**End of the long decade**

**WEEKEND JOURNAL**


# THE WALL STREET JOURNAL.

VOL. XXVII NO. 225 | **EUROPE** | Friday - Sunday, December 18 - 20, 2009

DOWJONES
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# Leaders press climate deal

*U.S., in a shift, backs European proposals on aid to poor nations as time grows short*

COPENHAGEN — Political leaders and diplomats launched an 11th-hour bid Thursday to break the impasse at the United Nations climate summit here after U.S. Secretary of State Hillary Clinton tentatively endorsed European proposals that rich nations come up with $100 billion a year over the next decade to help poor nations fight climate change.

*By Stephen Power, Guy Chazan and Spencer Swartz*

Shortly after Mrs. Clinton's appearance, French President Nicolas Sarkozy called for an urgent meeting of leaders to get on with "real" negotiations to secure a new global deal on climate change, warning that "failure would be catastrophic" for world leaders.

The flurry raised hopes among negotiators that they could have something to show when world leaders meet Friday to conclude the two-week summit. But Ed Miliband, the British climate minister, cautioned that reaching a substantive deal was still a "race against the clock."

World leaders will likely have to deal Friday with contentious issues—such as how aggressively their nations will cut greenhouse-gas emissions—while negotiators continue to finesse the text, he said.


Associated Press

U.S. Secretary of State Hillary Clinton's aid proposal allowed United Nations officials to show a more hopeful outlook in Copenhagen.

It remains unclear what kind of agreement will emerge from the summit. Some nations and many of the activists protesting outside the conference center want a legally binding deal that commits rich nations to substantial cuts in greenhouse-gas emissions and to hundreds of billions in aid to poor countries. But the U.S. has said it must await action by Congress on specific carbon caps, and has said major develop-

*Please turn to page 7*

# Dollar acquires renewed strength

By Alex Frangos

HONG KONG—The U.S. dollar stormed ahead against major currencies Thursday, partially on euro weakness, but also on a renewed confidence in how investors view the greenback.

The euro fell more than 1.2% versus the dollar Thursday, hitting its lowest level in three months after Standard & Poor's downgraded the debt of euro-zone member Greece. S&P also warned of more downgrades if Greece doesn't make a strong effort to fix its fiscal situation.

The euro traded below $1.4305 for the first time since Sept. 7. The dollar also gained 0.4% against the yen, easing some pressure on Japanese politicians who have fretted about the strong yen's impact on exports.

"The macro environment is seeing some very important shifts at the moment," said Richard Yetsenga, Asia currency strategist for HSBC in Hong Kong. "The U.S. economy all of a sudden doesn't look so bad. And the rest of the world doesn't look so good."

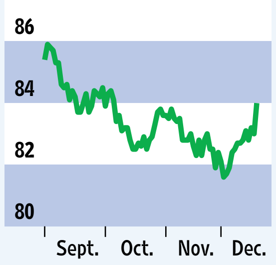
That notion has prompted traders to believe that the Federal Reserve will move to raise U.S. short-term rates sooner than other major central banks. That shift in sentiment helped the dollar gain about 2% against the Australian dollar and 1.3% against the pound.

On Thursday, the U.K. reported that retail sales declined 0.3%, much worse than economists' expectations.

*Please turn to page 3*

**Regaining strength**

J.P. Morgan trade-weighted U.S. dollar index




Source: WSJ Market Data Group

# Beefed-up bank-capital rules set for 2012

By Adam Bradbery

LONDON—A key rule-setting committee of the Bank for International Settlements said Thursday that beefed-up rules on the amount of capital that banks need to set aside against potential losses will be phased in as financial conditions improve, but with a target of the end of 2012.

The bank's Basel Committee on Banking Supervision, made up of central bankers and regulators from around the world, also said it will allow banks to improve the quality of the capital they hold over a "sufficiently long period."

The committee published a draft set of global standards designed to ensure that banks don't lend too much in the future but do have enough high-quality capital and liquid assets, allowing them to weather future financial crises.

The committee said it will raise the quality of the capital that banks hold and make sure it better covers the possibility of losses on trading activities and holdings of securitized assets, and from the default of trading counterparties in the derivatives market, securities-repurchase agreements and securities financing.

"The capital and liquidity proposals will result in more resilient banks and a sounder banking and financial system," said Nout Wellink, chairman of the Basel Committee and president of the Netherlands Bank. "They will promote a better balance between financial innovation and sustainable growth."

The Basel Committee said it will analyze, during the first half of 2010, the likely impact of the standards it plans to introduce. A fully calibrated set of requirements will then be issued at the end of 2010 and phased in as "financial conditions improve and the economic recovery is restored," it said. The committee said it is "mindful" of the need to introduce these measures in a way that doesn't hamper bank lending or crimp the economic recovery.

The committee's flexible approach resonated with regions concerned that new rules would hurt economic growth. Reports that the Basel guidelines wouldn't keep to a tight 2012 deadline sent Japanese bank shares soaring Wednesday. Investors cheered the prospect that lenders would face less pressure to raise capital.

Compared with their peers elsewhere, Japanese banks generally have lower core Tier 1 capital ratios—a measure of a bank's health. They have been raising billion of dollars this year in equity markets, contributing to a drop in share prices.

On Thursday, the banks held most of their gains.

Whether the end-2012 target date will be met depends on national regulators crafting new national rules. Some countries have lagged behind in past efforts at implementing capital rules. Most U.S. banks are due to start adopting the existing Basel II standards, crafted in 2004, only next year.

## The Quirk

An old-school board game goes viral among Silicon Valley's tech crowd. Page 29

## World Watch

A comprehensive rundown of news from around the world. Pages 30-31

## Editorial & Opinion

Tory MP Peter Lilley on the great global-warming groupthink. Page 13

THE WALL STREET JOURNAL.

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Bahrain BD 1.50 - Egypt $1.75 (C/V)
Jordan JD 2 - Kuwait KD 1 - Oman OR 2
Qatar QR14 - Saudi Arabia SR 14

## PAGE TWO

# U.K. can only watch as super profits lead to super bonuses for traders

**[ Agenda ]**

By Robin Johnson

It is deeply ironic that the U.K. government's quantitative-easing program has created a super boom in one part of the financial-services sector: namely gilts trading in London. This has led to super profits for traders, meaning super Christmas bonuses that the U.K. government is now attacking as an excess and an abuse. The government is seeking to tax those bonuses in order to assuage the population at large.

Gilt traders of fixed-income bonds have had a boom time this year. It was an inevitable consequence of quantitative easing that they would benefit from the injection of monies through the stimulus package into the markets. In every crisis there is an opportunity, and institutions in fixed-income trading immediately saw the attractiveness of taking active short-term positions in the gilt market, buying on a Tuesday and selling on the Thursday, when they knew the ultimate counterparty and the ultimate buyer was in fact the government of the United Kingdom. It was therefore a "no-loss situation" creating guaranteed profits and therefore guaranteed bonuses.

While the politicians may complain when they are in front of the cameras and get upset by headlines in the financial pages, in practice there is nothing the regulators and the politicians can do about it. Through the entire history of trading, whether it be from the 18th-century coffee shop to the floor of the London Stock Exchange and now computerized trading on screens in vast deal rooms, traders have been incentivized by the immediate trade. They take advantage of short-term positions and quick gains through commission-based trading. This has been the fundamental foundation of securities trading.

Bloomberg News

A griffin statue symbolizes the City of London, a premier financial center

Prior to the Big Bang in London, jobbers who price the market and brokers who traded the securities were distinct. But from the mid-1980s, these two separate trading professions came together into large trading desks of multinational banks. Further, during the past 10 years or so there has been a dramatic shift from commission-based trading on behalf of clients to proprietary trading (i.e., trading on your own account whether it be by a trader himself or more recently by the financial institution).

> **Initial furor with talk about going offshore, while it remains, seems now to have turned into belligerence**

A lot of the super profits that have been created by the institutions as a result of quantitative easing come from their own proprietary-trading desks. Ultimately they have been paid for by the governments that have introduced the stimuli packages in the first place.

Those banks trade on the proprietary position with the government. Unfortunately for those politicians who complain, it's the very nature of the market.

Gilt trading, as indeed other types of security trading, is a very mobile and portable platform. London has benefited considerably in the past 30 years from having strong technical platforms and exchanges in the City of London. This is why London has become the world's primary financial center, perfectly positioned between the Far East and the U.S.

However, any unilateral regulation by the U.K. Financial Services Authority or unreasonable fiscal actions taken by the British government will only encourage other financial centers—such as Switzerland and the Gulf, which are broadly in the same time zone as London—to entice and incentivize institutions and traders to their local exchanges. Regulators and politicians need to understand that while they can create rules and regulations, and they can insist on more transparency and disclosure, if the market sees an opportunity that in effect has a guaranteed return, that opportunity won't go unmissed.

In the short term, however, while traders are going to be very frustrated by the Treasury's bonus tax, it is clear that their accountants are going to be working overtime on devising structures to avoid paying the tax. The feeling in the City is that while traders will be prepared to accept the tax, they just expect a bigger bonus to, in effect, gross up the tax payment.

The initial furor with talk about going offshore, while it remains, seems now to have turned into belligerence. The government can seek to introduce what amounts to a quasi-Tobin or transactions tax by clawing back the bonuses that they created in the first place, but this isn't going to scare off the traders. Instead, they see it very much as a challenge to (a) continue to create the super profits to get the super bonuses and then (b) find creative ways for their firms to avoid paying the tax. The government shouldn't underestimate the mentality of the typical gilt trader.

Indeed, they are going to have to pay traders in order to maintain their loyalty. They will find ways to get the teams they want with more tax planning, increased salaries, grossing up of bonuses and other mechanisms involving payment in kind. The truth is that while Westminster burns, gilt traders will continue to play their fiddles.

*—Robin Johnson is a partner at international law firm Eversheds*

## What's News

■ **Demonstrators marched** through Athens to protest austerity measures, as concern over public finances in Greece and other struggling euro-zone economies continued to weigh on European financial markets. The euro slumped to less than $1.44. **4**

■ **The Bank of England** advised banks to make the most of strong profits and relatively stable financial markets to bolster their overstretched balance sheets. **5**

■ **Shares in Citigroup** fell sharply a day after the U.S. government abruptly shelved plans to start trimming its 34% stake in the bank. **17, 32**

■ **British Airways won** a court injunction preventing its cabin-crew members from striking over the holidays. **17**

■ **The U.S. signed on to** European proposals that rich nations come up with $100 billion a year over the next decade to help poor nations fight climate change. **1**

## Inside

Holiday warning: baggage theft is on the rise. **27**

Football finance: Europe's leading clubs, by the numbers. **28**

## ONLINE TODAY

### Most read in Europe

1. Insurgents Hack U.S. Drones
2. Democrat Blues Grow Deep in New Poll
3. How Facebook Is Making Friending Obsolete
4. Debt Fears Rattle Europe
5. Talks Stall Ahead of Leaders' Arrival

### Most emailed in Europe

1. Insurgents Hack U.S. Drones
2. Debt Fears Rattle Europe
3. Opinion: How to Stop Iran
4. Diabetes Meter Mates With PC
5. How Facebook Is Making Friending Obsolete

### The Source

europe.wsj.com/source

"And here, at least there may be scope for a little hope"

**David Cottle** on how big business may be our best hope for combating climate change.


### Continuing coverage

Following yesterday's high court decision track the latest developments in the BA dispute.

### Question of the day

Are you in favor of the U.S. climate-aid plan?

Vote online today at europe.wsj.com

### Yesterday's results

**Q:** Did the EU's Microsoft probe accomplish anything?

| | |
|---|---|
| Yes | 19.8% |
| No | 80.2% |

THE WALL STREET JOURNAL EUROPE
(ISSN 0921-99)
Stapleton House, 29 - 33 Scrutton Street,
London, EC2A 4HU

**SUBSCRIPTIONS, inquiries and address changes to:** Telephone: +44 (0) 207 309 7799. Calling time from 8 a.m. to 5 p.m. GMT. E-mail: subs.wsje@dowjones.com. Website: www.services.wsje.com

**ADVERTISING SALES** worldwide through Dow Jones International. Frankfurt: 49 69 9714280; London: 44 207 842 9600; Paris: 331 40 17 17 01.

Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Baslnevi.

Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003.
Registered address: Boulevard Brand Whitlock, 87, 1200 Brussels, Belgium

NEWS

# Better than a soda-vending machine

*Employees at German chemicals maker BASF have access to an enormous wine cellar, which turns a small profit*

By Allison Connolly

LUDWIGSHAFEN, Germany—Sales and profits are down at Germany's **BASF** SE. But employees are preparing for the holidays as they always have: by stocking up on wine from the company's 108-year-old wine cellar.

"I always get good quality," says Holger Dorra, a BASF employee who stopped by the cellar recently to buy wine for his parents, gingerly packing the bottles in the basket of his bike. "The price is OK for what you get."

The idea of a corporate wine cellar may sound like an old-fashioned indulgence—and downright lavish amid a recession—to those outside Europe. But the world's biggest chemicals company insists on keeping the wine-cellar door open. It's a tradition that is profitable. The cellar passes some of the savings from buying in bulk to employees, but not all the saving.

"Our aim is in good and bad times to have business," said Bernhard Wolff, the cellar's head of customer relations.

BASF's cellar, which Mr. Wolff concurs looks more like a store than the stereotypical cellar with vaulted ceiling, has one million bottles and 3,000 varieties, the cheapest being a 2008 Gimmeldinger Meerspinnefor €2.85 ($4.14) .

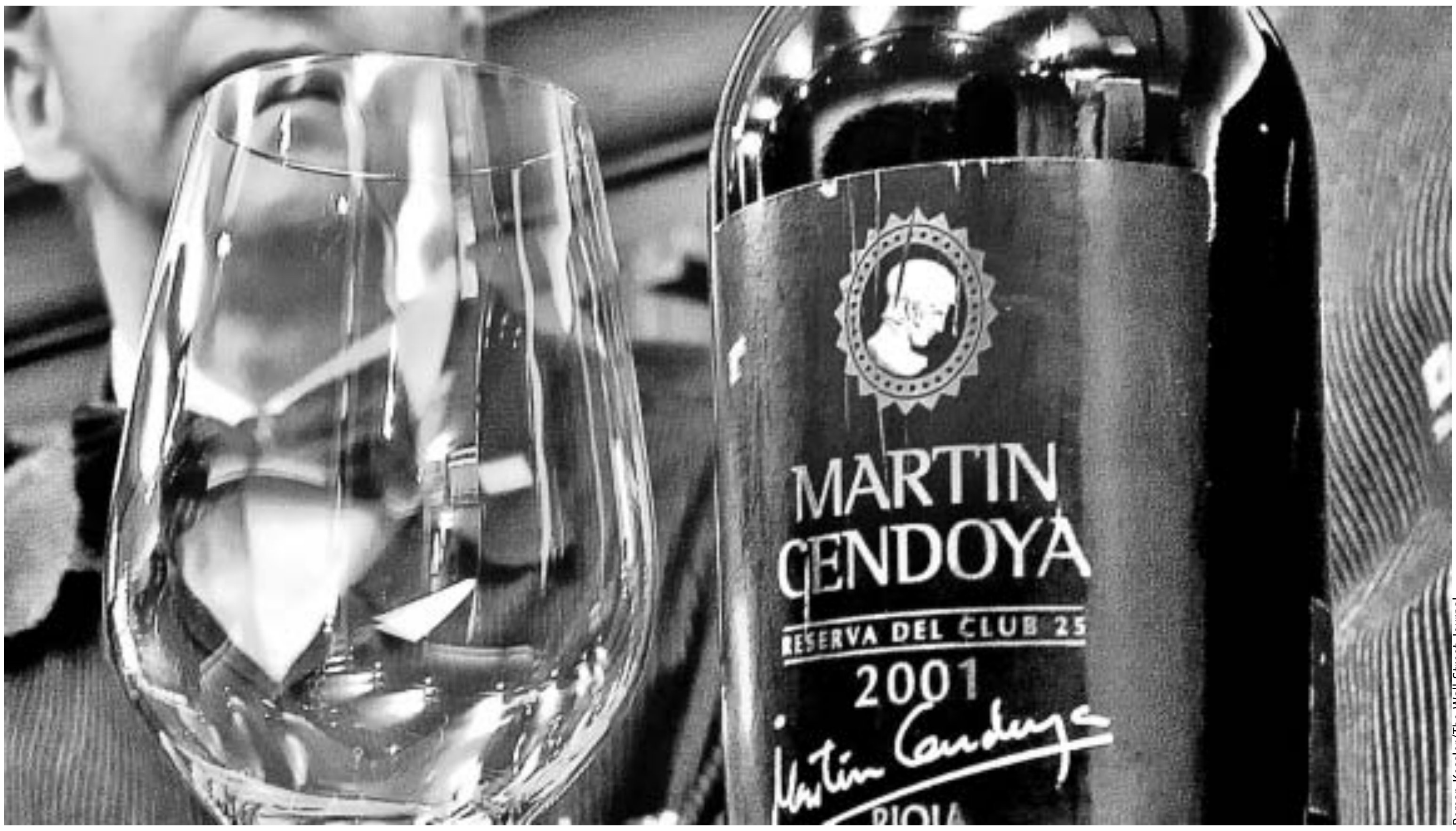
The cellar's staff of 20 includes sommeliers, oenologist engineers—who are considered wine scientists—and winemakers who taste thousands of wines each year and select their favorites for sale, changing up the list twice a year.

The selection spans the world, and includes Grand Cru Classé bordeaux from Chateau Mouton-Rothschild, Chateau Margaux and Chateau Haut-Brion; Vega Sicilia Unico from Spain; Caymus from California's winemaking Napa Valley; and Müller-Catoir from the nearby Wine Road in Germany.

On a recent afternoon, BASF wine-cellar workers were busy packaging bottles and gift wrapping boxes for shipment to friends, families and customers of BASF in more than 50 countries around the world. The wine also will be served at the company Christmas parties.

A few lucky BASF senior managers are appointed to the company's Wine Commission, which was created in 1900 and tasked with tasting and approving the cellar staff's choices. The joke among employees is that it's harder to get on the Wine Commission than the board of directors.

BASF isn't alone in the wine business. Aspirin maker **Bayer** AG also boasts a wine cellar on its Leverkusen, Germany, campus. It, too, is profitable and a source of pride among employees, manager Heinz-Jürgen Kaup said.




Roman Kessler/The Wall Street Journal

Roman Kessler/The Wall Street Journal

Above: a bottle of rioja in BASF's tasting room. Right: Bernhard Wolff, the cellar's head of customer relations, left, and Joachim Spies, its manager.

"They feel it's their wine cellar, not Bayer's," Mr. Kaup said. "It represents a good part of their life. It's not all about work."

Sales of more expensive wines are down at the BASF and Bayer wine cellars due to the economic downturn, their managers said. But they are still doing a brisk business in lower to moderately-priced wines, such as the Rieslings Germany is best known for. They keep prices down and quality high by buying directly from growers, particularly those in Germany and bordering wine-growing countries France and Italy.

Bayer's Mr. Kaup said his most expensive bottle is a 1993 Chateau Petrus Pomerol bordeaux that costs €1,071.75, but about 85% of bottles sold cost less than €10.

"It's wonderful to have those expensive wines you dream about in stock but [buying them] doesn't make sense in a recession," Mr. Kaup said.

BASF's oldest vintage dates back to the company's founding in 1865. Nestled in the heart of the Pfalz or Palatinate, one of Germany's most-famed wine growing regions, BASF opened the cellar as a service to employees who had to abandon their backyard winemaking to work at BASF. The company also saw it as a way to support local wine makers and be a good corporate neighbor. Some ferment wines from specific slopes exclusively for BASF, with the region's signature flavor of grapes grown from sandstone and volcanic soil.

"Wine is very important to the institution of BASF," wine cellar manager Joachim Spies said in a recent interview. "Most of the people here [in the region] make their money from wine."

Mr. Spies' family was one of those local winemakers. However, after an almost year-long stint in Napa Valley to train for the family business, he decided winemaking wasn't for him because he couldn't be faithful to just the family's five wines. At the wine cellar, he tastes vintages from around the world.

That passion was clear as he opened a Martin Cendoya Bodegas Heredad Ugarte rioja from 2001. He took a moment to relish the perfume from the cork. Then he examined the color of the wine over a special white light in the tasting room which he said best reveals the ripeness and elegance of the wine.

He poured some of the wine into a glass, following it with his whole nose and inhaled deeply. "Ah, perfect," he said, as he smacked his lips and rolled his eyes toward the ceiling. He and Mr. Wolff then proceeded to swirl and sip, noting the accents and flavors—vanilla, casis, grapefruit and even forest berries.

The cellar's busiest time is now. In the three days before Christmas last year, when the demand for chemicals was bottoming amid the global downturn, the BASF cellar saw 2,200 customers.

# *Dollar gains renewed strength on U.S. interest-rate speculation*

*Continued from first page*

The drop in sales rekindled concerns that indebted British consumers will remain more focused on saving money than spending it. (See related article on page 5).

The picture is different in the U.S. In recent weeks employment and retail sales data have surprised to the upside.

In the rest of Europe and in the Middle East, sovereign-debt concerns have rattled markets. Those fears intensified Thursday after Standard & Poor's Ratings Services said it has revised criteria for rating covered bonds, a key market for euro-denominated debt.

Shifting sentiment regarding short-term interest rates has only recently changed. The dollar fell fastest earlier this year against the Australian dollar and the Korean won as investors bet that Asian-Pacific economies would grow more robustly than the U.S. in coming months and raise interest rates first.

But news in the past two days gave investors the feeling that the bet against the dollar—and the U.S. economy—had perhaps gone too far. Third-quarter growth in Australia came in below expectations, damping predictions for another near-term increase in interest rates there. Korean unemployment took an unexpected turn upward in November. And investors are worried that capital raising by Chinese banks will suppress lending there.

Late afternoon in New York, the euro traded at $1.4348, down from $1.4534 late Wednesday, and at 129.01 yen from 130.50 yen. The dollar was at 89.85 yen from 89.79. The British pound traded at $1.6152, down from $1.6340, and the dollar was at 1.0461 Swiss francs, from 1.0385 francs.

*—Neil Shah and Takeshi Takeuchi contributed to this article.*

EUROPE NEWS

Associated Press

Workers chant slogans during a demonstration in central Athens on Thursday to protest planned cuts in public spending.

# Greek woes roil euro

*Amid protests in Athens, currency and markets feel downgrade's effect*

By Katie Martin
And Alkman Granitsas

Concern over public finances in Greece and other struggling euro-zone economies continued to weigh on European financial markets Thursday, pulling down the euro and pressuring bank stocks.

The euro slumped beneath $1.44, its lowest level against the dollar in three months, after ratings agency Standard & Poor's hit Greece with a fresh downgrade of its sovereign debt late Wednesday.

Meanwhile several thousand mostly left-wing demonstrators and students marched through the streets of Athens on Thursday, and some labor unions held a day-long strike, to protest government austerity measures.

The march and strikes, though limited, are a foretaste of the opposition that Greece's government is expected to face as it plans to cut public spending in coming years.

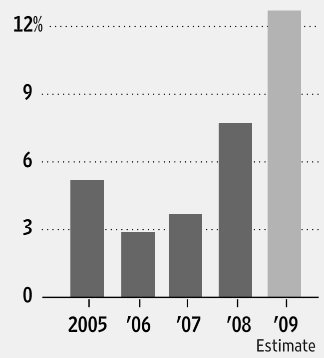
The downgrade from Standard & Poor's came just days after a parallel move from Fitch Ratings, and has intensified anxiety surrounding public finances in several euro-zone countries with fast-rising debt, including Greece, Ireland, Spain and Portugal.

"The [rating] move will keep attention on the fiscal woes engulfing some of the smaller euro-zone countries," said Stuart Bennett, a currency analyst at French bank Calyon in London. By contrast, sentiment on the dollar is growing rosier by the day.

"The euro is likely to continue to lose out, with the market willing to interpret most events and data as good for the dollar and bad for the euro," Mr. Bennett added.

**Debt worries**

Greece's deficit as a percentage of GDP




Sources: Eurostat

Most stock markets in the 16-nation euro zone opened lower on Thursday, with bank stocks leading the declines.

Demonstrators passed through Athens' central business district chanting slogans and waving banners demanding higher wages and opposing pension cuts.

The protest was organized by Greece's Communist-backed labor union PAME, which also declared a 24-hour strike that affected some municipal and health services, and coincided with separate strikes by journalists and teachers.

Neither of Greece's two main umbrella unions—one for the private sector and its public-sector counterpart—supported the strike and there was scant discernible effect on businesses in the city center.

Greece's new Socialist government, elected in a landslide victory Oct. 4, is under scrutiny by financial markets, ratings agencies and the European Commission to bring down a budget deficit estimated at 12.7% of gross domestic product this year.

Greece's bond market continued sliding Thursday as investors demanded higher premiums for buying Greek government bonds.

The gap in the yields that investors gain from Greek and much safer German government bonds swung wider on the news. That points to diverging investor views on the likely economic performance of countries in the 16-nation currency bloc.

The annual cost of insuring €10 million of Greek government debt using credit default swaps rose to €255,000, an increase of around €15,000 from late Wednesday.

As well as downgrading the country's debt by one notch to BBB+, S&P also left Greece on watch for a possible further downgrade.

The downgrades by S&P and Fitch suggest ratings firms aren't persuaded by Greece's efforts so far to repair its deteriorating budget. That means that borrowing terms are set to become still tougher for the southern European nation.

Greece accounts for less than 3% of the euro zone's economy, and in the event that Greece can't borrow enough money from capital markets to finance its budget—which observer say isn't a likely scenario—a bailout from other euro-zone members is seen as easily affordable.

However, European Union governments and institutions are worried that Greece's crisis could lead to deepening market skepticism about other euro-zone members, setting back the region's economic recovery.

*—Emese Bartha contributed to this article.*

# *Cracks in EU governance let debt problems slip by*

**[ Brussels Beat ]**

By Stephen Fidler

After months of complaints from governments and industry about the overvalued euro and the damage it is causing to economic growth in the euro zone, someone at last has done something about it. The euro fell to the lowest level against the dollar for three months Thursday thanks to Greece and its debt downgrades by two rating firms.

But if anyone was grateful to Greece, whose profound fiscal problems are being blamed for this hoped-for currency reversal, they weren't announcing it.

Indeed, it is probably not praise that is ringing in the ears of the Greek finance minister, George Papaconstantinou, as he travels Europe this week to drum up support for his government's tepidly received plan to bring its budget deficit under control.

Georges Ugeux, chairman and chief executive of Galileo Global Advisors, a New York boutique financial advisory firm, says repeated failure of European efforts to force Athens to put its house in order and deal with corruption, a big parallel economy, and fiscal fraud is starting to have important consequences.

He says the European Union has excessively indulged Greece. First, for legitimate political reasons, it brought Greece into the EU in 1981 to ensure that the colonels didn't return to power. Then, it turned a blind eye to the country's economic problems to allow it to adopt the euro in 2001, which he says emphatically should not have been a political decision.

Now, the problems surrounding Greece have laid bare a serious flaw in the governance of the euro zone.

The European Central Bank is powerless to deal with errant governments with big fiscal deficits. Its main indirect sanction is a lower limit it imposes on the credit ratings on the bonds it takes as collateral for its loans to banks.

(The ECB has temporarily lowered this bar as part of its reaction to the financial crisis. If it raises it again to "normal" levels, as currently envisioned at the end of next year, there is a good chance that Greek government bonds won't be accepted as collateral, something that would have ramifications for many banks outside Greece as well as inside.)

Instead, the issue gets batted over to the EU finance ministers. Here begins, says Mr. Ugeux, the horse trading and political bartering that he calls "the *souq*."

This process has so far proved incapable of dealing with Greece's repeated failure to meet the criteria associated with euro-zone membership, including a maximum 3% annual budget deficit, and even to tell the truth in its economic statistics. No wonder, as Mr. Papaconstantinou has said, Greece has a "credibility deficit."

Indeed, efforts to deal with Greece's continual and egregious missing of its fiscal targets aren't helped by the EU's ineffectiveness in dealing with repeated, though lesser, fiscal infractions of countries such as France and Germany and the rank political nature of some of its other decisions, such as keeping Lithuania out of the euro in 2006 ostensibly because it missed its inflation target by 0.1 of a percentage point.

This political decision-making is a big reason behind this week's weakness in the euro. People assume that whatever the Greeks do, its big EU brothers will bail it out.

One seasoned official observer, speaking on condition he not be identified, says his instinct isn't to worry much about Greece—at least from the standpoint of financial stability.

"The government has some well-off friends and neighbors," he says. Neither the Greek people nor Greece's euro-zone partners will be be very happy with the eventual outcome, he says. But he says Greece's problem "doesn't look like the sort of thing that crises are made of."

More worrying to him is an issue that attracted less attention this week: Austria, which has been playing its part in enlarging, in a small way, the euro zone's already hefty bank bailout bill. So far, according to calculations published this month by Piergiorgio Alessandri and Andrew Haldane of the Bank of England, support for financial institutions from euro-zone governments and the European Central Bank totals $3 trillion.

At the height of the financial crisis, a lot of attention was focused on Austria's three big banks—Bank Austria, which is a subsidiary of Italy's UniCredit, Erste Bank and Raiffeisen Zentralbank—particularly because of their exposure to Eastern Europe. In fact, according to some analysts, defaults by borrowers in the former communist bloc appear so far not to have materialized on the scale expected.

If that is good news, the rescue announced Monday of Hypo Group Alpe Aldria, Austria's sixth-largest bank, suggests continuing concerns about Austria's second-tier banks that have been rumbling under the surface since the bailout of Bawag in 2006.

The issue here, according to some analyses, is not their exposure to Eastern Europe but problems at home. The smaller Austrian banks struggle for profitability because the country has too many banks chasing too little business.

Facing an overbanked domestic market with few profitable opportunities, some banks don't seem to have the risk-management skills for more adventurous business forays. Yet, as HGAA's relationship with the late right-wing politician Jörg Haider suggests, there are links with local political power bases and lobby groups that throw obstacles in the way of the overhaul so clearly required in the banking system.

In fact, Austria's banking challenges look like a microcosm of those of neighboring Germany, which also suffers an excess of banks and where there isn't much evidence either of political appetite to sort them out.

# Ireland exits recession

*Despite 0.3% gain in GDP, recovery remains fragile, economists warn*

By Quentin Fottrell

DUBLIN—Ireland pulled out of recession in the third quarter but many analysts warned that significant hurdles still threaten the country's economic recovery.

Irish gross domestic product rose 0.3% during the third quarter from the previous quarter, the Central Statistics Office said, showing that in technical terms the country has emerged from recession.

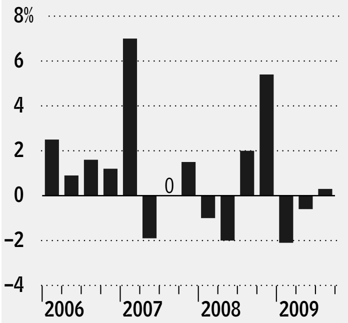
However, gross national product—a measure more closely watched by Irish economists, which excludes the profits from multinational companies based here—posted a steeper decline. That figure fell 1.4% in real terms from July to September, compared with a 0.5% drop in the second quarter.

"Ireland is not out of the woods just yet," according to Capital Economics. "It still faces considerable obstacles and activity will probably contract in 2010 and 2011 as a whole."

Most economists say they believe the latest data don't change the urgency of Ireland's crisis, which was triggered by an imploding construction sector and the near-collapse of its banks—and compounded by rising unemployment and soaring debt.

**Green shoots**

Ireland's GDP, change from previous quarter




Source: Central Statistics Office

Finance Minister Brian Lenihan this month delivered on his promise to cut public-sector spending by €4 billion ($5.8 billion) in 2010. That decision angered trade unions and voters, but was welcomed by the international investor community—especially amid the apparent unwillingness thus far of Greece, another heavily indebted euro-zone country, to take similar action.

Spending across Ireland remained weak. On a quarterly basis in the third quarter, consumer spending fell 0.7%, government expenditure declined 0.9%, and investment fell almost 9.9%.

On an annual basis, GDP was down 7.4% in the third quarter, compared with a 7.9% fall in the second quarter, while GNP was down 11.3% on the year, compared with a 12.2% drop in the previous quarter, the CSO said.

Some economists say employment is showing signs of stabilizing as certain sectors are beginning to hire, while non-Irish nationals are leaving the country. Others say older workers are opting in greater numbers for early retirement, while younger workers are returning to full-time education.

The unemployment rate rose to 12.4% in the third quarter from 11.6% in the previous quarter, the Central Statistics Office said Wednesday, reflecting the slump in the construction sector and weakness in manufacturing and services.

"The good news is that service exports seem to have bottomed," said Davy Research economist Rossa White. Domestic manufacturing is still struggling, he added.

A report by Ulster Bank said "there is a two-speed economy in operation: Improvement in the economy is being dominated by the multinational sectors while domestic sectors are still very weak."

## Putting on a brave face

Agence France-Presse/Getty Images

Silvio Berlusconi left the hospital saying he would remember the days after his Sunday attack for 'the hatred of a few and the love of many, many Italians.'

# BOE warns banks on stability

By Natasha Brereton And Ilona Billington

LONDON—Banks should make the most of strong profits and relatively stable financial markets to bolster their overstretched balance sheets and protect themselves against any possible worsening of conditions, the Bank of England advised.

In its twice-yearly Financial Stability Report, the BOE highlighted a significant recovery in financial conditions, but noted continuing vulnerabilities that could spell a return of turbulence. It also pointed out that British banks must refinance more than £1 trillion ($1.62 trillion) of wholesale funding over the next five years.

"Despite inevitable short-term costs, there is a strong case for banks acting now to improve balance sheet positions while conditions are favorable," the BOE said. It added that now was a good time for banks to raise external capital, lengthen funding maturities and come up with plans to cope with the withdrawal of public support.

The report stressed the importance of seeing recent improvements in financial and economic conditions in the context of strained balance sheets in a broad spectrum of countries and sectors.

"Given their balance-sheet vulnerabilities, banks remain exposed to any future deterioration in macroeconomic and market conditions, which could substantially raise the cost of funding and capital raising in the future," the central bank warned.

**The report stressed the importance of seeing recent improvements in financial and economic conditions in the context of strained balance sheets.**

Separately, on Thursday an unexpected drop in British retail sales in November cast new doubt on the recovery and on government hopes of a big rise in consumer spending.

The Office for National Statistics said retail sales fell 0.3% in November from October, the first month-on-month decline in six months. November sales were still up 3.1% from a year ago.

Retail-sales figures are volatile, but the drop in November sales is consistent with a recent cooling in consumer confidence.

The British government has pinned its hopes for economic recovery on a big pickup in consumer spending. In his prebudget report last week, Chancellor of the Exchequer Alistair Darling said he expects the economy to grow by between 3.25% and 3.5% in 2011 and 2012.

A strong recovery is essential if tax revenues are to rebound and allow the government to meet its target of halving its budget deficit by the year ending March 2014. But that forecast is based on the expectation that, after a weak 2010, consumer spending will rise by between 2.75% and 3.25% a year from 2011.

Economists warn that may be an optimistic view of how consumers are likely to behave when confronted with high unemployment levels, low wage growth, tax increases and the challenge of repaying debt accumulated when the economic outlook looked a lot brighter.

Meanwhile, the BOE's executive director for financial stability, Andy Haldane, told the BBC's Business Daily program that if international authorities don't reach agreement on regulatory overhaul, the U.K. should still consider going ahead, even if it means losing some financial business.

"Some of the downsides of carrying around a big financial system are now evident to all," Mr. Haldane said. "If some of that were to migrate overseas that would be unfortunate, but given the costs of carrying that financial system around, it may be a price worth paying."

**Seeking stability**

U.K.'s retail sales fell as the Bank of England urged banks to protect themselves against key risks:

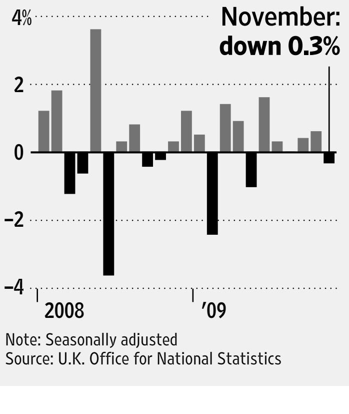
**Removal of government support,** which could cause volatility in asset prices

**Downgrades of sovereign debt,** which could raise the cost of bank funding

**Slower-than-expected recovery,** which could trigger larger bank-loan impairments

**Faltering asset-price rally,** which could lower bank profits

U.K. retail-sales volume, change from the previous month




Note: Seasonally adjusted
Source: U.K. Office for National Statistics

# German debt levels to hit bond market

By Emese Bartha And Andrea Thomas

FRANKFURT—The German government plans to sell a record €207 billion ($300 billion) in government bonds in 2010 to cover a 10.5% rise in public spending, adding a new burden to the euro-zone's leading bond market.

The total, which follows nominal bond issuance of €153 billion this year, is likely to keep Germany as the second-largest issuer of government bonds in the 16-member currency bloc, after Italy.

The market for German government bonds, called bunds, is a benchmark against which other euro-zone government bonds are measured because of Germany's top credit rating and the high liquidity of its government bonds,

The bund market remained buoyed Thursday as investors chose to stay in bunds amid credit-market jitters after Standard & Poor's Ratings Services downgraded Greece's sovereign-debt rating late Wednesday.

"The high issuance volumes are also the latest reminder that the issuance pressures will increase further in 2010, putting upward pressures on yields in general, starting already in early 2010," said Jan von Gerich, a bond analyst at Nordea Bank.

The new German government's first budget sees a record €85.8 billion in new borrowing next year. When spending for financial-sector bailouts and other extraordinary measures is included, total new debt will reach around €100 billion.

The German Finance Agency penciled in nominal government bond issuance of €56 billion in the first quarter, €59 billion in the second quarter, €46 billion in the third quarter and a further €46 billion in the fourth quarter.

Separately, Germany's economics ministry said in a document that the Federal Cartel Office will in the future be able to break up any company that has a dominant position in key markets and that blocks fair competition. In preparation of a draft bill due January 2010, the ministry said the intervention would be justified "to boost or allow competition to the benefit of consumers and the overall economy."

The measures come after the new center-right coalition government agreed on tougher competition in its coalition treaty signed in October, saying the cartel office didn't have sufficient power to boost competition.

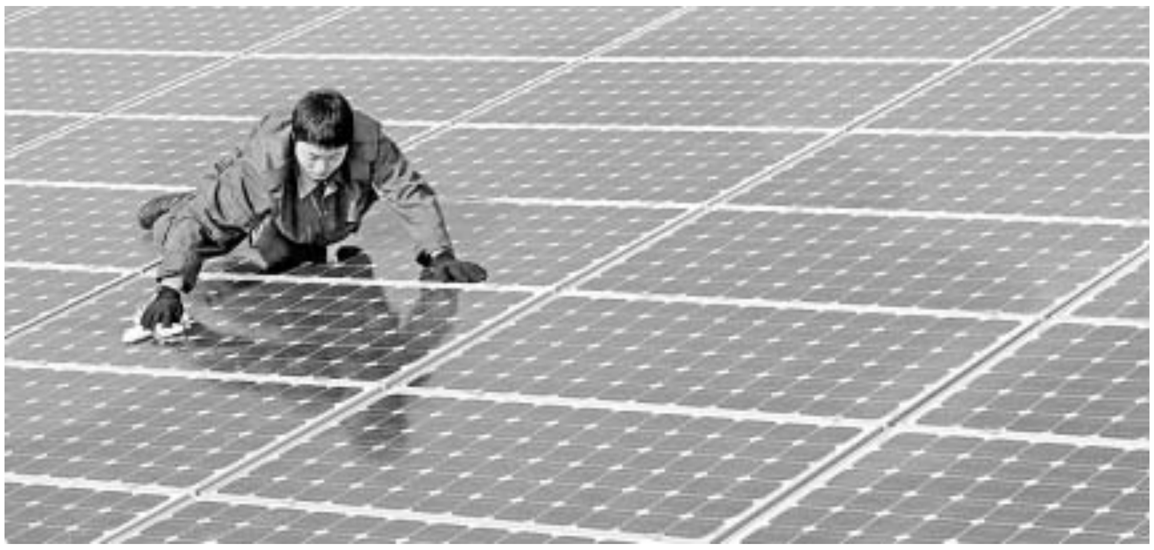
The measures will affect all sectors, but they are believed to be aimed mainly at utilities and media companies. Germany's energy market was liberalized in 1998, but the four biggest companies—**E.ON** AG, **RWE** AG, **EnBW Energie Baden-Württemberg** AG and **Vattenfall Europe** AG—produce more than 80% of Germany's electricity.

COPENHAGEN SUMMIT

# China takes lead in green technology

*World's top polluter combines cheap labor, capital in ambitious renewable-energy plan that could reshape business*

By Shai Oster



Reuters

A worker cleans solar panels on the roof of a building in Taiyuan, China, earlier this month.

BEIJING—Xu Shisen put down the phone and smiled. That was Canada calling, explained the chief engineer at a coal-fired power plant set among knock-off antique and art shops in a Beijing suburb. A Canadian company is interested in Mr. Xu's advances in bringing down the cost of stripping out greenhouse-gas emissions from burning coal.

Engineers led by Mr. Xu are working to unlock one of climate change's thorniest problems: how to burn coal without releasing carbon into the atmosphere.

Mr. Xu is part of a broader effort by China to introduce green technology to the world's fastest-growing industrial economy—a mission so ambitious it could eventually reshape the business, just as China has done for everything from construction cranes to computers.

China looms large over the global climate summit in Copenhagen, where Chinese officials are pressing the U.S. and other rich nations to accept new curbs on their emissions and to continue to subsidize poor nations' efforts to adopt clean-energy technology. China is the world's biggest source of carbon emissions. Less understood is the way China is now becoming a source of some of the solutions.

China's vast market and economies of scale are bringing down the cost of solar and wind energy, as well as other environmentally friendly technologies such as electric car batteries. That could help address a major impediment to wide adoption of such technologies: They need heavy subsidies to be economical.

The so-called China price—the combination of cheap labor and capital that rewrote the rule book on manufacturing—is spreading to green technology. "The China price will move into the renewable-energy space, specifically for energy that relies on capital-intensive projects," says Jonathan Woetzel, a director in McKinsey & Co.'s China office.

China's government is backing the trend. It wants to replicate the success of the special economic zones that transformed cities such as Shenzhen from a fishing village near Hong Kong into one of the biggest manufacturing export centers in the world. Set up when China began its economic reforms in the 1980s, the zones were designed to attract foreign investment into light manufacturing to kick-start exports. They became engines of China's economic boom.

Regulators will announce several low-carbon centers next year that will have preferential policies to promote low-carbon manufacturing and exports.

China's goals face big challenges. China could end up becoming simply a low-cost manufacturing base, not a source of innovation. Worse, its drive to cut costs could stifle innovation overseas.

And Beijing has a long way to go to reducing China's carbon footprint. For each out-of-date power plant it shut down in a two-year cleanup campaign, it added the capacity of roughly two more. Even some of the better power plants are run poorly because company bosses don't want to pay to clean up their emissions.

In the fight against global warming, some of the biggest gains are to be made in scrubbing carbon from coal-burning power plants. China and the U.S. together have 44% of the world's coal reserves, and aren't about to give up on the cheap and reliable source of power. According to U.S. government projections, world coal use could increase nearly 50% by 2030.

"If emissions aren't reduced from power plants, global warming cannot be avoided," says Jonathan Lewis, a climate specialist at the U.S.-based Clean Air Task Force, which has sought to pair U.S. utilities with Chinese companies. "The solution can be led by the U.S. and China."

Capture technology traps carbon-dioxide gases released by coal plants. The gas can be pumped deep underground, typically into salt caverns or aging oil fields. The carbon can be stripped either before or after the coal is burned. Postcombustion capture is simpler and can be retrofitted on existing power plants. Current versions cut energy output by a fifth or more.

Far more complicated is precombustion carbon capture, which involves completely redesigning plants. Coal is turned into a gas, the carbon is stripped out and the rest is burned. Called "integrated gasification combined cycle" plants, these cost billions of dollars and haven't been developed on a commercial scale yet.

China has a technological lead in turning coal into gas. It has been using the technology widely to make petrochemicals and fertilizers as a substitute for pricier natural gas. Houston-based **Future Fuels** LLC has licensed gasification technology from China to use in a plant in Pennsylvania.

Critics say current carbon-capture technologies are merely a Band-Aid for global warming. That is because they are so inefficient that even more coal has to be burned to produce the same amount of electricity. Also, the technology uses a lot of water and sequestering carbon underground isn't proven.

Still, some analysts estimate carbon capture could account for between 15% to 55% of the world's cumulative carbon-emissions reduction by 2100.

Among the reasons China can move so fast is that the government and its state-owned companies can push through projects without worrying about red tape. And efforts to test new power plants face only nascent public resistance in a few rich cities. Protectionist policies also favor domestic companies against foreign competitors.

Among those leading the ramp-up is Mr. Xu. These days, he is busy with three clean-coal projects. One is on the outskirts of Beijing, underneath looming cooling towers of the Gaobeidian Huaneng power plant.

Mr. Xu and colleagues work at a state-run research institute partly owned by **China Huaneng Group**, China's biggest utility. The state-owned giant produces about 10% of China's electricity, nearly all from coal.

The Beijing project, started before the 2008 Summer Olympics, traps a fraction of the carbon dioxide emitted by the plant, purifying and selling it for use in food packaging and for the fizz in sodas. Using what he has learned in Beijing, Mr. Xu is building another capture facility in Shanghai that will be 30 times as big.

If Mr. Xu's team can figure out how to bring the costs down—mostly by recycling energy lost in the process of scrubbing out the carbon—these units could be retrofitted to coal-fired power plants around the world.

Mr. Xu is also involved in the GreenGen project, a $1 billion power plant led by Huaneng that will turn coal into a gas before burning it. The project is scheduled to go online by 2011. Burning gas is more efficient than burning coal—meaning less coal is required to make the same amount of electricity. The less coal burned, the less carbon released.

Though carbon capture has moved into the mainstream, it is still at least five to 10 years away from becoming a widespread technology, analysts say.

In the meantime, China is reshaping two of the biggest green technologies in use already—wind and solar power.

In 2004, foreign firms owned 80% of China's wind-turbine market, according to energy consulting firm IHS Cambridge Energy Research Associates. Now, Chinese companies own three-quarters of the country's market, thanks to companies that make turbines a third cheaper than European competitors.

Chinese wind-turbine makers are starting to export. In October, **Shenyang Power Group** struck a deal to supply 240 turbines to one of the largest wind-farm projects in the U.S., a 36,000-acre development in Texas.

China already has a 30% share of the global market for photovoltaic solar panels used to generate electricity. Solar-power panel makers, including **Suntech Power Holdings** Co., **Yingli Green Energy** and **Trina Solar** Ltd., export most of their product to Europe and the U.S., contributing to a 30% drop in world solar-power prices.

Chinese competition is forcing rivals to shift production. **U.S. Evergreen Solar** Inc. said it will move its assembly line from Massachusetts to China. **General Electric** Co. said it will shut a facility in Delaware. **BP** PLC's solar unit said this spring it would stop output in Maryland and rely on Chinese suppliers instead.

Yet, despite China's armies of fresh engineering graduates, foreign companies still create and own most of the key technologies. "China lags about 10 years behind in technology," says Bernice Lee, a research director at Chatham House, a London-based think tank that analyzed patent holders on renewable and low-carbon technology.

As in other industries, China's cheap manufacturing may spark protectionism. In one hint of battles to come, Sen. Charles Schumer (D., N.Y.) wrote a letter to the U.S. energy secretary protesting the use of federal stimulus money to support the $1.5 billion wind project in Texas unless it relies on U.S.-built turbines.

Critics in rich countries accuse China of unfairly subsidizing companies via cheap loans from state-controlled banks and dumping excess supply overseas.

Others say China's missteps could hurt the market for all. "China is making prices cheaper in renewables today, by lunging into oversupply, as it does in most industries," says Daniel Rosen, principal of consulting firm Rhodium Group. "The question—and danger—is whether by oversupplying the market today China is damaging longer-term innovation and competition in the sector for the future."

In green technology, China has figured out ways to turn excess capacity to its advantage. Until this year, China's solar-panel makers exported nearly all their output to countries such as Germany and Spain, where governments supported growth in the sector.

That changed this year when solar-panel prices fell as dozens of new Chinese polysilicon-makers started operating. The sudden glut in the raw material to make solar panels coincided with a drop in orders from European companies hit by the recession. The result: Polysilicon prices fell by half from January peaks. HSBC estimates they could drop 20% more by the end of 2010.

Softening prices created an opportunity for Chinese regulators. Officials are now talking about raising solar power capacity targets five- or tenfold, so that by 2020 China could have more than double current global solar-power capacity.

Executives at Trina and Yingli say increased economies of scale from making more panels for China will push costs even lower. "We could go to $1 a watt by the end of 2010," which would be a landmark in bringing solar power in parity with conventionally produced electricity, says Yingli's chief executive, Miao Liansheng, a veteran of the People's Liberation Army who sold cosmetics before turning to solar panels.

"The Chinese manufacturers can now make [solar panels] a lot cheaper than Europe, the United States and Japan because the whole supply chain is now available in China," says Martin Green, who runs the photovoltaic center at the University of South Wales in Australia, a training ground for many scientists working in China's solar industry. "The Chinese are making it more affordable, and they're more adventurous in introducing new technology as well."

The ability to manufacture cheaply is attracting the notice of U.S. utilities. Huaneng says it can make gasification equipment cheaper than foreign rivals.

**Duke Energy** Corp., of Charlotte, N.C., signed a pact with Huaneng in August to share information on clean-coal technology. Duke says it would take eight years to build an IGCC plant in the U.S.—versus three in China.

**Green power**

While demand for renewable energy is expected to grow in China, it is dwarfed by other sources of energy.

**China's primary energy demand, in metric tons of oil equivalent**


Source: International Energy Agency

*Includes hydropower and other renewable energy

# Leaders press for a climate agreement

*Continued from first page*

ing nations, particularly China, must agree to control their emissions and make those actions verifiable. Virtually all the growth in man-made carbon-dioxide emissions in the coming decades is expected to come from China, India and other developing nations, according to a U.N. forecast.

The Obama administration's decision to back the British and European Union aid initiatives floated earlier this year was a significant shift, and it altered the atmosphere in Copenhagen as the bargaining headed into its final hours.

U.K. Prime Minister Gordon Brown first suggested in June that industrialized nations should raise $100 billion annually by 2020 to help poor nations combat the effects of climate change and green their economies. The EU backed that up in the fall. Mr. Miliband said the Clinton announcement wasn't coordinated with Britain and the EU, but he expressed support for the offer.

Mrs. Clinton said the proposal for long-term climate aid for poor nations depends on reaching "a strong accord" by the end of the summit. The money would come from public and private sources, she said, without specifying how it would be divided or what the U.S. share would be.

The public-private split could become a bone of contention. The Group of 77 developing nations—which is backed by China and has played an outsize role at Copenhagen—has said all the money should be government funds, and it should be in addition to existing overseas development aid. They want rich nations to commit between 0.5% and 1.5% of their GDP annually in financial assistance. The U.S. position is that private money can and should be included.

Mrs. Clinton's announcement is the latest move by U.S. officials to counter accusations from developing nations that the U.S. hasn't done enough to break the climate-talk deadlock. President Barack Obama is scheduled to arrive in Copenhagen Friday morning to meet with other world leaders and ratify a climate agreement—if there is one.

Mrs. Clinton said the U.S. wouldn't commit to the plan if all major economies don't commit to various provisions, including carbon-emission reductions that are verifiable and transparent. "If there isn't a commitment for transparency of some sort, that would be a dealbreaker," she said.


Getty Images; Reuters (2)

French President Nicolas Sarkozy said failure to secure a climate deal 'would be catastrophic' for world leaders.

He Yafei, China's vice minister of foreign affairs, said Thursday that China's carbon-intensity reduction target shouldn't be subject to international monitoring, despite mounting pressure for more transparency.

Mr. He called on the developed world to trust China's internal monitoring system and its sincerity in combating climate change.

There were some signs of movement on the issue of how rich countries can check the compliance of nations like China. "We have 75% agreement on the verification issue," Indian Environment Minister Jairam Ramesh told reporters. He said India had come up with a four-point formula on the issue, and that the U.S. agreed with three of the points.

The U.S. proposal on climate aid received a cautious greeting from other players. Some African nations that would benefit from the additional funding saw it as encouraging.

Mrs. Clinton's announcement drew criticism from the senior Republican on the House Energy and Commerce Committee, Rep. Joe Barton of Texas. Mr. Barton, an opponent of emission caps who has expressed skepticism that human activity is the main cause of climate change, described the U.S. offer as a "Christmas present" at the expense of U.S. taxpayers.

*—Selina Williams and Jing Yang contributed to this article.*

# China plans to develop solar projects in Europe

DOW JONES NEWSWIRES

COPENHAGEN — State-owned China Energy Conservation Investment Corp., the nation's flagship developer of clean and renewable energy, is in talks to invest in and operate solar utility projects in Spain, Italy and Germany, a company executive said.

The company late last month obtained a credit line of 20 billion yuan ($2.93 billion) for two years from the state-run Export-Import Bank of China to support its overseas expansion, said Zhang Jun, vice director of the business cooperation department of CECIC.

"The global financial crisis has left some solar projects in those European nations suspended but solar tariffs offered there are still quite attractive, so we are interested in taking over," Mr. Zhang said on the sidelines of the Copenhagen climate summit.

The move comes as China and other developing nations are demanding that rich countries provide tens of billions of dollars annually in funding as part of agreements being negotiated at the United Nations-sponsored climate-change conference.

China wants rich nations to provide 0.5% to 1% of their annual gross domestic product as funding to help developing nations combat climate change for the period to 2020 and beyond, said Zhu Guangyao, China's assistant minister of finance, in Copenhagen.

CECIC is a specialized government agency investing in energy-conservation and environmental-protection projects. Until now, its activities have been largely focused in the domestic Chinese market.

It aims to have installed solar-power generating capacity in China of at least 1,400 megawatts connected to the grid by 2012, a sharp increase from the current 20 megawatts.

CECIC is involved in various clean and renewable energy projects in China, including in the wind- and biomass-based power sectors, and will also test an investment model in overseas markets, Mr. Zhang said. "If the model proves to be successful, then it would be followed by a flurry of investment from other Chinese companies," he said.

CECIC intends to form a consortium with other Chinese companies, including solar-module manufacturers, to make the foray overseas, but it will hold the majority stake, he added.

In July, China-based Suntech Power Holdings Co., the world's second-largest supplier of solar modules, said it had entered a strategic agreement with CECIC to develop solar projects over the next five years.

CECIC, which brought online China's first 10-megawatt solar utility plant in September, has also submitted two solar projects to the nation's top economic planner, the National Development and Reform Commission, for approval to seek extra funding under the United Nations' Clean Development Mechanism, or CDM.

CECIC plans to list its wind power unit on the Hong Kong Stock Exchange within six months, and this will be followed by a listing on the mainland, Mr. Zhang said.

U.S. NEWS

# Debtor dilemma: pay mortgage, or walk

*Some underwater homeowners stop making payments, even if they can afford them, figuring it is in their best financial interest*

By James R. Hagerty
And Nick Timiraos

PHOENIX—Should I stay or should I go? That is the question more Americans are asking as the housing market continues to drag.

In good times, it would have been unthinkable to stop paying the mortgage. But for Derek Figg, a 30-year-old software engineer, it now seems like the best option.

Mr. Figg felt trapped in a home he bought two years ago in the Phoenix suburb of Tempe for $340,000. He still owes about $318,000 but figures the home's value has dropped to $230,000 or less. After agonizing over the pros and cons, he decided recently to stop making loan payments, even though he can afford them.

Mr. Figg plans to rent an apartment nearby, saving about $700 a month.

A growing number of people in Arizona, California, Florida and Nevada, where home prices have plunged, are considering what is known as a "strategic default," walking away from their mortgages not out of necessity but because they believe it is in their best financial interests.

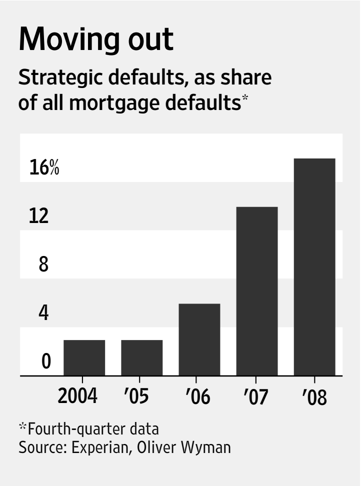
A standard mortgage-loan document reads, "I promise to pay" the amount borrowed plus interest, and some people say that promise should remain good even if it is no longer convenient.

George Brenkert, a professor of business ethics at Georgetown University, says borrowers who can pay—and weren't deceived by the lender about the nature of the loan—have a moral responsibility to keep paying. It would be disastrous for the economy if Americans concluded they were free to walk away from such commitments, he says.

Walking away isn't risk-free. A foreclosure stays on a consumer's credit record for seven years and can send a credit score (based on a scale of 300 to 850) plunging by as much as 160 points, according to Fair Isaac Corp., which provides tools for analyzing credit records. A lower credit score means auto and other loans are likely to come with much higher interest rates, and credit card issuers may charge more interest or refuse to issue a card.

In addition, many states give lenders varying degrees of scope to seize bank deposits, cars or other assets of people who default on mortgages.

Even so, in neighborhoods with high concentrations of foreclosures, "it's going to be really difficult to prevent a cascade effect" as one strategic default emboldens others to take that drastic step, says Paola Sapienza, a professor of finance at Northwestern University. A study by researchers at




Northwestern and the University of Chicago found that as many as one in four defaults may be strategic.

Driving this phenomenon is the rising number of households that are deeply "under water," owing much more than the current value of their homes. First American CoreLogic, a real-estate information company, estimates that 5.3 million U.S. households have mortgage balances at least 20% higher than their homes' value, and 2.2 million of those households are at least 50% under water. The problem is concentrated in Arizona, California, Florida, Michigan and Nevada.

Josh Cotner, who owns an insurance agency, says his mortgage balance is about $100,000 more than the market value of his home in Gilbert, Ariz. Mr. Cotner could rent a bigger home nearby for $600 a month, far below the $1,655 he now pays on his mortgage, home insurance and property tax. He says he recently stopped making mortgage payments because his lender wouldn't help him reduce the principal on his loan under a federal program in which he believes he is qualified to participate. Given the sometimes lengthy legal process of foreclosure, he may be able to stay in the home at least another nine months without making payments.

Banks warn they may get tough with strategic defaulters by pursuing legal claims on a borrower's other assets. "We will try to reduce people's payments if they have a hardship," says Thomas Kelly, a spokesman for J.P. Morgan Chase &

Kendrick Brinson/Luceo Images for The Wall Street Journal

Derek Figg in his Tempe, Ariz., home Tuesday. He owes about $318,000 on the home, but believes it's worth $230,000 or less.

Co. "But we have a financial responsibility to get people to pay what they owe if they can afford it."

Steven Olson, a loan officer and roof installer in Roseville, Minn., defaulted in 2007 on a plot of land in Florida he had bought as an investment. "I thought I could move on with my life," he says. But the lender, RBC Bank, a subsidiary of Royal Bank of Canada, sued him, seeking to make him pay more than $400,000 to the bank to cover its losses on the loan. Mr. Olson has hired a Florida lawyer, Roy Oppenheim, to resist the claim. An RBC spokesman declined to comment.

States where lenders generally can pursue such legal claims include Florida and Nevada but not California and Arizona, where laws generally prohibit lenders from pursuing other assets of mortgage borrowers. A new Nevada law will protect many borrowers from these judgments if they bought a home for their own use after Sept. 30, 2009.

Another risk for defaulters is that banks could sell the rights to pursue claims to collection agencies or other firms, which could then dun the borrowers for up to 20 years after a foreclosure. Such threats appear to deter some borrowers. A recent study from the Federal Reserve Bank of Richmond found that under-water borrowers were 20% more likely to default in a state where mortgage lenders can't pursue claims on other assets than in those where they can.

Brent White, an associate law professor at the University of Arizona who has written about this issue, says homeowners should make the decision on whether to keep paying based on their own interests, "unclouded by unnecessary guilt or shame." He says borrowers can take a cue from lenders that "ruthlessly seek to maximize profits or minimize losses irrespective of concerns of morality or social responsibility."

But it isn't just a matter of the borrower's personal interest, says John Courson, chief executive of the Mortgage Bankers Association, a trade group. Defaults hurt neighborhoods by lowering property values, he says, adding: "What about the message they will send to their family and their kids and their friends?"

In Mesa, another suburb of Phoenix, low prices are helping to draw buyers who may walk away from other homes. Christina Delapp bought a house out of foreclosure in July for $49,000 in cash. She says she will stop paying the mortgage on another home she still owns in Tempe if she can't sell in the next few months for more than the $312,000 that she owes.

Ms. Delapp, who has been jobless for 18 months, says that the new home is part of her survival strategy. "I feel very fortunate," she says. "Regardless of what happens to my credit, we've managed to put together the best safety plan that I possibly could."

Mr. Figg says that deciding to default on his loan was "the toughest decision I ever made." Still, lenders are guilty of having "manipulated" the housing market during the boom by accepting dubious appraisals, he says. "When I weighed everything," he says, "I was able to sleep at night."

# Unemployment claims increase

By Meena Thiruvengadam
And Darrell A. Hughes

The number of workers filing new claims for jobless benefits rose last week, along with the number of those collecting unemployment for more than a week. But separate measures of the economy's performance pointed to slight improvements in the labor market.

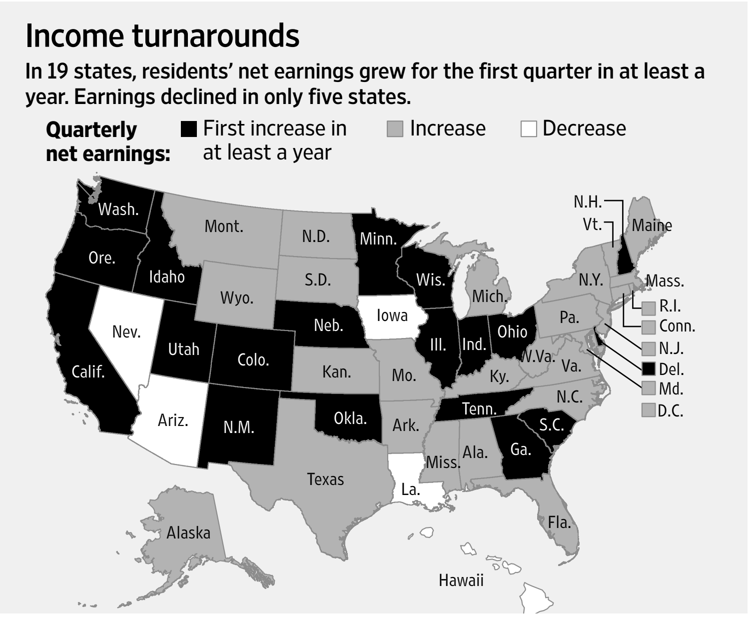
The Conference Board's index of leading economic indicators rose 0.9% last month, after gaining an unrevised 0.3% in October, its eighth consecutive monthly climb, as the drag from employment began to ease for the first time since the recession began. A different report from the U.S. Bureau of Economic Analysis found state personal-income growth averaged 0.3% in the third quarter of 2009. Nineteen states saw growth in earnings for the first time in at least a year.

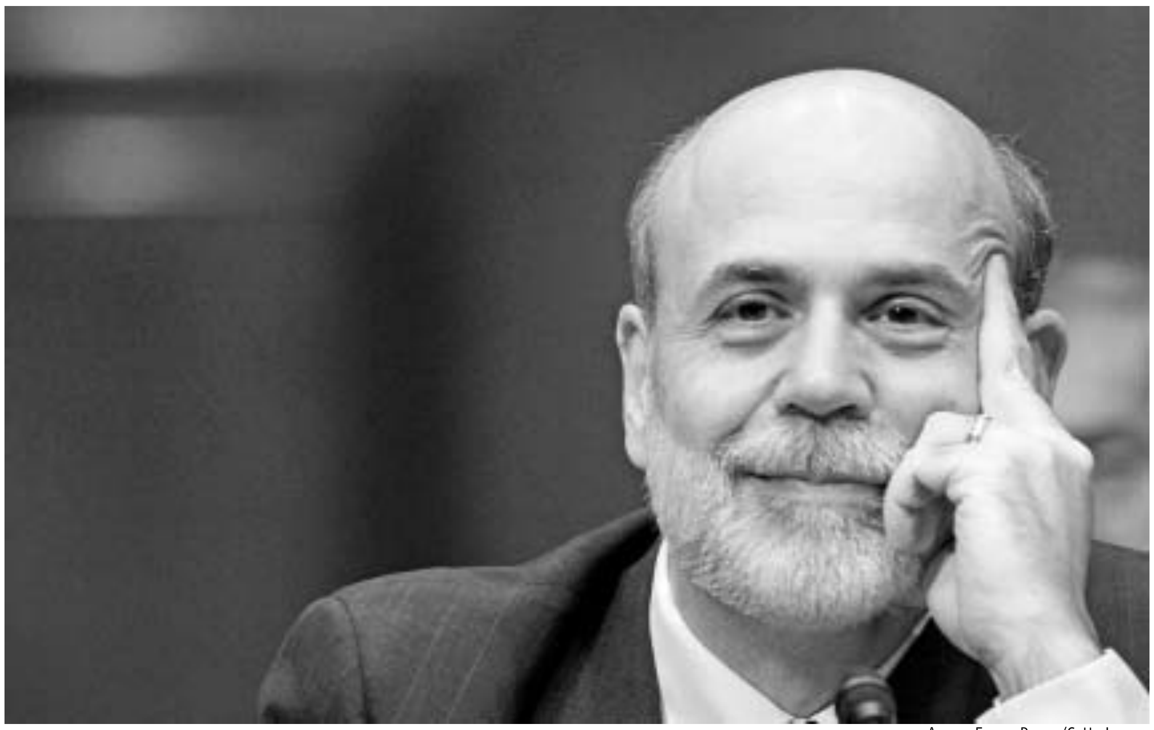
"The indicators point to a bright new year," said Ken Goldstein, economist at the board. "Employment largely held steady, making this the first month since December 2007 that it did not make a negative contribution to the index."

Initial claims for jobless benefits rose 7,000 to a seasonally adjusted 480,000 for the week ended Dec. 12, the Labor Department said. Labor revised last week's spike in claims downward to 473,000 from 474,000.

The tally of continuing claims in the week of Dec. 5, those drawn by workers collecting benefits for more than one week, rose 5,000, to 5,186,000. The four-week average of new claims, which aims to smooth volatility in the data, fell 5,250 to 467,500—its 15th consecutive drop.

*—Kathleen Madigan contributed to this article.*





Agency France-Presse/Getty Images

'Did Bernanke get all the calls right? Absolutely not. Did he make many mistakes? Absolutely,' said one senator of the Fed chief.

# Qualified support

*Bernanke is cleared for a second term, but faces a raucous Senate vote*

By Sudeep Reddy

WASHINGTON—The Senate Banking Committee cleared Ben Bernanke for a second term as chairman of the U.S. Federal Reserve, sending his nomination to the full Senate for what is expected to be a fiery debate next month.

By a 16-7 vote, the panel approved Mr. Bernanke after opponents seized on the Fed's shortcomings and most of its backers offered qualified support. Several lawmakers who voted for Mr. Bernanke mentioned a plan pending in the Senate to overhaul the Fed's role in financial regulation, posing a threat to Mr. Bernanke's authority at the central bank even if he is confirmed.

"I want to be clear that with my support comes my insistence that we carefully examine the role of an institution that runs the risk of becoming too complicated to succeed," said Sen. Chris Dodd (D., Conn.), the committee chairman, who voted to give Mr. Bernanke another four years.

The majority of Republicans on the panel voted against Mr. Bernanke, as did one Democrat, Sen. Jeff Merkley of Oregon. Some cited his decisions as a Fed governor earlier in the decade, while others pointed to his record in the first two years of his term as evidence that he doesn't deserve reappointment. "We talk a good game when it comes to accountability, but we rarely match our own rhetoric with action," said the committee's top Republican, Richard Shelby, who voted against the nomination.

At least four senators have vowed to block Mr. Bernanke's confirmation on the Senate floor next month; if they persist, the nomination would need 60 votes to clear. The largest number of "no" votes against a Fed chairman in recent history came in 1983 when 16 senators voted against renewing Paul Volcker's term after he raised interest rates to double digits to fight inflation.

While Mr. Bernanke is expected to be confirmed, a significant number of opposition votes could exacerbate market perceptions that he lacks political backing for withdrawing the Fed's extraordinary support for the economy quickly enough to prevent runaway inflation.

"I don't think markets would react well to a squeaker," said Michael Feroli, an economist at J.P. Morgan Chase. "To a certain degree, the market has already internalized the fact that there's a lot of political opposition to Bernanke and to the Fed in general. That hasn't been pleasant for the market and it probably has already adversely affected inflation expectations and the value of the dollar."

Speaking to reporters after the vote, Mr. Dodd acknowledged the risks of a protracted battle on the Senate floor. "It's not just any nomination. This is a major financial event," he said. For the Senate "to delay this unnecessarily, to create more disruption here, might serve the political purpose of causing some disruptions in the marketplace. But I don't think it's in anyone's interest for that to happen. So my hope is that we'll be able to move it along."

The vote led some lawmakers to channel the deep anger from constituents about the state of the economy under Mr. Bernanke's watch and his role in the financial crisis.

Sen. Kay Bailey Hutchison (R., Texas), who voted against the nomination, blamed him for selling a plan to Congress last fall to buy toxic mortgage assets through the Troubled Asset Relief Program that ultimately morphed into another purpose.

"I cannot in good conscience condone that kind of behavior with so much trust that Congress put in the group that put forward the TARP," she said. Ms. Hutchison also suggested Mr. Bernanke should have offered more warnings about the rising U.S. debt before speaking positively about a large fiscal stimulus program.

Most senators ultimately chose to back President Barack Obama's nominee with the view that changing leadership at the central bank would pose significant risks to the economy. Many lawmakers noted that Mr. Bernanke, while being too slow to react ahead of the crisis, responded skillfully to avert a possible repeat of the Great Depression.

"Did Bernanke get all the calls right? Absolutely not. Did he make many mistakes? Absolutely," said Sen. Bob Corker (R., Tenn.) "But I think that the experience that Chairman Bernanke has had over the last year and a half makes him by far, of the people that I know, the most well-equipped person to lead the Fed over the next several years."

# Government stakes will stay large

By Michael R. Crittenden

WASHINGTON—The U.S. government continues to reluctantly hold sizable investments in a handful of auto companies and financial firms, but hopes to exit from those positions in the next several years, a top Treasury Department official said Thursday.

"The government's role as a shareholder is to manage its investment, not to manage the company," Assistant Secretary Herbert Allison Jr. said in prepared remarks before a House panel.

The government still holds sizable investments in **Citigroup** Inc., **American International Group** Inc., **Chrysler Group** LLC and **General Motors** Co. Mr. Allison said the government wants to dispose of those holdings "as soon as practicable," and laid out the government's expected time line for each of the companies.

Insurer AIG is still winding down its financial-products unit, Mr. Allison said. The process is expected to be mostly done by the end of next year, he said.

Also, Mr. Allison said the Treasury expects AIG to sell its international life-insurance businesses either next year or in early 2011. The government would receive the first dollars from those sales.

He predicted the Treasury will sell about $26.5 billion of Citigroup common stock "in an orderly fashion within six to 12 months." Similar plans are in place for the auto dealers, he said.

# *Economic pain is leaving scars on Americans' spirit*

[ Capital Journal ]

By Gerald F. Seib

The lingering economic crisis hasn't just cost America trillions of dollars in lost wealth. It's also taking a heavy toll on the national psyche, leaving scars that may take years to heal.

This psychic damage has serious political implications, to be sure. It helps explain the souring attitudes toward President Barack Obama and the Democratic party now in charge, has produced a kind of national funk that spells trouble for incumbents of all stripes, and is a principal reason for the rising support for the kind of insurrection represented by the "tea party" movement.

But ultimately the impact transcends politics. Look inside the latest Wall Street Journal/NBC News poll and you will see the damage done to the traditional American spirit of optimism. The findings pose a deeper question: What effect does economic calamity have on a nation's soul?

At a minimum, the results suggest that, as an exceptionally difficult year draws to a close, the glimmers of recovery that can be seen at a macroeconomic level aren't fully filtering down to the grassroots of American life:

■ After Americans began expressing more optimism midyear that the country was again headed in the right direction, that sense of optimism now appears to be fading. In the new poll, just 33% of those surveyed said America was headed in the right direction, down from 42% in June. A majority said the country was "off on the wrong track."

■ Despite the slowing of job losses and a stock-market recovery, just 46% said they thought 2010 would be better for the country than this year has been.

■ More than four in 10 Americans said they considered it extremely likely that they would lose a job, have wages and bonuses cut, or be forced into a lower-paying job in the next year. (A third said one of those things already has happened.) A quarter of Americans fear a double-whammy, expecting to simultaneously lose income while also having to assume the burden of housing or financially aiding other family members.

A real recovery in 2010 would, of course, produce happier results than these Americans foresee. Yet even that might not be enough to heal what appear to be deeper scars.

Two in three said they weren't confident that life for their children's generation will be better than it has been for theirs. Almost the same share of Americans said the country is in a state of decline.

A stunning 39% said they expected China would be the world's leading nation in 20 years—compared with 37% who said the U.S. would be the leader.

Peter Hart, a Democratic pollster who conducted the Journal/NBC News survey along with Republican Bill McInturff, asked simply: "Where has all the optimism gone?"

Jay Campbell, a pollster who works for Mr. Hart, gives a partial answer: "It's hard to have optimism when you can't even pay your bills."

One of the striking things about these blows to national optimism is that they aren't hitting just lower-income Americans, who traditionally feel the brunt of pain during a deep economic downturn. The seeds of doubt also are seen among those at the top of the employment ladder.

Professionals and managers were almost exactly as likely as blue-collar workers to say they weren't confident life for the next generation would be better, and they were just as likely to say the country was in a state of decline. Two in 10 professionals said they were dissatisfied with their job security.

And with good reason, for the current economic fall—driven by declines in financial markets and housing values—has struck hard precisely at those in the upper middle class who once had reason to think they might be immune to swings in the economy.

One is Susan Streck-Moss, a marketing professional from New Canaan, Conn. She worked in television marketing for years, and then in corporate brand marketing. She suffered a serious back injury a few years ago, and subsequently tried to re-enter her profession in 2007—precisely, it's now clear, as the deep recession was beginning.

"I had great hope," she said. "I've never not gotten a job. I've never been turned down for a job. Suddenly, I thought I was in the acting business. It was constant rejection." She's been unable to find regular work since, and has joined networking groups where she meets others in the same predicament—professionals who have taken two and three mortgages on their homes waiting in vain for their luck to break.

At age 52, Ms. Streck-Moss said she lost her house and feared losing her apartment. "That's the new America," she said. "It's these people who have always had good jobs and raised their kids and sent them to college and done all the right things. Suddenly we find ourselves overwhelmed." Her summary: "It's a nightmare."

For the economy, the nightmare may well be ending. And perhaps an end to the economic nightmare will change the declining poll numbers for the Democrats who, inevitably, take the brunt of the blame because they're running Washington.

Whether a recovery rekindles the spirit of American optimism is a different question entirely.

**WORLD NEWS**

# Insurgents hack a key U.S. weapon

*Militants use $26 software to get data from the drones used for surveillance and targeting; Iran backing suspected*

WASHINGTON—Militants in Iraq have used $26 off-the-shelf software to intercept live video feeds from U.S. Predator drones, potentially providing them with information they need to evade or monitor U.S. military operations.

*By **Siobhan Gorman, Yochi J. Dreazen** and **August Cole***

U.S. Air Force

U.S. enemies in Iraq and Afghanistan have used off-the-shelf programs to intercept video feeds from unmanned aircraft.

Senior U.S. defense and intelligence officials said Iranian-backed insurgents intercepted the video feeds by taking advantage of an unprotected communications link in some of the remotely flown planes' systems. Shiite fighters in Iraq used software programs such as SkyGrabber—available for as little as $25.95 on the Internet—to regularly capture drone video feeds, according to a person familiar with reports on the matter.

U.S. officials say there is no evidence that militants were able to take control of the drones or otherwise interfere with their flights. Still, the intercepts could give America's enemies battlefield advantages by removing the element of surprise from certain missions and making it easier for insurgents to determine which roads and buildings are under U.S. surveillance.

The drone intercepts mark the emergence of a shadow cyber war within the U.S.-led conflicts overseas. They also point to a potentially serious vulnerability in Washington's growing network of unmanned drones, which have become the American weapon of choice in both Afghanistan and Pakistan.

The Obama administration has come to rely heavily on the unmanned drones to monitor and stalk insurgent targets.

The stolen video feeds also indicate that U.S. adversaries continue to find simple ways of counteracting sophisticated American military technologies.

U.S. military personnel in Iraq discovered the problem late last year when they apprehended a Shiite militant whose laptop contained files of intercepted drone video feeds. In July, the U.S. military found pirated drone video feeds on other militant laptops, leading some officials to conclude that militant groups trained and funded by Iran were regularly intercepting feeds.

In the summer 2009 incident, the military found "days and days and hours and hours of proof" that the feeds were being intercepted and shared with multiple extremist groups, the person said. "It is part of their kit now."

A senior defense official said that James Clapper, the Pentagon's intelligence chief, assessed the Iraq intercepts at the direction of Defense Secretary Robert Gates and concluded they represented a shortcoming to the security of the drone network.

"There did appear to be a vulnerability," the defense official said. "There's been no harm done to troops or missions compromised as a result of it, but there's an issue that we can take care of and we're doing so."

Senior military and intelligence officials said the U.S. was working to encrypt all of its drone video feeds from Iraq, Afghanistan and Pakistan, but said it wasn't yet clear if the problem had been completely resolved.

The potential drone vulnerability lies in an unencrypted downlink between the unmanned craft and ground control. The U.S. government has known about the flaw since the U.S. campaign in Bosnia in the 1990s, current and former officials said. But the Pentagon assumed local adversaries wouldn't know how to exploit it, the officials said.

Last December, U.S. military personnel in Iraq discovered copies of Predator drone feeds on a laptop belonging to a Shiite militant, according to a person familiar with reports on the matter. "There was evidence this was not a one-time deal," this person said. The U.S. accuses Iran of providing weapons, money and training to Shiite fighters in Iraq, a charge that Tehran has long denied.

Predator drones are built by General Atomics Aeronautical Systems Inc. of San Diego. Some of its communications technology is proprietary, so widely used encryption systems aren't readily compatible, said people familiar with the matter.

In an email, a spokeswoman said that for security reasons, the company couldn't comment on "specific data link capabilities and limitations."



# Drone strikes in Pakistan kill suspected militants

By Zahid Hussain

ISLAMABAD—Five drones fired 10 missiles that killed at least 14 suspected militants in Pakistan's northwestern border region, in one of the biggest attacks in the U.S. campaign of missile strikes.

The strikes could exacerbate tensions between the U.S. and Pakistan at a time when their alliance is strained on several fronts.

A Pakistani security official said the missiles targeted suspected militant hideouts in the Ambarshaga area of North Waziristan. The official said there was a separate missile attack in Miranshah, in the same region, though details of casualties weren't available. It wasn't clear whether there were any prominent militants among the dead in either attack.

The U.S. strikes come after Pakistani military authorities turned down a U.S. demand to extend Pakistan's antimilitant campaign in neighboring South Waziristan to target Sirajuddin Haqqani, a powerful Taliban commander based in North Waziristan, the security official said.

American officials say Mr. Haqqani presents a serious threat to the U.S.-led coalition forces in Afghanistan. Pakistani officials have complained publicly that the drone strikes infringe Pakistani sovereignty and fuel anti-American sentiment, though some have acknowledged privately that the strikes have been effective in killing insurgents.

But distrust between the two nations appears to be increasing, with Pakistan seeking to impose security checks on U.S. diplomatic vehicles in Pakistani cities and tougher visa restrictions for American officials.

A U.S. official in Islamabad said the slow granting of visas by Pakistani authorities has forced American consulate offices to sometimes function with only 60% of the desired staff at a time when a new U.S. law approved aid for Pakistani civil programs.

"The situation may affect our new $1.5 billion social-sector programs as we need more staff to carry out the work," said the official.

Pakistani police last week impounded U.S. diplomatic vehicles in the eastern city of Lahore after American officials refused to let the vehicles be searched, citing diplomatic immunity.

Pakistani security officials also have accused Americans of using fake registration numbers on their vehicles. In some cases, police said the occupants of official vehicles were armed and couldn't prove their identity.

The U.S. official said the nation's diplomats strictly observe the country's laws.

American officials also complain that Pakistani authorities are taking much longer to process visa applications for U.S. diplomats and officials from the U.S. Agency for International Development. The spat over visas and vehicle searches was earlier reported in Thursday's edition of the New York Times.

A Pakistani foreign ministry official blamed the U.S. for the delay in the visa process, saying it was largely because most of the time the applicants don't provide the required information.

"We do not intend to deny visas to anyone, but they have to follow the procedure," the official said.