News in Depth: New unrest on U.S. campuses as donors rebel

THE WALL STREET JOURNAL.

VOL. XXVII NO. 58 | EUROPE | FRIDAY - SUNDAY, APRIL 24 - 26, 2009

DOWJONES A News Corporation Company

europe.WSJ.com

THE WALL STREET JOURNAL.

What's News

Credit Suisse swung to a profit, helped by fixed-income trading, while Barclays indicated it had a stronger first quarter, providing fresh evidence of a recovery in the banking industry. Page 4

■ **The euro zone's economy** likely fell into its deepest contraction in the first quarter, as unemployment soared in member nations. Page 10

■ **The U.K.'s borrowing** plans are a cause for concern among investors, who worry the country is too optimistic. Page 19

■ **A late rally** left U.S. stocks higher after a day of hesitant trade. European shares fell despite a large gain for Credit Suisse. Page 20

■ **GM will temporarily idle** 13 North American factories, cutting output by 190,000 vehicles as it races to shrink bloated inventories. Page 7

■ **ConocoPhillips's profit fell** 80% in the first quarter as oil prices declined. Page 4

■ **A PCCW** management-led effort to take the company private has been dropped, a victory for Hong Kong regulators. Page 24

■ **Gazprom Neft plans** to buy a stake in Russian oil firm Sibir Energy, trumping a bid by TNK-BP announced just a day earlier. Page 5

■ **Jacob Zuma is poised** to become South Africa's next president, with early results showing a decisive victory for the ANC. Page 2

■ **A mayoral election** in Sochi is emerging as a key test of Medvedev's promises to relax the Kremlin's tight grip on Russian politics. Page 3

■ **Donors pledged** over $250 million to help Somalia's government extend its authority in the pirate haven. Page 11

■ **Deutsche Börse and NYSE** have resumed talks, but a deal isn't likely. Page 19

■ **U.S. homes sales** continued to slide and firms kept shedding jobs in March. Page 32

■ **Russia will cut** rates, in a sign of cautious confidence in the ruble and slowing inflation. Putin had demanded cheaper borrowing. Page 21

■ **Pakistan sent** a small paramilitary force to a district seized by the Taliban near the capital, highlighting its paucity of options. Page 9

■ **Novartis posted** a 15% drop in first-quarter profit. Page 5

EDITORIAL&OPINION

Berlin's fall
The German economy is hit hardest by the crisis. Review & Outlook. Page 14

Breaking news at europe.WSJ.com

Fiat sets its sights on GM

Italian car maker could take stake in European, Latin American operations

By Stacy Meichtry in Paris, Dana Cimilluca in London and John D. Stoll in Detroit

Sergio Marchionne

Fiat SpA is in talks to buy a stake in **General Motors** Corp.'s European and Latin American operations, people familiar with the matter said, as part of the Italian company's bold attempt to capitalize on troubles in the auto industry to transform itself into one of its biggest players.

A deal with GM would significantly strengthen Fiat's presence in markets it already serves. But any alliance with GM remains in limbo until Fiat resolves drawn-out negotiations to take a 20% stake in **Chrysler** LLC—a move that would allow Fiat to penetrate the U.S. market for the first time since the early 1980s.

The U.S. Treasury wants Fiat to reach a deal with Chrysler before pursuing any accord with rival GM, according to a person close to the talks in the U.S. The discussions have been held up because of a standoff between Chrysler's main creditors and the U.S. government.

Late Thursday or Friday in the U.S., Chrysler's lenders were expected to launch a counteroffer to a government proposal on debt concessions, this person said.

Negotiations over the auto maker's fate are expected to drag out among Chrysler, Fiat and the United Auto Workers union over the weekend, this person added, and could come perilously close to the April 30 deadline set by the U.S. Treasury, which has given emergency loans to both Chrysler and GM.

By negotiating with the two Detroit car companies at once, Fiat Chief Executive Sergio Marchionne is making a big double bet. Mr. Marchio-

Please turn to page 31

Suicide bombers kill more than 70 Iraqis

Reuters

GRIM AFTERMATH: A woman reacts to an attack on Shiites. Military officials, meanwhile, arrested the leader of an insurgent group. **Page 2.**

Turkey, Armenia break ice

By Marc Champion

YEREVAN, Armenia—Turkey and Armenia said they agreed on a "road map" to restoring relations, shortly before U.S. President Barack Obama is to make a closely watched statement on the 1915 mass murder of Armenians in the Ottoman Empire.

Better relations between the two countries could help stabilize a region increasingly important as a transit route for oil and gas supplies from the Caspian Sea region to the West.

The road map, worked out in marathon talks with U.S. and Swiss mediation that lasted late into Wednesday night, sets out a "sequence of steps" that the historic foes must take toward restoring diplomatic relations and reopening their border, which Turkey closed in 1993, according to people familiar with the matter.

The statement was a breakthrough, these people said, because for the first time both sides have gone on the record as saying they had

Please turn to page 31

Associated Press

Armenian President Serzh Sargsyan after a meeting at the European Union in Brussels in November.

Inside

Berlin's big year

A cultural agenda of fests 20 years after Wall's fall
Weekend Journal, page W8

Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	7957.06	+0.89
Nasdaq	1652.21	+0.37
DJ Stoxx 600	191.49	-0.46
FTSE 100	4018.23	-0.31
DAX	4538.21	-1.22
CAC 40	3008.62	-0.55
Euro	$1.3052	+0.38
Nymex crude	$49.62	+1.58

Election will move Iceland to the left

By Charles Forelle and Joel Sherwood

On Saturday, Icelanders are likely to do something they haven't done in more than two decades: Vote a left-wing government into power.

The new government will face the enormous task of cleaning up the wreckage of the country's collapsed financial system. It will also need to resolve internal divides over a touchstone issue: whether Iceland—long proud of its go-it-alone spirit—should join the European Union.

The parliamentary elections are the North Atlantic nation's first since the credit crunch in October felled its entire banking system, turning Iceland from a prosperous and happy Nordic country riding high on the riches of finance to a land of swelling unemployment and economic gloom.

Icelandic politics since 1991 has been dominated by the Independence Party, a right-leaning party with a free-market bent influenced by Margaret Thatcher and Ronald Reagan. Under longtime Independence Party Prime Minister David Oddsson, Iceland privatized swathes of state-owned businesses, remaking a sclerotic economy and spurring huge growth.

The privatization spree included the state-owned banks, which under private owners grew massively by borrowing and lending overseas—delivering wealth and jobs back home. All that came apart when the credit crunch cut off funding, a fatal blow because the tiny Icelandic government didn't have the means to bail out the banks.

The bank collapse shattered the standing of the Independence Party. Its leader, Geir Haarde, resigned as prime minister, and Mr. Oddsson, who had moved to become the head of the central bank, was forced out of that post.

Many observers—and opinion polls—predict the left-leaning Social Democratic Alliance will garner the most votes Saturday, taking about a third of the seats in parliament. The Left-Green Movement, further to the left, is polling roughly the same as the Independence Party. Party leaders have said the Social Democrats and the Left-

Please turn to page 30

LEADING THE NEWS

Iraq blasts target Shiites

A high-profile arrest comes as dozens die in suicide bombings

By Charles Levinson

BAGHDAD—Two suicide bombers killed more than 70 people Thursday in a pair of attacks targeting Shiites, the latest sign that insurgents are ramping up violence in Iraq as the U.S. begins withdrawing troops.

Iraqi military officials, meanwhile, said they arrested Abu Omar al-Baghdadi, leader of the Islamic State of Iraq, an insurgent umbrella organization that includes al Qaeda in Iraq, during a raid on a home in eastern Baghdad. Iraqi officials twice before claimed to have killed or captured Mr. al-Baghdadi but the reports have proved false.

Violence levels in Iraq remain near postwar lows, well below the conflict's darkest days in 2006 and 2007, but in the past month the trend has ticked upward, with high-profile, well-coordinated bombings that have left almost 150 Iraqis dead. On Wednesday, a roadside bomb in Baghdad killed a U.S. soldier, the twelfth one to die so far this month.

According to an Iraqi government tally published by the Associated Press on Thursday, 87,215 Iraqi citizens have been killed in violence since 2005. There aren't authoritative statistics for 2003 or 2004, according to the AP; a number of groups estimate more than 110,000 Iraqis have died in violence since the 2003 U.S.-led invasion.

U.S. and Iraqi officers say the upswing is due to insurgents trying to step up attacks to challenge Iraqi security forces as the U.S. shutters bases and pulls out of Iraqi cities ahead of a June 30 deadline. The moves are part of a 2008 pact, and the first step in a drawdown that will see all fighting troops out by the middle of next year.

"The next months are going to be a test for the Iraqi forces and the enemy is going to make their play as the U.S. withdraws from the cities," said Iraqi National Police Brig. Gen. Faisal Mohsen.

Both of Thursday's attacks targeted Shiites, as have many recent bombings, raising the specter of renewed sectarian tension just as Prime Minister Nouri al-Maliki tries to step up reconciliation efforts by reaching out to former Baathists and other disaffected Sunnis.

In one attack, in Baghdad's Karrada district, near a square filled with popular lunch spots, a suicide bomber killed at least 31 people, and wounded more than 50 when he blew himself up in a crowd of Iraqis who had gathered around police officers doling out food a little after 1 p.m., according to a spokesman for the Iraqi military in Baghdad.

Forty minutes earlier, near the town of Muqdadiyah in restive Diyala province northeast of Baghdad, another suicide bomber struck a restaurant filled with Iranian pilgrims, killing 47 and wounding 69, according to a spokesman for the U.S. military, Maj. Derrick Cheng.

Amid the bloodshed, Iraqi officials were buoyed by the capture of Mr. al-Baghdadi, who last month released a 17-minute audio message calling the U.S. withdrawal from Iraq a "recognition of defeat."

Mr. al-Baghdadi emerged as an important but shadowy insurgency figure in Iraq when he was declared the leader of the Islamic State in Iraq after its founding in 2006. In 2007, the U.S. military declared Mr. al-Baghdadi was a fictitious character, played by an actor in videos and created by al Qaeda's foreign leaders to give an Iraqi face to the movement.

U.S. plans to curb proxy voting by brokers

By Kara Scannell and Dan Fitzpatrick

The U.S. Securities and Exchange Commission plans to toss out a decades-long practice and block brokers from voting on their clients' behalf in uncontested director elections, people familiar with the matter said.

The change—sought for years by shareholder activists—could be announced as early as next week but wouldn't take effect until next January, these people said.

The issue is taking center stage at next week's Bank of America Corp. proxy vote. Chief Executive Ken Lewis is up for re-election to the bank's board and several large investors said they would vote against him.

Change to Win, a coalition of labor unions, has asked the SEC to move more quickly in time for the Bank of America vote. Under an analysis by Change to Win, 22% of votes at Bank of America director elections are "broker votes." If those votes are all cast in favor of Mr. Lewis, he would need only 36% of the rest of the votes to win a majority, according to the analysis.

Michael Garland, director of value strategies for CtW Investment Group, has called for Mr. Lewis's ouster. "Ken Lewis and other directors may only be elected as a result of the broker vote. They would be re-seated legally but illegitimately," Mr. Garland said.

Bank of America declined to comment.

Under current rules, investors must instruct their brokers on how to vote at least 10 days before the vote. If there are no instructions, brokers are entitled to vote however they wish. Generally brokers vote for management, under the theory that a shareholder who opposed the company's position would have issued instructions to vote that way. In the U.S., about 80% of investors' stocks are held in brokerage accounts.

Until now, uncontested director elections have been considered routine items. The SEC rule change is expcted to say that director elections are no longer routine items and brokers can't vote the stock either way without shareholder instructions.

ANC poised for victory in South Africa election

By Sarah Childress

PRETORIA, South Africa—The ruling African National Congress is set to win overwhelmingly in the national election held Wednesday, securing the two-thirds majority it needs to govern unopposed.

Final results won't be available for a day or two. But by Thursday evening, with more than half of the voting districts counted, the ANC had won 67% of the vote. This commanding lead over the other 25 parties ensures that ANC leader, Jacob Zuma, will be the nation's next president.


Jacob Zuma

The main opposition party, the Democratic Alliance, drew only 16.6% of the vote. The Congress of the People received 8%, an impressive figure for a party begun late last year by former ANC members.

Although the ANC has come under criticism in recent years, its victory underscores the deep affection many South Africans still hold for the party that freed the nation from apartheid.

It also displays the popularity of Mr. Zuma, who despite legal woes maintained a loyal following among poor blacks who identified with his humble background and were drawn to his charismatic personality.

On Thursday, officials from the various parties gathered in the center set up by the Independent Electoral Commission, the country's official polling body, in the capital, Pretoria. (The city changed its name several years ago to Tshwane.) National tallies for each party appeared on a huge digital screen, updating as districts filed their counts.

The results are a setback for the Democratic Alliance, which campaigned on a platform urging voters to "Stop Zuma," and erode the ANC's majority. Helen Zille, the DA leader, looked solemn as the ANC tally ticked higher. "One wants to prevent too much power getting into two hands," she said.

The DA's lead will secure its place as the official opposition in parliament, giving it at least some platform to express its criticism of the ANC. Ms. Zille pledged to be a "very strong opponent" of the ruling party in parliament.

The Congress of the People should also win some seats in parliament, allowing it to add its voice to that of the DA.

The ANC had anticipated a decisive victory—and will now be expected to deliver. But Mr. Zuma, speaking to reporters before the vote, promised to use that power "responsibly." The ANC promised a huge spending campaign to improve infrastructure and basic services, fight crime and provide more jobs. That would be a tall order under any circumstances, but especially now that South Africa's growth has slowed amid the global recession.

That isn't lost on the ANC. It is betting in part on the country's gold, uranium, platinum and diamond mining sectors, which haven't suffered as much as other commodities amid falling demand, to help buoy the economy in coming months. "We know our people have great expectations," Mr. Zuma said earlier this week. "They wil expect faster action and visible change."

CORRECTIONS & AMPLIFICATIONS

Vestas set up a representative office in Beijing in 1999. A Marketplace article Wednesday incorrectly said Vestas entered China in 2005.

The International Monetary Fund estimates that 2% of Japan's financial sector's total loans and securities outstanding will be written down from 2007-2010. A graphic accompanying a page-one article Wednesday incorrectly gave Japan's write-down percentage as 7%.

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.

ABB ... 6,20
AkzoNobel ... 8
Alaska Air Group ... 8
Alstom ... 6
Aluminum Corp. of China ... 23
Alvarez & Marsal Holdings ... 22
American International Group ... 23
Apple ... 20
Areva ... 6,8
Arkansas Best ... 6
Ashurst ... 22
Bank of America ... 19
Bank VTB ... 8
Barclays ... 4,23
BlackRock ... 19
BP ... 5
Burlington Northern Sante Fe ... 6
Chi-X Europe ... 22
China Huiyuan Juice Group ... 5
Chrysler ... 1,7
Citigroup ... 4,7
CME Group ... 23
Coca-Cola ... 5
ConocoPhillips ... 4
Continental Corp. ... 8,20
Credit Suisse Group 4,20
Delphi ... 7
Depfa Bank ... 8
Deutsche Börse ... 19,23
Ebay ... 20
EMI Group ... 8
FedEx ... 20
Fiat ... 1
Forward Air Corp ... 6
Foster's Group ... 23
Gazprom ... 5
Gazprom Neft ... 5
General Motors ... 1,7
Goldman Sachs Group ... 4
Groupe Danone ... 5
Honda Motor ... 7,23
House Party ... 28
HSBC Holdings ... 23
Hypo Real Estate Holding ... 8
Hyundai Motor ... 7
Iberia Líneas Aéreas de España ... 8
Industrial & Commercial Bank of China ... 23
ITV ... 8
JetBlue Airways ... 8
J.P. Morgan Chase ... 7,24
Kirin Holdings ... 23
L-3 Communications Holdings ... 8
Lion Nathan ... 23
Logitech International 20
London Stock Exchange Group ... 22
McGraw-Hil ... 21
Merrill Lynch ... 19
Mitsubishi UFJ Financial Group ... 23
Mizuho Financial Group ... 23
MOL ... 5
Moody's ... 21
News Corp. ... 4
Nissan Motor ... 7,23
Nomura Holdings ... 23
Norfolk Southern ... 6
Novartis ... 5,20
NYSE Euronext ... 19,22,23
OMV ... 5
PCCW ... 24
Pioneer ... 23
RadioShack ... 20
Raytheon ... 8
Roche Holding ... 20
Royal Dutch Shell ... 5
Sanofi-Aventis ... 5
Schaeffler Group ... 8
Sibir Energy ... 5
Sodexo ... 8,20
Sony ... 8
Sopexa ... 28
Sumitomo Mitsui Financial Group ... 23
Surgutneftegaz ... 5
Swedbank ... 21
Time Warner ... 8
TNK-BP ... 5
Toyota Motor ... 7,23
Union Pacific ... 6
United Parcel Service ... 6,20
US Airways Group ... 8
Vueling Airlines ... 8
Warburg Pincus ... 5

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium
Telephone: 32 2 741 1211 Fax: 32 2 741 1600
SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +44 (0) 207 309 7799
Calling time from 8am to 5.30pm GMT
E-mail: WSJUK@dowjones.com Website: www.services.wsje.com
Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Daniel Hertzberg M-17936-2003

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

Agius, Marcus ... 4
Alpert, Dan ... 24
Althin, Peter ... 8
Anderson, Tom ... 4
Angel, Nick ... 22
Balazs, Peter ... 5
Bedecarre, Tom ... 4
Bellegarde, Roland ... 22
Bogdanov, Vladimir ... 5
Carrig, John ... 4
Cen, Nedim ... 22
Chung, T.H. ... 7
Clarke, Troy ... 7
Cronin, Bill ... 22
Davis, D. Scott ... 6
DeWolfe, Chris ... 4
Diamond, Robert E. ... 4
Donohue, Craig ... 23
Dougan, Brady ... 4
Dyukov, Alexander ... 5
Flatley, Rob ... 22
Grade, Michael ... 8
Gudmundsson, Eggert ... 30
Henderson, Fritz ... 7
Hernadi, Zsolt ... 5
Hoekstra, Peter ... 15
Hogan, Joe ... 6
Hooper, Marcus ... 22
Kang Sang-min ... 7
Kapur, Amit ... 4
Kesayev, Igor ... 5
Kostin, Andrei ... 8
Kristinsson, Gunnar Helgi ... 30
Kuehn, Kurt ... 6
Lederman, Eli ... 22
Lee Soo-young ... 7
Lees, Jerry ... 22
Levinsohn, Ross ... 4
Lewis, Kenneth ... 2,19
Li, Richard ... 24
Magnason, Andri Snaer 30
Marchionne, Sergio ... 1
Miller, Jon ... 4
Mulva, James J. ... 4
Murdoch, Rupert ... 4
Najarian, Ed ... 24
Neumann, Karl-Thomas . 8
Ng, Francis ... 5
Raasuke, Erkki ... 21
Singh, Hirander ... 22
Spiliopoulos, Panagiotis 6
Strianese, Michael T. ... 8
Sunde, Peter ... 8
Tchigirinski, Chalva ... 5
Tordai, Peter ... 5
Van Natta, Owen ... 4
Varley, John ... 4
Vickers, Mark ... 22
Viehbacher, Christopher A. ... 5
Vinciquerra, Mike ... 19
Volz, Roger ... 20
Wajsgras, David ... 8
Weiss, Andrew ... 5
Williamson, Chris ... 10
Wolf, Michael ... 21
Yuzawa, Kota ... 7
Zhu Xinli ... 5

LEADING THE NEWS

In Sochi, local politics have turned national

Mayoral vote tests Kremlin's promise to relax regional grip

By Andrew Osborn

SOCHI, Russia—President Dmitry Medvedev has called Sunday's mayoral vote in this Soviet-era resort a "genuine political battle" that will enrich Russian democracy.

But on Sochi's palm-lined streets, there are no campaign posters. The candidate from the ruling pro-Kremlin party refuses to debate opponents, and local media decline to air political ads. The number of contenders has shrunk to six from 26—a development that opposition candidates allege is a result of a dirty-tricks campaign.

As the global financial crisis convulses Russia's regions, this seemingly parochial election 900 miles south of Moscow is emerging as a key test for Mr. Medvedev's promises to relax the Kremlin's tight grip on politics.

Sochi, sandwiched between snow-capped mountains and the Black Sea, will host the Winter Olympics in 2014, a project personally lobbied by then-President Vladimir Putin and backed by billions in government money.

The last thing the Kremlin wants is an off-message mayor. Mr. Putin has warned Sochi's 400,000 residents to beware candidates out to "realize their own ambitions." He has also likened certain unnamed candidates to "scum."

Critics say that Olympic-related corruption is rife and that planned construction work will wreck the local environment and turn the faded low-rise resort into a concrete jungle.

Though Sochi's mayor will play only a supporting role in the Games, several candidates say the Kremlin wants a loyalist from the ruling United Russia party. "It's not an election—it's a swindle," says Boris Nemtsov, a high-profile candidate from the anti-Kremlin Solidarity movement.

A Kremlin official denies government interference. "It's not surprising that the United Russia party is dominant," he said. "It is in many places."

Since Mr. Putin abolished direct elections for regional heads in favor of an appointment system in 2004, opponents say mayoral elections like this one are the only chance to challenge the Kremlin.

But while Mr. Nemtsov remains in the race, 20 others do not. Some withdrew voluntarily, while the local electoral commission disqualified others—such as former Bolshoi Ballet ballerina Anastasia Volochkova—on a technicality in how she filled out the registration documents.

Opposition candidates say authorities initially wanted to turn the contest into a circus featuring an array of unsuitable candidates that would disgust the electorate and dilute their opponents' support. They changed their mind, opponents say, when they realized that their own United Russia candidate—career civil servant Anatoly Pakhomov, who was appointed Sochi's acting mayor in January—might be edged out too. A spokesman for Mr. Pakhomov's party says these and other allegations are "hysterical" and smears designed to hide the fact that his opponents have no constructive ideas. The local election commission has so far raised no objections to the vote.

Billionaire businessman Alexander Lebedev is the highest-profile candidate to be removed from the running, over an allegation that minors had contributed money to his campaign. Mr. Lebedev has said he was set up.

Mr. Lebedev's supporters and some of his opponents say he was eliminated because he was a threat to the Kremlin candidate. "He was coming second," says Artyom Artyomov, Mr. Lebedev's spokesman. "He could have won."

Opponents call the Kremlin candidate, Mr. Pakhomov, a phantom. The spokesman for Mr. Pakhomov's party says he can't reveal where Mr. Pakhomov's campaign headquarters are. "We're waging a war here," he says. "It wouldn't make sense to tell our adversaries where we are."

He says the fact there's scant evidence an election is taking place is unimportant. "If somebody wants to vote, they'll find a way of getting information."

Unlike his rivals though, Mr. Pakhomov can regularly be seen on local TV, meeting selected groups of voters. By contrast, mentions of the Communist candidate Yuri Dzagania are accompanied by funereal music.

"This is a very dirty election," Mr. Dzagania says.

Local journalists have poured scorn on Mr. Nemtsov. A documentary deriding his character that Mr. Nemtsov calls an outrage has been regularly aired. Local TV has also broadcast what it says is a meeting between Mr. Nemtsov and Korean businessmen offering him cash to give the Olympics to a Korean city instead. Mr. Nemtsov's aides say the footage is a provocation and that the dialogue—which is shown in subtitles—has been doctored.

Opponents say state employees are being browbeaten into voting in early polling for Mr. Pakhomov.

Lists have been drawn up keeping tabs on who votes for whom, says Nadezhda Nikiforova, a former school director. "Any wrong word and they'll rip your head off."

At the concrete headquarters of the local United Russia party, students allied with the pro-Kremlin Young Guard movement seem split on the vote's fairness. One student, Tamara, who declines to give her surname, lists Mr. Pakhomov's achievements. But her friend, Irina, who also withholds her surname, says. "It's a show. There's no competition." Tamara whispers to Irina to "be quiet." Later, both girls appear on local TV mocking Mr. Nemtsov.

A peculiarly Russian election

Voters go to the polls in the Russian town of Sochi this Sunday to choose a mayor. The field has been narrowed from 26 to 6 amid allegations of Kremlin pressure.

Yuri Dzagania

The 62-year-old candidate from the Russian Communist party. An old-school socialist who rails against private capital and greed. A former aircraft engineer, he says the vote is a farce he's obliged to take part in.

Boris Nemtsov

The 49-year-old anti-Kremlin candidate and co-chairman of the opposition Solidarity Movement. A famously successful regional governor in the 1990s who rose to become deputy prime minister. He says the vote is being actively rigged with the help of the FSB secret service.

Anatoly Pakhomov

The 49-year-old front runner and Kremlin-backed candidate who's already acting mayor of Sochi. A former Communist who embraced the ruling United Russia party, he has worked in the region as an official at different levels. He only appears on slavishly loyal local media and refuses public debate.

Vladimir Trukhanovsky

The 55-year-old independent candidate who opponents accuse of being a Kremlin spoiler whose job is to take out Mr. Pakhomov's rivals. A businessman, his complaints have resulted in two candidates being removed. The local election commission says it can't supply his contact details.

Anastasia Volochkova

The 33-year-old prima ballerina and society lioness who used to be a regular at Moscow's famous Bolshoi Theater. She dances frequently in Sochi and surprised many when she said she was running for mayor. The local election commission disqualified her for a small error in her registration papers.

Alexander Lebedev

The 49-year-old billionaire businessman and former KGB agent who owns London's daily Evening Standard newspaper. A local court struck Mr. Lebedev from the ballot on a spurious technicality. Mr. Lebedev says he was set up by Mr. Pakhomov's supporters and is appealing.

Source: Candidate campaign material and interviews

Photos: Kommersant (Dzagania, Pakhomov, Trukhanovsky); Associated Press (Nemtsov, Volochkova, Lebedev)

CORPORATE NEWS

MySpace founders step aside

New digital chief, looking to revitalize networking site, plans management shake-up

BY JULIA ANGWIN
AND EMILY STEEL

The founders of MySpace are leaving the helm of the pioneering Web site that made social-networking a mainstream phenomenon, as owner **News Corp.** seeks to reinvigorate the once-hot property it scooped up four years ago.

The pushing aside of Chris DeWolfe and Tom Anderson, whose contracts weren't due to expire until October, represents a pivotal test for the viability of social-networking sites. While social-networking sites such as MySpace and Facebook have exploded in popularity in recent years, they have struggled to generate the kind of revenue and earnings prospects that can sustain them as businesses over the long haul.


Associated Press

MySpace CEO Chris DeWolfe is leaving the social-networking site.

News Corp. now aims to show that a large conglomerate, with a portfolio that includes many old-media properties including newspapers, can succeed at that task.

People familiar with the situation said News Corp. was completing a deal to name former Facebook Chief Operating Officer Owen Van Natta as chief executive to succeed Mr. DeWolfe. He would report to Jon Miller, the former AOL chief executive who was recruited to join News Corp. this month in a newly created position of chief digital officer. Charged with all News Corp.'s stand-alone digital properties, he was particularly given the mission of shoring up MySpace.

Spokeswomen for News Corp. and MySpace both declined to comment beyond a news release. Messrs. DeWolfe, Anderson and Van Natta couldn't be reached for comment.

News Corp. sees MySpace as critical in its transformation from a conglomerate of traditional television, movie and newspaper businesses to a new-media titan. But while MySpace grew quickly following News Corp.'s purchase, last year its revenue fell short of executives' targets. News Corp. also owns Dow Jones & Co., publisher of The Wall Street Journal.

MySpace is still the dominant social-networking site in the U.S. But its U.S. audience has fallen. In March, MySpace attracted 70.1 million unique visitors, down 3.6% from a year ago, according to comScore Media Metrix. Meanwhile, Facebook is nipping at its heels. Facebook surpassed MySpace's world-wide audience a year ago, and is growing fast in the U.S., with 61.2 million unique visitors in March, up 72% from a year earlier.

More broadly, MySpace, like other social-networking sites, still must overcome doubts about the medium's viability. Advertisers, for one, remain leery. "Advertising doesn't fit so neatly into a conversation that people are having among themselves," says Tom Bedecarre, chief executive of independent digital-ad firm AKQA.

MySpace was founded in 2003 by Messrs. DeWolfe and Anderson. Their email marketing division of a Los Angeles company called eUniverse, later renamed Intermix, was floundering, so they imitated a popular site at the time, Friendster.

They made two key improvements on Friendster: They allowed users to customize their profile pages, and they allowed users to create any identity they liked. Friendster, like Facebook today, encouraged members to use their real names.

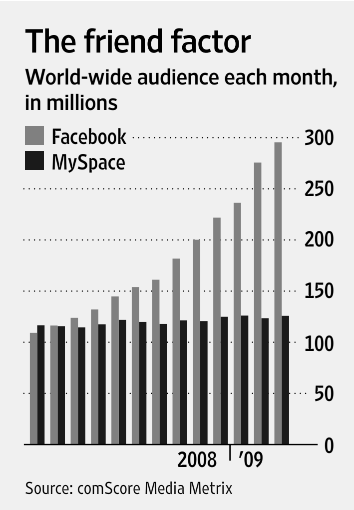
But just as MySpace was taking off, fueled in large part by its popularity with musicians, it was sold to News Corp. MySpace's parent company, Intermix, negotiated the $650 million deal directly with News Corp., leaving the MySpace founders out of the loop until the last minute.

News Corp. Chairman Rupert Murdoch immediately sought to mollify the founders with lucrative two-year pay packages of $30 million each, but Messrs. DeWolfe and Anderson still chafed at the fact that MySpace ad sales were taken over by executives at Fox Interactive Media, according to people familiar with the situation.

The rank and file of MySpace were also angry that their stock options were canceled after the acquisition and that they were forced to move from Santa Monica, Calif., to Beverly Hills, the people said.

Relations fell apart further. Mr. DeWolfe ignored suggestions from Fox Interactive Media President Ross Levinsohn about ways to improve the site. Mr. DeWolfe sought to amend a $900 million advertising deal News Corp. cut with Google Inc.—delaying its implementation, the people said. That deal is due to expire next year.

Mr. Levinsohn also clashed with Mr. Anderson, who is president of the site. Mr. Anderson controlled the product development and was criticized for not moving fast. In April 2006, MySpace bought the online karaoke service kSolo. MySpace



launched the karaoke feature on its site in April 2008—two years later.

The tension between the MySpace founders and News Corp. eventually led to Mr. Levinsohn's dismissal in November 2006. He was succeeded by his distant cousin, Peter Levinsohn, who eventually gave Mr. DeWolfe control of the advertising sales at MySpace that he had sought.

All this time, Facebook was steadily gaining on MySpace. Founded by Silicon Valley computer programmers as a social network for Harvard students in 2004, Facebook expanded to other college campuses and opened to everybody in 2006.

Facebook focused on building innovative features and encouraging third-party software developers to write applications for Facebook.

Meanwhile, MySpace, with its marketing and music background, fought back with entertainment, such as a celebrity news site and an expensive music joint venture.

Three top MySpace executives, including Amit Kapur, former chief operating officer, left in March to run a start-up. MySpace has yet to name successors for those positions.

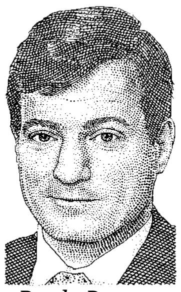
—Jessica E. Vascellaro contributed to this article.

Credit Suisse, Barclays rebound

BY KATHARINA BART
AND SARA SCHAEFER MUÑOZ

A pair of European banks provided fresh evidence of a banking-industry recovery, with Switzerland's **Credit Suisse Group** AG swinging to a better-than-expected profit and **Barclays** PLC indicating the first quarter of 2009 ran strongly ahead of last year.

Zurich-based Credit Suisse recorded a net profit of two billion Swiss francs ($1.72 billion) for the first quarter, helped by flourishing fixed-income trading. The profit was more than double the 952 million Swiss francs forecast by analysts. In the year-ago quarter, Credit Suisse posted a net loss of 2.15 billion Swiss francs after major write-downs on risky securities.


Brady Dougan

The return to profitability by Credit Suisse after a dismal 2008 reinforces the appearance of a growing gulf between profitable and unprofitable banks—and the key to the difference in the first quarter has been the ability to exploit conditions in financial markets that, though still uncertain, are more stable than late last year.

At Barclays's annual meeting, Chief Executive John Varley said that the bank's financial performance so far this year was well ahead of last year, and that the bank intends to resume paying dividends in the second half of this year.

Barclays, which will give details on this year's performance in its interim management statement May 7, also said it has no intention of raising further capital.

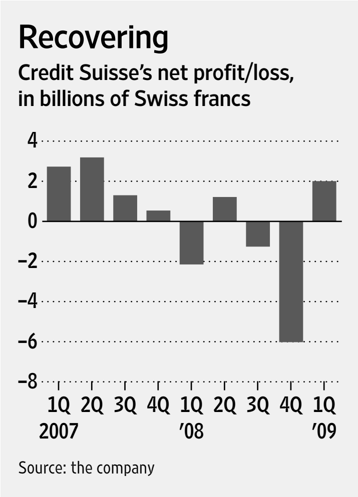
The banks' performance mirrors results from U.S. rivals such as **Citigroup** Inc. and **Goldman Sachs Group** Inc., which last week surprised market watchers with better-than-expected earnings.

As with the U.S. banks, Credit Suisse benefited from healthy trading, particularly in fixed-income, where buying and selling of interest-rate products, foreign exchange and high-grade debt hit records. That bolstered core net revenue to 9.56 billion Swiss francs, from 2.93 billion francs a year earlier.

Credit Suisse Chief Executive Brady Dougan said the first weeks of the second quarter have continued in much the same style as the first.

However, he repeatedly cautioned that Credit Suisse isn't calling the bottom of the financial crisis.

"While we may still be affected by continued volatility and market disruptions if difficult conditions persist, we believe that we are in a



position to weather the storms and perform well when market opportunities arise," Mr. Dougan said.

Even as Barclays previewed strong financial results, however, shareholders sent a strong message to Chairman Marcus Agius by re-electing him with an unusually low percentage of support, a reflection of discontent over a costly deal the bank struck with Persian Gulf investors last autumn.

Mr. Agius was re-elected by 83.7%, while Mr. Varley was elected by 98.4% of the vote, and Robert E. Diamond Jr., head of Barclays investment-banking operations, by 98.3%. Usually, board approvals top 90%.

Conoco's profit drops 80% amid declining oil prices

BY RUSSELL GOLD

ConocoPhillips reported an 80% drop in quarterly profit as lower prices for crude oil, natural gas and gasoline weighed on earnings, deepening concerns about whether the company's spending spree of recent years is handicapping it in the recession.

The Houston company borrowed money in the first quarter and ended share repurchases, moves that allowed it to avoid having to cut its capital spending or stock-dividend payments.

The strain on ConocoPhillips's finances is adding to worry about its management team, which has seen frequent turnover over the last few years. In particular, investors are questioning whether Chairman and Chief Executive James J. Mulva saddled the company with too much debt by paying too dearly for assets when oil and gas prices were soaring.

ConocoPhillips took a $34 billion write-down in the fourth quarter, erasing the value of numerous assets, including a 20% stake in Russian oil company OAO **Lukoil** it bought in 2004.

The company said first-quarter net income was $840 million, or 56 cents a share, compared with $4.14 billion, or $2.62 a share, a year earlier. Revenue fell 44% to $30.7 billion.

ConocoPhillips shares were up $1.87, or 5%, to $39.93 in 4 p.m. composite trading Thursday on the New York Stock Exchange. The earnings topped the mean estimate of analysts surveyed by Thomson Reuters for profit of 42 cents a share on revenue of $26.34 billion. But investors have taken a generally dim view of the stock as oil prices have fallen. Since July, when oil hit an all-time high, ConocoPhillips shares have dropped about 57%, compared with 34% for Chevron Corp. and 26% for Exxon Mobil Corp.

Mr. Mulva is expected to retire in two years after having run the company since 1999. The heir apparent is John Carrig, who became president and chief operating officer last year after six years as chief financial officer.

This month, UBS downgraded its rating of the stock to "neutral" from "buy," in part citing deals ConocoPhillips struck last year for gas fields in Abu Dhabi and Australia before commodity prices fell.

Worries about Mr. Mulva's spending began in 2005, when Conoco bought natural-gas producer Burlington Resources Inc. for $35 billion. The day after the deal was announced, gas prices hit $15.38 per million British thermal units on the New York Mercantile Exchange, a record high that still stands. Prices are now less than one-fourth that level.

CORPORATE NEWS

Novartis net drops 15%

Swiss drug maker takes hit to earnings from strong dollar

By Anita Greil
And Julia Mengewein

ZURICH—Swiss drug maker **Novartis** AG on Thursday posted a 15% drop in first-quarter net profit as the dollar weighed on earnings.

Net profit fell to $1.96 billion from $2.32 billion a year earlier as the conversion into the strong dollar pushed down earnings generated in other currencies. Net profit from continuing operations stood at $1.98 billion.

Sales fell 2% to $9.71 billion. However, stripping out currency fluctuations, sales were up 8%.

At Novartis's flagship pharmaceuticals unit, sales rose 3% to $6.4 billion, but they were up 12% in the currencies in which sales were generated. The impact of the dollar's strength was offset somewhat by new product launches and regional

Hurt by the dollar

Novartis's net profit, in billions

Source: the company

rollouts of existing products.

The blood-pressure treatment Diovan, which will lose patent protection around 2011-2012, remained the best seller, with sales of $1.4 billion. The cancer drug Gleevec, the second-best-selling product, contributed $894 million.

Sandoz, Novartis's generics unit, saw sales fall 9% as it suffered from a lack of launches in the U.S. The drug maker said Sandoz's U.S. sales should resume growing this year. At the consumer-health unit, sales declined 11% as the economic downturn started to hurt. The unit sells drugs that don't require a prescription.

"Especially pharma benefitted from lower marketing costs, leading to a better-than-expected profitability" said Vontobel analyst Andrew Weiss, adding that the company's restructuring measures are taking effect.

The efficiency program, named Forward, is going ahead faster than planned and, in the first quarter, Novartis realized savings of $329 million. "The program is set to exceed the cost savings goal of $1.3 billion for 2009 and $1.6 billion in 2010" from 2007 levels, Novartis said.

Novartis said it still expects 2009 sales to grow at a mid-single-digit rate excluding currency fluctuations, driven by its pharmaceutical division. But it said it may not reach record results this year for underlying net and operating profit, "if recent exchange rates continue during the year."

Sanofi sees opportunity in China

By Gordon Fairclough

SHANGHAI—The chief executive of **Sanofi-Aventis** SA said the Chinese government's plan to improve people's access to health care presents an important growth opportunity for the French drug maker as it tries to lessen reliance on sales of blockbuster medicines in the West.

As Sanofi moves to boost its China business, it is also keen to look into possible deals—including acquisitions or partnerships—with Chinese pharmaceutical companies, the company's CEO, Christopher A. Viehbacher, told reporters Thursday during a visit here.

"We don't want to be just on the margins of health care in China," said Mr. Viehbacher, who said he wants to "transform this business into one that is far less dependent on the traditional blockbuster model" with growth driven by a few big-selling medicines.

Earlier this month, Sanofi agreed to acquire Brazilian drug maker Medley. The Paris-based company, which is expanding in generics and emerging markets, has also done a deal to buy Laboratorios Kendrick of Mexico and it owns nearly 97% of Zentiva NV, a Czech generic-drug maker.

Sanofi is an industry leader in blood-thinning drugs. Two of its best-selling drugs, the hypertension medicine Aprovel and anticlotting drug Plavix, will face increased competition from generics after 2012, when they lose patent protection.

The loss of patent protection for commercially-successful drugs and shortages of possible replacements in major companies' research-and-development pipelines have been driving a wave of consolidation in the global pharmaceutical industry.

Christopher A. Viehbacher

While Mr. Viehbacher said he wouldn't "take any strategic option off the table," he made it clear he views megamergers with skepticism. He says he is looking for deals "that clearly build upon the strengths of the company," adding that "they could be of any size." He says Sanofi isn't—"to my knowledge"—in active acquisition talks.

In China, Mr. Viehbacher said, Sanofi is open to deals—ranging from acquisitions to joint ventures to equity stakes—with local drug makers that would allow the company to participate in the high-volume business for basic drugs that is expected to arise under China's health-care revamp. Chinese health authorities are assembling a list of "essential drugs" that will be purchased by government entities in large volumes from suppliers.

Coke mulls stake in China's Huiyuan

By Rick Carew
And Duncan Mavin

HONG KONG—**Coca-Cola** Co. is in talks with **China Huiyuan Juice Group** Ltd. that could include taking a minority stake in the Chinese juice maker's assets, according to people familiar with the situation, after its full-takeover plan was thwarted by regulators.

Coke is considering a range of options in hopes of a deal that will satisfy Chinese regulators, these people said. China's Ministry of Commerce last month struck down Coke's proposed $2.4 billion takeover on competition grounds. The people cautioned that talks are ongoing and a deal isn't certain.

By seeking a minority stake, Coke is returning to a formula used in most China deals. Beijing typically limits foreign investors to minority stakes in its largest companies in an effort to bring in foreign expertise, while keeping control in Chinese hands.

China Huiyuan Juice

Thursday's close: HK$5.06, down 0.4%

Source: Thomson Reuters Datastream

"We are now focusing our energies and expertise on growing our existing brands and continuing to innovate with new brands, including in the juice segment," said a Coca-Cola spokesman in Hong Kong.

Huiyuan is 23%-owned by France's **Groupe Danone** SA. U.S. private-equity firm **Warburg Pincus** LLC owns 6.8%, and founding chairman, Zhu Xinli, owns 36%.

The price of a revised offer from Coke is uncertain, but the valuation is unlikely to be close to the HK$12.20 per share, or about $1.57, offered by Coke last September. Huiyuan's shares closed down 0.4% Thursday at HK$5.06.

Huiyuan is keeping an "open mind" on its options, the company's chief financial officer, Francis Ng, told a news conference last week.

Coke and Huiyuan are flexible about the structure of any deal, said a person close to the matter. Coke could take a minority stake in Huiyuan or the two could form a joint venture in which Huiyuan would inject some assets and Coke would inject cash. It is possible that a new Chinese partner could team up with Coke, the person said.

MOL holders adopt rules to halt stealth takeovers

By Edith Balazs

BUDAPEST—Shareholders in Hungarian oil and gas company **MOL** Nyrt. approved a raft of defense measures, fearing a stealth takeover attempt by Russia's OAO **Surgutneftegaz.**

At Thursday's annual general meeting, shareholders agreed to all the proposed changes to the company's statutes, including tightening holding disclosure regulations and rules governing the dismissal of board members, and authorizing the management to buy treasury shares or to raise MOL's capital.

Russian oil producer Surgut bought its stake in MOL from Austrian oil and gas company **OMV** AG at the end of March, for €1.4 billion ($1.82 billion)—close to double the market price. OMV sold its stake after failing to take MOL over last year.

The Russian company didn't notify MOL or Hungarian authorities of its intention to acquire a stake, a move that makes the purchase "an unfriendly step," MOL Chairman and Chief Executive Zsolt Hernadi said.

"With the planned amendments to MOL's articles of association ... the chances of Surgut or any other company behind it to take over MOL are practically zero," said Peter Tordai, an analyst at KBC Securities.

Surgut's buy triggered a flurry of responses from the government, with Foreign Affairs Minister Peter Balazs stressing the state's desire to see MOL remain independent.

Surgut seeks "to build a mutually beneficial and long-term partnership on the basis of synergies between the strong positions of both companies in the best interests of all shareholders," according to a letter signed by Surgut's general director, Vladimir Bogdanov.

Surgut was excluded from Thursday's annual meeting on the grounds that its stake hadn't been entered into MOL's stock register and that the Hungarian Energy Office hadn't acknowledged the purchase of the shares. Surgut reacted angrily, saying it had been prevented from attending the meeting "for unknown reasons," having "satisfied timely all necessary requirements to be included into the shareholder register of the company."

Under the new statutes, holders of 2% or more of MOL shares will be obliged to report the composition of the shareholder group they represent and identify the "ultimate benefiting owner" of the stake. Failure to comply with the amendment will result in suspension of voting rights.

Also, under the modified statutes, the annual general meeting may only decide on the dismissal of a single board member. No further dismissals will be possible for three months afterward.

Gazprom Neft to purchase Sibir stake, trumping rival

By Guy Chazan

Russia's state-controlled OAO **Gazprom Neft** swooped on small Russian oil company **Sibir Energy** PLC Thursday, trumping a bid by rival **TNK-BP** Ltd. announced just a day earlier.

The battle for Sibir could be a harbinger of more deals to come as big, cash-rich energy companies gobble up smaller players hit by the credit crunch and the low price of oil.

It was unclear, however, if Gazprom Neft intended to acquire all of Sibir or was just trying to prevent other oil companies from doing so.

The tussle over London-listed Sibir unfolded rapidly. Credit Suisse International said Wednesday that it was offering to buy shares in the company on behalf of TNK-BP, Russia's third-largest oil producer by output and a 50-50 joint venture between **BP** PLC and a group of Soviet-born billionaires, for 430 pence ($6.22) a share, valuing the company at $2.4 billion. Within hours, Russian investment bank Renaissance Capital said Gazprom Neft, the oil-producing unit of natural-gas company OAO **Gazprom**, was offering 500 pence a share for Sibir, valuing it at $2.8 billion and prompting TNK-BP to withdraw.

Sibir said an unnamed third party that made an informal approach pulled out in the wake of the bids from Gazprom Neft and TNK-BP.

In a statement, Renaissance Capital said Gazprom Neft expected to own more than 16% of Sibir. "We are pleased to have become a significant minority shareholder in a company that we regard as a world-class asset," said Alexander Dyukov, Gazprom Neft's chief executive.

TNK-BP declined to comment. A spokesman for BP said the company was "a little disappointed, but there'll be other opportunities to invest in Russia in the future."

Sibir has been seen as a takeover target since late last year, when the global economic downturn and collapse in the Russian stock market ensnared its key shareholder, Moscow property tycoon Chalva Tchigirinski. Share trading has been suspended since February, after the company revealed Mr. Tchigirinski owed it $325 million. Sibir last traded at 174 pence a share. Russia's Sberbank holds Mr. Tchigirinski's stake and that of business partner Igor Kesayev as collateral on unpaid loans.

A person close to Gazprom Neft said the company was surprised by the timing and high price of TNK-BP's offer, so it decided to come back with a "knockout bid." He said the aim was to amass enough stock to block another buyer from taking a substantial position in Sibir's shares.

In any case, accumulating more shares in Sibir could prove tricky. Gazprom Neft already has bought about half of the freely traded shares, but Mr. Tchigirinski has shown no desire to sell his 23.5% stake in the company, which has a 50% interest in an oilfield in Siberia named Salym. Mr. Kesayev also owns 23.5%. The city of Moscow, which owns 18% of Sibir, also says it doesn't want to sell.

Analysts said the Gazprom Neft bid will be good news for **Royal Dutch Shell** PLC, the Anglo-Dutch supermajor that is Sibir's 50-50 partner in the Salym field. Shell would prefer to have Gazprom as a partner there over BP, one of its main rivals.

—Gregory L. White contributed to this article.

CORPORATE NEWS

UPS is hit by downturn

CEO warns against protectionism as net takes a 56% tumble

BY ALEX ROTH

United Parcel Service Inc.'s chief executive expressed concern Thursday that the recession, which hammered the company's first-quarter profit, could ignite harmful protectionist impulses.

D. Scott Davis criticized the initial proposals in Congress to insert Buy American provisions in the $787 billion U.S. stimulus bill, saying such proposals "sent bad signals to the rest of the world." He also expressed concerns that countries in Europe and Asia might retaliate.

"Global trade has sponsored two decades of dramatic growth and increased prosperity in countries everywhere," Mr. Davis said in a conference call with analysts. "Now is not the time to back away from the progress that has been achieved in the mistaken belief that any one economy can regain strength independently of the rest of the world."

The global downturn is hurting virtually every segment of the world's largest package-delivery company, whose health is widely seen as a barometer of the economy.

First-quarter profit at UPS fell 56%. Company officials said they expect the second quarter to be even worse than the latest, although the rate of volume declines likely won't be as steep. The company's average daily delivery volume around the globe fell 3.9% in the quarter, to 14.5 million packages.

Bloomberg News

Profit at UPS declined sharply amid fewer deliveries of packages.

"Hopefully we will hit bottom later this year and begin seeing growth at the end of the year or early next year in the U.S.," Mr. Davis said.

In the past year, the company has shed roughly 10,000 of its more than 300,000 U.S. employees, mostly through attrition. By the end of this year, the company is planning to reduce its fleet of aircraft from 263 to 212.

Declines in UPS's volume were hardly a surprise; last week, the Air Transport Association of America said U.S. air-cargo volumes had dropped 21% in February compared with a year earlier—the seventh consecutive month of year-to-year declines.

In a bit of good news for the company, UPS gained "a little more than half" the revenue of customers looking for a new package-delivery company after DHL exited the U.S. market in January, said Kurt Kuehn, UPS's chief financial officer.

The company posted quarterly net income of $401 million, or 40 cents a share, compared with $906 million, or 87 cents a share, a year earlier.

Earnings, excluding a one-time charge for taking 44 planes out of service, declined 43%, the company said.

Revenue fell 14% to $10.94 billion

ABB posts 35% decline in profit, plans more cuts

BY GORAN MIJUK

ZURICH—**ABB** Ltd. Thursday reported a 35% drop in first-quarter net profit and flagged additional cost cuts to combat the challenging infrastructure and power markets as well as the uncertain outlook for the industry.

The Swiss electrical-engineering company said net profit came to $652 million from $1 billion a year earlier.

In addition to high raw-material costs, currency swings and write-downs, the company said the drop was also due to slackening demand for capital-intensive infrastructure projects, especially in the automotive sector and other heavy industries that tap ABB's automation products and industrial robots.

Revenue fell 9.4% to $7.21 billion from $7.96 billion a year earlier. Meanwhile, orders, which indicate future sales growth, dropped 16% to $9.15 billion from $10.94 billion, even as ABB was able to attract big electrical infrastructure projects in the Middle East and Africa.

Analysts were disappointed by the results, saying ABB couldn't pass higher raw-material costs to customers, something it was able to achieve in the past when markets in Asia, the U.S. and the Middle East were growing fast.

Another point of concern was ABB's cash flow. The company's net cash position declined 11% to $4.8 billion from $5.4 billion. That may curtail ABB's efforts to expand through acquisitions, analysts said.

ABB, however, sought to stifle the concerns. "We are looking for bolt-on acquisitions," Chief Executive Joe Hogan said. Mr. Hogan said he expects ABB to turn cash-flow positive during the remainder of the year and remain financially disciplined, saying that "keeping our investment grade credit rating is key."

ABB's long-term corporate debt is rated single-A-minus by Standard & Poor's and Single-A-3 by Moody's. At the end of March, the company had $2 billion in outstanding bonds, the bulk of which is due to be repaid in 2011 and 2013.

To counter the declining trend in sales and orders, ABB said it would expand its current cost-cutting program to $2 billion from $1.3 billion.

"We are determined to stay ahead of the market on cost while remaining alert for opportunities to grow the business," Mr. Hogan said.

ABB said that business in March had improved somewhat but that it was too early to say whether the market had bottomed out, adding that visibility was limited.

Mr. Hogan said he saw pockets of growth in India and China as well as in business areas such as power, where customer demand for efficient and cost-saving power equipment was still healthy.

But analysts remained skeptical. "The fact that they are extending their cost-cutting program shows that the outlook remains somewhat jittery, and that the bottom may not have yet been reached," said Vontobel analyst Panagiotis Spiliopoulos.

Shares in ABB, which over the past few weeks rose sharply as investors bet that the orders and sales might stabilize in the first quarter, were down 6.8%.

Slump persists for freight haulers

BY ALEX ROTH

The first updates of the year on freight volumes at some of America's biggest trucking and rail haulers show the U.S. transportation industry remains mired in a deep slump.

On Thursday, **United Parcel Service** Inc. reported first-quarter earning fell 56% and offered a gloomy outlook for the current quarter. The world's largest package-delivery company, forecast average daily, U.S. domestic-shipping volume this quarter will be off between 4% and 6%, compared to a 4.3% drop in the first three months of the year.

Shipment volumes are followed closely because a rebound in transportation usually precedes by several months a larger economic recovery. In recent days, executives at several major transportation companies said cargo levels remain depressed despite signs of life in other areas.

Forward Air Corp., a large freight and logistic company, said its shipments continue to decline at a double-digit rate compared with last year. "I wouldn't say it's necessarily getting worse," Bruce Campbell, president and chief executive of the Greenville, Tenn., air-cargo company, said this week. "I would most certainly say it's not getting better. And we don't anticipate for it to get better in the near term."

The Air Transport Association of America last week said U.S. air-cargo volumes had dropped 21% in February compared with a year ago. That was the seventh consecutive month of year-to-year declines.

Union Pacific Corp. Thursday separately reported its overall volume slumped 21% in the first quarter, accelerating from a 12% slide in the fourth quarter of last year. It said net income dropped 18.3%, to $362 million, or 72 cents a share, down from $443 million, or 85 cents a share, a year ago.

Jim Young, chief executive of the Omaha, Neb.,-based railroad, said a steep decline in freight volumes at his company may have bottomed. Carloadings, a key measure of shipments, appeared to have stabilized at about 145,000 a week, down from about 180,000 a week a year ago, he said.

Mr. Young said second-quarter freight volumes "will clearly be down" compared to year-ago levels, although he didn't provide any figures. Volumes are likely to "limp along" at current levels through much of 2009. "It's not deteriorating anymore," he said.

Rival **Burlington Northern Sante Fe** Corp. is expected to report its first-quarter results late Thursday. Its results will be closely followed for signs that shipment volumes in the railroad industry, which moves everything from Chinese-made consumer goods to coal for U.S. utilities, also have reached bottom.

Matthew Troy of Citigroup Investment Research said recent data suggest that volumes have begun "to bump along what could be a bottom." However, he added, "I don't think we'll see a recovery anytime soon."

The industry's latest numbers are grim. For the first two weeks of April, the U.S. railroad industry's car-load volumes were down more than 20%, compared with a 17.3% drop for the month of March and a 14.5% drop in February, according to the trade group Association of American Railroads. The industry blames some of the April declines on weather issues in the Midwest.

On Wednesday, **Norfolk Southern** Corp., the nation's fourth-largest railroad by revenue, reported that its rail-car volumes dropped 20% for the quarter ended March 31. For the first full week in April, volumes were down 29%, company officials said.

Arkansas Best Corp., one of the nation's largest trucking companies, on Wednesday said April's decline was similar to the 15.7% drop recorded during the first three months of the year.

Bob Costello, lead economist for the American Trucking Associations, said the organization next week is planning to release March truck-tonnage numbers. He predicts those figures, when seasonally adjusted, will show "no improvement or even a loss" compared with February. "I don't think we've hit bottom yet," Mr. Costello said.

Alstom sees further sales growth, considers Areva unit

BY SHAI OSTER

BEIJING—Despite slowing global demand for power plants, French heavy-engineering firm **Alstom** SA said it expects sales to keep growing and it is still considering a bid for the power transmission and distribution unit of cash-strapped **Areva** SA.

"We have an important backlog that we are executing. The guidance we are giving is that sales continue to grow," Philippe Joubert, president of Alstom Power, a unit of Alstom, told reporters.

He estimated that demand in the global power market could decline 25% to 30% for the next few years, but said Alstom's diversified technology and international presence will minimize the impact on it, particularly as developing countries such as China, Brazil and India still offer room for growth. For the industry, Asia accounts for nearly two-thirds of global orders, up from half before the financial crisis, he said.

China's stimulus package won't result in a spike in orders for Alstom, but will guarantee that previous plans won't be derailed by lack of financing, company executives said. Alstom, which makes high-speed trains as well as power-generation units, has sizable market shares in China in supplying hydro-electric turbines, boilers and the conventional power-generating parts of nuclear power plants.

The transportation unit has benefited from increased investment in rail infrastructure in China, and is in talks with the Chinese government about a new generation of super-high-speed trains that's now under development.

Mr. Joubert said Alstom remains interested in buying back French nuclear-engineering group Areva's transmission and distribution unit, which it sold to Areva in 2004. "We think this activity will fit perfectly in the portfolio," he said. "If Areva shareholders are interested to sell, we are certainly interested to buy."

Areva, the world's largest nuclear power-plant building company by revenue, has been struggling to fund its building plans, even though it is in advanced talks to sell reactors in the U.S., U.K. and India and has already won orders in China, where a massive expansion is under way with some 20 reactors under construction or in the bidding phase.

Analysts suggest that Areva's transmission and distribution unit could be sold for as much as €5 billion ($6.5 billion).

FOCUS ON AUTOMOBILES

Hyundai profit falls 43%

Despite sales decline, auto maker forecasts a decent second half

By Kyong-Ae Choi

SEOUL—**Hyundai Motor** Co. posted a 43% decline in first-quarter net profit as the global economic slowdown weighed heavily on sales, but it expects vehicle sales to recover from the second quarter.

The company's positive outlook was echoed by analysts who forecast vehicle sales to get a boost from the quarter ending in June on seasonal demand and stimulus packages from various governments.

Hyundai, South Korea's top car maker by revenue, said net profit for the three months ended March 31 fell to 225 billion won ($167 million) from 392.7 billion won a year earlier, while sales declined 26% to 6.032 trillion won. Operating profit plunged 71% year-to-year to 153.8 billion won.

"Strong demand for small fuel-efficient cars and a favorable [dollar/won] exchange rate fell far short of offsetting a sharp decline in vehicle sales in the first quarter," said Lee Soo-young, deputy general manager of Hyundai's investor relations team.

The dollar rose 48% to an average of 1,415.22 won in the first quarter from 955.97 won a year earlier.

Hyundai said it will seek to boost profitability this year by launching new models and continuing to exploit the favorable exchange rate.

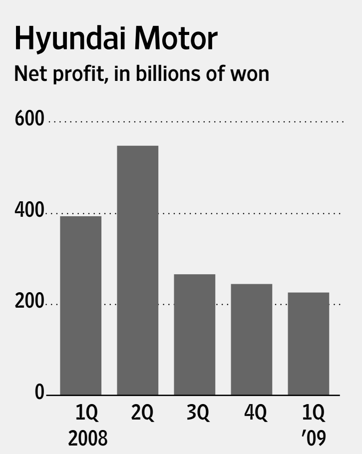
Analysts said Hyundai is now at a critical juncture when it has to transform the current crisis into a "golden" opportunity to emerge as a competitive car maker.

"Hyundai has taken the right step when it spent more on marketing in exploring new markets, while benefiting from a weak won," said Kang Sang-min at Tong Yang Securities, adding that Hyundai's marketing costs rose to 340 billion won in the first quarter from 230 billion won a year earlier.

The company is looking to raise its U.S. market share to more than 5% this year from 4.3% in the first quarter with fuel-efficient vehicles and differentiated marketing strategies, said T.H. Chung, senior executive vice president of the financial and accounting division.

South Korea's stimulus package, which will take effect May 1 and end Dec. 31, will provide a 70% discount on consumption, registration and acquisition taxes for new car purchases. The company and analysts said the temporary program will likely boost South Korean carmakers' results this year.

Hyundai's domestic market share was at 51.7% as of end-March. The company posted an 18% drop in domestic sales and a 12% decline in exports for the quarter ended March, bringing total sales to 616,325 units, a 14% decline from a year earlier.



Source: the company

A Hyundai employee works at the vehicle plant in Jeonju, South Korea ▶


Bloomberg News

Chrysler lenders given new offer

By Jeffrey McCracken

The U.S. Treasury, in an escalating back-and-forth that may determine whether **Chrysler** LLC avoids liquidation, has quickly responded to Chrysler lenders that rejected an earlier Treasury bid to slash the car maker's debt.

The Treasury now proposes that the banks and other lenders accept as payment 22% of the $6.9 billion they are owed plus a 5% equity stake in Chrysler, said several people familiar with the matter.

That is up from an earlier Treasury proposal that the banks and other lenders accept 15% of what Chrysler owes them and receive no Chrysler stock.

The lenders, which include **Citigroup** Inc. and **J.P. Morgan Chase** & Co., rejected that offer outright and instead proposed Monday they get paid about 65% of the debt, or about $4.5 billion. In addition, the lenders sought a 40% Chrysler stake and a seat on the company's board, according to a copy of the proposal provided by individuals outside the lenders group.

The new government offer leaves the U.S. and Chrysler lenders at least $3 billion apart with one week left before an April 30 Treasury deadline to determine the auto maker's fate.

The two sides are also far apart in how big an ownership stake the lenders would get in a restructured Chrysler.

If concessions can't be reached with the lenders and the United Auto Workers union by the deadline, the company will likely be forced to liquidate in bankruptcy court.

GM to slash output 25%, idle 13 plants in summer

By Sharon Terlep

General Motors Corp., hit by a sharp and prolonged sales decline, will slash production by 25% this summer as it temporarily idles 13 North American assembly plants.

GM North American chief Troy Clarke said Thursday the shutdown is the biggest he can recall for the auto maker, struggling to survive on government loans.

The company will build 190,000 fewer vehicles between now and July as it idles plants for up to eight weeks.

Affected factories build slow-selling and outdated models such as the Cadillac STS sedan and full-size SUVs like the Chevrolet Suburban. But plants building newer models, including the recently launched Chevrolet Traverse crossover, also are on the list.

The move comes as a deadline imposed by the Obama administration to dramatically restructure or go bankrupt nears. While the company scrambles to avoid a bankruptcy, Chief Executive Fritz Henderson has said in recent weeks a Chapter 11 filing is becoming more "probable."

Mr. Clarke said GM consulted with the administration's auto task force on the decisions, but was not pressed into making the cuts.

"It was an internal decision," he said.

Halting production will further erode revenue for GM, which has been burning through billions of dollars in the worst sales environment in decades. GM's sales are down 40% through March compared to last year.

The cost of continuing to pump out cars and trucks, however, would be greater. The auto maker is saddled with excess inventories, which already are heavily discounted. And dealers must pay interest on vehicles that sit on lots. "The units don't get better while they're sitting up there," Mr. Clarke said.

GM said the downtime also will protect the company against a parts shortage should **Delphi** Corp., the company's bankrupt former parts arm, fail to continue operating.

The auto maker, in a news release, said lenders to Delphi have rejected a proposal that would have resolved Delphi's bankruptcy case and ensures the supply of parts to GM.

"We're trying to protect ourselves," Mr. Clarke said.

GM's hourly workers, represented by the United Auto Workers, will get most of their pay during the shutdown from a combination of state unemployment benefits and payments from GM.

Japanese auto makers cut their domestic production

By Yoshio Takahashi

TOKYO—Three of Japan's biggest auto makers cut domestic production sharply last month as they moved to reduce inventories amid stagnant demand in major markets.

Toyota Motor Corp. and **Nissan Motor** Co. cut output by more than half in March from a year earlier, while **Honda Motor** Co.'s output sank 40% as exports from Japan slumped to other Asian countries, the U.S. and Europe.

However, the production cutback was in line with the car makers' plans, and some industry observers see signs that the downturn in their domestic output could bottom soon.

Goldman Sachs Wednesday raised its forecast for global vehicle sales this year to a 13% decline from an 18% fall because of the impact of government support for global auto industries.

China and India have lifted auto sales with measures such as tax relief, Goldman Sachs analyst Kota Yuzawa said. "Subsidies may be seen as eating into future demand, but we emphasize the benefits for capacity utilization during a demand slump," he said.

CORPORATE NEWS

VTB's profit drops 85%

Bank says it can curb rising loan defaults; more government aid

By Andrew Langley

MOSCOW—OAO **Bank VTB**, one of Russia's biggest lenders, said it is confident it can keep rising loan defaults in check, even as it reported a steep drop in 2008 net profit as the economic downturn forced it to set more funds aside to cover bad debts.

As Russia's first recession in a decade deepens, banks are gearing up for a spate of loan defaults that Finance Minister Alexei Kudrin has called a "second wave" in the country's economic crisis.

Officials forecast nonperforming loans at 10% of portfolios by the end of the year, around three times their current level, as corporate and individual borrowers struggle to repay debts amid tight credit conditions and rising unemployment.

"We don't expect the [2009] allowance for loan impairment to rise beyond 8% of our total gross loan portfolio," state-controlled VTB said Thursday. "Our current working assumption is that the percentage growth in our loan portfolio in dollar terms this year will be in the mid-teens."

Reuters

Bank VTB says it is relying on a capital injection of $5.31 billion in the fall.

London-listed VTB said it is relying on further government support in the form of a capital injection in the autumn valued at 180 billion rubles ($5.31 billion).

As of April, bad debts totaled 3.4% of VTB's portfolio, Chief Executive Andrei Kostin told the Kommersant daily this week.

VTB said its net profit fell to $218 million in 2008 from $1.48 billion in the previous year. Eating into profits were provisions against bad loans, which VTB increased to $2.48 billion from $526 million as Russia's economic outlook soured toward the end of last year.

Analysts at Moscow-based bank UralSib said VTB would have posted a net loss for the year without new accounting rules boosting its securities-trading book and a $349 million gain from buying back its own Eurobonds inexpensively from hedge funds desperate to unload holdings at big discounts.

"Overall, the bank remains loss-making, and we expect the upcoming quarterly results to also be distorted by one-offs and not truly reflect VTB's business picture," the UralSib analysts wrote.

VTB also warned that margins are likely to fall this year. "Given current central bank interest-rate policies and the likelihood of continued tough macroeconomic conditions, we expect interest margins to come under pressure," it said. "Our focus for the year ahead will be on supporting customers through these difficult times."

U.S. defense firms are upbeat

By August Cole
And Christopher Hinton

Defense contractors **Raytheon** Co. and **L-3 Communications Holdings** Inc. reported higher first-quarter results and said the diversity of their operations leaves them prepared to weather shifting military priorities.

U.S. Defense Secretary Robert Gates targeted costly weapons programs for cutbacks in his 2010 budget proposal, but increased money for cybersecurity, unmanned aerial vehicles, battlefield surveillance and communications systems suited for fighting insurgents.

That leaves L-3 "well-positioned for strategic growth in priority areas," such as intelligence, training and foreign assistance, L-3 Chairman and Chief Executive Michael T. Strianese said on a conference call.

Unlike some contractors, Raytheon and L-3 aren't dependent on a handful of big government contracts for the bulk of their sales. "Our largest program only makes up only 4% of our top-line sales," Raytheon Chief Financial Officer David Wajsgras said in an interview.

Raytheon, Waltham, Mass., on Thursday posted net income of $460 million, or $1.12 a share, up 15% from $399 million, or 92 cents a share, a year earlier.

Revenue rose 9.9% to $5.88 billion.

Raytheon also raised its profit outlook for the year to $4.55 to $4.70 a share from $4.45 to $4.60 a share. The increase reflects share buybacks as well as strength in missile-systems, battlefield-electronics and computer-networking operations, Mr. Wajsgras said.

Raytheon's funded backlog, which reflects future work, was $23 billion at the end of the first quarter, up about $1 billion from the end of last year.

L-3 Communications, which has contracts spanning an array of work including training foreign militaries to upgrading government aircraft, said first-quarter net income rose 4.7% to $201 million, or $1.66 a share, from $192 million, or $1.51 a share.

Revenue at the New York company increased 3.7% to $3.64 billion.

L-3 lifted the low end of its full-year outlook and now forecasts earning $7.17 to $7.32 a share, up from $7.12 to $7.32 a share.

Airlines get a boost as fuel prices fall

A WSJ News Roundup

Airlines got a boost in the first quarter from declining fuel prices.

US Airways Group Inc. and **Alaska Air Group** Inc. narrowed their losses, and **JetBlue Airways** Corp. posted its first quarterly profit in four years.

US Air, based in Tempe, Ariz., on Thursday posted a first-quarter loss of $103 million, or 90 cents a share compared with a loss of $237 million, or $2.58 a share, a year earlier.

Revenue fell 14% to $2.46 billion.

Excluding net special credits and net realized losses and gains on fuel hedging transactions, US Airways reported an operating profit of $8 million.

The carrier's total costs fell 19% with fuel expenses diving 54% to $378 million.

US Air also added to its checked-baggage fees. US Airways already charged $15 for the first checked bag and $25 for the second. But an extra $5 a bag now will be charged to passengers who pay those fees at the airport. Passengers can avoid the extra $5 charge if they prepay their baggage fees by checking in online.

Seattle-based Alaska Airlines posted a loss of $19.2 million, or 53 cents a share, compared with a net loss of $37.3 million, or $1.01 a share, a year early.

Revenue fell 12% to $742.4 million as the carrier reduced seat capacity by 9.3%.

Excluding a fuel-hedge gain of $10 million, the company's loss was 70 cents a share.

Alaska Airlines and its commuter sister company, Horizon Air, said they will match most major U.S. carriers in charging passengers $15 for the first checked bag, effective July 7, for tickets purchased beginning May 1.

JetBlue posted net income of $12 million, or five cents a share, compared with a loss of $10 million, or five cents a share, a year earlier.

Revenue fell 2.8% to $793 million.

JetBlue, Forest Hills, N.Y., paid 31% less for fuel in the latest quarter than a year earlier. The carrier restructured its fuel hedges last year so it wasn't tied to as many contracts this year as fuel got cheaper.

GLOBAL BUSINESS BRIEFS

Continental AG

Weak customer demand leads to short-time program

German automotive supplier **Continental** AG, which is being taken over by **Schaeffler Group** KG, said Thursday that 25,000 workers will be on short-time work hours by the end of April due to weak customer demand. Chief Executive Karl-Thomas Neumann told the company's annual general meeting that it could take up to five years for demand to recover to the level seen in 2007, before the global economic downturn. In 2008, the company reduced its workforce by a total of 8,000 and cut around 5,000 contract positions. By the end of March this year, the company had cut another 6,000 jobs world-wide. Meanwhile, several thousand Continental employees marched in Hannover to protest two possible factory closures in Germany and France.

AkzoNobel NV

Dutch coatings and chemicals company **AkzoNobel** NV swung to a net loss in the first quarter as demand dropped in all its divisions in every region. The maker of Dulux paints and Liquid Nails adhesive reported a net loss of €7 million ($9 million), compared with a net profit of €105 million a year earlier as revenue fell 13% to €3.27 billion. Revenue at its decorative-paints business dropped 11% to €1.02 billion. It was down 14% to €968 million at performance coatings and fell 11% to €1.29 billion at its specialty-chemicals business. Margins fell despite cost-cutting. AkzoNobel declined to give a 2009 outlook, but repeated its medium-term target of a margin for earnings before interest, taxes, depreciation and amortization of 14% by the end of 2011.

ITV PLC

U.K. commercial broadcaster **ITV** PLC on Thursday set the timetable for Michael Grade's exit as chief executive as it moved to further shore up its finances. The company said it will sell its SDN unit and separately raise a further £58 million ($84 million) in financing. However, ITV said it isn't planning a further rights issue as it believes it has adequate liquidity, but added that it is evaluating "all options" to improve the strength of its balance sheet. The company, which has seen its earnings pummeled by the downturn in advertising, said Mr. Grade will step down as CEO and become non-executive chairman as soon as regulatory reviews are completed. Mr. Grade was appointed executive chairman in early 2007 to help turn the company's fortunes around.

Sodexo SA

Catering and services company **Sodexo** SA posted stable profit for its fiscal first half, boosted by group-wide cost-cutting and rising demand from companies for outsourced catering. In the six months ended Feb. 28, net profit remained stable at €219 million ($285 million) compared with a year earlier, despite higher financial charges linked to acquisitions. Revenue rose 7.8% to €7.63 billion. The news sent the company's stock up 6.9%. Sodexo's organic growth rate in the first half stood at 3.7% compared with 9.2% a year earlier, and the company said it still aims for an organic growth rate this year of between 2% and 5%, along with additional revenue growth of around 2% from recent acquisitions.

Vueling Airlines SA

Spanish carrier **Vueling Airlines** SA announced a narrower first-quarter loss after cutting routes. The company, which is set to merge with **Iberia Líneas Aéreas de España** SA's low-cost airline Clickair, also said it would post a full-year profit. Vueling narrowed its net loss to €6.3 million ($8.2 million) from €22.6 million a year earlier, while revenue fell 15% to €74.1 million. Total costs fell 30%. Vueling said it expects revenue to rise and costs to fall sharply in the second quarter. Passenger traffic to all Spanish airports sank 19% in the first quarter, but Vueling said its strategic plan, which has cut 15 unprofitable routes, would lead the 5-year-old airline to its first full-year operating profit. Separately, Iberia said it plans to freeze the wages of its top 140 senior managers in an effort to cut costs.

Pirate Bay

A defense lawyer in the Pirate Bay file-sharing case said Thursday he will demand a retrial after the judge acknowledged he was a member of copyright-protection organizations. A Stockholm court last week convicted four men behind the Web site of helping others commit copyright violations and gave them one-year prison sentences. They were also ordered to pay damages of 30 million kronor ($3.6 million) to entertainment companies, including **Time Warner** Inc.'s Warner Bros., **EMI Group** Ltd., **Sony** Corp.'s Columbia Pictures and Sony Music Entertainment. Peter Althin, who represented Pirate Bay spokesman Peter Sunde in the case, said he would request a retrial.

Hypo Real Estate Holding

Germany's lower house of Parliament on Thursday established a committee to investigate whether the government bungled its attempts to shore up **Hypo Real Estate Holding** AG before moving to nationalize it. Opposition lawmakers charge that the government's bailout attempts were disorganized and poorly communicated. Hypo RE has become the most prominent German victim of the financial crisis. The lender ran into trouble last September after its Dublin-based unit **Depfa Bank** PLC failed to find short-term funding. Since then, the government has shored up Hypo RE with loan guarantees covering some €87 billion ($113 billion) and moved earlier this month to take over the lender in an offer valued at €290 million.

Areva SA

French nuclear-engineering company **Areva** SA said Thursday that revenue in the first quarter of 2009 rose 8.5% from a year earlier to €3 billion ($3.9 billion) and confirmed its previous forecast that operating income, revenue and order backlogs will rise in 2009. "The growth engines for first-quarter revenue were the Reactors & Services division and the Transmission & Distribution division, with growth of 9.2% and 16.1%, respectively," Paris-based Areva said in a statement. Revenue outside France was buoyant, rising to €2.03 billion from €1.86 billion in the first quarter. This year's sales outside France represent 68% of total revenue. Areva, which is 91% state-controlled, is the world's largest manufacturer of nuclear reactors.

—Compiled from staff and wire service reports.

Pakistan responds to Taliban advance

Small, ineffective troop deployment is sign of government's limited options; militants seen gaining territory

Pakistan sent a small paramilitary force Thursday to an area seized this week by the Taliban just 110 kilometers from Islamabad, a modest response that left one police officer dead and highlighted the government's paucity of options in fighting a spreading militancy.

*By **Zahid Hussain** in Islamabad and **Matthew Rosenberg** in New Delhi*

The force of a few hundred troops from the Frontier Corps—an often underequipped and poorly paid force designed to police the country's border with Afghanistan—was too small to seriously challenge the Taliban fighters who took over Buner district, home to about one million people, Tuesday and Wednesday. The Taliban had arrived from neighboring Swat, a valley north of the capital where the militant group signed a truce with the government in February.

The peace deal was supposed to stop the Taliban's armed advance into Pakistan's heartland and bring some relief to Swat's 1.5 million residents, who had suffered in the fighting between the Taliban and Pakistan's military. Instead, the Taliban have pushed even further toward the capital, although Buner isn't within striking distance of Islamabad.

The militants' arrival in Buner was a violation of the peace accord, diplomats and analysts said, but Pakistan's government and military appeared unable to quickly craft an effective plan to stop them.

Authorities said the Frontier Corps forces were there only to protect government buildings and bridges and declined to say whether they were sent in response to the Taliban takeover. One Frontier Corps platoon was met with gunfire as it moved through the district, killing a police officer accompanying it. Officials declined to say if they knew the identity of the assailants, though suspicion immediately fell on the Taliban.

There was no sign Thursday of Frontier Corps presence in Buner's main town, Duggar, the Associated Press reported.

Prime Minister Yousuf Raza Gilani told reporters that the government remained hopeful the peace deal in Swat would hold. "We will review our policy if the peace is not restored in Swat," he said.

How the Pakistan government handles the growing threat of the Taliban will affect the future not just of the nuclear-armed nation of 170 million but of neighboring Afghanistan. There, an expanded U.S. force is battling against a rising insurgency by the Afghan Taliban.

U.S. military officials and policy makers say that the porous border with Pakistan is one of their chief obstacles to winning the war. They also have criticized Pakistan for not doing enough to prevent insurgents crossing the border to attack U.S. troops. If the Taliban continues its march in Pakistan, it could deflect resources and political attention from the border to preventing the overrunning of Pakistan itself.

Indeed, even as the Taliban seized Buner, police and security agencies were put on high alert in the neighboring Mardan and Swabi districts, where Taliban activity is now reported to be rising. The city of Mardan, in the district of the same name, is the third-largest city in the North West Frontier Province, where Buner is located. It is considered the gateway from the mountainous northwest to the plains where Islamabad lies.

Agence France-Presse

Taliban gather during a council meeting with residents in Buner district Thursday. Pakistan deployed paramilitary troops in an effort to rein in the militants.

"If the Taliban continue their advances at the current pace they will soon be knocking at the doors of Islamabad," said Fazl-ur-Rehman, who leads the Jamiat-e-ulema-e-Islam, the country's largest Islamic party, in remarks to parliament on Wednesday.

The Pakistani government's ability to push back forcefully against the advance is limited.

A senior military officer said there was growing pressure from the army to renew the fight against the 6,000 to 8,000 militants who officials estimate are now in Swat and Buner.

There is no guarantee the army would win if hostilities resumed. Even though it has received huge financial backing from the U.S. to improve its military capabilities since the U.S. terror attacks in 2001, Pakistan's 500,000-strong military remains geared toward the threat of conventional warfare with India rather than counterinsurgency. The militants in Swat fought the army to a standstill for 18 months before the peace accord was signed, with 3,000 militants in combat with four times as many soldiers. The army has no soldiers currently in Buner.

"We are fully aware of the present threat posed by terrorism and are taking all measures to counter it," said Maj. Gen. Athar Abbas, chief military spokesman. "Of course it requires more capacity building and better techniques to fight militancy."

Any military response also would require the backing of Pakistan's citizenry. "We need public support to fight militants," Gen. Abbas said.

So far, that public support has been lacking. The Swat peace deal won broad support in Pakistan's parliament and was signed last week by President Asif Ali Zardari, a move that formalized the imposition of Sharia law in the area. Many poorer Pakistanis find the Taliban's promises of speedy justice and equality attractive.

Pakistan's populace also has railed against missile strikes against militants in the mountains by U.S. drones. The strikes are viewed by many as an invasion of the nation's sovereignty. Using missile strikes as close to the capital as Swat and Buner could provoke a massive public backlash that ends up strengthening the Taliban.

Pakistan's political elite, for its part, is often more focused on internal squabbles and power struggles, critics contend, and still hasn't come to appreciate the looming threat the Taliban poses as it moves toward the capital.

"These people are savages, yet we don't put them behind bars. Why? If we don't have the wherewithal to take them on, we should admit as much and stop making ludicrous claims that the enemy will be defeated in due course," wrote the influential Dawn newspaper in an editorial Thursday. "Striking 'deals' with an enemy that is simply buying time won't help either. Talibanization is not just a threat, it is the reality today. Face it."

Meanwhile, the Taliban consolidated its control on Buner after taking over government buildings and the homes of wealthy landlords, setting up checkpoints and patrolling roads. Taliban spokesman Muslim Khan said the militants wouldn't interfere with Buner's administration. But local officials said courts shut down after Taliban representatives said Islamic courts would be established. The police, the officials added, have largely melted away.

Senior U.S. officials have made increasingly blunt comments in recent days about the threat the militants pose to the existence of the Pakistani state. They are calling on the Pakistani military to fight the Taliban, rather than cutting deals.

"It is important they not only recognize it [the threat] but take the appropriate actions to deal with it," U.S. Secretary of Defense Robert Gates said Thursday.

—Jay Solomon in Washington contributed to this article.

U.S. faces more Afghan violence

By Yochi J. Dreazen

WASHINGTON—The shape of the Afghan conflict is shifting, as U.S. reinforcements have brought hints of progress along the porous eastern border with Pakistan, while security conditions in southern Afghanistan continue to deteriorate, according to U.S. officials.

Senior American commanders say they believe the war may be won or lost in southern Afghanistan, a Taliban stronghold and one of the world's largest opium-producing regions, where an estimated 80% of Afghanistan's insurgent violence occurs. A shortage of U.S. forces has allowed the Taliban to create havens in the south.

"We're at a stalemate" in the south, said U.S. Maj. Gen. Michael Tucker, deputy chief of staff for operations for the American-led North Atlantic Treaty Organization force in Afghanistan. He didn't provide figures on worsening violence.

"We just simply do not have enough forces to address the needs of the people down there," he said by video link from Kabul. "The enemy, obviously, is taking advantage of that posture."

More than 21,000 new U.S. forces are expected to deploy to Afghanistan in coming months. The addition will push U.S. troop levels there to about 65,000, their highest since the start of the war in 2001. Most of the reinforcements will be sent to southern Afghanistan, where the U.S. and its allies are preparing a major offensive against the Taliban.

About 4,000 American reinforcements deployed to eastern Afghanistan earlier this year, and senior U.S. commanders said they believe the additional troops helped to improve security conditions in the volatile region.

"We're approaching what you could actually, cautiously, term irreversible momentum in the east," Gen. Tucker said. He didn't provide any figures on that point. astern Afghanistan has long been a source of concern for U.S. commanders, because militants operating from havens in Pakistan's border areas cross into Afghanistan to commit attacks there.

Gen. Tucker said the Pakistani military's continuing offensive against militants in the restive Pakistani border province of Baijur had contributed to the security gains in eastern Afghanistan. He also credited a U.S.-backed program that has been creating armed local militias in the area to combat the Taliban.

In the south, conditions are gloomier. U.S. officials estimated that the Taliban reap hundreds of millions of dollars a year from narcotics trafficking, giving the group money to recruit new fighters and buy sophisticated weaponry.

The Taliban also exert de facto control over many rural parts of the south, adjudicating disputes and running shadow courts and local governments.

"The south is the center of gravity for the Taliban," Gen. Tucker said. he Obama administration's strategy for Afghanistan aims to stem the Taliban's momentum. U.S. officials said they hope the influx of new forces into southern Afghanistan will help to oust the militants from local strongholds and prevent their return. he U.S. is expanding its counternarcotics efforts in the south, in an effort to make it harder for the Taliban to replenish their coffers. Gen. Tucker said U.S., NATO and Afghan forces have confiscated more drugs so far this year than in all of 2008.

Associated Press

Adm. Mike Mullen, right, on Wednesday in Wardak province, west of Kabul, Afghanistan, where U.S. troops deployed for the first time this year.

The economy's next move

A look at history shows three scenarios along with their odds

By David Wessel

There is no doubt where the economy is now. "By any measure, this downturn represents by far the deepest global recession since the Great Depression," the International Monetary Fund declared Wednesday.

CAPITAL

But there's more than the usual uncertainty about where it is going. The key is the U.S. Even though its slice of the world economy is smaller than it once was, it's still huge. The U.S. led the world into the abyss, and it will lead the world economy out of it.

But how fast and when?

The alphabet can help to imagine the possibilities and the path of the economy. There's the letter V: the kind of quick rebound that usually follows a deep recession. Or U: a longer recession and slow recovery. There is L: years of painfully slow growth. And W: a temporary upturn as the economy feels the jolt of fiscal stimulus that quickly wears off. Finally, there's the big D, not the shape but another Great Depression.

With history a guide, consider three starkly different scenarios.

Deeper decline

How the current global recession compares with three recent deep downturns

	2009 projected	Average (1975, 1982, 1992)
Per capita output*	–2.5%	–0.4%
Industrial production	–6.23%	–2.01%
Total trade	–11.75%	0.48%
Unemployment rate (pct. pt. chg.)	2.56	1.18

*Purchasing power parity weighted
Source: International Monetary Fund

The V

The late Victor Zarnowitz, a student of the business cycle, had a rule: "Deep recessions are almost always followed by steep recoveries." The mild recession of the early 1990s and early 2000s were followed by mild recoveries. But the U.S. economy grew faster than a 6% pace in the four quarters after the deep 1973-75 recession and faster than a 7.75% pace after the even deeper 1980-82 downturn.

"In deep recessions," says Michael Mussa of the Peterson Institute for International Economics, "there is usually a growing sense of gloom as the recession deepens." Then the forces that triggered recession—say, plunging home prices—abate. The adrenaline of tax cuts and government spending kicks in. With inventories so lean, the slightest uptick in demand prompts a sharp increase in production, and the natural dynamism of capitalism reasserts itself.

"Experience suggests all of this should work, and I believe it will," Mr. Mussa predicts. Governments have administered huge doses of fiscal and monetary stimulus. Home-building and car-buying are so low they can't fall much further. Many consumers shy away from buying because they're frightened, not broke, and that state of mind can change quickly and liberate pent-up demand.

But the Federal Reserve caused the deep recessions of the 1970s and 1980s when it put its foot on the brake to stop inflation; it ended them when it let up. This time, Fed has its foot to the floor and the economy is still slowing. And so much stock-market and housing wealth has evaporated that a quick turn in consumer spirits seems unlikely. Plus, the repair of the banks remains far from complete, restraining lending.

The odds of the V: 15%.

The Big D

If one asked a roomful of economists two years ago to put odds on a repeat of the Great Depression, nearly all would have said zero. In early March, The Wall Street Journal posed the question to about 50 forecasters—defining depression as a decline in output per person of more than 10%, four times worse than the decline the IMF anticipates. On average, they put odds at one in seven; several put them above one in four.

"This is a Depression-sized event," says economic historian Barry Eichengreen of the University of California at Berkeley, citing the global decline in industrial production and world trade. The big difference: In 1929, governments dithered, or worse. In 2009, they've rushed to the rescue.

To go from today's deep recession to a depression something would have to go wrong. It could be a financial catastrophe on the scale of last fall's bankruptcy by Lehman Brothers or another panic-inducing event. Or a crash in the dollar, one that forces interest rates up at just the wrong moment. Or it could be political gridlock that stops governments in the U.S. or Europe from spending enough to fix the banks before a big one fails, or keeps them for doing more on the fiscal or monetary fronts as the economy deteriorates.

Or it could be virulent deflation that pulls down prices and incomes, making debts, which don't fall when prices do, a heavier burden. The textbook remedy is easy money and big government deficits. But so much of that has been tried it's easy to question its efficacy or to imagine resistance around the world to doing.

The odds of the big D: 20%.

The L

For a decade after its stock market and real-estate bubble burst in 1990, Japan bumped along at an annual growth of just 0.5%. It was dubbed the Lost Decade, and it could happen in the U.S. The recession ends but the economy plods along, growing too slowly to bring down unemployment for years.

As the IMF observed this week, recoveries following recession caused by financial crises are "typically slower." Those following recessions that occur simultaneously across the globe "have typically been weak." Back in the 1990s, as U.S. banks struggled, the Fed talked a lot about "financial headwinds." Those were zephyrs compared to the gale-force winds that the economy confronts today.

If financial markets stabilize but don't improve steadily, or if housing prices continue to drift down, or if confidence remains shaky, the U.S. economy could languish for a time. American consumers, once known for spending in the face of prosperity or adversity, could finally decide to prepare for retirement by saving more, having just learned that neither 401(k) retirement accounts nor home values rise inexorably. And the U.S. can't count on increasing exports, the solution when emerging-market economies run into financial trouble and the reason Japan didn't do even worse in the 1990s. The rest of the world is in no shape to buy.

An unfolding depression could scare Congress to act boldly, but the L is less ominous—and perhaps more likely as a result. There would be months when the economy appeared to be strengthening so the temptation to wait-and-see would be strong.

Put the odds of the L at 55%. That adds to 90%. So put 10% odds on the U, less pleasant than the euphoric V but far less painful than a Lost Decade. That's the rough consensus of economic forecasters; it means U.S. unemployment grows for another year and a half.

Bottom line: The odds favor a long slog.

Euro zone's economy contracts

By Nicholas Winning

LONDON—The euro zone probably fell into its deepest economic contraction in the first quarter, and soaring unemployment in the 16 countries that share the currency means the road to recovery will be rocky.

Markit Economics said Thursday that the preliminary euro-zone composite-output index—one of the earliest and most closely watched gauges of private-sector activity—rose to a six-month high of 40.5 in April from 38.3 in March.

Although a reading below 50 indicates activity is contracting, the result beat expectations and helped to lift the euro against the U.S. dollar.

"This represents an encouraging start to the second quarter and suggests a return to stability in the euro area by the end of the year is possible," said Chris Williamson, chief economist at Markit.

However, Markit's purchasing managers' index is still consistent with a quarterly rate of contraction of gross domestic product of at least 0.5%, he said. The euro zone's gross domestic product shrank by a record 1.6% in the fourth quarter.

Other economic figures released Thursday also suggested that the worst of the economic contraction may have passed. Data from France's national statistics agency showed business sentiment there recovered more than expected in April, albeit from a record low. The index measuring business leaders' confidence rose to 71 from 68 in March, which was the lowest level since the survey began in 1976.

Confidence among business executives in Belgium improved slightly in April, but remained near record lows, the Belgian central bank said Thursday. The bank's main index rose to minus 29.4 in April from minus 31.8 in March.

—Geraldine Amiel, Nina Koeppen and Adam Cohen contributed to this article.

CAPITAL JOURNAL ▪ Gerald F. Seib

Ford closed the book on Watergate to focus on looming U.S. crises

At the outset of his presidency, as he tried to run a country in turmoil and economic distress, Gerald Ford faced a critical decision: Should he allow an emotional legal ordeal to proceed, knowing it would leave the country mired in a deeply divisive debate left over from the previous administration, or should he make a tough decision to move forward instead?

Democrats now find themselves in a very similar position, this time on the question of whether terrorism suspects were tortured.

In Mr. Ford's case, the issue was the pending Senate trial of his predecessor, Richard Nixon. Mr. Nixon had been impeached by the House of Representatives for his role in the Watergate break-in and cover-up, and had resigned, paving the way for Vice President Ford to become President Ford. But the trial of the former president was looming, certain to be a gripping political spectacle of the first order.

There was great bloodlust among Nixon critics who wanted the trial. Mr. Ford had different concerns, though. Inflation was on the loose, the nation's energy situation precarious, its international reputation sinking.

So he pre-emptively pardoned Mr. Nixon in hopes of allowing the country to move on. Mr. Ford paid an enormous political price in the short term; indeed, he probably lost the 1976 election as a result. But in the long run, history has vindicated him almost entirely.

Today's situation is hardly identical, of course. The Watergate break-in and subsequent cover-up were tawdry domestic political crimes, while torture poses broader moral questions with international implications. But in their ability to affect how the government spends its time and energy, and what price is paid in the meantime, the quandaries are similar.

Right now, the Obama White House is trying to tame the debate, without killing it off entirely. But that's tricky, and may not be working.

Many in the president's Democratic Party, particularly its left wing, want a full-court legal and political press against those responsible for harsh interrogations of terror suspects since the attacks of Sept. 11, 2001. Convinced that the interrogation tactics constituted illegal torture, many Democrats want trials for those who conceived and executed the strategy during the Bush administration, or at least a congressional investigative commission.

On the other side, a Republican backlash is rapidly developing, arguing that the interrogation practices did their job and saved the country from more attacks.

It is hard to escape the feeling that President Barack Obama, having declared an end to the controversial techniques, now would like the matter to just go away so he can focus on the economic crisis. "The president's big concern is that we not get bogged down in a backward-looking debate that becomes a kind of proxy for all the debates of the last seven years," says one of Mr. Obama's top advisers. "There is a lot of pent-up energy around all these issues, but they can be very divisive."

Yet the White House also knows of the great agitation among Democrats who want to hold somebody accountable, somehow. So, much as it did on the subject of bonuses for bank executives receiving federal aid, the White House appears to be trying to let its party vent, fearing a backlash if it squashes the process, but apparently also hoping the hot air will slowly seep away.

Thus, the president has said he wants to look forward rather than backward, has declared that he doesn't favor prosecuting Central Intelligence Agency interrogators who followed the rules they were given, and declined to form on his own any kind of investigative commission.

But Mr. Obama also seems to know he faces a backlash among his supporters if he tries to cut off debate. So he has released previously secret memos describing the precise rules for interrogations promulgated by the Bush administration.

And then, this week, he pointedly didn't rule out prosecution of the Bush administration lawyers who wrote the memos, saying that decision is up to his Justice Department. More important, Mr. Obama didn't say the one thing he could have to cut off the debate: He didn't call on Congress to drop the idea of creating a special commission to investigate torture allegations, but merely said such a commission should be independent rather than partisan.

The president's advisers insist that, though their party controls Congress, the White House doesn't really have the ability to stop lawmakers from going down that path, only the ability to influence how they might do so. The broader question is what that distraction might do to the president's agenda—driving, as it would, even bigger wedges between the parties in Congress.

One who has dealt with that dilemma is Tom Korologos, a former U.S. ambassador who worked in the Ford White House on legislative relations. Mr. Ford, Mr. Korologos says, "smelled what could have been a horrendous Washington event" in a Nixon trial. He decided it would be better for the country to forgo that event.

More than that, he adds, Mr. Ford concluded it would better for his own agenda: "We were in the middle of an inflation fight. We were in the middle of a lot of international issues. It would have sucked the air out of a whole lot of goals he pursued."

That is the danger Mr. Obama faces as well.