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Breaking news at europe.WSJ.com

Banks paid hefty bonuses

Hundreds of employees at firms that got U.S. funds received at least \$1 million

By KERRY GRACE BENN AND JESSICA PAPINI

Several large, troubled banks that got U.S. government assistance paid hundreds of employees bonuses of at least \$1 million last year, according to New York Attorney General Andrew Cuomo.

J.P. Morgan Chase & Co. topped the list of banks that gave large bonuses, with 1,626 people receiving \$1 million or more, including more than 200 people getting at least a \$3 million payment. Goldman Sachs Group Inc., which employs less than a seventh of the number of people that J.P. Morgan does, paid 953 people bonuses of \$1 million or more, including 212 of them who received \$3 million or more.

Both banks have repaid the

federal bailout money and posted strong profits in the most recent quarter. J.P. Morgan declined to comment on the report. Goldman Sachs didn't immediately return a phone call seeking comment.

Mr. Cuomo's office on Thursday released the data in a report that criticized banks for continuing to pay hefty bonuses, intended to reward good performance, when the banks were reporting large losses or profit declines during the financial crisis. Bank compensation has become "unmoored" from performance and the system should be changed, Mr. Cuomo's office said.

The report prompted the U.S. House of Representatives' investigative panel to say it will probe pay practices at banks that have received

TARP recipients

How many employees at each bank received bonuses in excess of:

Bank	Millions		
	\$3	\$2	\$1
Bank of America	28	65	172
Bank of New York Mellon	12	22	74
Citigroup	124	176	738
Goldman Sachs	212	391	953
J.P. Morgan Chase*	200	-	1,626
Merrill Lynch	149	-	696
Morgan Stanley	101	189	428
State Street	3	8	44
Wells Fargo	7	22	62

*Over 200 employees at J.P. Morgan Chase received bonuses of \$3 million or more. Source: Office of New York's Attorney General

the most government aid. The House is scheduled to vote Friday on a bill that would give shareholders more say on ex-

ecutive compensation at public companies, and would single out financial firms for greater scrutiny on how they pay their executives. The U.S. Treasury Department has already created a pay czar to vet compensation for top employees at businesses receiving major federal aid.

The report provides a rare, numbers-based glimpse into the secretive world of bonuses being paid by major banks. Shortly after its release Thursday, employees of major Wall Street companies were comparing notes about which companies paid the greatest number of large bonuses. The report didn't release the names of people who received bonuses.

Wall Street companies often allocate as much as half of *Please turn to page 26*

Hamas is ready to discuss peace

By JAY SOLOMON AND JULIEN BARNES-DACEY

DAMASCUS—The chief of the Palestinian militant group Hamas, in a direct appeal to President Barack Obama, said his organization is prepared to cooperate with the U.S. in promoting a peaceful resolution to the Arab-Israeli conflict if the White House can secure an Israeli settlement freeze and a lifting of the economic and military blockade of the Gaza Strip.

Khaled Meshaal, 53 years old, said in a 90-minute interview at Hamas's Syrian headquarters that his political party and military wing would commit to an immediate reciprocal cease-fire with Israel, as well as a prisoner swap that would return Hamas fighters for kidnapped Israeli soldier Gilad Shalit.

Hamas's leader also said his organization would accept and respect a Palestinian state based on 1967 borders as part of a broader peace agreement with Israel, provided Israeli negotiators accept the right of return for millions of Palestinian refugees and the establishment of a capital for the Palestinian state in East Jerusalem.

That pledge falls short of recognizing Israel, a necessary step for Hamas to be included in peace talks, but many Middle East diplomats say it could mark an impor- *Please turn to page 26*

DJIA nears best month in seven years

Earnings season | Net income or loss for the latest quarter

VOLKSWAGEN



Net income fell to €283 million from €1.64 billion **83%**

SHELL



Net income fell to \$3.82 billion from \$11.56 billion **67%**

SIEMENS



Net income fell to €1.26 billion from €1.37 billion **8%**

ALCATEL



Net income up to €14 million from a loss of €1.1 billion **Swings to profit**

BSKYB



Fiscal-year net income up to £259 million from £127 million loss **Swings to profit**

EDF



First-half net income was unchanged at €3.11 billion **Unchanged**

By PETER A. MCKAY AND DONNA KARDOS YESALAVICH

U.S. stocks rallied Thursday to their highest close in nearly nine months as second-quarter earnings results on the whole continued to top analysts' estimates.

With one trading session to go, the Dow Jones Industrial Average has climbed 8.4% for the month, putting it on track for the biggest monthly gain since October 2002.

Earnings fueled European markets as well. The pan-European Dow Jones Stoxx 600 Index climbed 2.2%, its 12th gain in the past 14 sessions, aided by BT Group, Rolls

Royce and miner Antofagasta.

Thursday's earnings reports and smaller-than-expected rise in U.S. weekly jobs claims cut to the heart of in-

Buzz in the markets

■ European stocks are back to November levelsPage 18

■ Treasuries scorecard: finally, a solid auctionPage 18

■ Chinese stocks rebound after Wednesday's slumpPage 21

investors' fears about the economy, including the possibility that credit will remain scarce and consumption weak because of a sagging job market. "More than anything, it's

the economics and earnings data that's gotten us here," said Jim Paulsen, chief investment strategist at Wells Capital Management. "We have gotten so close to [1000 in the Standard & Poor's 500-share index], you just sort of sense that unless there's a horrible GDP number [on Friday], we're going to have to go up and challenge this thing."

U.S. gross domestic product is expected to have contracted an annualized 1.5% in the second quarter, a far smaller decline than the 5.5% annualized decline seen in the first quarter.

The S&P 500 climbed 11.60 points, or 1.2%, to 986.75. The S&P hasn't crossed above

1000 on either an intraday or a closing basis since Nov. 5, 2008. Its intraday high on Thursday, at 996.68, was less than five points from that psychologically important mark.

The Dow Jones Industrial Average gained 83.74 points, or 0.9%, to 9154.46. Thursday was the 15th session this month in which it has posted a gain, making it the most "up" day in a month since April 2007, which had 17 days.

The technology-focused Nasdaq Composite Index gained 16.54 points, or 0.8%, to 1984.30 after briefly trading above 2000 for the first time since October.

Investors were perhaps *Please turn to page 26*

Inside



The Internet as art

The medium is the new message in the digital age **Weekend Journal, page W6**

Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	9154.46	+0.92
Nasdaq	1984.30	+0.84
DJ Stoxx 600	225.25	+2.21
FTSE 100	4631.61	+1.85
DAX	5360.66	+1.71
CAC 40	3435.49	+2.08
Euro	\$1.4062	-0.01
Nymex crude	\$66.94	+5.67

LEADING THE NEWS

Suspected ETA bomb kills 2 on Majorca

Police officers die in week's 2nd blast blamed on Basques

BY THOMAS CATAN AND SUSANA FERREIRA

MADRID—A bomb exploded under a police car on the Spanish Mediterranean island of Majorca on Thursday, killing two officers, in the second strike on security forces in two days.

Spain's government and police blamed both attacks on ETA, the Basque separatist group, which on Friday marks the 50th anniversary of its founding and is seeking to show that it is still in business after a crackdown by Spanish and French police.

ETA has killed more than 825 people in its four-decade violent campaign.

For several hours after the blast, Spanish authorities blocked planes and ships from leaving the island, popular with British and German tourists, as they hunted for the bombers. Police in Majorca detonated a second device found attached to the underside of a vehicle belonging to the Guardia Civil, Spain's paramilitary police.

Tour operators struggled to rearrange tourists' travel arrangements and reassure them that they weren't in danger. Nick Sandham, a spokesman for the **Thomas Cook Group PLC.**, said they had had to try to get representatives past police roadblocks to resorts. "We

have members of our team reaching out to holiday-makers," Mr. Sandham said.

The attack came a day after a powerful bomb packed into a van ripped through a Guardia Civil barracks in the northern Spanish city of Burgos. More than 60 people were injured in the predawn blast, but none seriously.

The government said it was a miracle that none of the 120 people sleeping inside—a third of them children—were killed. ETA often dispenses with its traditional telephone warnings when attacking security forces.

The two Guardia Civil officers killed on Thursday were identified as Carlos Sáenz de Tejada, 28, and Diego Salva, 27. Police said several people also were injured in the blast, though none seriously.

The bombers "will not escape," vowed Prime Minister José Luis Rodríguez Zapatero. "They will be pursued, convicted and spend the rest of their days in jail."

The European Union also condemned Thursday's "barbaric attack." In a statement, the EU's executive body said that Spain has "the complete solidarity of the European Commission in the fight against terrorism."

ETA, an acronym for Basque Homeland and Freedom, has killed more than 825 people in its four-decade violent campaign for an independent Basque nation in the south of France and north of Spain. It is classed as a terrorist organization by the U.S., Spain and the EU.

Since the organization abandoned a cease-fire in December 2006, Spanish and French security forces have arrested dozens of suspected ETA militants and several alleged ETA leaders. The Spanish government had claimed the group was severely weakened by the law-enforcement assault.

However, the sophisticated



A man views wreckage Thursday in Majorca, where two were killed by a bomb, the second attack blamed on Basque separatists.

preparations for Wednesday's attack suggested that the group still preserves some operational capacity. A police spokesman confirmed reports that police had checked the license plate of the van before it exploded but found it had matched that of a local resident. Police believe that ETA cloned the registration plates and matched the make and color of the van to confound security procedures.

Analysts say ETA has spent the past months rebuilding its operational structure to deal with greatly increased cooperation between French and Spanish security forces. Joint operations by law enforcement on both sides of the border have denied ETA its traditional

sanctuary in the south of France. Security officials say that electronic eavesdropping also has helped disrupt the group's communications.

"They have people, they have explosives, they have weapons," said Juan Frommknecht, a lawyer who studies ETA. "What they're missing is the freedom to move about that they previously enjoyed, the ability to coordinate and organize themselves and contact the leadership."

ETA, Europe's last active home-grown terrorist group, earlier this decade attempted to follow the path of the Irish Republican Army, which laid down its arms to pursue its goals by purely political means. In March 2006, ETA declared a "permanent cease-fire" and entered peace talks with Mr. Zapatero's center-left government. But the negotiations collapsed just nine months later, when ETA detonated a huge bomb in Madrid's Barajas airport, killing two people.

In recent months, the group has been polling its members on its future course, analysts and security officials say. "The debate has now

ended," said Mr. Frommknecht. "The hard-liners have won."

The tourist industry in Spain has already been suffering the effects of the global economic downturn, with visitor numbers down around 10% this summer. ETA's attack in Majorca raised fears on the Balearic Islands that tourists could be scared away.

"This year has been bad because of the financial crisis," said Lucía Sánchez, a travel agent at Viajes Canales. "This a calm island. Nothing like this has ever happened here."

CORRECTIONS & AMPLIFICATIONS

Italian state-controlled defense and aerospace company Finmeccanica SpA will create a joint venture to invest in developing civil projects in Africa and the Middle East with the Libyan Investment Authority. A Money & Investing article Thursday incorrectly said they were defense projects.

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LEADING THE NEWS

German firm warns Iran staff not to rally

Move by Knauf Gips to threaten dismissal demanded by Tehran

BY FARNAZ FASSIHI
AND MATTHEW KARNITSCHNIG

A privately owned German company, Knauf Gips KG, warned its Iranian employees working in Iran that they would be immediately dismissed if caught in antigovernment protests, according to a document reviewed by The Wall Street Journal.

The order by Knauf, a drywall manufacturing company with decades of business history in Iran, highlights the challenges foreign companies face balancing the postelection turmoil still percolating in Iran and the regime's actions to suppress it.

Since protests following Iran's disputed June 12 presidential elections, Iran has cracked down on supporters of the opposition, particularly Irani-

ans or dual nationals employed by Western companies, embassies and the media. Iran has accused some of fomenting a velvet revolution and acting as links between opposition leaders and foreign countries.

Germany's commercial relations with Iran stretch back to the Middle Ages and have been particularly strong since the beginning of 20th century. Germany is Iran's third-largest trading partner after China.

Some 85 German companies have operations in Iran, ranging from Deutsche Lufthansa AG to auto supplier ZF Friedrichshafen AG, according to the German-Iranian Chamber of Commerce. In addition, 7,000 to 8,000 German companies conduct business in Iran through local representatives, the chamber says.

Iran has been heavily criticized by Western countries, particularly by Germany's chancellor, Angela Merkel, for its use of force in crushing opposition rallies against the reelection of President Mahmoud Ahmadinejad.

So far, the Bavaria-based Knauf appears to be the only German company to issue such an order, according to Michael Tockuss, managing director of the Hamburg-based German-Iranian Chamber of Commerce. Other companies have advised employees to avoid large crowds for their own safety, he said.

But the crisis is having an impact on foreign companies, said business consultants. "Certainly, it is not business as usual for Western companies in Iran; not under these circumstances," said an Iranian business consultant in Dubai.

Iran's government pressured Knauf to issue the order after a senior executive was arrested during Friday prayer demonstrations two weeks ago, according to people familiar with the case. The company was told that such a letter would be a condition to the executive's release.

The employee is a 34-year-old dual national of Germany and Iran and heads Knauf Iran's operation. He was released four days after Knauf agreed to issue the orders but faces trial, according to the company and others.

Isabel Knauf, a founding-family member who is on the supervisory board of the Iran operation, signed a letter that was circulated confidentially to all Iranian employees last week. "We would like to remind all of our employees to remember that they are not only representing their private opinion when being politically active, but their actionals could fall back negatively on our

Knauf companies in Iran," said the July 21 letter. "Therefore, from now on, if anybody from our company gets caught demonstrating against the current government, he or she will be immediately dismissed."

Reached by phone in Turkey, Ms. Knauf described the situation as "very complicated," declining to discuss the matter in detail because the case against is pending. People close to the company said their primary concern in writing the letter was the executive's safety.

Knauf General Counsel Jörg Schanow said employees aren't allowed under company policy to participate in demonstrations as company representatives. Knauf's intention with the letter wasn't to forbid its Iranian employees from participating in all demonstrations, he said. "One should exercise some restraint if such actions are going to damage the company," Mr. Schanow said.

Some Iranian employees of European companies in Iran expressed outrage at being punished by a European company for practicing democratic values such as participating in peaceful rallies. They said European companies shouldn't become a source of suppression—but rather use their economic clout and long ties to pressure Iran's government. "I wonder if they would feel the same if the East German communists were running the show here," said one European company executive.

A German Foreign Ministry spokesman said the government wasn't aware of the Knauf case but added, "If

it's true that German companies are restricting or forbidding staff from demonstrating, then the German government doesn't welcome it."

The recent crisis in Iran has had a chilling impact on foreign companies doing business with Iran. Many companies are now turning to their foreign ministries for help in trying to secure the release of their employees or consultants from Iranian jails.

In a separate case, Bijan Khajepour Khoei, a business and economic consultant and chairman of Atieh Bahar Group, was arrested June 27 at Tehran airport when he arrived from a trip to Vienna and London.

For years, Mr. Khajepour Khoei has been traveling around Europe lobbying companies' boards to invest in Iran. His whereabouts are unknown and his family fear for his health because he is diabetic.

Mercedes-Benz parent Daimler AG, for example, which has a representative office in Tehran, places no restrictions on its employees' political activities outside of work hours, according to a spokeswoman. A number of major German companies active in Iran contacted by the Journal, including engineering groups Siemens AG and Linde AG and BASF AG, the chemical giant, said they have similar policies.

"If employees are politically active, that is their private business," said Thomas Moller, a spokesman for BASF.

—Almut Schoenfeld
and Marcus Walker in Berlin
contributed to this article.



An Iranian antiriot policeman raises his baton at protesters at Thursday's cemetery rally. Police beat protesters with batons to disperse several thousand.

Police attack demonstrators at Iran graveside memorial

ASSOCIATED PRESS

TEHRAN—Iranian police fired tear gas and beat antigovernment protesters with batons to disperse thousands at a graveside memorial Thursday for victims of postelection violence, witnesses and state television said.

Demonstrations that drew thousands more later spread to other parts of the capital, Tehran, and more clashes with security forces erupted. Witnesses said police fired tear gas at dozens of demonstrators on Valiasr Street who set tires and trash cans ablaze in response.

Police barred opposition leader Mir Hossein Mousavi from joining the crowd around the grave of Neda Agha Soltan, a young woman shot to death at a June 20 protest over the disputed presidential election. The 27-year-old music student's dying moments were filmed and circulated widely on the Web, and her name became a rallying cry for the opposition.

"Neda is alive, Ahmadinejad is dead," some of those at the ceremony chanted, referring to President Mahmoud Ahmadinejad, who the opposition claims won the

June 12 election by fraud.

Witnesses Thursday said plainclothes forces charged at them with batons and tear gas, some of them chanting, "Death to those who are against the supreme leader." State television also reported that police used tear gas to disperse the demonstrators.

An amateur video that purports to show the memorial depicts thousands marching through the cemetery, chanting and flashing victory signs. Some wore green T-shirts, the color of Mr. Mousavi's opposition movement.

With Thursday's ceremony, the opposition aimed to harness growing anger over abuses in the postelection crackdown and give their movement momentum in the face of continuing arrests.

Allegations of torture against jailed protesters have become an embarrassment to the clerical leadership, bringing criticism from top clerics and even fellow conservatives.

The government has said the first trials of detained opposition supporters would begin Saturday, involving about 20 people.

LEADING THE NEWS

IMF urges EU to sustain fiscal stimulus

Region's emergence from recession called 'highly uncertain'

BY ILONA BILLINGTON
AND TERENCE ROTH

LONDON—The International Monetary Fund urged euro-zone policy makers to sustain fiscal stimulus next year, revitalize the banking sector and keep interest rates low, asserting that the form and timing of the region's emergence from recession was "highly uncertain."

The euro area remains in recession with signs of improvement not yet signaling a recovery, the IMF said in its latest assessment of the 16 countries sharing the euro. Gross domestic product in the region is expected to contract by 4.8% this year and by 0.3% in 2010.

Bank lending remains subdued and the financial system is still under considerable strain, the IMF said. The fund pushed for more

programs that could become dangerously inflationary unless quickly unwound once the recovery takes hold. But that won't happen until banks are fixed first, according to the IMF.

"I think what is most important for the pace of economic recovery in the euro zone is how decisive policies are toward revitalizing the banking sector," Marek Belka, director of the IMF's European department, said on a conference call. "So much depends on the health of the banks, he said. "The more that is done to clean the banks, to enable them to perform their functions best, the more robust the recovery will be."

Deflationary pressures are strong as contracting demand depresses prices. The European Central Bank should work to keep interest rates low with unlimited liquidity provisioning for the banking system. "It will be essential to maintain this stance as long as disinflationary pressures persist," the IMF said in its report.

Government fiscal policies

It urged euro-zone policy makers to have in place medium-term exit strategies to consolidate public finances once their economies get moving.

steps to shore up the euro-zone's banking system, including disclosure rules, recapitalization, treating toxic assets and resolving unviable financial institutions.

European central banks for the past year have slashed interest rates and added more innovative means to pump billions into their banking systems to prevent defaults and to revive bank lending to businesses and households. Governments have instituted an array of expansionary fiscal programs to stir demand, piling up debt and leaving bloated budget deficits. Policy makers have recently begun weighing the form and timing of "exit strategies" from high-octane stimulus

should remain expansive, continuing economic-stimulus plans into next year, the IMF said. But it also urged that policy makers have in place medium-term exit strategies to consolidate public finances once their economies get moving.

The IMF projects that by next year, the average budget deficit in the euro zone will be as much as 6.9% of the region's GDP, compared with a recent low of 0.3% in 2007. That elevates next year's deficit to more than double the 3% limit set in euro-zone fiscal guidelines.

The IMF maintains only a consultative status in the euro zone, but has been actively propping up Eastern European government finances

with emergency credit deals.

The report came amid a stream of economic data out of the region that continued to provide a mixed picture at the half-year mark.

German jobs data Thursday, and a new survey of euro-zone business and consumer sentiment, sounded cheerier notes. The number of people out of work in Germany, Europe's largest economy, surprisingly fell in July, the Federal Labor Office said Thursday. The number of unemployed Germans was down 6,000, to 3.46 million in July, leaving the jobless rate unchanged at 8.3%. Officials cautioned that 30,000 unemployed people enrolled in a new government-sponsored training schemes were excluded from official jobless rolls.

In Brussels, the latest monthly survey by the European Commission, the executive branch of the European Union, showed the overall Economic Sentiment Indicator, or ESI, for the euro zone set an eight-month high of 76.0 from 73.2 in June. The index gives 100 as the long-term average, with economists projecting the index would have to return to over 90 to indicate economic expansion.

The continued pickup in confidence from record lows is consistent with other survey evidence that has indicated the economy won't contract as sharply in the second quarter as it did in the first. "July's rise in the economic sentiment index is another encouraging sign that the euro-zone recession is easing, but it might still be too soon to hope for activity to actually expand," said Jennifer McKeown, European economist for Capital Economics in London.

But not all euro-zone countries are equally poised to pull out of recession. Ireland and Spain, whose government debt and deficit levels have lost them their triple-A ratings, face more trouble this year, according to separate economic projections issued by their central banks Thursday.

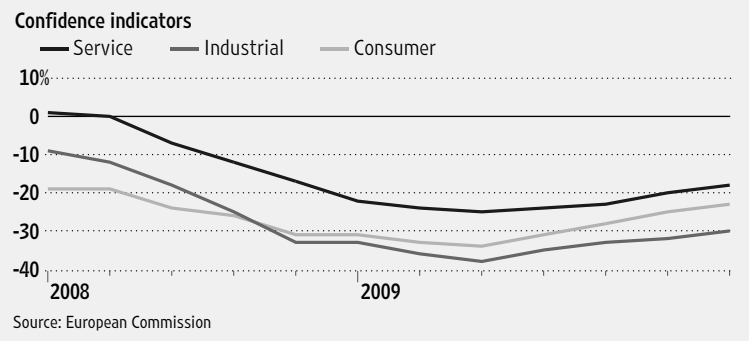
The Irish monetary authority said in its latest quarterly report that it expects gross domestic product to contract 8.3% this year after



A customer pays for clothes at the Hugo Boss store in Budapest, Hungary

Confidence returning

The economic sentiment indicator percentage change. Its long term average (1990-2008) equals 100



falling 3% in 2008.

Ireland was the star economy of the EU in the 1990s as it pulled in foreign investment with attractive tax rates, creating an unprecedented leap in output and wealth and fueling a fierce property boom.

But the country has been among the hardest hit in the EU after the global credit crisis exposed the fragility of the domestic banking system, which was overburdened by loans to the construction sector and overreliant on wholesale bank funding in money markets, which seized up during the credit crunch.

Unemployment is likely to double to an average 12.8% this year and move up to 15% in 2010, accord-

ing to the central bank. Fiscal strains are rising as tax intake falls and welfare expenses soar, creating a budget deficit of 10.7% this year from 7.8% in 2008, the Irish central bank said.

In Spain, where the collapse of the construction boom last year sent the economy into a tailspin, the Spanish central bank said stronger net exports might have eased pressure on the economy in the second quarter. In its monthly economic report, the central bank calculated Spanish GDP fell 0.9% from the first quarter and at a 4% annual rate.

—Nicholas Winning and Geoffrey T. Smith contributed to this article.

U.K. home prices likely to improve, industry group says

BY NICHOLAS WINNING

LONDON—U.K. house prices have a "reasonable chance" of ending the year slightly higher than where they started it, the Nationwide Building Society said Thursday in one of the most upbeat comments on the market since it was throttled by the credit crisis.

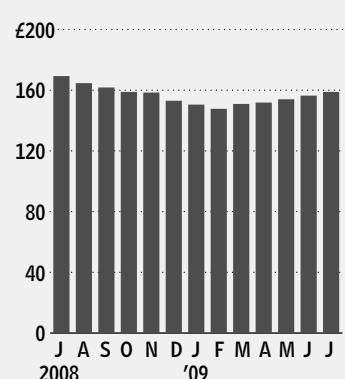
"Only a few months ago, such an outcome would have appeared unthinkable," Martin Gahbauer, Nationwide's chief economist, said in the report.

Nationwide said the average price of a house rose for the third consecutive month in July, increasing 1.3% to £158,871 (about \$260,000), which it attributed to a modest rise in sales and a shortage of available properties to buy. Prices rose a revised 1% in June.

The data suggest that the U.K. housing prices, hit hard by the global credit crisis and ensuing recession, may be starting to recover, helped by pent-up demand and low supply of properties on the market. Also, consumer confidence has been

U.K. rebound?

Average U.K. housing prices, in thousands



A property for sale in London

buoyed by the government's fiscal stimulus and bank-support measures, Nationwide said.

Some economists said the data provide signs of broader economic strength. It's "further evidence that the housing market has bottomed,

helping to remove some of the downside risks facing consumer spending," Alan Clarke, an economist at BNP Paribas, said in a note.

Philip Shaw, an economist at Investec, said the Nationwide data may help convince the Bank of Eng-

land that it doesn't need to increase its bond-buying program and pump more money into the recession-hit economy.

Nationwide cautioned that if housing prices continued to rise at the rate seen over the past three months

they may outpace earnings, rents and other indicators. Rising unemployment was also likely to have an impact on the housing market, it said.

Prices have risen a cumulative 1.3% over the first seven months of the year and are at their highest level since October 2008, Nationwide said. Although house prices were still 6.2% lower than they were in July 2008, that was an improvement from June's 9.3% year-on-year drop.

The Royal Institution of Chartered Surveyors said the Nationwide data reflected the strength of the turnaround in the sentiment in the housing market, but it noted that mortgage finance was rising only very modestly.

BOE data released Wednesday showed mortgage approvals hit a 14-month high of 47,584 in June, but net mortgage lending rose marginally to £343 million.

"RICS believes that the recent support for prices is to a large extent a sign of a lack of supply of properties," Simon Rubinsohn, chief economist at RICS, said in a note.

CORPORATE NEWS

VW delivers quarterly profit

Liquidity increases in time to help seal Porsche deal; Renault swings to first-half loss

BY CHRISTOPH RAUWALD
AND DAVID PEARSON

Volkswagen AG managed to turn a profit in the second quarter with enough cash to put it in a strong position in its merger talks with Porsche Automobil Holding SE, while rival Renault SA posted a first-half net loss of €2.71 billion (\$3.81 billion).

Both companies were hit by the sharp downturn in demand and remained vague on their prospects for the rest of the year, although each said they expected to increase their shares of the market this year.

Volkswagen, Europe's largest auto maker by sales, reported earnings in the second quarter ended June 30 fell 83% to €283 million (\$397 million) from €1.64 billion in the same period a year earlier. Revenue fell 7.8% to €27.2 billion.

As Volkswagen and Porsche near completion of a drawn-out merger agreement, analysts have been looking at how much cash Volkswagen has to back up a purchase. Net cash flow at Volkswagen's automotive operations soared to €4.3 billion in the first six months from €2.3 billion last year.

Its net liquidity increased €4.3 billion from the beginning of the year to €12.3 billion as of June 30, giving it additional muscle to finance the planned acquisition of Porsche's core sports-car operations.

"Preserving our financial flexibil-



The Volkswagen logo is reflected in a car's side-view mirror in front of a Volkswagen Golf Polo BlueMotion

ity is a top priority," said Volkswagen Chief Financial Officer Hans Dieter Pötsch.

It reported revived demand mainly for the company's compact cars and hatchbacks sparked by scrapping incentives, while the premium Audi AG division steered better through the industry gloom than its rivals due to its lower exposure to the troubled U.S. market, a large presence in China and the launch of several new or updated models.

Audi was the biggest contributor to the group's earnings in the first half of the year with operating profit of €823 million compared to €1.3 billion in the same period in

2008. Operating profit at the core VW passenger car brand fell to €216 million in the first half of the year from €1.3 billion last year.

Second-quarter vehicle sales were down 3% on the year at 1.66 million cars and trucks. Production was down 10% to 1.57 million vehicles in the April-to-June period, indicating a further reduction of inventory.

France's Renault swung to a first-half net loss from a net profit of €1.58 billion a year earlier. More than half of the net loss was accounted for by an aggregate €1.58 billion in losses from Renault's shareholdings in Nissan Motor Co., AB Volvo and Russia's AvtoVAZ. Rev-

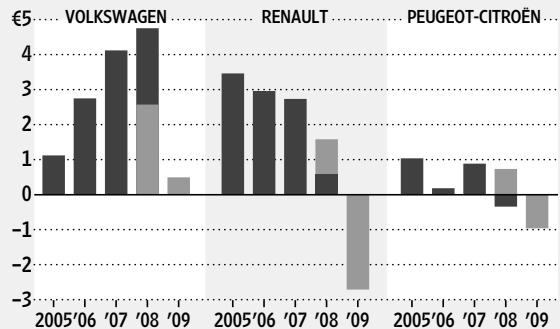
enue fell 24% on a like-for-like basis to €15.99 billion in the first half.

Renault's automobile division managed to generate €848 million of free cash in the first half, and Chief Financial Officer Thierry Moulounguet told analysts that, depending on how the market behaves in the coming months, "we should be able to continue on this trend."

At the beginning of 2009, Renault set a target of reducing inventories by between €800 million and €1 billion over the full year. The reduction over the first half was €860 million, and Mr. Moulounguet said the full-year target could be exceeded.

Rough road

European car makers reported setbacks in the first half of the year. Net profit/loss, in billions



Sources: the companies; Bloomberg News (photo)

Slump drives losses at Mazda, Mitsubishi

BY YOSHIO TAKAHASHI

TOKYO—Mazda Motor Corp. and Mitsubishi Motors Corp. fell into the red in the most-recent quarter, as the economic slump kept potential customers away and the strong yen reduced overseas earnings.

This is the third consecutive quarter that the two Japanese auto makers have reported a loss, but they were able to stem the bleeding they had experienced in the quarter ended March 31 as they pushed ahead with labor-cost reductions and curtailed research and development spending.

Mazda, in which Ford Motor Co. owns a 14% stake, said it posted a net loss of 21.52 billion yen (\$226.6 million) in the three months ended June 30, a reversal from the net profit of 14.98 billion yen it posted in the same period a year earlier.

Mazda's sales sagged 45% to 428.23 billion yen from 771.83 billion yen.

Mitsubishi Motors reported a net loss of 26.44 billion yen in the



Mitsubishi Motors Corp. President Osamu Masuko, second from left, walks past the 'i-MiEV,' an electric car aimed at the mass market and launched in Japan.

quarter, compared with a net profit of 10.3 billion yen a year earlier. The maker of the Outlander and Pajero sport-utility vehicles said its sales dropped 58% to 259.12 billion

yen from 610.1 billion yen.

But the two car makers were able to cut their net losses by at least half in the three months ended in June, compared with the prior quarter.

Following narrower losses already reported by Honda Motor Co. and other major car makers, the quarter-to-quarter improvement in earnings at Mazda and Mitsubishi Motor is the latest sign that the worst may be over for auto industry.

"We got off to a good start to return to profitability on an operating basis in the second half," Mazda Chief Financial Officer Kiyoshi Ozaki said. Mazda aims to post a second-half operating profit of 10 billion yen.

Still, murky prospects for when the U.S., Europe and other faltering markets will recover weigh heavily on the two companies, prompting them to leave unchanged their earnings forecasts for the full fiscal year.

Mazda continues to expect a net loss of 50 billion yen and Mitsubishi Motors, which in July launched its electric car in Japan for the mass market, maintained its forecast for a net profit of five billion yen.

The two companies report earnings under Japanese accounting standards.

Ford stalls Volvo bidding, awaits a result on Opel

BY NORIHIKO SHIROUZU

Ford Motor Co. has slowed the bidding process for its Volvo unit in an effort to get a better price for the Swedish car brand, according to a person close to the U.S. company.

The knowledgeable person said Ford has decided to wait for General Motors Co. to wrap up the sale of its Opel unit in Germany, and is hoping to invite a loser in that two-way bidding race to bid for Volvo.

"Expect nothing to happen for another three to four weeks" as Ford waits for GM to finalize an Opel buyer, said the person.

The person added there currently are three bidder for Volvo: a group led by China's Geely Holding Group Co., Beijing Automotive Industry Holding Co. and a Europe-based group of investors, which the person wouldn't identify. The three were supposed to submit final bids for Volvo in mid-July, and Ford had intended to choose a buyer relatively quickly.

Beijing Auto, which also had been bidding for Opel and its British sister brand, Vauxhall, dropped out of that race earlier this month because of issues involving intellectual property rights. That development prompted Ford to alter its schedule for the Volvo sale, the person said.

A group led by Canadian auto-parts supplier Magna International Inc. is now competing for a majority stake in Opel with private-equity firm RHJ International SA, a Brussels-based company linked to U.S. buyout group Ripplewood Holdings LLC. Magna's bid is backed by Russia's Sberbank Rossia and auto maker OAO GAZ Group.

The person close to Ford said the American car maker decided to slow the bidding process to ratchet up competition and try to get "the best possible price" for Volvo. Ford is "looking for the best buyer and most socially acceptable buyer possible," the person said.

Volvo sales in the U.S. fell almost 36% in the first six months of the year compared with the same period in 2008, according to Autodata Corp.

The person said Ford expects Beijing Auto to go after Volvo more aggressively now that it pulled out of the Opel race. Ford also wants Magna or RHJ—whichever fails to buy Opel—to also take part in the Volvo bidding, the person added.

Ford has said that half the proceeds from a Volvo sale would be used to pay back part of debt Ford accrued when it borrowed \$23.5 billion in 2006.

A Beijing Auto spokesman declined to comment. An executive at Geely also declined to comment.

MAN coasts on backlog as truck orders dry up

BY SARAH SLOAT

FRANKFURT—German truck maker and engineering company MAN SE on Thursday reported a 95% drop in net profit in the second quarter as demand shriveled.

"Incoming orders are low and a turnaround is currently not in sight," the company said. "We are expecting that industrial production

will take several years to recover following the sharp downturn."

With Europe's truck market squeezed by declining demand, MAN's net profit dropped to €22 million (\$31 million) from €442 million a year earlier. Revenue fell 20% to €3.11 billion from €3.89 billion.

MAN said its is currently propped up by a good order backlog, which stands at €8.7 billion. How-

ever, the company booked only €2.3 billion in new orders in the second quarter, down 45% from a year earlier. With a 53% decline, order intake was particularly weak at MAN's main commercial-vehicles division.

"This reflects the extremely difficult situation in the sector, which is being much harder hit by the economic downturn than, for example, the passenger car industry," MAN

said. It also said it believes it has hit bottom in terms of orders for commercial vehicles, but that at this time there is no sign of a turnaround in the European truck market, which it expects to shrink 50% this year. The commercial-vehicles division had an operating loss in the second quarter, and MAN said it would be difficult to achieve a profit in the unit in the second half.

International Investor

State of change

NYSE's fast-trade hub rises up across the river in New Jersey > Page 22



CORPORATE NEWS

Exxon, Shell feel slump's squeeze

Oil firms' earnings, output rates tumble as demand weakens

BY RUSSELL GOLD
AND ANGEL GONZALEZ

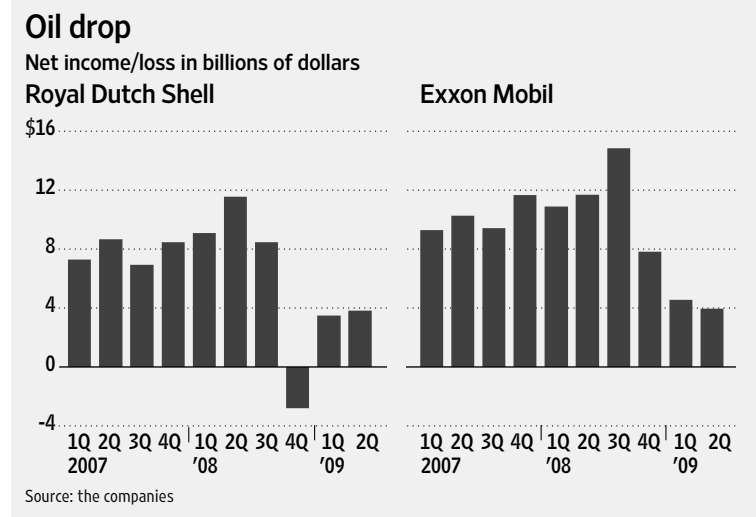
The global recession's withering impact on petroleum prices and demand dragged down profits at Exxon Mobil Corp. and Royal Dutch Shell PLC, two of the world's largest oil companies.

"Our results show that no one is immune from global economic conditions," said Kenneth Cohen, a vice president at Exxon, the Texas-based oil company that had a peak market capitalization of half a trillion dollars in 2008 and is still the world's largest publicly traded company.

The companies posted sharply lower second-quarter profits and declining production rates that disappointed analysts' expectations. Exxon said profit fell 66% from a year earlier to \$3.95 billion. Profit at the Anglo-Dutch Shell, one of Europe's largest public companies by market capitalization, dropped 67% to \$3.82 billion.

The recession is severely testing the energy giants' strategies, which have been focused on maintaining strong investment in future production while preserving hefty stock-dividend payments to shareholders. Exxon is also engaged in a substantial share-repurchase program.

Shell's new chief executive, Peter Voser, has responded to the downturn by cutting 20% of senior management positions, saying he wanted "fewer people thinking



about strategy and more people implementing it."

In contrast, Exxon said it isn't cutting jobs and is sticking with its \$29 billion capital-spending plan in 2009. Despite the difficult economic conditions, said Exxon CEO Rex Tillerson, "We continued our capital investment program at near record levels while returning over \$16 bil-

lion to our shareholders during the first half of the year."

But Exxon said it dialed back its share-repurchase program in the second quarter to \$5 billion, down from \$7 billion at the beginning of the year. The company said it expects to buy back only \$4 billion of shares during the current quarter.

Exxon dipped heavily into its

enormous cash stockpile in the second quarter. It ended the quarter with \$15.6 billion in cash, down \$9.4 billion from the first quarter.

Both companies also had trouble sustaining oil and gas production rates.

In what J.P. Morgan said in a research note would probably be the worst performance among the large global oil companies, Shell said its total production fell 5.3% compared with the year-earlier period. It cited shutdowns in Nigeria because of political unrest, production cuts by the Organization of Petroleum Exporting Countries that affected Shell projects in those countries, and weaker natural-gas demand.

Exxon said its oil and gas production fell 3.1%, to 3.68 million barrels, from a year earlier, the second-lowest quarter since the company was formed in a megamerger in late 1999. A drop in European demand for gas led Exxon to ratchet back production by 12% in the region.

But Exxon reaffirmed its expectations for an annual growth rate of 2% to 3%, noting the growth would occur in the year's second half as gas projects come online in Qatar.

Neither Exxon nor Shell was optimistic about a turnaround in economic conditions—and therefore energy demand—in the near future. In a prepared statement, Shell's Mr. Voser said "we are not banking on a quick recovery."

Exxon Vice President David Rosenthal said on a conference call with reporters that "we are operating in a tough business environment. I would tell you it is certainly too early for us to call a bottom."

—Guy Chazan
contributed to this article.

Dow Chemical posts loss on buyout charges

BY ANA CAMPOY
AND MIKE BARRIS

Dow Chemical Co. reported a loss in the second quarter as aggressive cost-cutting and an uptick in demand for its chemical and plastics products weren't enough to offset costs associated with its purchase of rival Rohm & Haas Co.

Excluding the costs of the merger and other charges, Dow would have posted a profit, but overall sales revenue in the quarter was still disappointing, down 31% from the year-earlier period as consumers and industry continued to curb spending.

Although the company expects business conditions to brighten in the third quarter, it isn't counting on a significant turnaround for the rest of the year. That outlook "is prudent given the growing uncertainty in the global economy," said Chairman and Chief Executive Andrew Liveris during a conference call with analysts.

The chemical sector, which makes the building-block materials for most

consumer products, has been pummeled by the global economic downturn as manufacturers cut production and slashed inventories. In response, companies such as Dow ratcheted back production, shuttered plants and cut thousands of jobs. Since the beginning of the year, Dow said it has cut costs by \$600 million.

Business picked up in the second quarter amid signs that customers are no longer reducing inventories. Demand in China improved too, as the government's stimulus package sparked purchases of building materials and consumer products such as electronics. Sales jumped 20% from the first quarter at Dow units that make materials used in electronics and paints.

On Thursday, the company's shares rose 6.5% to \$21.58 in mid-afternoon trading on the New York Stock Exchange.

Still, many chemical companies expect overall global demand to remain weak in coming months. German chemical giant BASF SE on Thursday

cut its full-year outlook after second-quarter net profit fell 74%; U.S.-based DuPont Co., which posted a 61% decline in profit last week, expects sales volumes in the third quarter to remain below year-ago levels.

Dow's second-quarter loss came to \$344 million, or 47 cents a share, compared with a year-earlier profit of \$762 million, or 81 cents a share. Excluding restructuring and other charges, Dow would have earned five cents a share compared to the eight-cent loss analysts polled by Thomson Reuters had anticipated. Revenue fell to \$11.32 billion from \$16.35 billion.

Dow's second-quarter loss comes at a time when it is reorganizing its business to absorb the \$16.3 billion acquisition of Rohm & Haas earlier this year, and dealing with the heavy debt load it incurred to buy it.

"They are obviously getting things done, but it's a very difficult environment that they are operating in," said Michael Judd, an independent analyst who runs Greenwich Consultants.

On Thursday, Dow said it is selling its stake in OPTIMAL, a Kuala Lumpur-based commodity chemical joint venture, to its partner Petrolim Nasional Berhad, Malaysia's state-owned oil company, for \$660 million. The proceeds will help repay a short-term loan the company used to for the Rohm & Haas purchase.

The company also is looking to shed other assets, possibly including part of its AgroSciences unit.

Dow is in talks with a Kuwait state-owned energy company and two other state-owned oil companies about forming a joint venture that would control some of Dow's basic-chemical businesses. A joint-venture with Kuwait fell apart last year.

On Thursday, Dow said it reorganized several latex, rubber and plastic businesses it wants to sell into a new unit called Styron Corp. It could fetch about \$1 billion or \$2 billion, said Mr. Liveris.

—Allison Connolly
contributed to this article.

L'Oreal profit climbs 2.6% as sales pick up

BY MAX COLCHESTER

PARIS—L'Oreal S.A., the world's biggest cosmetics company, posted a 2.6% increase in sales in the second quarter of 2009 as demand for its shampoos and beauty products began to pick up.

The Paris-based L'Oreal, whose products include Giorgio Armani perfume, Lancôme skin cream and Garnier shampoo, said that sales rose to €4.39 billion in the three months ended June 30.

In a statement, the company said it expects its performance to gradually improve over the course of 2009. L'Oreal didn't break out profit for the quarter.

Since the turn of the year, L'Oreal's sales have suffered as consumers have reduced spending on luxury cosmetics and retailers cut orders of beauty products.

Stripping out the impact of currency exchange rates and acquisitions—notably the purchase of perfume company YSL Beaute—L'Oreal's sales were down 2.1% in the second quarter of 2009 compared to the same period last year.

In a statement, Jean-Paul Agon, L'Oreal's chief executive, said that the company's sales would improve over the year as demand rises in China, Brazil and Russia. Mr. Agon was also confident that retailers would soon start to replenish stocks of L'Oreal products.

"The market context is still negative but the distributor inventory reduction effect is clearly less pronounced than in the first quarter," Mr. Agon said during a conference call with analysts.

While sales in the company's consumer products division, which includes the Maybelline and Garnier brands, held up, demand for the company's luxury cosmetics range fell.

Stripping out currency effects, L'Oreal's luxury products division, which includes Lancôme skin cream, recorded a 8.3% drop in sales to €969 million. This was less than the 13% drop in the first quarter of the year. The company said sales had picked up during the second quarter as stores started stocking up on these products again.

The company reported double-digit sales growth in Asia, Eastern Europe and Africa. Sales in North America were up 7% but fell 2.8% in Western Europe.

L'Oreal isn't the only cosmetics company to feel the effects of a slowdown in household spending. On Wednesday, U.S. cosmetics maker Revlon Inc. reported that sales fell 12% in the second quarter of 2009 to \$321 million.

Economy & Politics

Staying in school

Indonesian terrorists rely on shelter from sympathetic Islamists > Page 10



Électricité de France records flat first-half profit

BY ALEX MACDONALD
AND ADAM MITCHELL

LONDON—French utility Électricité de France SA Thursday posted flat first-half profits in a deteriorating market, aided by higher prices on power contracts that helped offset costs related to its Brit-

ish Energy purchase.

The company reported net income of €3.11 billion (\$4.36 billion) for the six months ended June 30 as sales increased 8% to €34.9 billion.

Interest expenses and other charges related to this year's £12.5 billion (\$20.46 billion) acquisition of U.K. nuclear power operator Brit-

ish Energy weighed down the net profit, though the consolidation of the U.K. unit boosted EDF's earnings from operations.

EDF will also book a net cash gain of €1.2 billion by selling a 20% stake in British Energy to the U.K. utility, Centrica PLC, subject to regulatory approval.

Centrica, the U.K.'s largest utility by customers, Thursday posted a 28% rise in first-half net income to £537 million.

A strong performance in its downstream retail business more than offset lower profits from its upstream gas and power generation business.

CORPORATE NEWS

Air France reports 1st-quarter loss

Carrier anticipates further deterioration in passenger traffic

BY KAVERI NITHTHYANANTHAN AND A.H. MOORADIAN

Air France-KLM said Thursday it fell into the red in its fiscal first quarter and forecast continued deterioration in its passenger business for the second quarter.

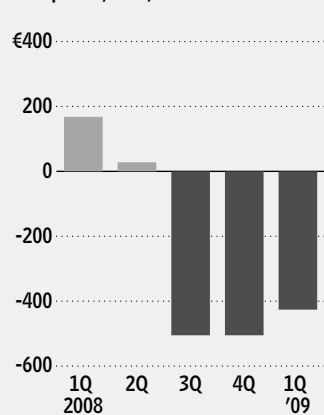
The Franco-Dutch airline posted a net loss of €426 million (\$599 million), compared with a year-earlier net profit of €168 million. The airline had already said last week that first-quarter revenue declined 21% to €5.17 billion.

Passenger traffic, measured in revenue passenger kilometers, fell 5.8%, while cargo haulage dropped 23%. Air France-KLM said, however, that it sees a gradual stabilization of its cargo business.

Airlines world-wide have been hit hard by a collapse in passenger bookings and cargo haulage as the global recession has crimped the pocketbooks of travelers and businesses. The International Air Transport Association, or IATA, said Thursday that weak passenger demand and falling yields pushed airlines' revenue on international markets down by between 25% and 30% in June, just as the industry enters its peak travel season.

Air traffic fell 7.2% in June from a year earlier, while load factor, a measure of how full an airline's planes are, fell 2.3 percentage points to 75.3%. Airlines cut capacity by 4.3%, still trailing the drop-off in demand, said IATA.

Air France-KLM
Net profit/loss, in millions



Note: Fiscal year ended March 2008
Source: the company

"International passenger demand remains very weak," said Giovanni Bisignani, IATA's Director General and Chief Executive. "While it appears that there is stabilization in some markets, this comes at a steep price."

Fears over swine flu are delaying recovery in the Asian-Pacific region, with carriers recording an annual traffic decline of 14.5% in June.

North American airlines recorded a 6.7% annual decline in traffic. Load factors there were the highest across all regions at 82.6%.

European carriers' traffic fell 7.1% in June, while load factor stood at 77.3%. Latin American airlines posted a 4.7% fall in passenger demand, IATA said. There are early indications that the region is starting to recover from the swine flu, which hit there in May, the industry group added.



Air France airplanes sit on the tarmac at Roissy Charles de Gaulle airport near Paris

However, Middle Eastern carriers continued to grow, with demand increasing 12.9%. Carriers increased capacity by 15.2%, with particularly strong traffic growth on routes to Europe and Asia.

Air France's and IATA's reports came just a day after Deutsche Lufthansa AG posted a €216 million loss for its first-half. However, releasing additional details on its results, the German flag carrier said Thursday that it remained in the black for the second quarter, as net profit dropped to €40 million from €337 million a year earlier.

Lufthansa booked a tax credit of between €40 million and €50 million from the acquisition of British Midland Airways, or bmi, which was completed at a cheaper price than Lufthansa originally expected, said Chief Financial Of-

ficer Stephan Gemkow.

Despite the deteriorated trading conditions, Lufthansa embarked on a buying spree over the past year, taking a 45% stake in the parent of a small Brussels airline, SN Holding SA, and raising its stake in bmi to 80%. It is also trying to acquire ailing Austrian Airlines AG and earlier this week said it is nearing an agreement with the European Commission, the European Union's executive arm, over antitrust approval for the deal.

Mr. Gemkow also said that Lufthansa is in talks with SAS AB over the Scandinavian carrier's 20% stake in bmi. SAS has previously said it wants to sell the stake as quickly as possible, but Mr. Gemkow said that the talks haven't yet resulted in any agreement.

—Jan Hromadko
contributed to this article.

AstraZeneca seeks to increase flu-vaccine doses

BY JEANNE WHALEN AND JASON DOUGLAS

British drug maker AstraZeneca PLC said it is scrambling to tweak its swine-flu vaccine in order to make more doses available, as it reported a 5.6% increase in second-quarter profit and raised its full-year earnings guidance.

Chief Executive David Brennan said the company may be able to deliver up to 200 million doses of H1N1 vaccine if it can figure out a way to deliver the vaccine through droppers instead of nasal sprayers.

AstraZeneca has planned to deliver the vaccine via nasal sprayers, which it normally uses for other flu vaccines. But availability of the devices is limited. The company estimates it can deliver 40 million doses in sprayers by March 2010.

AstraZeneca is talking to the U.S. Food and Drug Administration about using a dropper; if it gets permission, it will be able to produce more doses, Mr. Brennan said.

He added that troubles in the global economy have hit the company less severely than anticipated, helping boost second-quarter results and the 2009 earnings forecast. Strong sales of the cholesterol drug Crestor and hypertension drug Toprol XL also boosted the forecast.

The company now expects core earnings per share for 2009 to be between \$5.70 to \$6.00, up from its previous target of between \$5.15 and \$5.45 a share. Core EPS excludes restructuring costs and amortization. AstraZeneca said second quarter profit rose to \$1.71 billion from \$1.62 billion a year earlier. Second quarter revenue was flat year-on-year at \$7.96 billion.

The company got an unexpected boost from Toprol XL because makers of cheap generic copies of the drug have been unable to deliver their pills to market due to manufacturing problems. AstraZeneca has been able to step into the breach and revive a product that had previously lost much of its sales due to generic competition. But the company cautions the bump will likely be temporary.

AstraZeneca said it has set aside provisions of \$430 million in relation to various federal and state investigations, and civil lawsuits, relating to the company's marketing and pricing practices. It said the sum represents a "reasonable estimate of the losses expected" from these investigations and lawsuits. Companies often record such provisions when they are close to settling investigations or lawsuits. Mr. Brennan declined to provide more detail on the provisions.

The company has disclosed that the various investigations and lawsuits it is facing involve a number of its drugs, including the heartburn drug Nexium and the schizophrenia drug Seroquel. Among other things, federal and state investigators are looking for evidence that AstraZeneca marketed its drugs for uses not approved by regulators, an illegal practice known as off-label marketing. Several states have also sued the company, alleging that it overcharged them for drugs.

Mr. Brennan said the company expected the U.S. Food and Drug Administration to make a decision Thursday about whether to approve the company's new drug for diabetes, Onglyza, to be marketed with Bristol-Myers Squibb Co. If approved, it would be one of AstraZeneca's most important new products.

—Sten Stovall
contributed to this article.

EASA urges replacement parts on Airbus jets

BY DANIEL MICHAELS

The European Aviation Safety Agency Friday plans to urge airlines flying large Airbus jetliners equipped with the same brand of airspeed probes as those on a recently crashed Air France plane to replace the probes, an agency spokesman said.

The unusual move comes nearly two months after an Air France A330 en route from Rio De Janeiro to Paris crashed in the Atlantic, killing all 228 people onboard. Automated data sent from the plane indicated problems with its speed probes, known as pitot tubes.

In its recommendation, EASA is due to propose that Airbus A330 and A340 jetliner models with the

latest airspeed sensors made by Thales SA of France have at least two of the three probes on each plane replaced by sensors made by Goodrich Corp. of the U.S., EASA spokesman Daniel Hoeltgen said.

The proposal also will call for banning an earlier model of Thales speed probes—the same model that was on the crashed Air France plane.

Thales officials couldn't be reached to comment. A Goodrich spokeswoman said the company is "ready to support our customers."

Airbus, which agreed to the proposal with EASA, late Thursday notified its customers of the proposed change, a spokesman said.

The "proposed precautionary measure" will be presented to the

aviation industry for consultation in coming weeks, Mr. Hoeltgen said. If adopted, it would become mandatory, he added.

"This is the result of the ongoing technical analysis undertaken by the agency and information received on the performance of the different types of pitot probes in operation," Mr. Hoeltgen said. He said the newer Thales probes aren't deemed unsafe. "Information we have indicates the Goodrich probes are more reliable," he said.

Airbus spokesman Stefan Schaffrath said that Goodrich pitot tubes are the standard model on A330s and A340s, installed on roughly 80% of the 1,000 planes in service. The proposed change will let customers "take bene-

fits from the greater in-service experience with the Goodrich probes."

Mr. Schaffrath said that all pitot tubes meet official certification objectives, but he said there is "a difference in performance with the Goodrich model." He added: "We are convinced Thales will deal with the issue and come up with a solution that will allow our customers to have a choice again." Airbus is a unit of European Aeronautic Defence & Space Co.

Recommending a change of manufacturers is unusual for an air-safety agency. Normally when a part is found to have flaws, EASA or the U.S. Federal Aviation Administration recommends fixes rather than outright replacement.

BAE gets a lift from a weak pound and F-35 fighter

BY JONATHAN BUCK

LONDON —BAE Systems PLC Thursday swung to a first-half net loss due to accounting adjustments despite a 28% rise in revenue. But the company said it expects full-year results to benefit from the continued weakness of sterling against the dollar.

"The group continues to expect good growth for 2009 as a whole, despite a lower level of land vehicle sales," the defense company said in a statement.

Finance Director George Rose told reporters the net loss was due

to accounting actions related to currency fluctuations.

Although it reports in pounds, BAE Systems generates 58% of its sales in the U.S. and is the sixth-largest supplier to the U.S. Defense Department. The U.S. last year accounted for more than half the world's spending on defense.

BAE Systems said it was aligned for changes in Pentagon priorities.

Its position in advanced electronic warfare systems is expected to deliver growth from the transition of F-22 systems to the production of systems for the F-35

Lightning II, a contract potentially worth hundreds of billions of dollars. BAE Systems' share of the workload is between 15% and 20%, comprising 10% of the airframe and other support work.

BAE Systems reported a net loss in the six-month period ended June 30 of £88 million (\$144 million), compared to a net profit of £586 million in the same period a year ago. Revenue climbed 28% to £9.94 billion from £7.75 billion.

Earnings before interest, tax and amortization, excluding impairment of intangible assets, finance costs and disposals, rose

19% to £979 million from £820 million. It boosted its dividend by 10.3% to 6.4 pence per share. Net debt shrank to £316 million from £708 million.

Mr. Rose added that the company's pension-fund deficit had increased by £1 billion to £3.1 billion. It has a 20-year deficit reduction plan and faces its next actuarial valuation in April, 2010.

Analysts said the pension deficit was a negative, but the earnings were solid. "The underlying operating business remains extremely robust," said Numis Securities, which rates BAE a "buy."

CORPORATE NEWS

Alcatel returns to profit

For the first time since Lucent merger company in black

Alcatel-Lucent SA posted its first quarterly profit since its creation in 2006, while its chief executive said he foresees the company returning to "normal" profitability by 2011 after breaking even this year.

By Loretta Chao in Beijing and A.H. Mooradian in Paris

CEO Ben Verwaayen also said in a telephone interview he expects the Asia-Pacific region to become a larger portion of Alcatel's global revenue.

The Franco-American telecommunications company reported earnings of €14 million (\$19.6 million), helped by €277 million in gains from asset sales. A year ago, it had a loss of €1.1 billion, weighed down by an €810 million impairment charge related to its wireless business.

Alcatel-Lucent sold its 20.8% stake in defense contractor Thales SA for €1.57 billion in May. The company said Thursday it is evaluating other sales of non-core assets.



Ben Verwaayen, chief executive officer of Alcatel-Lucent, said he aims for the company to break even this year and make a small profit next year.

The results beat analysts' expectations for a loss of €169 million, despite a 4.8% fall in revenue. The company's shares rose 9.4% to €1.98 in Paris trading.

Mr. Verwaayen said he aims for Alcatel-Lucent to break even this year and make a small profit next year as well, then return to stronger profitability in 2011. A growing emphasis on Asia is part of that strategy, he said.

"We've said that every quarter will be a little better than the previous one," he said. "Asia has played a very important role in that."

Asia generated 19% of Alcatel-Lucent's revenue in 2008. Mr. Verwaayen declined to estimate how much that share will grow. But with other global markets declining, continued expansion in China, India and Australia will increase the region's contribution to total revenue, he said.

"Asian consumers are extraordinarily young compared to the rest of the world, and extraordinarily curious in using new technologies," he said. "Therefore you can see a lot of operators looking to serve that market, which is good for us."

Like rivals, Alcatel-Lucent has suffered from weakening demand for

network equipment from telecommunications operators that make up its core customer base and which are struggling with increased competition and the economic crunch.

One bright spot in the industry has been China, where operators are rolling out third-generation wireless networks that enable high-speed data services like wireless video.

Analysts say Chinese vendors Huawei Technologies Co. and ZTE Corp. are leapfrogging foreign rivals to win a much larger share of 3G sales than they had for China's existing networks.

Mr. Verwaayen said Alcatel is "well positioned in China," because it sells equipment using each of the three 3G technology standards China's three carriers are using. But he acknowledged the growing competition from Chinese rivals.

"In our particular industry it is absolutely true there are new kids on the block who are no longer new kids. They are very established players," he said. "We'll have to cope with it."

Alcatel-Lucent has reported winning \$1.7 billion in contracts with China Mobile Ltd. and China Telecom Corp. Mr. Verwaayen said Alcatel's total contracts are "well above" that amount, but didn't elaborate.

BT starts to heal losses at global-services unit

By KATHY SANDLER

Signs of recovery in BT Group PLC's beleaguered global-services division lifted its shares, even as the telecom company posted a 44% drop in net profit for its fiscal first quarter.

Net profit fell to €214 million (\$350 million) for the three months ended June 30, from €381 million a year earlier, as the company's pension deficit widened and the interest income it used to enjoy swung to an outflow. Sales rose 1% to €5.24 billion.

The global-services division does outsourcing work, providing information-technology and telecommunications services to corporate multinationals. Billed as a way for BT to offset declining use of fixed-line phones, the division saw its costs grow far faster than its revenue, enough to force a profit warning last year as it booked £1.3 billion in restructuring costs.

Last year the company cut 15,000 jobs, including contractors, and Chief Executive Ian Livingston said in May it plans cuts "of a similar level" in the current fiscal year that began in April. About one-third of the new cuts are expected to come from global services. BT had a staff of 108,000 at the end of December.

BT's preferred measure of profitability—earnings before interest, taxes, depreciation and amortization, and costs associated with staff leaving the company, or Ebitda pre-leavers—fell to £1.37 billion from £1.42 billion, predominantly due to declining profitability at global services.

Global-services revenue was £2.08 billion, up 4% from last year, and ahead of analysts' consensus ex-

pectations for £2.05 billion. Ebitda pre-leavers, down 66% to £62 million, was nevertheless ahead of consensus expectations of £42 million and an improvement on the prior quarter, when it was £43 million.

"BT Global Services is making progress although there is still much to do," said Mr. Livingston. But investors were encouraged enough to send BT's shares up 13% to 126.9 pence in late trading in London.

"There is still much to do," BT's chief executive said of global services.

A reduction in calls and fixed-line revenue meant that BT's retail sales fell 2% in the first quarter to £2.11 billion. But the company has driven down costs aggressively, leading to a 26% rise in earnings before interest tax depreciation and amortization, again not including costs associated with departing staff, to £476 million.

BT said it still expects revenue to fall 4% to 5% in the current fiscal year, reiterating guidance provided at the full year in May. It also forecast a reduction in capital expenditure and operating costs of more than £1 billion.

FinnCap research director Andrew Darley said the cost controls augur well for cash conversion but cautioned that "as ever with cost savings as a route to growth in profit, the potential is finite."

BSkyB continues incursion on telecom companies' turf

By KATHY SANDLER

LONDON—British Sky Broadcasting Group PLC has kept up its attack on the turf of its telecommunications rivals, expanding its broadband and telephone services in tandem with its pay-TV service, and tightening its grip on homes throughout Britain.

The company said Thursday it swung to a net profit of £259 million (\$424 million) for its fiscal year ended June 30 from a net loss of £127 million a year earlier, when charges weighed on its results. With cash-strapped consumers electing to get more of their entertainment at home, BSKyB's sales rose 8.3% to £5.36 billion from £4.95 billion.

Subscriptions to the company's triple-play offering, which includes one of BSKyB's television packages, broadband Internet and a telephone line, jumped 60% to 1.5 million customers out of the company's total customer base of 9.44 million. That means there are 7.9 million customers still to upgrade, said BSKyB Chief Executive Jeremy Darroch.

Selling these extra services has proved crucial to BSKyB's efforts to retain customers. Despite the recession, BSKyB lost no more customers in its fiscal fourth quarter than it did the previous year, before belt-tightening really kicked in.

From a standing start in 2006, BSKyB has extended its broadband service to about 2.2 million custom-

ers, signing up roughly half of all U.K. broadband net additions in each of the past fiscal year's quarters to one of its broadband packages, the cheapest of which comes free with a Sky TV and Sky Talk bundle.

In addition to keeping customers for longer, these upgrades make each customer more valuable: Average revenue per customer rose £37 to £464, further boosted by the company's aggressive push into its higher-priced high-definition TV package.

BSkyB has run a concerted marketing campaign for the past six months to promote its Sky+ HD set-top boxes, cutting the price per box to £49 from £150, incurring about £130 million of extra investment costs.

The effort has paid off with 291,000 new HD customers in the fourth quarter and a total of 16% of its customers now receiving the HD service, up from 6% last year.

Mr. Darroch said there will be higher investment costs in HD next year, but these will lead to higher revenue because of an increased subscription price.

While the CEO doesn't think the difficult economic environment will ease in the next 12 months, he still sees "substantial opportunity ahead for our business."

News Corp., which owns Dow Jones & Co., publisher of The Wall Street Journal, holds about a 39% stake in BSKyB.

Telefónica's net profit falls 6.1%

By JASON SINCLAIR AND RUTH BENDER

Earnings from France Télécom SA and Spain's Telefónica SA showed that rapid cost cuts occurring across Europe's telecommunications sector aren't necessarily enough to beat regulatory and competitive pressures on its revenues.

Telefónica, Europe's largest telecom company by market capitalization, said net profit for the quarter

ended Jun. 30 fell 6.1% to €1.93 billion (\$2.71 billion). Telefónica's net profit declined in the second quarter because of the slowdown in some of its mature European markets and after asset sales boosted the year-earlier figure. In the first quarter last year, it booked a combined €257 million gain from the sale of radio operator Airwave and a stake in Spanish pay-TV firm Sogecable.

Many of Europe's telecom companies have slimmed down to gain traction in a fierce fight for dominance in the competitive European mobile and broadband market. The cost cuts are also designed to preserve margins as national and European regulators force down the cost to consumers of voice calls, text messaging and data.

Telefónica had said in May it was reducing expenses and capital expenditure in response to the weak European market, saying the cuts would help preserve cash flow and honor dividend commitments. Telefónica's operating expenses fell 6.6% in the second quarter to €8.47 billion.

"Our capital-expenditure and operating-expenditure cuts are focused on the right areas," Telefónica's chief executive for Europe, Matthew Key, said in an interview. "We

always said 2008 would be our peak for capital expenditures."

Telefónica has benefited from its exclusive contract to sell Apple Inc.'s iPhone, which helped to cement its top spot in the intensely competitive U.K. market.

France Télécom, which also faces pressure in key European markets, plans to cut costs in the second half of the year after lowering general expenses in the first half. Net profit for the first six months ended June 30 fell 4.3% to €2.56 billion. Second-quarter revenue fell 3.8% to €12.77 billion from €13.28 billion last year, as all regions declined amid the economic downturn, except France, Africa and the Middle East.

Dutch telecom company Royal KPN NV last week lowered its revenue guidance for 2010, despite posting higher second-quarter net profit mainly because of lower demand from businesses.

But the effects of the global downturn aren't affecting all companies equally. Vodafone Group PLC, the world's largest mobile operator, last week reported a 9.3% rise in first-quarter revenue and reiterated its full-year guidance, despite the steady decline in European revenue.

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ECONOMY & POLITICS

BOE to expand asset-purchase program

Central bank move to buy secured commercial paper aims to increase liquidity as banks remain reluctant to lend

BY NATASHA BRERETON

LONDON—The Bank of England plans to wade deeper into the business of lending to U.K. companies, as banks remain reluctant to loan money, possibly hobbling any economic recovery.

The central bank said Thursday that it will launch a new facility to buy securities based on commercial paper, short-term IOUs companies issue to finance everything from payrolls to consumer loans such as credit cards. The bank said it will pay for the facility with money borrowed by the U.K. government or with funds authorized by the bank's Monetary Policy Committee. The BOE wouldn't say how much the new facility would hold.

The move, which echoes similar programs in the U.S., Japan and continental Europe, comes at a time when U.K. banks have remained reluctant to lend despite efforts by the government and central bank to boost capital and pump cash into the system. Some analysts saw it as underscoring the possibility that the central bank might expand both the size and scope of its policy of quantitative easing. But other analysts were skeptical that the launch carried implications for monetary

Economic boost

Weekly purchases of gilts by the Bank of England's asset purchase facility, in billions



Source: Bank of England



The Bank of England has intervened to prop up the U.K. economy.

policy, and described it as a technical move.

The Bank of England's next regular policy meeting is Aug. 5-6. "I expect that its policy bias will transition more strongly towards credit quantitative easing," said Lena Komileva, an economist at Tullett Prebon.

The central bank has completed the £125 billion (\$204.63 billion) of asset purchases targeted under its quantitative-easing policy, with

about £122 billion of those purchases made up of government bonds, alongside smaller quantities of commercial paper and corporate bonds.

Some observers expect that the central bank could add £25 billion to the program next week, and even ask the government for a larger allocation beyond that.

The Bank of England said the new facility will open Monday and remain in place for as long as

"highly abnormal" conditions in corporate-credit markets last. The bank will buy secured commercial paper backed by high-quality assets, including short-term credit to companies, such as trade receivables and equipment leases, and to consumers, such as credit-card loans.

Prices of U.K. government bonds rallied on the news, as some investors speculated the announcement made an expansion of the bank's

quantitative-easing policy more likely.

The Bank of England originally announced in June that it was planning to launch a secured commercial-paper facility. It also is considering a supply-chain finance facility. Ratings company Standard & Poor's this month described the proposed program as a "positive move" to support the market's revival, but it also highlighted the limitations of its eligibility criteria.

Some analysts questioned the program's effectiveness. The market for the types of commercial paper the bank is targeting is tiny, and the benefit for the small- and medium-sized enterprises most in need of credit is dubious, said Marc Ostwald, market strategist at Monument Securities.

The U.S. Federal Reserve started buying asset-backed commercial paper in September 2008, while the Bank of Japan began in January, in an effort to ease corporate fund-raising conditions.

The European Central Bank in July started a €60 billion (\$84.21 billion) asset-purchase program, under which it will gradually buy covered bonds in both primary and secondary markets. Covered bonds are issued by banks to refinance loans on commercial or residential mortgages.

Some China cities raise water prices

BY ANDREW BATSON

BEIJING—Cities across China are raising the price of water, in moves that try to balance the need to conserve an increasingly scarce resource with the effects on a public used to low fees.

On Friday, the city government of Luoyang, in central Henan province, will hold a public meeting to argue for a proposed water-price increase of 40% to 48%. Water prices in the dry region haven't risen since 2003, which the government says is exhausting meager supplies and keeping the local water utility in the red. At least half a dozen other major cities have raised water prices in the past few months.

The changes reflect a growing official consensus that low prices are part of China's water-shortage problem, since they give companies and households little incentive to use water carefully. In March, Premier Wen Jiabao said, "We will press ahead with reform of water prices." The government is also spending billions of dollars on a controversial system of canals to divert water from the flood-prone south to the dry north.

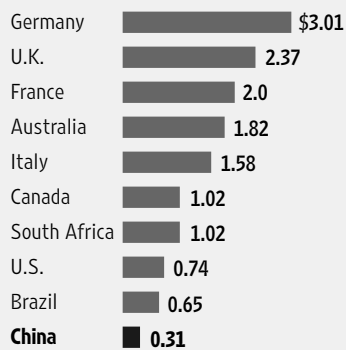
The amount of water available per person in China is just one-quarter of the world average, and it is particularly scarce in the north. The World Bank has estimated that water shortages cost China about 1.3% of its annual economic output, with a further 1% lost to water pollution.

"Given the underpricing of water in China and its environmental consequences, I feel it is wise for governments to take the opportunity of low inflation pressure to adjust the water tariff," said Jian Xie, a senior environmental specialist at the World Bank.

China's consumer-price index is

Too cheap?

Price of water, in U.S. dollars per cubic meter



Source: Deutsche Bank

below where it was a year ago, which has given municipalities an opportunity to boost fees for both households and businesses. Shanghai raised residential water prices 25% in June and plans a 22% increase in November 2010. The central city of Zhengzhou raised water fees 25% in April, and officials say prices will have to change more rapidly in the future.

Yet, there has been "strong public reaction" to the price increases in some cities, the National Development and Reform Commission said in a notice in early July. Some local news reports have suggested the price increases are being driven more by corporate greed than a real need to conserve water. The agency, which supervises the prices of regulated goods like water, said local governments need to take public concerns into account as they plan for necessary price increases.

The rise in water bills has upset consumers even in cities where rates haven't been rising. Zheng

Hong, a lawyer in Beijing who lives with seven family members, says his household spends 60 yuan to 70 yuan (\$8.78 to \$10.25) a month for tap water. He is against any inprice creases. "The lower, the better," he says. "Compared to my hometown in Henan province, the water prices in Beijing are already pretty high."

Mr. Xie of the World Bank says that while the recent price boosts should be affordable to most urban residents, local governments—which generally set water prices—should be careful they don't hurt the poor. The eastern city of Nanjing raised residential water prices 12% in April but also rolled out subsidies to reduce the impact on low-income households.

China's water prices are still low by global standards, even with the average residential water fee in major cities now up 3% since the end of 2008, to 2.44 yuan per ton. Average water prices in Europe are anywhere from four to 10 times higher, according to Deutsche Bank estimates.

Observers argue that China needs higher prices for other major resources, not just water. Last week, the International Monetary Fund urged China to allow "the costs of other factors of production, such as energy, water and land, to increase further."

Higher prices for major resources would help remove implicit subsidies that inflate corporate profits and encourage excessive investment, economists say. This year, the government has also taken steps to allow local prices for gasoline and diesel fuel to more closely reflect their global costs, and changes to electricity pricing could also be in the offing.

—Sue Feng
contributed to this article.

Nations fall short on pledges of spending toward recovery

BY BOB DAVIS

Wealthy industrialized nations have provided less than half of the support they pledged to prop up their financial sectors, according to new data from the International Monetary Fund.

The so-called advanced economies of the Group of 20 have made capital injections of \$425 billion in banks and other financial institutions, 42.3% of the amount announced, the IMF said. The countries' treasuries have also spent \$333 billion to purchase assets and make loans to financial institutions—just 18.4% of the amount announced.

The IMF said the relatively limited spending suggested that the financial crisis hasn't turned out to be as dire as once anticipated.

"This outcome appears to reflect a variety of factors including the precautionary nature of initial announcements, indications of increasing stability and improved bank liquidity," said an IMF report.

The IMF warned that the rate of spending could reflect "lags in implementation." If that were to occur, debt levels would rise even more steeply than they have thus far. The G-20 includes industrialized and large developing nations. Among the industrialized nations are Canada, Australia, France, Italy, Germany, Japan, Britain and the U.S.

The new data came as part of a report warning again that debt levels in industrialized nations are rapidly increasing and that governments need to make clear how they will ultimately reduce the debt to more-sustainable levels. Otherwise, the IMF warned, interest rates could rise, un-

dermining the effect of government stimulus spending and weakening an anticipated recovery.

By 2014, debt levels in industrialized G-20 nations are expected to climb to about 119.7% of gross domestic product from 78.8% in 2007, the IMF said. That 40.9-percentage point increase, the steepest since World War II, is the result of stimulus spending aimed at fighting the recession, and increasing payouts for pensions and health care for aging populations. The IMF generally

The IMF warned it was too early for nations to eliminate stimulus spending.

views a 65% debt level as more appropriate for industrialized nations.

The IMF warned that it was too early for nations to start eliminating stimulus spending—and indeed that a new round of stimulus may be required in 2010.

It urged nations to lay out specific steps to show how they will handle debt in the longer term, to avoid spooking markets. It cited deficit-reduction commitments announced by Germany, Japan and the U.S., but said they weren't sufficient.

"The risk is that if the public starts to worry about medium-term sustainability and an inevitable rise in interest rates, that that will undercut the effectiveness of the stimulus," an IMF official said.

ECONOMY & POLITICS

How Indonesia terrorism endured

A militant finds refuge and recruits at Islamic school

BY TOM WRIGHT

PALEMBANG, Indonesia—As police investigate the suicide bombings at two Jakarta hotels two weeks ago, new evidence indicates terrorists avoided capture for years by relying on the shelter of sympathetic Islamists.

Many intelligence experts agree that terrorist networks in the world's most populous Muslim-majority nation are significantly weaker than a few years ago, before U.S.-trained Indonesian security forces ramped up efforts to wipe them out.

But militants who have eluded capture are still able to rely on numerous havens, often Islamic schools, while they gather the fresh recruits and small amounts of money needed to mount more attacks on Indonesian soil.

Investigators have said they believe Noordin Mohamed Top, a Malaysian believed to have carried out a number of terrorist attacks in Indonesia since 2003, orchestrated the bombings July 17 killed six foreigners, an Indonesian waiter and the two suicide bombers.

Mr. Noordin was formerly a key figure in Jemaah Islamiyah, the al Qaeda-linked Southeast Asian terrorist network whose members orchestrated bombings in Bali that killed more than 200 people in 2002. After a major Indonesian police crackdown, the group renounced violence, leaving Mr. Noordin to forge links with smaller radical Islamic groups.

His new network's activities in and around Palembang, a sprawling city of 1.5 million people on the Indonesian island of Sumatra, show how they operated. The city, a melting pot of Malay, Indian and Chinese people known for its criminal gangs, is the home of the Masjid Agung, one of the nation's largest mosques.

In 2006, according to police documents, an emissary of Mr. Noordin known as Syaifuddin Zuhri, but who used the alias Sabit, arrived at a small Islamic school called al Furqon, about four hours' drive south of

lowed him to give a sermon to the group.

In the sermon, Mr. Sabit claimed he had direct links to Osama bin Laden and urged the members to launch a jihad against America and its allies, according to the testimony of Abdurrahman Taib, a leading member of the study group. The following year, Mr. Sabit told Mr. Taib that he had been sent by Mr. Noordin, the police files show.

Mr. Sabit introduced Mr. Taib to a master bomb maker, who later trained others in the group, and sup-

Jemaah Islamiyah members arrested last year included Mr. Sugandi, the head of the religious school—which is now shuttered—and a 35-year-old Singaporean known as Fajar Taslim, who had helped to radicalize the group and was wanted in Singapore for a foiled attempt to attack Western targets there in 2001.

Six suspects picked up had no previous known connection to Jemaah Islamiyah or any other violent group, suggesting Mr. Noordin's network was able to successfully radicalize people.

Eight members of the group confessed and were convicted of the teacher's murder and of planning attacks, and received prison sentences of between 10 and 18 years. Mr. Sugandi was given a five-year sentence for harboring terrorists, and his school shut down. Mr. Sabit wasn't captured then but was arrested in June in Cilacap, a town in Central Java where police now say they believe the Jakarta attacks were planned.

In Indonesia, a secular nation of 240 million people with thousands of moderate Islamist academies, there are about 50 radical Islamic schools opened by alleged members of Jemaah Islamiyah.

Sidney Jones, an expert on Southeast Asian terrorist networks at the Brussels-based International Crisis Group, a peace-advocacy body, said the school heads—who want to see the establishment of an Islamic state and are highly distrustful of Indonesia's secular government and police—often allow known terrorists to stay with them as long as they promise not to engage in acts of violence while there.

"You can be at any one of these schools and link in to Noordin" or his associates, said Ms. Jones, who first outlined the story of the Palembang group in a report in May.

The Indonesian government has hesitated to close the schools because of the difficulty of proving direct links to terrorism and the sensitivity about government interference in religious education, said a senior Indonesian antiterrorism official.

Heri Purwanto, a 25-year-old who was in the Palembang study group and made a living hawking prepaid cards for mobile phones, was guarding the group's bombs in a derelict house in the city when police arrested him. His mother, Purwati, who lives in a run-down wooden house at the end of a narrow maze of alleys in a poor part of the city, contends her son was never a radical Muslim and is at a loss to explain his involvement.

Ms. Purwati said she complained to guards at her son's Jakarta prison that he was sharing a cell with Mr. Taslim, the Singaporean, and could become further radicalized.

Some members of the study group, who police have been unable to prove were involved in the attacks, have remained free. A lawyer for one of them says those arrested had become more radical through contact with Mr. Sabit and others.

Mr. Sabit was arrested in June in Cilacap, a town in Central Java where police now say they believe the Jakarta attacks were planned.

Just a few days before the bombings, police raided an Islamic school in Cilacap run by a man who is the father-in-law of Mr. Noordin and a relative of Mr. Sabit, uncovering bomb-making material. The material was similar to an unexploded bomb found later at the JW Marriott.



Palembang. His mission: To exhort a nonviolent study group of about 10 people concerned about Christian conversions of local Muslims to consider attacks on Western targets.

Mr. Sabit, who had fought in Afghanistan in the 1980s, knew the founder of the religious school, a Jemaah Islamiyah member and Afghan veteran called Ani Sugandi, and had helped him recruit hard-line teachers, according to police testimony viewed by The Wall Street Journal.

Mr. Sugandi later told police he had refused requests to join in the violence, but sheltered Mr. Sabit and al-

plied him with a loaded revolver and 11 spare bullets to be used in attacks on "infidels," Mr. Taib said in trial testimony.

Members of the group in 2007 killed a Christian schoolteacher in Palembang who had persuaded his Muslim female students not to wear their veils. The members also built bombs and planned to attack tourist cafes in a Sumatran hill resort popular with backpackers, according to testimony. The group called off the attacks at the last minute because they didn't want to also kill Indonesian Muslims.

China detains activist ahead of key observance

BY SKY CANAVES

BEIJING—Chinese authorities detained a prominent legal activist, escalating a clampdown on dissent ahead of the politically sensitive 60th anniversary of the founding of Communist Party rule.

Xu Zhiyong, co-founder of a legal advocacy group called the Open Constitution Initiative, was taken from his home in northwestern Beijing at 5 a.m. Wednesday by a uniformed police officer and five plainclothes men, according to a report posted on the group's Web site Thursday. The group said another of its staffers, Zhuang Lu, has been unreachable since Wednesday.

A person who answered the phone at the Open Constitution Initiative's office Thursday afternoon said Mr. Xu's whereabouts were unknown and the reasons for his detention were unclear. Mr. Xu's mobile phone was turned off, and his blog was last updated Tuesday night.

Officials at the Beijing Public Security Bureau couldn't be reached to comment.

Human-rights groups say 53 lawyers, many of whom take on civil-rights cases, have been effectively disbarred this year by local judicial authorities. On Thursday, the Yirenping Center, a legal-aid group focused on fighting discrimination against people who have hepatitis B, was raided by authorities on suspicion of engaging in unlicensed publishing activities, according to the Associated Press.

In June, the government formally arrested Liu Xiaobo, one of China's most prominent advocates for political change, on allegations of subversion. And the government in recent months has increased efforts to censor what it considers politically or morally subversive sites on the Internet.

Phelim Kine, an Asia researcher at the New York-based Human Rights Watch, said the detention of Mr. Xu is "the latest in an ongoing campaign against human-rights defenders." He said it is unclear what the reasons are for the increased activity, or whether it is because of official concerns about disruptions of the 60th anniversary of founding of the People's Republic of China on Oct. 1, which is intended to be a celebration of party rule.

Mr. Xu has been the driving force behind the Open Constitution Initiative, known in Chinese as Gongmeng, an association of volunteer lawyers, scholars and activists established in 2003. The group describes itself as "committed to building a modernized China and promoting human rights, democracy and rule of law." It has taken on sensitive cases, such as those of the families of children who were sickened in last year's scandal over melamine-tainted milk. In May, the legal group released a report that challenged Beijing's position on the causes of deadly riots last year in the Tibetan capital of Lhasa and other Tibetan parts of China.

In July, Beijing tax officials charged the group with failure to pay taxes on contributions received and demanded payment of fines of 1.4 million yuan, or more than \$200,000. A hearing was held on the matter last week but no final decision had been reached, Mr. Xu said on July 24. The group said Mr. Xu was supposed to meet with tax officials on Wednesday and Thursday, but didn't appear.

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