Leading the News: BOE leader splits with U.K. government on bank lending

THE WALL STREET JOURNAL.

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What's News

Rising unemployment in the U.K. among young people marks the next economic challenge facing policy makers ahead of next year's election. The country's jobless rate jumped to 7.8% in the second quarter. Page 3

■ **The Fed kept** interest rates near zero but suggested the U.S. economy is on more stable ground, further sign that the recession is either already over or will be soon. Page 10

■ **U.S. stocks gained** after the Fed said it would complete its planned purchase of long-term Treasury securities by October. European shares also rose. Page 20

■ **The U.S. trade gap widened** in June to $27.01 billion from $25.97 billion in May, largely on higher oil prices. Page 10

■ **Nestlé reported** disappointing sales growth in the first half, but its pet-care division remained resilient. Page 5

■ **BHP's annual profit fell** 62% amid declining prices and demand, but the mining company retained a strong cash flow. Pages 7, 32

■ **Industrial production fell** in the euro zone in June, reversing May's gain, indicating a slow recovery. Page 2

■ **E.ON profit doubled** in the second quarter thanks in part to lower costs, but sales declined 9.8%. Page 7

■ **Russian lawmakers** plan to implement a "cash for clunkers" program early next year to lift car sales. Page 8

■ **SAS reported a wider** second-quarter net loss, and the Scandinavian airline said it intends to cut as many as 1,500 more jobs. Page 5

■ **The macro-driven rally** in European airline stocks may be low on fuel. Pages 19, 32

■ **ING returned** to a profit in the second quarter after three quarters of losses, but the result was still down sharply from a year earlier. Page 21

■ **Emerald Energy's board** recommended shareholders approve a nearly $900 million bid from Sinochem. Page 21

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EDITORIAL&OPINION

Show trials in Iran

Europe discovers the evil nature of the Islamic Republic. Page 13

Breaking news at europe.WSJ.com

U.S. wins copyright ruling

WTO tells China to ease distribution rules for intellectual-property owners

BY JOHN W. MILLER AND PETER FRITSCH

The World Trade Organization handed China its biggest defeat yet in a long-running battle over copyright protection for American books, music and movies in the world's most populous country.

Wednesday's 460-page ruling could be a big boon for Hollywood filmmakers, videogame designers and rock stars from Bruce Springsteen to Madonna, allowing them to sell their creations at cheaper prices and better distribution.

The WTO ordered Beijing to stop forcing U.S. intellectual property-rights owners to deal with only government-controlled companies, a drain on logistics and costs. Both the U.S. and China can appeal the ruling.

"The U.S. clearly won on key issues," says Simon Lester, founder of WorldTradeLaw.net LLC, a Washington-based consultancy.

Chinese distribution rules are a major obstacle for exporting to the country, say European Union and U.S. officials. They openly discuss the possibility of filing a similar case for auto parts, for example.

The WTO also told China it must let foreign companies sell music over the Internet, in what could help **Apple** Inc. and its iTunes music-downloading business.

The three-judge panel ruled in favor of China on

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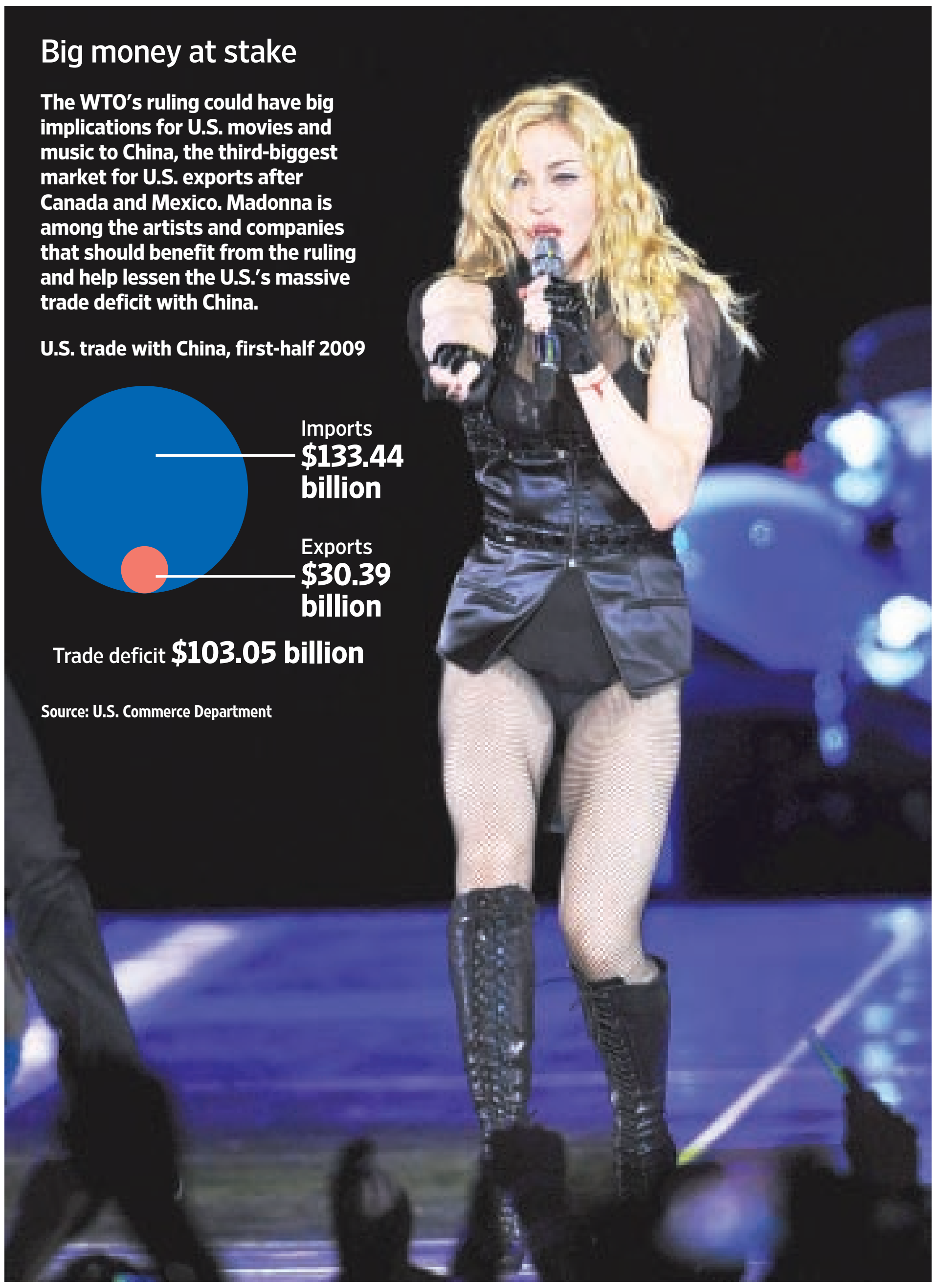

Reuters

UBS settles inquiry on taxes

UBS AG and the Swiss and U.S. governments have finalized a settlement in a tax-evasion investigation that has pried open the once-discreet domain of Swiss banking, a Justice Department attorney said Wednesday.

By Carrick Mollenkamp, Laura Saunders and Stephen Fidler

The parties didn't detail the settlement details. It is likely that the settlement will be filed, possibly under seal, with the U.S. federal court in Miami over the next week.

At the crux of the case is the Internal Revenue Service's legal effort to obtain the identifications behind some 52,000 secret accounts tied to U.S. citizens, which the IRS says are being used to avoid taxes.

The IRS likely will end up with 8,000 to 10,000 names, though it isn't known how the names will ultimately be transmitted to the Treasury. In February, UBS ended a parallel criminal probe, agreeing to a $780 million settlement and to turning over 250 account names.

One option is that UBS will give the identities to the Swiss government, which will allow the UBS clients to appeal in Switzerland.

Lawyers representing UBS clients on Wednesday provided more detail about the types of account holders they anticipate will be revealed to government authorities.

The lawyers said some account holders appear to be engaged in criminal activity, and used the secret accounts to launder gains from drugs, prostitution or organized crime.

A second camp consists of U.S. citizens who sought to evade taxes. Attorney Kevin Packman of Holland & Knight in Miami said about half his clients didn't pay U.S. income tax on income from offshore assets.

Another group includes multinational citizens whose nationalities include the U.S. Many in this group traditionally banked in Switzerland because of its political stability. Another category includes so-called "asset protectors" such as doctors and spouses seeking to avoid big legal payouts in malpractice

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Rio arrests rattle companies

Foreign businesses in China have started to take steps to protect themselves as the formal arrest of four employees of miner **Rio Tinto** renewed questions about the boundaries of acceptable commercial behavior here, and the penalties for overstepping the line.

By James T. Areddy in Shanghai and Sky Canaves and Shai Oster in Beijing

Australian Stern Hu and three Chinese nationals were formally arrested on Tuesday on suspicion of bribery and stealing commercial secrets, after more than five weeks in detention.

The four were part of a team of minerals salesmen working for a company that has bargained hard with China over the price of iron ore, which is needed to make steel and is one of the costliest items in China's overseas shopping basket.

China appears to have backed away from accusations that the four stole state secrets, a more grave criminal offense that can carry the death penalty.

But nervousness remains among some foreign companies about what might land them in similar trouble, according to China-based lawyers and corporate executives.

A lawyer with an international law firm said she was asked to prepare a report for a European company about the likelihood its executives might face state security charges conducting their business in China. Some foreign companies, according to other lawyers, have begun purging potentially sensitive data from their computers.

Companies need to ensure employees in China are "careful about what types of information and data they ask for, receive, or use in the course of their work and especially information from governmental agencies and quasi-agencies such as state-owned enterprises," said James Zimmerman, a Beijing-based partner at Squire Sanders & Dempsey.

"This case has increased the level of uncertainty of operating in China," said Mr. Zimmerman.

Rio Tinto has ordered at least one foreign executive to remain out of China, according to a person familiar with the matter.

The Anglo-Australian mining company continued to de-

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Inside

Hands-on style

President as micromanager: How much detail is enough? **News in Depth**, pages 16-17

Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	9361.61	+1.30
Nasdaq	1998.72	+1.47
DJ Stoxx 600	228.65	+1.02
FTSE 100	4716.76	+0.97
DAX	5350.09	+1.22
CAC 40	3507.24	+1.48
Euro	$1.4212	+0.52
Nymex crude	$70.16	+1.02

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Switzerland SF 5 - Syria S£ 210 - Turkey TL 4.5 - U.S. Military (Eur) $2.20 – United Kingdom £1.50

THE WALL STREET JOURNAL.

LEADING THE NEWS

Euro zone hits a bump

Industrial output fell in June; worries over corporate credit

BY ILONA BILLINGTON AND MICHAEL WILSON

Industrial production in the 16 countries that use the euro fell in June, reversing the gain posted in May amid new warnings on the creditworthiness of European companies.

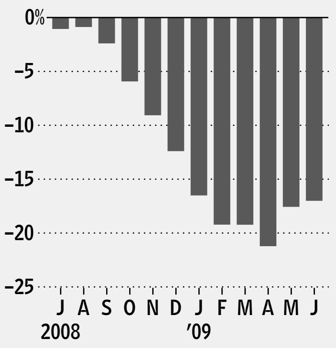
Figures released Wednesday by European Union statistics agency Eurostat showed industrial production fell 0.6% from May, and slid 17% from a year earlier, slowing from the 17.6% annual decline in May. It was the smallest yearly drop since February. Eurostat also revised the May monthly increase up to 0.6% from the original 0.5% gain.

The fall shows why the euro zone's emergence from its deep recession is expected to be slow and bumpy. However, the slowdown of the year-to-year decline indicates that the recovery—as shown in recent pickups in purchasing managers' surveys—is continuing.

"Manufacturing activity in the 16-country region is probably at or very close to its trough," said Martin van Vliet, economist for ING Economics. "Unfortunately, we fear that the climb back up will be much slower than in previous industrial recoveries."

Stalling engine

Industrial production in the 16 countries that use the euro. Year-to-year percentage change



Source: Eurostat

Separately, Moody's Analytics said in a report that the overall creditworthiness of Western European companies fell to a new low in the second quarter.

Western European companies suffered a total of 177 downgrades in the quarter, the report says, considerably higher than the previous record of 134 set in the first three months of 2009.

Financial institutions across the majority of Western European countries saw most of the rating cuts, with a record 122 downgrades.

Moody's said the rapid deterioration in loan portfolios, accelerating asset impairments and thinning cushions of capital to protect against future losses were mainly to blame.

Many European businesses are struggling with a lack of pricing power as demand remains slack. On Wednesday, France reported its third month of falling consumer prices. The consumer-price index published by statistics office Insee fell 0.4% from June and dropped 0.7% from a year earlier. That joined other recent indications that the euro zone as a whole could post its second straight month-to-month drop in consumer prices for July.

Still, economists minimized the risk of deflation, defined as a protracted decline in the prices of goods and services that causes long-term damage to the economy.

"We expect inflation to gradually increase and return ... to positive territory by November," said Luigi Speranza, an economist at BNP Paribas.

In Spain, home sales fell 26% in June on the year, amid continued pressure from the collapse of the decadelong housing boom, according to data from Spain's National Statistics Institute.

Nonetheless, the decline in home sales slowed; they had fallen 32% in May and 48% in April.

India's output at factories, mines surged in June

BY NEELABH CHATURVEDI AND PRASANTA SAHU

NEW DELHI—India's industrial output in June grew at its fastest pace in 16 months with manufacturing rebounding smartly, a sign that government stimulus measures are helping the economy.

Analysts said output at factories and mines should remain resilient in the coming months helped by robust local demand, although the extent of the recovery likely will be limited by weak monsoon rains.

The index for industrial production expanded 7.8% from a year earlier in June, after a 2.2% increase in May, data from the Central Statistical Organization showed Wednesday.

Manufacturing activity, which makes up for nearly 80% of the output index, expanded 7.3% from a year earlier in June, rising for the third month in a row. Output at mines surged 15.4%, while power generation climbed 8%.Output of capital goods climbed 11.8% from a year earlier in June, while the production of consumer durables during the month jumped 15.5% from a year earlier.

Scant rain could hinder India's economic revival.

Estonia's GDP decline seems close to the bottom

BY JOEL SHERWOOD

Estonia's economic decline deepened in the second quarter, but its quarter-to-quarter slide slowed, triggering hope that the worst of the recession may be over for the Baltic country.

Estonia's gross domestic product was 16.6% lower in the second quarter compared with the year-earlier period, Statistics Estonia said Wednesday. In the first quarter, economic output fell 15.1% compared with a year earlier.

The national statistics agency said slowdowns in manufacturing and construction weighed on output.

Economists were encouraged, however, that the seasonally adjusted GDP fell only 3.7% in the second quarter from the previous quarter. In the first quarter, GDP fell 6.1% from a quarter earlier.

"This would indicate that the pace of decline in the economy is slowing, and the contraction is likely to moderate towards the end of the year," said Annika Lindblad, an economist with Nordea Bank AB.

The Baltic region needs good news. Estonia, along with neighbors Latvia and Lithuania, has seen its economy damaged by the global financial upheaval.

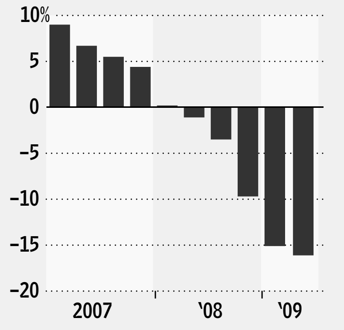
Credit agency Standard & Poor's Ratings Services this week downgraded its Estonia and Latvia ratings, citing continued economic challenges. It put Lithuania on review. But of the three countries, Estonia's prospects look the least grim, analysts said.

Lithuania had the worst-performing economy in the region. In the second quarter its GDP contracted by 22% from a year earlier.

Latvia has been forced to turn to the International Monetary Fund for emergency funding and is struggling to keep its budget deficit at less than 10% of GDP.

Deepening recession

Estonia's quarterly GDP, change from a year earlier



Source: Statistics Estonia

Estonia, however, still has a chance to keep its budget deficit under 3% of GDP. If its government cuts spending further, the country could qualify to enter the 16-nation bloc that shares the euro currency this year.

Acceptance into the common currency zone would raise investor confidence in Estonia's small, fragile economy.

"It looks as if the economic decline has reached the bottom," economists at Denmark's Danske Bank A/S said in a research note after the country's GDP figures were released Wednesday. "Estonia's economic situation is in better shape than the other Baltic states."

CORRECTIONS & AMPLIFICATIONS

Turk Telekom has an 81% holding in Turkish telecom operator Avea. A Corporate News article published Aug. 10 incorrectly said **Telecom Italia** SpA owns 49% of Avea.

INDEX TO BUSINESSES

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

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INDEX TO PEOPLE

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

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

LEADING THE NEWS

U.K. might recover, but boom won't return

Central bank chief warns slow lending will drag on growth

BY LAURENCE NORMAN AND NATASHA BRERETON

LONDON—Britain's banks discovered they had a powerful ally in Bank of England Governor Mervyn King on Wednesday, when he distanced himself from the government and signaled he believed the banks were doing all they could to increase lending.

At the same time, he said the lack of lending would drag on the U.K.'s economy, alongside slow household spending and government debt.

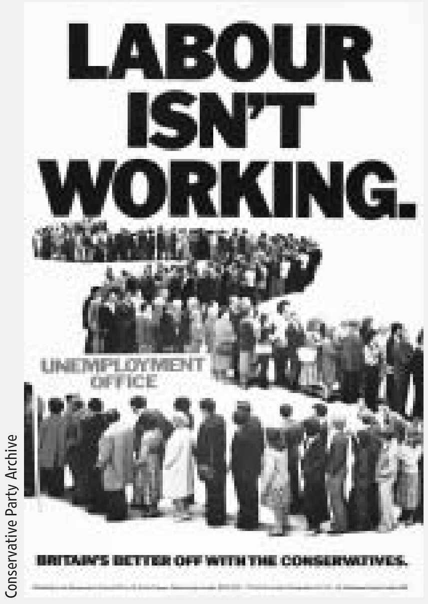
Mr. King was quick to stress that expectations of a fairly rapid return to robust rates of growth shouldn't be taken as an imminent return of the levels of activity before the crisis set in.

The speed at which lending recovers is a critical factor for how quickly the U.K. economy rebounds after five quarters of contraction that have knocked 5.7% off output. In its inflation report, the Bank of England said tight credit conditions are key to its forecast that the U.K. faces a "highly uncertain" and "slow recovery."

While Mr. King rebuked the banks for pre-crisis errors and warned against a return to past business practices, he said the banks had "strong incentives" to focus on rebuilding their capital bases, rather than rapidly stepping up the provision of affordable loans to business.

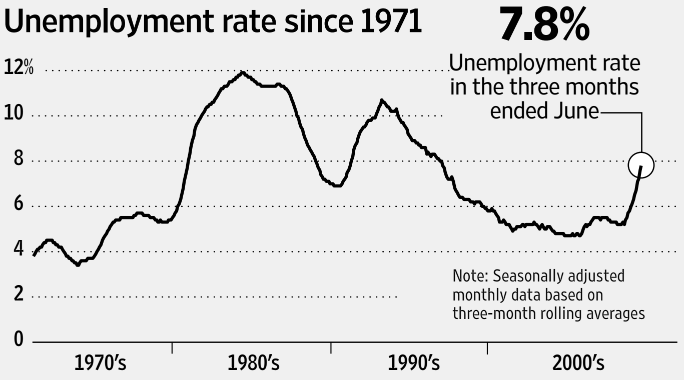
In a news conference following the release of the report, Mr. King was asked if banks had the balance right between repairing balance sheets and making new loans.

Whatever works | The U.K. government's stimulative efforts face many obstacles



Conservatives used the U.K.'s jobless rate as a rallying point during their 1979 political campaign.

Source: U.K. Office for National Statistics; Bank of England



Gross domestic product fell in the second quarter
-5.6%
percentage change from a year earlier

Lending to non-financial companies fell in the second quarter
£14.7 billion to **£615.3 billion**

Money supply growth has slowed in the second quarter to
3.7%
annualized growth rate of M4

Mr. King's answer was that banks are still in a "very bad way" and that it will take them several years to restore their health and "be in a position again to lend more."

By contrast, Prime Minister Gordon Brown and Treasury chief Alistair Darling have publicly rebuked lenders for not providing enough credit to companies and households.

While Mr. King and the government have been in broad accord on the aggressive policy response to the recession, the central bank chief has disagreed with the government in a few areas. He has urged the government to speed up its plans for cutting its budget deficit, and he has criticized parts of the government's proposed changes to bank regulation.

Mr. King said the Bank of England had been disappointed that its bond-buying program hadn't increased the amount of money in the economy.

He declined to say whether policy makers were aiming for a specific growth rate in the money supply, but he stressed that it needed to be "significantly above" current levels.

The central bank will maintain its stock of asset purchases until it starts to see signs that money growth and nominal spending are recovering, he said.

The inflation report indicates it is unlikely that the Bank of England will tighten monetary policy soon, and that it is possible it will have to provide further stimulus.

The central bank said that if it were to raise its key interest rate next year as investors expect, the inflation rate would be below its 2% target in mid-2011, a clear signal that policy will remain loose for a prolonged period.

"The inflation report gives a clear signal that policy is unlikely to be tightened any time soon and certainly does not rule out a further extension of quantitative easing," said Vicky Redwood, U.K. economist at Capital Economics.

The central bank's growth forecasts weren't as downbeat as some economists feared they might be following the decision to expand the size of the bond-buying program. Indeed, the Bank of England said it was "somewhat" more upbeat than at the time of its May inflation report.

But it continued to stress that the ability of the economy to grow would be restrained by the weak state of the banking system.

There have been signs that larger companies are finding it easier to access credit. On Monday, the Confederation of British Industry said overall credit conditions had eased in the three months to July. But its survey also showed that credit remained expensive and that credit conditions continued to curtail business investment.

Mr. King also denied that the U.K. central bank has been using its asset purchases to try to weaken the pound. Some analysts, surprised by the Bank of England's move last week to boost its quantitative-easing program by £50 billion ($82.4 billion) to £175 billion, interpreted the step as an effort to boost exports by weakening sterling.

But Mr. King sounded relaxed about the currency's level.

"I don't think there's any point getting worried or upset by exchange rates. They always move around," he said.

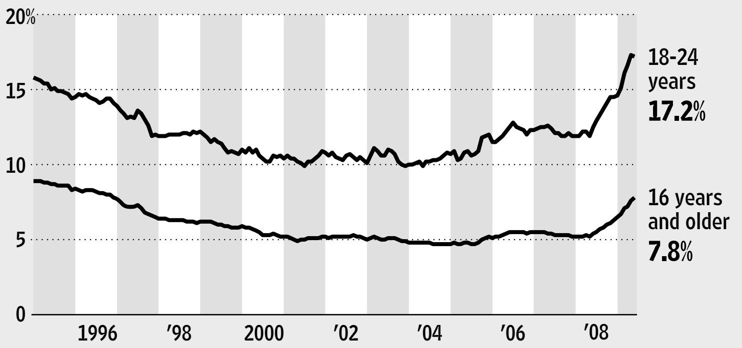
"Since we don't control them, the best thing is to respond to them in the most sensible way that you can, which is, as we do, [to] look at the implications for inflation and activity."

—Katie Martin contributed to this article.

The U.K. generation without jobs

BY JOE PARKINSON

Leaders of the pack | U.K. unemployment rates



Note: Seasonally adjusted monthly data based on three-month rolling averages
Source: U.K. Office for National Statistics

LONDON—More evidence of rising unemployment, particularly among young people, has highlighted the next economic challenge facing U.K. policy makers going into next year's election.

Recent business surveys have indicated that the U.K. economy could emerge from its worst recession in 50 years by 2010. But the job figures underscore risks of future setbacks, or at best a sluggish recovery.

Official data published Wednesday showed joblessness jumped to its highest level in 14 years in the second quarter. Also, more recent data showing the number of new workers claiming benefits rose more than expected in July.

The jobless rate rose to 7.8% from 7.1% in the year's first period, with 2.4 million people reported out of work, the highest level since the third quarter of 1995. Officials see worse to come. Bank of England Governor Mervyn King, even as he said growth is likely to resume in coming months, warned when presenting new economic forecasts that totals will continue rising "for the forseeable future."

Jobs are being lost at all stratas, but younger workers are particularly vulnerable. Among European economies, the U.K. tops the list in the incidence of youth unemployment: Nearly 40% of all U.K. workers losing a job are age 16 to 25, according to International Labor Organization figures.

Some 928,000 Britons under 25 are looking for work and the number is seen topping one million soon, according to the ONS. The jobless rate in that age group of 19.1% towers over the comparable 17.8% rate in the U.S.

Even the U.K's best-qualified graduates are struggling to find work as the employment situation deteriorates. Oliver Courtney, an Oxford graduate about to complete a master's degree from another elite college, said he has been sending out applications for the past year and has secured only two interviews.

"Pretty much every student, no matter how qualified, is in the same boat," he said. "There is going to be a real sense of despair unless things start to pick up."

Prime Minister Gordon Brown's Labour government in the spring launched a program guaranteeing jobs for young people out of work for more than a year. But some in his own party question whether the program is any more sustainable than previous initiatives in the past 12 years of Labour government.

"A new generation are growing up jobless. We must acknowledge that the government's New Deal strategy failed to get many unemployed people into work, even at the height of the boom," Frank Field, a former Labour Party welfare minister, has said about the effort.

Mr. Brown's overall approval ratings have tumbled to 16 points behind the opposition Conservative Party. According to latest polling from Ipsos Mori, his popularity is falling fastest among 18- to 34-year-olds, who would normally be more likely to vote for Labour than for the Conservatives. Mr. Brown must call an election by June 2010.

U.K. Business Secretary Peter Mandelson said the government will continue to commit resources to the problem. "What we cannot do is deliver these places by ourselves; we need the public and private sector to help us mount this national campaign to back young Britain," he said in a BBC radio interview.

Mark Harper, who is likely to become minister for labor if Conservatives gain power, said he worries that a "generation of young people are being written off." The Conservatives would immediately create 100,000 apprenticeships as a first step, he said.

"Unemployment is fast becoming the most pressing social, economic and political problem plaguing Britain," Mr. Harper said. "Over the last year, 2,000 people have lost their jobs every day."

One reason for the jump in youth unemployment is that significantly more Britons leave school early compared with other developed countries, which means more unskilled young people are being thrown into a rapidly deteriorating labor market.

"We put way more young people into work than France or Germany or other developed economies and many are totally unprepared, particularly during a recession," said David Bell, a labor market economist at Stirling University in Scotland.

At the London School of Economics, an elite university and a launch pad for top jobs in banking and business, shellshocked students are reconsidering their futures.

"I'm getting out of the U.K. for the next year at least. Hopefully, the market will have recovered by then," said Katie Allen, a 21-year old law student who is heading for India. "My pounds might buy me less now, but I think getting away is a better option."

Meanwhile, U.K. grocer **William Morrison Supermarkets** PLC said it will create 7,000 jobs this year as part of its store-expansion plan, exceeding its original target by 40%. A third of the new recruits will be 18 to 24 years old, Morrison said. The company said it has exceeded its initial target of 5,000 jobs five months early, and an additional 2,000 jobs are targeted by year-end.

Morrison's rivals, including **Tesco** PLC, **J Sainsbury** PLC and Asda Group Ltd., a unit of **Wal-Mart Stores** Inc., have all been hiring staff this year. Grocers, discounters and online players have fared better than the retail industry as a whole during the downturn, while sellers of furniture, clothing and electrical goods have been hit the hardest.

—Lilly Vitorovich contributed to this article.

LEADING THE NEWS

Egypt has a problem with Russian wheat

A scandal strains a key state food plan and a trade route

BY SARAH MCFARLANE

A criminal investigation into a shipment of Russian wheat in Egypt is having ripple effects across the world's wheat market and putting pressure on a bread program vital to the government.

Since the investigation began in May, authorities have rejected several Russian wheat shipments arriving in ports, citing quality concerns. They have also detained and released on bail four staff members from the government wheat buyer's office, and continue to detain the head of a large Egyptian grain trading firm.

Egypt's General Prosecution Office says it suspects forged inspection certificates were used for a Russian wheat shipment that contained too many insects and weed seeds for human consumption.

The investigation has discouraged traders from offering Russian wheat, which is some of the cheapest in the world, on worries that unclear purchasing standards could lead to shipments being rejected or delayed.

When global grain prices jumped last year and demand for subsidized bread increased, the resulting food shortages caused protests in Egypt. The unrest provided a stark reminder of the dangers facing governments of developing nations who let people go hungry.

It is also a significant wheat market. With 83 million people, Egypt is the most populous Arab nation and the second-most populous African state. Egypt's General Authority for Supply Commodities, or GASC, buys around six million tons of wheat each year to supply the subsidized bread program. In recent years, roughly half of this has been sourced from Russia, which has undercut other wheat producers.

An Egyptian woman waits in line to buy bread in March 2008, when a spike in food prices increased demand for subsidized bread.
Egypt's subsidized bread program makes it the world's largest wheat importer.

But in recent months, GASC has bought more French wheat than usual, purchasing around 570,000 tons since July, compared with 90,000 tons of Russian wheat. As long as traders are reluctant to offer Russian wheat, the Egyptian government will have to absorb the extra cost of buying more expensive wheat from other countries—likely to be millions of dollars—rather than increasing bread prices.

"The costs to Egypt could be really high," said Keith Flury, wheat market analyst at German-based research firm F.O.Licht.

Global wheat prices are below last year's highs, as the world reaps a second consecutive bumper wheat crop, which will buffer Egypt to some extent. But to ensure the government secures the quality of wheat it needs at fair prices, Egypt wants to keep its sourcing options open.

Since the investigation began, officials have increased their scrutiny of Russian wheat imports at Egyptian ports. Grain trading houses have reacted either by ceasing to offer Russian wheat, or by charging a $10- to $15-a-ton premium for Russian wheat sales to the Egyptian government.

In March, Russian wheat offers to Egypt were around $20 lower a ton than for U.S. or French wheat. However, now it is only around $3 a ton less, partly because of the risk of selling to Egypt. Traders say they are simply pricing in a premium for risks associated with a sudden lack of clarity in government standards.

"Over the past few weeks, there have been efforts to clarify regulations pertaining to inspection of wheat and the storage facilities in which imported wheat is being shipped," said an official from Egypt's Ministry of Trade and Industry. "If this is being seen as a type of rigidity, this is probably just a time of adjustment to these regulations," the official said.

Officials at GASC, along with the chief executive of one of Egypt's largest wheat importers, **Egyptian Traders** Co., are being questioned by the country's General Prosecution Office over allegations that documents relating to a shipment of Russian wheat were forged.

Ashraf El Attal, the chief executive of Egyptian Traders Co. was unavailable to comment Wednesday, as "he is being investigated at the moment," a company representative said.

RIAS Trading SA, the Swiss office of Rosinteragroservis, Russia's second-largest grain exporter, said the information on the inspection certificate presented by Egyptian Traders Co. to GASC for the wheat was different from the information RIAS had on its certificate issued before the shipment left Russia.

Prior to the investigation, GASC considered up to 18 offers from local and international trading houses when it tendered for wheat. In recent months, most of Egypt's local grain trade houses have ceased to make offers to GASC, cutting the bids for its latest tender to nine. Only two of those offers included Russian wheat.

Some Russian grain exporters have begun to exclude Egypt as a potential destination for their wheat because of the risks associated with trading wheat with the country.

RIAS has had a shipment of wheat—the Sea Bird—held for three months at the Red Sea port of Safaga as a result of a payment dispute between GASC and Egyptian Traders Co. for a previous shipment.

"For me, Egypt is off the map," said Chris Vanhonacker, commercial director at RIAS. "It's in the same category as Somalia because the detention of the Sea Bird is an act of piracy."

A GASC official said in July it was holding the shipment until it received payment from Egyptian Traders Co. for a previous shipment.

Traders say U.S.-based grain merchant Bunge declined to make an offer to GASC in its tender last week, holding off until the government answered its letter requesting clarification of the bid terms. Bunge declined to comment on the matter.

"It's quite a murky situation, especially with some of the [grain] companies wanting clarification from GASC and not getting it," said F.O. Licht's Mr. Flury.

—Summer Said in Dubai contributed to this article.

Memories of Lehman fade from a key measure of risk

BY ADAM BRADBERY

LONDON—Banks will soon face a test of whether they have learned a big lesson of the financial crisis.

From the middle of next month, the market volatility resulting from last year's collapse of Lehman Brothers Holdings Inc. will stop showing up in in a commonly used measure banks use to determine how much risk they can take.

The result is that the models will give a green light to start taking chances again. If banks act on this, a range of markets could see a boost in both trading volumes and volatility. If they don't, it will be a sign that they are no longer relying on the oversimplified risk-valuation models that blinded so many to the risks exposed by the crisis. "I think this will be a good test of banks' risk-management areas," said Peter Rothwell, senior manager in the financial-risk-management group at KPMG LLP in London, who said banks should now have reviewed the assumptions in their models.

The positive signals would be generated by what are known as value-at-risk, or VAR, models. They are designed to show how likely it is a bank will take a large loss on a portfolio of assets in the future given volatility in the past. In addition to predicting the likelihood of losses, the models are used to calculate the amount of capital that has to be set aside to cover those losses. The most-commonly used VAR models use a year's worth of pricing data to calculate the risks to a portfolio, which means that, from mid-September, the volatility that was created in prices after the Lehman collapse will start to fall out of these models.

Despite one-year VAR's acknowledged flaws and bankers' attempts to come up with other tools, some consultants say it remains deeply embedded in bankers' behavior in the absence of an alternative industry-wide standard.

"The VAR model still determines the behavior of many banks and, as the Lehman volatility falls out over time, these banks will feel safer," said Selwyn Blair-Ford, senior domain expert at FRSGlobal, which advises financial firms on risk and regulatory issues. The one-year model won't show an abrupt drop in risk—markets remained highly erratic for more than two months after Lehman Brothers ran aground in mid-September. Deutsche Bank AG, Barclays Bank, UBS AG and Citigroup said they weren't able to comment on their use of VAR models.

Regulators around the world are planning to impose more rigorous requirements concerning the way banks use the models, but these aren't expected to be in place before the end of next year.

The Bank for International Settlements' Basel committee on banking supervision, which sets global capital rules, plans to introduce rules forcing banks to introduce stress-tested VAR models by the end of 2010. The regulations would discourage taking too many risks during economic booms. In the meantime, the U.K.'s Financial Services Authority has been urging banks to start reviewing the way they use and construct their VAR models, according to regulatory consultants.

The FSA also has asked banks to overlay their VAR models with separate stress tests, which construct deliberately extreme scenarios to predict a worst-case, and often system-wide, challenge to their businesses, say consultants who advise banks on managing market risks.

"While there's debate about how we should change the regulatory environment in this area, it hasn't been done yet so banks are still working with their VAR models and it's a real problem," said Mr. Blair-Ford.

The British Bankers' Association said, however, it would be very surprised if banks decided to take more risks when volatility drops out of their VAR models, not least because they know new regulations on the use of modeling are on the way.

"The lesson of the past year of has been that slavishly following the output of 'black-box' models does nothing to enhance good risk management and that ignoring market events just because they happened more than 12 months ago won't wash," said Simon Hills, executive director of prudential capital and risk at the BBA.

"Although this isn't going to come into effect until the end of 2010 at the earliest, it would be short-sighted of firms to ignore the proposals," said Hills.

Some regulatory experts say senior executives at financial institutions now have a much greater understanding than before the crisis of how VAR models work and what their limitations are.

As a result, most banks are now already using stress tests—which are more extreme than ever before—to second-guess the conclusions of the models. "It's quite rare now to have an institution that just uses VAR," said John Hitchins, head of U.K. banking at Pricewaterhouse-Coopers LLP. "Most of them use stress- and scenario-testing models around their positions, so although the VAR model may be saying it's OK to have a bigger position, they may still be caught by limits coming out of other stress tests."

Some banks also use longer-term VAR models that would continue to include the impact of Lehman over a greater period of time. But many of these models are weighted to place more emphasis on recent data, which means the Lehman-induced volatility will gradually have less of an impact.

CORPORATE NEWS

Pet care shines in bland Nestlé results

Swiss food and beverage giant is the latest to show consumers will keep spending on their dogs and cats

By Goran Mijuk
And Anita Greil

Nestlé SA, the world's largest food and drink producer by sales, reported disappointingly slow growth Wednesday, a sharp contrast to the better than expected volumes turned in recently by rivals such as **Unilever** PLC.

But the company did a lot better with animals than it did with humans. The same focus on premium, higher-margin products that may have put a damper on overall sales growth paid off in the company's big pet-care division, as recession-stressed consumers still found ways to spend more on their dogs and cats.

Drug companies and insurers are also beefing up product offerings for pets.

The strength of spending on pets, which Nestlé says held up globally, has caught the eye of companies across the world economy. The main beneficiaries are companies selling pet food, but the growing market is drawing increasing interest from players in sectors ranging from health care to insurance.

"Growth in pet care remains resilient," said Nestlé Chief Financial Officer Jim Singh. The company, Mr. Singh said, is scaling back underperforming and mainstream products in favor of premium offerings "that are delivering improved nutritional benefits for pets."

Overall, the Swiss owner of brands such as Nescafé and Maggi said first-half profit fell 1.9% to 5.1 billion Swiss francs ($4.7 billion), while sales dropped 1.5% to 52.3 billion Swiss francs. The company said organic growth, which measures the change in sales after stripping out recent acquisitions and divestitures, came in at 3.5% in the first half.

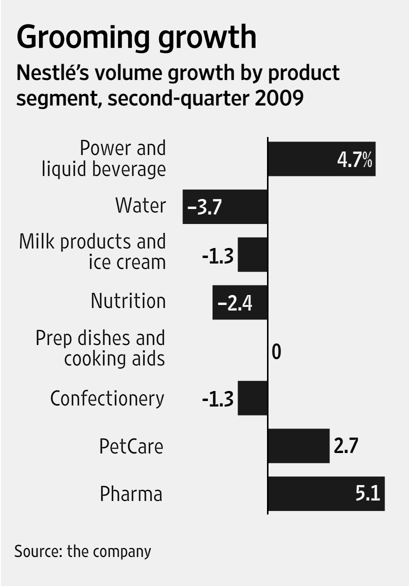
Nestlé said it would do better in the second half, but ditched its previous target of growth approaching 5%. The company, however, said performance in its pet-care business was "excellent."

The American Pet Products Association, a trade group, estimates U.S. spending on pets will rise to $45.4 billion this year, from $43.2 billion in 2008. The total includes $17.4 billion for food and more than $22 billion for over-the-counter medicine and veterinary care.

Nestlé, one of the biggest producers of pet food following its 2001 acquisition of Ralston Purina Co., is in a good spot to tap into that market. The company said sales at its pet care division posted organic growth of 9.1% in the first half, better than all but one of the company's seven main product areas. The division's sales came in at 6.4 billion Swiss francs, 12% of the company's total.

Despite the tough economic times, consumers weren't deterred by Nestlé's price hikes, which helped lift the pet-care division's profit margin by more than a percentage point to 15.7%.

Brands such as Purina and Friskies are among Nestlé's fastest growing, with sales of each up by more than 6% in the first half. Dog Chow, which saw sales jump by more than 16%, is Nestlé's second fastest growing large product, outstripped only by coffee system Nespresso, which has a growth rate above 20%.




Nestlé's own supermarket in Vevey, Switzerland
European Pressphoto Agency

Drug companies also are chasing after pets. **Sanofi-Aventis** SA put $4 billion on the table last month to buy the 50% of animal-health company Merial it didn't already own from U.S. peer **Merck & Co.**

Sanofi Chief Executive Chris Viehbacher said sales at Merial have grown 50% over the past five years to nearly $2.7 billion in 2008, while delivering an operating margin of close to 30%—a level of profitability only a handful of makers of human medicine can boast.

In 2008, world-wide sales of animal-health products increased at a healthy 7.3% pace to $19.2 billion, with pets by far the largest segment, Sanofi said in a discussion of its decision to buy the rest of Merial. Mr. Viehbacher told analysts that sales of medicines for "companion animals" have been less affected by the recession than those for livestock.

Eli Lilly & Co. Chief Executive John Lechleiter has also expressed interest in building up his company's animal-health business.

The bright outlook for pet products is also luring insurers into the market in search of growth rates faster than those for than traditional car and life insurance.

For example, Swiss property and casualty insurer **Mobiliar** earlier this year launched Switzerland's first pet insurance product. Every third household in Switzerland owns a cat or a dog, putting the potential customer base around 1.8 million, said Stephan Guenther, product manager at MobiCasa, Mobiliar's household unit.

"Demand was very strong after the first few months and beat our expectations," he said.

Market research company Datamonitor thinks the U.K. pet insurance market will probably grow to around £700 million ($1.15 billion) in 2012, from £440 million in 2007.

And in the U.S., only 0.3% of all cats and dogs are currently insured, according to Ohio-based insurer **Embrace Pet Insurance**. That's about 800,000 animals.

—Martin Gelnar contributed to this article.

SAS to chop jobs as loss widens

By Ola Kinnander


Associated Press
SAS Chief Executive Mats Jansson at the airline's earnings presentation on Wednesday. The carrier plans to trim as many as 1,500 more jobs and reduce salaries.

STOCKHOLM—Scandinavian airline **SAS** AB said Wednesday it would cut as many as 1,500 more jobs and reduce salaries as it posted a wider second-quarter net loss amid falling traffic. The carrier's net loss widened to 1.05 billion Swedish kronor ($143 million) from a 422 million kronor net loss a year earlier, as revenue dropped 15% to 12.22 billion kronor from 14.41 billion kronor.

SAS presented a new two-billion-kronor cost-savings program, which it said will lead to layoffs of between 1,000 and 1,500 staff. It also said its previously announced four-billion-kronor cost-cutting effort was "ahead of schedule," adding that it now aims to cut a further 500 million kronor.

In total, about 9,000 employees are expected to leave SAS as a result of all its efforts to slim operations. It had about 23,000 employees at the start of the year.

"SAS must compete on the same basis as its competitors, which ultimately is a matter of survival," Chief Executive Mats Jansson said.

The company, half of which is jointly owned by Sweden, Denmark and Norway, posted an operating loss of 942 million kronor, compared with a 150-million-kronor operating profit a year earlier.

SAS was suffering even before the global economic downturn as it struggled to cut its bloated cost base despite opposition from labor unions trying to hold on to lucrative deals for pilots and cabin crew.

The key to SAS returning to profitability will be its efforts to reach new collective agreements with all or most of its 39 unions, said Orion Securities analyst Alexander Solovjov. In June, the carrier started negotiations with the unions but was unable to reach agreement on lower pay. It will now begin further talks in a bid to implement payroll and pension cuts of between 10% and 20% for flight-deck and cabin personnel.

Airlines world-wide have reported mounting losses or slumping profits as the credit crunch and the economic downturn cut demand for air travel and cargo. In recent weeks, several have said there are signs of stabilization in air-passenger traffic, although the downturn in the industry is expected to continue through at least next year.

TUI Travel returns to profit but warns of tougher winter

By Kaveri Niththyananthan

LONDON—**TUI Travel** PLC, Europe's largest holiday company, posted a profit for its fiscal third quarter, but warned that the economic downturn and fears about job losses will hit bookings in the winter holiday season.

TUI Travel returned to the black with a net profit of £33 million ($54 million) from a net loss of £216 million a year earlier, when impairment charges and losses from the sale of aircraft in a leaseback transaction weighed on results.

Revenue for the quarter ended June 30 edged down 1.1% to £3.58 billion from £3.62 billion as the company cut capacity in the U.K. and Germany. However sterling's weakness boosted revenue from outside the U.K.; stripping out currency fluctuations, revenue was down 9%.

The company estimated that swine flu ate £8 million out of profits as it had to refund forced cancellations and repatriate affected travelers. Results were also hit by weak demand in France for travel to Madagascar and the French West Indies amid civil unrest.

Average selling prices for summer holidays fell 3% in central Europe, 2% in Western Europe, and the company is facing a fierce price war with competitors in Switzerland, where there's excess capacity.

The timing of Easter, which fell in the third quarter this year and the second quarter last year, helped boost to results.

TUI, created in September 2007 through the merger of TUI AG's tourism assets with U.K. travel company First Choice Holidays, said it delivered an additional £21 million in synergies from the merger, and eliminated losses in Germany and the U.K. by cutting the number of flights.

Many consumers had already booked their summer holidays before the brunt of the recession hit. But TUI Travel warned that consumers seem more prepared to forgo a second holiday, and bookings for the winter are behind the levels seen a year ago.

The 2009/10 winter season is likely to be the "toughest period we will have," Chief Financial Officer Paul Bowtell told analysts.

In response, TUI has already cut winter capacity by 15%, helping it to raise average selling prices for winter holidays by 9%. It said it has so far sold 20% of the holidays available for this winter.

"We anticipate market conditions will remain challenging and expect the later booking pattern to continue in the next financial year," said Chief Executive Peter Long.

CORPORATE NEWS

Smart phones shine amid handset slump

Mid-range models getting squeezed out, according to Gartner

By Gustav Sandstrom

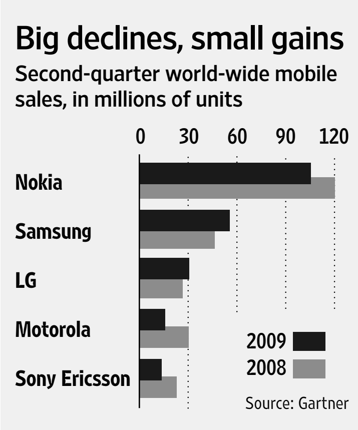
STOCKHOLM—Global sales of smart phones continued to rise in the second quarter as some users sought more features for their money, research firm **Gartner** Inc. said Wednesday.

However, the overall mobile-phone market declined from a year earlier for the third consecutive quarter, though the decline was at a slower pace than in the previous quarter, Gartner said in its quarterly report on the industry.

The rapid downturn in consumer spending has hammered the wider market as customers delay upgrades and hold off buying new phones. Prices of phones have been falling as phone companies and vendors try to stimulate demand. However, sales of smart phones are on the rise as vendors and wireless companies focus on marketing these devices in the hope of making more revenue per device.

Consumers who would usually buy midrange phones are either now purchasing smart phones, which offer features such as email, or are trading down to less-expensive handsets, said Gartner's research director, Carolina Milanesi. "We are seeing a lower revenue opportunity than we did a quarter ago," she said.

Gartner said about 286 million handsets were sold in the three months ended June 30, down 6.1% from a year earlier. That's an improvement on the record 9.4% drop in the first quarter from a year earlier.



Still, similar to a trend seen in the first quarter, sales of smart phones, such as **Apple** Inc.'s iPhone and **Nokia** Corp.'s N97 touch-screen handset, rose 27% to 41 million units.

The overall handset market could return to positive growth in volume terms by the fourth quarter, Ms. Milanesi said, helped by improving consumer confidence and new product launches from vendors including Sony Ericsson and **Motorola** Inc.

The three months ending Dec. 31 "is going to be a very strong quarter; there are a lot of products coming in time for Christmas," she added.

Heavyweight Nokia maintained its leadership position in the second quarter, even though its market share fell to 36.8% from 39.5% in the year-earlier period as it lost ground to **Samsung Electronics** Co. and **LG Electronics** Inc.

Samsung's market share increased to 19.3% from 15.2%. LG's market share increased to 10.7% from 8.8%. Motorola's market share fell to 5.6% from 10%.

Sony Ericsson's market share fell to 4.7% from 7.5%. Gartner said the company has suffered from an uncompetitive range of handsets, missing key trends like full keyboards, Internet browsing and navigation.

Sony Ericsson is a joint venture of Japan's **Sony** Corp. and Sweden's **Telefon AB L.M. Ericsson.**

IEA sees demand for oil rising on Asian needs

By Spencer Swartz

LONDON—The International Energy Agency slightly raised its forecast for world oil demand on improved Asian economic activity, but said the extra crude that countries such as Russia are pumping out will offset the increase in consumption.

In its widely watched monthly oil-market report on Wednesday, the Paris-based agency said it expects 2009 global oil consumption, led by growth in China, to average 83.94 million barrels a day.

That figure represents an upward revision of 190,000 barrels a day from the IEA's July report, but is still a 2.7% drop from last year. Global demand under the new outlook is on par with 2005 levels, underlining how tepid consumption remains.

The world also has plenty of oil at its disposal, the IEA said, with non-Organization of Petroleum Exporting Countries producing more supply and with inventory of distillates and other oil products still brimming at multiyear highs. Russia and other non-OPEC nations, which produce about six out of 10 barrels consumed daily globally, are expected to churn out around 160,000 barrels a day more this year than previously expected.

"We have Russia surprising to the upside, which is pretty much canceling out the upward demand revision," said David Fyfe, editor of the IEA report.

Since January, the IEA has revised up its outlook on supply from Russia, the world's biggest oil producer, by a total of 360,000 barrels a day as some new fields in Western Siberia enter service and as enhanced oil recovery techniques squeeze out more hydrocarbons from existing fields.

But the IEA, a watchdog to big energy-consuming nations like the U.S., is more optimistic on those producers than other industry forecasters.

Russia suffered its first drop in oil production in a decade in 2008, and analysts say they think harsh fiscal terms and tax policies on foreign companies have dealt a blow to exploration efforts that will undermine output over the next year, if not longer.

Some analysts say they think Russia will pump around 9.7 million to 9.8 million barrels a day on average this year, rather than the 10.07 million barrels a day expected by the IEA.

The agency expects global crude demand to rise 1.6% next year—marginally higher than its previous outlook and outpacing non-OPEC supply growth of about 1% in 2010.

Light, sweet crude for September delivery rose $1.21, or 1.74%, to $70.66 a barrel in midday trading on the New York Mercantile Exchange.

BHP profit tumbles 62%

Miner is cautious but sees indications demand is returning

By Clare Ansberry And Robert Guy Matthews

BHP Billiton LTD. posted a 62% drop in annual profit for its latest fiscal year amid falling prices and demand.

But BHP, the world's largest mining company by output, retained a strong cash flow that leaves it well positioned for a recovery and acquisitions in an industry likely to continue consolidating.

Chief Executive Marius Kloppers said the last 12 months were the most difficult he has seen and that the restocking of inventories world-wide may not indicate the underlying demand of end users. Inventory restocking should be completed by early next year, he said, and there are emerging signs of demand improving in North America, Europe and Japan.

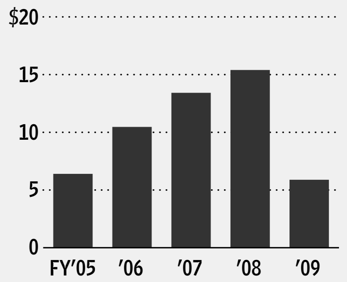
"We are already seeing some early evidence of buying because inventories are depleted," Mr. Kloppers said in an interview. But he cautioned that the global recovery will be slow, in light of the massive debt accumulated in some countries. "We won't be able to come out of this recession with the same velocity of past recessions."

Still, Mr. Kloppers said long-term demand for a majority of commodities remains strong, given projected growth in China and continued demand to develop that country's infrastructure.

The Anglo-Australian company earned US$5.88 billion in the 12 months to June 30 down from US$15.39 billion a year earlier. Excluding charges, income fell 30%, to US$10.72 billion.

BHP Billiton

Net profit, in billions of U.S. dollars



Note: Fiscal years end June 30 of year shown
Source: the company

Revenue fell 16% US$50.21 billion.

Despite the industrywide drop in prices from last year, BHP reported a record US$18.9 billion in cash flow. The company said that has allowed it to build its portfolio and continue paying out a dividend while competitors have halted projects and cut payouts to shareholders.

The cash also positions BHP well for acquisitions. Mr. Kloppers said he expects that the industry's substantial consolidation over the last 10 to 15 years will continue because scale is increasingly important in the capital-intensive mining business.

Spot-market prices for aluminum, copper, nickel and, especially, iron ore have increased as demand has strengthened since the beginning of the year. For iron ore, the spot price has climbed to more than $100 a metric ton this month, a good sign that BHP will win a concession on contract prices from Chinese steelmakers this year. The negotiations between steelmakers and miners should have been settled by April.

Mr. Kloppers attributed the delay in part to difficulty in determining what the price might be in 12 months, in light of market volatility.

E.ON profit more than doubles

By Jan Hromadko

FRANKFURT—**E.ON** AG said its net profit more than doubled in the second quarter in part because of lower costs, as sales dropped 9.8%. The company added that full-year earnings wouldn't fall as much as anticipated.

Germany-based E.ON, one of Europe's largest energy companies, cited lower increases in interest and tax expenses as the main reasons for its slightly improved 2009 outlook. The company also said it is seeing the first signs that the demand slump caused by the recession is abating.

In a separate statement, the company confirmed it will sell its Thüga unit, a holding company that bundles stakes in about 100 municipal utilities, to a consortium of German municipal utilities for €2.9 billion ($4.1 billion). The transaction is expected to close in 2009, subject to antitrust approval.

E.ON reported net profit of €1.85 billion from €882 million a year earlier, mainly because of lower interest and tax expenses. The company said the earnings also were helped by favorable currency fluctuations, gains on derivative positions and divestments.

Improved results from newly acquired businesses in Italy, France, Spain and Russia, as well as higher profit from the company's renewable-energy unit, helped increase operating profit.

But the company's sales fell to €16.58 billion from €18.38 billion amid weaker demand.

Looking ahead, E.ON now expects 2009 after-tax profit adjusted for nonrecurring items to fall 5% and 10% from 2008, after previously forecasting a 10% drop.

"The figures look pretty good at first, but at second glance they're only in line with expectations," said Sal. Oppenheim analyst Stephan Wulf. E.ON recorded a "very strong trading result," he said, but cautioned that this performance might not be sustainable, given the volatile nature of that business.

"The slightly increased guidance for adjusted net income is nice, but given that it still aims for flat adjusted Ebit the improvement isn't likely to be based on operating factors," Mr. Wulf said.

E.On

Daily share price on the Frankfurt Stock Exchange

Wednesday's close: €27.19, up 5.3%

Source: Thomson Reuters Datastream

Wednesday, E.ON shares gained 5.1% to €27.31 in Frankfurt.

E.ON on Monday named Chief Operating Officer Johannes Teyssen to succeed Chief Executive Wulf Bernotat, effective May 1.

Framework set for VW-Porsche deal

By Dana Cimilluca

Porsche Automobil Holding SE and **Volkswagen** AG will take another step toward uniting Thursday, when they are expected to announce the framework of a deal that would raise much-needed cash for Porsche and ultimately fold it into VW, people familiar with the matter said.

The supervisory boards of the German auto makers are expected to vote Thursday morning on a so-called memorandum of understanding, which would be a precursor to a more detailed and firm merger agreement, one of the people said.

As part of the deal, a state-backed Qatari investment fund is expected to lend Porsche's holding company €250 million ($354 million), about a third of what it earlier had planned, one person said. Qatar also may buy a larger-than-expected 10% stake in Porsche's holding company, which has a market value of €7.7 billion, this person said.

Porsche was forced into VW's arms when its bold attempt to buy its much larger rival backfired. Porsche had bought a roughly 50% stake in VW, Europe's largest car maker, and secured options on another 20%. But the roughly €10 billion in debt it accumulated in the process ultimately proved too much to bear.

Amid slumping auto demand, Porsche is trying to raise funds to pay off the debt, which is set to cost the storied company its independence.

As part of the complicated deal, which would ultimately merge both the Porsche holding company and its auto unit into VW, Porsche and VW likely will raise fresh capital, one of the people said. It is unclear how big the capital increases will be, but late last month Porsche said it could sell new shares worth roughly €5 billion.

To maintain their stake in the sports car maker, the Porsche and Piech families plan to sell an auto distribution business in Austria to VW for more than €3 billion, one of the people said. Qatar also is expected to buy a 17% stake in VW through the options Porsche accumulated, which are valued at as much as €5 billion.

Spokespeople for Porsche, VW and Qatar couldn't be reached.

Bloomberg News

Cemex loaded up with debt to buy Australia's Rinker Group, which owned the plant shown here in 2007. The borrowing has since strained Cemex's finances.

Cemex wins bank accord to ease short-term debt

By Anthony Harrup

MEXICO CITY—Cement and building-materials conglomerate **Cemex** SAB cleared a major hurdle this week in its efforts to refinance close to $15 billion in short-term debt, a move that gives the global giant a lifeline to get its finances in order.

The news comes as a major relief for the Monterrey, Mexico-based company, which in the past year has suffered a drop in earnings, saw its investment-grade rating vanish, and laid off more than 10% of its work force. The damage flowed not only from the world-wide economic downturn, but also an ill-timed acquisition that expanded its exposure to the U.S. housing market just before the crash.

Cemex officials reached an agreement with a group of creditor banks that includes New York-based **Citigroup** Inc., **Banco Bilbao Vizcaya Argentaria** SA and **Banco Santander** SA of Spain, and the U.K.'s **HSBC Holdings** PLC and **Royal Bank of Scotland Group** PLC.

In broad terms, the agreement will extend through 2014 the maturities on debt that is currently scheduled to come due in 2009 through 2011. The deal will call for periodic payments of principal before 2014 and is also widely expected to require the company to issue new equity.

The company said in a news release it will give details of the terms once documentation is completed and the refinancing takes effect. Cemex officials declined to comment for this article.

The onset of the global economic crisis and the U.S. housing market slump hit Cemex hard. In 2007, the company borrowed heavily to finance the $15.5 billion acquisition of Australia's Rinker Group Ltd., a building-materials company with heavy exposure to U.S. markets.

The plan was to pay off the borrowings quickly, but the sudden drop in construction activity around the globe left Cemex with a large debt burden and significantly reduced earnings, raising the prospect of insolvency for one of the world's largest players in building materials.

Cemex managed to refinance $4 billion in short-term bank debt in January, as the worsening global economic situation crimped its cash flow. The company then tried to sell $500 million in bonds in March, but canceled those plans after balking at the high yields demanded by investors.

Cemex then went back to its banks to negotiate a more ambitious debt rescheduling—talks that culminated in this week's agreement.

The refinancing removes the risk of a near-term insolvency, but with net debt of $18.3 billion and operating cash flow expected to fall this year to $3.1 billion from $4.3 billion in 2008, Cemex still faces a rocky road ahead.

The company has agreed to sell its Australian operations to Switzerland's **Holcim** Ltd. for $1.62 billion. The proceeds, along with expected free cash flow, should cover 80% of the payments on principal the company has to make through mid-2011. Nonetheless, Cemex hasn't ruled out the need for additional refinancing in the next few years.

Investors' relief that the debt burden had been addressed was tempered by concerns that the new debt and equity issue would prove costly for shareholders.

Covenants on the rescheduled debt will limit the company's ability to invest or make acquisitions.

For a company that in two decades grew from a regional cement producer into one of the global industry's leaders with operations in more than 50 countries, the new restrictions could make life relatively dull for the next few years as Cemex works to lower its debt.

In April, Chief Executive Lorenzo Zambrano, commenting on the ill-timed Rinker purchase, said the crisis wouldn't deter Cemex from again pursuing growth through acquisitions in the future. "Cemex isn't a static company," he said.

"Although Cemex bonds and hybrid notes have rallied significantly over the past several weeks, we believe the positive news flow is not entirely priced in yet and expect further upside in the near term," Barclays Capital debt analyst Christopher Buck said in a report.

The failed bond sale turned out to be a blessing in disguise, as bond debt can be much tougher to renegotiate, said James Harper, director of corporate research at Connecticut-based BCP Securities. "It's much more complicated to restructure capital markets debt," he said. "It takes longer, and who knows if you will succeed."

The refinancing removes the risk of a near-term insolvency, but then shareholders will start to calculate the cost, said Carlos Hermosillo, an analyst at the Vector brokerage in Mexico City.

CORPORATE NEWS

Russia adopts 'clunkers' incentive

Rebate for old autos covers foreign brands produced in country

By Will Bland and Steve McGrath

Russian lawmakers plan to support the country's domestic-car industry with a trade-in program similar to the "cash for clunkers" plans that have lifted auto sales in Europe and the U.S.

The Trade and Industry Ministry hopes to sway prospective car buyers by offering a 50,000 ruble ($1,550) rebate toward a new car when they hand in old vehicles to be scrapped, a spokeswoman for the ministry said. The program is expected to be launched early next year, she said.

To qualify for scrapping, cars must be more than 10 years old, and the rebate can be spent only on Russian-made cars. That would include cars made by companies such as **Ford Motor** Co., **Renault** SA, **General Motors** Co., **Volkswagen** AG and **Nissan Motor** Co., all of which have factories in Russia.

Meanwhile, Ford's European division called for European governments to extend their scrapping incentives, as it reported a 5% rise in sales in its major European markets and boosted its market share in July, largely because of the programs.

These scrapping deals benefit manufacturers of small cars because to get the discount, consumers must buy cars with low carbon-dioxide emissions. Ford has been a big beneficiary because its subcompact Fiesta and Ka models meet the criteria. However, most European governments have set a budget for the programs, and they are set to end when the money runs out.

The company warned that industrywide sales in Europe, the world's second-largest auto market after the U.S., could fall by as many as 2 million new vehicles in 2010 if the programs are cut off at the end of this year, Ingvar Sviggum, Ford of Europe's vice president, marketing, sales and service, said in a conference call with reporters.

Ford, including the Swedish Volvo brand, is the third-biggest seller of cars in Europe, behind Germany's Volkswagen and France's **PSA Peugeot-Citroën** SA. Ford's strength in Europe contrasts with that of U.S. rival GM, which has seen sales of its unprofitable Opel brand shrink.

Despite the scrapping programs, industry executives remain cautious, predicting the downturn will last through at least next year. One of the biggest struggles is in Russia, where the drop in oil prices has pushed the economy into a deep recession.

Russia's economy has contracted sharply since last summer, discouraging would-be car buyers and pushing the country off its course to become the biggest auto market in Europe. It finished 2008 as the Continent's second-biggest market, after Germany.

Car makers that import vehicles into Russia, such as Italy's **Fiat** SpA, have experienced sharper drops in sales, but the slump in demand has put a particular strain on the country's biggest car maker, OAO **AvtoVAZ**, which has idled production lines, jeopardizing around 25,000 jobs.

Car sales in Germany, France, Italy and Spain have grown recently in response to incentives programs. Politicians in these countries have stressed environmental benefits from replacing older vehicles with more energy-efficient modern models. In Russia, the program may not be as strict on fuel-efficiency standards for the new cars.

"It will be harder to implement this type of scheme in Russia," said Ivan Bonchev, the head of Ernst & Young's automotive unit in Russia. The car-scrapping industry isn't regulated, and the design of some older Russian cars means that they are hard to process as scrap, he said.

The head of Ford in Russia, Nigel Brackenbury, welcomed the plan, but said that it "should include imported vehicles in order to have the maximum effect."

—Jeff Bennett and David Pearson contributed to this article.

Kia profit rises as incentives help boost sales

By Kyong-Ae Choi

SEOUL—**Kia Motors** Corp. said second-quarter net profit soared amid a weaker won and a domestic sales boost from tax incentives and new models.

The South Korean car maker, a 39%-owned affiliate of **Hyundai Motor** Co., said net profit for the three months ended June 30 soared to 347.09 billion won ($279.2 million) from 85.96 billion won a year earlier. Operating profit nearly tripled to 330.32 billion won from 116.96 billion won, while sales rose 12% to 4.676 trillion won.

The dollar's 23% rise against the won in the second quarter helped offset lower demand from overseas markets and a drop in the value of Kia's exports as it shipped more small and midsize models, the company said.

Associated Press

New models contributed to Kia's second-quarter earnings gain.

Analysts said the launch of new models in overseas markets and lower overseas inventories will likely help Kia report stronger results in the second half.

Kia has launched the Forte sedan in the U.S. and China, and will introduce the Sorento R sport-utility vehicle in Europe in the second half, with its overseas inventories down to 3.7 months now from five months at the end of 2008, said Suh Sung-moon at Korea Investment & Securities.

Partial strikes by Kia workers remain a concern, he said. Kia's union, which doesn't have an agreement with the company, has staged several partial strikes and one general strike since June 29, and it plans to stage a daily eight-hour strike, which began Tuesday, until Aug. 31.

Kia said it will try to reach an agreement with the union as quickly as possible to prop up sales. Unionized workers are demanding an increase of 87,709 won in basic monthly pay.

The auto maker said Wednesday that the planned strikes may cause 650 billion won in production losses and lead the company to fall short of its aim to raise its domestic market share to 35% from 31%.

The company, which sold a total of 791,107 vehicles in the January-July period, aims to sell 1.49 million vehicles this year, Kia Chief Financial Officer Lee Jae-rok said during an investor-relations session after the announcement of second-quarter earnings. The new target is up 6.4% from the 1.4 million vehicles that Kia sold globally last year.

To meet the rapid recovery in local demand, Mr. Lee said Kia aims to move up the start of production at its Georgia plant in the U.S. The plant, which was originally scheduled to kick off in January 2010, has capacity to manufacture 300,000 vehicles a year.

Continental AG's CEO quits, ending power struggle

By William Launder

FRANKFURT—The chief executive of German automotive supplier **Continental** AG, Karl-Thomas Neumann, stepped down Wednesday, concluding a months-long power struggle with the company's majority shareholder, **Schaeffler Group**, for control of its operations.

Continental said Elmar Degenhart, previously head of Schaeffler's auto unit, will succeed Mr. Neumann effective immediately. Mr. Degenhart also will head Continental's Powertrain division.

Herzogenaurach-based Schaeffler and Continental have been locked in a battle for control since the family-owned Schaeffler ran into financial difficulties following its takeover of the Hannover-based tire maker.

"Today's decisions clear the way for a trust-based collaboration between the two companies in the interest of their customers," said Jürgen Geissinger, Schaeffler's president and chief executive.

As part of the management shake-up, Rolf Koerfer said he would be willing to step down as chairman of Continental's supervisory board once a new chief financial officer has been chosen and other executive changes have been made. The previous finance chief, Alan Hippe, left the company earlier this year.

Continental said a search is under way for a new finance chief from outside both companies. It also appointed three of its executives to join its management board: Ralf Cramer, Helmut Matschi and Nikolai Setzer.

The changes point to a clash of interests on Continental's supervisory board, where Schaeffler exercises a stronger influence over the company.

Continental's deputy supervisory board chairman, Werner Bischoff, has previously said Mr. Neumann lost the support from the supervisory board's shareholder representatives, which are dominated by Schaeffler. Labor representatives, who comprise the other half of the board, have supported Mr. Neumann. They have criticized Mr. Koerfer, who they say is rarely independent and tends to represent the interests of Schaeffler.

Schaeffler said it remains on track with its preparations for a capital increase and its goal to become a global company with three main units.

Mr. Neumann will receive €7.4 million ($10.5 million) in severance payments, Mr. Bischoff said. A Continental spokesman wasn't immediately available with contact information for Mr. Neumann.

—Katharina Becker in Hannover and Nico Schmidt in Frankfurt contributed to this article.

Toyota to sell new Prius in China

By Norihiko Shirouzu

BEIJING—**Toyota Motor** Corp. plans to start selling its latest generation Prius cars in China next year, according to company executives, despite poor sales there of the current version.

The new version of Toyota's fuel-efficient vehicle could go on sale as early as March, the executives said, with a planned sales target of 3,000 new vehicles a year. The current Prius launched in China in late 2005.

Sales have been disappointing, however, partly because of the car's price tag of as high as 280,000 yuan, or nearly $41,000, due to taxes and duties on imported parts. In the U.S., the Prius generally sells for $22,000 to $27,000.

Toyota sold only 550 vehicles last year, down from less than 1,000 in 2007, according to the company.

GLOBAL BUSINESS BRIEFS

Escada AG

Bankruptcy protection filing expected as debt plan fails

Debt-laden German fashion company **Escada** AG said it will probably file for bankruptcy protection Thursday. The Munich-based company, once among the world's biggest fashion brands, had hoped to use a bond exchange to quickly reduce €100 million ($141.5 million) of the company's debt. The bond exchange, however, was approved by holders of just 46% of Escada shares, compared with 80% necessary to execute the swap. The swap was also necessary for a wider restructuring at the company. Escada, famous for women's apparel and accessories, operates 182 of its own shops and 225 franchise shops in some 60 countries employing about 2,300 people—600 of whom are in Germany. Shares in Escada closed down 55% Wednesday in Frankfurt.

Sara Lee Corp.

Sara Lee Corp. narrowed its fiscal fourth-quarter loss, but sales dropped in part because of currency-exchange fluctuations. The food maker issued a downbeat forecast for its current fiscal year, projecting earnings excluding divestiture gains of 84 cents to 90 cents a share on net sales of $12.9 billion to $13.2 billion. Sara Lee's loss narrowed to $14 million, or two cents a share, for the period ended June 27, from a loss of $672 million, or 95 cents a share, a year earlier. The latest quarter included a $207 million write-down on Sara Lee's Spanish bakery business. The prior year had $850 million in write-downs. Excluding items such as the write-downs, earnings were flat at 29 cents a share. Net sales fell 9.8% to $3.16 billion.

US Airways Group Inc.

US Airways Group Inc. and **Delta Air Lines** Inc. plan to swap 167 pairs of takeoff and landing slots at two of the nation's most congested airports, with each airline adding service to small U.S. cities. The move comes as U.S. airlines have cut capacity to cope with a decline in business as well as leisure travel. At the same time, airlines are coming under increasing scrutiny from U.S. regulators, especially at New York's LaGuardia Airport, where slots for each takeoff and landing are tightly controlled by the Federal Aviation Administration. The proposal would more than double Delta's nonstop flights at LaGuardia, adding 125 slots, essentially forming a hub for domestic flights.US Airways will get 42 pairs of slots at Ronald Reagan Washington National Airport now operated by Delta.

Babcock & Brown

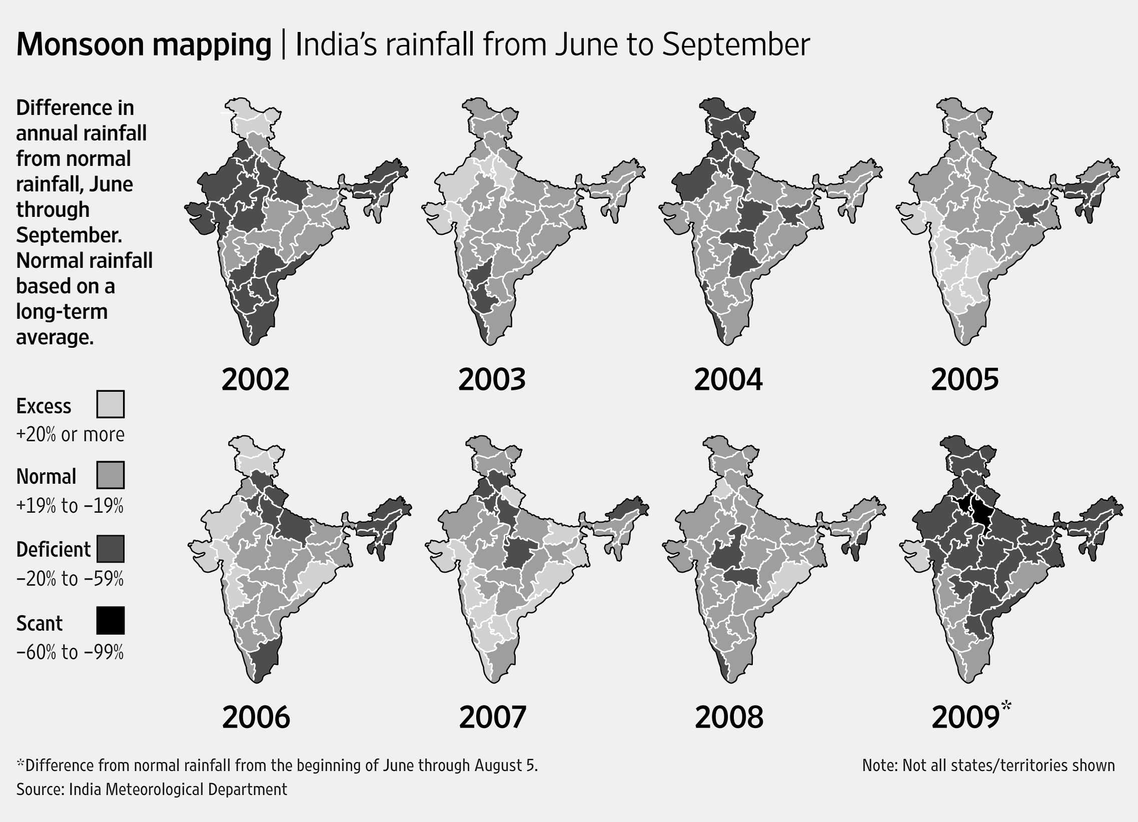
Global infrastructure owner **Babcock & Brown Infrastructure Group** said it expects to book an asset impairment charge of as much as 920 million Australian dollars (US$763 million) for the year ended June 30. The charge includes an estimated loss of €120 million (US$170 million) on last month's sale of a 40% sake in its Euroports business. BBI said the impact of global economic conditions across its portfolio of assets, particularly its Northern Hemisphere ports, was a key reason for the impairment charge.

—Compiled from staff and wire service reports.

India wants rain, and a decent forecast

In a dry monsoon, H.R. Hatwar aims to improve predictions that 600 million farmers rely on to plan their crops

By Sonya Misquitta
And Geeta Anand



PUNE, India—The India Meteorological Department has a spotty record in predicting the all-important monsoon rains. It is up to H.R. Hatwar, a slight, gray-haired man who sits behind a large desk with maps and charts scattered around his computer, to try to improve the forecasts that India's 600 million farmers rely on to plan their crops.

"No prediction is 100% accurate anywhere in the world," he says, promising the 130-year-old institution is "doing all it can to improve its overall forecast."

This year, the department predicted normal rainfall; it later adjusted expectations to below normal, and on Monday, more than halfway into a June-September monsoon season that has been so dry that five states have declared drought, India's official weather forecaster said it expected monsoon-season rainfall to be "deficient."

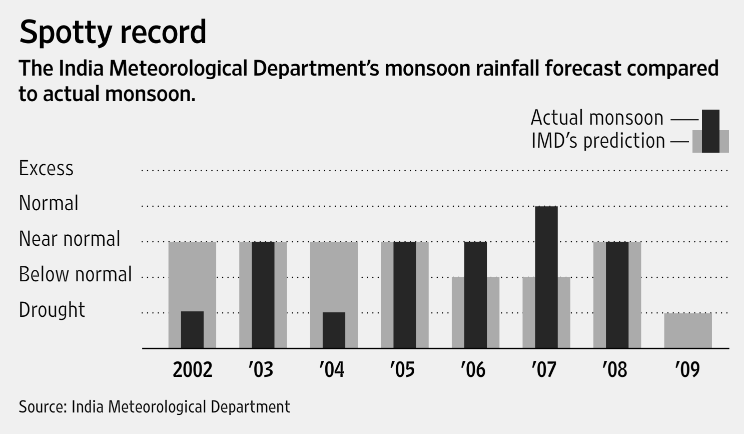
Peter Webster, a professor at the School of Earth and Atmospheric Sciences at Georgia Institute of Technology in Atlanta, says if India drops its focus on the monsoon's arrival date and the average national rainfall and puts its efforts into 20-day forecasts that show regional rainfall, it would give farmers the time they need to decide what crops to sow, and when.

In India, it's up to the state or central governments to declare a drought, because it entails contingency planning and relief aid. Mr. Webster says India's national drought declaration in 2002 could have been prevented had the department provided timely 20-day forecasts. "If they had planted in the active period their plants would have survived," he says.

Mr. Hatwar says he is developing 20-day forecasts and hopes to begin issuing them in a year or two. Such extended-range forecasts require advanced computing power that the department is only beginning to put in place, he says. For now, it relies on insufficient data and outdated equipment that requires measurements be taken manually.

It's hard to overstate the importance of the monsoon to India and the national obsession about exactly when it will make landfall (always in the southern state of Kerala, almost always in early June). Agriculture makes up nearly 18% of national gross domestic product, according to Morgan Stanley. Most farmers, without the benefit of irrigation, have just the annual June-to-September rains to water their fields.

A weak rainfall can hurt crop output, drinking-water supply, power generation and consumer demand—and add another obstacle to government efforts to improve the rural economy as a key to sustained GDP growth.



Citigroup economist Rohini Malkani estimates that an insufficient monsoon could shave close to two percentage points off annual growth. Almost 80% of the country is under the threat of drought, Agriculture Minister Sharad Pawar said this week.

Finance Minister Pranab Mukherjee said Tuesday he's still optimistic the economy can grow at the earlier estimate of over 6% in the fiscal year ending March 2010. "There is no point in pressing the panic button. This country has the capability of handling a drought situation," he said.

India's Ministry of Earth Sciences recently approved $620 million to be spent over five years to modernize weather technology. Mr. Hatwar says his department plans to set up 1,000 automatic weather stations—there are now 125. He says it will also have another 2,000 stations to measure precipitation. The new devices, which relay data by satellite, will let him make better predictions, he says.

Mr. Webster of Georgia Tech says the department will have to change its statistical model, too, complaining it has used the same one more than 50 years. "The basic problem of the India Meteorological Department is that they are mired in the past," he says. Mr. Hatwar defends his model, noting that it has accurately gauged the country's average rainfall for most years.

The British set up the department in 1875. In the early days, it gathered measurements of rainfall and temperature by telegram, the same way it sent flood and drought warnings. Now information is relayed via satellite, and forecasts are delivered by radio and television.

A mathematician by training, Mr. Hatwar, 59 years old, stumbled into meteorology by accident. In 1972, he gave a paper on fluid mechanics at the prestigious Indian Institute of Science in Bangalore. His impressed mentor suggested he enroll in the institute's doctoral program, after which he joined the Meteorology Department in 1977.

Back then, he pored over weather charts made by hand from data received from Russian satellites. Today, Mr. Hatwar studies computer-generated charts and satellite images of the monsoon's progression. "A lot of progress has been made," he says.

Outcry amid Taiwan rescue effort

By Ting-I Tsai

TAIPEI—Public criticism mounted over the Taiwan government's emergency response and release of information on casualties resulting from Typhoon Morakot, as officials more than doubled the death toll and the rescue effort in a devastated village continued.

The official death toll was raised to 103, with 61 missing, but the tally didn't include the residents around the village of Shiao Lin, which was largely buried by mudslides. Rescuers struggled through poor weather to search for what officials said were 100 people still unaccounted for and feared buried by the mud.

Military personnel and relief workers were slowed by rain and poor visibility as they moved to evacuate about 700 survivors found in the area as of Tuesday night. A military helicopter airlift operation was slowed and the area continued to be difficult to reach by land.

Family members and Taiwanese media cast a critical eye on the government's response, focusing on President Ma Ying-jeou. "The rescue has been too slow. The government rescue team doesn't seem to be well coordinated. It doesn't look like we have enough resources, either," said Chang Hsiu-yu, a Taipei resident whose relatives have been trapped in a village next to Shiao Lin.

Critics focused on the Ma administration's decision to refrain from issuing an emergency order that would give the government greater power to requisition personnel and equipment. The government has also declined to ask for assistance from international organizations.

The government said both steps were unnecessary. Presidential spokesman Wang Yu-chi said legal changes made after a 1999 earthquake gave the administration enough power and flexibility to deal with the catastrophe. "The rescue needs to be improved, but we don't think issuing an emergency order would help," he said.

Lee Yuan-yi, deputy director-general of the Fire Bureau of Kaohsiung county, where the hardest-hit villages are located, said weather and unstable ground, not a lack of resources or personnel, have hampered the rescue efforts.

Bloggers have initiated a campaign to plead for help from international rescue organizations.

Chou Chong-mei, a social worker from a village near Shiao Lin, said she still hasn't heard of anything about her friends. "The rescue is challenging, but it could have been better organized. I don't know why they can't offer the list of 700 people found alive first," Ms. Chou said. The county government said it only had the names of those who had been evacuated.

Enterprises, business groups, and charities have announced donations for the relief of the victims, and Taiwan High Speed Rail Corp. has offered free seats for rescuers to travel to southern Taiwan. According to the Ministry of Foreign Affairs, the international community has also expressed condolences and donated money. The U.S. government said Wednesday it will donate $250,000 to the Taiwan Red Cross.


Reuters

A handout photo from the Taiwan Military News Agency shows soldiers cleaning up mud following Typhoon Morakot, in central Taiwan on Wednesday.

Taiwan's media has been filled with images of worried families confronting President Ma when he visited the region to monitor relief efforts. Mr. Ma offered what many viewers saw as perfunctory answers to family members who complained that the relief effort wasn't adequate and that Mr. Ma's bodyguards kept them from getting closer to him to state their complaints.

—Charmian Kok contributed to this article.

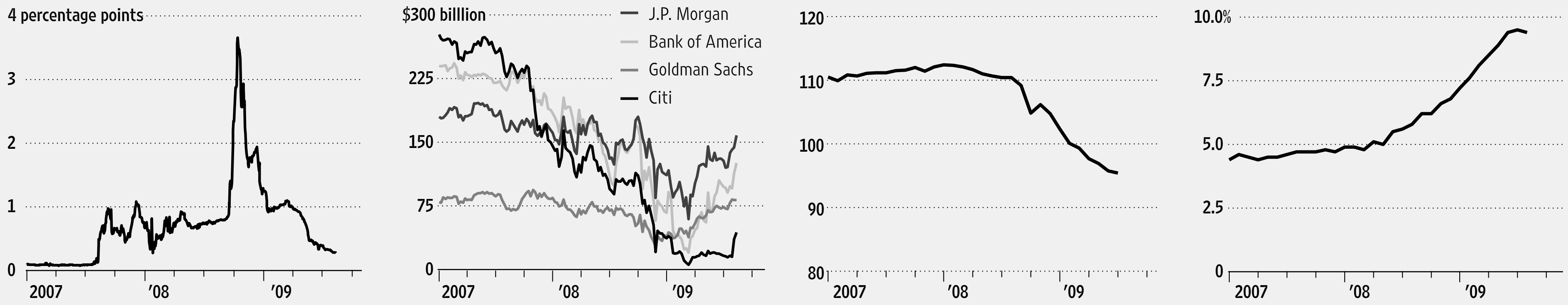
Taking the temperature | Two years of financial and economic crisis in the U.S.

The credit markets are healing... The gap between interbank loan rates and the expected average federal-funds rate over the next three months has narrowed*

But the banks rebound is uneven... Market capitalization; weekly data

Industrial production hasn't turned up... Index of industrial production

And unemployment is likely to rise Civilian unemployment rate, 16 years and older



*Spread between three-month London interbank offered rate (Libor) and the overnight index swap rate

Sources: Thomson Reuters (spread); WSJ Market Data Group (bank market values); Federal Reserve (industrial production); Labor Department (unemployment rate)

U.S. economy is better, but not healthy yet

Housing prices, Fed's exit strategy remain as worries

BY DAVID WESSEL

CAPITAL

It was two years ago, in August 2007, when it became evident that the housing virus was passing into the banking system. A couple of Bear Stearns hedge funds were liquidated. BNP Paribas suspended withdrawals from funds that had invested in U.S. subprime mortgages. Then banks suddenly began to be reluctant to lend even to each other. The European Central Bank administered $131 billion in emergency first aid in a single day, Aug. 9, 2007. The U.S. Federal Reserve followed, more cautiously.

A full year later, the patient didn't seem to be in all that much danger. At the August 2008 Fed conclave at Jackson Hole, Wyo., Stanley Fischer, the prominent economist and Israeli central banker, marveled that despite the "worst financial crisis since World War II, the real economy in the United States is still growing, albeit at a slower pace."

Then, the patient took a turn for the worse. In the fall of 2008, the financial system came terrifyingly close to cataclysmic collapse. The Fed rushed to the rescue, but the worst downturn since the Great Depression ensued nonetheless.

Today, under Dr. Ben Bernanke's care, the patient has moved out of intensive care. The crisis is talked about in past tense. The risks of Depression 2.0, as the Fed chairman puts it, have faded. Credit markets, the circulatory system of a modern economy, are healing. The U.S. economy is on the verge of growing: 27 of 47 economists surveyed by The Wall Street Journal this week say the recession has ended. The stock market is rising, betting on better times ahead. Economic forecasters are upgrading their outlooks for the second half of the year. One could almost hear a sigh of relief coming from the Fed's headquarters Wednesday as officials ended their meeting with a declaration that "economic activity is leveling out."

Don't get carried away. The patient may be out of danger, but he isn't healthy yet. Unemployment in the U.S. remains at an uncomfortably high 9.4%. The best bet is that the economy will grow so slowly that unemployment won't come down for a year or more. Business executives and consumers remain understandably cautious. A whiff of bad news could prompt them to curtail spending.

As economists Kenneth Rogoff and Carmen Reinhart document in their forthcoming book on financial crises of the past, "This Time is Different: Eight Centuries of Financial Folly," recovery from a recession provoked by financial crisis is painfully slow. On average, unemployment rises for nearly five years. That would mean another 2½ years of rising unemployment in the U.S.

So two years after this crisis began, Ben Bernanke still has a worry list. Here are three items on it.

■ Housing prices. They may be stabilizing, but if they fall further they will retard the recovery. Optimists look at inventories, see a traditional business cycle and predict business will begin investing and hiring. Pessimists look at balance sheets, debt burdens and asset prices, and remain worried.

The stock market is up, and that's a plus for household wealth. But housing prices, though showing signs of stabilization in some place, may keep falling. Zillow.com, the residential real estate Web site, says one-quarter of mortgage holders owe more than the value of their homes, and estimate that will rise to 30% by mid-2010. More pessimistically, Deutsche Bank predicts that 48% of mortgage holders could find themselves under water by early 2011.

Falling home prices depress consumer spending, of course. But that's not all. Homeowners who are under water are more likely to default on mortgages. That means more foreclosures in the months ahead even if official arbiters eventually declare that the recession ended this summer.

■ The timing of the Fed's exit strategy. The central bank must carefully plan the moment when it withdraws the credit medicine and lets the private-sector economy-the heart and lungs of any capitalist economy-take over. Move too soon, and the economy will falter, perhaps even relapse. Wait too long, and the fever of inflation results.

Getting this right will require substantial skill at reading the economy's health. It also will require political courage. To avoid inflation, the Fed must drain credit and raise rates before the economy is back to normal. Congress won't be happy.

"The Congress has almost never been favorably disposed towards a tightening of monetary policy," says former Fed chief Alan Greenspan. "We do not recall the Fed ever receiving a letter from the Congress, imploring them to raise rates. Letters pressing for lower rates are too numerous to mention."

■ Lack of a plan to prevent further crises. The president has offered one, but Congress isn't moving quickly to adopt it or an alternative. The crisis exposed the inadequacy of the tools the Fed and the Treasury have to cope with the collapse of a big financial firm that isn't a bank, such as Bear Stearns, Lehman Brothers and American International Group. As panic fades, the sense of urgency in Congress is abating. That leaves the U.S. economy unnecessarily vulnerable—and that may be Mr. Bernanke's biggest worry.

Write to me at capital@wsj.com. Discuss at wsj.com/capital

Fed holds interest rates near zero

BY MAYA JACKSON RANDALL AND BRIAN BLACKSTONE

WASHINGTON—U.S. Federal Reserve officials on Wednesday left official interest rates near zero but suggested that the economy is on more stable ground, further signs that the severe recession is either already over or will be very soon.

Still, officials said they would slow their plans to buy as much as $300 billion of Treasury securities in order to provide a smooth transition in those markets. The rescue program was widely expected to expire in September. Now, the Fed plans to continue purchases through October.

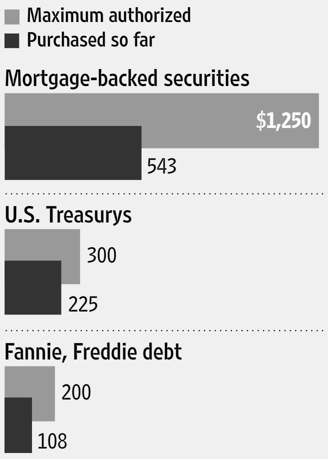
"The committee has decided to gradually slow the pace of these transactions and anticipates that the full amount will be purchased by the end of October," officials said in a statement.

In another sign that the central bank's policy-making committee remains skeptical about the strength of the recovery, Fed officials gave no indication that they are contemplating rate increases.

The Federal Open Market Committee voted 10-0 to maintain the target federal-funds rate for interbank lending at a record-low range of zero to 0.25%. The panel also reiterated its commitment to keeping rates low for some time.

Shopping list

U.S. Federal Reserve's securities purchases so far, in billions



Note: figures as of Aug. 5
Source: Federal Reserve

The committee "continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period," officials said in the statement they released at the conclusion of their two-day meeting.

They added that economic activity is "likely to remain weak for some time." At the same time, officials tweaked their statement to acknowledge that economic data have been more upbeat. Information "suggests that economic activity is leveling out," they said.

Since the previous Fed committee meeting, the housing market has shown some signs of stabilization, and there have been slow but steady improvements in manufacturing. All of this suggests that a recovery from the worst financial crisis since the 1930s is under way.

Additionally, the Commerce Department recently reported that economic activity fell 1% in the second quarter, good news given that the decline was much smaller than the contraction over the previous nine months.

U.S. trade deficit grew in June on rising oil prices

BY NICHOLAS CASEY

The U.S. trade deficit widened in June, forced up by higher oil prices, as growth in both imports and exports signaled renewed life in global trade.

Total June exports rose 1.9% to $125.78 billion, with imports increasing 2.3% to $152.79 billion. That resulted in a trade deficit of $27.01 billion, up 4% from a slightly revised $25.97 billion in May, the Commerce Department reported Wednesday.

The deficit was largely due to energy prices, which have been on the rise again this summer. Adjusted for inflation, the trade deficit narrowed to its lowest level in 10 years.

"What we're having is a leveling out right now," said Joshua Shapiro, an economist with Maria Fiorini Ramirez Inc., an economic consulting firm. "The evidence is that we're in the stabilization phase."

U.S. energy-related imports rose to $22.4 billion from $17.70 billion in May, heavily influenced by a $7.96 spike in the price of a barrel of crude oil. But the figure also reflected increased energy consumption by American consumers; roughly 20 million more barrels of crude oil were imported in June than the month before.

Export gains included industrial supplies and materials, which were up $1.2 billion; capital goods, which rose roughly $400 million; and foods and beverages, which rose $250 million. Exports of consumer products were largely flat.

The trade figures indicate that the roughest parts of the recession may be past, as American consumers ratcheted up some purchases, and demand in other countries for U.S.-made goods was on the rise. "This would be consistent with the economy growing," said Nigel Gault, an economist with IHS Global Insight.

Exports have grown for two straight months since hitting a low point in April.

—Tom Barkley contributed to this article.