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Breaking news at europe.WSJ.com

Bernanke offers crisis strategy

Fed chairman's plan for U.S. economy includes anti-inflation steps, extends near-zero rates



Fed Chairman Ben Bernanke, testifying before a congressional panel Tuesday, rejected assertions that the central bank's liquidity programs are stoking inflation. 'I'm proud of the work we've done,' he said.

BY TOM BARKLEY
AND MAYA JACKSON
RANDALL

WASHINGTON—Federal Reserve Chairman Ben Bernanke shed light Tuesday on the tool kit the central bank can employ to unwind its crisis measures, but he made clear to lawmakers that the economy remained too weak to start tightening monetary policy.

The central-bank chairman also spent part of his Capitol Hill hearing on defense, with Republicans criticizing the Fed and attacking the Obama administration's plans to make it a new super-regulator of the financial system.

Mr. Bernanke reiterated that despite recent improvements in the economy and financial markets, the federal-funds rate would likely remain near zero for an extended period. But he also laid out a number of other steps the Fed could take to tighten policy as needed to head off a potential buildup in inflation.

"In light of the substantial economic slack and limited inflation pressures, monetary policy remains focused on fostering economic recovery," Mr. Bernanke told the House Financial Services Committee.

"However, we also believe that it is important to assure the public and the markets that the extraordinary policy measures we have taken in response to the financial crisis

and the recession can be withdrawn in a smooth and timely manner as needed, thereby avoiding the risk that policy stimulus could lead to a future rise in inflation," he said.

During the give-and-take with lawmakers, Mr. Bernanke rejected assertions that the Fed's liquidity programs were stoking inflation and argued in favor of the Fed keeping its consumer-protection role.

Mr. Bernanke also made clear that he thought the central bank could monitor systemic risk while maintaining its ability to protect consumers.

"I'm proud of the work we've done," he told the House panel.

Taking aim at pending legislation that would subject the Fed to greater oversight, Mr. Bernanke warned that audits by the Government Accountability Office of monetary policy would encroach on the central bank's independence. That, in turn, could stir up inflation challenges, he said.

"We have to be extra careful that the markets and the public don't think that Congress is trying to influence monetary-policy decisions," Mr. Bernanke said during testimony.

Still, lawmakers were reluctant to accept the idea that greater oversight would hurt the Fed. Rep. Bill Posey (R., Fla.) said he didn't think Congress should do that. *Please turn to page 17*

Volvo is optimistic despite record loss

BY OLA KINNANDER

STOCKHOLM—AB Volvo posted its worst-ever quarterly net loss Tuesday as sales dwindled in the wake of the economic downturn, but the truck maker said the drop in demand now appears to have bottomed out.

The world's second-biggest truck maker by sales after Daimler AG posted a net loss of \$718.5 million for the three months ended June 30, compared with a year-earlier net profit of 5.13 billion kronor.

Volvo has now racked up a total of 11.16 billion kronor in net losses over the past three quarters. The latest loss was deepened by 3.2 billion kronor

in write-offs related to provisions for credit losses, layoffs and costs associated with an agreement reached with the United Auto Workers union for retiree health-care benefits.

Revenue fell 33% to 53.96 billion kronor from 80.31 billion kronor.

The Göteborg, Sweden-based company had a net order intake of 26,624 trucks in the second quarter—down 51% from a year earlier, but up 32% from the first quarter.

"We see that the decline in demand has started to level off and that the markets have stabilized, even though it is still difficult to predict the rest of the year," Volvo said.

The company, which makes *Please turn to page 31*

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As the wheels turn

The Tour de France is a soap opera again—and that's good **Marketplace**, page 28

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4 p.m. ET

	CLOSE	PCT CHG
DJIA	8915.94	+0.77
Nasdaq	1916.20	+0.36
DJ Stoxx 600	215.02	+0.84
FTSE 100	4481.17	+0.85
DAX	5093.97	+1.27
CAC 40	3302.89	+0.98
Euro	\$1.4228	+0.11
Nymex crude	\$64.72	+1.16

Rising U.K. debt reflects downturn

BY LAURENCE NORMAN

LONDON—The U.K. government borrowed a net £41.2 billion (\$68.2 billion) in the first quarter of the fiscal year started in April, the highest total since records began in 1946 and a sign of the recession's erosive effect on government finances.

The U.K. government is aiming to borrow £175 billion in its current fiscal year, as slumping demand and rising unemployment in decades cut into tax receipts and boost welfare spending.

At £19.6 billion, the government's borrowing, net of the debt it paid off, in its fiscal first quarter was double the amount it borrowed in last

year's first quarter.

However, there were signs that the rise in debt was moderating in June. The government borrowed a net £13 billion, up from £7.5 billion in June 2008, although that was below the £16 billion in red ink economists were expecting in a survey last week.

Despite rising welfare costs linked to the recession, the overall June rise in central government expenditure was held to 2.8% from a year earlier.

Meanwhile, central government tax revenue fell by 5.7% on the year, a slower pace than the year-to-year tax revenue declines of 11% posted in April and May and *Please turn to page 31*

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LEADING THE NEWS

Chinese firm investigated

EU, Namibia probe actions by company linked to leader's son

Authorities in Africa and Europe opened separate investigations into allegations of wrongdoing involving a company connected to Chinese President Hu Jintao's son, a potentially embarrassing development for the leadership in Beijing.

By Gordon Fairclough in Shanghai, Sarah Childress in Nairobi, Kenya, and Marc Champion in Brussels

Officials in Namibia are investigating corruption allegations in a deal involving state-owned Chinese company Nuctech Co. President Hu's son, Hu Haifeng, is a former president of Nuctech and now the Communist Party secretary of its parent company, Tsinghua Holdings Co., according to the parent company's Web site.

Three people, including a Chinese citizen identified in court documents as Nuctech's Africa representative, have been arrested as Namibia's Anti-Corruption Commission looks into a payment made by Nuctech to a local consulting com-

pany after the Chinese firm, which sells security inspection systems, won a deal to supply scanners for Namibia's ports and airports. Hu Haifeng isn't a suspect in the case, the commission said.

Phone calls to Nuctech and Tsinghua Holdings weren't answered Tuesday. China's Foreign Ministry didn't respond to a request for comment.

Meanwhile, the European Union is investigating whether Nuctech engaged in unfair trade in its sales of X-ray scanners in Europe, following a complaint the company was selling the products at abnormally low prices. There is no indication Hu Haifeng was aware of pricing of Nuctech products.

The EU and Namibia cases don't appear to be related.

Hu Haifeng's connection to any public scandal could prove embarrassing to the Communist Party and President Hu's administration, which has waged a high-profile campaign against corruption at home.

Relatives of China's top leaders generally keep an extremely low profile. It isn't clear when the younger Mr. Hu, who is believed to be in his late 30s, left his position at Nuctech.

Namibian investigators say that after the Namibian government signed a \$54 million deal with Nuctech for scanners and made a \$12 million down payment, Nuctech paid \$12 million to a local consultancy, Teko Trading.

"It goes to corruption if these people were given this money in order to influence the authorities to give a contract to this company," said Paulus Noa, director of the Namibia Anti-Corruption Commission.

He said the commission has handed over information to prosecutors to help them determine whether they should proceed with the case.

Meanwhile, police have already arrested Teko's co-owners and the person identified as a Nuctech em-

ployee. The three have each been charged with fraud, bribery and failing to report a corrupt transaction. They were expected to appear in court Wednesday. Their lawyers couldn't be reached for comment.

Beijing has been on high alert for potential political distractions in a year full of sensitive political dates, most notably the 60th anniversary of the establishment of Communist Party rule on Oct. 1.

In a sign of the sensitivity of the case, Chinese-language versions of foreign news reports about Nuctech that had been posted in recent days on at least two Chinese Web sites were later removed. Efforts to search for "Hu Haifeng" or "Nuctech" on Baidu.com, China's most popular Internet search engine, returned a message saying: "The results of your search may not comply with relevant laws, regulations and policies."

In the other case linked to Nuctech, the European Commission said it began an investigation in March, prompted by "dumping" allegations by a U.K. competitor of Nuctech, **Smiths Detection Group Ltd.** The commission's initiating document for the probe says it involves "significant" dumping margins on sales of the machines, which X-ray trucks and shipping containers.

The commission calculates dumping margins by comparing what it calls "normal" prices for a product—defined in this case as the price at which it sells in the U.S.—with the price at which it is exported to the EU.

Smiths produces 80% of all cargo scanners made in the EU, a €200 million (\$284 million) market, but has been losing market share to Nuctech recently, according to the commission's case-initiation document.

The commission has 15 months from March to complete its investigation, but in the meantime can impose provisional penalties, such as increased tariffs.



Strong demand for Hermès leather goods helped push quarterly sales sharply higher for the luxury house. Models displayed its fashions at a Paris show in June.

Hermès revenue up 12% as handbag sales thrive

BY MAX COLCHESTER AND MIMOSA SPENCER

French luxury house **Hermès International SA** posted strong sales for the second quarter, raising hopes that global demand for pricey clothes and bags could increase.

Hermès, known for its silk scarves and leather handbags, said sales rose to €446.6 million (\$635.3 million) in the three months ended June 30, up 12% from the same period last year. The company said it is on track to hit a target of flat sales this year, compared with 2008.

Hermès didn't break out profits for the quarter.

"If you had told me last year that we would have flat sales in 2009, I would have kissed you on both cheeks," said Hermès Chief Executive Patrick Thomas in an interview.

As recession took hold in rich countries and consumer demand sagged, 2009 looked set to be a rocky year for the luxury industry. Consultant Bain & Co. forecast in a June report that the global luxury-goods market would shrink 10% this year.

However as major fashion companies **LVMH Moët Hennessy Louis Vuitton SA** and **PPR SA** prepare to present their results next week, analysts say the worst of the crisis could be over. Luca Solca, an analyst at Sanford C. Bernstein, says he expects LVMH's Louis Vuitton and PPR's Gucci brands to report "similar trends" to Hermès.

"There are early signs that the market could be rebounding," he

said. Still, Hermès isn't an industry bellwether. A large part of the company's sales comes from its leather goods and saddlery division. Its wallets and popular Kelly and Birkin handbags so far have resisted the crisis better than so-called hard luxury products, such as high-priced watches and jewelry.

The leather-goods division reported a 33% rise in sales to €228 million during the quarter. Part of the reason for that rise was double-digit percentage growth in Asia, excluding Japan. The luxury-goods market in China, in particular, is growing.

The company said that it would continue its expansion in Asia and the Americas, opening five new stores in the second half of 2009.

However, the brand's watch and tableware businesses, some of which isn't sold in Hermès's own stores, continued to suffer as independent stores held back on ordering new stock. Hermes announced a 11% fall in watch sales compared with the same period last year. Mr. Thomas predicted that 2009 would be "horrible" for this division.

Overall sales for the quarter were up 13.5% in the Americas but fell 6.9% in Europe, excluding France. Sales in Asia-Pacific, excluding Japan, increased 36.7%.

Despite Hermès's results Mr. Thomas remained cautious. He noted that a spread of the H1N1 swine flu could have a negative effect on sales as tourists curtail travel and spend less in foreign countries.

CORRECTIONS & AMPLIFICATIONS

Georgian President Mikheil Saakashvili said his country's hopes of joining NATO are "almost dead. It's tragic. If they manage to kill NATO [Georgia's hopes of joining the alliance], it means the Russians fought for the right reasons." A page-one article Monday on Mr. Saakashvili's interview with The Wall Street Journal incorrectly shortened Mr. Saakashvili's comments.

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LEADING THE NEWS

CEO-to-be quits Temasek

Singapore fund blames differences over 'strategic issues'

BY PETER STEIN
AND COSTAS PARIS

Plans for a foreigner to run Singapore's Temasek Holdings Pte. Ltd. for the first time fell apart as the state-owned investment firm said Charles "Chip" W. Goodyear won't become chief executive after all.

The unexpected departure of Mr. Goodyear, formerly chief executive of BHP Billiton Ltd., is likely to raise questions about Temasek's direction and its willingness to embrace change as it seeks to raise professional standards. Ho Ching, the 56-year-old current CEO who had planned to step down, will remain until a new successor is named.

In a statement, Temasek blamed the decision on "differences regarding certain strategic issues." The board and Mr. Goodyear, a 51-year-old American, agreed to terminate the transition process and his role as CEO-designate and board member effective Aug. 15, it said. He was to have become CEO on Oct. 1.

Mr. Goodyear couldn't be reached for comment. A Temasek spokesperson said he was on vacation.

A major player on the international investment scene, Temasek manages a portfolio with about 185 billion Singapore dollars

(US\$128.36 billion), and is one of the world's most experienced sovereign-wealth funds.

At an internal briefing Tuesday afternoon, Temasek Chairman S Dhanabalan told employees that Mr. Goodyear initiated the decision to leave, according to someone present. During a question-and-answer session, those who attended the meeting were largely silent.

Already, some of Mr. Goodyear's initiatives to bring about change had met with a poor reception. His proposals for the firm's new strategic direction were considered too risky by some, a person familiar with the situation said.

In addition, this person said Mr. Goodyear planned changes in senior management that weren't well received by Temasek's board.

Temasek had named Mr. Goodyear in February as the successor to Ms. Ho, who is married to Singapore Prime Minister Lee Hsien Loong.

His appointment was hailed as a move that would inject fresh blood into Temasek, a company set up in 1974 as a vehicle to hold government investments and assets, including major stakes in some of the city-state's more prominent businesses.

Aside from his experience at BHP Billiton, Mr. Goodyear was chief financial officer at Freeport McMoRan Inc., a copper-and-gold producer. Some speculated he might help Temasek make inroads into commodity-related investments at a time when rising demand from China is presenting opportunities in that sector.

At the time of his appointment, Ms. Ho noted that "Chip has capabilities that I don't have."

The trim, silver-haired Mr. Goodyear brought a more worldly background to Temasek than Ms. Ho, whose career has been based in Singapore, where she began work at the Ministry of Defense and took over as Temasek's CEO in 2004.

As CEO-designate, Mr. Goodyear pushed to instill a tighter sense of discipline within the company, say people at Temasek. People who didn't show up on time for internal meetings were fined for each minute they were late, they say. Typing messages on BlackBerrys during meetings was prohibited. Attendees at meetings were pressed to defend their positions on investments in front of their peers, something few were used to doing.

Temasek's chairman says the firm hopes to build on some of Mr. Goodyear's "process initiatives" even after the CEO-designate's departure.

The past year has been a difficult one for Temasek. Earlier this year, it came under pressure at home over big losses from its investments in Western banks. Shortly after the announcement of Mr. Goodyear's appointment, Singapore's government disclosed that the value of Temasek's investment portfolio fell 31% in the eight months that ended in November, a drop of 58 billion Singapore dollars.

Temasek sold out of its investments in Bank of America Corp. and Barclays PLC at the end of last year and the beginning of this year, before



Ho Ching, left, with announced-successor Charles Goodyear at a news conference in February 2009

In, then out | Key events in Temasek's recent history

December 2008 - January 2009: Most of Temasek's roughly 2% stake in Barclays sold for a total loss of about \$850 million

First quarter 2009: A 3.8% stake in Merrill Lynch & Co., now part of Bank of America, sold for a loss of about \$4.6 billion

Feb. 6, 2009: Temasek announces that Charles Goodyear, a former BHP

Source: WSJ reporting

Billiton CEO and a former associate at Kidder Peabody, will succeed Ho Ching as CEO on October 1, 2009

Feb. 10: The Singapore government said that Temasek's portfolio shrank 31% to S\$127 billion in the eight months to November 2008

July 21: Temasek announces Goodyear won't take over as CEO

a rally in global markets that would have recouped some of the company's losses. Temasek defended its decisions, saying the nature of its investment in Merrill Lynch fundamentally changed after the sale to Bank of America, and the global investment environment also was different from when it first entered its deals.

Mr. Goodyear's experience at Temasek will raise doubts about

whether another foreigner will be welcome in the top job at Temasek.

In response to whether Temasek would consider other foreigners for the job, Mr. Dhanabalan said in a statement that "Temasek should be helmed by the best person for the job," and noted that the company would continue with its succession planning.

—Se Young Lee
contributed to this article.

Faurecia's outlook signals worst over for auto industry

BY DAVID PEARSON

PARIS—French car-parts maker Faurecia SA said Tuesday it expects to break even on an operating basis in the second half, despite a sharply wider first-half loss, and signaled that the worst of the automobile industry's slump was over.

Faurecia, which is 71%-owned by French auto maker PSA Peugeot-Citroën SA, is one of the first European companies in the auto sector to report first-half results, and is often viewed as a bellwether for its parent company, as well as for the broader European automotive industry.

The company's first-half loss swelled to €364.6 million (\$518.7 million) from a €22.2 million loss a year earlier. Revenue dropped 34% to €4.38 billion from €6.6 billion, reflecting a 34% drop in automobile production in Europe and a 52% plunge in North America.

A €406 million reduction in costs damped the impact of the industry downturn by about 60%, said Faurecia, which raised its target for full-year cost cuts to €700 million from €600 million.

Even though the company expects its second-half sales to drop 10% in Europe and 35% in North America, it was optimistic in its outlook for the rest of the year. Faurecia said its second-quarter operating loss narrowed to €27.6 million from €160 million in the first quarter.

"It's a bit too soon to say that we'll be in positive territory" on an operational basis in the second half, Chief Executive Yann Delabrière said in an interview with French radio station BFM.

However, Mr. Delabrière warned that, in value terms, the outlook was less favorable, as car makers were producing more smaller and cheaper cars with fewer extras.

Gazprom may delay gas project

MOSCOW—Russia's OAO Gazprom said Tuesday it may delay development of the giant Shtokman gas-condensate field if demand for gas remains depressed.

The state-controlled company said last month it would postpone the launch of another major field, Bovanenkovo, on the remote Yamal peninsula, as the global recession cuts demand for its natural gas in Russia and Europe.

In the first phase of development, Gazprom had originally planned for Shtokman to produce 23.7 billion cu-

bic meters of natural gas a year starting in 2013 and up to 7.5 million metric tons of liquefied natural gas, or LNG, a year starting in 2014.

"This timeline may be revised accordingly to reflect natural gas market conditions," the company said in the eurobond memorandum Tuesday.

Gazprom's European exports fell by almost a third in the first half of the year to 60.4 billion cubic meters from 89.1 billion a year earlier, amid high gas prices and falling demand, the company said in the memorandum.

WHAT KIND OF ENTREPRENEURS GROW GREAT COMPANIES THAT STAY IN TOUCH WITH THEIR INNER GARAGE?

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CORPORATE NEWS

Southwest Airlines, UAL turn in profits

But Continental Air posts a loss as the airline industry continues to face lackluster demand amid the recession

BY SUSAN CAREY

Southwest Airlines Co. distinguished itself among some of its larger rivals by producing a second-quarter profit, reversing three uncharacteristic quarters of red ink.

But the chief executive of the discount giant said the tough operating climate makes it impossible to predict a profitable third quarter, normally the strongest period for the industry.

United Airlines parent UAL Corp. also reported a small profit, including hedge gains and accounting charges. But without those items, the carrier notched a loss of \$323 million.

United said its passenger revenue fell by 25%, compared with a year ago, and its international revenue declined by nearly 32%. As a result, the No. 3 U.S. airline by traffic said it plans to trim overseas capacity by 7% in the last four months of the year.

Continental Airlines Inc. said it lost \$213 million in the June quarter on a 23% decline in revenue, marking its seventh consecutive quarter of deficits. The Houston-based carrier said it will eliminate another 1,700 positions and raise its fee for checked baggage by \$5 for those who don't prepay online.

Last week, American Airlines parent AMR Corp. posted a big second-quarter loss. Delta Air Lines Inc. and US Airways Group Inc. are expected to announce losses when they report later this week. By contrast, discounters JetBlue Airways Corp. and AirTran Holdings Inc. are expected to be profitable, as is Alaska Air Group Inc.

Dallas-based Southwest, the No. 5 U.S. airline by traffic, said it



Continental Airlines posted a \$213 million second-quarter loss. Above, Continental jets in January at a Houston airport terminal.

earned \$54 million, or seven cents a share, down from \$321 million, or 44 cents a share, a year earlier. Excluding items, earnings came to \$59 million, or eight cents a share, compared with \$121 million, or 16 cents a share, a year earlier.

Total revenue fell 8.8% to \$2.6 billion from a year earlier. Unit revenue—the amount taken in for each seat flown a mile—slid by 6%, Southwest said. Unless passenger demand rebounds strongly, Southwest expects third-quarter unit revenue

to decline more than it did in the June period. Gary Kelly, chairman and chief executive, said the current recession is creating “without a doubt one of the worst revenue environments for the airlines, ever.”

In an effort to resize the airline to the weak demand picture, Southwest said 1,400 employees signed up for early employment buyouts in the second quarter, a voluntary program that will cost about \$70 million. The company's fuel bill declined by 23% in the latest quarter. Southwest, the

only large U.S. carrier with an investment-grade credit rating, said it had \$2.4 billion of cash and short-term investments at the end of June, and only “minimal” debt obligations for the rest of the year.

Chicago-based United said it earned \$28 million, or 19 cents a share, compared with a year-ago loss of \$2.7 billion on a huge goodwill impairment item. Revenue fell to \$4 billion from \$5.4 billion a year earlier. Its fuel bill declined by 64% in the latest quarter and it produced

\$305 million of positive free cash flow in the period.

The company, which has been rumored to be facing a liquidity crisis, said it closed the quarter with \$2.6 billion of unrestricted cash, up \$600 million from the start of the year and \$100 million better than earlier guidance. United also raised an additional \$155 million in cash earlier this month through a secured financing transaction. “Our solid cash balance...holds us in good stead with the agreements we have in place with our primary credit-card processing companies,” said Kathryn Mikells, UAL's chief financial officer.

United said its unit revenue fell 17% in the latest quarter, but it is maintaining solid cost control and expects its unit costs, excluding fuel and items, to be basically flat for the rest of the year.

Continental, the No. 4 U.S. airline by traffic, said that excluding charges of \$44 million, it posted a loss of \$169 million, or \$1.36 per share, in the June quarter. While its fuel expenses fell 46%, revenue skidded by 24% on weak business travel demand, promotional pricing and the effects of the H1N1 virus scare.

As a result, Continental said it intends to raise revenue and reduce costs to achieve about \$100 million in annual benefits by 2010. Aside from reducing another 1,700 jobs on top of 500 reservations positions announced earlier and voluntary leaves of absence for 700 flight attendants, Continental said it will raise its checked bag fee by \$5 for those who don't prepay online, and raise its telephone reservations booking fee by \$5.

Continental closed the quarter with \$2.7 billion of unrestricted cash and short-term investments.

Merck profit slips amid deal costs

BY PETER LOFTUS

Merck & Co.'s second-quarter profit fell 12% amid merger costs and lower vaccine sales, while cost cuts helped merger partner Schering-Plough Corp. report higher quarterly earnings.

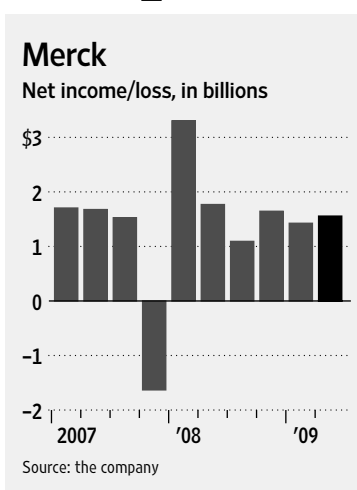
Both companies faced headwinds from a weak economy and unfavorable currency-exchange rates, as well as sales declines for their jointly marketed cholesterol drugs, which have been hurt by concerns about their efficacy and safety.

Merck, based in Whitehouse Station, N.J., is in the process of acquiring Schering-Plough in a cash-and-stock deal valued at \$41 billion when announced in March. The deal is subject to government anti-trust clearance and approval by both drug makers' shareholders. It is expected to close by year-end.

Merck, which has been hurt by drug-patent expirations and research setbacks, pursued Schering to gain access to a relatively strong late-stage research pipeline. Merck also expects the deal to generate significant cost savings, including a planned 15% reduction in the combined entity's work force.

Although Merck's numbers were down, they exceeded Wall Street expectations.

Some of the upside appeared to



come from a rebound in Merck's top-selling drug, Singulair, an allergy and asthma medication. Singulair sales rose 16% to \$1.3 billion, following declines in recent quarters amid reports of the drug's possible association with suicidal behavior. Deutsche Bank this week said Singulair demand was helped by a “strong” allergy season.

Merck said earnings for the three months ended June 30 fell to \$1.56 billion, or 74 cents a share, from \$1.77 billion, or 82 cents a share, a year earlier. The latest quarter included restructuring and merger costs; excluding these, earnings were 83 cents a share,

well ahead of the 77-cents-a-share mean estimate of analysts surveyed by Thomson Reuters.

Merck's second-quarter sales fell 3% to \$5.9 billion, but exceeded the Thomson Reuters estimate of \$5.84 billion. Sales were weighed down by currency rates; excluding this effect, sales would have risen 3% from a year earlier.

Schering-Plough, based in Kenilworth, N.J., said second-quarter profit rose 45% to \$671 million, or 38 cents a share, from \$462 million, or 26 cents, a year earlier. Excluding one-time items, earnings would have been 46 cents a share, ahead of the Thomson estimate of 45 cents a share.

Sales dropped 5.6% to \$4.6 billion, with unfavorable currency rates reducing growth by 10 percentage points. Sales of arthritis drug Remicade rose 2% to \$565 million, while gains also were posted for allergy drug Nasonex and cancer drug Temodar.

At Schering's animal-health unit, sales fell 17% to \$677 million. Chief Financial Officer Robert Bertolini attributed the drop to “tough global economic conditions,” difficult comparisons with a year-earlier period that included the launch of a bluetongue vaccine, and the impact of 2008 product divestitures.

Schering's consumer-product sales dropped 5% to \$381 million.

J&J deal with Elan gives drug firm sway over Biogen

BY JEANNE WHALEN

Pharmaceutical giant Johnson & Johnson has cut a deal that gives it significant influence over the future of U.S. biotech company Biogen Idec Inc., a partner of both companies said Tuesday.

As part of an agreement earlier this month to buy 18.4% of Irish biotech firm Elan Corp., J&J also acquired a chance to snatch away one of Biogen's most valuable drugs if Biogen is ever taken over by another company, Elan officials said. Neither Elan nor J&J disclosed the arrangement in announcing J&J's investment.

Currently, Elan and Biogen jointly own and sell the multiple-sclerosis drug Tysabri, but each has the right to buy out the other if one is approached by a potential acquirer.

Under the deal with Elan, J&J would have the right to finance Elan's purchase of Biogen's Tysabri stake and would take ownership of the stake if it exercised that right, Elan officials said on a conference call with investors Tuesday. Because J&J has deeper pockets than Elan, the deal makes Biogen more likely to lose its Tysabri stake if the company is taken over.

If J&J decided not to exercise its right, Elan would have to finance the purchase of the Tysabri stake some

other way, Elan officials said.

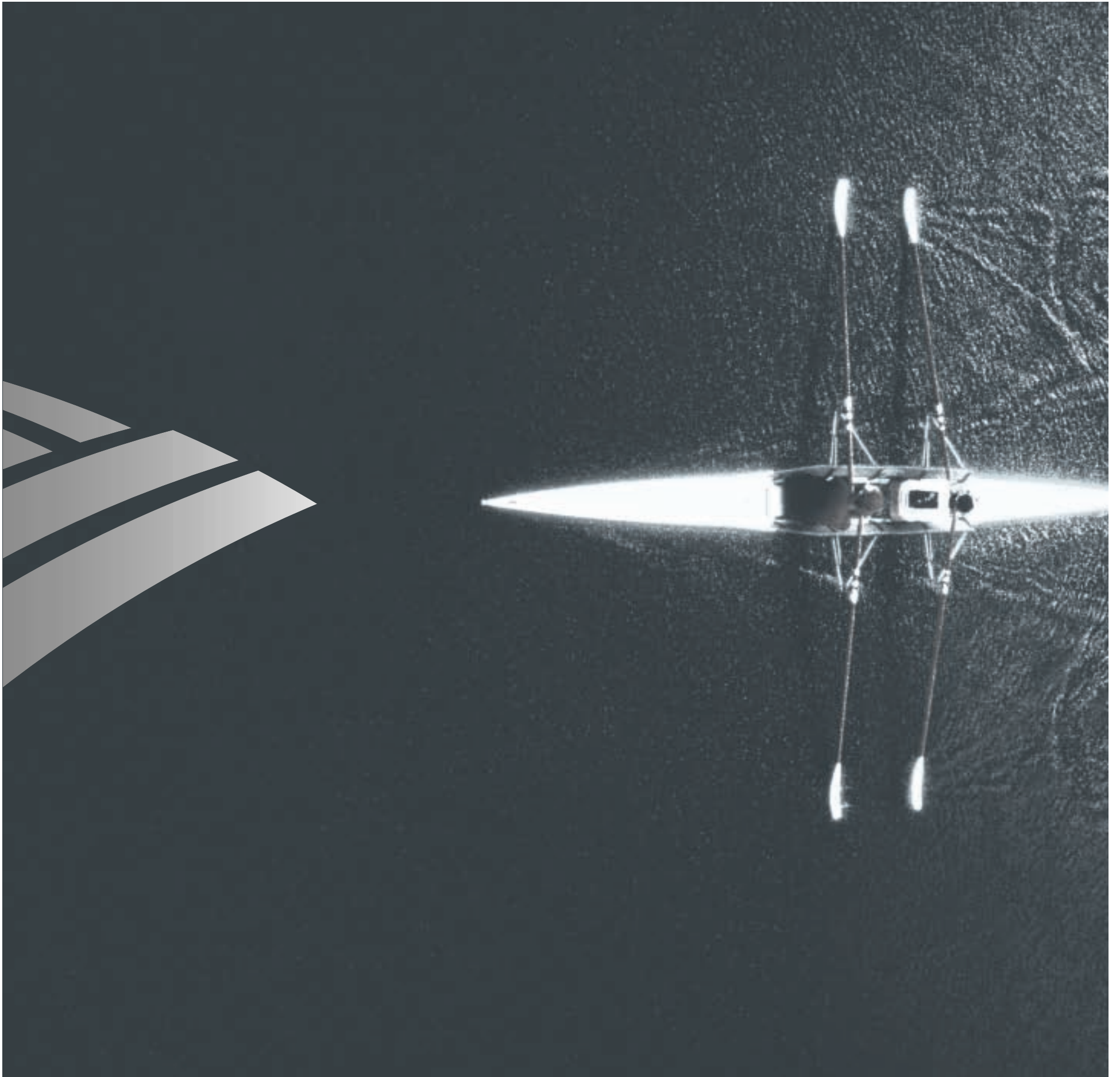
A spokeswoman for Elan said J&J didn't compensate Elan for the Tysabri arrangement. A J&J spokesman said the company had “nothing to add” to Elan's statements. A Biogen spokeswoman declined to comment.

The Tysabri deal gives J&J a lever over Biogen, one of the few remaining independent biotech companies of significant size, a valuable property at a time when big drug companies have been scrambling to refill their pipelines of drugs in development. It also shows that J&J's interest in Elan goes beyond the Irish company's experimental drugs for Alzheimer's disease, the main reason J&J cited for taking its Elan stake. Tysabri generates nearly \$1 billion in revenue a year.

The fact J&J could have the ability to take away one of Biogen's most lucrative products could discourage any potential suitor from bidding for the biotech, said Matt Strobeck, a partner at Westfield Capital Management Co., which a Biogen spokeswoman declined to comment.

Elan also said Tuesday that cost cuts and increased demand for Tysabri helped narrow its second-quarter net loss to \$68.2 million from \$71.5 million a year earlier.

—*Quentin Fottrell*
contributed to this article.



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CORPORATE NEWS

Grocer lifts profit forecast

U.K.'s Morrison says fiscal 2010 will show it gained customers

BY LILLY VITOROVICH
AND MICHAEL CAROLAN

LONDON—William Morrison Supermarkets PLC on Tuesday upgraded its earnings forecast for fiscal 2010 as the U.K. grocer lured customers from bigger rivals with its low-priced fresh-food range and cut costs more than expected.

Worries about the U.K.'s rapidly deteriorating economy have punished many fashion, home-furnishing, electronics and white-goods retailers and have also intensified the competition among grocers over the past year. As consumers seek to save money on groceries, players such as Morrison, J Sainsbury PLC and Asda Group Ltd.—a unit of U.S.-based Wal-Mart Stores Inc.—have been taking market share from heavy-weight Tesco PLC and up-market food chains Waitrose and Marks & Spencer Group PLC.

Morrison saw its market share jump to 11.6% in the 12 weeks ended July 12 from 11.2% a year earlier, according to data published Tuesday by market-research company Taylor Nelson Sofres.

At Tesco, the U.K.'s biggest retailer by sales, market share fell to 30.8% during the period from 30.9% a year earlier, said TNS, which monitors the household grocery purchasing habits of 25,000 demographically representative U.K. households. Asda, the country's No. 2 re-

Total till roll

Market share of Britain's consumer spending for the quarter ending July 12



*Includes Co-op and Somerfield
Source: TNS

tail player, saw its market share rise to 17% from 16.7% during the period.

In its unscheduled trading update, Morrison said its strong performance in the first quarter of fiscal 2010 continued in the second quarter, with sales growth "well ahead of the market."

As a result of operational improvements, Morrison said, its full-year gross margin, excluding fuel, will exceed its original forecast by around 0.4 percentage point.

Morrison said the initiatives in its Optimization Plan, put in place in 2007 under the helm of Chief Executive Marc Bolland, are progressing well and are expected to exceed expectations by £20 million (\$33.1 million). The company declined to release the details of the plan, saying a full report for



Marc Bolland

the first half, ending Aug. 2, will be published Sept. 10.

"The business's performance to date, the successful implementation of the Optimization Plan and its continuing customer growth now give the board confidence that the company's full-year results will be ahead of its earlier expectations," Morrison said.

Morrison said it is benefiting from its focus on fresh and locally sourced food as well as price cuts and promotions.

Mr. Bolland said the strong performance was driven by double-digit growth in the company's fresh-products categories. He said candy and cakes also sold well, with cake sales up "far higher than double digit" in percentage terms, as customers turned to treats during the economic downturn.

The strong volume growth has helped the company produce supply-chain savings, Morrison said. A company spokeswoman declined to elaborate on the savings.

Morrison's bullish trading update Tuesday was well received by retail analysts and investors, who pushed the stock up. The shares closed up 8.2% to 274 pence, valuing the company at £7.23 billion, in an overall higher London market.

"Morrison is demonstrating that it has kept the best of its old retail DNA and is benefiting from a strong infusion of the new," Bank of America Merrill Lynch retail analysts said in a research note. They reiterated their buy rating on the stock.

Last month, the company posted a 8.2% rise in sales at stores open at least a year, excluding fuel and value-added taxes, for the fiscal first quarter. But the company didn't raise its full-year outlook, which disappointed the market.

Lockheed profit falls 17% as information unit slips

BY KERRY GRACE BENN

Lockheed Martin Corp.'s second-quarter profit fell 17% on pension-related charges and challenges in its information-systems business. Still, the defense contractor's results beat views.

Chairman and Chief Executive Bob Stevens said recently that he expects Lockheed to squeeze out even more operating profit as key programs mature and boost profitability. And he noted Tuesday that Lockheed is applying additional resources to the information-systems business to boost results there.

Lockheed, the biggest supplier of information technology to the U.S. government, posted income of \$734

million, or \$1.88 a share, compared with \$882 million, or \$2.15 a share, a year earlier. The latest results included 19 cents a share in pension-related expenses, while the prior year's included a net gain of 19 cents.

Revenue rose 1.8% to \$11.24 billion. Analysts surveyed by Thomson Reuters expected earnings of \$1.81 a share and revenue of \$11.14 billion.

Gross margin fell to 9% from 10.8%.

At its information-systems and global-services business, earnings declined 8.8% amid lower volume on security solutions and a year-earlier gain. Revenue for the segment rose 5.6%. Earnings at the aeronautics division grew 9% as revenue rose 7%.

India files police complaint about Continental frisking

BY SANTANU CHOUDHURY

NEW DELHI—India's Bureau of Civil Aviation Security filed a complaint on Tuesday with local police against Continental Airlines Inc. for frisking the country's former president, APJ Abdul Kalam, before he boarded a flight to New York.

The filing of a first information report followed strong protests by lawmakers in Parliament earlier in the day.

The civil aviation ministry said in a statement that the frisking took place on April 21 in New Delhi. The police report, filed on the directions of the civil aviation ministry, said the staff of Continental Airlines had "wrongfully" frisked Mr. Kalam, in contravention to bureau rules that exempt specified VIPs from such body checks.

The Bureau of Civil Aviation Security, which is part of the civil avia-

tion ministry, is responsible for laying down standards of pre-embarkation security and antisabotage measures for all civilian flights in India.

The police report was filed after the U.S.-based carrier failed to respond to a show-cause notice issued by the bureau July 9 seeking an explanation, the statement said.

Laurent Recoura, Continental's senior country director in charge of India, said the frisking was done because it had to follow the rules of the Transportation Security Administration/U.S. Department of Homeland Security for all carriers flying to the U.S.

"TSA requirements impose a final security check in the aerobridge just before boarding the aircraft," he said. "This procedure is followed by all carriers flying to the U.S. from most of the countries in the world, and there is no exemption to this rule."

Retailer Next boosts outlook

BY LILLY VITOROVICH
AND JONATHAN BUCK

LONDON—Next PLC, a U.K. clothing and houseware retailer, Tuesday raised its full-year profit guidance after better-than-expected product negotiations with suppliers and sales received a boost from warm weather.

Next, which competes against Marks & Spencer Group PLC and department-store chains, brought forward a trading update by one week to report a 1.3% rise in total sales, excluding value added tax in the 25 weeks ended July 18 from a year earlier.

Retail sales rose 1.4% for that

period, while sales from stores open at least a year were down 1.9%. Directory sales edged up 1.1%. It said better weather this year helped boost retail sales by between 2% and 3%.

Next, which began its end-of-season sales July 18 with 19% less stock than last year, said increased sales at full price and better clearance rates had allowed it to add £15 million (\$24.8 million) to its internal profit forecast for the first half ending July 25. It has also added £15 million to its internal profit forecast for the second half as a result of better-than-planned prod-

uct negotiations and sourcing.

Charles Stanley analyst Sam Hart said Next's performance was "materially better than guidance provided" at the time of its fiscal first-quarter trading update in May, when the group forecast a decline in first-half retail same-store sales of between 4% and 7%, and broadly flat Directory sales.

Mr. Hart has provisionally upgraded his profit before tax forecast by around 8% to £405 million for fiscal 2010 and upgraded the stock to accumulate from hold. That compares with £429 million in fiscal 2009.

Ray Shaw, 75, was Dow Jones president

BY STEPHEN MILLER

Ray Shaw, former president of Dow Jones & Co., publisher of The Wall Street Journal, died Sunday at age 75.

After retiring from Dow Jones at 55 in 1989, Mr. Shaw built a new career as chairman of American City Business Journals Inc., a Charlotte, N.C., publisher.

A native of El Reno, Okla., Mr. Shaw got his start as a reporter at his hometown paper and later worked on the Daily Oklahoman and for the Associated Press. He was hired at the Journal in 1960 and worked as a reporter and editor be-

fore becoming founding managing editor of AP-Dow Jones, an international news service operated jointly with the AP.

In 1979, he became president and chief operating officer of Dow Jones, the second-highest-ranking executive at the company. Mr. Shaw helped expand into electronic publishing.

"He was a first-rate newsman who then became an even better news and business executive," said Peter R. Kann, associate publisher of The Journal while Mr. Shaw was president, and later chief executive officer of Dow Jones.

Mr. Shaw died after going into shock when he was stung by a wasp,

although he had no known allergy to stings, his son said.

In April, Mr. Shaw was given a distinguished achievement award by the Society of American Business Editors and Writers, which cited him for accomplishments "in his so-called retirement."

He purchased ACBJ with newspaper and broadcast mogul Edward Gaylord for \$43 million in 1989, and sold it to Advance Publications Inc. in 1995 in a deal valued at \$268.9 million.

"Ray was a special person who represented what is best in journalism," said S.I. Newhouse Jr., chairman of Advance.

—Russell Adams
contributed to this article.

Feud at South Korean car plant deepens as police spray tear gas

ASSOCIATED PRESS

SEOUL—Helicopters sprayed tear gas on auto workers using slingshots to shoot nuts and bolts at riot police Tuesday amid a tense labor dispute at the main factory of a South Korean auto maker.

Hundreds of fired Ssangyong Motor Co. workers have been occupying part of the company's plant in Pyeongtaek, about 70 kilometers south of Seoul, for two months to protest massive job cuts that are part of a restructuring plan.

South Korea's fifth-largest auto maker has been in bankruptcy protection since February after falling sales and mounting red ink raised questions about its survival as a company.

Lee Won-muk, a Ssangyong spokesman, said an estimated 500 to 600 people are occupying a paint shop at the factory. Some 2,000 riot police were deployed outside of the factory while 1,000 others were inside the plant grounds, said an officer with the Gyeonggi provincial police.

The police officer said there were no major clashes. He said about 600 workers were either inside the paint factory or on the roof.

Police used two helicopters to

drop liquid tear gas on protesters atop the paint shop, he said.

On Monday, riot police entered the grounds of the factory, which houses Ssangyong's only assembly line, along with a court official calling on the workers to give up.

Violent labor disputes aren't unusual in South Korea, and riot police are often deployed, though major clashes resulting in deaths are rare. Media reports, however, said the paint shop contains flammable materials that could potentially ignite amid a major clash.

Union spokesman Lee Chang-kun said the workers will try to resist if police launch an assault and suggested such a fight could turn bloody.

There has been no dialogue to defuse the row since late June when Ssangyong's labor union rejected a compromise offer from management to rehire some of the workers by 2012 and give others opportunities to retire with more benefits or help to find other jobs, said Lee Won-muk, the company spokesman.

Ssangyong is majority-owned by Shanghai Automotive Industry Corp. Ssangyong said the production stoppage has cost it 230 billion won (\$184.8 million) in lost output.

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Actelion Holding AG**Profit Jumps 55%
On Strong Sales Gains**

Swiss biopharmaceutical company Actelion Holding AG said Tuesday second-quarter profit jumped 55%, driven by strong sales of its flagship drug Tracleer. Profit rose to 116.2 million Swiss francs (\$108.8 million) from 74.9 million francs a year earlier. Sales of Tracleer, which accounts for nearly 90% of total revenue, increased 22% to 387 million francs, pushing total sales up 27% to 449.6 million francs from 354.4 million francs. Actelion said it now expects both full-year revenue and cash operating profit to rise 16% to 19% in 2009. The drug maker had previously forecast a 12% to 15% rise in revenue when stripping out currency fluctuations, and a 10% to 12% increase in operating profit, as measured by cash earnings before interest and tax. Tracleer treats a rare form of high blood pressure.

Caterpillar Inc.

Caterpillar Inc. on Tuesday reported a 66% decline in second-quarter profit but raised its full-year forecast as expense cuts start to yield results. The world's largest maker of construction and mining equipment by sales lifted its 2009 earnings forecast to between \$1.15 and \$2.25 a share, but trimmed its revenue forecast to between \$32 billion and \$36 billion. That compares with projections in April for earnings of \$1.25 a share on revenue of \$31.5 billion to \$38.5 billion. The company's second-quarter earnings exceeded Wall Street's expectations. "There is still a great deal of economic uncertainty in the world, but we are seeing signs of stabilization that we hope will set the foundation for an eventual recovery," Chairman and Chief Executive Jim Owens said in a written statement.

United Technologies Corp.

United Technologies Corp.'s second-quarter profit fell 24% on restructuring charges and a weak performance at its Carrier unit. The Hartford, Conn., company makes Otis elevators, Sikorsky helicopters and jet engines. It is struggling as airlines order fewer engines and as a weak construction market has hurt demand for elevators and Carrier's climate-control equipment. The company posted a profit of \$976 million, or \$1.05 a share, down from \$1.28 billion, or \$1.32 a share, a year earlier. The latest results included a net 16 cents a share in restructuring charges, while the prior year's results included six cents in restructuring charges. Revenue fell 17% to \$13.2 billion.

DuPont Co.

DuPont Co.'s second-quarter profit plunged 61% as the global economic downturn continued to zap demand for the plastics and chemicals used in most consumer products, from T-shirts to cars. The Wilmington, Del.-based chemical maker said business picked up somewhat from the beginning of the year, boosted by government-stimulus spending and inventory rebuilding at manufacturing plants. Still, most of DuPont's units recorded double-digit declines in sales compared to the year-ago period, raising questions about the timing and strength of an anticipated economic recovery. The company reported earnings of \$417 million, or 46 cents a share, down from \$1.08 billion, or \$1.18 a share, a year earlier. Revenue decreased 22% to \$6.86 billion.

Standard Chartered PLC

Standard Chartered PLC said it appointed Katherine Tsang as chairwoman of the lender's Greater China operation. Ms. Tsang's appointment takes effect Aug. 15. Currently, she is chief executive of the lender's China unit, Standard Chartered Bank (China) Ltd. Her position at the bank's China unit will be filled by Lim Cheng Teck, chief executive of the lender's Singapore operation, the bank said.

Global Gaming Factory X

The would-be buyer of file-sharing Web site the Pirate Bay said Tuesday that it was uncertain whether the purchase will be completed. Sweden-based Global Gaming Factory X AB will only buy the Pirate Bay if it can turn it into a "legitimate business," the company's lawyer, Ricardo Dijkstra, said in a Dutch court. Whether the acquisition will be completed is "very much the question," he added. GGF has said it hopes to strike a deal with copyright holders, though the Swedish company hasn't presented details of how its service would work. GGF said last month it planned to buy the Pirate Bay domain name and related Web sites for 60 million kronor (\$7.7 million). The Dutch court is hearing a civil case brought against the Pirate Bay by a pro-copyright organization. In April, four men responsible for the site were sentenced to one year in prison and ordered to pay damages of 30 million kronor for copyright violations.

Ryanair Holdings PLC

Irish budget airline Ryanair Holdings PLC said Tuesday it will cut capacity from London's Stansted Airport this winter, reducing the number of aircraft based there to 24 from 28. Ryanair will cut the number of flights this winter to 1,008 a week, down 37% from the 1,600 weekly flights last year and from 1,850 flights per week in 2007. The reduced capacity will result in 2.5 million fewer passengers passing through Stansted Airport between October and March than in the summer season, Ryanair said. Chief Executive Michael O'Leary blamed the move on the £10 (\$16.50) tourist tax and high airport charges. The carrier said it expects some 2,500 jobs to be lost at Stansted as a result of its cuts, but declined to say how many of them would be Ryanair employees.

Iberdrola Renovables SA

Renewable-energy company Iberdrola Renovables SA, the world's biggest wind-power generator, said its net profit fell 24% in the first half of 2009, amid a drop in electricity prices and a rise in costs. The unit of Spanish energy company Iberdrola SA said earnings fell to €148.5 million (\$211.3 million) in the half year ended June 30 from €194.2 million a year earlier. The company's earnings before interest, taxes, depreciation and amortization, or Ebitda, rose 6% to €581.6 million during the period, thanks to a rise in electricity output in the U.S. and the U.K., which compensated for lower electricity prices in Spain. Net revenue in the first half rose 1.1% to €947.9 million.

—Compiled from staff
and wire service reports.

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ECONOMY & POLITICS

Biden assures Kiev on joining NATO

Vice president's message from Washington is seen as counter to Russia's efforts to expand its sphere of influence

BY PETER SPIEGEL

KIEV, Ukraine—U.S. Vice President Joe Biden told the Ukrainian president that the Obama administration continues to support Kiev's efforts to join NATO and other Western organizations, a clear rebuke of efforts by Russia to claim the former Soviet republic as part of its sphere of influence.

Although Mr. Biden didn't mention Russia by name on Tuesday, he said the U.S. opposed any efforts by outsiders to "dictate what alliances you will seek" or bilateral relationships Ukraine seeks to improve.

"If you choose to be part of Euro-Atlantic integration, which I believe you have, we strongly support that," Mr. Biden said at a news conference with Ukrainian President Viktor Yushchenko after the two met for an hour and a half. "We do not recognize, and I want to reiterate it, any sphere of influence."

Ukrainian, Georgian and some Eastern European officials have expressed concern that President Barack Obama's attempts to "reset" relations with Moscow, including reviving long-dormant nuclear-reduction talks, had put the emerging democracies on Russia's border on the back burner of U.S. foreign-policy priorities.

In addition to the nuclear talks, the Obama White House is reliant on Russia for its most important non-



U.S. Vice President Joe Biden and Ukraine President Viktor Yushchenko plant a tree at a memorial in Kiev on Tuesday.

proliferation priorities, including blocking nuclear exports from North Korea and halting Iran's weapons program. Nonproliferation has emerged as central to the new administration's foreign policy.

But Mr. Biden's trip, which was uncharacteristically announced

weeks in advance and ahead of Mr. Obama's recent summit in Moscow, is intended to allay those concerns, and Mr. Yushchenko thanked Mr. Biden for the "clear, consistent and persistent policy" the Obama administration has outlined.

"We'd like to see these ties [to

Moscow] be successful, but of course we don't want to see this at the expense of Ukraine or the creation of any zones of special interest," Mr. Yushchenko said. "It's particularly important for us to have a very clear policy from the U.S. in this regard, and I believe

the vice president will reiterate this to the world."

At his weekly news conference in Moscow, Russian foreign-ministry spokesman Andrei Nesterenko said neighboring countries were free to choose alliances and denied Moscow was attempting to "usurp" other nations' international rights.

But he added that the U.S. should keep Ukraine's historical ties to Russia in mind, and said any new alliances should be negotiated in the open. "It's important that this be done transparently, without under-the-carpet games and not at the expense of others' interests," Mr. Nesterenko said.

The leaders of Ukraine and Georgia have expressed interest in joining NATO, but the alliance failed to formally give either country a "membership action plan," an official road map to membership. Their membership was a top Bush administration priority, but the formal invitations were blocked after European objections.

Mr. Biden, who also met with Ukrainian Prime Minister Yulia Tymoshenko and Russian-backed opposition leader Victor Yanukovich, is scheduled to give a major address Wednesday in Kiev before flying on to Tbilisi, Georgia, where aides said he will give similar reassurances to President Mikheil Saakashvili.

—Gregory L. White in Moscow
contributed to this article.

Pakistan's resolve to dismantle terrorist group is unclear

BY MATTHEW ROSENBERG

NEW DELHI—The sole surviving gunman in last year's Mumbai terror attacks may have sealed his fate with a dramatic courtroom confession Monday, but Pakistan's determination and ability to dismantle the group that plotted the assault remains an open question.

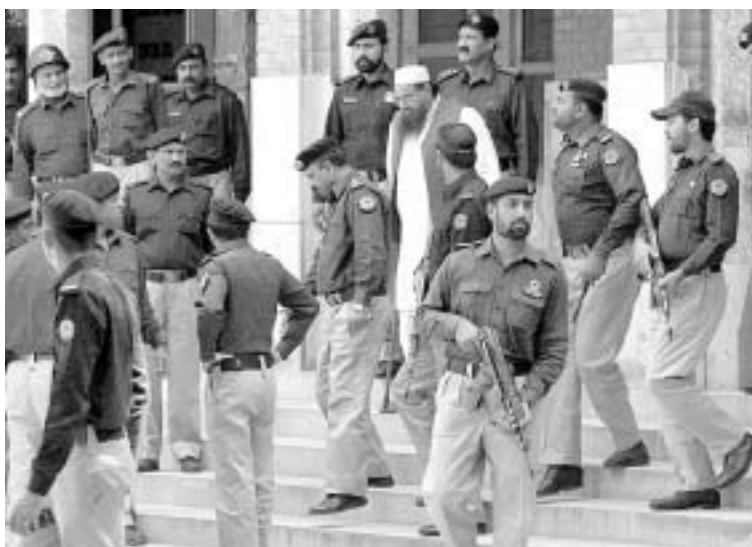
Pakistan, after initially denying any of its citizens took part in the three-day assault that left more than 170 people dead, has in the past six months sought to convince India and the U.S. that it is doing everything in its power to shut down the group responsible, Lashkar-e-Taiba.

"The Pakistani nation and its government fully understand the enormity of the challenge," said Farahnaz Ispahani, a spokeswoman for Pakistani President Asif Ali Zardari. "This nation has paid in blood for its commitment against terrorism."

Indeed, five of the alleged plotters arrested in Pakistan weeks after the attack are to go on trial in the coming days. And Pakistani officials say Prime Minister Yousaf Raza Gilani earlier this month gave his Indian counterpart a dossier detailing what Islamabad knows about Lashkar's involvement in the attack.

But the optimism engendered by those moves has been tempered by what U.S. and Indian officials see as worrying signs of business as usual in Pakistan, where previous attempts to shutter Lashkar often have stalled in the face of official indifference and, at times, connivance.

Lashkar's co-founder, Hafiz Mohammed Saeed, was released last month from house arrest by a Pakistani court, which cited a lack of evi-



Pakistani police escort Hafiz Saeed, co-founder of Lashkar-e-Taiba, outside a Lahore courthouse in March. He later was released from house arrest.

dence to hold him. And the group's infrastructure is still largely intact, even if its leadership is in disarray, say U.S. and Pakistani officials.

"Taking some of the top leadership off the streets may have impaired the group's activities, but ... Lashkar has a pretty deep bench, and so from an operational perspective it can keep going," said Stephen Tankel, an expert at King's College London who is writing a book on Lashkar.

The stakes are high in seeing a long-term crackdown on Lashkar, which is believed to have a few thousand active members and many more in reserve. Aside from the very real chance of it again striking India, the group, if left intact, could remain an obstacle to better relations

between India and Pakistan.

That, in turn, would likely hamper the fight against the Taliban by keeping the bulk of Pakistan's large military focused on the border with India, not the militants. Yet Lashkar's long ties to Pakistan's powerful security establishment and the deep roots it has put down in rural towns and villages through its charity arm, leave the government with a difficult challenge.

While the army and the Inter-Services Intelligence spy agency insist they no longer support Lashkar, the relationship remains ambiguous. An ISI official acknowledged in an interview that the spy agency still maintains informal contacts with Lashkar but insisted they were purely

monitoring the group, not aiding it.

"We don't operate in a safe part of the world," the officer said. "It's our job to know what they are doing."

U.S. and other Western officials say they believe that some weapons and money still flow to the group but that the aid is limited and not provided on orders from top commanders.

Intelligence field officers and Lashkar operatives "have had years to develop friendships," said a U.S. official. "They have definitely been growing apart. But the relationship is still there on some level."

Lashkar was one of a number of Islamist groups once nurtured by the ISI and used as a proxy against Indian forces in the divided Himalayan region of Kashmir and Afghanistan. Many of those groups have now turned on Pakistan, launching suicide attacks in cities and fighting alongside the Taliban in the mountains of the northwest. Lashkar, in contrast, has remained focused on India, India's part of Kashmir and, to a lesser extent, Afghanistan, say U.S. and Pakistani officials.

With Pakistan's resources being stretched thin by the fight against the Taliban and its militant allies, "it is hard for us to devote what we need to devote to winding up an organization like Lashkar," said a senior Pakistani official.

But, the official pointed out, Pakistan is at the very least taking action against those it can link directly to the Mumbai attack.

On Monday, the lone survivor of the attackers, Mohammed Ajmal Kasab, a Pakistani being tried in an Indian court, unexpectedly asked to change his plea to guilty. He then detailed how he had been

recruited and trained by Lashkar.

The case was adjourned Tuesday while the judge decides whether to accept his guilty plea and confession. Before the adjournment, Mr. Kasab described how he and a friend were directed to a Lashkar office when they sought training as bandits in Rawalpindi, a city near Islamabad that is dominated by the military.

Those offices still operate, just in a more low-key way. A former Lashkar member who later went to work for the group's alleged charity arm, Jamaat-ud-Dawa, said in an interview last month that he was still working with "the same people."

Jamaat was shut down in December after the U.N. declared it a front for terror. But officials say it has since re-emerged under the guise of Falah-i-Insaniat, which helped provide aid to the more than two million people who fled recent fighting between the army and Taliban in the Swat Valley of northwestern Pakistan.

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ECONOMY & POLITICS

Afghan Taliban kill seven

Suicide bombers hit government offices; 8 insurgents killed

BY ANAND GOPAL

KABUL—A group of insurgents, some of them in burqas, stormed government buildings in two eastern Afghan cities Tuesday, leaving at least 15 dead, including eight attackers. The attacks are the latest in a series of complex assaults that mark a shift in the Taliban's tactics this year.

The incidents come as U.S. and Afghan government forces push to secure major cities and highways ahead of the August presidential polls. While beefed-up security has kept Kabul safe from attacks so far this summer, Tuesday's events show the insurgents are still capable of orchestrating complicated assaults in urban centers.

Six Taliban suicide bombers in burqas raided the provincial governor's compound and Afghan security installations in the city of Gardez, killing seven before being killed themselves, said a provincial spokesman.

Around the same time, two suicide bombers attacked an airport in the city of Jalalabad, according to a provincial police chief. The pair were killed before they were able to harm anyone.

In Gardez, one attacker detonated his suicide vest near the National Security Directorate, killing himself and five Afghan security officials. Afghan forces killed two others before they



An Afghan soldier stands guard near a burqa used by an attacker in Gardez, Afghanistan, in one of several coordinated Taliban assaults on Tuesday.

could detonate their vests. Elsewhere in the city, a pair of bombers tried to enter the governor's compound when they were stopped by security guards, local officials said. The bombers and two civilians were killed in the ensuing gun battle. A sixth attacker was shot dead near a police station.

Zabiullah Mujahed, a spokesman for the Taliban, claimed responsibility for the attacks.

While suicide bombers have tended to be lone attackers in years past, this year the Taliban and allied insurgent groups have increasingly resorted to coordinated, multi-pronged assaults. In May, 11 suicide bombers targeted government build-

ings in the eastern city of Khost, leaving 20 dead. In April, a trio of Taliban guerrillas disguised as government soldiers struck a government office in Kandahar, killing 13.

But the government of President Hamid Karzai changed key security officials earlier this year and officials say that the new security team has made Kabul's security a priority by drawing on police from surrounding provinces to guard the city's streets. In response, insurgents have shifted their sights to less-fortified provincial capitals such as Gardez and Khost, which are small urban centers that are easier to penetrate.

Southeast Asia attracts increased U.S. interest

BY JAMES HOOKWAY

BANGKOK—U.S. Secretary of State Hillary Clinton is due to attend a Southeast Asia-based security summit on the Thai island of Phuket on Wednesday in what diplomats from both sides of the Pacific are describing as a revival of U.S. interest in a region comprising several major exporters, the world's most populous Muslim nation and 570 million people.

But discussions on strengthening Washington's trade and security ties with the 10-member Association of Southeast Asian Nations, or Asean, will likely be overshadowed by two long-running problems in the region: How to deal with a nuclearized North Korea, and how to persuade Myanmar's military junta to allow a degree of democratic change in the reclusive nation.

The U.S. has longstanding ties to several Southeast Asian nations. U.S. troops are on the ground in the Philippines helping to train local soldiers as they attempt to root out al Qaeda-affiliated terrorist groups. Similarly, the U.S. has helped to train and equip Indonesia's counterterrorism forces, which are now hunting for the masterminds behind the bombings that killed nine people—including two suicide bombers—at two hotels in Jakarta on Friday.

Total trade between the U.S. and Asean exceeded \$178 billion in 2008, and, in an opinion piece Mrs. Clinton wrote and was published in Bangkok newspapers Tuesday, she said "there is no doubt that our economies' fortunes and our nations' futures are more intertwined than ever before."

Some regional diplomats see the Asean group as the kernel of a broader free-trade bloc spanning the Pacific and also encompassing China, Japan, South Korea. Mrs. Clinton is scheduled to sign a nonaggression pact with Asean in Phuket, as China did in 2003, which analysts say could enable the U.S. to later enmesh itself within the so-called East Asia Summit group, which includes the 10 Asean members plus trade partners China, India, Japan, South Korea, New Zealand and Australia.

"America is shaping itself to be a real player in the region again," says Thitinan Pongsudhirak, director of the Institute of Security and International Studies at Bangkok's Chulalongkorn University. The U.S. is once more engaging with East Asia as a region rather than as a series of bilateral agreements, he said.

To reinforce the point, senior U.S. administration officials in Bangkok said Tuesday the U.S. plans to open a new diplomatic mission to the Asean secretariat at its headquarters in Jakarta, Indonesia.

Former Secretary of State Condoleezza Rice skipped the annual Asean Regional Forum, as it's known, two times in three years during the second term of President George W. Bush, partly because of other pressing matters. But now, one senior administration official said, the U.S. is "trying to step up its game" in Southeast Asia, a resource-rich part of the world where China is also trying to assert its diplomatic and commercial power.

The region's many political and security problems frequently crowd out trade and economic discussions,

however—particularly the question of how to deal with North Korea.

Besides the U.S. and Asean, representatives from China, the European Union, Japan, Russia and South Korea will attend, along with a host of ministers from other countries. Usually, North Korea's foreign minister attends, but this year Pyongyang sent a roving ambassador in his place amid growing international criticism for its weapons tests and an increasingly hard-line, militaristic stance after North Korean leader Kim Jong Il fell ill almost a year ago.

In Bangkok on Tuesday, Mrs. Clinton said the Obama administration was concerned that North Korea may have military ties to Myanmar, although she didn't say if the concern was related to North Korea's nuclear capabilities. "It would be destabilizing for the region," she told reporters.

A senior administration official said the U.S. was concerned about the possibility that North Korea could be assisting Myanmar on a possible nuclear-weapons program. But he added that the U.S.'s intelligence on any suspected transfer of nuclear technology or military equipment from North Korea to Myanmar was incomplete.

A North Korean ship tracked by the U.S. Navy in June and July on suspicion of carrying a banned arms cargo was rumored to be heading for Myanmar, but in the end never docked there. U.S. and Asian diplomats say Myanmar has become a transshipment point in recent years for North Korean arms and contraband.

Mrs. Clinton suggested, however, that North Korea could still be tempted back to talks on rolling back its nuclearization policy. "But they have to be willing to change their behavior and agree to de-nuclearize North Korea ... and we stand ready to respond if we get any signal that there would be a serious commitment to doing that," she said.

Myanmar, meanwhile, is a source of constant embarrassment to Asean. Regional analysts have said Asean's unwillingness to expel or take other harsh measures against the military-run, resource-rich country could affect the grouping's ability to secure wider trade pacts with some of its biggest trading partners.

Several Southeast Asian nations, notably democracies Indonesia and the Philippines, have been pushing the group to take a stronger stance against the military leaders in Myanmar, which is also known as Burma. Indonesian Foreign Minister Hassan Wirayuda told the Associated Press on Tuesday that elections that the Myanmar junta is planning for 2010 must include opposition leader Aung San Suu Kyi. Ms. Suu Kyi, a Nobel Peace laureate, is currently on trial and faces up to five years in prison on charges of violating the terms of her house arrest by allowing an uninvited American guest to stay at her home.

"We should see whether from now until 2010 [Myanmar] develops a credible process leading to truly democratic elections acceptable to the international community," Mr. Wirayuda said.

—Rachel Pannett
contributed to this article.



Hillary Clinton

Sweden official seeks price targets

BY JOEL SHERWOOD

STOCKHOLM—One of the architects of inflation targeting—now a widely used central-bank policy—says central banks should encourage expectations that they will let prices overshoot their target, and then do so.

That would help combat rising unemployment and aid economic activity around the world, Lars E.O. Svensson, deputy governor of the Swedish Riksbank, said in an interview. He said he isn't "concerned about monetary policy getting too expansionary now," saying the costs of potential deflation and high unemployment would be greater than that of higher inflation.

That message has extra resonance because Mr. Svensson is one of the intellectual authors of a theory that says central banks that announce and try to meet published inflation-rate targets will have an easier time keeping inflation in check than central banks that prefer to have more flexibility when setting their monetary policy.

Mr. Svensson stressed that underlying price levels were a more effective target than inflation rates for a central bank in the long run.

"He's had a lot of influence at central banks around the world," said Michael Woodford, a professor at Columbia University and Mr. Svensson's former colleague at Princeton University. Mr. Svensson's view also contrasts with admonitions from European Central Bank President Jean-Claude Trichet, who last weekend urged euro-zone governments to cut back on public spending.

The flood of fiscal stimulus and monetary easing—represented in near-zero rates in the U.S., the U.K. and Sweden, and euro-zone money market rates below the ECB's 1.0% policy rate—has sparked a debate among economists over whether a dangerous bout of inflation lies ahead or whether major economies remain stuck in a deflationary liquidity trap.

Mr. Svensson is in the latter camp. Earlier this month, he argued for the Riksbank to cut its main interest rate to zero, objecting to the eventual decision of the other board members to cut it to 0.25% from 0.50%.

But he did score a victory in that the Swedish central bank set its deposit rate in negative territory. That means that banks pay to store their excess reserves with the Riksbank, which gives them an extra inducement to turn those reserves into loans, rather than hoarding them.

"There is nothing strange about negative interest rates," he told the other five Riksbank board members, according to minutes from the July 1 meeting. Mr. Svensson has also advocated currency depreciation, or at least the prevention of rises in the currency's value, as a tool against deflation for smaller countries like Sweden.

A weaker krona "is part of expansionary policy and means that activity is higher and unemployment lower in this country than they otherwise would be," he said. He emphasized that a weaker krona shouldn't be taken as a threat to trading partners. Even if a weak krona would make imports more expensive, he be-

lieves the boost to Sweden's demand would ultimately result in more imports. "We can consume, invest and import more," he said.

However, that logic doesn't apply to major economies, such as the U.S., where a cheaper currency doesn't have much impact on domestic demand but has a big impact on the rest of the world as its large amount of exports suddenly become cheaper, he said.

Within Sweden, he said keeping interest rates low will help moderate job losses and some inflation shouldn't be feared. Prices are well below the point where they should be over the long run, he says, and a rise in prices would represent a return to those long-term trends.

Mr. Svensson describes this concept—price-level targeting—as a benchmark with a "memory." Most central banks that have an inflation target aim to get to the same level of inflation, say 2%, whether or not inflation was far slower than that the year before. By focusing on prices, the central bank allows for inflation to overshoot targets temporarily to offset those occasions when it had undershot inflation targets the year before.

His idea fits with Swedish tradition. The Riksbank is the only central bank—back in the 1930s—to target price levels rather than inflation rates.

"Flexible inflation targeting is a very good monetary policy regime," Mr. Svensson said. "Flexible price-level targeting may be even better in the long run."

—Christopher Emsden in Milan
contributed to this article.