Fashion: The fall of Christian Lacroix

THE WALL STREET JOURNAL.

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■ **British Airways posted** its first ever first-quarter pretax loss as a private airline, but its CEO said traffic may improve slightly this month. Page 5

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■ **Nigerian authorities** ignored warnings about a violent Islamist sect until attacks last week that killed over 700 people, Muslim clerics said.

■ **Troops patrolled** the Pakistani city of Gorja after eight Christians died in riots led by Muslims, police said.

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■ **Died: Corazon Aquino,** 76, former president of the Philippines, of cancer, in Manila.

EDITORIAL&OPINION

Death of a democrat

Cory Aquino inspired people from South Korea to Eastern Europe. Page 13

Breaking news at europe.WSJ.com

Associated Press

Soldiers carry the coffin of Spc. Alexander Miller on Sunday during a casualty-return ceremony at Dover Air Force Base in Delaware. The Department of Defense said Spc. Miller, of Clermont, Fla., died during Operation Enduring Freedom in Afghanistan.

Afghan insurgents strike

Weekend attacks kill nine foreign soldiers in wake of war's bloodiest month

By Matthew Rosenberg

KABUL, Afghanistan—Afghan insurgents killed nine foreign soldiers—six of them Americans—on Saturday and Sunday, in one of the deadliest weekends in Afghanistan for the U.S. and its allies since the fall of the Taliban in 2001.

The bloody opening to August came after the most lethal month for the coalition in the nearly eight-year Afghanistan campaign. In July, 75 foreign troops were killed, more than 40 of them Americans.

U.S., Afghan and allied officials say the spike in deaths is the result of two colliding factors: a big infusion of U.S. soldiers and Marines, thousands of whom are now pressing deep into Taliban strongholds in the country's south; and a push by insurgents to violently intimidate as many ordinary Afghans as they can ahead of presidential elections scheduled for Aug. 20.

"The Taliban and other enemies of Afghanistan are fighting hard to maintain their access to the people," said Lt. Cmdr. Christine Sidenstricker, a U.S. military spokeswoman. "We have a lot of operations that are disrupting their ability to control the local population and conduct narcotics operations," which are a major source of funding for the insurgency.

More operations, she said, "unfortunately sometimes translates into an increase in casualties."

The number of U.S. soldiers and Marines in Afghanistan has more than doubled in the past year to 62,000;

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U.K. eyes complex assets in probe

By Dominic Elliott And Matt Turner

LONDON—The U.K.'s Serious Fraud Office is investigating sales of structured products such as credit-default swaps and collateralized debt obligations, amid concern that some bankers may have knowingly sold complex assets based on flawed valuations before the global financial crisis struck two years ago.

"Some of them are incredibly complicated and they are sold by very, very clever people," Richard Alderman, the director of the Serious Fraud Office, said. "The question is not just were they mis-sold, because that gives rise to a number of regulatory issues, but was there actually fraud. Or in other words, did those selling them actually know they weren't worth what the institution said they were?"

Credit-default swaps are insurance-like contracts designed to protect investors against losses on bonds or loans, though in recent years they have been used more often to speculate on the health of companies or countries. CDOs are packages of different slices of debt that are given a single credit rating, enabling them to be traded.

The U.K. probe is the latest sign that policy makers and regulators on both sides of the Atlantic are scrutinizing structured products,

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Spying affair widens at Deutsche Bank

By David Crawford And Matthew Karnitschnig

BERLIN—A detective at the center of the Deutsche Bank spying affair says the bank's effort to monitor its critics was more extensive than previously disclosed in that it included a plan to target as many as 20 people, including a number of investors.

The detective's statements appear to contradict the bank's assertion that the spying affair was limited in scope. The affair first came to light in May when **Deutsche Bank** AG said it had discovered efforts involving "questionable investigative or surveillance activities" directed by its corporate security department and outside contractors. It has so far disclosed four separate incidents involving its agents between 2001 and 2007 in which the bank used the detective, Bernd Bühner, and others to monitor people affiliated with the bank.

Mr. Bühner, a contractor who played a key role in most of the operations under scrutiny, told The Wall Street Journal in an interview that he received a list of names in 2006 at a meeting with Deutsche Bank representatives that included members of the bank's legal department.

"They had the names ready. A paper with the list of names was prepared by the

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Inside

Heavy cost

A China killing reflects anger over corporate overhauls

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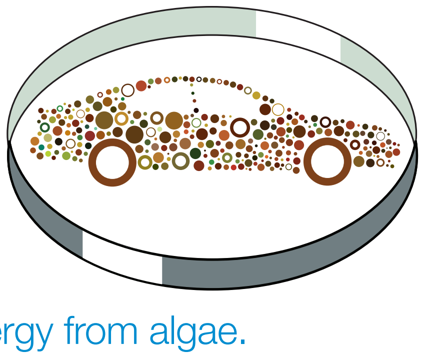
Markets

	CLOSE	PCT CHG
DJIA	9171.61	+0.19
Nasdaq	1978.50	-0.29
DJ Stoxx 600	224.91	-0.15
FTSE 100	4608.36	-0.50
DAX	5332.14	-0.53
CAC 40	3426.27	-0.27
Euro	$1.4176	+0.81
Nymex crude	$69.45	+3.75

– fuel for thought –



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LEADING THE NEWS

Criticism widens in Iran

Ahmadinejad rival urges punishment in protesters' killings

ASSOCIATED PRESS

TEHRAN, Iran—Criticism of Iran's mass prosecution of political activists widened Sunday with the main conservative challenger to President Mahmoud Ahmadinejad demanding that authorities also seek punishment for those accused of killing protesters.

The sharp rebuke by Mohsen Rezaei—on the eve of Mr. Ahmadinejad's scheduled inauguration for a second term—also showed the broad scope of opposition to the crackdowns after the disputed June 12 elections.

Conservatives such as Mr. Rezaei have increasingly joined ranks with liberal factions to denounce the harsh tactics by Iran's leadership including sweeping arrests, media blackouts and attacks blamed for at least 30 deaths.

But Mr. Rezaei brings added weight as a former commander of the powerful Revolutionary Guard, which has led the backlash against groups claiming widespread fraud and paved the way for Mr. Ahmadinejad's re-election.

In a letter to the head of Iran's judiciary, which is directly controlled by the ruling clerics, Mr. Rezaei said trials must be held for anyone linked to deadly attacks on the streets or torture of detainees. Among the dead is the son of one of Mr. Rezaei's top aides. "Otherwise, justice will not be realized, and it is possible that unrest will not end," Mr. Rezaei said, according to a report posted on his Web site.

The turmoil has complicated U.S. President Barack Obama's efforts to step up diplomatic engagement with Iran. The relationship became even trickier Saturday as Iranian state TV confirmed that Iran has detained three Americans who allegedly crossed the border from northern Iraq a day earlier.

Kurdish officials said the two men and a woman were tourists who had mistakenly crossed into Iranian territory Friday while hiking in a mountainous area near the resort town of Ahmed Awaa. One of the Americans was identified as Joshua Fattal, according to Kurdish officials and a statement from his family in Elkins Park, Pa. "This case will be reviewed based on its natural trend," Iran's official IRNA news agency quoted the head of the parliament's foreign-policy committee, Alaeddin Boroujerdi, as saying Sunday.

The Swiss Embassy in Tehran is working to learn more about the Americans' fate through its contacts with the Iranian Foreign Ministry, Swiss Foreign Ministry spokeswoman Nadine Olivieri said. Switzerland has represented U.S. interests in Iran since American diplomats were taken hostage at the embassy in Tehran 30 years ago, and the U.S. State Department asked the country to intervene in this case.

The trials of political activists began Saturday in the Revolutionary Court system, first used to sentence officials of the Western-backed monarchy that was toppled by the 1979 Islamic Revolution.

The trials' more than 100 defendants spanned nearly a dozen years of efforts to challenge Iran's Islamic systems—from supporters of opposition leader Mir Hossein Mousavi to several top allies of former President Mohammad Khatami, who began the openings for greater political and social freedoms with his election in 1997.

The blanket trial on broad charges of trying to bring down the nation's political order appeared part of an attempt by authorities to rattle and discredit the core of the reform movement in one blow.

Officials say the opposition was a tool of foreign countries aiming to topple the Islamic state. State media quoted Mohammad Ali Abtahi, who served as Mr. Khatami's vice president, as "confessing" to working to foment unrest.

But rights groups have said such confessions are often obtained under duress in Iran. The trial was closed to all but Iran's state media.

Mr. Khatami called it a show trial to deflect attention from the "real crimes" carried out by authorities following the election. The former president, who held office from 1997 to 2005 and is Mr. Mousavi's close ally, criticized the court for not allowing defense lawyers access to the courtroom or the case files.

Mr. Mousavi, in a statement on a pro-reform Web site, also called the proceedings a "theater" and demanded trials against "inquisitor and tortures ... who have played with the life of the reputation" of the country. "What do they expect to convince people with?" the Web site reported Sunday. "A weak indictment based on confessions that share the tones of medieval torture."

The growing criticism came as Mr. Ahmadinejad prepared to officially begin his second four-year term. Iran's supreme leader, Ayatollah Ali Khamenei, is scheduled to officially endorse the president Monday, and he is set to be sworn in before parliament on Wednesday.

Reuters

Former Iranian Vice President Mohammad Ali Abtahi, dressed in a prison uniform, speaks at a tribunal session in Tehran on Saturday.

Germany company withdraws Iran letter

BY MATTHEW KARNITSCHNIG

Knauf Gips KG, a German building materials company that last week told its employees in Iran they would be fired if they participated in political demonstrations, withdrew the threat on Friday after The Wall Street Journal published an article about the policy.

"Without question, the formulation of the July 21, 2009 letter from Knauf Iran P.J.S.C. was unfortunate and needs to be corrected," Knauf Executive Board Chairman Manfred Grundke said in a statement.

The letter in question, written by Isabel Knauf, a member of the company's founding family who helps oversee its Iranian business, said: "If anybody from our company gets caught demonstrating against the current government, he or she will be immediately dismissed."

Mr. Grundke said in the statement that as a company, Knauf exercises restraint in political matters in the countries where it operates but that the policy doesn't extend to its employees' private activities.

"Naturally, our employees can participate in political demonstrations at any time without having to worry about work-related sanctions," he wrote.

The company, which employs a few hundred people in Iran, is still trying to clarify the details of why the letter was written, he said.

The Journal reported on Friday that Iran's government pressured Knauf to issue the order after a senior executive was arrested during prayer demonstrations two weeks ago.

The privately held company, which has 22,000 employees around the world, was told that such a letter would be a condition for the executive's release, according to people familiar with the matter.

The arrested executive, a 34-year-old dual national of Germany and Iran who heads Knauf's Iran operation, was released four days after the company agreed to issue the order but still faces trial.

The case drew wide attention in Germany, a country with a sizeable Iranian minority and longstanding ties with the country. Germany's Foreign Ministry reiterated on Friday that it opposes any retribution against protestors by companies in Iran.

Founded in 1932, Knauf, which has annual revenue of about 5.5 billion euros, is based in rural Bavaria and operates in more than 40 countries around the world.

In addition to drywall, the company makes fiber board and other building materials. Knauf's U.S. operation, located in Shelbyville, Indiana, makes building insulation.

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

China gains more ground in manufacturing

As U.S. lead shrinks, economists debate what should be done

By Timothy Aeppel

China is on its way to surpassing the U.S. as the world's largest manufacturer far sooner than expected. The question is, Does that matter?

In terms of actual size, the answer is, no. But if size is a proxy for relative health of each nation's sector, the answer is, yes.

Anyone who walks the aisles of a U.S. retailer might think China already is the world's largest manufacturer. But, in fact, the U.S. retains that distinction by a wide margin. In 2007, the latest year for which data are available, the U.S. accounted for 20% of global manufacturing; China was 12%.

THE OUTLOOK

The gap, though, is closing rapidly. According to IHS/Global Insight, an economic-forecasting firm in Lexington, Mass., China will produce more in terms of real value-added by 2015. Using value-added as a measure avoids the problem of double-counting by tallying the value created at each step of an extended production process.

As recently as two years ago, Global Insight's estimate was that China would surpass the U.S. as the world's top manufacturer by 2020. Last year, it pulled the date forward to 2016 or 2017.

"The recent deep recession in U.S. manufacturing does mean that China's catch-up is occurring a few years earlier than would have been the case if there had been no recession," says Nariman Behravesh, the group's chief economist.

U.S. manufacturing is shrinking, shedding jobs and, in the wake of this deep recession, producing and exporting far fewer goods, while China's factories keep expanding. If manufacturers on both sides of the Pacific were thriving, there would be little reason to butt heads. But given the massive trade gap between the two nations and uncertainty in the U.S. over when and to what degree manufacturing will recover, China's ascent has become a point of growing friction.

Chinese manufacturing activity continued to tick up in July from the previous month, data from the China Federation of Logistics and Purchasing showed Saturday. The Purchasing Managers Index edged up to 53.3 in July, from 53.2 in June and 53.1 in May.

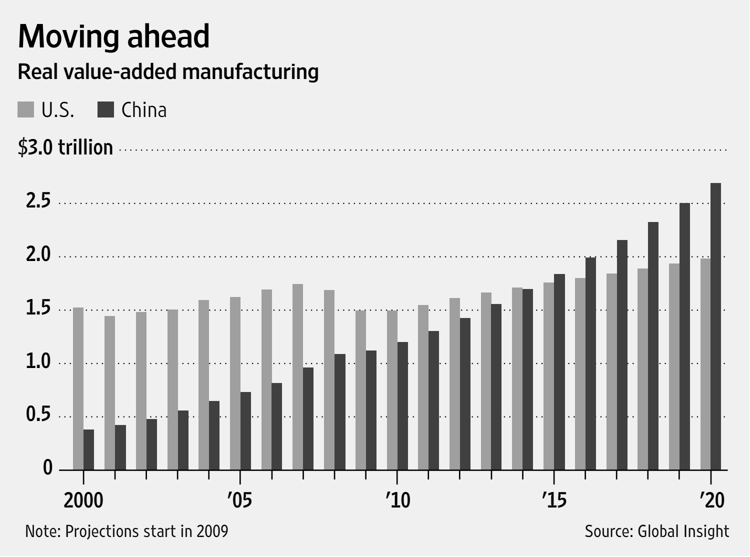
Many economists argue that the shrinking of U.S. manufacturing—both in terms of jobs and share of gross domestic product—is a normal economic evolution that started long before China emerged as a manufacturing powerhouse. From their point of view, the shrinking would happen regardless and is actually a sign of health that the sector doesn't need to be big to be productive and is shedding low-skill jobs and creating select higher-skill ones.

Global Insight's Mr. Behravesh is one of those who views China's rise as normal, even healthy. "In the natural course, countries go from agriculture to manufacturing to services," he says. "To subsidize manufacturing pushes [the U.S.] backwards down that curve."

But another school of thought—one known by the somewhat backhanded label of "manufacturing fundamentalists"—contends the U.S. decline isn't natural and must be reversed to retain America's economic power. From their perspective, that necessitates fighting Chinese policies that fuel low-cost exports, swamping a variety of industries from textiles to tires.

"The notion that we can be a nonmanufacturing society is folly," says Peter Morici, an economist at the University of Maryland. "It's pseudoscience that gives rise to the collapse of civilizations."

The Obama administration is stepping carefully through this minefield. At a two-day conference last week, the first meeting of a new forum designed to foster closer cooperation between the two countries, China's tightly managed currency policy was barely discussed even though it is a hot-button issue for many U.S.-based producers and organized labor. They argue that China undervalues its currency to gain a competitive advantage for its exports, which sell at a lower price in the U.S.



The U.S. Business and Industry Council, which represents U.S.-based manufacturers, accused the Obama administration of "panda-hugging." The administration earlier this year softened its stance on the issue when it declined to label China a currency manipulator.

John Engler, president of the National Association of Manufacturers, says he doesn't expect China to surpass the U.S. before 2020. "It may or may not continue to grow so rapidly," he says. "The importance of the China challenge to the U.S. depends on how we respond to it," such as implementing tax and investment policies that encourage domestic producers to expand.

Mr. Engler's group faces a delicate issue of its own regarding China: Many of its powerful members produce in China and are eager to avoid controversy on trade issues, while the group's large roster of smaller members are often outspoken critics of China.

Even in its weakened state, manufacturing remains a surprisingly large part of the U.S. economy. The sector generates more than 13% of the nation's GDP, making it a bigger contributor to the economy than retail trade, finance or the health-care industry. In China, manufacturing represents 34% of GDP.

Still, the concern remains that U.S. manufacturers now being hit by the economic downturn will never recover. J.B. Brown, president of **Bremen Castings** Inc., a family-owned foundry in Bremen, Ind., says the downturn has halted what had been a hopeful trend that emerged last year of work returning to the U.S. from China.

"I see a lot of people starting to look at going overseas again," he says, in part because costs are rising in the U.S. even in the depth of this recession. He notes, for instance, that Bremen's electricity rates jumped 17% this year—and the company has been warned they could increase even more next year. Foundries like Bremen use large amounts of electricity to heat metal.

China complains to WTO on trade barriers

By John W. Miller

BRUSSELS—China launched formal complaints at the World Trade Organization in a bid to take down trade barriers set up by the European Union and U.S., a sign Beijing is fighting more aggressively to keep foreign markets open for its exports.

The targets of its two complaints are high EU import tariffs on Chinese screws and a U.S. ban on the import of Chinese poultry. Beijing had already announced the suit against the U.S.

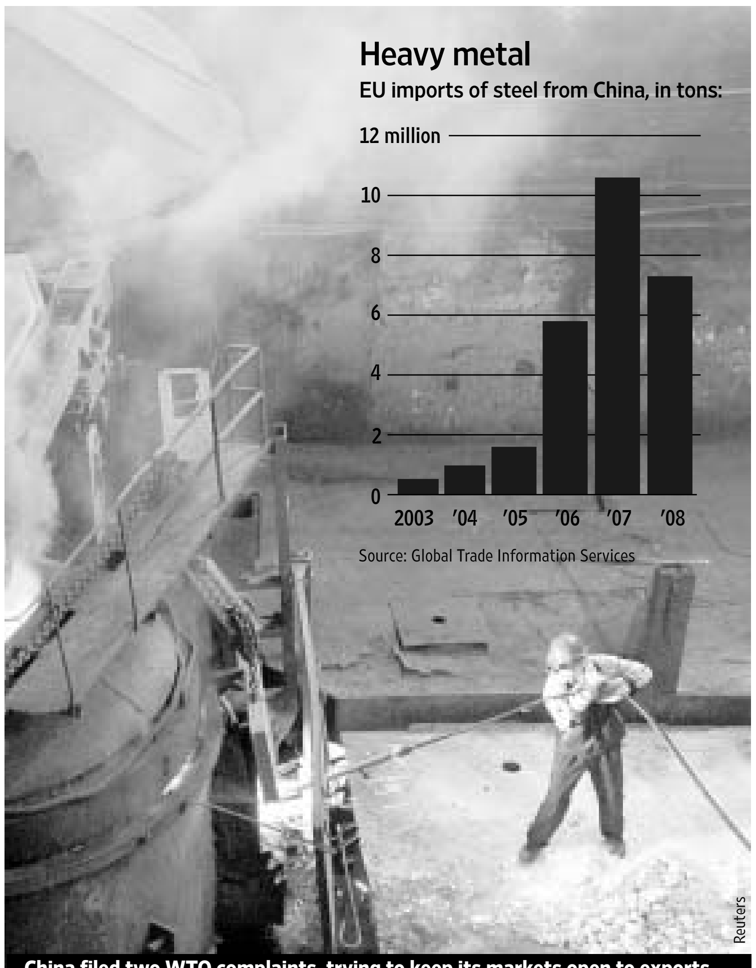
China insists it is countering protectionism and fears about job losses at home in a slumbering global economy. Brussels and Washington say the sanctions are justified by lax business and health rules in China. The EU and the U.S., the two biggest buyers of Chinese goods, combined had $610 billion of imports from China last year.

In both cases, the WTO could dismiss the complaints or give China the right to reduce imports by as much as it lost in trade by imposing higher import tariffs on some EU and U.S. goods by the end of 2010.

The two suits are signs of China's coming-of-age in global trade politics, say trade experts. When China joined the WTO in 2001, its exports took off so fast that minor impediments to trade weren't even noticed.

"It took them a few years to care about and understand the process," says Simon Lester, chief administrator at WorldTradeLaw.net LLC, a Washington-based consultancy.

At a multilateral trade summit in Geneva in July 2008, China played a leading role for the first time, says Mr. Lester. China has recently built a sparkling trade mission down the street from WTO headquarters in Geneva. It has started spending more money on legal advice, say lawyers for major trade-law firms.



China filed two WTO complaints, trying to keep its markets open to exports. Above, a laborer at a steel plant in Shenyang.

On Friday, Chinese trade officials accused the EU of failing to follow WTO procedure when it raised tariffs on the import of steel fasteners, the technical word for screws and similar parts, earlier this year.

The EU said Chinese companies were benefiting from tax breaks and bargain raw-material costs, then illegally "dumping," or selling below cost, fasteners on the EU market. Chinese prices were 30% to 50% lower, the EU said.

Under WTO law, if domestic companies are losing substantial sales, countries can fight dumping with increases in import tariffs. That is what the EU did in January, hitting Chinese fastener imports with duties of 26.5% to 85% for the next five years. Sales—almost a billion dollars a year—fell off dramatically.

The suit on Friday is the first time China has challenged a European antidumping duty at the WTO. Brussels has levied more than 140 antidumping duties against China since 1979. China filed a similar complaint against the U.S. last year over paper products.

China said it had tried to warn the EU. The government "and the industry on many occasions have expressed their positions and registered serious concerns with grave dissatisfaction, which however have not led to any solutions," the Chinese mission to the WTO said in a statement.

EU officials defended the duties. "Antidumping measures are not about protectionism, they are about unfair trade," said Lutz Guellner, a spokesman for the European Commission. "The EU's decision to impose measures was taken on the basis of clear evidence that unfair dumping of Chinese products has taken place with state distortion of raw material prices.'

China also petitioned the WTO to launch an investigation of a U.S. ban on chicken imports. Beijing had already announced its intention to launch the suit a month ago. The U.S. has banned the import of Chinese poultry products on health grounds since 2007.

In its suit, Beijing complained Washington was imposing "naked discriminative measures." U.S. officials say they are still studying whether Chinese chicken is safe to eat. China still imports U.S. poultry, mostly feet and other products.

Sports

Hum in the scrum

South Africa's rugby players maul their way to the top > **Page 30**

LEADING THE NEWS

U.S. 'cash for clunkers' low on funding

Program set to end Tuesday unless Senate passes $2 billion extension; consumers jump at deal to trade in autos

By Corey Boles

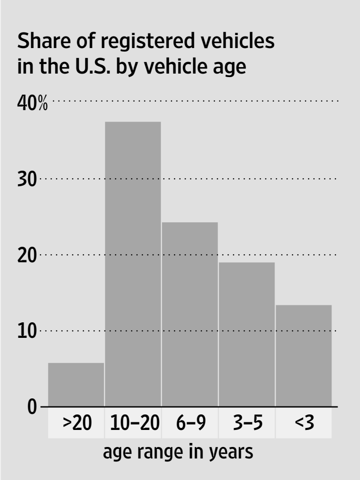
WASHINGTON—U.S. Transportation Secretary Ray LaHood said Sunday that unless the Senate approves $2 billion in additional funding this week, the Obama administration could pull the plug as early as Tuesday on the "cash for clunkers" program.

Mr. LaHood said the administration would honor cash-for-clunkers deals made through Tuesday. "What I'm committed to saying this morning is that any deal that is made tomorrow or the next day and is in the pipeline will be reimbursed," Mr. LaHood said in an interview on C-SPAN's "The Newsmakers" Sunday morning.

Senate Democratic leaders said Sunday that they hoped to bring the $2 billion extension to the Senate floor this week.

"We are waiting to see what kind of cooperation we can get from Republicans," said Jim Manley, a spokesman for Senate Majority Leader Harry Reid of Nevada.

Separately, **Chrysler Group** LLC said it is dropping an offer to double the government's "cash for clunkers" rebates as Chrysler dealers say they are running short of vehicles following the jump in demand.



The government's offer of up to $4,500 to consumers who agree to scrap aging gas guzzlers has depleted stocks of unsold vehicles at many dealerships to their lowest levels in years. That could set the stage for Chrysler and other car makers to boost production and rehire laid-off workers. It could also encourage auto makers to raise prices—as Chrysler is effectively announcing it will do by ending its offer to match the government vouchers.

But the uncertainty over whether the government's pump-priming will continue has thrown a cloud over the program's apparent success in stimulating consumer demand.

Mr. LaHood seemed unsure Sunday how much of the program's original $1 billion budget has already been claimed by customers who traded in gas guzzlers for new vehicles. Initially, Mr. LaHood said the entire $1 billion hadn't been spent. Later in the interview he said repeatedly that the money was exhausted but that dealers would get reimbursed for deals they have already done.

Auto makers and dealers are pressing to keep the program rolling. Despite administrative difficulties, the clunkers program excited consumers and provided a quick jolt to the U.S. economy after 19 months of recession. Car dealers reported their highest weekly sales volumes in nearly two years as consumers appear to have used the program to buy as many as 250,000 new cars.

Across the country, dealers said consumers continued to stream into showrooms in pursuit of clunker rebates, despite the uncertainty about the program.

In Warren, Mich., Carl Galeana said a bigger issue was his inventory, which is running low after the program sparked a surge is sales.

"If we had more inventory, we'd be selling more cars," he said. "Demand is huge."

Mr. LaHood expressed confidence that the Senate would act to approve the $2 billion extension before its scheduled recess starts at the end of this week. But he made clear if it failed to do so, the administration would end the clunkers program. The House started its recess Friday after passing the $2 billion cash-for-clunkers extension.

Some senators have said the program doesn't do enough to ensure that consumers buy efficient vehicles in place of the cars and trucks they scrap. Mr. LaHood said the administration believed the program was working fine. But at least two senators, Susan Collins (R., Maine) and Dianne Feinstein (D., Calif.), have said they will oppose extension of the clunkers program it is made more environmentally rigorous.

The U.S. program officially kicked off July 1, but the Department of Transportation needed nearly a month to put rules in place and set up an elaborate computer and banking system to register dealers and handle transactions. Not until July 24 were dealers able to register and process claims. Days after the program launched, it became apparent to DOT officials that they didn't know how much of the $1 billion allocated to the plan had been spent.

Concern spread to the White House and its Office of Management and Budget, where officials began to comb through the federal budget for money they might draw on to pay dealers should the program bust its budget. Early Thursday evening, OMB sent out word that there was none to be had.

Mr. Ray LaHood began briefing lawmakers Thursday afternoon, informing them that the fund was depleting rapidly. Around 4 p.m., Mr. LaHood called National Automotive Dealers Association President Phillip Brady and told him the department was "terminating" the program at midnight that night, according to NADA spokesman Bailey Wood.

Late Thursday, the White House scurried to announce that the program hadn't been suspended. Aides to President Barack Obama issued the same message to a group of lawmakers Friday morning at a hastily called meeting.

Dealers have expressed growing concern that the money would run out before they got paid. Some larger dealerships say they have hundreds of thousands of dollars of clunker claims outstanding.

Mr. LaHood pledged Sunday to resolve the backlog of several thousand applications immediately. "We are fixing this today," he said.

—Matthew Dolan, Sharon Terlep, Neil King Jr., Andrew Grossman and Kate Linebaugh contributed to this article.


Bryan Derballa for The Wall Street Journal

Rick Serra of Paragon Honda in Queens, N.Y., inspects a 1992 Chevy 1500 pickup. If the vehicle qualifies, it can be traded in as part of the 'cash for clunkers' program.

WSJ.com

Online today
Reporters comment on the success and challenges of the "clunkers" program at
WSJ.com/US

Malaysia detains dozens following antigovernment rally

By James Hookway and Celine Fernandez

Malaysia detained dozens of antigovernment protesters on Sunday, following a massive weekend demonstration in Kuala Lumpur that raised the stakes in a long-running struggle for political power in the country.

On Saturday, riot police fired tear gas and water cannons during clashes with thousands of demonstrators who were protesting a long-standing law allowing detention without trial. The law—known as the Internal Security Act—enables Malaysian authorities to detain indefinitely individuals they consider to be security risks. In the past, al Qaeda-linked terrorists have been held under the provision.

Opposition leader Anwar Ibrahim and human-rights activists say the law also is used to stifle dissent in Malaysia, where the National Front coalition has ruled the country without interruption since independence from Britain in 1957. The law represents a "powerful threat to anybody criticizing the government," Mr. Anwar said in a phone interview.

Last year, the law was used to detain a blogger, a journalist and members of a Hindu-rights activist group.

On Saturday afternoon, as many as 10,000 protesters converged in the center of Malaysia's main city, intending to march to the national palace, where they planned to submit a petition to repeal the security law. Police fired tear gas to break up the protesters before the march began.

Analysts said the showdown could buoy Mr. Anwar's opposition alliance in its effort to win enough support to form a new government.

Inspector General of Police Musa Haji Hassan said in a statement Saturday that police arrested 310 protesters because the rally hadn't been granted a permit.

"Because of their defiance, police were left no choice but to disperse them by spraying tear gas and throwing water at the demonstrators," Mr. Musa said. The number of detainees was revised up to 438.

By late Sunday, 39 protesters remained in custody, an opposition lawyer told the Associated Press.

Mr. Anwar, the opposition leader, said the police response to the demonstration indicated that the government is trying to clamp down on growing distrust in the way Malaysia's political leaders use colonial-era laws such as the Internal Security Act.

"The way the police acted reflects the government's fear. Even people who were dispersing after the protest was broken up were fired on with tear gas," said Mr. Anwar, who attended the rally.

State media reported that Prime Minister Najib Razak said the protesters had been warned not to assemble, and said he had received many complaints about traffic disruptions in the area. Mr. Najib said he would leave it to the police to determine what to do with the people detained during the protest. In the past, he has pledged to consider amending the Internal Security Act.

Other government officials and political activists have said the internal security law is needed to combat terrorism and maintain social order in this nation, which is home to large ethnic-Chinese and -Indian minorities, as well as the majority Muslim Malay population.

After a series of electoral reverses over the past year, the ruling National Front saw its margin of loss narrow in the most recent provincial election last month. James Chin, a political-science professor at the Malaysian campus of Australia's Monash University, said despite those gains, the rally was intended to "send a strong signal to the rest of the world that nothing has changed in Malaysia" in terms of human rights in recent years.

A number of political analysts say Malaysia's tension seems in many ways to be a retread of events a decade ago, when Mr. Anwar, then a deputy prime minister, was fired from the government for questioning its economic policies. Mr. Anwar then was convicted of allegedly sodomizing two male aides—a crime in this mostly Muslim country.

Mr. Anwar's conviction was overturned after a successful appeal in 2004, enabling him to return to politics. Last year, as the opposition made its largest-ever election gains, Mr. Anwar was charged with sodomizing a man who once worked in his office.

Mr. Anwar says he is not guilty in both cases, saying the charges were fabricated by political enemies, whom he didn't identify, to destroy his political career.

Mr. Najib, the prime minister, has denied playing any role in instigating the case against Mr. Anwar.

CORPORATE NEWS

Focus turns to GM's Whitacre

Auto maker's chairman will strive to turn around company, fend off political meddling

By John D. Stoll
And Kevin Helliker

The board of the new **General Motors** Co. meets for the first time Monday, putting a spotlight on Edward E. Whitacre Jr., the former telecommunications executive the U.S. government is counting on to make its $50 billion bailout of the auto maker pay off.

As chairman of a company now majority-owned by Uncle Sam, Mr. Whitacre will have to engage in an unusual, two-front battle: While working with GM Chief Executive Frederick "Fritz" Henderson to turn around a company that spent 40 days in bankruptcy reorganization, the lanky Texan will also have to fend off political meddling from Washington.

"Whitacre needs to provide cover for Fritz so that [Mr. Henderson] doesn't spend all his time dealing with issues that have nothing to do with profitability," said Bill George, the former chairman and chief executive of Medtronic Inc., who was approached about the GM chairman job and turned it down, saying he was too busy.

The two-day board meeting will be the first for Mr. Whitacre as well as six other directors who have been appointed since GM's exit from bankruptcy July 10.

As part of proceedings, the 13-member board will tour GM's technical center in Warren, Mich., and drive some current and future GM models at the company's proving grounds in Milford, Mich. They also will discuss critical issues facing GM, such as the sale of its Opel unit in Europe, how to halt its market-share losses in the U.S. and what course will bring GM back to profitability.

Mr. Whitacre, 67 years old, who declined to be interviewed for this article, turned Southwestern Bell into a telecommunications powerhouse that eventually acquired former parent AT&T Inc. He retired as AT&T chairman and chief executive in 2007.

He goes into the GM job with no automotive background, but for more than a month he has been working to get a handle on GM's internal challenges and its future relations with the government.

On the GM side, he has been talking to Mr. Henderson three or four times a week since agreeing to become chairman, said people familiar with the situation.

Reuters

The U.S. government is counting on GM Chairman Edward E. Whitacre Jr., shown last month, to make its $50 billion bailout of the auto maker pay off.

Mr. Whitacre embarked on 10-day vacation earlier in July but remarked to associates that he got only three days of rest due to the demands of the GM job, said informed people. Last week, Mr. Henderson also flew to Mr. Whitacre's home in San Antonio, these people said.

In a sign Mr. Whitacre plans to maintain a hands-on role, he has told associates that he is considering spending at least one day a week in Detroit and renting an apartment in a nearby suburb, according to a person briefed on his plans.

"He is impatient, and that's a good thing," said Robert Lutz, GM's marketing chief, who said he has met with Mr. Whitacre three times and accompanied Mr. Henderson on the trip to San Antonio.

Mr. Lutz said Mr. Whitacre believes GM has good enough cars and trucks to compete but has to turn around consumer perceptions about the company. "He absolutely believes in the power of well-done advertising," Mr. Lutz said.

At some point Mr. Whitacre and the new board will also have to decide whether Mr. Henderson, a GM lifer who was in the executive suite while the company incurred tens of billions of dollars in losses and ran out of money, is the right person to head the company over the long term.

In a July 10 interview, Mr. Whitacre said Mr. Henderson will be judged "by how much money he makes."

The new chairman will be doing all this while trying to keep the U.S. government at arm's length. While being interviewed for the GM job, he said he would take it only if the Obama administration's automotive task force essentially were to dissolve, said people familiar with the matter.

His concern was that the task force—which had ushered GM into bankruptcy, played a big role in restructuring it and in the end approved Mr. Whitacre as chairman—could become a kind of second board of directors.

"Ed wanted to be clear on what the role of the government was going to be at the company," said Steven Rattner, who headed the task force until he resigned in late July. Two other task-force members who have worked closely with GM, Henry Wilson and Matthew Feldman, are expected to resign by the middle of August, said people familiar with the matter.

While shrunken, the task force remains in place, headed by Ron Bloom, a former investment banker and adviser to the United Steelworkers of America union.

In an interview, Mr. Bloom said his job is to "monitor" the government's investment. "We in government need to give these companies the maximum opportunities to succeed," he said. "The way to do that is to let them run their business."

GM aims to sell stock to the public in 2010, and Mr. Bloom warned that any tampering from Washington could make the stock unattractive to investors.

Another group Mr. Whitacre will have to work with is the United Auto Workers union and its president, Ron Gettelfinger. The union's trust that provides health care for retired workers now is GM's second-largest shareholder with a 17.5% stake, after the U.S. government, which has a 60% stake.

At SBC Communications, which later became AT&T, Mr. Whitacre cultivated cordial relations with the unionized work force, to the point where front-line workers felt comfortable calling him at home.

James Kobler, a wire splicer in Kansas, once called Mr. Whitacre at his St. Louis home to report a problem, which Mr. Whitacre referred to the company's top executive in Kansas. "I interrupted him cleaning his garage, and he couldn't have been more gracious about taking my call and hearing me out," Mr. Kobler said.

—Sharon Terlep contributed to this article.

Total, Eni expect output gains as profits fall

By Adam Mitchell

European oil companies **Total** SA and **Eni** SpA on Friday posted declines in second-quarter profit as output fell, but said they expect to boost their production during the second half of the year.

The companies share some production challenges. Lower demand for oil and natural gas has taken its toll, encouraging them to produce less gas and prompting the Organization of Petroleum Exporting Countries to cut output quotas several times late last year to defend prices.

Security issues in Nigeria also cut output for both Total and Eni. Eni was able to offer investors reassurance on production, saying average daily hydrocarbon production is likely to increase by between 0.5% and 1% on the year. Oil and gas output fell 2.2% from a year earlier in the second quarter. The Italian company said it plans to boost output in places such as Congo and the U.S. to offset the factors hindering its output.

Total, meanwhile, said that ramping up new fields in offshore Nigeria, the Gulf of Mexico and Norway, and starting up liquefied-natural-gas projects in Yemen, Qatar and the Angolan Tombua Landana oil field will help it improve volumes over the remaining months of the year.

The French oil company's production performance cast a cloud over the stock, with analysts expressing concern that the company is now likely to post lower output in 2009 for the second year in a row. Total posted a 7.3% drop in volumes in the second quarter compared with a year earlier.

Even though demand and prices have weakened amid the economic slump, large oil companies are confident that supply will become tighter as the downturn eases.

Other big energy companies also are having trouble sustaining oil and gas production rates, as both **Exxon Mobil** Corp. and **Royal Dutch Shell** PLC showed Thursday in their earnings reports. A drop in European demand for gas led Exxon to pare back output by 12% in the region. With most of the world's conventional oil resources controlled by state-owned companies, international energy companies increasingly face the challenge of making do with harder-to-access reserves. Maintaining production growth is tough for all.

While Eni was able to say it will raise output volumes over the full year, its strategy of buying smaller energy companies to boost growth has contributed to widening its net debt to €18.4 billion ($26.2 billion) at the end of June from €16.5 billion at the end of March.

Eni surprised investors Friday by slashing its interim dividend to 50 European cents a share from 65 cents a share a year earlier, aiming to preserve the strength of the company's credit rating and have sufficient funds to finance capital spending. By contrast, Total confirmed an interim dividend of €1.14 a share, to be paid in November, the same amount as the interim payment last year.

Total's second-quarter net profit slid 54% to €2.17 billion while Eni's fell 76% to €832 million, with prices and demand for crude and petroleum products far lower than a year earlier.

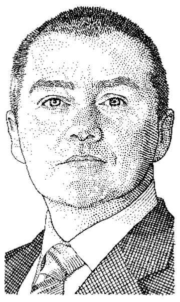
BA posts loss, but chief says traffic is stable

By Kaveri Niththyananthan

LONDON—**British Airways** PLC, citing declining passenger numbers and cargo volumes, reported its first pretax loss for the fiscal first quarter since its shares were listed 22 years ago.

Chief Executive Willie Walsh said traffic has stabilized and may improve slightly during the peak summer month but, like its rivals, the British flag carrier warned that those still flying are spending less and yields are volatile.

British Airways posted a pretax loss for the quarter ended June 30 of £148 million ($247.2 million), compared with a profit of £37 million a year earlier. Its loss after tax was £106 million, compared with a profit of £27 million a year earlier, as revenue fell 12% to £1.98 billion.



Willie Walsh

The airline's revenue decline wasn't as steep as those of European rivals **Air France-KLM** and **Deutsche Lufthansa** AG. The Franco-Dutch carrier said Thursday that first-quarter revenue fell about 21%, while the German carrier posted a 19% revenue decline for the same period.

British Airways said it was hit mainly by falling numbers of passengers flying business and first class during the economic downturn, lower average revenue per passenger and lower fuel surcharges. Business-class traffic across the Atlantic has been the airline's main profit driver.

Average passenger revenue per filled seat for each kilometer flown, or yield, fell 9.7% in the quarter to 6.06 pence compared with 6.71 pence a year earlier. The pound's weakness, particularly against the dollar, helped cushion the fall. At constant currency rates, average revenue per passenger was down 13% on the year.

Mr. Walsh told reporters he expected second-quarter yields to show a year-to-year decline and weaken by a greater proportion than seen during the first quarter. The airline said it will park 22 aircraft over the winter, more than the 16 it had originally planned. It expects to cut capacity by 5% this winter, and 3.5% this summer.

With revenue down, the airline has been forced to become more efficient and drive costs lower. It has upgraded its Web site to increase sales of nonflight items such as hotel and car rentals. Operating costs fell 6.6%, with unit costs down 3%.

British Airways now has hedged 70% of its fiscal-year fuel needs at an average of $71 a barrel, Mr. Walsh said. Based on current fuel prices and exchange rates, the carrier expects its current-fiscal-year fuel bill to be £450 million to £500 million lower than the £3 billion it paid last year.

The airline said it is on track to cut 3,700 jobs in the current financial year and has shed 1,450 jobs since March 31. Over the past 12 months, British Airways has reduced its staff by 4,000 workers to 39,175.

SABMiller volume is flat as Europe demand drops

Poland and Russia bear heavy declines; Chinese sales recover

BY MICHAEL CAROLAN AND LILLY VITOROVICH

Brewer **SABMiller** PLC reported flat sales for its fiscal first quarter as the economic downturn weighed on demand, particularly in Eastern Europe.

SABMiller said Friday that its core lager volume, which tracks underlying sales trends and strips out the effects of acquisitions and disposals, was unchanged in the quarter ended June 30 from a year earlier. That compares with a 1% decline in the fiscal fourth quarter.

"The global economic slowdown has continued to dampen consumer demand, although the impact on volumes has varied between our markets," Chief Executive Graham Mackay said in a prepared statement.

Core lager volume fell 7% in Europe. SABMiller, the world's second-biggest brewer by volume, after **Anheuser-Busch Inbev** NV, said "household debts, tighter credit controls and rising unemployment continued to depress consumer spending," resulting in beer-market contraction across the region. In Poland and Russia, core lager volume fell 8% and 9%, respectively.

In the U.S., the company's MillerCoors LLC venture with **Molson Coors Brewing** Co. reported a 0.8% fall in sales from distributors to retailers.

Core lager volume in Africa and Asia rose 11% amid weak year-earlier volume for China because of the Sichuan earthquake.

Bloomberg News

SABMiller's MillerCoors joint venture reported a 0.8% sales drop for distributors in the quarter through June. Above, a driver in Texas delivered Miller beer in May.

PPR profit falls, but revenue beats forecasts

BY MIMOSA SPENCER

PARIS—French luxury-to-retail company **PPR** SA said first-half net profit fell 76% from a year earlier but that revenue declined less than expected.

Profit dropped to €188.8 million ($269 million) from €777.1 million a year earlier, when results were boosted by the sale of YSL Beaute to **L'Oreal** SA. Revenue was down 3.5% at €9.24 billion amid an ongoing decline in sales from PPR's furniture-retail and catalog businesses.

Both earnings and sales were better than expected, with a good level of profitability at the Gucci brand, Citigroup said in a research note. PPR said that its luxury division posted a slight increase in recurring operating profit to €305 million from €303 million. The division also raised its proportion of total operating profit to 42% from 40% from a year earlier.

PPR, whose activities range from its mass-market catalog business to high-end fashion, has been dogged by lingering talk it will eventually hive off some of its extensive retail operations and focus on the higher-margin luxury business. Chairman and Chief Executive François-Henri Pinault tried Friday to dispel such talk, repeating comments he made in February that the company had no plans to sell or buy any businesses this year.

Mr. Pinault also said the company was confident any improvement in the overall economy would significantly help its results, but added that it was too early to predict when markets will improve. PPR didn't provide a full-year outlook.

However, when stripping out currency fluctuations, acquisitions and disposals, PPR's total sales fell at a faster pace in the second quarter than in the first quarter, PPR said. The only area of growth was Italian fashion brand Bottega Veneta, known for its woven leather goods, on which the company has been focusing.

PPR has cut costs in an attempt to buffer the impact of the global downturn, which has hit its furniture retailer Conforama and Redcats catalog business especially hard. First-half sales from the divisions fell 11% and 7% respectively.

—Natascha Divac and Natali Schwab in Frankfurt contributed to this article.

MGM Mirage to face review over Macau deal

BY JONATHAN CHENG

HONG KONG—New Jersey's gambling commission reopened **MGM Mirage's** license to run a casino in Atlantic City for review, citing an ongoing investigation into its relationship with Pansy Ho, its business partner in the Chinese enclave of Macau.

The move by the New Jersey Casino Control Commission, which was expected, underscores the regulatory challenges that the Las Vegas casino operator faces.

MGM Mirage owns the Borgata Hotel Casino and Spa in Atlantic City through a 50-50 joint venture with **Boyd Gaming** Corp., which disclosed the New Jersey authorities' reopening of the Borgata gaming license in a regulatory filing Friday.

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Anglo crafts its defense

Miner touts progress, calls Xstrata advance a 'distraction'

By Guy Chazan

Mining giant **Anglo American** PLC sought Friday to bolster its defenses against rival **Xstrata** PLC's unwelcome advance by disclosing progress on cutting costs and operational goals across the group.

But some analysts said Anglo has more to do to convince shareholders it is better off alone than combined with Xstrata, whose proposal for a merger of equals was roundly rejected by Anglo's board in June.

Anglo executives batted away questions about Xstrata on its earnings call Friday, but the subtext in presentations on its first-half results was clear: It is determined to stay independent and is on track to deliver more value to shareholders.

It introduced its new chairman, Sir John Parker; disclosed progress on three massive mining projects in South America; and unveiled a restructuring at troubled subsidiaries Anglo Platinum and diamond producer De Beers.

Cynthia Carroll, Anglo's chief executive, in an interview called the company's cost and efficiency initiatives a "major achievement." The programs produced cost savings of more than $450 million in the first half and should deliver more than $1 billion by the end of 2009, she said. Anglo has reduced headcount by 15,000, putting it in sight of its target of 19,000 by year's end, and its pipeline of new projects should increase the company's production by a third by 2013, she said.

Bloomberg News

Anglo American Chief Executive Cynthia Carroll, shown in January, called the company's cost and efficiency initiatives a 'major achievement.'

She declined to comment on the Xstrata approach, calling it a "distraction" for management. "We're focused on delivering our strategy, and if someone's coming your way and suggesting they could do things differently, of course it's a distraction," said Ms. Carroll.

Anglo said profit fell 31% in the first half to $3 billion. Operating profit of $2.1 billion, however, exceeded analysts' consensus forecast of $1.94 billion.

"It was a finely crafted defense," Des Kilalea, a mining analyst at RBC Capital Markets, said of Ms. Carroll's presentation. But he noted that Xstrata would probably have an "equally finely crafted response" at its earnings presentation next week.

Xstrata's proposal for a merger of equals, revealed in June, would create the world's third-largest miner by market value after Melbourne-based **BHP Billiton** Ltd. and Brazil's **Vale** SA. Xstrata has said a merger would result in $1 billion in cost savings beyond Anglo's own efficiency drive.

Anglo has been hit hard by the badly depressed demand for commodities such as platinum, used to make catalytic converters for cars. Shareholders have also accused management of sitting out a wave of mergers and acquisitions during the commodities boom, then overpaying for a big Brazilian iron-ore project at the top of the cycle. There was also anger when it suspended its dividend in February.

China defends arrests of Rio staff

By Lyndal McFarland

MELBOURNE, Australia—A senior Chinese official said China's government believes that crimes allegedly committed by detained **Rio Tinto** executive Stern Hu would have breached Australian laws if they occurred in Australia.

"The facts of the case would constitute a violation of Australian laws were the facts [to] happen here," China's vice foreign minister, Liu Jieyu, said to Australian Broadcasting Corp. television while in Australia on Sunday.

Mr. Hu and three other Chinese Rio Tinto employees have been held in Shanghai without charges since early July on suspicion of stealing state secrets while negotiating annual iron-ore deals. Iron ore, an ingredient for making steel, is a vital resource for China, which has sought to take the lead in negotiations between steel consumers and mining giants.

Details of the alleged crimes have been scant, and Rio Tinto has said it has no evidence that Mr. Hu or the other detained employees were involved in wrongdoing. Mr. Liu indicated the Chinese government believes the case against Mr. Hu, an Australian citizen, is strong, and the decision to prosecute him is in the interests of foreign businesses working in China. "I'm sure a sound rule-based commercial environment would serve the benefits of all countries," Mr. Liu said.

So far, Australian consular access to Mr. Hu has been limited, and Australian lawmakers, including Prime Minister Kevin Rudd, have pushed for more access and have cautioned China that the world would watch the situation closely.

Mr. Liu urged Australia to respect his country's right to prosecute Mr. Hu. "Mutual respect between countries means that we respect each other, including the independence of judiciary," he said.

Australia's foreign minister, Stephen Smith, said he had met with Mr. Liu during his visit to Australia, and had discussed the matter of Mr. Hu's detention with the Chinese official. Mr. Smith told Sky News he reiterated to Mr. Liu the matter should be "managed carefully so that it doesn't detract from the relationship."

Asset sales boost Enel profit 29%

By Liam Moloney

ROME—Asset sales and other gains pushed **Enel** SpA's first-half profit up 29%, and the Italian utility said Friday it will sell as much as €10 billion ($14 billion) in bonds to slice away at its large debt pile.

Profit rose to €3.52 billion from a year earlier, while revenue declined 3% to €28.46 billion.

Stripping out gains, including €308 million from the sale of Enel's Italian high-voltage power lines to Terna SpA and more than €900 million from an accounting gain related to the acquisition of a 25% stake in Endesa SA, profit was up 3%, helped by the company's international assets and Italian power generation.

Enel also said its board approved the sale of as much as €10 billion in bonds by June 30, 2010. At the end of June, Enel's net debt stood at €55.8 billion, up from €50.8 billion three months earlier, after buying the Endesa stake.

The Italian state-controlled utility expects net debt to fall to less than €50 billion by the end of the year, if it manages to cash in the proceeds from the planned sale of a minority stake in its renewables unit, Chief Executive Fulvio Conti said Friday.

In March, Enel, Europe's most-indebted utility, announced a capital increase of as much as €8 billion and other multibillion-euro measures such as asset disposals and a change in its dividend policy.

Enel said it expects full year earnings to be higher than last year thanks to forward sales of electricity and cost-cutting measures.

UBS, Swiss reach pact with U.S. on tax probe

UBS AG and the Swiss government, rocked by months of embarrassing details about bank secrecy and guilty pleas for UBS clients, agreed with U.S. authorities to settle a tax-evasion inquiry.

*By **Carrick Mollenkamp** and **Laura Saunders** in New York and **Stephen Fidler** in London*

The agreement appears to signal that thousands of U.S. client accounts will be turned over to U.S. revenue agents.

The settlement, announced during a teleconference with a federal court judge Friday ahead of a scheduled hearing in Miami on Monday, closes one chapter in the long-running case that centered on the Internal Revenue Service's demand that the bank turn over the identities of 52,000 UBS accounts belonging to U.S. citizens.

Details of the settlement weren't provided during the call, with the U.S. Justice Department simply reporting that the parties had reached an agreement in principle and would work to resolve remaining issues in the coming week. Another conference that could shed more light on the deal is set for Friday.

But lawyers involved in the case said one likely scenario is that UBS will turn over the identities of some, but not all, of the 52,000 accounts.

"I think it's possibly going to push north of 10,000," said William M. Sharp Sr., a Tampa, Fla., lawyer who is representing UBS clients.

An official transfer of accountholder identities might not happen until Sept. 23, the deadline for an IRS process that allows Americans to try to pay taxes and reduced fines in hopes of avoiding criminal prosecution and heavy fines. Once the names are handed over, the IRS's criminal team is expected to review them and decide whether to prosecute those offenders or pursue lesser civil punishment that is still costly for offenders.

"We have never before seen so many U.S. citizens and residents potentially subject to criminal tax prosecution on the same basic issue," said Bryan Skarlatos, a partner at New York law firm **Kostelanetz & Fink** LLP who is representing UBS clients.

In a statement, UBS acknowledged Friday's conference call and declined to comment. The Swiss Justice Ministry and the U.S. Justice Department also declined to comment.

The U.S. probe, which has led to guilty pleas for three UBS clients this year, is expected to expand to outside consultants that may have helped steer business to UBS or other Swiss banks.

UBS and the Swiss government argued in the tax-evasion case that Swiss bank-privacy law meant the bank couldn't hand over the account identities. It now appears that UBS and the Swiss government have combed through the files and identified enough potential fraud to make them willing to hand over information about certain accounts.

Swiss laws don't provide confidentiality if people engage in fraudulent activities such as setting up accounts with shell companies that lack any real business substance.

"I think that eventually the U.S. will get all the names it wants," said Charles Falk, a criminal tax lawyer in Mendham, N.J., who is representing UBS clients. "The U.S. and Swiss want to find a way to disengage, and giving over the names is a way to do it. They'll find a way that won't technically compromise the law but at the same time release names."

For UBS, news of a settlement at least means the financial firm is closer to ending the probe, which had cut into the bank's prized private bank and helped contribute to outflows of billions of Swiss francs of client money.

The U.S. inquiry also hit other Swiss banks that counted on American clients. "In principle, an agreement like this always reduces uncertainty," said Jan Bielinski, a spokesman for Bank Julius Baer & Co.

UBS announces second-quarter results Tuesday, and analysts expect UBS to report a pretax quarterly loss of 1.03 billion Swiss francs ($946.5 million) compared with a loss of 4.13 billion a year ago.

EU plans to clear Lufthansa in deal for Austrian Airlines

By Carolyn Henson

BRUSSELS—European Union antitrust chief Neelie Kroes said Friday she intends to clear **Deutsche Lufthansa** AG's takeover of **Austrian Airlines** AG, though with conditions attached.

After talks earlier Friday, the German carrier offered further measures to allay competition concerns, the European Commission said.

Lufthansa is proposing to pay €4.49 ($6.40) a share for Austrian Airlines' outstanding shares. The takeover also will receive help from the Austrian government in the form of €500 million in restructuring aid.

Neelie Kroes

The airline already was offering to give up slots on five city routes flying out of Vienna to ensure that it passes the European Commission's competition scrutiny, according to a document seen by Dow Jones Newswires.

"Commissioner Kroes has instructed her services to draft a conditional clearance decision," according to the commission's statement.

The draft decision will be considered by EU member countries and a final proposal will be presented for adoption by the commission "as soon as possible," the statement added.

The commission sent out a questionnaire to Lufthansa's competitors and other interested parties to see whether they think the offer made by Lufthansa was enough to remove competition bottlenecks identified in the commission's investigation into the takeover.

The deadline for companies to reply to the commission's questionnaire was Thursday. Lufthansa's latest offer was in response to the concerns raised by competitors, the commission said.

CORPORATE NEWS

Ford sales rise for first time in two years

By Matthew Dolan

Ford Motor Co.'s sales increased in July, the first year-over-year jump for the auto maker in almost two years, according to the company's sales analyst.

The increase was the first by any of the six largest auto makers since last summer and the first bump up for Ford since November 2007, sales analyst George Pipas said in an interview Sunday.

Ford's news came as uncertainty continued to swirl about the future of the popular "Cash for Clunkers" government voucher program for new-car sales. U.S. Transportation Secretary Ray LaHood said the government would honor any clunkers-program car sales through Tuesday. But he warned that unless the Senate approves a $2 billion funding extension this week, the White House would be forced to pull the plug on the program that rewards owners of older, gas-guzzling cars for turning their vehicles in for a new car or truck.

"I am not sure we would have gotten the bump except for the last week," Mr. Pipas said, referring to the start of the clunkers program on July 24. The program was so successful that the administration feared on Thursday that the $1 billion in funding was about to run out.

Mr. Pipas declined to say how much Ford's gain was expected to be when the results are officially reported on Monday. He said retail sales would increase amid a continuing decline in fleet sales to government and other, large commercial customers. He described the retail bump only as "notable" and the overall increase in monthly sales as less than that.

But any monthly gain from a year earlier could be one of the strongest indicators yet that the trough in auto sales has been reached and that the industry may be on its way to a recovery, however slow. The last time any of the six largest auto makers reported a year-over-year increase in monthly sales was in August 2008 by Nissan Motor Co., according to Mr. Pipas.

At Ford, the most-traded-in vehicle last month was the Ford Explorer sport-utility vehicle and most buyers drove out with new Ford Focus compact car.

"The two goals of the program were to jump-start auto sales as a way to start the recovery and to get buyers into more fuel-efficient cars," Mr. Pipas said. "On both counts, it's going to be a home run."

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GLOBAL BUSINESS BRIEFS

OAO Mobile TeleSystems

Control of sister company is sought for $1.28 billion

Russian mobile operator OAO **Mobile TeleSystems** is seeking to buy 51% of sister company OAO **Comstar United TeleSystems** in a deal valued at $1.28 billion that would transform MTS into Russia's biggest integrated telecommunications operator by sales, a person familiar with the matter said, confirming reports of the offer in Russian newspaper Kommersant. Analysts said the deal would benefit both parties as well as conglomerate AFK Sistema, which controls the two operators. But some cautioned that MTS, which is listed in New York, will only be able to reap the full reward of a tie-up with Comstar if it buys the whole company. Sistema declined to comment. The move would mirror a similar transaction by MTS rival OAO **Vimpel Communications**, which paid $4.3 billion for fixed-line provider Golden Telecom last year.

Roche Holding AG

Roche Holding AG said the U.S. Food and Drug Administration accepted the Swiss drug maker's second submission of documents to win approval for its rheumatoid arthritis drug Actemra. Roche said Friday that the resubmission includes a proposed risk evaluation and mitigation strategy to ensure that health-care professionals prescribe and administer the drug correctly, and that patients understand the known and potential risks. The European Union granted approval for the drug in January. The FDA will take around six months to review the application. Actemra could eventually generate annual sales of $1 billion or more. But in March, it emerged that Actemra might have been a factor in the death of 15 out of nearly 5,000 people who took the drug in Japan. Actemra was developed by Japan's **Chugai Pharmaceutical** Co., which is controlled by Roche.

Michelin SA

French tire and rubber company **Michelin** SA said Friday it swung into the red in the first half after the recession caused tire sales to drop sharply, but said it still managed to generate cash. Blaming restructuring costs in France and North America, the company reported a first-half net loss of €119 million ($167.4 million) compared with a net profit of €430 million a year earlier. Revenue fell 13% to €7.13 billion from €8.24 billion. Michelin's sales to vehicle manufacturers have nose-dived over the past year as the automobile industry has suffered its biggest collapse in more than 60 years. At the same time, sales of replacement tires have been hit as car and truck owners postpone replacing tires, drive fewer miles or switch to cheaper brands. Michelin noted, however, that original-equipment car-tire markets "showed signs of stabilizing in the second quarter."

JCDecaux SA

JCDecaux SA reported a 96% drop in first-half net profit, but also became the latest advertising company to say the slump may be over, echoing comments from chief executives of **Omnicom Group** Inc. and Paris-based **Publicis Groupe** SA. JCDecaux's co-Chief Executive Jean-Francois Decaux Friday said "We are not expecting a rebound of the advertising market in the second half of the year, but a stabilization. We have the impression that we've hit bottom, especially in those markets that have proven most difficult like the U.K. and Spain," he said. JCDecaux said first half earnings before interest, taxes, depreciation, and amortization fell 40% to €166.4 million ($234 million). Net profit fell 96% to €4.4 million.Chief Financial Officer Gerard Degonse said costs were cut by €31.1 million in the first half. Revenue fell to €925.4 million from €1.07 billion.

AOA Severstal

Russian steelmaker OAO **Severstal**'s second-quarter crude-steel production fell 28% from a year earlier and was essentially flat from the first quarter as poor sales from its overseas assets outweighed a pick-up in domestic demand. The company, which has assets in Russia, U.S. and Italy, produced 3.81 million metric tons of steel globally, down from 5.27 million tons a year earlier. Output of rolled products dropped 29% from a year earlier and 1% from the previous quarter to 2.87 million tons. Severstal said Friday that its crude-steel production in Russia, its main production base, fell 31% to 2.12 million tons from a year earlier but rose 2.6% from the first quarter. Prices for semifinished steel products in Russia fell 60% from a year earlier and fell 9.7% from the first quarter to $289 a ton.

Audi AG

Audi AG stayed in the black in the first half, although profit dropped 26% amid declining demand for its luxury cars. Net profit fell to €671 million ($956 million) from a year earlier, as sales slipped 16% to €14.53 billion. Second-half operating profit at **Volkswagen** AG's premium division is likely to decline from the €823 million it posted for the first half, Chief Financial Officer Axel Strotbek said in a conference call. Audi came through the industry gloom better than its rivals thanks to its lower exposure to the U.S. market, a large presence in China and the launch of several new or updated models. "We're maintaining our targets of selling 900,000 vehicles by the end of the year," said Mr. Strotbek. In the first half, Audi sold 466,000 cars. In 2008 it sold about one million cars.

Schneider Electric SA

French electrical-equipment maker **Schneider Electric** SA on Friday posted a 59% drop in net profit for the first half of the year, but said the industrial market is bottoming out. Net profit fell 59% to €346 million from €851 million the previous year, which was in line with a €350 million forecast. Revenue dropped 13% to €7.75 billion, which was below an average forecast of €7.9 billion. Chief Financial Officer Emmanuel Babeau said he was optimistic about the second half as market trends are expected to improve slightly and the group has reined in costs and adapted to the difficult economic environment. The company has made cost cuts of more than €300 million of a total €450 million target for 2009, Mr. Babeau said. Its plans to save €1.6 billion by 2011 will be achieved ahead of schedule, he added. The company's shares surged because its earnings before interest, taxes and amortization, an important profit figure for the market, fell less than analysts forecast.

Lafarge SA

French cement maker **Lafarge** SA reported a 49% drop in second-quarter net profit Friday, and said it will continue to cut costs as the economic downturn hurts its volumes and prices in some regions. Net profit fell to €387 million ($551.6 million) from €761 million a year earlier, as revenue declined 14% to €4.36 billion and falling volumes pressured margins. Lafarge has achieved slightly more than half of the targeted €400 million cost savings for this year, said Chief Financial Officer Jean-Jacques Gauthier. The company also has sold about €750 million in assets so far this year, out of a €1 billion objective. Companies like Lafarge have high fixed costs linked to their plants, increasing the pressure of falling volumes on margins. Lafarge, which operates across the world and competes with Mexico's Cemex SAB and Switzerland's Holcim Ltd., said it now expects volumes to decline between 4% and 8% this year, compared with a previous forecast of a 3% to 5% decline.

Merck KGaA

German pharmaceutical and chemicals company **Merck** KGaA Friday said it is appealing a European Union panel decision not to approve its leading oncology drug Erbitux for use in non-small-cell lung cancer. The CHMP, a committee of the European Medicines Agency, last week issued a so-called negative opinion on the use of Erbitux in non-small-cell lung cancer, saying the benefits of Erbitux in treating that disease didn't outweigh its risks and that the benefits of Erbitux were modest in terms of survival times. "Merck is committed to making Erbitux available to NSCLC patients," Merck said Friday in a statement. The panel's July 24 opinion surprised investors and, coupled with Merck's weaker-than-expected second-quarter earnings, had sent shares in the German company sharply lower that day. Erbitux is currently approved for some types of bowel cancer and head and neck cancer.

BAE Systems PLC

Four European countries signed Friday a €9 billion ($12.65 billion) deal to build 112 more Eurofighter Typhoon fighter planes, a boost for the companies involved in production of the advanced jet. The German Defense Ministry said the deal, also signed by Spain, Italy, and the U.K., will see its air force receive 31 of the planes. It didn't break down how many aircraft the other countries involved will be receiving. It said the overall contract also included the purchase of 241 EJ 200 type jet engines. The plane is built by a consortium of European military manufacturers, including **BAE Systems** PLC, **European Aeronautic Defence & Space** Co. NV and Italy's **Finmeccanica** SpA. Currently in use by the German, Italian, Spanish, British and Austrian air forces, the plane has had its share of criticism. The Eurofighter Typhoon program has been dogged by delays and cost overruns and criticized as better suited to the Cold War.

Air France-KLM SA

European air-safety regulators told world airlines they will have to replace hundreds of air-speed sensors of the type that may have contributed to the Air France Airbus A330 crash in June. The announcement came after Airbus, a unit of **European Aeronautic Defence & Space** Co. recommended airlines exchange some of the speed sensors manufactured by **Thales** Corp. for another model. Investigators have focused on the possibility the external monitors on the A330 iced over and gave false speed readings. Air France is a unit of **Air France-KLM** SA.

J.P. Morgan Chase & Co.

J.P. Morgan Chase & Co. appointed Frank Gong, its chief China economist and head of China research, to the newly created role of vice chairman of China investment banking. Mr. Gong will report to Fang Fang, chief executive of J.P. Morgan China, which recently underwrote the $884 million Hong Kong initial public offering of BBMG Corp. The bank also appointed Mr. Gong as chairman of China diversified industry clients. J.P. Morgan said Mr. Gong will focus on expanding the coverage of the firm's corporate clients in China and work on the Wall Street bank's long-term growth strategy in the country. Qian Wang, a member of the bank's Greater China research team, will take on Mr. Gong's responsibilities in economic research, and become senior China economist. Frank Li, head of Asian-Pacific auto and auto-parts research, will be head of China stock research.

Bank of America Corp.

A former senior banker at **Bank of America** Corp.'s Bank of America Merrill Lynch, Bing Wang, has rejoined the bank as its head of China corporate finance, according to a memo reviewed by Dow Jones Newswires. Before his departure in October, Mr. Wang was with the bank's private-equity division. In his new capacity, Mr. Wang will be responsible for originating and executing transactions across all market sectors for Chinese corporate customers, according to the document. It said he will report to Erh Fei Liu, China country executive and head of China global corporate and investment banking.

All Nippon Airways Co.

All Nippon Airways Co. reported a fiscal first-quarter net loss after suffering from a drop in business travel amid the economic slowdown and canceled vacations following the outbreak of the H1N1 influenza. However, Japan's second-biggest airline by revenue aims to meet its net profit target for the current fiscal year by implementing additional cost-cutting steps. The Tokyo-based carrier reported a net loss of 29.20 billion yen ($308.6 million) in the three months ended June 30, compared with a net profit of 6.65 billion yen a year earlier. Revenue dropped 22% to 269.90 billion yen.

Reliance Communications Ltd.

Reliance Communications Ltd. Friday said net profit for the fiscal first quarter rose 8.3%, boosted by interest income and foreign-exchange gains. The Indian telecom operator's key operational parameters, such as average revenue per user, and average minutes of usage per user, continued to decline as the company tapped low-revenue-generating rural subscribers to boost its customer base in the world's fastest-growing telecom market. Net profit for the April-June period rose to 16.37 billion rupees ($342.3 million) from a year earlier. Total revenue rose 15% to 61.45 billion rupees, helped by the addition of 6.95 million customers and revenue from non-telephony services, the company said. ARPU dropped 6.3% to 210 rupees from the previous quarter ended March 31, while the number of minutes of use per wireless customer fell 1.9% to 365 rupees per month.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Court upholds Deripaska ruling

Britain to allow former business partner to sue Russian magnate over disputed Rusal stake

By Alan Cullison

A British court upheld a ruling that could shed light on the origins of the empire of Kremlin-connected magnate Oleg Deripaska, who amassed large stakes in Russia's metals plants in the 1990s.

Britain's court of appeals ruled Friday that Michael Cherney, who says he is a former Deripaska business partner, may sue him in Britain over a disputed stake in Mr. Deripaska's holding company, Rusal.

Mr. Deripaska tried to have the case thrown out of court on jurisdictional grounds. The case has required him to reveal in pretrial motions details of his business dealings in the 1990s. While both sides could settle before the case goes to trial, the revelations thus far could complicate Mr. Deripaska's efforts in recent years to buff his reputation and turn his company into a global player.

Reuters

Russian Prime Minister Vladimir Putin, left, in June, chided Oleg Deripaska for conditions at his factory in Pikolyovo, Russia.

A spokesman for Mr. Deripaska in London on Friday called the accusations in Mr. Cherney's lawsuit "vexatious."

The spokesman said Mr. Deripaska was "disappointed" in the court ruling, but said that he would continue to fight Mr. Cherney's claims in the U.K. Mr. Deripaska's lawyers had argued that the dispute between the two men—both Russian—should be settled in a Russian court.

The London appeals court ruled that Mr. Cherney, now residing in Israel, had well-founded fears of assassination or arrest on trumped-up charges if he returned to Russia.

The appeals-court judge also noted that there was "a close link between the Russian state and Mr. Deripaska" and that there could be a significant risk of government interference in any trial.

In a statement, Mr. Cherney said he was pleased with the ruling. "I hope that Mr. Deripaska will now focus on the real issues between us and I look forward to moving towards an early trial of them in London," he said.

Mr. Deripaska says he never broke any laws in the 1990s, although he has said the operating environment in Russia was a difficult one. During the period, contract killings were commonplace in Russia's newly privatized and profitable aluminum industry.

Mr. Deripaska has been denied a visa to the U.S. because of State Department concerns about his possible connections to organized criminal groups. Mr. Deripaska has denied any links to organized crime.

In the lawsuit, Mr. Cherney says he was a business partner of Mr. Deripaska in various metals enterprises, and that the metals titan broke an agreement struck at a London hotel in 2001 under which Mr. Deripaska paid him $250 million and agreed to hold in trust a 20% stake in Mr. Deripaska's Rusal. Mr. Cherney says Mr. Deripaska paid him the $250 million but didn't grant him the 20% stake in Rusal.

In a decision handed down by Britain's High Court of Justice, where Mr. Cherney initially filed his suit, the judge recounted Mr. Deripaska's position, as the magnate represented it in proceedings filed with the court.

Mr. Deripaska said Mr. Cherney, who also grew rich in the metals business in the 1990s, was never a business partner in a normal sense of the word, the judge wrote in his representation of Mr. Deripaska's pleadings, but someone Mr. Deripaska was forced to rely upon who ran a "protection" racket.

According to the same earlier-court decision, Mr. Deripaska said he agreed to pay Mr. Cherney $250 million at the London meeting as a kind of severance fee to end his relationship with him. Mr. Cherney denies any relationship with a protection racket.

Iceland will lift capital controls later this year

By Joel Sherwood And Clare Connaghan

Iceland's central bank on Friday outlined plans to begin lifting capital controls later this year, a day after the International Monetary Fund said it postponed a meeting to review its funding for the country.

Elsewhere, Standard & Poor's Corp. said it raised Ukraine's foreign-currency rating outlook to positive from stable, reflecting what it said was the government's progress in implementing budget and financial-sector changes to comply with IMF conditions.

In Iceland, the central bank said it will begin lifting capital controls once foreign-currency reserves are adequately stocked, which it said should happen by November. Restrictions on capital flows were installed late last year in an effort to support Iceland's krona after banks virtually collapsed and the country tottered on the brink of bankruptcy.

The news followed a plan by Iceland to apply to join the European Union, which would require eventual euro adoption, and measures to recapitalize the banking sector—both steps toward reintegrating with Western economies.

Restrictions on foreign-currency inflows for new investment will be removed first. Provided that goes well, the central bank said, the next phase will be removing capital-outflow restrictions, an action that will unlock foreign capital trapped in Iceland since the crisis erupted.

Further details of the program will come Aug. 5, the central bank said.

Efforts to revive Iceland's banking industry received a blow when the IMF said it had postponed a meeting to review funding for the country. Iceland received an initial $827 million from the IMF when the deal was agreed to in November, and eight further payments are subject to review. Iceland's Nordic cousins have pledged an additional $2.5 billion in aid, also subject to IMF review.

"As Iceland has fulfilled all the conditions set for the program review, it is regrettable that its approval by the executive board will now be postponed," Iceland's Prime Minister Jóhanna Sigurdardóttir said Friday. She said she hopes the review vote will happen soon.

Meanwhile, despite S&P's upgrade of the outlook on Ukraine's debt rating, the ratings agency said parliamentary elections due to be held in January mean that economic and political risks will persist. The agency rates Ukrainian long-term foreign-currency debt at CCC-plus, among the riskiest credits around.

"The predictability of policy making continues to be poor due to Ukraine's weak institutions, and the high turnover rate among key decision makers," S&P credit analyst Franklin Gill said. Ukraine has been battered by the tumbling price of steel, its chief export, along with currency and fiscal crises.

But Ukrainian politics have recently stabilized, and these factors encouraged the IMF on Tuesday to approve the immediate release of an additional $3.3 billion to Ukraine, the third tranche of a $16.4 billion loan package announced late last year.

—Ayse Ferliel contributed to this article.

Euro zone consumer prices continue to fall

By Nicholas Winning And Christopher Emsden

LONDON—The latest euro-zone unemployment and consumer-price data underscore the threats bedeviling the 16-nation bloc as it tries to recover from recession.

The annual contraction in euro-zone consumer prices accelerated in July, increasing the risk of deflation. The annual CPI rate fell 0.6% in July from a year earlier, the European Union's official statistics agency said.

Separately, the euro zone's unemployment rate rose to its highest level in a decade, Eurostat added. The jobless rate rose to 9.4% in June, the highest level since June 1999.

Reuters

European economists say they hope for a revival in the U.S. economy to help stir a global recovery. Above, people enter a government job center in Madrid in June.

Deeper deflation

Euro zone's consumer-price index, year-to-year percentage change

Source: Eurostat via Thomson Reuters Datastream

The continued rise in the number of people out of work darkens the outlook for consumer spending and suggests it may take longer for the region to recover from recession.

Europe's woes echo trends in Japan, where analysts say Friday's reports of falling prices and increasing unemployment could hurt the nation's economy.

European economists say they hope for a revival in the U.S. economy to help stir a global recovery and renewed demand for Europe's sagging export trade. But the combination of rising joblessness and falling prices at home risks delaying consumer spending, as households either economize or hold out for lower prices on purchases.

Retailers are feeling the effects. Pedro Feduchi, who runs a Madrid store that sells high-end furniture, reports business has been lackluster. "People are coming in but nobody is buying anything," the 50-year-old retailer says. "Everybody seems to have decided that now the thing to do is boost savings."

The bent toward frugality—and uncertainty about the future—was emphasized by Milan architect Giovanni Contro. "I have a job but there's no security right now," he says.

Fiscal strains are growing. With more people out of work, rising welfare costs put more strain on budget deficits as tax receipts melt away.

The strains are familiar to Kevin Barry of Dublin, who runs a recruitment company specializing in placing engineers, architects and project managers. For Mr. Barry, 2008 "for me and my company was fantastic, it was probably the best year we've ever had," the 36-year-old says. By contrast, 2009 "has been a complete disaster. ...People are very cautious and my clients are keeping their cash very tight."

The jobless data show 158,000 people joined unemployment lines across the euro zone in June, bringing the number of jobless to 14.9 million—more than the populations of Austria and Ireland combined. The unemployment rate among those under age 25 was 19.5% in June.

The annual CPI rate remains well below the level of around 2% that the European Central Bank targets in the medium term. The data aren't expected to prompt an immediate policy response by the ECB, which previously has said it expects consumer prices to decline for several months before beginning to increase by the end of the year.

—Joe Parkinson and Nina Koeppen contributed to this article.

Businesses key to ending recession

Investment cuts slow, inventories decline in signs of an upturn

BY JUSTIN LAHART

After registering its steepest downturn since the end of World War II, the U.S. economy looks poised to start growing again. But with consumers expected to keep a tight lid on spending, a recovery hinges greatly on how businesses behave in the months ahead.

If they stop slashing their inventories and investment, it could mark the first legs of an upturn. Business showed some signs of healing in the government's report on second-quarter gross domestic product, but executives remain very cautious.

Investment in equipment and software contracted at a 9% annual rate for the quarter after collapsing at a 36% rate during the first three months of the year and a 26% annual rate in the final three months of 2008. Exports contracted at a 7% rate, after tumbling by 30% and 20% in the two previous quarters, respectively.

And executives might have moved about as far as they can go to pare their inventories, cutting them at an annual rate of $141 billion in the second quarter and $114 billion in the first. By selling off goods they held in inventory, companies needed to produce much less. Now with stocks running bare, firms could be in a position to increase production again.

In a conference call with investors Thursday to discuss its second-quarter results, boat maker **Brunswick** Corp.'s CEO, Dustan McCoy, said the company's fiberglass-boat production amounted to just 13% of what dealers sold. All the rest came out of stockpiles.

The auto sector is one area where inventory cutting might have set the stage for an upturn. Published production levels suggest an increase of about 60% in auto production in the third quarter from the second, enough to raise GDP by about two percentage points, according to estimates by Goldman Sachs.

Group 1 Automotive Inc. CEO Earl Hesterberg said in a conference call Tuesday that the auto retailer's used-car inventories have fallen below normal "as we've been challenged to acquire enough vehicles in the open market at competitive prices."

Dave Lerman, CEO of South Bend, Ind.-based **Steel Warehouse** Co., said inventories had been reduced to "even slightly uncomfortably low levels" in the industry. "This uptick we've seen in the steel business is an attempt to start buying at least at the level of sales."

Mr. Lerman, whose firm sells steel to manufacturers, has slashed his stockpiles of steel by 50% from last year, when he was caught with too much inventory as the commodity boom quickly turned to bust. Lately, he has seen business improve. One sign: Steel mills are starting to take longer to make delivery on his orders. In response, he has hired back 20 workers after laying off more than 100 and has started ordering above his sales levels.

But executives are broadly cautious about the outlook, and many doubt a robust upturn is at hand.

"We're chasing every nickel," says Ron Mager, president of machine-tool dealer Machinery Systems Inc., in Schaumburg, Ill. When his orders dried up last year, he cut his work force down to 68 people from 78 people. Conditions are looking up now, but not enough to convince him to start rehiring aggressively. "I expected July to be a disaster," he said. "It's always our slowest month—there are plant shutdowns even in good times. And July was our best month of the last four."

Though not yet convincing, improvements in the business landscape stood in contrast to consumer behavior in the second quarter. As the unemployment rate soared to 9.5%, households cut back. Consumer spending contracted at a 1.2% annual rate after rising slightly in the first quarter.

I don't go out to eat like I used to, I don't go on trips like I used to," said 52-year-old Donald Folks, who runs a lawn-care business in Coatesville, Pa. "You're afraid to spend what money you've got. You're holding on until something turns around."

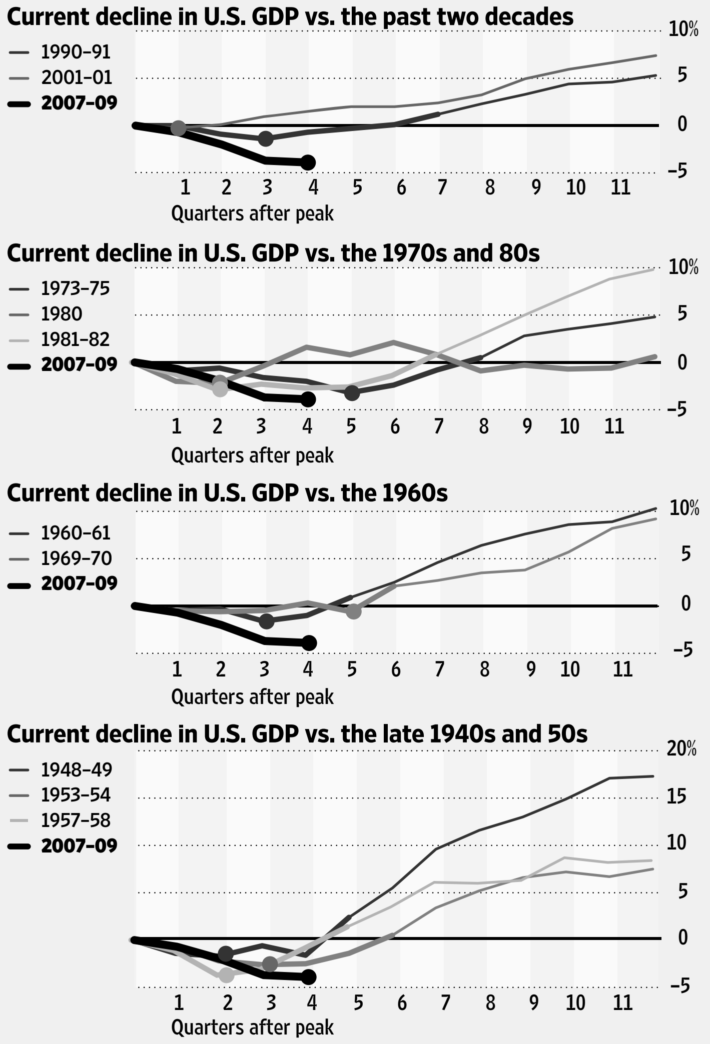
The combination of consumer and business caution means that the economy will grow only slowly, said Goldman Sachs economist Edward McKelvey. On the one hand, consumers will remain wary of spending until they see the labor market stabilize and paychecks increase. On the other, companies tend to take their cues from consumer spending.

"We're not going to have a strong recovery," Mr. McKelvey said. "It's likely going to be a pretty sluggish affair."

Several firms raised estimates in response to the decline in inventories, including Deutsche Bank, which now forecasts 2% growth, up from a previous forecast of 0%.

From bad to worst

With the announcement of 2009 second-quarter GDP and the revision of the historical data by the U.S. Commerce Department, the current decline in U.S. GDP became the steepest peak-to-trough decline since the end of World War II. Charts show change in gross domestic product from its peak in each economic cycle:



Note: GDP is adjusted for inflation and seasonal shifts. Source: U.S. Commerce Department

U.K. may tighten official policies on immigration

BY ALISTAIR MACDONALD

LONDON—The U.K. government is planning to review its immigration policies, in a move likely to make it more difficult for foreigners to become British citizens.

The country's Home Office on Monday plans to announce new proposals that could see foreigners have to score a certain number of points to become British citizens—a requirement already in place for people entering the country to work or study. This would extend a system, modeled after one in use in Australia, which was introduced last year and which grades workers and students hoping to enter the U.K. on criteria including education, age and need for their skills.

Further details of the new proposals weren't immediately available, but a Home Office spokeswoman said their aim would be to "provide flexibility for the government to respond to the changing economic needs of the country."

The move comes at a time when unemployment has hit a 12-year high and concerns about terrorism have fueled a surge in protectionist sentiment in the U.K., long one of the world's most open countries. Earlier this year, workers at a number of refineries staged large-scale strikes to protest the use of foreign workers. Meanwhile, once-marginal anti-immigration politicians have been gaining ground.

The U.K. has already been tightening its immigration policies, starting several years ago. The points-based system has raised hurdles for all but the most highly skilled workers to enter and live in the country.

The Home Office said its proposals will be put out for public and political consultation. The spokeswoman said the proposals would aim to strengthen the country's current citizenship process, which already requires candidates to display good conduct, speak English and demonstrate that they are making a contribution to the community.

"The points-based system has already proved to be a powerful tool for controlling migration for the benefit of both British people and the economy," she said.

In 2009, England, which receives the majority of the U.K.'s immigrants, is expected to overtake the Netherlands to become the most densely populated country in Europe. According to government calculations, immigration will add seven million people by 2031 to the U.K.'s population of nearly 61 million. Critics say recent increases are placing a huge burden on public services, as hospitals and schools face increased demand but no increase in their budgets.

In elections last June, two members of the British National Party won seats in the European Parliament, the first electoral success for the anti-immigration party.

Other European countries also are clamping down on new immigration as their economies slow and citizens complain that too many people are being allowed in. Britain, however, with France and Germany, was among the first to open its borders to large-scale immigration from non-European countries after World War II.

Some industries, including the catering and banking sectors, have complained about the increased restrictions.

Geithner sees 'hard choices' ahead on deficit

BY JESS BRAVIN

WASHINGTON—U.S. Treasury Secretary Timothy Geithner said signs were emerging of an economic recovery, but that a health-care overhaul, tighter regulation of financial markets and "hard choices" to pay down the deficit were needed to assure future prosperity.

"We need to make sure that we are making the kind of investments that will build a more productive economy, gains of growth more broadly shared," Mr. Geithner said on ABC News's "This Week," which aired Sunday. "That's why it's so important as we focus on recovery that we're making investments in health-care reform, in education, in infrastructure, fixing our financial system."

Timothy Geithner

In addition to such efforts, he said, the U.S. needs to "have the will to bring these deficits down once recovery is firmly established." Mr. Geithner added, "That's going to require some very hard choices. And we're going to have to do that in a way that does not add unfairly to the burdens that the average American already faces."

Asked whether that included the possibility of new revenue—presumably through raising taxes—Mr. Geithner didn't rule it out. "Well, we're going to have to look at—we're going to have to do what's necessary," he said.

The Congressional Budget Office has projected the federal budget deficit will grow to $1.8 trillion for the current fiscal year, which ends Sept. 30.

Sen. John McCain (R., Ariz.), appearing on CNN's "State of the Union," expressed doubt that the administration was concerned about the deficit. While "it's very clear that the stimulus has had some effect," he said, "what I worry more than anything about is the long-term effects because we are committing generational theft."

Several other administration officials appeared on the Sunday news programs with message similar to Mr. Geithner's: President Barack Obama's economic policies were beginning to show results, but long-term economic growth would depend on broad policy changes.

Christina Romer, head of the Council of Economic Advisers, said she expected gross-domestic-product growth by year's end but that "it will be awhile after that before we see employment actually going up."

With unemployment benefits set to expire for about 1.5 million people by year's end, according to the National Employment Law Project, Ms. Romer told CNN that an extension of the benefits was "absolutely on the table."

Lawrence Summers, director of the National Economic Council, said on NBC News's "Meet the Press" that "the economy is no longer in free fall," and that "people are speculating about when the recession is going to end," rather than whether it will become a depression.

Asked whether the administration planned to seek additional stimulus funds, Mr. Summers said the money already allocated had yet to achieve its full effect. Funding from the $787 billion stimulus package was moving into the economy, and its impact would "increase with the passage of time," he said.

He also said the administration wasn't planning to seek more funding for the Troubled Asset Relief Program, which was set up last year to help troubled financial companies.

Mr. Summers played down questions about health legislation's chance of passage. The House shut for August recess last week without approving any legislation, and Senate leaders have indicated that little additional progress was likely to be made on the issue in the chamber before it recesses toward the end of the week.

"Yes, there are continuing controversies," Mr. Summers said, "but let's not forget that we are closer to comprehensive health-care reform than this country has ever been."