dollars. Now, the only way to get union representatives or officers on the phone is to catch them at their desk or station. Recordings that used to say, "please leave a message," now say "please call back."

"It's all good business practices, but now it's extreme business practices to the point where we're not wasting anything," Mr. Sapienza said. "We're cutting to the bare minimum."

At the proving grounds in Milford, Mich., where the clocks are now frozen in time, GM has switched to regular Ticonderoga No. 2 pencils instead of the more expensive mechanical pencils that used to be freely available in storage closets, known in GM-speak as "pull stations." Many of the moves have left employees scratching their heads. "Is this the best they can do to save money?" asked one engineer recently while checking the drawers at one pull station near his desk. "There's a lot of rubber bands but not much else—a handful of pens and Post-It notes," he said.

Bill Jordan, president of UAW Local 599 in Flint, Mich., where GM builds engines, said he has noticed that the copy machines and printers that used to be spread out throughout the massive facility have disappeared. "They're doing their best to combine anything and everything they can to make it through the next few months," Mr. Jordan said.

—Neal E. Boudette contributed to this article.

CORPORATE NEWS

Auto suppliers take steps to conserve cash

Parts makers extend holiday shutdowns, crack down on credit

By Timothy Aeppel

U.S. auto suppliers are scrambling to extend their holiday-season shutdowns, shedding workers and developing contingency plans to deal with a potentially devastating failure of some of their biggest customers in Detroit.

The moves come as **General Motors** Corp. on Friday announced more production curbs and lawmakers in Washington began hashing out conditions that the Big Three auto makers—GM, **Ford Motor** Co. and **Chrysler** LLC—will have to meet before Congress will consider giving them an emergency $25 billion cash infusion. Many suppliers are counting on a federal bailout to rescue their big customers—and, by extension, themselves.

In the meantime, suppliers, still unsure of what will happen to the nation's car makers, are conserving cash by shifting to shorter workweeks, canceling capital-spending plans and accelerating layoffs. Problems in the supply network have the potential to spread pain to a wide swath of the U.S. economy. Auto suppliers employ more than 730,000 workers in the U.S., about three times more than the Big Three.

Nescor Plastics Corp. in Mesopotamia, Ohio, which makes plastic parts such as cup holders, in the past month has shifted to a four-day workweek, implemented an across-the-board salary reduction and canceled costly machine upgrades planned for the company's normal two-week holiday shutdown. The company also has added a week both before and after its two-week shutdown in which it will operate at only partial strength.

Like many auto suppliers, Nescor doesn't sell directly to the car makers. Rather, its plastic parts are sold to larger suppliers that assemble modules that get fitted onto cars on the assembly line.

"Over the past 12 months, we had three customers file Chapter 11 on us, so we know what it means when you suddenly aren't getting receivables you're counting on," says Darrell McNair, the company's president. The company has cut back on purchasing materials.

Angell-Demmel Managing Director Richard Anglin says the main survival strategy for suppliers like him is a tighter credit policy. Two years ago, Angell-Demmel began shifting away from allowing customers to pay bills 60 or 90 days after they take delivery. It is now 30 days, or, in some cases, payment in advance. The Dayton, Ohio, company, which makes decorative metal parts and many of the nameplates used on cars, now relies on an outside insurance agency to rate the credit risks of customers.

"I'm not sure what would happen if a GM would go into bankruptcy," he says. "I'm just not sure how you plan for that, other than what we're doing now."

Many suppliers would like to cut their exposure to the Big Three, but that is difficult to do at a time when the entire industry is in a deep swoon. GM's sales were off 45% in October, for instance, compared with a year earlier. Most analysts expect the slide to continue.

"The biggest problem facing suppliers right now is that they still don't know where the bottom of this market is, because it just keeps falling," says Kimberly Rodriguez, an auto expert at consulting firm Grant Thornton LLP.

Ms. Rodriguez estimates that a third of U.S. auto suppliers are in danger of insolvency and this number would spike in the event of a bankruptcy-court filing by one or more of the Big Three producers. Ms. Rodriguez says that many suppliers that normally would have already filed for bankruptcy protection themselves have resisted doing so, in part because the financing necessary to conduct a restructuring under Chapter 11 of the U.S. Bankruptcy Code is no longer available to them because of the credit crunch.

Honda to pare its work force, reduce output

By Yoshio Takahashi

TOKYO—**Honda Motor** Co. announced further car-output cuts for the current fiscal year and said it plans to shed 270 workers from its domestic temporary work force as the economic crisis trims auto demand.

Japan's second-biggest car maker by sales volume after **Toyota Motor** Corp. said Friday it will cut domestic production by 40,000 vehicles from its previous target of 1.32 million vehicles for the fiscal year ending March 31, as it scales back shipments of models for export such as the Accord sedan for North America and Europe.

Meanwhile, at the company's U.K. factory where it makes the Civic small car and CR-V sport-utility vehicle, it will produce 21,000 vehicles fewer than its earlier plan of 196,000 vehicles, reflecting the sluggish European market.

These cuts come after Honda said Thursday that it would trim its North American output by 18,000 vehicles from its previously planned 1.43 million for the fiscal year.

Honda is the latest big Japanese auto maker to announce output cuts this month, following Toyota and **Nissan Motor** Co. as the worsening economic outlook restrains consumers from buying new vehicles.

Honda's combined output volume for Japan, Europe and North America will fall to 2.87 million vehicles for this fiscal year from its previously projected 2.94 million. The company hasn't disclosed its global production plan for this fiscal year.

The Japanese car maker said it is maintaining its global sales outlook of 4.02 million vehicles for the current fiscal year.

Honda will terminate the contracts of 270 temporary employees working at its Saitama plant, north of Tokyo, by year end. The number of jobs to be shed represents 6% of the company's 4,400 domestic temporary employees and 0.2% of its 178,900 full-time global workers.

The car maker will suspend operations at its U.K. plant in February and March, although it will retain the plant's 4,800 regular production and back-office workers.

Disney fights pirates at China unit

Company grapples with bootlegs shown on video site 56.com

By Sarah McBride
And Loretta Chao

The Disney TV show **'Hannah Montana'** is among the bootlegs on YouTube-like Chinese video site 56.com, in which a Disney affiliate has a stake.

With its animated hit "Wall-E," **Walt Disney** Co. has learned first-hand how hard it is to keep copyright piracy at bay in China, even on a video Web site in which it holds a stake.

For months, several high-quality, full-length bootlegs of the robot love story by Disney's Pixar unit—released just last week on DVD in the U.S.—have been freely available to watch on the YouTube-like Chinese video site 56.com, which has had Disney as an investor since 2006. The bootlegs were put there by users of the site, and could be located even by visitors who don't read or speak Chinese.

While 56.com managed to remove some copies of the movie in recent months, others persisted. Earlier last week, the copies disappeared from the site after The Wall Street Journal began asking questions about them.

When Disney's venture-capital affiliate, Steamboat Ventures, invested in 56.com two years ago, it knew it faced a big challenge preventing pirated movies and TV programs from showing up there. But the firm says it was attracted to the site's "refined, controlled and effective technology platform," as well as its large user base.

The situation highlights the risk U.S. media companies face in attempting to grab a piece of the burgeoning market for online video in China, where DVD piracy was rampant even before the boom in Internet video. The chance to get a foot in the door comes with the danger of being associated with piracy, which Disney and its peers in Hollywood have tried for years to stamp out. As recently as Thursday, Disney, in a regulatory filing, said "the unauthorized use of our intellectual-property rights may increase the cost of protecting these rights or reduce our revenues."

Copyright piracy isn't just a problem in China, of course. Sites in Russia, Sweden, the U.S. and elsewhere facilitate the theft of copyrighted material. Last year, media giant **Viacom** Inc. sued YouTube over copyrighted video that ended up on the **Google** Inc. unit's site. The suit is still pending. While YouTube says it works to remove any unauthorized material, it is a complex and constant challenge.

The pitfalls are clear at 56.com, where pirated films from almost every major American studio can easily be found. Besides "Wall-E," the site as recently as last week offered crisp streams of movies like "Horton Hears a Who" from **News Corp.**'s Twentieth Century Fox; "Iron Man" from Viacom's Paramount; and "Kung Fu Panda" from **DreamWorks Animation SKG** Inc.

56.com declined to comment.

John Ball, founder and managing director of Steamboat, says the firm was aware that pirated content was a potential issue when it made its investment in 56.com, but thought it could promote legal content on the site and work toward eliminating pirated material. One of the company's investment strategies "is to help the legitimate evolution of digital content online," he says .

Eric Garland, chief executive of Big Champagne LLC, a firm that consults for copyright owners on piracy issues, says Disney's involvement in such a site is "ironic" and "shocking." But he added that Mr. Ball's rationale has some merit, as simply shutting down the site would drive infringing users to other sites.

The 56.com site—the words for 56 in Chinese sound similar to the words for "I'm Happy"—allows users to upload videos that can be searched and played by others. They typically pop up with a thumbnail profile of the uploader, including his or her online name and a photograph.

The site's written piracy policy calls for taking down all copyrighted content within 24 hours of being asked, says Steamboat's Mr. Ball, who calls that an impressive goal compared with other Chinese online-video companies. He credits 56.com's compliance strategy to Steamboat's involvement with the site, which has about 1.39 million daily visitors, according to ChinaVenture Investment Consulting Ltd.

By some estimates, about 180 million people in China have watched online video, and given the size of that market, many media investors feel they must have a presence there. MySpace China, which counts News Corp. as an investor, earlier this year announced a content partnership with another Chinese online-video company, **Youku.com**. News Corp. is the publisher of The Wall Street Journal.

Youku.com recently offered user-uploaded bootlegs ranging from Fox titles like "What Happens in Vegas" to movies by rival studios, such as "Hellboy II: The Golden Army" from **General Electric** Co.'s NBC Universal.

"We're committed to deterring piracy," said a Fox spokeswoman. She said the studio consistently sends takedown notices to sites in China and elsewhere.

Victor Koo, chief executive of Youku.com, says his company is in the process of developing video-fingerprinting technology that would block uploads of copyrighted content and "further improve our [intellectual property] protection going forward." It also manually removes copyrighted videos as it finds them, he says.

Steamboat isn't the only venture-capital firm to invest in piracy-heavy sites in China. **Sequoia Capital China** LLC and **Susquehanna International Group** LLP also have investments in 56.com. Representatives of both firms declined to comment.

IDG Technology Venture Investment LLC invests in several online video sites in China with substantial amounts of user-uploaded pirated content or links to it, including search company **Baidu.com** Inc., Web portal **Sohu** Inc., and online video site **Tudou.com**. A spokeswoman for IDG China says it has asked its companies to "address the piracy issue," and that it stresses "the need and importance of respecting intellectual-property rights."

The vast majority of these site's users are in China, but studios say they create problems that extend around the world, because so many other sites draw on them for their own content, a practice known as "leeching." People familiar with the situation say at least some studios have considered suing the venture-capital firms over their investments, but have held back for now, partly to give the sites a chance to work with filtering technologies.

Steamboat—whose Chinese Internet investments also include CTS Media, an advertising network for streamed video, and Trooden, which develops multiplayer games for mobile phones—first invested in 56.com at the end of 2006, and added to the initial sum the following year. Its total investment is believed to be less than $30 million.

Both companies declined to comment on the financial details of their relationship.

Steamboat says it is working to improve 56.com's record in sifting out pirated material. Some newer movies don't seem to be available on the site. And in recent weeks, 56.com has started testing a program from Santa Clara, Calif.-based **Vobile** Inc., which screens online video for copyrighted content. A person familiar with the matter says the system can stop such material from being uploaded, but plowing through the backlog is a giant project. Steamboat is also an investor in Vobile.

The site also uses a 50-person filtering team, but that team spends a lot of time weeding out government-censored content, such as pornography and videos of protests, which are more crucial for Chinese companies to avoid. Falling afoul of government bans could cost them the right to do business; 56.com was shut down for several weeks this summer, but the company said the closure stemmed from a technology problem.

—Gao Sen and Kersten Zhang contributed to this article.

Debt pressures build on Redstone

By Merissa Marr

The latest rout in **Viacom** Inc. and **CBS** Corp. shares, which sank to new lows last week, is turning up the pressure on Sumner Redstone as he battles to resolve his family's debt problems.

Mr. Redstone startled investors last month by dumping $233 million of his stock in Viacom and CBS, which he controls through his family holding company, **National Amusements**. The move was a bid to fix his debt problems after the stock market lurched lower and National Amusements breached an asset-to-debt covenant. But it didn't work, and his family has since been in talks with its lenders about restructuring a $1.6 billion debt pile.

Investors in Viacom and CBS have grown increasingly concerned that Mr. Redstone will have to sell more stock in the two companies as market conditions worsen. Mr. Redstone has said repeatedly that he doesn't plan to sell any more stock in either.

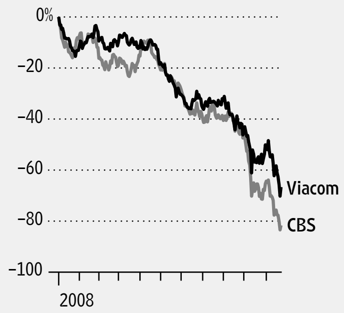
While the banks can't force Mr. Redstone to sell more stock, because the debt isn't secured, the plummeting value of his assets could give him less wiggle room in negotiations with lenders. Mr. Redstone is expected to have to sell some assets as a condition of a restructuring, according to people familiar with the situation.

If the banks pulled the plug on the debt now, National Amusements would likely have to file for Chapter 11 bankruptcy-law protection, people familiar with the situation said.

But while the banks are under pressure themselves, that scenario could ultimately prove a bigger headache than a restructuring, and it's not currently on the table, the people said.

Not amused

Year-to-date share performance of Viacom and CBS on the New York Stock Exchange



Source: WSJ Market Data Group

U.S. deal maker could lose control of publishing firm

By Peter Lattman
And Russell Adams

The publisher of men's magazine Maxim is in restructuring talks that are expected to turn over the company to creditors, in another blow to star media deal maker Steve Rattner.

The negotiations are fluid and could still fall apart, according to people familiar with the discussions. Financial results at **Alpha Media**, the publisher of Maxim and a separate music magazine called Blender, have dropped sharply amid an advertising slowdown, causing the firm to violate debt covenants.

Maxim's crisis marks the latest setback for Mr. Rattner, a prominent Wall Street deal maker and investor whose firm manages New York City Mayor Michael Bloomberg's multibillion-dollar fortune. Mr. Rattner's **Quadrangle Capital Partners** has struggled with its private-equity portfolio and recently unwound its hedge fund amid market turmoil.

Quadrangle's private-equity fund paid about $250 million for Alpha Media in August 2007, lauding the company as an "unrivaled" play for reaching 18- to 34-year-old males. The New York-based firm put up about $90 million of equity and borrowed the rest to purchase the titles from British publisher Felix Dennis.

Among Alpha Media's largest lenders is private-equity firm **Cerberus Capital Management** LP, which controls a large chunk of the company's $125 million in senior debt and is central to the restructuring talks.

The company's earnings before interest, taxes, depreciation and amortization, or Ebitda, have plummeted, say people familiar with the matter. When Quadrangle acquired Alpha, it was generating about $28 million in Ebitda; it is on track to generate about $8 million in Ebitda in 2008.

Amid a broad magazine downturn, ad pages in Blender are down 25% through September, according to the Publisher's Information Bureau. Maxim's ad pages have fallen 3% over that period.

Alpha Media isn't the only magazine publisher struggling of late. American Media, the private-equity owned publisher of the National Enquirer and Star magazine, is locked in protracted restructuring negotiations with bondholders. And broad job cuts are under way at publishing giants **Time** Inc. and **Condé Nast Publications**.

Part of Quadrangle's investment plan was to bring in Chief Executive Kent Brownridge, the longtime No. 2 at Us Weekly and Rolling Stone publisher Wenner Media. Mr. Brownridge, who fired most of the top publishers and editors to bring in his own team, immediately shuttered the ailing men's magazine Stuff to focus on the Maxim and Blender properties.

But the business struggled during what has been a terrible year for the magazine industry, and Mr. Brownridge left Alpha Media in August.

Quadrangle has had a number of setbacks this year. The firm is winding down a $500 million hedge fund focused on media investments amid weak performance and investor redemptions. Spanish cable operator Grupo Corporativo Ono, one of Quadrangle's largest private investments, recently cut 30% of its work force and removed its founder.

Cellphone-location tools spur a race among firms

By Amol Sharma
And Jessica E. Vascellaro

Companies are racing to provide a key service that could finally give location-based cellphone applications mass reach.

Location-based services—programs that track users' whereabouts via their cellphones to do such things as recommend nearby restaurants or provide local weather reports—aren't new, but developers have had difficulty bringing them to the mass market because of the complex coordination required with wireless carriers and handset makers.

Now **Nokia** Corp., **Google** Inc., and several technology start-ups are looking to solve that problem by working with the carriers and handset makers, along with other sources, to supply developers with the location information. In most cases, they would charge developers to use their "location platforms." But there are other potential business models, such as sharing location information in exchange for being able to sell ads on their Web sites or applications.

"It is a massive prize. It's about who controls access to location—who do you go to for the locations of millions of phones around the world," said Sam Altman, co-founder and chief executive of Mountain View, Calif. based Loopt Inc., one of the start-ups establishing itself as a location platform.

ABI Research predicts that location-services will be a $13 billion business by 2013, up from $515 million last year.

The most important tool these new platforms can provide developers is helping locate a phone. Many new mobile-phones come with Global Positioning System, or GPS, chips that tap into a network of satellites to find a phone's position. But to get an accurate fix, especially in urban areas with tall buildings or indoors, that information often must be combined with a phone's location based on the cellular towers it is accessing. Phones that have Wi-Fi transponders can get additional data by looking up the nearest hot spot. Getting access to that data and crunching it down to specific geographic coordinates is heavy lifting for small developers.

"This is one of the reasons location services aren't growing the way they should be growing," said Isaias Sudit, CEO of Loc-Aid Technologies Inc., another of a handful of start-ups providing location platform services. Other start-ups include Useful Networks, Skyhook Wireless and uLocate Communications Inc.

Loopt

Location-based services, such as Loopt's 'buddy finder,' require complex coordination with carriers.

Mr. Sudit started Loc-Aid in 2004 to launch mobile location services, including a scavenger hunting application, but quickly ran into problems. He decided two years ago to focus his efforts on building a software platform to make other developers' lives easier. So far Mr. Sudit has partnerships with two Canadian wireless carriers for location positioning data and he says he plans to be live with several U.S. carriers in the next few months.

Nokia, the world's largest cellphone manufacturer, has plunged aggressively into location services since its $8 billion acquisition this year of digital map-maker Navteq. The company included GPS-enabled navigation in about 70% of the phones it shipped in the third quarter. Its next step will be to open a location platform, perhaps even the underlying map data, to other software makers, though details haven't been announced. "You can lower the barriers of entry to allow more and more people to make applications," said Nokia executive Michael Halbherr.

Loopt offers a "buddy-finder" application that lets users keep tabs on their friends by plotting their locations on a map, a service that **Apple** Inc. has marketed in recent iPhone commercials. The three largest U.S. carriers, Verizon Wireless, **Sprint Nextel** Corp. and **AT&T** Inc., hold equity in Loopt, according to a person familiar with the matter.

Boeing plans layoffs in '09 amid Pentagon cutbacks

By J. Lynn Lunsford

Boeing Co. will lay off some workers and reduce costs next year to remain competitive amid an expected decrease in Pentagon spending, the delay in some contract awards and the potential effect of a global recession in the airline industry, company officials said Thursday.

In a memo to employees, Boeing Chairman and Chief Executive Jim McNerney said he believes a record backlog of orders in both the commercial and military sides of business will help the aerospace company weather "what clearly has become a more challenging business environment."

Rick Stephens, the company's senior vice president for human resources and administration, said the company is taking steps to cut costs, including an announcement Wednesday that it was laying off roughly 800 people from a plant in Wichita, Kan.

Mr. Stephens said the company would try to minimize the number of layoffs "through natural attrition, release of outside contract hires and job transfers within Boeing."

Food prices lift Heinz

Ketchup firm focuses on raising efficiency and conserving cash

By Julie Jargon

Reuters

Heinz CEO **William Johnson**, seen addressing shareholders in 2006, says pricing discussions with retailers 'are not particularly friendly right now.'

Higher prices helped boost **H.J. Heinz** Co.'s results in its fiscal second quarter, but its chief executive warned that the ketchup company can't rely solely on price increases to drive future growth.

Chief Executive William Johnson said he doesn't expect food prices to come down at all, but he said in a conference call with investors that pricing discussions with supermarkets and other retailers "are not particularly friendly right now."

Packaged-food companies have succeeded in recent months in passing on price increases even amid the general U.S. economic downturn. The consumer-price index in October fell 1% on a seasonally adjusted basis—the biggest one-month decrease since the Labor Department began publishing seasonally adjusted changes in February 1947—but the food-and-beverages index rose 0.3%.

Mr. Johnson said consumers tend to adjust to higher food prices, adding, "I don't think anyone should expect to see this pricing being given back."

But with supermarkets resisting further increases, Heinz is looking at other ways to protect its profit margins, Mr. Johnson said. The Pittsburgh-based company is trying to make production more efficient and enticing shoppers with "value" propositions.

For instance, in the U.K., Heinz recently started a marketing campaign showing how Heinz beans can make a healthy lunch for less than £1 ($1.50).

Mr. Johnson also said the tough global economy has prompted Heinz to focus on conserving cash. He said he plans to appoint a Heinz executive to act as cash "czar."

"Cash now more than ever is king and we are exploring every opportunity to enhance our cash flow," he told investors.

Heinz on Friday reported net income for its quarter ended Oct. 29 of $276.7 million, or 87 cents a share, up 22% from $227 million, or 71 cents, a year earlier, reflecting gains from currency hedging. Revenue rose 3.5% to $2.61 billion.

A bright spot for labor

U.S. coal companies hire as other sectors continue to shed jobs

BY KRIS MAHER

MOUNDSVILLE, W. Va.— Amid waves of bleak economic news, Fred McCardle seems to be a rarity. He is working 60 hours a week, at almost double the pay of his old job, and just bought a $500 flat screen TV.

"It's nice to have a little extra money," says the 42-year-old, who quit his job at a concrete company and was hired as a coal miner soon after by **Consol Energy** Inc. The company is spending $3 million on billboards to attract workers across a swath of Eastern states—West Virginia, Pennsylvania, Virginia and Kentucky—and hired 15 new miners this week at the McElroy mine, where Mr. McCardle is working.

Mining is one of only two areas of the private sector that added jobs in October—the other was health care. While 7,000 new mining jobs are hardly enough to register in a national economy that shed 240,000 jobs last month, they make a difference in parts of the country like Appalachia that have historically felt the deepest pain during recessions.

Indeed, economists say demand for coal could help communities throughout Appalachia fare better than areas in California or Florida hurt by the housing bust, or parts of the Midwest hurt by auto-industry woes. Unemployment in West Virginia, the second-biggest coal-producing state behind Wyoming, was 4.7% in October, compared with 6.5% nationally.

"I don't think West Virginia is going to avoid the national downturn altogether, but we're in better shape" than many other states, said George Hammond, an economist at West Virginia University. The coal-mining industry generates needed revenue for the state's coffers through special taxes amounting to $419 million in fiscal 2008. Its 600 coal mines employ about 50,000 people and support numerous other jobs, from truck drivers to accountants.

Mining's fortunes could shift quickly, especially as coal prices soften and the incoming administration of President-elect Barack Obama trumpets clean energy. Mining communities, often isolated geographically, have few industries to fall back on.

Industry officials, however, remain cautiously optimistic. While U.S. coal prices are down from July peaks as mild weather weakens demand and the export market softens, the current price is still about 30% higher than in January. The use of coal, which generates more than half the nation's electricity, tends to remain fairly constant even when economic activity slows. Utilities burn more than one billion tons of coal a year. By contrast, steelmakers use about 23 million tons of U.S. coal a year.

Associated Press

The coal-mining industry has been adding jobs in the U.S., bringing relief to historically struggling areas like Appalachia. Above, a mining site in West Virginia.

"Electricity demand never really changes," said Paul Forward, an analyst with Stifel, Nicolaus. He expects utilities' demand for coal to be down 1% this year and up 0.7% next year.

The tough economic climate buys time for coal-mining companies as utilities delay expensive conversions to nuclear fuel and other alternative fuel sources. The miners also think the Obama administration will favor clean-coal technologies and be reluctant to undermine any industry that is supporting the economy.

"We're still seeing a fairly bullish picture in employment on the coal side," said Luke Popovich, a spokesman for the National Mining Association.

A resilient coal industry is benefiting communities like Moundsville, a small city on the Ohio River. Years ago, companies such as Louis Marx and Co., which made the once ubiquitous Big Wheel children's toy, and Fostoria Glass, which made fine stemware, closed down. But the mine is still here.

Consol is the biggest private-sector employer in the area, with about 800 workers at the McElroy mine, the largest operating coal mine in the eastern U.S. Most employees live either in town or in surrounding Marshall County, pop. 35,000, which had a 4.4% unemployment rate in September.

The company plans to hire several hundred people who showed up at a recent career fair held at a minor-league baseball park. Billboards touting the importance of coal as an energy source are plastered around the region, not to sell coal but to attract workers to replace Consol's aging work force.

Alpha Natural Resources Inc. of Abingdon, Va., is also hiring, and in May it started paying workers a gas allowance and gave every employee 25 shares of stock in a retention effort. In October, it increased pay for most jobs.

Patriot Coal Corp., which employs 4,000 people, has 200 job openings for miners, electricians, equipment operators and supervisors. "If someone is willing to work hard they have an opportunity to make $90,000 a year," said Janine Orf, director of investor relations.

In Moundsville, small-business owners said the economy isn't booming, but it is better than many other areas of the country. Standing-room crowds have filled the new Buffalo Wild Wings restaurant on recent weekends, said Chris Lenevich, a manager there.

"I think everyone in our area is working that wants to work," said David Knuth, of the Marshall County Chamber of Commerce.

CORPORATE NEWS

Wal-Mart CEO to retire, in surprise move

International chief Mike Duke is named to run giant retailer

In a sudden change of leadership at the world's largest retailer, **Wal-Mart Stores** Inc. said Chief Executive H. Lee Scott Jr. is retiring and will be succeeded by Mike Duke, who heads the company's growing international operations.

Mr. Duke joins Wal-Mart's board immediately and will take over as CEO Feb. 1 to steer the discounter through the current global economic turmoil.

Mr. Scott, who in recent years led the company through a period of

By ***Ann Zimmerman, Miguel Bustillo*** and ***Joann S. Lublin***

slowing growth and rising public criticism of its labor practices, will continue as chairman of Wal-Mart's executive committee and become a company adviser.

The ascent of Mr. Duke, who at 58 years old is just a year younger than the man he is succeeding, puts a well-regarded insider at the helm of Wal-Mart as it executes a strategy of remodeling many of its U.S. stores while grabbing a greater share of the global retail market.

Mr. Scott and Mr. Duke weren't made available to comment.

Wal-Mart shares rose $2.26, or 4.5%, to $52.92 at 4 p.m. in New York Stock Exchange composite trading on Friday.

The handoff—only the fourth CEO change in the company's 46-year history, and the third since founder Sam Walton turned over the reins in 1988—comes as the retailer enjoys a renaissance.

After years of struggling with stagnant U.S. sales, Wal-Mart regained strength in the past year, posting strong revenue and profit with its renewed emphasis on low prices as well as improved merchandise and expanded marketing.

Mr. Duke's challenge will be shepherding Wal-Mart into a future where its traditional growth engine, its U.S. superstores, no longer yield the upside they once did. Even though its U.S. sales have beaten the competition's recently, they are growing at about half the rate they did earlier in the decade, when fewer supercenters dotted the landscape. Meanwhile, the company is pursuing promising but riskier expansion in emerging markets such as Brazil and China.

Mr. Duke's varied 13 years of experience at Wal-Mart—which includes tenures as the head of its logistics operation as well as stints running its U.S. and foreign operations—make Mr. Duke the steadiest hand available for the task, according to some of Wal-Mart's business partners and the company itself.

In a memo to employees, Wal-Mart Board Chairman Rob Walton, eldest son of the founder, offered reassurance about the unexpected timing of the management change, saying it was the culmination of a well-honed succession plan. He said it was Mr. Scott's decision to retire, and that Wal-Mart's current market strength in the midst of economic turmoil made it a good time for the transition.

"We think the right time is now, a time of strength and momentum for our company," he wrote. "Our strategy is sound and [Mr. Duke] has been actively involved in developing and executing this strategy."

The search for a successor to Mr. Scott began two years ago, said a person familiar with the situation, and was formalized during a November 2007 meeting at a time when Wal-Mart's fortunes remained at a low ebb. The upshot: Mr. Duke and Eduardo Castro-Wright, the 53-year-old head of Wal-Mart's U.S. operations, emerged as the front-runners to succeed Mr. Scott, the informed individual said.

Mr. Duke's selection was popular

Bloomberg News/Landov (left); Associated Press

In a rare change in leadership for Wal-Mart, **Lee Scott**, left, will give way to **Mike Duke**, who will take over as chief executive of the discount retailer on Feb 1.

inside headquarters as well as among people who do business with the company, said some suppliers.

When to step down was left up to Mr. Scott, according to the company and other insiders. Now, "he feels he has the company positioned where he wants it to go," said a person knowledgeable about the succession planning.

Mr. Duke's age, however, was also apparently a consideration, this person said. Since he is just a year younger than Mr. Scott, waiting much longer might have aged Mr. Duke out of the job, which he is expected to hold only five or six years.

Although Mr. Castro-Wright was passed over for the top position, he was given an expanded role as vice chairman and head of the company's global procurement operation. Mr. Castro-Wright is a former CEO of a division of **Honeywell International** Inc., Honeywell Transportation and Power Systems Worldwide, and former president of Honeywell Asia Pacific.

He joined Wal-Mart in 2001 and previously headed its Mexican business, Wal-Mart de Mexico, before being put in charge of U.S. store operations in 2005.

Mr. Duke worked at Federated Department Stores and May Department Stores for 23 years prior to joining Wal-Mart in 1995. As head of the international division, he pulled out of two unprofitable markets, Germany and South Korea, an acknowledgment that the company had failed to win over customers.

In Bentonville, Ark., Wal-Mart's headquarters city, where office parks are filled with liaisons to Wal-Mart from other Fortune 500 companies, reaction to Mr. Duke's ascent was overwhelmingly positive.

"He is a very strong manager who is not going to make any mistakes," said Paul Prebil, **Goodyear Tire & Rubber** Co.'s Wal-Mart sales director in Bentonville.

It was a very different time when Mr. Scott took over Wal-Mart in January 2000, embarking on a tenure marked by turmoil and change. He grappled with store saturation and falling investment returns in the company's U.S. division, while fending off critics who blasted the retailer's pay, benefits and treatment of its employees. A class-action sex-discrimination suit against Wal-Mart is still pending in a federal court in San Francisco.

Mr. Scott also dealt with a series of scandals, including an investigation into stores hiring illegal immigrants, and a top executive accused of stealing from the company.

But in the past three years, Mr. Scott led a turnaround of Wal-Mart's U.S. operations, bringing in executives from outside the once-insular company. Mr. Scott reached out to critics and started an environmental initiative to reduce company waste and increase fuel efficiency.

"We hope with the change of leadership Wal-Mart will turn over a new leaf and allow workers to choose freely whether or not to organize a labor union, rather than continue its coercive antiunion campaigning," said Carol Pier, labor-rights and trade senior researcher at Human Rights Watch, a nonprofit organization.

Wal-Mart's stock, while still down 20% from when Mr. Scott became chief executive, has climbed 11% this year—making Wal-Mart the only Dow Jones Industrial Average component to notch gains for 2008.

Mr. Duke's rise comes as Wal-Mart plans to shift two-thirds of capital expenditures to high-growth markets abroad.

Wal-Mart is also predicting that it will post an operational profit this year in Japan, where it has long struggled and continues to post comparable-store losses.

But the international push, which Mr. Duke has spearheaded, comes rife with risks. Wal-Mart cut its annual profit projections last week, citing fluctuations in currency-exchange rates. Despite its optimism about Japan, the world's second-largest retail market, it also revealed that its Japan sales growth declined compared with the year earlier.

GLOBAL BUSINESS BRIEFS

AngloGold Ashanti Ltd.

Bridge loan of $1 billion avoids fire sale of assets

AngloGold Ashanti Ltd. on Friday said it secured a $1 billion bridge loan that buys it time to refinance until credit markets have recovered, meaning it won't be forced into a fire sale of assets. The South African gold miner continues to discuss the sale of what it terms non-strategic assets, but Chief Executive Mark Cutifani said this can take time. "We're not sellers if it's not for value," he said. The loan with Standard Chartered Bank will be used to repay a convertible bond due Feb. 27. "This was the last brick in the wall to make us bulletproof," Mr. Cutifani said.

Basilea Pharmaceutica AG

Swiss biotechnology company **Basilea Pharmaceutica** AG said its Zevtera superbug-fighting antibiotic received a positive vote from the scientific advisory committee of European pharmaceuticals watchdog EMEA. The vote should pave the way for European Union approval later this year or early next year, according to analysts. Superbugs such as methicillin-resistant Staphylococcus aureus, or MRSA, cause complicated, sometimes fatal, skin infections. Analysts say that Zevtera, generically known as ceftobiprole, could bring in between one billion Swiss francs ($818.4 million) and 1.6 billion francs in its best years. Basilea is collaborating with **Johnson & Johnson**'s Cilag GmbH International to develop the antibiotic. The advisory board also backed **Roche Holding** AG's RoActemra, a new drug for the treatment of rheumatoid arthritis.

Repsol YPF SA

Spanish savings bank **La Caixa** SA said it has held talks to sell part of its stake of more than 12% in **Repsol YPF** SA to Russian oil company OAO **Lukoil**. The bank said a possible deal depends on a parallel sale by Spanish construction company **Sacyr Vallehermoso** SA of its 20% interest in Repsol. Through buying a stake in Repsol, Lukoil would gain part of the Spanish oil-and-gas company's refining capacity in Spain and Latin America of nearly 1.2 million barrels a day. La Caixa didn't elaborate on how much of the Repsol stake it may sell to Lukoil, and Lukoil declined to comment. Sacyr said it remains open to discussions on any of its assets.

Carnegie AB

The board of **Carnegie** AB said it was questioning the legality of the Swedish government's decision to take over the Swedish investment bank after Sweden's National Debt Office said earlier it had started the sales process. Carnegie put up shares in units Carnegie Investment Bank AB and insurance branch Max Matthiessen AB as collateral for a five billion Swedish kronor ($595 million) loan from the Swedish central bank, which was then transferred to the debt office. The office took control of the shares Nov. 10, after Sweden's financial regulator revoked Carnegie's banking license because of illegal trading activities.

Absa Group Ltd.

South African lender **Absa Group** Ltd. said it appointed Maria Ramos to succeed Steve Booysen as chief executive, starting in March. Absa is majority owned by U.K. bank **Barclays** PLC. Ms. Ramos said Friday that she will step down at the end of February as CEO of **Transnet** Ltd. "The challenge always was, 'Where to next?' " said Ms. Ramos, who oversaw the rebranding of the company that runs South Africa's rail network and ports, and helped return it to profitability. Mr. Booysen said, "Having achieved the significant goals that I set for myself at the start of my term as group chief executive and with Absa performing well, this is a good time to move on."

Fortis NV

The Dutch government said it will merge the retail-banking operations of **Fortis** NV and ABN Amro and named former Finance Minister Gerrit Zalm chief executive of the combined bank."ABN Amro and Fortis have to go forward as one powerful Dutch company," said Dutch Prime Minister Jan Peter Balkenende. The state bought Fortis's Dutch businesses, including ABN Amro, for €16.8 billion ($21 billion) in October after it lost the confidence of investors and depositors.

A.P. Moeller-Maersk AS

Danish shipping company **A.P. Moeller-Maersk** AS said its Maersk Line unit will cut capacity by 8% next year between the Far East and North America in response to an anticipated drop in demand. In the latest sign of a slowdown in global trade, the world's largest container shipper by volume signed a vessel-sharing agreement with France's **CMA-CGM** SA, the world's third-largest, in an effort to cut industry capacity. "These changes are made in anticipation of a more difficult trading environment in 2009 and a part of our efforts to further rationalize deployment," Maersk said. The new agreement will take affect in May, using the Suez and Panama canals, and includes the Far East to the U.S. East Coast and the Far East to the Pacific Northwest.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Clinton faces familiar list of problems

Obama's likely choice for secretary of State carries a hawkish reputation on North Korea, Iran and Palestinians

By Jay Solomon

WASHINGTON—As U.S. secretary of state, Sen. Hillary Clinton would seek diplomatic solutions to problems her husband and President George W. Bush largely failed to solve, from North Korea's nuclear program to the Arab-Israeli conflict and the U.S. standoff with Iran.

Sen. Clinton's international stature would help gain the attention and cooperation of world leaders, say current and former U.S. diplomats. Even the former first lady's critics acknowledge that her tenacity and attention to detail could make her an effective chief American diplomat.

Still, Sen. Clinton's foreign-policy doctrine, as outlined during the presidential campaign, is considerably to the right of President-elect Barack Obama's. The two could form an effective good-cop, bad-cop combination, supporters say. Others fear a reprise of the ideological battles between the White House and State Department that marked President George W. Bush's administration.

Representatives of Mr. Obama and Sen. Clinton continue to have intensive talks and have resolved the financial-disclosure issues surrounding the international charity work of her husband, former President Bill Clinton, according to a transition aide. People on both sides say Mr. Obama is on track to announce Sen. Clinton as his choice.

"We're still in discussions, which are very much on track," said Philippe Reines, a senior adviser to Sen. Clinton, on Friday. "Any reports beyond that are premature."

Associated Press

North Korea's Kim Jong Il toasts Madeleine Albright in October 2000, left; late Palestinian leader Yasser Arafat, with Bill Clinton and former Israeli Prime Minister Ehud Barak in July 2000. President-elect Barack Obama wants to work to rebuild **U.S. ties globally**.

Meanwhile, an official close to the transition team said Friday that retired Marine Corps Gen. James Jones has moved up the list to become the favorite to become Mr. Obama's national-security adviser.

His choice would likely mean James Steinberg, a top foreign-policy adviser to the Obama campaign, would move over to the State Department and become Sen. Clinton's deputy, the official said. Another Obama confidante, Susan Rice, would then be positioned to be Gen. Jones's deputy.

Sen. Clinton has earned a reputation as being among the more hawkish Democrats during her eight years in the Senate. She voted in favor of the Iraq war, though she later distanced herself from the decision and accused the Bush White House of providing skewed intelligence to Congress. She has also supported stringent economic sanctions against Iran for its nuclear activities, and broke with Mr. Obama last year by backing a Bush administration initiative to label an Iranian military body, the Revolutionary Guard Corps, a terrorist organization. During the campaign, she threatened to "totally obliterate" Iran if the country carried out a nuclear strike on Israel.

Sen. Clinton ranks among Israel's staunchest defenders in Congress, raising concerns among some Arab diplomats about her ability to be a peace broker between Palestinians and Israelis. Many Arab governments have voiced hope that the Obama administration will view their positions more favorably than Mr. Bush did.

"She's not incredibly popular in the Arab world, but she's a known quality, which could help," said an Arab diplomat working on the Palestinian issue.

Sen. Clinton has joined with Mr. Obama in pledging to break from the unilateralist foreign policies that often defined the Bush administration, while working to rebuild American alliances globally. She has called for the U.S. to work closely with the United Nations and to empower multinational bodies like the International Criminal Court.

In facing the rising power of China and Russia, Sen. Clinton has called for a sustained effort to integrate Beijing and Moscow more effectively into global economic and political bodies. "Our relationship with China will be the most important bilateral relationship in the world in this century," she wrote in Foreign Affairs last year.

Sen. Clinton and Mr. Obama have both indicated they will continue an engagement strategy with North Korea pursued by Mr. Bush that echoes an agreement the Clinton administration originally made with Pyongyang in 1994.

The deal calls for North Korea to verifiably dismantle its nuclear-weapons programs in exchange for economic aid and normalized relations with Washington. But in recent days, Pyongyang has indicated it could balk at the verification measures Washington is demanding, a development that could leave the Obama administration facing a fresh crisis once in office in January.

Some Democratic foreign-policy specialists grumble that the inclusion of Sen. Clinton and veterans of Mr. Clinton's foreign-policy team undercuts Mr. Obama's calls for change in Washington. Former Middle East negotiator Dennis Ross, for example, is expected to take a similar job under Mr. Obama. Critics note that Mr. Clinton's teams failed to achieve some of the same initiatives that Mr. Obama is championing, such as normalizing ties with Iran and building bridges to Syria.

One advantage for Mr. Obama is the Democrats' dominance in Congress. "I think Obama could have the same exact team as Clinton and produce a lot more results," said M.J. Rosenberg, director of policy analysis at the Israel Policy Forum.

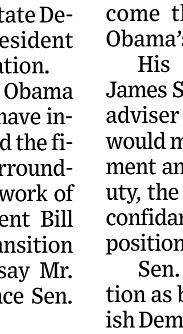
—Monica Langley contributed to this article.

Obama favors Republicans with Scowcroft ties

By Yochi J. Dreazen And Siobhan Gorman

WASHINGTON—Many of the Republicans emerging as potential members of the Obama administration have professional and ideological ties to Brent Scowcroft, a former national-security adviser turned public critic of the Bush White House.

Mr. Scowcroft spoke by phone with President-elect Barack Obama last week, the latest in a months-long series of conversations between the two men about defense and foreign-policy issues, according to people familiar with the discussions.



Brent Scowcroft

The relationship between the president-elect and the Republican heavyweight suggests that Mr. Scowcroft's views, which place a premium on an Israeli-Palestinian peace accord, might hold sway in the Obama White House.

Defense Secretary Robert Gates, who was deputy national-security adviser under Mr. Scowcroft in the George H.W. Bush administration, is almost certain to be retained by Mr. Obama, according to aides to the president-elect. Richard Haass, a Scowcroft protégé and former State Department official, could be tapped for a senior National Security Council, State Department or intelligence position. Mr. Haass currently runs the Council on Foreign Relations.

Other prominent Republicans with close ties to Mr. Obama include former Secretary of State Colin Powell, who endorsed the Democrat in the final days of the campaign, and Indiana Sen. Richard Lugar, a senior member of the Senate Foreign Relations Committee.

"I think most of my close associates have a generally similar view," Mr. Scowcroft said in an interview. "What's the old story about birds of a feather?"

Mr. Scowcroft said his biggest piece of advice for the new administration was that it should make a renewed push to help broker an Israeli-Palestinian peace deal. He also endorsed Mr. Obama's call for diplomatic engagement with Iran.

"Compared to the other alternatives we face with Iran, we ought to give it a really good, sincere try," Mr. Scowcroft said. "I have a hunch that we'll be more successful than a lot of detractors think."

Obama aides declined to comment on the substance of the conversations. A transition aide said the president-elect has "deep respect for Brent Scowcroft."

Mr. Scowcroft's re-emergence caps a tumultuous few years for the 83-year-old former Air Force general. In the run-up to the Iraq war, Mr. Scowcroft wrote an opinion column in The Wall Street Journal arguing against an invasion and warning that it would "seriously jeopardize, if not destroy" the Bush administration's war on terrorism. In speeches and interviews, he regularly criticized both the decision to invade Iraq and the Bush team's handling of the war effort.

The White House responded by removing Mr. Scowcroft from his position as chairman of a foreign intelligence advisory board. Defenders of the Bush policy say the president has planted the seeds of democracy in the Middle East and preserved strong ties with Israel, which had a tense relationship with the elder President Bush when Mr. Scowcroft was national-security adviser.

Mr. Scowcroft's views place a premium on Israeli-Palestinian peace.

Mr. Scowcroft, who stayed neutral in this year's presidential campaign, is a prominent advocate of a "realist" approach to foreign policy that favors deal-making over the ideological commitments the second Bush administration was known for.

"He said before the war that this is a war of choice that we shouldn't be engaged in. I think that has resonated with Obama," said Amy Zegart, a public-policy professor at the University of California, Los Angeles, who served as an adviser on national-security matters to Mr. Bush's 2000 campaign.

In the interview, Mr. Scowcroft said the Bush administration's two terms were "difficult years." He said Mr. Obama's election left him optimistic that the nation might now go down a different path.

"The general mood of the last administration has been more a combination of idealism and self-assertion," he said. "And if the election was a vote on foreign policy—and I'm not sure it was—then you can say, yes, that idea has been rejected in favor of realism."

Sen. Lugar, in an interview, said the president-elect appears to have a "pragmatic" view of foreign policy. The Republican lawmaker took himself out of the running for secretary of state shortly after the election, but he said that he hoped to use his perch on Capitol Hill to help the new administration retool American foreign policy.

"He will need some partners in Congress," Sen. Lugar said. "And perhaps we can be helpful in that way."

Mr. Scowcroft said he had no plans of returning to government service. But he acknowledged missing the thrill of the game. "When one sees what one thinks are the possibilities, it's hard not to want to help," he said.

—Gerald F. Seib contributed to this article.

Further rate cuts by Bank of Japan appear unlikely

By Tomoyuki Tachikawa And Megumi Fujikawa

TOKYO—Bank of Japan Gov. Masaaki Shirakawa said the central bank will do what it can to supply liquidity to financial markets, but hinted against further cuts in the country's already low interest rates.

"In terms of securing smooth functions in the short-term money market, there is a possibility that an additional rate cut might cause various problems under already-accommodative financial conditions," Mr. Shirakawa said Friday.

"Especially now that the deterioration in financial market functions has been an issue, the BOJ needs to consider" the impact of further monetary loosening.

Mr. Shirakawa's comments came after the BOJ board voted unanimously to keep its policy interest rate steady at 0.30%.

The remarks suggest the central bank is digging in its heels at current levels. But Mr. Shirakawa said Japan's economic downturn is likely to be lengthy and the BOJ is "studying what policy we should implement when economic conditions become more severe down the road." Last month, the BOJ cut the overnight target by 0.20 percentage point.

—Takeshi Takeuchi contributed to this article.