Leading the News: Falling consumer prices keep European central banks busy

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What's News

BMW posted a 76% drop in second-quarter earnings as demand for luxury cars sagged. The auto maker shied away from giving a concrete outlook for the remainder of the year. Page 30

■ **Toyota reported** a $816 million loss for the fiscal first quarter, but it predicted a narrower loss than expected for the first half. Page 30

■ **Miner Xstrata reported** profit fell 77% as it pressed its case for a proposed merger with Anglo American and dismissed calls to sweeten the offer. Page 6

■ **U.S. stocks edged higher** as the Nasdaq and S&P held key levels. In Europe, shares fell as investors took profits after recent gains. Page 18

■ **U.S. consumer spending** rose in June, driven by higher gas prices, even as Americans saw their personal income fall. Page 3

■ **The Church of England** appointed RMB's Tom Joy to manage its $7.5 billion investment portfolio. Page 17

■ **A report on Russia's** war with Georgia last year has been delayed by the international mission conducting the evaluation. Page 2

■ **Hillary Clinton arrived** in Kenya, starting an Africa tour on which she is expected to emphasize Obama's support of good governance. Page 9

■ **Munich Re warned** of an uncertain outlook even as the reinsurer posted a 14% rise in second-quarter profit. Page 19

■ **Statoil posted** a sharp decline in its second-quarter net profit, citing an "unusually high" tax rate. Page 7

■ **Infineon raised** $1.04 billion in a capital increase the chip maker said will let it restructure its finances and leave it debt-free. Page 20

■ **Australian police arrested** four men they allege were planning a suicide attack on a military base on the outskirts of Sydney. Page 9

■ **The Taliban shelled** Kabul, a minor attack that could add to security concerns, threatening to undermine the legitimacy of Aug. 20 polls. Page 9

■ **Romania cut** interest rates to 8.5%, their lowest level in over a year, to help revive economic growth. Page 20

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EDITORIAL&OPINION

Sold out
Germany Inc.'s export business model isn't working so well. Page 13

Breaking news at europe.WSJ.com

Associated Press

Bill Clinton, seated left, and others in his delegation pose with Kim Jong Il in Pyongyang on Tuesday, in a photo provided by North Korea.

Kim pardons journalists

North Korean leader orders Americans' release after meeting Bill Clinton

By Evan Ramstad And Jay Solomon

North Korean leader Kim Jong Il pardoned two American journalists held in Pyongyang and ordered their release, state media reported, after meeting with former U.S. President Bill Clinton.

Mr. Clinton's surprise trip, apparently focused on an effort to secure the release of the two women, poses diplomatic and political risks for the Obama administration, yet also holds the prospect of changing a long-fractious relationship that has become more antagonistic over the past year.

Mr. Clinton arrived Tuesday morning in a private aircraft that flew directly from Anchorage, Alaska, with a delegation that included his former White House chief of staff, John Podesta. Kim Kye Gwan, the North Korean vice foreign minister who has long been in charge of dealing with the U.S., and some other senior officials met Mr. Clinton, video footage provided to international news agencies showed.

No one from the U.S. government went along, and U.S. agencies, including the White House and State Department, declined to comment about the trip. Press Secretary Robert Gibbs said the White House wouldn't comment while Mr. Clinton was there because "we do not want to jeopardize" the outcome of his work.

Euna Lee and Laura Ling, journalists for San Francisco-based Current TV LLC, were arrested on the North Korea border with China on March 17 while filming a report about North Korean refugees. In June, a North Korean court found the reporters guilty of illegally entering the country and sentenced them to 12 years in prison.

Senior Obama administration officials said Tuesday

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Novartis CEO is target of attacks

By Jeanne Whalen

A burst of attacks on Swiss drug giant **Novartis** AG, including a theft of the ashes of the chief executive's mother from a grave site, have raised concerns that aggressive animal-rights groups are stepping up their campaign against the drug industry.

Novartis officials said Tuesday they believe animal-rights groups are behind the attacks, which they said have included a fire this week at CEO Daniel Vasella's vacation home in the mountainous Tyrol region of Austria. The theft of Dr. Vasella's mother's ashes was discovered late last month at a cemetery in a small Swiss village, where Novartis said graffiti indicated the possible involvement of animal-rights crusaders.

Novartis said the incidents are part of a string of suspicious activity that started late last year. In recent months there has been a fire at a Novartis-owned tennis club near company headquarters in Basel, Switzerland, and the smashing of windows of employee cars in Switzerland and Germany.

Daniel Vasella

In May, some Novartis employees in Germany began finding "rudimentary" incendiary devices under the tires of their cars while they were parked at home, the head of global security for Novartis, James Christian, said in an interview Tuesday. None of devices went off, he said, and no one has been hurt.

One prominent animal rights group was quick to deny any connection to any of the incidents, and police contacted about several of the incidents in Switzerland and Austria said they don't yet have suspects.

The incidents revived memories of aggressive activists who earlier this decade targeted **Huntingdon Life Sciences Group** PLC, a laboratory in the U.K. that animal-rights groups have long criticized for carrying out research on animals. New legislation and a police crackdown in the U.K. have since less-

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Pay rises at UBS despite net loss

UBS AG Chief Executive Oswald Grübel ruled out Tuesday guaranteeing bonuses to investment bankers.

By Stephen Fidler, Katharina Bart and Vivek Ahuja

"I think, in general, guarantees are a mistake," he said of a tactic to retain top staff that became a symbol of the excesses that led to the credit crunch.

UBS's investment bank nevertheless recorded higher performance-related compensation and basic salary increases in the second quarter, despite posting a pretax loss of 1.8 billion Swiss francs ($1.7 billion). Total staff expenses at the investment bank were 24% higher than in the first quarter, rising to 1.5 billion francs even as the number of staff at the division fell by 1,100. UBS Chief Financial Officer John Cryan said competitive pressure for talent contributed to an approximately 80% rise in bonus accruals at a group level.

UBS's net loss widened as its focus on shoring up its balance sheet meant it missed a revival across markets that has led to strong earnings from many peers. (See articles on pages 4, 17, 19 and 32.)

BNP Paribas SA said Tuesday that investment-banking activities contributed to a 6.6% rise in its second-quarter net profit.

Inside

Grande plans

Latest Starbucks buzzword: 'lean' Japanese techniques
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Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	9320.19	+0.36
Nasdaq	2011.31	+0.13
DJ Stoxx 600	227.79	-0.29
FTSE 100	4671.37	-0.24
DAX	5417.02	-0.18
CAC 40	3476.37	-0.04
Euro	$1.4400	-0.11
Nymex crude	$71.42	-0.22

LEADING THE NEWS

Report on Russia-Georgia conflict delayed

Fact-finding mission grapples with deluge of new documents

BY MARC CHAMPION

A year after Russia fought a war with its former Soviet neighbor Georgia, the argument over who was to blame for a conflict that at one point threatened to reignite the Cold War is raging again.

The five-day conflict left hundreds dead, Georgia's army crushed and two parts of its territory—Abkhazia and South Ossetia—under Russian occupation, perhaps lost forever. It also left the West struggling with how to respond to Russia's determination to assert a sphere of influence. But the core questions left by the war—who was to blame, why was it fought and whether genocide was committed—remain hotly disputed.

An international fact-finding mission, headed by a Swiss diplomat, has delayed its report on the war from the original due date of July 31 to the end of September. According to the mission's deputy chief, German diplomat Uwe Schramm, that's because reams of documents arrived at the last minute from both sides, and the mission wants to conduct "a full and responsible evaluation of all the material available."

All parties to the conflict are trying desperately to entrench their version of what happened before the report comes out. At least three books in English alone on the Aug. 7-12 war have been published recently or soon will be. All three recount the war as the final step in a Russian plan to de facto annex neighboring territories and halt Georgia's efforts to attach itself to the West.

On Thursday, the Georgian government is due to present a similar view of events in its own 40-page report on the war, which was reviewed by The Wall Street Journal.

Meanwhile, South Ossetia, the tiny Russian-backed enclave where most of the war was fought, on Saturday will open a genocide museum to highlight a key claim on which Russia based its massive military intervention. A Russian made-for-TV action flick called "Olympus Inferno," released in March, promotes its case that Georgia began the war in order to seize lost territory.

A recent article in German magazine Der Spiegel went viral in Russian media and on blog sites when it claimed to have seen documents from experts on the international commission indicating that the commission would blame the war on Georgian President Mikheil Saakashvili. The head of the commission, Swiss diplomat Heidi Tagliavini, issued a harsh rebuttal describing the article as "entirely fictitious." The documents quoted proved to be newspaper articles written before the commission existed.

Pressure on Ms. Tagliavini, who served in Chechnya, Bosnia and Moscow in the 1990s, and for four years until 2006 as the head of the United Nations observer mission in Abkhazia, is immense. What she says could have lasting repercussions, diplomats and analysts say.

"If you believe this war was fought by Russia to defend its sphere of influence and prevent Georgia from going West, then the policy conclusions you draw are very different from if you think it was self-induced by Saakashvili," says Ronald D. Asmus, a former U.S. diplomat and head of the German Marshall Fund office in Brussels, whose book on the conflict comes out later this year. "Yes it matters," he says.

Georgian officials acknowledge they have the bigger hill to climb, because only an unambiguous report blaming Moscow for the war could change the status quo. A report that fingered Georgia for starting the war, and Russia for overreacting—the conventional wisdom in Western capitals—would simply reinforce the facts on the ground, they say.

Rushing to war

The dispute over how last August's Russia-Georgia war began still rages.

February 2008
Kosovo declares independence and is recognized by most Western countries.

March
Russia withdraws from an arms embargo on Abkhazia.

April
NATO denies Georgia a roadmap to membership, but says it will eventually join. Russia establishes direct relations with the de facto governments of Abkhaza and South Ossetia.

May
Russia rebuilds railroad into Abkhazia and boosts military presence.

June
Violence begins to escalate in South Ossetia.

July
Russia conducts massive military exercises on Georgian border.

August
Saakashvili orders an assault on South Ossetia, and Russia responds massively.

Western diplomats say the fact that in a year only Nicaragua has followed Moscow in recognizing Abkhazia and South Ossetia as nations is a major diplomatic defeat for Russia. But according to Sergei Markov, a political analyst with close ties to the Kremlin, Russian officials aren't concerned. "What for? If Abkhazia and South Ossetia are recognized by nobody but Russia, that's good for Russia. These countries will be tied to Russia, like northern Cyprus is to Turkey," he says.

The commission has peppered both sides with questions about the immediate period before Mr. Saakshvili ordered his forces to attack at 11:35 p.m. last Aug. 7, and also about the months before, when Russia already appeared to begin integrating the two territories, and afterward, when Georgian villages were terrorized and people forced to flee. In many cases, their houses were then burned and bulldozed.

Russian officials continue to claim that Georgian forces were guilty of genocide, forcing Russian intervention. A special investigative committee of the Russian Prosecutor's Office set up to tally civilian deaths has found that 162 South Ossetians died in the conflict. That's less than the 1,500 to 2,000 that Russia claimed in the first days of the war, but Moscow now says it has documents proving that the Georgian intent was genocide, even if it was unable to carry out the plan.

Moscow has produced a key piece of evidence for Ms. Tagliavini, a document titled Order No. 2, allegedly issued by Georgian military commanders at 5:15 a.m. on Aug. 7, telling the soldiers they would be restoring "Georgian jurisdiction" in South Ossetia. If genuine, that would support Russia's accusation that the Georgian attack was decided early on, and not, as Mr. Saakashvili claims, as a late-night response to a Russian invasion. Shota Utiashvili, a senior Georgian interior ministry official, called the Russian document "a total fabrication."

Georgia, for its part, has provided the commission with what it says are intercepts of telephone conversations between members of a South Ossetian militia from 2 a.m. to 4 a.m. on Aug. 8, in which they say Russian armor and troops had already passed through the 3.66-kilometer Roki tunnel that connects Russia with South Ossetia. One purported intercept, part of the report reviewed by the Journal, was timed at 2:20 a.m. and goes like this:

Lagoev: Where are our big brothers?

Gaseev: They are coming, they just passed through the tunnel.

None of these documents or intercepts could be independently verified. If genuine, the intercepts would support Mr. Saakashvili's claim that he received intelligence at around 11 p.m. on Aug. 7 that a Russian column was approaching the entrance of the tunnel. He says it was in response to this news that he ordered his troops to move forward. Russian officials didn't return calls for comment.

Last year, however, Russian officials did acknowledge as genuine intercept transcripts from 3 a.m. the previous night, Aug. 6, during which Ossetian soldiers talked about the tunnel being "full" with a Russian column. Moscow claimed the troops were part of a routine troop rotation, although under the terms of their peacekeeping mission no troops were allowed to pass through the tunnel at night. Georgian officials say it was the arrival of that first column that forced them to pull troops up into position on the 7th. The news at 11 p.m. of the second column, the officials say, triggered war.

—Andrew Osborn contributed to this article.

CORRECTIONS & AMPLIFICATIONS

In a recent survey by the National Ovarian Cancer Coalition, 83% of women said their doctors hadn't discussed the symptoms of ovarian cancer with them. A Health Journal column Tuesday incorrectly called the group the National Ovarian Cancer Association.

Iceland's foreign-currency debt is rated triple-B-minus by Standard & Poor's; its local-currency rating is triple-B-plus. A Money & Investing article Tuesday didn't specify which rating it was citing.

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

European prices keep the focus on growth

Central banks still have plenty of room for monetary stimulus

BY ILONA BILLINGTON AND TERENCE ROTH

LONDON—New evidence suggesting that European consumer prices will keep contracting is likely to keep the region's top central banks focused on reviving their economies.

An index of euro-zone producer prices fell by 6.6% in June from a year ago, the sharpest fall since records began in 1982, the Eurostat statistics agency said Tuesday. Prices edged up 0.3% from May on rising energy prices. Without energy factors, prices would have contracted 0.1% from the month before.

The result indicates that, despite signs that the euro-zone economy is stabilizing after a yearlong downturn, low demand is still pressuring the prices companies can charge at factory gates. Rising unemployment in the 16 countries sharing the euro currency and weak global demand likely will prolong the trend, economists say.

That same scenario holds throughout the rest of Europe. Other major central banks, including the Bank of England and the Swiss National Bank, are expected to keep injecting generous amounts of money into their economies as they begin to emerge from recession.

The European Central Bank holds a policy meeting on Thursday, when it is expected to keep its official interest rate at 1% and its program of pumping additional €60 billion ($86.4 billion) into the banking system with purchases of covered bonds.

Economists expect the ECB will be on hold for the next several months before considering the first steps of winding down monetary stimulus once the recovery takes hold.

"With several indicators still signaling a risk of deflation, the bank will have to explain how to make sure it doesn't happen here," said Peter Vanden Houte, euro-zone economist for ING Economics.

In the U.K., which isn't in the euro zone, consumer prices are still in positive territory, but have been slowing sharply. A month-to-month drop in June producer prices reported last month indicated price pressures will remain.

The Bank of England's policy panel meets Wednesday and Thursday, when financial markets will watch for a possible decision to increase the volume of its own bond-purchasing plan. The release of the BOE's next inflation report, due Aug. 12, could include other policy clues.

The U.K. central bank has so far bought £125 billion ($211.8 billion)—equivalent to around 9% of nominal gross domestic product—of mostly U.K. government bonds under its "quantitative easing" policy.

But BOE money-supply data released Tuesday confirmed that the flow of money to U.K. households and businesses remains sluggish. This raises expectations that the BOE will announce plans to expand the program by £25 billion.

Source: Eurostat

The Swiss National Bank, the country's central bank, won't hold another policy session until next month. But it is widely expected to continue its policy of keeping the three-month Swiss franc London interbank offered rate at 0.25% at least for the rest of the year.

The view received further confirmation Tuesday when the national statistics office said July consumer prices fell 0.7% from June and 1.2% from a year ago.

Economists also say the SNB is likely to continue to pump liquidity into the banking system by buying Swiss franc-denominated bonds or selling Swiss francs against other currencies if needed.

In other economic news, Spanish jobless claims were reported shrinking for the third consecutive month in July, helped by the summer tourism season and the government's €8 billion infrastructure plan.

The Labor Ministry said jobless claims fell by 20,794, or 0.6%, to 3,544,095 in July from June. But that total was still up 46% from July 2008.

—Natasha Brereton and Jonathan House contributed to this article.

U.S. consumer spending rises even as incomes decline

BY JEFF BATER

WASHINGTON—U.S. consumer spending climbed in June, but the gain seems to have been driven by rising gasoline prices. Meanwhile, the income of Americans took the largest tumble in four years during June, reflecting the rising unemployment that is challenging the economy as it struggles out of recession.

Personal income decreased at a seasonally adjusted rate of 1.3% from the month before, the Commerce Department said Tuesday. Wages and salaries as well as transfer payments both fell.

The drop, the biggest since the 2.3% decline in January 2005, was a payback for May income increasing 1.3%. Federal-government stimulus of the economy had driven the surge, involving a large sum of transfer payments, including temporary benefits for older people. The 1.3% gain marked a revision downward from an originally reported 1.4%.

Spending increased 0.4% from the prior month. Adjusting for inflation, though, spending dipped by 0.1%. U.S. Energy Department data show retail gasoline hit a 2009 peak, at $2.69 a gallon, during the week ended June 22. The last time inflation-adjusted spending rose was in February, up 0.1%, echoing recent reports on lackluster spending by consumers.

Spending in May rose 0.1%, revised downward from an originally reported 0.3% gain.

Disposable personal income—income after taxes—fell by 1.3% in June. Disposable income rose 1.6% during May.

Without government support, personal income is under pressure as the U.S. workweek gets shorter. In a report showing that the U.S. unemployment rate rose to 9.5% in June, the Labor Department said the average workweek for production and nonsupervisory workers on private nonfarm payrolls fell by six minutes to 33 hours—the lowest since records began in 1964.

The bad job market is endangering a U.S. recovery. A key report last week said the economy contracted from April through June by 1%, much less than over the winter. But the data showed consumer spending decelerated in the spring, and spending is a big part of the economy. While analysts foresee the economy rising in the current, third quarter, fear for jobs will likely keep wallets tight and hinder the expected growth during the rest of the year.

The data Tuesday showed that personal saving as a percentage of disposable personal income was 4.6% in June, the Commerce Department said. It was 6.2% in May, 4.7% in April and 3.7% during March.

An important price gauge eased in June. The price index for personal consumption expenditures excluding food and energy, year over year, rose 1.5%, after climbing 1.6% in May. The Federal Reserve watches this core index closely for signs of inflation pressures. Fed officials define their statutory goal of price stability as inflation of 1.5% to 2%.

The core index increased 0.2% in June compared with May after rising 0.1% in May.

But inflation watchers remain vigilant. The Fed and the federal government have pumped out a lot of money to revive the economy. The efforts could backfire, unlocking inflation and pushing interest rates higher.

China's migrants find new jobs, amid mixed signs of a rebound

BY ANDREW BATSON

BEIJING—China's government said most rural migrant workers have found new jobs after mass layoffs last year, indicating the effects of its stimulus are filtering into the job market. But the downturn is still being felt in weaker growth of household incomes, which could hold back consumer spending.

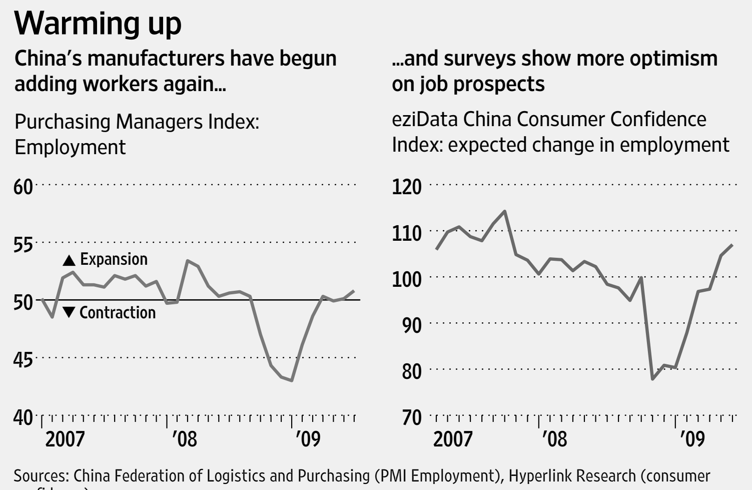
Less than 3% of migrant workers who have returned to cities in recent months are still looking for jobs, said Wang Yadong, a deputy director-general at China's labor ministry. He said 95% of migrant workers preferred to seek work in cities this year rather than go back to farming. He declined to give more detailed figures, and didn't explain how the estimates were made. Mr. Wang's report is the first official update since February on the migrant job situation.

Itinerant rural workers are the backbone of China's manufacturing and construction industries, with tens of millions crossing the country every year for work far from their home villages. They were also among the worst-hit by the global downturn last year: Officials previously estimated that 18 million to 23 million of them—about 13% to 15% of the migrant-worker population—had lost their jobs as of January.

Since then, China's economy has pulled back from the brink, thanks to a huge expansion of government investment and lending from state banks. "Our economic stimulus plan has had a clear impact on employment," said Liu Yuanchun, an economist at Renmin University in Beijing.

He noted that while the job market is performing better than many expected a few months ago, the picture is cloudy because government figures aren't reliable. "The actual number of migrant workers who have returned to the cities and found jobs may not be as high as the official figures say," he said.

China's regular employment data have never reflected migrant-workers layoffs, which were measured by special surveys. Yet there are other scattered signs of an improving job market. Recent purchasing managers' index surveys indicate many manufacturers added jobs in May and June. And the government's revenue from income taxes rose 2% in the second quarter, according to economist Stephen Green of Standard Chartered, which also suggests payrolls are expanding.



Sources: China Federation of Logistics and Purchasing (PMI Employment), Hyperlink Research (consumer confidence)

The International Monetary Fund says businesses such as consumer-durables manufacturing and infrastructure construction are absorbing the laid-off workers.

Mr. Wang said the government's estimate of the total migrant worker population had increased by about 10 million since the end of 2008, to 150 million people in June. That figure could be evidence that job opportunities are still drawing more people off the farm this year.

He emphasized that the government will continue measures to boost employment, as three million recent college graduates have yet to find a job. "China's employment situation is still very serious," Mr. Wang said. "There are still a lot of companies whose businesses are in trouble, and the risk of job losses is still high."

New jobs for migrants this year may not be as good as those they had before. Some scholars report that migrant workers have often had to accept lower wages to find new work in recent months. The southern city of Shenzhen, long a magnet for migrant workers, recognized this trend by cutting its average wage guideline for this year by 3.8%, to 2,750 yuan ($402) a month.

Official measures of income and consumption are still rising this year, although at a slower rate. The government's survey of rural households shows average income from migrant work grew 7.7% in the first half of 2009, down sharply from 19.6% growth in the year-earlier period.

Yet a central-bank survey in May found urban households' satisfaction with their income was at its lowest level since 1999. Mr. Liu, the Renmin University economist, said official income figures don't include commissions or bonuses, which are likely to be down sharply. "Many people feel their incomes are declining, and their expectations for future income are not so great, so they are cutting back on their daily consumption," he said.

LEADING THE NEWS

UBS's latest loss blunts improving finances

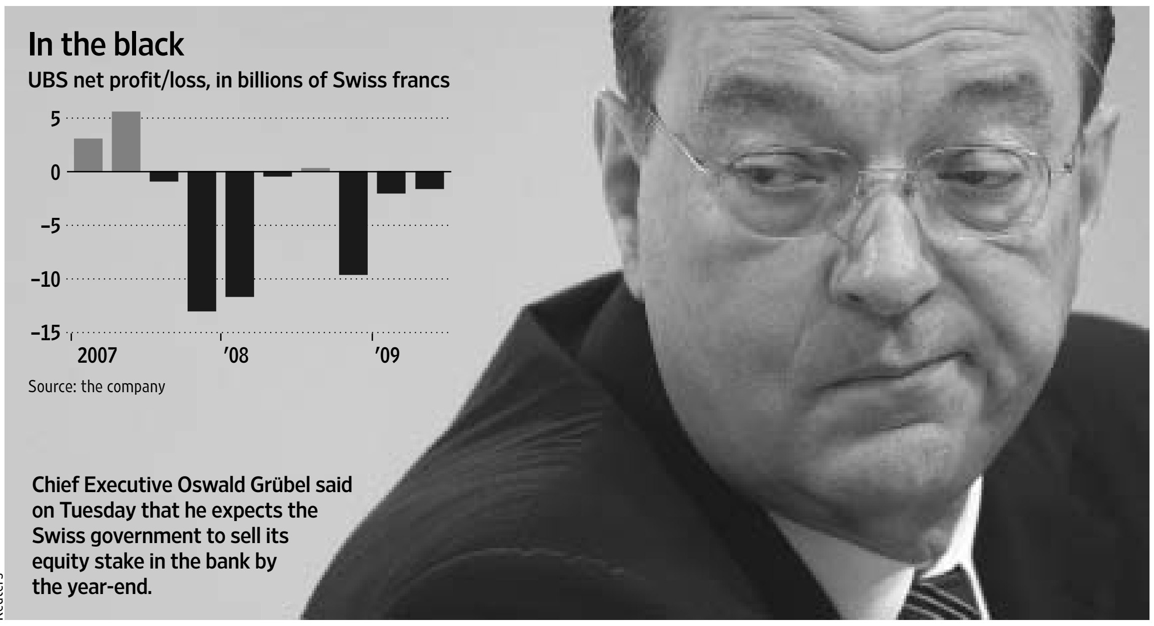
Grübel expects sale of government stake; risk aversion pinches

By Stephen Fidler And Katharina Bart

UBS AG said Tuesday that it had bolstered its finances in recent months, but further losses added to questions about whether the Swiss bank can relaunch its wealth-management and investment-banking businesses.

Oswald Grübel, who took over as group chief executive in February, painted a picture of a bank returning to its conservative roots as UBS reported a net loss of 1.4 billion Swiss francs ($1.32 billion) for the second quarter of 2009. He said he expects the Swiss government to sell its 9.3% investment in the bank by year's end as UBS takes steps toward cutting risk and building up its capital. And he said UBS won't compete for talent by offering guaranteed bonuses to highflying bankers.

The bank's risk-averse stance prevented it from cashing in on reviving financial markets like some of its competitors had, while clients continued to leave its wealth-management business amid concerns about a continuing U.S. investigation into tax evasion. The loss was slightly higher than analysts' expectations, and up from a loss of 395 million francs a year earlier.



Chief Executive Oswald Grübel said on Tuesday that he expects the Swiss government to sell its equity stake in the bank by the year-end.

"We were busy derisking the bank, with making the regulators happy with our capital and leverage ratios, and also getting the bank in a space where we have more freedom in reacting to markets," Mr. Grübel said in a telephone interview.

UBS's balance sheet shrank during the quarter by 14% to 1.6 trillion francs, as improved markets led to a reduction of its derivatives book and allowed it to sell some assets. As a result of this and the sale of new shares to U.S. investors in June, the bank boosted its Tier 1 capital ratio—a key measure of financial strength—to 13.2%. That is likely to increase to 13.7% once the sale of its Banco Pactual subsidiary is completed in the third quarter, putting UBS among Europe's best-capitalized banks.

But the efforts to shore up UBS's finances failed to stanch outflows from the bank's wealth- and asset-management businesses, an exodus that Mr. Grübel warned is likely to continue. Net money flows out of its global asset-management business were 17.1 billion francs in the second quarter, while 5.8 billion francs flowed out of its U.S. wealth-management businesses. Meanwhile, its global and Swiss wealth-management division—battered by U.S. government efforts to clamp down on alleged tax evasion by UBS customers—suffered 16.5 billion francs of outflows.

UBS agreed to pay $780 million in February to settle a criminal case with the U.S. Justice Department. On Friday, an agreement in principle was announced in a civil case with the U.S. Internal Revenue Service; the deal is expected to include the handover to U.S. authorities of account details of suspected U.S. tax cheats. Details of the settlement are expected this Friday. John Cryan, the bank's chief financial officer, wouldn't comment on the settlement, but noted that the bank had made no additional provisions for settlement costs in the second quarter.

Although the bank failed to take advantage of stronger financial markets, it paid more to hire and keep people who might be able to do so in the future. Personnel costs rose to 4.58 billion francs from 3.96 billion in the first quarter "mainly due to higher accruals for performance based compensation," the bank said.

However, Mr Grübel said UBS would not pay multiyear guarantees to attract bankers, saying he believed such payments were wrong. "I think, in general, guarantees are a mistake," he said. He said he saw no evidence that UBS had to pay more than its rivals to attract top staff.

The bank chief said he expected the Swiss government would probably unwind its investment in the bank by year's end, though he said he had no indication of when the sale would take place. The government took a 9.3% stake in UBS last fall in the form of mandatory convertible notes, and the bank expects these to be converted into shares before the government sells them.

In its business outlook, UBS said it remains cautious overall, and that a sustainable economic recovery can't yet be spotted. However, Mr Cryan said business in the third quarter has continued in much the same fashion as at the end of the second quarter, indicating the bank isn't seeing the usual summer lull.

Investment banking, Fortis assets a boon to BNP profit

By Jethro Mullen

PARIS—**BNP Paribas** SA, France's largest bank by market value, said its second-quarter net profit rose 6.6%, helped by another strong performance by its investment-banking division and the acquisition of assets from stricken Belgian peer Fortis.

Profits at many banks—mainly those with large investment-banking operations, such as BNP Paribas, Credit Suisse Group and Goldman Sachs Group—have benefited from a recovery in financial market activity in the first two quarters of 2009. Others, hit harder by the crisis and lacking such extensive investment-banking activities, like UBS AG, have continued to struggle.

Paris-based BNP Paribas said Tuesday that its net profit increased to €1.6 billion ($2.31 billion) from €1.51 billion in the second quarter of 2008.

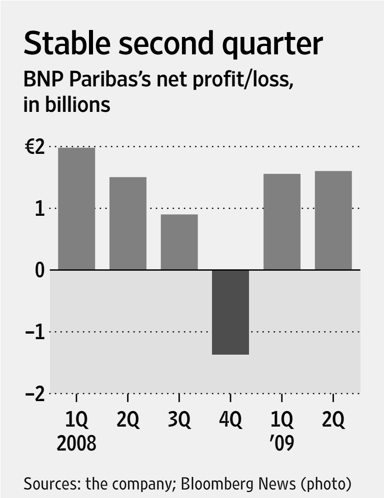
Total revenue increased 33% to €9.99 billion from €7.52 billion.

The growth was spearheaded by the corporate and investment-banking unit, where revenue increased 81% to €3.35 billion, with burgeoning activity in fixed-income operations and a significantly improved performance in the equities business.

Chief Executive Baudouin Prot said at a news conference that the investment-banking unit should continue to report good results, provided that financial markets return to normal levels and client business remains strong. Mr. Prot declined to give an overall 2009 outlook for the bank.

The earnings were boosted by an €815 million gain due to negative goodwill related to the May acquisition of Fortis. Negative goodwill is a gain resulting from the purchase price of an acquisition being lower than its actual asset value.

The performance of the Fortis assets during the second quarter added a further €261 million to BNP Paribas's net profit. That, along with the negative-goodwill contribution, offset most of the damage from about €1.2 billion in charges related to goodwill impairments, write-downs on shares, and the change in value of the bank's own debt.



Baudouin Prot, CEO of BNP Paribas ▶

Including the Fortis operations, BNP Paribas booked €2.35 billion in provisions for credit risk during the quarter, more than triple the amount taken a year earlier, as the economic recession squeezes the finances of companies and consumers who have borrowed money.

Mr. Prot said in a conference call later in the day that he hopes the level of provisions will be the highest reached by the group in the next year to 18 months.

BNP Paribas said its Tier 1 capital ratio had risen to 9.3% from 8.8% at the end of March. The ratio is the core measure of a bank's capital adequacy, comparing equity, preferred shares and retained earnings to total assets.

The bank's second-quarter results "are solid in our view, driven by strong revenues in CIB and Investment Solutions, with Fortis's contribution slightly better than expected," analysts at J.P. Morgan said in a note to clients.

Slide in UniCredit profit not as grim as feared; quarterly gain

By Sabrina Cohen

MILAN—**UniCredit** SpA posted a 74% fall in second-quarter net profit, hurt by lower fees and income from equity investments.

Italy's largest bank by market value said net profit in the quarter ended June 30 fell to €490 million ($706.2 million) from €1.91 billion a year earlier.

That was more than the €427 million forecast by analysts polled by Dow Jones Newswires and sent shares up 3.2% in Milan.

Net profit also was 9.6% higher than its first-quarter net profit of €447 million.

Net trading income almost doubled, to €957 million compared with €484 million a year earlier. In the first quarter, the bank reported a net trading loss of €93 million.

Since the global financial crisis has skewed the results of many banks, analysts say comparisons with the previous quarter often are a better gauge of a bank's performance.

Higher provisions on bad loans hurt Unicredit's bottom line. Net write-downs of loans and provisions for guarantees rose to €2.4 billion from €634 million a year earlier, mainly because of worsening economies in Italy, Germany and Central and Eastern Europe. The bank didn't provide a forecast for upcoming quarters.

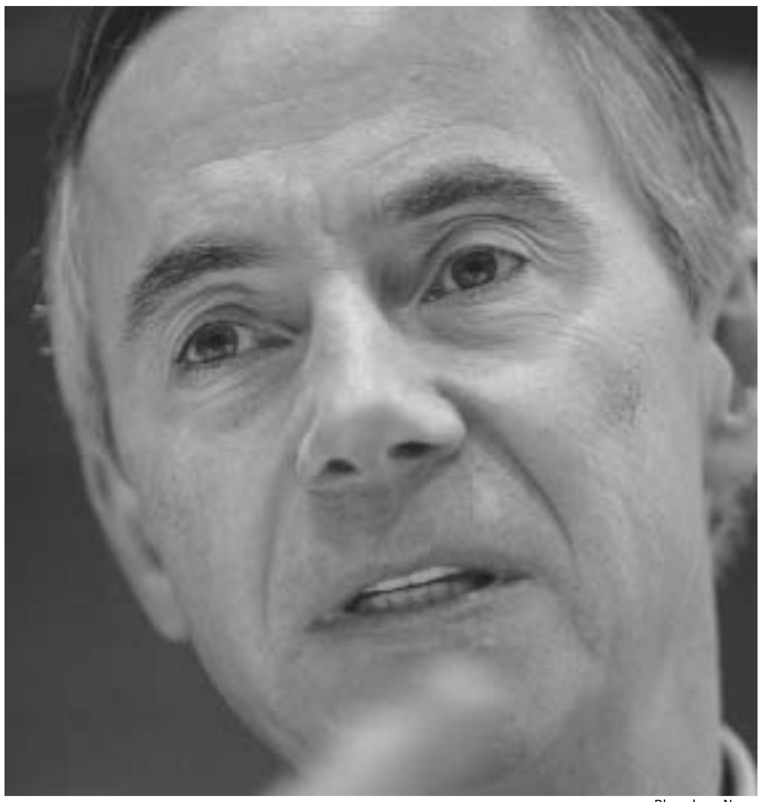
Unicredit developed its business operations in Central and Eastern Europe following the acquisition of German lender HVB in 2005. About 16% of its revenue comes from the area.

The investment-banking unit improved from the first quarter on stronger financial markets and strong client-related activity, the bank said. It posted a pretax profit of €379 million in the second quarter, down from €411 million a year earlier but a large change from the €1.46 billion loss in the fourth quarter of 2008 and the €169 million pretax profit in the first quarter of this year.

The bank said its core Tier 1 ratio, a measure of bank health, was 6.85% at the end of June, up from 6.69% at the end of March. Analysts and central banks look for a ratio or 7% or higher. Unlike most European lenders, most Italian banks haven't yet used government-sponsored plans to strengthen their capital.

UniCredit has sought aid from the Italian government to strengthen its capital ratios and is still evaluating whether to apply also for the same financial instruments in Austria. In May, it said it would seek about €4 billion from both Italian and Austrian governments.

CORPORATE NEWS



Bloomberg News

Sandy Flockhart, chief executive of HSBC's Asian-Pacific unit, speaks in March in Hong Kong. Asia is expected to remain a prime source of growth for the firm.

HSBC positions itself for listing in Shanghai

By Aries Poon

HONG KONG—**HSBC Holdings** PLC is taking steps toward a hoped-for initial public offering in Shanghai that will help raise the company's profile in the Chinese market, its Asia-Pacific chief executive said.

Asia will continue to be the engine of growth for the U.K.-based bank, with loans in the region likely to increase in the second half from a year earlier, Sandy Flockhart said in an interview. China is "the largest part of the puzzle" of growth and will be an investment focus over the next 25 to 50 years, he said.

The main reason for the planned IPO "is to widen our shareholder base and to give an opportunity to those...who would like to invest in a financially diversified bank," Mr. Flockhart said.

While HSBC is seeking to be among the first batch of foreign companies to list in China via a 2010 listing, the timing of the deal is still subject to authorities' decision to allow it. Foreign-controlled companies haven't been permitted to list on stock exchanges in China, but Chinese officials have said in recent years that they intend to allow it. HSBC has said for about three years it would seek a China offering if the government gave a green light.

Mr. Flockhart said HSBC has already hired advisers for the planned listing but didn't name the banks or specify the offering's time frame.

People familiar with the situation said HSBC has chosen **China International Capital** Corp. and **Citic Securities** Co. to handle its planned $3 billion to $5 billion Shanghai IPO.

Apart from the IPO, Mr. Flockhart said the development of a stock-brokerage business in China remains a "very high priority" for the bank. The biggest challenge, he said, is in finding a suitable joint-venture partner with which to launch the operation.

In China, HSBC has an 18.6% stake in **Bank of Communications** Co., the nation's fifth-largest lender by assets; a 16.7% holding in **Ping An Insurance (Group)** Co. of China Ltd.; 8% ownership of **Bank of Shanghai** Co., and a 49% stake in **HSBC Jintrust** Co, a Shanghai-based fund company.

Including the eight billion yuan ($1.17 billion) of registered capital in its China-incorporated unit, HSBC's total investment in China was valued at $8.8 billion as of the end of June, Mr. Flockhart said.

Elsewhere in Asia, Mr. Flockhart expects India, Singapore, South Korea, Malaysia and Vietnam to be among HSBC's markets that will recover rapidly from the recent downturn. "We will see the recovery led by Global Markets and commercial banking. Wealth-management products have lost some of their short-term attractiveness, but eventually we will see that come back," he said.

HSBC's Global Markets business includes securities trading, margin financing and client hedging activities.

HSBC said Monday its Asian business earned a pretax profit of $4.52 billion in the six months ended June 30, offsetting a $3.7 billion pretax loss in its beleaguered U.S. consumer-finance operation.

The bank as a whole posted a first-half net profit of $3.35 billion, improving from a net loss of $1.99 billion in the second half of last year.

Mr. Flockhart said HSBC would choose to expand its footprint in the region organically, at least for now, after considering a number of acquisition opportunities in the first half.

"What's been on offer hasn't been significant to change the space that we are in, and we can achieve what we can do organically without risking shareholders' money on something that's not right," he said.

Even so, he said the bank won't rule out merger or acquisition deals.

Separately, Mr. Flockhart said **Australia & New Zealand Banking Group** Ltd.'s plan to buy some of **Royal Bank of Scotland Group** PLC's Asian banking operations won't likely change the competitive landscape of the region's banking sector.

"The real competitors here are the big Chinese banks and the big local competitors in local markets. International banks, apart from Standard Chartered, are less evident," Mr. Flockhart said.

Web start-ups branch out

As plans to sell application ads fizzle, firms hawk virtual goods

By Emily Steel

Meez

Meez users can create avatars for use on social-networking sites, dressing their online characters with virtual clothing such as a $3 Rocawear T-shirt or a $2 hat.

If at first you don't succeed, try again—and if you are an Internet company, do it quickly.

Slide Inc. is learning this lesson well. The San Francisco-based company, which was started by PayPal co-founder Max Levchin and has raised a total of about $75 million, makes some of the most popular applications on social-networking sites, including a game called SuperPoke, where users can send their friends virtual hugs, slaps and sheep.

To capitalize on its popularity, Slide opened an ad-sales office in New York last summer and hired a team to sell standard online ads, such as the graphical ads that border a Web page. It typically sold such ad campaigns for $50,000 to $200,000.

Now, Slide is scrapping those ad efforts. It recently fired its ad-sales team and instead is focusing on selling so-called branded entertainment campaigns, where an advertiser is incorporated into games that are already popular among consumers. It is also ramping up its virtual-goods business, such as spoofs of famous works of art. It hopes that segment will account for the majority of its revenue this year.

"Think of us like an e-commerce business," says Keith Rabois, Slide's vice president of strategy and business development.

Slide is among a group of companies, including **RockYou**, **Zynga** Inc. and **Meez**, that are diversifying their businesses by selling virtual goods to consumers and branded entertainment ads to marketers.

A year ago, investors thought of these start-up companies primarily as application, or widget, makers, referring to games and other applications for social-networking sites such as Facebook and MySpace. Some of the most-hyped businesses on the Web a year ago were such companies.

Backed by venture-capital dollars, these companies had grand plans to capitalize on their popularity among Web users by selling ads. They opened New York offices, hired ad-sales executives and hosted hip widget conferences to evangelize the new media to marketers.

Turns out, it wasn't such a good idea, particularly during a recession. Now, many of these companies, such as Slide, are searching for more and different ways to earn money.

"A year ago, advertising was seen as the cool new way to create a great deal of revenue," says Sean Ryan, founder and chairman of Meez, a San Francisco-based Web site where consumers can create animated characters for social-networking sites. "It turns out those applications didn't have enough engagement to deliver the advertising."

But whether these new ventures will become a viable business model or are just the latest fad remains to be seen. Virtual goods are an untested business model at massive scale. The companies also are likely to face intensifying competition from Facebook and MySpace, which are bulking up their business with marketers and and experimenting with virtual goods, too. MySpace is owned by **News** Corp., which also owns Wall Street Journal publisher Dow Jones & Co.

Amid shrinking ad budgets, marketers have been hesitant to experiment with new advertising models. Marketers are projected to spend about $70 million this year on widgets and applications, up 76% from the approximately $40 million spent in 2008, according to research firm eMarketer Inc. That is just a sliver of the total $1.1 billion spent on social networks in the U.S. this year and the total $24.5 billion spent on the Web.

Mr. Ryan says selling virtual goods is a better model. One example he is betting on: dressing up online characters, or avatars, with virtual clothing, such as a $3 Rocawear T-shirt. Slide, the maker of SuperPoke, sells items for $1 to $50, ranging from a tool that created background scenery for virtual pets to the spoofs of famous paintings.

The changes have meant scrapping the term used to describe some of these companies.

"We are not a widget company. We are a distributed media company," says Ro Choy, chief revenue officer at Rock You. "The reality of our company is that we were not a widget company. We make money through our relationships with advertisers and partners."

Widgets and applications first became popular in 2007, when Facebook started allowing outside developers to build applications on its site. Other social-networking sites soon followed. Piqued by widgets' popularity among consumers, several marketers turned to the widget and application makers to experiment by building their own applications but found it hard to stand out from the pack.

Xstrata presses for deal

Miner dismisses call to sweeten Anglo bid; profit is down 77%

By Guy Chazan

Miner **Xstrata** PLC reported a drop in net profit of 77%, even as it pressed its case for a proposed merger of equals with rival **Anglo American** PLC and dismissed calls to sweeten the offer.

In an interview, Mick Davis, Xstrata's chief executive, expressed frustration that Anglo's board has so far refused to engage with him, but said the company would be patient.

"These big deals take a long time to do," Mr. Davis said. "I've done so many [of them] I can't get worked up about the short-term movements."

He was speaking as Xstrata unveiled first-half results that it said proved it had "weathered the storm." Net profit fell 77% to $643 million. Adjusted to exclude exceptional items, profit fell 68% to $909 million, a result that was much better than most analysts expected.

Xstrata was hit by the steep decline in commodity prices this year amid the global recession, with prices of metals like copper and nickel slumping by more than 50% year-on-year. Some mining companies say the outlook is beginning to improve, though, with China driving an uptick in demand for some metals.

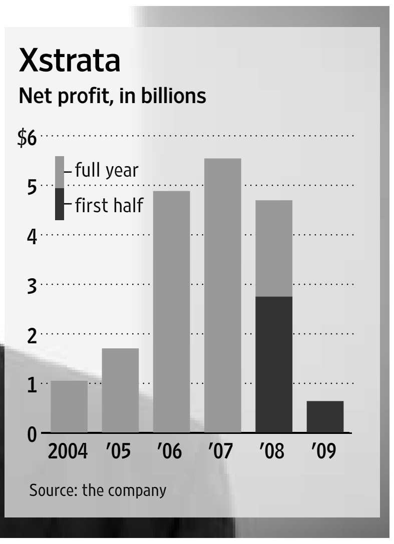
Xstrata launched its proposal for a no-premium merger of equals in June. The tie-up would create the world's third-largest mining company by market value after **BHP Billiton** Ltd. and Brazil's **Vale** SA, and the world's top producer of zinc, platinum, diamonds, coal for power stations and ferrochrome. But Anglo swiftly rejected the offer as "totally unacceptable."

Mr. Davis was taken aback by the vehemence of Anglo's snub. He said he was surprised that Anglo rejected Xstrata's proposal so quickly and that it has steadfastly refused to engage with the company ever since. But Mr. Davis dismissed calls for Xstrata to offer a premium, either by adding cash or allowing Anglo investors to own more than half of the combined company.

"Both sets of shareholders are bringing equivalent sets of assets to the table and the combination is giving rise to synergies that they both should be entitled to share in equally," he said.

Mick Davis, chief executive officer of Xstrata

Bloomberg News



Yet some Anglo investors insisted there would be no deal without a premium. "There's a value gap between what Xstrata is proposing and what Anglo is worth," said Anwaar Wagner, a portfolio manager at Old Mutual Investment Group, an Anglo shareholder. "If Xstrata comes up with an offer that recognizes the inherent value of Anglo, then clearly shareholders will consider it."

Anglo shares have underperformed Xstrata's in the last month, suggesting investors may be growing more pessimistic that there will be a deal. But some think a merger will happen sooner or later. "These are great assets that work well together...and it's worth being patient," says James LaTorre of the Harbor International Fund, which is an investor in both Xstrata and Anglo.

In London on Tuesday, Xstrata shares fell 2.1% to 847 pence ($14.35). Anglo shares fell 2.6% to 1,971 pence.

Xstrata's CEO rejected calls for the company to offer a premium for Anglo.

Industry observers assume that if a tie-up happens, Mr. Davis, widely admired in the mining industry for his management skills, would end up running the combined company, squeezing out Anglo's chief executive, Cynthia Carroll. In the interview, he denied that he had such plans, saying the two companies could "bring in someone independent."

He also denied that cultural differences between Xstrata and Anglo could scrap a deal—an issue that Anglo's new chairman John Parker has raised as a possible obstacle to any merger. Xstrata is seen as lean and entrepreneurial, whereas Anglo is older, more established and centralized.

"I don't see how different cultures is an impediment to putting companies together," Mr. Davis said. "BHP and Billiton had two diametrically opposed cultures. Today [the merged company] seems to be fine operating unit."

—Dana Cimilluca contributed to this article.

The Property Report

Location, location

Germany's open-ended funds are back on the real-estate prowl > **Page 28**

CORPORATE NEWS

StatoilHydro net hit hard by taxes

Lower oil, gas prices weigh on revenue; total output down

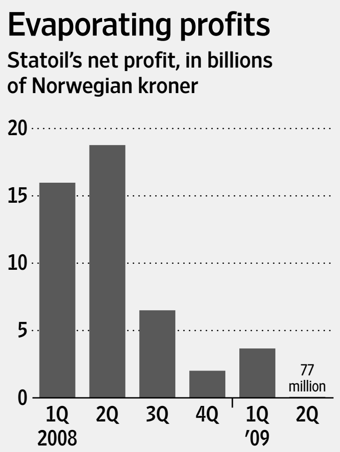
BY ELIZABETH ADAMS

StatoilHydro ASA said Tuesday that its second-quarter net profit was nearly wiped out by an "unusually high" tax rate, but its underlying profit beat market forecasts, supported by the company's strong international operations.

The Norwegian oil and gas company reported a second-quarter net profit of 77 million Norwegian kroner ($12.8 million), down from 18.77 billion kroner in the year-earlier period. It said the earnings were hurt by the introduction of the U.S. dollar as the currency for its day-to-day business, a move aimed at limiting the effect of currency fluctuations on its financial income. The company continues to use Norwegian kroner to report its earnings.

StatoilHydro said that after the change, its income tax totaled 19.5 billion kroner in the second quarter, equivalent to a tax rate of 99.9%. That compared with tax of 43.2 billion kroner in the year-earlier period, equivalent to a tax rate of 69.6%

"In the second quarter of 2009 the taxable income was higher than the income before tax, which increased the reported tax rate in the quarter," the company said.



Sources: the company; Bloomberg News (photo)

Workers at StatoilHydro platform Sleipner T, in the North Sea off the coast of Norway

Carnegie analyst John Olaisen said the net-profit drop was "due to plenty of one-offs," and market watchers said they preferred to focus on underlying operating profit of 29.2 billion kroner, down from 56.3 billion kroner a year earlier.

StatoilHydro said the decline in underlying operating profit was largely due to falling oil and gas prices and lower volumes. That also weighed down revenue, which fell 39% to 104.63 billion kroner from 170.61 billion kroner.

Oil prices were down 40% in the quarter from a year earlier, while gas prices were down 18%—negatives only partially offset by improved gas margins and a 4% increase in gas volumes.

Falling overall production from maturing Norwegian fields was partly compensated for by robust international output. The company's total equity production in the period slipped 2.8% to 1.845 million barrels of oil equivalent a day, from 1.898 million barrels a day a year earlier. Still, the company reiterated its 2009 and 2012 daily production targets.

Meanwhile, in its international unit, which represents a small but growing portion of the company's overall production, output of liquids from international fields due to StatoilHydro rose 36% from a year earlier to 303 million barrels of oil equivalent a day, while gas due to the company rose 64% to 90 million barrels a day.

Chief Executive Helge Lund said StatoilHydro has boosted efforts to reduce costs in a difficult environment. He added that the global economic outlook seems "somewhat less pessimistic," but noted that while the balance of risks appears to have improved, uncertainty remains high.

In the second quarter, StatoilHydro drilled 22 exploration and appraisal wells—14 in Norway and eight internationally.

The cost of production per barrel in the 12 months ended June 30 was 38 kroner, down from 46.20 kroner a barrel in the year-earlier period, as the company shed most of the costs relating to restructuring after buying Norsk Hydro's ASA oil and gas assets in 2007.

William Hill warns on profit for retail business

BY LILLY VITOROVICH

U.K. betting group **William Hill** PLC Tuesday warned its retail business will miss profit expectations for 2009 due to slow business in July and uncertainty amid the recession, and said it will move its online betting operations to Gibraltar to cut its tax bill.

William Hill's performance in July was affected by weak margins on horse racing—it paid out more to successful gamblers—alongside the inevitably quieter weekends outside the football season.

William Hill said the transfer of its online betting service, Sportsbook, and fixed-odds games to Gibraltar is part of the ongoing integration of William Hill Online, which was created in December through the combination of William Hill's existing online business with assets acquired from Playtech Ltd.

Analysts expect the move to Gibraltar, where the tax rate is lower than in the U.K., to save William Hill £10 million ($17 million) annually, Chief Executive Ralph Topping said. William Hill, which has around 16,000 employees, paid almost £300 million in U.K. taxes and levies in 2008, according to the company.

It's the first U.K.-based gaming company to move its online operations to Gibraltar, the home of pure online gaming companies such as **PartyGaming** PLC and **32 Red** PLC.

Mr. Topping said the economic environment remains tough, making it difficult to predict clear trends. "Whilst we have shown resilience in the first half, as we look to the balance of the year we are cognizant of rising unemployment and constraints on consumer spending generally," he said.

William Hill's shares closed down 9.8% at 168 pence ($2.85). The profit warning also hurt shares in **Ladbrokes** PLC, William Hill's biggest rival in the U.K, on fears it will deliver grim news on Thursday when it reports its interim results. Its shares closed down 7% at 167.10 pence.

William Hill said first-half net profit dropped 26% to £58.7 million from a year earlier, hurt by higher operating expenses related to its online operations as well as higher energy and retail-related costs. Net revenue rose 5% to £515.5 million, driven by a 58% rise in online net revenue. Retail net revenue fell 1%.

William Hill declared an interim dividend of 2.5 pence a share, down from 7.75 pence a year earlier.

The company said its online operations are continuing to perform well and the group remains comfortable with market consensus for the recently enlarged business.

Retailer Macy's adapts to weaker sales

BY RACHEL DODES

When Terry J. Lundgren became chief executive of **Macy's** Inc. five years ago, he set out to revitalize the 151-year-old retailer, and further reshape an industry that had undergone two decades of consolidation.

He engineered the biggest takeover in department-store history—the $17 billion acquisition of May Department Stores Co.—and rebranded regional chains including Marshall Field's and Filene's under a national Macy's banner. Then came the worst economy since the Great Depression.

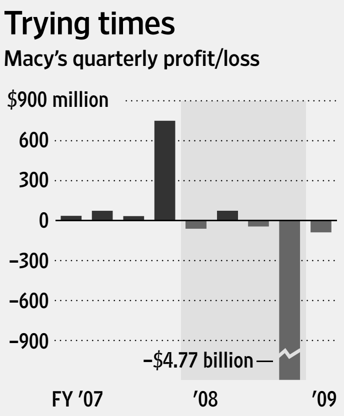
Today, Mr. Lundgren is managing through growing unemployment, slumping consumer spending and falling profits. Macy's, one of the nation's largest department stores by revenue, saw sales at stores open at least a year fall 8.9% in June, its 14th consecutive month of year-over-year declines.

In an interview with The Wall Street Journal, the 57-year-old retail executive said he is using the recession to remake Macy's again. He's reshuffled management and launched an effort to better tailor store merchandise to regional tastes. "This is the best time to figure out what you'd like to look like in the future," he said.

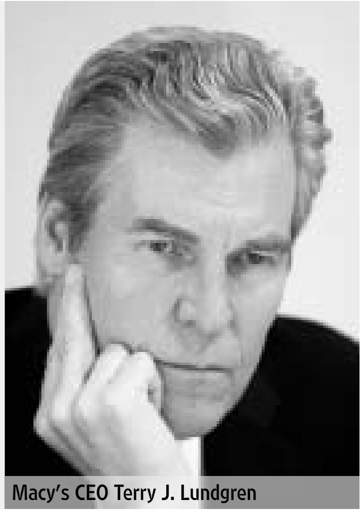
Is the consumer showing any signs of life?

Terry Lundgren: It looks to us that we've bottomed out and are bumping along the bottom. It's not good news but it's not getting worse, I think, for us and for other retailers.

Our purchasers are women. She's spending the same amounts but just shopping with a great deal of discretion. Value is the word, even if it's at regular price. The intrinsic value of what she's buying is very important. That message is probably going to stay with us for some time.



Note: Fiscal year ended Jan. 31
Source: the company



Macy's CEO Terry J. Lundgren

Do you want to see more of a stimulus package?

I want to see more stimulus in the hands of those who need it, and I want to see more jobs created with the stimulus package. I want to get more people to work. I don't think our [national] unemployment number is done yet.

So do you think more of a package is needed?

No, not more of a package, just more of what already has been agreed to be distributed. What I was enthusiastic about was this whole term of "shovels in the ground," getting this in the hands of people who can work on infrastructure, build those things that need to be built anyway—highways, transportation and the like, get people working. That works for me. That's my customer, as well as Wal-mart's and Penney's and Kohl's. That's what we need. We need jobs and job security.

Do you think about lowering your average selling price or changing your product blend, as some of your competitors have done?

Here's the challenge. We have [a men's pants brand], and they typically go out the door between $29.50 and $32.50, with all the coupons and everything. We and the manufacturer together agreed to mark them down to $21.99 or something like that. Selling like hotcakes. Every other pants around them stopped selling.

So we were getting tremendous sell-through at low price points and no margins. And I am not making my pants sales for last year, because my average sale dropped by 30%. It's really hard to make the math work. I have to have 30% more transactions on this product to break even.

Are you worried that customers are trained to wait for discounts, particularly after last holiday season?

I'm not worried about it. I'm counting on it. If we get an upside surprise, that would be a wonderful thing. But they will not forget the value they had last year.

The only way customers are going to start buying at full price again, [is] when they can't have their way on discounts. The key is you have to give good value, but it doesn't have to be 80% off.

Do you think the level of consumption will ever get back to what it was, once the recession is over?

None of us know that. But I think it will not be what it is today. There was a period of time when it was easy, there was no price resistance in certain product categories. I think that's over. I think there will be price resistance, but [consumer spending] will come back. It will be better.

I think it's all part of the human psyche. There is a certain release valve associated with shopping and having someone take care of you for a change. There's something to that hunt for a special jacket. That psychology may be hard to explain, but I do think that will return over time.

CORPORATE NEWS

PepsiCo seals deal to buy bottlers

Sweeter bid brings price to $7.8 billion; cost savings sought

By Anjali Cordeiro

Ending a nearly four-month-long impasse, **PepsiCo** Inc. sweetened its bid and secured deals to acquire its two largest bottlers for a total of $7.8 billion in a push to revive its North American beverage business.

PepsiCo, based in Purchase, N.Y., raised its offer to $36.50 for each share of **Pepsi Bottling Group** Inc. it doesn't already own, well above its April bid of $29.50 a share. It raised its offer for **PepsiAmericas** Inc. to $28.50 a share from $23.27 a share. Both offers are in cash and stock.

Pepsi Bottling's shares were up 8.2% to $36.37 in afternoon trading, and shares of PepsiAmericas gained 8.7% to $28.43. PepsiCo shares were up 4.9% to $58.95.

Bloomberg News

Cases of Pepsi soft drinks sit on a shelf in a store in Draper, Utah, in February. PepsiCo on Tuesday offered to purchase the company's two largest bottlers.

Since the April announcement of the bids, there have been few indications from any of the three companies on whether the deals would go through or at what price. The sweetened prices for the bottlers were in line with what several analysts had predicted.

PepsiCo said the deal would give it annual pretax savings of $300 million by 2012, higher than its original forecast. Still, investors and analysts said PepsiCo might be able to wring out even more savings than its latest estimate.

"I'm glad it's done," said Walter Todd, a portfolio manager at Greenwood Capital, which holds PepsiCo shares. "I think PepsiCo is low-balling the synergies."

PepsiCo had been expected to sweeten its bid, but investors were uncertain about how high the beverage maker would go and couldn't discount the possibility that it would walk away from a deal.

"The price is in line with our expectations," J.P. Morgan analyst John Faucher wrote in a research brief. "We think getting the deal done removes a big overhang on PepsiCo."

The deal will allow PepsiCo to control 80% of its North American beverage distribution, a move the company has said would allow it to cut costs amid stagnant soda sales.

PepsiCo Chief Executive Indra Nooyi said that while the company has had a constructive partnership with the bottlers for the past decade, changes in the North American beverage industry "demand that we create a more flexible, efficient and competitive system that can drive growth" of Pepsi's products.

—Kevin Kingsbury contributed to this article.

GE to pay $50 million to settle SEC charges

By Paul Glader
And Kara Scannell

General Electric Co. agreed to pay a $50 million fine to the U.S. Securities and Exchange Commission to settle civil fraud and other charges that GE's financial statements in 2002 and 2003 misled investors.

The fine settles a probe that started in 2005 into GE's accounting procedures, including financial hedges and revenue recognition. In a complaint filed with U.S. District Court in Connecticut, the SEC said the Fairfield, Conn., conglomerate used improper accounting methods to boost earnings or avoid disappointing investors.

"GE bent the accounting rules beyond the breaking point," said Robert Khuzami, director of the SEC's Division of Enforcement, in a prepared statement. "Overly aggressive accounting can distort a company's true financial condition and mislead investors."

GE agreed to pay the fine without admitting or denying the SEC's allegations. The SEC noted efforts by GE's audit committee to correct and improve the company's accounting during the probe. GE twice restated its financial results and disclosed other errors. The probe led to several employees being disciplined or fired.

"We are committed to the highest standards of accounting," said GE spokeswoman Anne Eisele. "While this has been a difficult and costly process, our controllership processes have been strengthened as a result, and GE is a stronger company today." GE said it doesn't need to further correct or revise its financial statements related to the investigation.

The SEC complaint focused on GE's accounting for four items over various periods: derivatives, commercial-paper funding, sales of spare parts and revenue recognition. The commission said GE in 2002 and 2003 reported locomotive sales that hadn't yet occurred in order to boost revenue by $370 million. A 2002 change in accounting for spare parts in its aircraft-engine unit increased that year's net income by $585 million, the commission said.

In early 2003, the SEC alleges, GE changed how it accounted for hedges on its issuances of short-term borrowings known as commercial paper. The commission said the change boosted GE's pretax earnings for 2002 by $200 million. Had it not changed the methodology, the commission said, GE would have missed analysts' earnings estimates for the first time in eight years, by 1.5 cents.

"Every accounting decision at a company should be driven by a desire to get it right, not to achieve a particular business objective," said David P. Bergers, director of the commission's Boston office, which led the investigation. "GE misapplied the accounting rules to cast its financial results in a better light."

The settlement resolves the GE accounting inquiry, but Mr. Bergers said similar SEC investigations of other companies continue.

GE's shares were up one cent at $13.73 in afternoon trading on the New York Stock Exchange. Investors and analysts said the settlement represented closure.

"I feel as though the company has corrected its practices," said David Weaver, a portfolio manager at Adams Express in Baltimore, which owns about 1.5 million GE shares. "Going forward, I feel a little more comfortable with the cleanliness of [GE's earnings] numbers."

Matt Collins, an industrial analyst at Edward Jones in St. Louis, said the accounting issues had been "frustrating for investors, but they were never material." He said investors are now focused on the recession and losses at GE's finance unit.

The SEC under enforcement chief Mr. Khuzami is trying to close cases older than three years unless they are critical to the agency's program. The goal is to clear out the pipeline so attorneys can work on current cases, although one person familiar with the matter said that wasn't a consideration in this case.

Macau gambling magnate Stanley Ho has surgery

By Jonathan Cheng

HONG KONG—Macau gambling magnate Stanley Ho, the 87-year-old tycoon whose casinos have the biggest market share in the Chinese enclave, is in satisfactory condition after undergoing surgery, his office said in a statement Tuesday.

Between Mr. Ho, his daughter Pansy and his son Lawrence, the Ho family holds three of Macau's six gaming concessions. Mr. Ho's casino company, **SJM Holdings** Ltd., has continued to thrive even after Mr. Ho's 40-year-long gaming monopoly ended in 2002. His casinos, including his flagship Grand Lisboa, control about a quarter of the former Portuguese colony's gambling revenues.

Mr. Ho, a colorful character who is openly polygamous and who has a major boulevard in Macau named for him, is one of China's wealthiest men and has long dominated Macau's local business scene. Even in his old age, he is an active personality and a fixture of the Hong Kong tabloids. Mr. Ho also has considerable political sway, in part through his seat on the Chinese People's Political Consultative Conference, and his comments on government policy are closely followed.

Mr. Ho is a figurehead for Macau's six concession-holders, organizing and serving as the first chairman of a six-party Chamber of Macau Casino Gaming Concessionaires and Sub-concessionaires. The chamber agreed to cap the commissions that its members pay to intermediaries who bring high-rolling gamblers to the casinos and lend them money to play. In recent months, the issue had become a source of contention among the operators, which include **Wynn Resorts** Ltd. and **Las Vegas Sands** Corp.

A spokeswoman for Mr. Ho's office didn't respond to questions about the nature of the surgery Mr. Ho underwent, or about whether any contingency plans were in place in the event of Mr. Ho's inability to carry out his duties at his companies.

Shares in Mr. Ho's companies both fell Tuesday. Casino operator SJM Holdings closed at HK$3.15 (41 U.S. cents), down 4.6%, while **Shun Tak Holdings** Ltd., the property-and-logistics concern under his control, closed at HK$5.88, down 2.9%.

Ford's ex-CEO to lead BHP Billiton board

MELBOURNE, Australia—**BHP Billiton** Ltd. said former **Ford Motor** Co. Chief Executive Jacques Nasser will become its new chairman when long-serving incumbent Don Argus retires early in 2010.

Lebanese-born Mr. Nasser, who migrated to Australia as a child, joined the mining company's board as a nonexecutive director in 2006 and is a member of the board's risk and audit committee.

The 61-year-old lives in the U.S., but a spokeswoman for BHP, the world's largest miner, said he has committed to spend the majority of his time in Australia after taking up the chairmanship.

The 71-year-old Mr. Argus has been on BHP's board for 13 years and has been chairman since 1999.

GLOBAL BUSINESS BRIEFS

EADS

Aer Lingus postpones delivery of 5 Airbus planes

Irish airline **Aer Lingus Group** PLC said Tuesday it has delayed the delivery of five new Airbus aircraft and will exit the leases on two further planes ahead of schedule as it seeks to cut its spending in the next three years. The carrier said that the stabilizing of its long-haul fleet to eight aircraft until 2013 will contribute to "a significantly stronger net cash position and balance sheet." The company said it will take delivery of one new A330-300 aircraft from Airbus as planned, in April, but has delayed the delivery of three A330s as well as two A350s until after 2013. Separately, Airbus said it reached a deal with Thai Airways International PCL to delay the delivery of six A380 superjumbos by about two years. Airbus is a unit of European Aeronautic Defence & Space Co.

General Motors Co.

The German Economic Ministry said negotiations for a sale of Adam Opel GmbH, a unit of **General Motors** Co., have progressed and all parties want to clear up remaining issues by the end of the week. Representatives from the two bidder groups, **Magna International** Inc. and **RHJ International** SA, as well as GM met with government officials Tuesday. No decision was expected from the meeting. Separately, GM Europe said progress was made clarifying issues from the final offers received two weeks ago. GM hopes to make a recommendation to the Opel Trust Board shortly, it added. The German Economic Ministry also said it urged a higher equity contribution from the bidders.

Beiersdorf AG

Consumer-goods company **Beiersdorf** AG of Germany posted a 41% drop in quarterly net profit amid falling consumer spending brought on by the global economic slump. The maker of Nivea skin cream and Tesa adhesive tapes said second-quarter net profit fell to €87 million ($125 million) from €147 million a year earlier. Sales declined 4.5% to €1.5 billion from €1.57 billion. Beiersdorf expects sales growth through the end of the year at the company's consumer business segment, which includes cosmetics. The unit's sales for the year are likely to be higher than in 2008, Beiersdorf added. The company doesn't expect to match 2008's sales at the Tesa unit.

DSM NV

DSM NV raised its cost-savings target after reporting a 95% decline in second-quarter net profit, but said customer destocking was now largely over. The Netherlands-based chemicals company said profit in the three months ended June 30 was €10 million ($14.4 million), down from €192 million a year earlier. Total revenue fell 21% to €1.95 billion. The company, which produces chemicals for the nutrition, pharmaceutical and materials industries among others, said it will achieve "several tens of millions euros" more than the €125 million cost-savings target it had for 2010, according to Chief Financial Officer Rolf-Dieter Schwalb.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Afghan attacks threaten vote

Taliban shell Kabul in bid to weaken presidential poll on Aug. 20; fraud also is a concern

By Anand Gopal
And Matthew Rosenberg

Associated Press

A man clears broken glass at a residence near the U.S. Embassy in Kabul, after a Taliban rocket attack Tuesday morning.

KABUL—Taliban militants fired rockets into Afghanistan's capital from about 20 kilometers away before dawn Tuesday, feeding fears that violence will undermine presidential elections already tainted by concerns about fraud.

The attack was the first on Kabul in nearly six months, and relatively minor, wounding two people and damaging a few buildings. But it appeared to make good on the insurgents' threat to disrupt the vote, coming after the deadliest month for international forces since the start of the war, at a time when more U.S. forces have arrived in part to help secure as much of the country as possible before the vote on Aug. 20.

At least seven rockets fired from north of Kabul slammed into the city, said Muhammad Khalil Dastyar, Kabul's deputy police chief. Two hit the city's diplomatic area, landing near the U.S. Embassy and the headquarters of the North Atlantic Treaty Organization force in Afghanistan. It wasn't clear if either was specifically targeted.

Zabiullah Mujahed, a Taliban spokesman, said the insurgents were targeting the international airport, part of which is used for military purposes, and the headquarters of the Afghan National Army. Neither was hit.

This summer has seen record levels of violence in the lead-up to the second presidential election since the U.S.-led coalition ousted the Taliban in the wake of the 2001 terrorist attacks in the U.S.

Afghan and Western officials estimate that roughly 10% of the roughly 7,000 polling centers might not open because the lack of security. "Not everyone's going to vote," said Ambassador Richard Holbrooke, the U.S. special representative for Afghanistan and Pakistan, after a trip to the region last week.

Mr. Holbrooke said the vote will still be credible. "It's an extraordinary thing to hold an election in the middle of a war," he told reporters in Washington.

But there are growing indications that many more people than currently estimated may not be able to vote because of a lack of security, especially in the south and parts of the east that are dominated by the Pashtuns, the ethnic group that makes up the core of the Taliban.

According to internal Afghan government documents reviewed by The Wall Street Journal, 116 districts—29% of the country's total, representing about 14% of polling stations—are "high risk" or "extreme risk" areas where it may be too dangerous for people to vote.

Government officials have invited the Taliban and other groups to lay down their arms and take part in the polls. Taliban representatives say the elections aren't a sovereign affair, but are controlled by the U.S., and therefore refuse to take part.

About half of those districts are in the south and east. A handful have no government presence at all. In the rest, insurgents control the countryside, and the Taliban have told people not to vote. In Paktika province, on the eastern border with Pakistan, officials say security problems have forced them to move or abandon about 20% of the polling stations.

Afghanistan's Independent Elections Commission says it should have a complete assessment of the security situation in the coming days.

President Hamid Karzai remains the front-runner. Only one of the nearly 40 challengers—former Foreign Minister Abdullah Abdullah, has mounted a serious challenge.

No matter who wins, there are growing concerns that the legitimacy of the vote may be called into question if security concerns keep large numbers of voters away, further reducing the legitimacy of the government and possibly leading to large protests, say analysts and Western diplomats.

The election-day security plan, for now, is to have Afghan police guard polling centers, while the Afghan army secures district capitals. U.S. and allied forces will try to stay out of sight and back up the Afghan forces, if needed, according to Afghan and Western officials. While there won't be enough Afghan or Western forces to secure every troubled district, officials say they hope the security measures will at least free some troubled areas to vote.

That is little reassurance to some voters. "Where we live there is almost no government presence. It is Taliban territory. If anyone in our village votes, the Taliban will butcher us within the hour after we return home," said Muhammadullah, a 26-year-old farmer in the southern province of Kandahar.

Even campaigning has been difficult in such areas. Campaign offices have been bombed and campaign convoys carrying ballots and other supplies have been attacked.

Afghanistan's rugged terrain and limited roads are another challenge. More than 3,000 donkeys are being used to transport ballots to remote villages, where monitoring the vote will be difficult, if not impossible.

That has opened the door to accusations of fraud, fears backed up by what observers say was widespread cheating during the voter registration process, which took place largely in the winter.

The Free and Fair Election Foundation of Afghanistan, a U.N.-funded watchdog, found irregularities and violations in up to 85% of registration centers in some of the four phases of the registration drive. The group photographed children with registration cards and found officials selling cards, among other violations.

An official at the elections commission said his agency had found only a few instances of registration fraud. A senior U.S. official in Kabul said everyone who votes will get an ink mark on their finger, and "it would be very hard for someone to vote twice."

Australia police foil alleged plot against base

By Alex Wilson
And Lyndal McFarland

MELBOURNE—Australian police arrested four men who they allege were planning a suicide attack on an Australian military base.

Police said that the arrested men are all Australian citizens with some being of Somali descent and others Lebanese, and that members of the group have supported the Islamic insurgency in Somalia. The men were planning to use automatic weapons in the attack, police said.

The arrests will renew concerns that Australia has put itself in a position where it faces terrorist threats given its strong support for the war on terror. The country has sent troops to wars in Afghanistan and Iraq and Australians have been the target of bombings in other countries including in Bali in 2002 and outside Australia's embassy in Jakarta in 2004.

Former Prime Minister John Howard often reminded Australians of the threats they faced but those worries diminished somewhat when Prime Minister Kevin Rudd was elected in late 2007 given his commitment to withdraw troops from Iraq, a process completed this year.

Mr. Rudd said the group was alleged to be affiliated with the al Shabaab terrorist group in Somalia, which is believed to be linked to al Qaeda, and that some of its members allegedly traveled to Somalia to take part in hostilities there. He said Tuesday that the arrests are "a sober reminder that the threat of terrorism to Australia continues."

Victoria Police Commissioner Simon Overland said police will allege the men planned to attack the Holsworthy Barracks on Sydney's south western fringe, and had carried out reconnaissance on other military installations. "Details of the planning indicated the alleged offenders were prepared to inflict a sustained attack on military personnel until they themselves were killed," said Australian Federal Police Acting Commissioner Tony Negus.

About 400 officers from the Australian Federal Police, Victoria Police and New South Wales Police launched raids at homes in Melbourne early Tuesday, executing 19 search warrants across the city at 4.30 a.m. local time.

One of the arrested men, 25-year-old Nayef El Sayed of Glenroy, appeared in the Melbourne Magistrates' Court Tuesday charged with preparing for or planning a terrorist act. He didn't apply for bail and was remanded in custody until his next court date, a committal mention set down for Oct. 26.

Police said they are not ruling out further arrests. The men are to be charged under Australian antiterror laws enacted in 2005, which have already been used to jail six Melbourne men in 2008.

—Iain McDonald contributed to this article.

Hillary Clinton starts Africa trip with Kenya visit

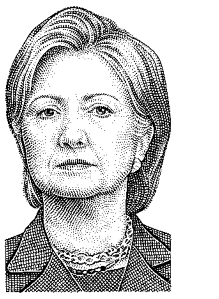
By Sarah Childress

NAIROBI, Kenya—U.S. Secretary of State Hillary Clinton opened her African trip Tuesday in this East African hub, where she is expected to reiterate the support for good governance and sustainable development that President Barack Obama expressed in his brief visit to Ghana, in West Africa last month.

The stop in Kenya will be significant not only for the food-security theme Mrs. Clinton is expected to emphasize in this agricultural economy, but also for the strong political message that the U.S. aims to send to Kenya's recalcitrant coalition government. Since the coalition was cobbled together last year, it has failed to implement any reforms or prosecute perpetrators of the violence that erupted after flawed presidential elections in December 2007.

Last week the Kenyan government outlined its intention to rely on notoriously corrupt local courts—rather than to form a special local tribunal—to try individuals suspected of organizing or participating in the postelection violence.

Officials said that they would attempt to reform the local courts before the trials. Some of those suspected of organizing the violence that killed more than 1,000 people early last year are believed to be government ministers, and few Kenyans say they believe the existing justice system, even with extensive reforms, would offer a fair trial.



Hillary Clinton

On Tuesday, the U.S. Embassy in Nairobi issued a statement before Mrs. Clinton's arrival that expressed "deep concern" over the government's decision about the trials, and said that it only added to the "culture of impunity" in Kenya.

On Wednesday, Mrs. Clinton is likely to underscore that message at a scheduled meeting with President Mwai Kibaki and Prime Minister Raila Odinga. The meeting is a rare concession for Kenya's bitter political rivals, who tend to avoid being in the same room together.

On Thursday, Secretary Clinton plans to hold bilateral talks with Somali President Sheikh Sharif Sheikh Ahmed, who has struggled to bring warring factions together to stabilize the conflict-ridden nation. Mrs. Clinton also plans to travel to South Africa, to meet with newly elected President Jacob Zuma, who is beset by protests from poor township dwellers and working to pull the country from its first postapartheid recession.

Secretary Clinton will visit Angola, an emerging economic power on the continent and a major oil exporter to the U.S. She will address gender-based violence during a visit to the Democratic Republic of the Congo, where rape has become a weapon in the country's longtime conflict. Mrs. Clinton will visit Nigeria, a major U.S. supplier of oil and gas, and Liberia, which has a historical relationship with the U.S. She will finish her trip on Cape Verde, an island nation that is a democracy and a major recipient of U.S. aid.

Nigeria's amnesty program is criticized

Offer to pay stipend to militants is seen avoiding real issues

BY WILL CONNORS AND SPENCER SWARTZ

LAGOS, Nigeria—A high-profile government amnesty program aimed at stopping militants in Nigeria's oil-rich delta region from bombing pipelines is coming under fire for not seeking ermanent solutions to the area's underlying problems.

The amnesty program, scheduled to begin Thursday and run two months, is the biggest public effort yet by President Umaru Yar'Adua to ease the unrest in the Niger Delta that has cost the country billions of dollars in lost oil revenue.

But Nigerian state governors, analysts, and the militants themselves have criticized the plan because it does little to address the core causes of the militancy and criminality that have plagued the Niger Delta for decades, such as the lack of education, jobs and basic services.

State governors from the Niger Delta region, a powerful group but rarely in agreement, last week threatened to withdraw from the amnesty program because it lacked "a definite postamnesty plan arrangement for the region."

With oil revenue down sharply this year, the Nigerian government desperately needs the program to work. Nigeria has lost the title of Africa's biggest oil producer to Angola with more than one million barrels a day of its production shuttered from militant attacks in recent months.

The government has budgeted about $63 million for rehabilitation and reintegration programs, and for allowances for thousands of militants. But many key questions remain unanswered, including what happens after the two-month amnesty window.

The militant leader many consider to be the most powerful in the region, Government Ekpemupolo, better known as Tompolo, has indicated he won't accept the offer. In hiding since his camp was attacked by soldiers in May, Tompolo said through a close adviser Monday that he was open in principle to amnesty, but that he and his men don't think the current deal is genuine.

"They are aware of the trick," the adviser said. "They are not going to surrender anything. They don't believe in what the committee is all about."

The committee he refers to is a group of government officials charged with organizing and implementing the program. Air Vice Marshall Lucky Ararile, chief coordinator of the amnesty committee, concedes that the militant leaders themselves are unlikely to play a public part in the process.

"The leaders don't have to come out if they don't want to," Mr. Ararile said in an interview. "Or they can come with a few hundred of their boys, for example, then leave and say it's not for them."

Mr. Ararile said the government wasn't willing to negotiate any kind of deals aside from the official amnesty offer.

Although details are still being finalized on how exactly the program will work, each militant who agrees to disarm is to receive an allowance of around $135 a month plus $100 or so a month for food. The payments, will run for an open-ended amount of time and not just the August to October timeframe the amnesty is slated to run, according to a senior Nigerian oil official familiar with the matter.

"This [payments to militants] will run several months. Otherwise things will collapse and we'll be facing the same situation again," said the official, adding that payments are likely to keep flowing well into 2010 to militants who accept the amnesty and embrace peace.

With an estimated 10,000 to 25,000 militants potentially covered by the amnesty, the payments are likely to run up quite a bill over time, but the government is hoping the result will be that more oil is pumped, which will more than cover the money handed over to militants.

This strategy has raised concern among many analysts who say that the government may be just pouring money down the drain. "The government may be hoping to buy some time to recalculate its next steps in attempting to tackle the crisis. However, amnesty by itself will not be the panacea," said Rolake Akinola, a West African analyst at Control Risks, a consultancy in London.

Past payment programs haven't worked. A plan in spring 2007, for example, by the government of Rivers state, one of the delta's main oil-producing states, to shower thousands of dollars on militants who renounced violence quickly ended in tatters, without enhancing security or improving the lives of the people in the region. It's unknown how much the Rivers state government spent on its program.

In 2004, the federal government paid militant leader Ateke Tom over $2,000 for each of the 360 AK-47s he turned in, well above the then-market price. Asari Dokubo, another militant leader, struck a similar deal.

Yet, militant leader Mr. Tom told The Wall Street Journal in June that during the cash-for-arms program in 2004, he turned in only a small fraction of his arms.

In addition to the allowance payments, the government was involved in talks with militants to pay them money for their weapons, according to people involved in the talks. When asked, government officials denied this. Some officials in the federal government also are pushing a controversial idea to have foreign oil companies contribute funds to the payouts. It's unclear what laws, if any, a company might break by contributing payments to the government's plan, but doing so would court ethical and public-relations problems for the companies, analysts said.

"This is a potential legal snake pit for the oil companies. They cannot have documented payments that go to militants," said Peter Lewis, director of African studies program at John Hopkins University in Washington.

Companies could potentially make payments under the guise of "community development." **Chevron** Corp., **Eni** SpA, and **Exxon Mobil** Corp. and others already spend millions of dollars collectively on community projects in the Niger Delta, including to the Niger Delta Development Commission, a government-run agency created in 2000 that bankrolls various infrastructure projects.

A spokesman for **Royal Dutch Shell** PLC, one of the biggest foreign companies operating in Nigeria, wouldn't confirm nor deny whether Shell had been contacted by the government about making payments to the militants and called the amnesty program "a matter for the government."

An official from another major oil company, declining to be named, said the company wouldn't make payments if the government makes such a request. Other companies, including Exxon Mobil, didn't respond to requests seeking comment.

Another problem the government faces is that the volume of AK-47s, and other guns and weaponry in the delta region, has increased sharply in recent years, a result of rising oil prices prior to the global recession that boosted the amount of money flowing into Nigeria. An individual may turn in one weapon under the amnesty program, but have several others stashed away. There are also plenty of outlets for getting new weapons.

Associated Press

A member of the Nigerian navy patrolled an oil depot alongside pipelines damaged in an attack by Niger Delta militants, in Lagos, Nigeria, last month.

Brazil's leader is seeking distance from an ally

BY JOHN LYONS

SÃO PAULO, Brazil—Brazil's President Luiz Inácio Lula da Silva faces a possible political setback amid corruption allegations that have brought pressure on an important ally to resign as head of the Senate.

The ally, José Sarney, is a former president and a leader of the Brazilian Democratic Movement Party—the biggest party in Congress. An alliance with Mr. Sarney has helped to ensure voting majorities for Mr. da Silva and his left-leaning Workers' Party over the years.

Mr. Sarney, who has denied wrongdoing, told reporters in Brasília on Monday that he didn't plan to resign. "I am in high spirits, I've never stopped being confident," he said.

The Senate ethics committee is to meet this week to discuss a dozen allegations against Mr. Sarney. Federal police say they are investigating some claims.

According to news reports and public claims by opposition politicians, Mr. Sarney advanced legislation through Congress that financially benefited himself, his family and his political allies. Other allegations in articles and broadcasts include evading taxes with an offshore account and embezzling public funds through a charitable organization. The allegations couldn't be independently verified.

Mr. Sarney may still weather the storm. Even if he steps down as president of the Senate, he will likely remain a senator, many political analysts say.

Still, a resignation would hobble Mr. Sarney just as President da Silva needs him to help shepherd a congressional investigation into accounting practices at state-controlled oil giant Petroleo Brasileiro SA.

Some political analysts say they expect Mr. da Silva's political opponents to use the Petrobras investigation to seek out potentially harmful information about the management of the company that could be used against Mr. da Silva's party in national elections next year.

Mr. Sarney also is needed to deliver popular votes for Mr. da Silva's handpicked presidential successor—Dilma Rousseff, his chief of staff. After two terms in office, Mr. da Silva isn't eligible for re-election, and Ms. Rousseff's mediocre popularity ratings suggest she will need cross-party alliances to win.

As the allegations emerged, Mr. da Silva stood by Mr. Sarney, saying that the Senate president should be given the benefit of the doubt and that Mr. Sarney's history of public service afforded him special treatment. Mr. Sarney, who is recognized for helping Brazil make the transition to democracy from a military dictatorship, shouldn't pay a political price for the alleged wrongdoing, Mr. da Silva said.

Last week Mr. da Silva moved to cut his ties, signaling in a news conference that he would no longer back Mr. Sarney.

A premier gets back in the saddle on holiday

Agence France-Presse/Getty Images

RIDING THE RANGE: Russian Prime Minister Vladimir Putin rides a horse during his vacation outside the town of Kyzyl in southern Siberia on Monday.