Money & Investing: Big money managers find opportunities in bad times

THE WALL STREET JOURNAL.

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What's News

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Oil-market madness

Gordon Brown and Nicolas Sarkozy on ending wild price swings. Page 15

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Deadly ethnic violence grips China

Agence-France Presse

NEW HOSTILITIES: Uighur women grab a riot policeman as they protest in Urumqi Tuesday. Tensions with Han Chinese spiked in the northwest after weekend rioting that claimed at least 156 lives. **Pages 10-11.**

Obama seeks middle road in Russia

By Jonathan Weisman, Gregory L. White and Alan Cullison

MOSCOW—After some tough talk before his Russia visit, President Barack Obama concluded a two-day summit with conciliatory words for Russian Prime Minister Vladimir Putin and a major address that praised Russia's contribution to history and art while challenging the Kremlin to change its behavior and policies.

But Mr. Obama's visit to Moscow is likely to fuel criticism by some in the U.S. who see his proposed "reset" in relations with Russia as a series of concessions by Washington.

Whether Mr. Obama will profit now depends in large part on the magnanimity of Moscow, which has been skeptical of his administration. With a tight lock over all the major television channels, the Kremlin has in recent years relied on a steady anti-American message to stoke national pride and shore up its control within the country.

The White House's top Russian expert, Michael McFaul, urged that the summit's successes be judged by how relations have improved from the depths they reached in the latter years of the Bush administration.

But mistrust still runs deep on both sides. The main results of the summit—agreements to wrap up a new arms-control treaty and permission from Moscow for the U.S. to ship war materiel through Russian airspace to Afghanistan—were relatively modest, analysts said.

"By focusing on nuclear weapons and Afghanistan, they achieved the maximum that they realistically could have," said Fyodor Lukyanov, editor of Russia in Global Affairs, an influential Moscow journal. "Everything else—Iran, NATO, Georgia, all the other topics—will be much more difficult."

Trade off

■ Russia ranks among world's most-closed economies 2

Four hours of cordial talks with Russian President Dmitry Medvedev on Monday were followed by what appears to have been a much tougher working breakfast with Mr. Putin, in which both sides stood their ground on areas of disagreement. Before and during the visit, Mr. Obama highlighted his common views with Mr. Medvedev, a longtime Putin aide who has cast himself as a progressive,

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Oil 'speculation' foes bridge the Atlantic

By Alistair MacDonald, Guy Chazan and Carolyn Cui

LONDON—Policy makers on both sides of the Atlantic launched an effort to crack down on what they called "speculation" in oil markets, underscoring growing concerns that a sharp rise in oil prices could worsen the global economic downturn.

In an opinion piece submitted to The Wall Street Journal, U.K. Prime Minister Gordon Brown and French President Nicolas Sarkozy wrote that governments need to act to curb a "dangerously volatile" oil price that defies "the accepted rules of economics" and "could undermine confidence just as we are pushing for recovery."

Hours earlier in Washington, the Commodity Futures Trading Commission, the main futures-market regulator in the U.S., announced it would hold hearings on whether to introduce tougher regulation of oil-futures markets. The rules, which drew immediate criticism from traders, would seek to curb the influence of speculative investors such as hedge funds and investment banks by limits

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Clamping down

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New prescription

Drug companies see poorer nations as a sales cure

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Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	8163.60	-1.94
Nasdaq	1746.17	-2.31
DJ Stoxx 600	200.20	-0.74
FTSE 100	4187.00	-0.19
DAX	4598.19	-1.15
CAC 40	3048.57	-1.09
Euro	$1.3994	+0.49
Nymex crude	$62.93	-1.75

Farewell, 'King of Pop'

Reuters

SINGING PRAISES: Michael Jackson fans pay tribute in Mexico City, as stars packed a memorial service in Los Angeles. **Page 3.**

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Switzerland SF 5 - Syria S£ 210 - Turkey TL 4.5 - U.S. Military (Eur) $2.20 - United Kingdom £1.50

THE WALL STREET JOURNAL.

LEADING THE NEWS

EU weighs market rules

Finance officials aim for policies that end boom-and-bust cycle

BY ADAM COHEN

BRUSSELS—European Union finance ministers agreed that new rules are needed to avoid boom-and-bust cycles in financial markets, but they rejected Germany's bid to suspend capital requirements for banks.

The ministers, following their monthly meeting in Brussels, criticized the current bank-capital rules outlined in the Basel II Accord. This international agreement, signed in 2004, was designed to ensure banks had enough capital in reserve to guard against risks.

EU policy makers have criticized this framework for being "pro-cyclical," saying it allows banks to shed reserves when the economy appears healthy and forces them to stockpile capital when risks emerge—when the economy likely already has started to contract.

These risk provisions exacerbate economic downturns, German Finance Minister Peer Steinbrück told the 27-nation bloc's finance ministers. He lobbied for a temporary suspension of the Basel II rules to encourage risk-averse banks to lend more. Recent data from the European Central Bank show that bank lending is contracting and EU business groups are warning that blocked credit channels remain the main obstacle to an economic recovery.

Most EU ministers opposed Mr. Steinbrück's idea, but agreed that they want the European Commission, the EU's executive arm, to study this issue and present a full report by early October.

Mr. Steinbrück also said that Germany "may need measures that are unprecedented in the history of the Federal Republic," in reference to direct lending by companies by the Bundesbank, the German central bank. A spokesman for the Bundesbank said direct lending to companies isn't being discussed.

Accounting rules and remuneration standards also are up for review, with a broad legislative proposal slated for later in the autumn.

International coordination is another key concern. Since the start of the financial crisis, the EU has pushed the U.S. and other countries in the Group of 20 to write stronger rules. G-20 leaders in November called for an international review of policies that could create pro-cyclical conditions.

The EU likely will raise these issues this week, when leaders from the Group of Eight leading nations meet Wednesday in Italy. These talks about new financial-market regulations will continue at September's G-20 meeting in Pittsburgh.

The EU finance ministers didn't say how they would alter the Basel II standards, but stressed in a communiqué that banks should have "counter-cyclical capital buffers ... to be raised in good times and to be drawn down in downturns."

—Jethro Mullen and Roman Kessler contributed to this article.

Agence France-Presse

German Finance Minister Peer Steinbrück speaks with reporters Tuesday during a meeting of the Economy and Finance Council at EU headquarters in Brussels.

Russia's borders harden as Obama calls for trade

BY JOHN W. MILLER

BRUSSELS—A new report ranked Russia among the world's most-closed trading economies, as U.S. President Barack Obama used a speech in Moscow to call for free trade.

A study by the World Economic Forum, a think tank that holds a high-profile annual meeting in Davos, Switzerland, each year, placed Russia 114th out of 121 nations in terms of ease to trade with, behind such economies as Ethiopia, Mauritania and Pakistan.

In his Moscow speech on Tuesday, Mr. Obama said Americans and Russians should pursue "free and fair" trade. In particular, the president said, "people everywhere should have the right to do business or get an education without paying a bribe."

Russia's trade regime is increasingly in the spotlight. Last month, the nation said it intended to sharply revise its longtime bid to join the World Trade Organization. And trade data suggest Russia's appetite for imports has waned.

In the new study, the forum pubished a second-annual Enabling Trade Index, an analysis of trade friendliness, including such components as customs procedures, roads, tariffs and corruption. The survey found that the most open economies in the world were Singapore, Hong Kong and Switzerland.

In the WEF's rankings, Russia fell six places from 103rd in the inaugural survey last year. The latest report captures data and developments from 2008 only, and therefore doesn't include recent policy adjustments. Amid the global downturn in trade, for instance, Russia has implemented import tariffs on goods including cars and plastics.

A Kremlin official declined to comment because he said he hadn't had time to read the report.

Customs data from Germany, Russia's largest trading partner, suggest the country is importing less. German goods exports to Russia were down 40.3% in the first three months of 2009. That is sharper than the WTO's estimate of a 10% fall in global trade in the period.

Last month, Russia said it would withdraw its bid to join the 153-nation WTO, a Geneva-based institution that oversees global trade and adjudicates disputes. Instead, Russia said it would launch a customs union next year with two former Soviet republics, Belarus and Kazakhstan, and that the three countries would apply jointly to the WTO.

Russian President Dmitry Medvedev said Tuesday that Russia remains committed to joining the WTO. However, trade officials say a joint bid would be unprecedented and likely would take years.

CORRECTIONS & AMPLIFICATIONS

India's urban bank-deposit growth rate for the quarter ending December 2007 was 27.6%. A chart accompanying an International Investor article Monday on the country's state banks incorrectly showed the figure as 22.6%.

INDEX TO PEOPLE

This index lists the names of businesspeople and government regulators who receive significant mention in today's Journal.

WSJ.com For more people in the news, visit CareerJournal.com/WhosNews

INDEX TO BUSINESSES

This index of businesses mentioned in today's issue of The Wall Street Journal Europe is intended to include all significant references to companies. First reference to these companies appear in boldface type in all articles except those on page one and the editorial pages.

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Remembering Jackson

Memorial service to the music icon reaches around world

ASSOCIATED PRESS

LOS ANGELES—Michael Jackson's public memorial Tuesday took on a spiritual tone, opening with a church choir singing as his golden casket was laid in front of the stage and a shaft of light evoking a cross as Lionel Richie gave a gospel-infused performance.

Pastor Lucious W. Smith of the Friendship Baptist Church in Pasadena gave the invocation, followed by Mariah Carey singing the opening performance with a sweet rendition of the Jackson 5 ballad "I'll Be There," a duet with Trey Lorenz.

"We come together and we remember the time," said Mr. Smith, riffing off one of Mr. Jackson's lyrics. "As long as we remember him, he will always be there to comfort us."

The service began with Smokey Robinson reading comments from Nelson Mandela, Diana Ross and other friends of the King of Pop. Following a long silence inside the venue, piano music and a gospel choir kicked things off with a stained-glass motif in the background.

An estimated 20,000 people were in the Staples Center as Mr. Jackson's flower-draped casket was brought to the venue in a motorcade under law-enforcement escort.

Fans with a ticket wore gold wristbands and picked up a metallic gold program guide on their way in. The pallbearers who placed Mr. Jackson's casket into the hearse each wore a gold necktie, a single spangly white glove and sunglasses. Mr. Jackson died at age 50 on June 25.

Mr. Jackson's hearse had been part of a motorcade that smoothly whisked his body 10 miles across closed freeways from a private service at a Hollywood Hills cemetery to his public memorial and awaiting fans.

The traffic snarls and logistical nightmares that had been feared by police and city officials hadn't materialized. The thousands of fans with tickets began filing in early and encountered few problems, and traffic was actually considered by police to be lighter than normal.

Earlier in the morning, Mr. Jackson's family members and dozens of friends, led by his parents, Joe and Katherine, were seen entering a building at the cemetery. News reports estimated as many as 20 helicopters circled overhead.

The public memorial was televised live around the world and streamed over the Internet.

Outside the Staples Center, Claudia Hernandez, 29, said she loved Jackson's music as a girl growing up in Mexico. Now a day-care teaching assistant in Los Angeles, Ms. Hernandez said she cried watching TV coverage of his death.

"I'm trying to hold in my emotions," said Ms. Hernandez, wearing a wristband to allow her admittance to the service and holding a framed photograph of Mr. Jackson. "I know right now he's teaching the angels to dance."

More than 1.6 million people registered for the lottery for free tickets to Mr. Jackson's memorial. A total of 8,750 were chosen to receive two tickets each.

Associated Press

The Jackson brothers — from left: Randy, Marlon, Jackie, Jermaine and Tito — accompany the casket to the memorial service.

Los Angeles was the epicenter of Jackson-mania, but the outpouring of emotion was world-wide. Belgium's two national public broadcasters planned to broadcast the memorial live, and several hundred Jackson fans gathered at a Hong Kong mall late Tuesday.

Holding white candles, Hong Kong singer William Chan and Taiwanese pop star Judy Chou led the audience in observing a 30-second silence. Many of the fans clutched red roses and wore black; some donned Mr. Jackson's trademark fedora hats.

In the U.S., about 50 movie theaters across the country planned to show the memorial live, free of charge. "There are certain people in our popular culture that just capture people's imaginations. And in death, they become even larger," President Barack Obama told CBS while in Moscow.

CORPORATE NEWS

GE moves to prop up limping divisions

Unable to sell lighting and appliances operations, conglomerate is putting money into developing new products

BY PAUL GLADER

Last year, **General Electric** Co. said it wanted to stop making light bulbs and appliances. Now, it is putting money back in those businesses.

GE last month said it would add 400 jobs to build water heaters at its appliance division in Louisville, Ky. Meanwhile, the company is upgrading its line of high-end refrigerators and opening a training and sales showroom in Brussels.

In lighting, GE is introducing products using light-emitting diodes and pouring money into research on organic LEDs, a promising energy-efficient technology.

Jim Campbell

GE is among many companies the recession has saddled with businesses they would rather exit. Besides lighting and appliances, GE has tried unsuccessfully to sell operations in railcar leasing and private-label credit cards.

Qwest Communications International Inc. recently called off an auction for its long-distance network, indicating it was unable to find a buyer. **Cablevision Systems** Corp. in May shelved plans to explore selling some assets, including New York's Madison Square Garden.

Jim Campbell, chief executive of GE's lighting-and-appliance group, says GE CEO Jeffrey Immelt has told him to "run the business like we're going to be in it for a long time."

"We've continued to invest," Mr. Campbell says. "Despite the tough economy, we've held our expenses at constant, and are continuing to launch new products every quarter." Mr. Immelt declined to comment.

In 2007, the lighting-and-appliance group posted record revenue of $12.66 billion and operating profit of $1.03 billion, earning it accolades at GE as a top-performing unit. But amid the housing bust, the recession and stepped-up competition, revenue dropped 7.3% last year as profit tumbled 65%.

Although the lighting-and-appliance group carried the GE brand into millions of households, its plants have aged, and its labor and production costs have increased, especially compared with those of foreign competitors. The decline in home construction dealt a further blow.

Mr. Immelt told Mr. Campbell in April last year that GE planned to sell its appliance division. When GE and potential buyers couldn't agree on a sale, GE said last July it would spin off the lighting and appliance units together as a separate public company. That plan was hobbled by the recession and credit crunch.

Mr. Campbell says he must invest in new technology, even if GE doesn't own the operation for long. But GE is cutting costs companywide, forcing Mr. Campbell to juggle spending and saving. He has closed some factories and recalled some U.S. managers working abroad.

"As I look in the rearview mirror, we probably should have started more aggressive cost cutting much sooner," he says. Now he is scaling back on some product lines while ramping up investment in others.

Deane Dray, a senior vice president at FBR Capital Markets in New York, says that after the aborted sale and spinoff, rivals may find it easier to poach some of the unit's 40,000 employees.

"It's damaging for everybody," he says. "You have to run it like a core business even though you have declared it to be noncore."

The lighting division is winding down its manufacture of traditional incandescent bulbs, closing some factories and converting lines to newer products. It expects revenue in LED applications to rise 30% this year to $150 million.

In the appliance division, GE's union of 2,100 hourly workers in Louisville voted in May to freeze wages as part of GE's agreement to build energy-efficient water heaters in Louisville. GE also is getting $17 million in government incentives. It hopes the products will open markets and inject new life into GE's appliance business.

Mr. Campbell thinks there is still a chance GE might decide to hang on to the units, especially in light of the subsidies and tax breaks the Obama administration is doling out for energy efficiency. "I really can't speculate on it," Mr. Campbell says. "Ultimately, it's up to Jeff [Immelt] and the board."

General Electric

GE is putting money into research on organic light-emitting diodes, which can be used in safety outerwear.

Christian Lacroix show illustrates haute couture's woes

BY MAX COLCHESTER

PARIS—Few company figureheads are fêted after filing for bankruptcy protection, having never made a profit.

But as French designer Christian Lacroix strolled down the catwalk after his haute couture fashion show on Tuesday, members of the crowd cheered. Some shed tears. "We must save the soldier Lacroix," said Ines de La Fressange, a former model. "He represents French couture."

The possible demise of the Christian Lacroix label shows how there is no middle ground in haute couture. Labels struggle to survive except as part of large, multiproduct fashion corporations with deep pockets and a global marketing machine—or as niche players with low overheads and a cult following.

The Christian Lacroix label fell between the two. The brand expanded over the last three years in the U.S., but didn't have the support of a large fashion player willing to absorb successive losses and the cost of development.

Originally, haute couture made money by selling unique clothes to rich clients. Increasingly, however, the designs have been seen as a way for luxury houses to showcase talent and build brand awareness.

The media buzz generated from haute couture shows boosts sales of high-margin items such as perfumes, handbags and sunglasses. Sales of haute couture itself—expensive to hand-produce and with a tiny clientele—make up only a small portion of revenue for fashion houses.

Sidney Toledano, chief executive of **Christian Dior** SA, said couture brands must make that investment pay through the publicity generated for other luxury products. "In this industry you either keep it on a small scale or go completely global," Mr. Toledano said after a recent Dior fashion show. "You need the means to do this: the best designers, the best artisans and the best management. It is like Formula One racing."

Christian Lacroix SNC, which is owned by the **Falic Group**, a U.S. operator of duty-free stores, filed for protection from its creditors in May. Unless it finds a buyer by the end of this month, the French fashion house, for which Mr. Lacroix is creative director, will cut its staff to 12 from 124. The only operation to continue would be Christian Lacroix's licensing arm, which comprises men's wear, scarves and wedding dresses.

The Christian Lacroix brand is well-known and a critical darling for iconic shapes such as the 1980s "bubble" dress. Founded in 1987 by **LVMH Moet Hennessy Louis Vuitton** SA, the Christian Lacroix label was sold to the Falic Group in 2005. The new owners expanded in the U.S., opening new stores in Las Vegas and New York. The group tried to leverage Mr. Lacroix's haute couture reputation to sell high-end ready-to-wear garments. The designer's spring collection includes a $6,685 silk calligraphy print gown and a $4,505 silk trench-coat. But the designer's perfume launch didn't go well.

The company's plans were "dramatically hindered" by the recession, Nicolas Topiol, Christian Lacroix's chief executive, said in a prepared statement. According to a spokeswoman, Christian Lacroix had sales of €30 million, or about $40 million, last year and had a €10 million net loss. The label has never made a profit in its 22-year history.

Christian Lacroix's problems follow those of other haute couture operations. Stand-alone designers Balmain, Nina Ricci and Ungaro have already stopped holding couture shows, and only display ready-to-wear collections.

"It stopped being a business a while ago," says Didier Grumbach, president of the French Fashion Federation. "Without sales of [ready-to-wear] it is clear that haute couture can't exist."

This year Paris's haute couture week has been cut to three days from four. Mr. Toledano says that in 10 years' time there could be as few as three couture houses putting on shows regularly, down from the 11 regulars putting on shows this week. "Few companies will survive," he said.

Mr. Lacroix said he was confident the tradition would continue. "There are new people coming into Paris haute couture," said Mr. Lacroix. "It is not over."

EU is likely to fine GDF, E.ON in competition case

BY PEPPI KIVINIEMI
AND ALESSANDRO TORELLO

BRUSSELS—**GDF Suez** SA of France and Germany's **E.ON** AG will likely be fined by the European Commission Wednesday for agreeing not to compete with each other in their national gas markets, according to people familiar with the case.

Although the amount of the fine isn't known, people familiar with the case expect it to be "significant" given both companies' market power. The commission, the European Union's executive branch, is entitled to fine the companies as much as 10% of their annual global turnover. While it seldom sets the fines that high, aspects such as the size of the market affected and severity of the offense influence the final amount.

The commission sent a list of charges to the companies in June 2008, accusing them of having agreed not to sell natural gas in each other's home markets, particularly gas supplied through the Megal pipeline. The pipeline, which transports gas from southern Germany to the French-German border, is jointly owned by both companies.

The companies have argued that the commission's investigation mainly concerns gas-transport agreements signed in 1975 in connection with the construction of the Megal pipeline during the early days of the European natural-gas industry, and that those agreements were terminated in 2004.

E.ON, through its subsidiary E.ON Ruhrgas AG, and Gaz de France, which is now part of GDF Suez, are the leading suppliers of natural gas in Germany and France and two of the largest players in the European gas industry.

An E.ON Ruhrgas spokesman said the company was expecting a decision on the case in the "near future." GDF Suez Chief Executive Gerard Mestrallet said last week the company will appeal any fine imposed by EU antitrust authorities relating to its cooperation with E.ON.

The commission's competition spokesman Jonathan Todd declined to comment on the case.

—Adam Mitchell in Paris contributed to this article.

Boeing sets deal to buy key Dreamliner factory

Firm to forgive debt, pay $580 million to Vought Aircraft

BY PETER SANDERS

Boeing Co. agreed to acquire manufacturing operations from one of its key suppliers on the delayed 787 Dreamliner aircraft at a cost of $1 billion.

The purchase of a plant in North Charleston, S.C., from Vought Aircraft Industries would mark the second time Boeing has taken over a key part of the Dreamliner's supply chain.

Boeing is paying $580 million in cash and will forgive $422 million in cash advances paid to privately held Vought for work on the 787.

The move gives Boeing additional control over a sprawling global supply chain that has created numerous problems for the 787, leading to delays in testing and production. Those delays have cost Chicago-based Boeing millions of dollars in penalties and concessions and have damaged the company's credibility with customers.

For Dallas-based Vought, the deal relieves the closely held company of financial pressure from the weight of the complex Dreamliner program. Vought has been owned since 2000 by **Carlyle Group**, a private-equity firm.

Vought will continue to work on other aspects of the 787 and on additional Boeing commercial and military aircraft. The deal is expected to close in the third quarter.

Moody's Investor Service said Boeing's A2 rating would be unaffected by the planned purchase, though it said the cost will reduce Boeing's "financial flexibility."

Boeing shares were down 3.8% at $39.03 in late-afternoon trading on the New York Stock Exchange.

"While such a transaction should afford Boeing greater control over 787 production, we see another negative in that Boeing is bringing more fixed cost into the company," the opposite of what it accomplished in the 2005 sale of an operation that became Spirit AeroSystems Holdings Inc., analyst Robert Spingarn at Credit Suisse wrote in a note after the Vought negotiations were reported last week.

Vought makes parts of the 787's composite rear fuselage at the North Charleston plant. It is one of the many suppliers around the world that Boeing uses to manufacture parts of the Dreamliner, which is then assembled at Boeing's Everett, Wash., facility.

Keeping its 787 suppliers healthy and on track is one of the biggest challenges Boeing faces. Last year, Boeing bought another of Vought's interests in the 787 program—a South Carolina facility that does fuselage subassembly. Boeing has also been forced to send its engineers and managers to monitor the work of suppliers in such locations as Japan and Italy.

Last month, Boeing again delayed the Dreamliner's first test flight after ground tests revealed structural flaws near where the wings join the plane's body. Boeing hasn't determined a new schedule for test flights and early deliveries.

—Doug Cameron contributed to this article.

Star Alliance defends route plan

BY SUSAN CAREY AND ELIZABETH WILLIAMSON

Circle of friends

Many of the world's major airlines belong to one of three global alliances, whose members cooperate in varying forms.

Alliance	Lead airlines	Number of members	Status
Star	United, Lufthansa	21	Justice Department objects to tentative DOT grant of U.S. antitrust immunity to nine members, plus Continental
SkyTeam	Delta, Air France	13†	Six members* granted U.S. antitrust immunity in 2008
oneworld	American, British Airways	10	Three members seeking U.S. antitrust immunity

†Excluding Continental, which has given notice

*Including Air France unit KLM and Delta unit Northwest

Nine airlines in the global Star Alliance, plus aspiring member **Continental Airlines** Inc., criticized the Justice Department for philosophical bias and faulty analysis in its objections to their plan to cooperate more closely on international routes.

In early April, the Department of Transportation provisionally granted the airlines' request for antitrust immunity for their cooperation plan. By statute, the DOT, which has sole authority over such arrangements, was supposed to issue a final ruling June 1.

But on June 26, the Justice Department's new antitrust chief, Christine Varney, weighed in with a broadside against the airlines' plan, saying it would lead to higher fares, hinder competition and hurt consumers. Ms. Varney wasn't confirmed in her new post until late April, after the DOT had given the plan its provisional approval.

The Justice Department recommended the airlines limit their cooperation plan to trans-Atlantic markets. It also listed several overseas routes it said should be "carved out" of the agreement because they are served by Continental as well as current members of the Star group, implying that the alliance partners would likely reduce competition on these routes once Continental joined.

Although the timing of the department's objections was irregular, the DOT quickly reopened the long-closed comment period, giving the parties until Monday to respond to them.

In their comments, the Star airlines and Continental said the Justice Department was incorrect in its conclusion that the cooperation plan would boost airfares. In a 52-page document, they said the Justice Department had wrongly urged the DOT to abandon almost two decades of successful international aviation policy and "substitute a narrowly focused and ill-conceived policy that ignores unique considerations affecting international aviation."

"Such a myopic policy," the airlines said, would hobble Continental and the Star members in their efforts to compete with the rival SkyTeam alliance, which is led by **Delta Air Lines** Inc. and **Air France-KLM** SA and already has U.S. antitrust immunity for some of its members.

They said the Justice Department's position also would discourage foreign governments from entering liberal aviation treaties with the U.S. Other countries typically consider U.S. antitrust immunity for airlines participating in global alliances a condition for such treaties.

Continental, **UAL** Corp.'s United Airlines, **Deutsche Lufthansa** AG, **ACE Aviation Holdings** Inc.'s Air Canada and six European carriers, in essence asked the DOT to ignore the Justice Department's opinion and give prompt final approval to their cooperation plan.

A DOT spokesman said his department doesn't comment on pending cases.

It isn't clear what the DOT will do—or when. Continental is in the process of leaving SkyTeam to join the Star alliance.

European airline traffic off as June failed to see pickup

BY KAVERI NITHTHYANANTHAN

Several European carriers Tuesday reported falls in traffic for June, historically the month when travel starts to pick for the peak summer months.

The poor traffic numbers illustrate airlines' difficulties amid the economic downturn. Yields and profit margins are expected to be squeezed further as carriers compete more aggressively to fill seats by reducing fares. So far, European full-service airlines have been slow to cut capacity to meet shrinking demand.

Air France-KLM SA said passenger traffic measured in revenue passenger kilometers, which factor in how far passengers are flown, fell 6.4% last month from the year-earlier period.

Even though the carrier cut capacity by 5%, its load factor, an indicator of how many seats an airline fills with paying passengers, fell 1.1 percentage points to 80.3%.

Traffic on Air France-KLM's European network dropped 6.8%. Network carriers such as the Franco-Dutch airline are increasingly losing market share to low-cost carriers as travelers look to less-expensive alternatives. Air France-KLM cut capacity in Europe by 3.9%, but its load factor fell 2.3 percentage points to 72.8%.

Meanwhile, Irish carrier **Aer Lingus Group** PLC's short-haul strategy, focused on growth out of London's Gatwick Airport, appears to be working, as its passenger numbers rose. It remains to be seen what impact this strategy will have on its yield and profitability. For many carriers, long-haul routes allow for greater profit margins than short-haul flights.

Aer Lingus reported a 7.5% increase in the number of passengers it carried in June to 1.03 million. The shift in focus saw its short-haul capacity increase 12%. The number of passengers Aer Lingus carried on short-haul routes jumped 11%, while the number of long-haul passengers fell 14%, following the carrier's decision to cut long-haul capacity by 16%.

Overall traffic slipped 0.7% to 1.6 billion revenue passenger kilometers, while capacity fell 0.5%. Load factor slipped 0.2 percentage point to 81.3%.

Scandinavian carrier **SAS** AB said traffic in June fell 14%, while capacity was reduced by the same amount. Load factor remained unchanged at 76.7%. The airline said it expects yields in June to fall 5.3%, the same as in May, and warned second-quarter revenue would come under pressure.

Finnair Oyj reported a 13% drop in traffic. The decline had the effect of reducing the average price per passenger kilometer more than 18% in the second quarter, the Finnish carrier said.

CORPORATE NEWS

Sales of BMW, Mercedes show signs of stabilizing

New models tempered overall June decline, car makers report

By Christoph Rauwald

FRANKFURT—Luxury-car sales fell last month, but the drop wasn't as severe as in previous months.

"There are first indications of a slight recovery," **BMW** AG executive-board member Ian Robertson said in a written statement.

BMW, the world's largest luxury-car maker by sales, said sales fell 13% from a year earlier to 105,220 vehicles. It posted a 19% decline for the first half.

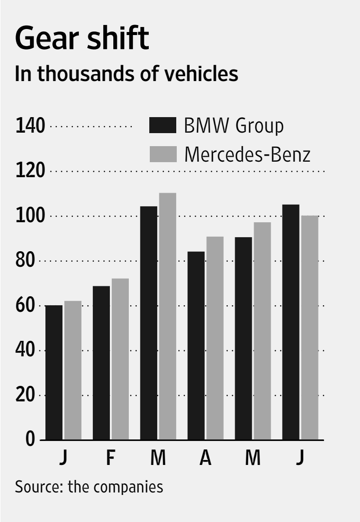
Sales of the revamped Z4 roadster jumped to 3,825 cars last month from 1,796. Sales of the new generation of BMW's flagship 7 Series rose 20% to 4,357 cars.

"New models like the BMW 5 Series Gran Turismo and the BMW X1 will give sales a further boost in the second half," Mr. Robertson said.

Sales of **Daimler** AG's Mercedes-Benz brand, the second-largest maker of premium cars, fell 5.4% to 100,300 cars. The drop was cushioned by sales of the new-generation E-Class, a key model for the Stuttgart, Germany, auto maker. Mercedes-Benz's first-half sales fell 19%.

"We expect to see our sales stabilize in the second half," sales chief Klaus Maier said in a prepared statement. The company reduced inventories to "the lowest levels in years" by the end of the second quarter.

Sales are expected to benefit in coming months from the introduction of the revamped E-Class sedan and coupe in important markets such as the U.S. and China.



Auto-parts supplier Lear files for bankruptcy

By Jeff Bennett
And Kevin Kingsbury

Lear Corp. filed for bankruptcy protection Tuesday, and the maker of automotive seats and electronics will attempt to reorganize quickly and shed more than 70% of its debt.

The company's fate is being closely watched for possible effects on the global supply chain and as a test of lender sentiment in the auto sector.

Lear is among a handful of large seat suppliers, with more than two-thirds of its sales outside the U.S. Any disruptions in Lear's product flow would shut down auto-maker assembly plants around the world.

The Southfield, Mich., company listed $4.5 billion of debt and $1.3 billion of assets as of May 30, according to documents filed with the U.S. Bankruptcy Court in the Southern District of New York. Lear plans to submit its reorganization plan within the next 60 days.

The filing covers Lear's U.S. and Canada divisions, along with some of their subsidiaries. The majority of the company's overseas operations aren't included in the Chapter 11 filing.

Lear has received commitments from secured lenders, led by **J.P. Morgan Chase** & Co. and **Citigroup** Inc., for $500 million in new debtor-in-possession financing, the funding companies typically use to finance stays in bankruptcy court. The DIP funding will convert into financing with a three-year term upon Lear's emergence from bankruptcy protection.

"We have made our own way with our creditors, and given the level of support and our strength, we hope to move through the process quickly," Lear spokesman Mel Stephens said. He declined to provide a timetable.

The restructuring would leave Lear with $1.1 billion in debt and $500 million of convertible shares.

Despite cost cutting, Lear has been unable to stay ahead of declining revenue. The company on Monday said it expects revenue to drop 33% to $9.07 billion this year from 2008 and to reach $11.38 billion in 2010.

In 2007, billionaire investor and then-Lear shareholder Carl Icahn offered to buy the company for $37.25 a share. Investors rejected the offer, and Mr. Icahn later sold his holdings.

Airbus says talks on A350 funding are continuing

By A.H. Mooradian

European aerospace giant Airbus said Tuesday that talks are continuing with the four governments that make up the Airbus consortium over financing for the new A350 jetliner program.

U.K. business secretary Peter Mandelson earlier in the day told a British parliamentary committee that the U.K. has made a fresh offer of financial assistance for the A350 project. He didn't specify what the offer was and Airbus declined to comment. "I can only confirm that talks with the four governments are ongoing," an Airbus spokeswoman said.

To date, only France and Germany have publicly pledged specific financial assistance toward the €10 billion-€11 billion ($14 billion-$15.4 billion) Airbus needs to get the A350 off the drawing board and into the air. Their pledges total €2.5 billion. The other two countries in the consortium are the U.K. and Spain.

A spokeswoman in London at Lord Mandelson's Department for Business, Innovation and Skills declined to comment on any specific figures the U.K. might be offering.

To date, the problem holding up a financing accord among the four countries is said to be Spain, which is thought to be balking at the contribution that might be expected of it.

The Airbus governments have been talking about allocating the additional A350 financing to reflect how much work on the project would be assigned to companies in their respective countries. Airbus is a division of aerospace giant **European Aeronautic Defence & Space** Co.

CORPORATE NEWS

Ikea weighs more job cuts as sales growth slows

Decreased spending by consumers hurts furniture company

By Gustav Sandstrom

Swedish furniture giant **Ikea** AB on Tuesday said it is considering further job cuts, in a sign that even discount retailers are feeling the pinch of the slowdown in consumer spending.

"There might be layoffs, since we have to adjust the organization to the dampened sales growth," said spokeswoman Charlotte Lindgren, adding that the company doesn't yet know how many jobs would be affected.

The economic slowdown has helped Ikea boost its market share as its low-price products have won out over those of more expensive competitors. Nonetheless, its sales are about eight billion Swedish kronor, or $1 billion, below budget for 2009, Ms. Lindgren said.

Ikea, the world's largest maker of flat-pack furniture, has already cut some 5,000 jobs from its global work force of about 140,000 over the past 10 months.

However, the company will be hiring new staff for the some 15 stores it plans to open in this year, the spokeswoman said.

The closely held retailer has expanded rapidly over the past few years more than tripling its sales to €21.2 billion, or $29.6 billion, between 1998 and 2008.

It might take about two years until Ikea's market situation improves, Ms. Lindgren said.

Reuters

Ikea has cut some 5,000 jobs from a work force of about 140,000 over the past 10 months. Above, the Swedish furniture company's founder, Ingvar Kamprad.

Retail companies around the globe have seen their revenue decline as consumers have been reluctant to spend money amid the economic slowdown.

Last week, U.K.-based retailer Marks & Spencer Group PLC said it remained "cautious about the outlook for the remainder of this and next year" as it reported lower first-quarter sales from stores in its home market.

ThyssenKrupp, Salzgitter battle steel slump

By Martin Rapp

FRANKFURT—German steelmakers **ThyssenKrupp** AG and **Salzgitter** AG have announced capacity cuts this year, but not enough to match the slump in demand, analysts say.

The economic crisis has had a big impact on the steel industry worldwide. In Germany, orders halved and crude steel production fell by almost 45% between January and May. For the full year, German steel trade association Stahl forecasts production to drop by well over 25%, to almost 1960s levels.

German steelmakers have responded less aggressively to the resulting overcapacity than their rivals. At the end of 2008, market leader **ArcelorMittal** announced 9,000 job cuts in its administration section, about 3% of the company's work force. And in the first quarter, it cut the number of blue-collar workers to 305,000 from 316,000. **Corus Group** PLC, Europe's second-largest steel producer and part of Tata Steel, is laying workers off, with almost 15% of the company's 40,000 jobs currently under threat.

In the first half of its fiscal 2009, ThyssenKrupp cut its work force by 3.4% to 192,000 and Salzgitter has generated work-force cuts mostly by having staff work shorter hours.

Spokesmen for both Salzgitter and ThyssenKrupp said their cost-cutting programs are sufficient for the time being. However, both companies said much depends on whether the uptick survives the summer and how the market develops in the fall.

Commerzbank analyst Dirk Netting said he doesn't expect the global steel industry to reach its record production of 1.35 billion metric tons until 2012 or 2013.

ThyssenKrupp said in March it would streamline its structure and cut up to 2,000 jobs in the steel unit by the end of 2010.

"After the Bundestag election, maybe even around Christmas, when companies adjust their medium-term targets based on the order situation, I expect the announcement of additional, similar [cuts from ThyssenKrupp]," said Mr. Nettling.

In its fiscal year 2009, which ends Sept. 30, ThyssenKrupp aims to cut costs by €1 billion and save another €500 million by streamlining its corporate structure. About 5,000 temporary workers have lost their jobs and hundreds of administrative positions will go.

ThyssenKrupp is also strongly linked to the car industry. As a result, WestLB analyst Ralf Doerper said, ThyssenKrupp is more likely to need to cut costs further.

Salzgitter, meanwhile, has cut its employees' working hours, and at the end of the first quarter had an unchanged number of staff from the previous year—almost 26,000. In June, 9,000 employees were working shorter hours, of whom more than 5,000 were in the steel operations.

Of the two, Salzgitter is under less pressure than its larger competitor, said Hermann Reith, an analyst at BHF Bank. "The cost reduction isn't needed as much as at ThyssenKrupp, because there aren't any merger-related capacity overhangs," Mr. Reith said, pointing to the consequences of the merger of Thyssen and Krupp 10 years ago.

Mr. Doerper said Salzgitter has another advantage — fewer long-term contracts.

Not that Salzgitter is immune. "Should the crisis continue at the level of the past 12 months for another year, more severe cost cuts on the employee side will hardly be avoidable," said Robert Greil, analyst at Merck Finck & Co.

Wyeth's Prevnar works in reduced dose, study says

By Peter Loftus

Wyeth's childhood vaccine Prevnar can be given in fewer doses than some standard regimens and still sufficiently protect against a bug that causes meningitis and pneumonia, a new study says.

The finding—published online Tuesday by the medical journal JAMA—could hurt sales of the best-selling vaccine in the world if more national governments opt for fewer doses in their immunization programs. But officials from Wyeth and the U.S. Centers for Disease Control signaled that was unlikely to happen in the U.S. anytime soon.

Wyeth, based in Madison, N.J., sold more than 47 million doses of Prevnar world-wide in 2008, generating $2.7 billion in sales. The vaccine stands to be one of the prizes New York-based **Pfizer** Inc. inherits when it closes its planned acquisition of Wyeth, expected later this year.

The 1,000-child study, financed by the Dutch Ministry of Health and conducted in the Netherlands, concluded that giving Prevnar to infants in two initial doses, followed by a booster shot, reduced the rates of carriage of the targeted bacteria in vaccinated children in the second year of life by about 60%, versus unvaccinated children.

Prevnar is currently given in three initial doses followed by a booster shot—known as 3-plus-1—in the U.S., Germany, the Netherlands and elsewhere.

"In my opinion you could safely go to two-plus-one," said Elisabeth Sanders, one of the study's co-authors and professor of pediatric immunology and infectious diseases at University Medical Center Utrecht in the Netherlands.

Wyeth's executive vice president of vaccine research and development, Emilio Emini, said the 2-plus-1 schedule can be effective, but he didn't expect any significant changes in dosing schedules in national immunization programs.

The U.S. schedule of 3-plus-1 has the benefit of very rapidly building up immunity in infants, Mr. Emini said. He expects the Prevnar schedule to stay the same in the U.S. because it matches the schedules for other childhood vaccines.

The CDC currently recommends infants receive Prevnar shots at two, four and six months, plus a booster shot between 12 and 15 months.

"We've had terrific success in this country with the existing schedule we have," said Matthew Moore, a medical epidemiologist with the CDC, which estimates Prevnar has helped prevent more than 200,000 cases of pneumococcal disease since its launch.

Wyeth has developed a new vaccine designed to provide broader protection against pneumococcal disease, Prevnar-13, and is awaiting U.S. and European regulatory action.

Rio Tinto employees are detained in China

By Jeffrey Sparshott

LONDON—Four employees from **Rio Tinto** PLC's Shanghai-based iron-ore team have been detained since Sunday by Chinese authorities, though the company doesn't know why they are being held, Rio Tinto officials said Tuesday.

"The reasons for these actions are unclear. Rio Tinto intends to cooperate fully with any investigation the Chinese authorities may wish to undertake and has sought clarification on what has occurred," said a statement from the the Anglo-Australian miner.

Rio's iron-ore team is negotiating annual contract prices with Chinese steel mills.

China's steel association has insisted on a cut of at least 40% from last year's contract price. But major Japanese and Korean steelmakers have already reached separate iron-ore supply contracts based on price cuts of 28% to 33%, a figure that Rio considers the benchmark for the industry.

The company hadn't been able to make contact with the employees since they were detained on Sunday, London-based Rio Tinto spokesman Nick Cobban said.

GLOBAL BUSINESS BRIEFS

Lundbeck AS

Deal is reached to acquire LifeHealth for $147 million

Lundbeck AS said it agreed to acquire U.K.-based **LifeHealth** Ltd. in a $147 million deal, boosting the Danish drug maker's earnings from Xenazine, a treatment for a symptom of Huntington's disease. The transaction builds on an earlier deal: Lundbeck in March bought U.S.-based drug maker Ovation Pharmaceuticals Inc. in a move to get into the U.S. market for Xenazine, bolstering its pipeline ahead of the patent expiry in 2012 of its blockbuster depression treatment Lexapro. Xenazine, also called tetrabenazine, is a treatment for chorea, a symptom associated with Huntington's disease. The LifeHealth deal "strengthens Lundbeck's U.S. platform," Chief Executive Ulf Wiinberg said.

Telefonica SA

Telefonica SA Tuesday won the exclusive contract to sell **Palm** Inc.'s new Pre smart phone in its European markets, as European mobile operators battle for a share of falling revenues in a saturated market. The Palm Pre was launched in the U.S. last month and will be available in time for Christmas through Telefonica's operations in the U.K., Spain, Germany and Ireland, the companies said. No details on cost or contracts were released. The Pre is widely seen as a competitor to **Apple** Inc.'s iPhone, which has been sold by Telefonica in the U.K., Spain and Ireland since November 2007, in the process helping the company cement its top spot in the intensely competitive U.K. market.

Piaggio SpA

Europe's largest scooter maker by sales, **Piaggio** SpA, is entering the wider race among vehicle makers for greater fuel efficiency with the first-ever hybrid electric-and-gasoline scooter. The Italian company, which makes the Vespa and controls 25% of the European scooter market, launched the three-wheeler Tuesday in Rome and will roll it out across Europe by August. The company plans to sell the vehicle in the U.S. some time next year. The hybrid scooter costs €9,000 ($12,580), significantly more than its gasoline-only competitors. Piaggio's wealthier rivals, **Honda Motor** Co. and **Yamaha Motor** Co., are expected to come up with their own hybrid versions.

BASF SE

German chemical company **BASF** SE on Tuesday said Chinese authorities have approved the expansion of its Nanjing chemical joint-venture site, with a combined investment of $1.4 billion. BASF and **China Petroleum & Chemical** Corp., or Sinopec, will jointly invest approximately $1.4 billion to produce specialty chemicals for the Chinese market, serving industries such as construction, electronics, pharmaceuticals, automotive and chemical manufacturing. The investment, which includes the construction of 10 new chemical plants and the expansion of existing facilities, will strengthen the venture by broadening the product scope and further leveraging the advantages of the integration.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

India aims to build more roads

Highways minister sets ambitious goals, heads abroad to seek infrastructure investment

BY GEETA ANAND

NEW DELHI—India's highways minister said he plans "a quantum jump" in road building in the coming year and this month begins a world tour to try to revive foreign interest in investing in Indian infrastructure.

"This is a paradigm shift, not merely an increase in spending," Kamal Nath, minister of road transport and highways, said of his building plans in an interview with The Wall Street Journal.

India has been trying to make $500 billion in upgrades to its crumbling roads, ports and airports—with about one-third of the investment coming from the private sector. But the plans announced with great fanfare two years ago have fallen short of expectations, as foreign investors, weighed down by the financial crisis, have mostly stayed away.

When the National Highway Authority of India put out requests for proposals for 60 road projects at the end of last year, it received no bids on 38 projects. Mr. Nath, India's commerce minister until the newly reelected Congress party gave him the highway job in May, is setting out on a roadshow to Hong Kong, Singapore, the U.S. and Europe to sell highway construction in India as an investment opportunity.

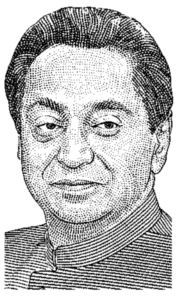
ICICI Bank Ltd., India's largest private bank, is setting up the roadshow, Mr. Nath said. The government wants foreign investors to help fund infrastructure improvements in return for profits from tolls and other fees.

India's decrepit infrastructure threatens to hinder growth, even in an economy less affected than others by the financial crisis.

In his office Monday evening, just a few hours after Finance Minister Pranab Mukherjee announced a 23% increase in the country's highway budget—lifting it to $4 billion from nearly $3.3 billion—Mr. Nath showed detailed plans for increasing the pace of road building.

Bloomberg News

India plans to seek foreign funding for infrastructure projects, such as roads. Earlier this year, construction progressed along National Highway 1, in Amritsar.



Kamal Nath

The plans, with timelines for land acquisition, bidding and building, envision the construction of 127 roads in the coming year, at a cost of 982 billion rupees (about $20 billion.)

This investment plan envisions funding from the government as well as Indian and overseas investors.

India has been building about two kilometers of roads a day. Mr. Nath says he has challenged his department to increase the pace tenfold, to 20 kilometers a day. The goals represent such a large increase in building that his department "doesn't know what hit them," he said.

Tushar Poddar, an economist for Goldman Sachs in Mumbai, says India's infrastructure projects, including highways, remain too high risk with too low an expected return to be attractive to most foreign investors. Goldman Sachs is staying on the sidelines for now, he said.

"The investment opportunity is not great by any stretch of the imagination," Mr. Poddar said. "It's got a long way to go."

Mr. Nath said foreign interest is high. "I see a huge amount of money coming in," he said. "India remains a good parking lot, a good investment destination."

Mr. Nath said in the recent past the problem has been timing. When foreign investors were announcing fund after fund focused on Indian infrastructure in 2007, the Indian government was still fine-tuning the terms of the public-private partnership agreement that would guide the projects, he said. When these so-called concession agreements were finally ready last year, Mr. Nath said, the financial crisis had hit and foreign interest had diminished.

But Mr. Nath said many investors are still eager to invest, and he has made significant changes in the terms of public-private partnership agreements to heighten their interest.

To draw more bidders, he says, he has changed the conflict-of-interest rules so that investors can hold a small interest in multiple groups competing for the same road projects as long as that interest is below 10%. Until now, investors who held more than a 1% interest in a project were barred from investing in other groups bidding for the same project.

The change in the conflict-of-interest rule will allow existing investors to bid on more projects, but won't solve the broader problem of many foreign investors remaining weighed down by the global financial crisis, says Supratim Sarkar, senior vice president and group head at SBI Capital Markets Limited, the investment-banking subsidiary of the government-controlled State Bank of India.

"The European and U.S. investors have to first clean up their own books before they can invest here," Mr. Sarkar said.

With many foreign investors still struggling and most foreign markets down world-wide, Mr. Sarkar said it isn't wise to put too many infrastructure projects out to bid now.

"Too many road projects in one year will cause fatigue in the sector," he said.

Mr. Nath said attracting investor money wasn't a problem. However, there are obstacles to moving quickly on building, he said, and the biggest challenge is speedily buying the land for roads. He said he was trying to develop a more-efficient system for the government to acquire land.

London police urged to revisit protest tactics

BY CASSELL BRYAN-LOW

LONDON—A U.K. government watchdog said London's Metropolitan Police made mistakes in handling April's Group of 20 summit protests here—during which one person died—and called on the force to review its tactics.

In a report issued Tuesday, the watchdog said the police focused too much on preparing to confront violence and should have placed greater emphasis on facilitating peaceful protest. The report said police public-order training in tactics and use of force needs to be changed, particularly in light of the 2012 Olympic Games, which London will host.

Her Majesty's Inspectorate of Constabulary conducted the review at the request of the Metropolitan Police commissioner. Public concern about police conduct during the protests arose after news reports during the summit showed police using batons and shields to push back crowds.

On April 1, Ian Tomlinson collapsed and died after walking home through a G-20 protest that he wasn't participating in. Video later emerged showing Mr. Tomlinson being pushed to the ground by a police officer. His death and individual complaints are being investigated by the Independent Police Complaints Commission.

The Metropolitan Police, in a statement, said balancing its duties of facilitating protests, minimizing the effect of demonstrations on others, and maintaining peace isn't easy but that it wants to "address areas of public concern."

The watchdog noted challenging circumstances for the police, including ensuring the security of world leaders, as well as handling roughly 10 separate protests across the city. The report said the police succeeded in ensuring a safe environment for the G-20 summit and minimal damage to businesses and residents.

The report said police training needs to focus more on distinguishing between disorderly and peaceful protesters. Currently, it "focuses largely on dealing with disorder and unrest," including officers in protective equipment carrying shields. "In reality," the report said, "such scenarios are rare."

The Metropolitan Police added, "Whilst containment is the most effective tactic that we currently have to deal with violence and disorder in these types of situation, the MPS has always acknowledged that there are challenges associated with it."

Reuters

Riot police advance through London in April, during demonstrations against the G-20 summit meeting. Roughly 10 separate protests were held across the city.

Euro economies seen stabilizing, but at low levels

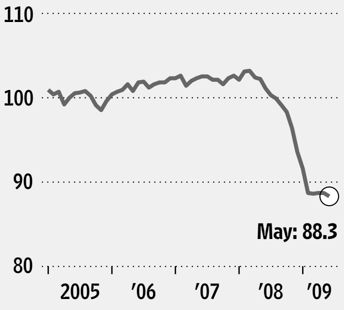
BY ILONA BILLINGTON AND MARCUS WALKER

LONDON—The pace of recession continues to ease in Europe's leading economies, but the economy remains fragile and the recession is far from over, data released Tuesday showed.

In Germany, Europe's biggest economy, new orders in the crucial manufacturing sector rose by an unexpectedly strong 4.4% in May from April, buoyed partly by high auto sales. German new orders have now risen for three months in a row since hitting a low in February.

Fragile recovery

U.K. manufacturing index, monthly data



Source: U.K. Office of National Statistics

That adds to other recent signs of strength in other German data, from retail sales to business confidence, which suggest the economy is stabilizing after its precipitous decline in late 2008 and early 2009. However, the economy is stabilizing at a low level: April's new orders were still down over 30% from a year earlier.

Meanwhile French exports jumped 4.5% in May from April, which helped to bring down France's trade deficit to €2.7 billion ($3.75 billion) in May from €3.8 billion in April. Economists said strong French export data, helped by sales of airliners, were a further sign that the euro area's industrial sector stabilized.

The U.K.'s recession is also past the worst, the British Chambers of Commerce said Tuesday, but it added that the government must continue efforts to support confidence so that a sustained recovery can emerge.

The BCC's latest survey of Britain's economic health said that recent data and economic measures showed welcome progress in the manufacturing and services sectors in recent months.

"The pace of decline in the U.K. economy is clearly moderating," said David Kern, chief economist at the BCC. "But serious downward pressures persist across all sectors and regions."

The BCC said the most striking result of the survey was the marked improvement in companies' confidence, which followed two quarters of sharp declines.

However, data published Tuesday by the Office for National Statistics highlighted how fragile the situation is. The ONS said manufacturing output in May fell 0.5% from April and 13% from a year earlier. The data were weaker than expected: Economists had forecast a monthly gain.

New alliances in Mexico

President must rely on rivals in wake of midterm defeats

By David Luhnow

MEXICO CITY—Mexican President Felipe Calderón, fresh from a major defeat in midterm elections, started the last half of his term relying on help from a party he spent most of this career fighting: the Institutional Revolutionary Party, or PRI.

The PRI, which ruled Mexico for 71 consecutive years until it lost the presidency in 2000, was the big winner in Sunday's vote, garnering 37% of ballots cast for a new lower house of Congress, compared with 28% for Mr. Calderón's conservative National Action Party, or PAN.

The leftist Party of the Democratic Revolution, or PRD, which came close to winning the presidency in 2006, got just 12% of the vote amid divisions in the party.

The PRI's strong showing was a huge comeback for a party that placed third in the 2006 contest. Its tally will give it an estimated 238 seats in the 500-seat house. Together with allies in the Green Party, which took a surprising 7% of the vote, the party will have an effective majority. "We won just about everything," a smiling Beatriz Paredes, the head of the PRI, told supporters.

Mr. Calderón, a former lawyer, is best known for his war against drug cartels, a battle that remains popular despite leading to some 12,000 deaths since December 2006. He faced an uphill battle with an economy that is one of the world's hardest-hit from the global recession, with output expected to fall at least 5.5% this year.

The PRI's well-oiled party machinery at a local level also gave it an edge at the polls amid generally low voter turnout.

Since Mr. Calderón's conservative party won the presidency in 2000 under former leader Vicente Fox, Mexico's divided political landscape has meant the party lacks a congressional majority, limiting its room to maneuver. Because the Party of the Democratic Revolution generally has a hard-left ideology, the PRI has been the major power broker in the country, supporting or blocking legislation at will. As a result, the Mr. Calderón's PAN has been unable to dismantle the legacies of single-party rule. PRI-backed labor unions, for instance, still dominate areas like education and the oil sector.

In the past year, Mexico slipped to No. 60 from No. 52 on the World Economic Forum's rankings of global competitiveness. Now the PRI will be stronger than ever. Because Mexico's laws give the lower house of Congress exclusive control over the budget, the PRI will largely control the purse strings for the next three years, analysts said.

The PAN lacks the necessary votes for a legislative veto. "Mr. Calderón is now the PRI's hostage," said Luis Rubio, head of a free-market think tank in Mexico City called CIDAC.

The president, knowing he will have to get PRI support for any major bill, tried to bury the hatchet with the party from a bruising campaign. The PAN largely ran on Mr. Calderón's war on drugs and painted the PRI as corrupt and unwilling to tackle drug gangs.

"The race is over. Now it's time to...reach agreements that can recover our economic growth, job creation and public safety," he said late Sunday.

The PRI has successfully painted itself as more experienced than the PAN. Its new slogan says "Today's PRI: Proven Experience. New Attitude." But analysts said the party has done little soul-searching from its loss of the presidency, when it was widely viewed as corrupt.

"Among voters, they have credibility as a governing party that can be summed up like this: 'We might be corrupt, but we're more efficient than the other guys,' " Mr. Rubio said.

Growing political clout from the PRI could hurt Mr. Calderón's war on drugs. Many PRI members have been ambivalent about the effort, worried about the army's growing presence in various cities. Some party insiders have also argued that cutting backroom deals with organized crime in Mexico is the best way to control violence.

Some analysts hold out hope that the PRI's victory will push it to be cooperative as it tries to convince voters that it can be trusted with the presidency. They said the PRI may even cooperate on thorny issues like tax reform to shore up the country's weakening finances.

"As the party best positioned ahead of the 2012 presidential elections, the PRI has incentives for some of the country's fiscal challenges to be addressed sooner than later," Roberto Melzi at Barclay's Capital wrote in a research note.

That window, analysts say, will stay open for about a year and a half before the next election begins to pit the PAN and the PRI against each other again. Mr. Calderón won't have much time.

Pope calls for an authority to oversee world markets

By Stacy Meichtry

ROME—Pope Benedict XVI issued a critique of the global economic crisis on Tuesday, a rare papal move, calling for a "true world political authority" charged with exercising greater oversight of financial markets.

In a letter titled "Caritas in Veritate," or "Charity in Truth," the pope said the United Nations and other international bodies need to "acquire real teeth" to properly monitor markets, stem the current crisis and prevent future ones. "There is urgent need of a true world political authority," the pope wrote in the 44-page document, known as an encyclical.

His call comes on the eve of the summit of leaders of the Group of Eight leading nations in the Italian mountain town of L'Aquila. During the meeting, G-8 leaders are scheduled to discuss how to establish new global standards for regulating international finance.

The pope is expected to give a copy of the encyclical to U.S. President Barack Obama when the two meet at the Vatican on Friday, Cardinal Renato Martino, a top Vatican official, said in an interview.

Popes seldom weigh in on economic matters and rarely in the form of an encyclical, one of the most authoritative forms of papal writing. When popes do address the economy, it is usually during moments of tectonic shift.

In 1891, Pope Leo XII wrote "Rerum Novarum," or "On New Things," a response to Marxism in light of the economic upheaval caused by the Industrial Revolution. In 1967, Pope Paul VI issued "Populorum Progressio," a treatise on the need for economic development around the world. And in 1991, John Paul II issued "Centesimus Annus," a critique of socialism and communism following the fall of the Berlin Wall.

In "Caritas in Veritate," Pope Benedict offered a sweeping indictment of the troubles that fueled the global economic crisis, ranging from outsourced labor, to lax market regulation, to managers and financiers driven by profit and "darkened reason."

He wrote that "today's international economic scene, marked by grave deviations and failures, requires a profoundly new way of understanding business enterprise."

The release of the document was initially planned two years ago to coincide with the 40th anniversary of Pope Paul VI's encyclical. However, the document underwent numerous revisions as the sands shifted beneath the global economy, with the U.S. subprime-mortgage crisis growing into a financial crisis that toppled some of the world's biggest banks and sapped the world economy.

Some observers said the pontiff's stern critique of the modern marketplace will serve as a wake-up call to financial and business leaders, particularly in the U.S.

"He's trying to develop a moral foundation to support the sustainability of free markets," said Carl Anderson, chief executive of the Catholic order Knights of Columbus, based in New Haven, Conn., and a member of several Vatican advisory bodies.

"A lot of people are looking at the [pope's] meeting [with Mr. Obama] in terms of issues like abortion. But a big issue with this encyclical is: Are American Catholic businessmen going to listen?" Mr. Anderson said.

Some analysts, however, questioned the pope's call for a world financial watchdog, noting that he stopped short of describing what form the authority should take.

"I don't get the sense that Pope Benedict is very confident in some of [his] policy prescriptions, said Kishore Jayabalan, a former Vatican official who heads the Istituto Acton, a Rome-based think tank focused on the intersection of faith and economic policy.

Mr. Jayabalan said he was surprised that the pope, a theologian known for deeply argued religious and moral positions, didn't delve more deeply into the root causes of the financial crisis. "Was it market failure or government invention? To a theologian, it's probably not clear which of those is the correct answer," he said.

Big U.S. banks refuse state's IOUs

By Ryan Knutson

A group of the biggest U.S. banks said they would stop accepting California's IOUs on Friday, adding pressure on the state to close its $26.3 billion annual budget gap.

The development is the latest twist in California's struggle to deal with the effects of the recession. After state leaders failed to agree on budget solutions last week, California began issuing IOUs—or "individual registered warrants"—to hundreds of thousands of creditors. State Controller John Chiang said that without IOUs, California would run out of cash by July's end.

But now, if California continues to issue the IOUs, creditors will be forced to hold on to them until they mature on Oct. 2, or find other banks to honor them. When the IOUs mature, holders will be paid back directly by the state at an annual 3.75% interest rate. Some banks might also work with creditors to come up with an interim solution, such as extending them a line of credit, said Beth Mills, a California Bankers Association spokeswoman.

Meanwhile, on Monday morning, a budget meeting between Gov. Arnold Schwarzenegger and legislative leaders failed to produce a result. Amid the budget deadlock, Fitch Ratings on Monday dropped California's bond rating to BBB, down from A-minus, the latest in a series of ratings downgrades for the state.

The group of banks included **Bank of America** Corp., **Citigroup** Inc., **Wells Fargo** & Co. and **J.P. Morgan Chase** & Co., among others. The banks had previously committed to accepting state IOUs as payment. California plans to issue more than $3 billion of IOUs in July.

Ms. Mills of the CBA said some banks were concerned that there aren't processes in place to accept IOUs, and also worried about fraud issues. She noted that not all banks have set a July 10 deadline, and that dozens of credit unions in the state will keep accepting IOUs.

Wells Fargo's head of community banking, Lisa Stevens, said: "We're very disappointed, as are many Californians, that California has taken the unfortunate step of issuing IOUs in lieu of payments to some businesses and individuals." She said that Wells Fargo was "reluctant to take this step [of not accepting IOUs], but are doing so to help our customers who are not at fault and with the expectation that the legislature and governor will complete the budget within days."

State officials said they were disappointed by the banks' decision. Garin Casaleggio, a spokesman for Mr. Chiang, said: "We don't want anybody to suffer who can't redeem them when they need cash."

Two Iceland firms investigated

Associated Press

REYKJAVIK, Iceland—The offices of two Icelandic investment firms were searched Tuesday in a criminal investigation related to the collapse of the nation's banking system last year, Iceland's special prosecutor said.

The special prosecutor's office said investigators searched nine locations, including seven houses, associated with the investment firm Milestone and an insurer it controls called Sjova.

"The investigation focuses on a suspicion of alleged breaches of corporate law, laws on insurance companies and in some cases the penal code," the prosecutor said in a brief statement. "This involves great sums of money and the investigation touches on a great number of people and many incidents," the statement added. It offered no details of suspected wrongdoing.

Milestone's telephone rang unanswered on Tuesday and the issue wasn't addressed on the firm's Internet page.

Thor Sigfusson, a former Sjova chief executive officer, was quoted in an Icelandic Internet report as saying "all of my actions can stand broad daylight." Mr. Sigfusson said he was unaware of any illegal activity.

More U.S. consumers fall behind on debt payments

By Aparajita Saha-Bubna

Rising unemployment is increasingly pushing strapped U.S. borrowers to miss payments, with delinquencies on home-equity loans reaching a record, and balances on delinquent credit cards surging, according to the American Bankers Association.

Delinquencies on consumer debt—the number of borrowers at least 30 days behind on payment—rose to 3.23% in the first quarter from 3.22% in the prior quarter. During the same period, balances on these consumer loans, which include auto loans, jumped to 3.35% from 3.16%, the ABA said.

"The number one driver of delinquencies is job loss," said James Chessen, chief economist at the association. "When people lose their jobs, they can't pay their bills. Delinquencies won't improve until companies start hiring again and we see a significant economic turnaround."

He said the unemployed may be using bank cards to bridge a temporary income gap, especially with less home equity to fall back on as housing prices continue to fall. In the first quarter, delinquencies on bank-issued credit cards rose 0.23 percentage point to 4.75%, according to the report. The balances on those delinquent card accounts jumped 1.08 percentage points to a record 6.6% of total credit-card debt.

Higher delinquencies, fueled by rising unemployment and the economic slump, force companies to squirrel away capital to reserve for potential losses; ultimately, companies must write off loans if customers can't pay up.

Delinquencies for home-equity loans touched record highs, rising 0.49 percentage point to 3.52% in the first quarter. Delinquencies on auto loans extended through banks increased to 3.01% from 2.03%.

UNREST IN XINJIANG

China says dissident sparked unrest

Rebiya Kadeer, now in the U.S., denies directing Uighurs

By James T. Areddy

China's government charged that Rebiya Kadeer, a millionaire-turned-dissident based in Washington, masterminded the riots that began Sunday in the city of Urumqi and have left at least 156 dead.

Mrs. Kadeer has worked since being released from a Chinese jail in 2005 to lift the profile of her ethnic group, the Uighurs, who populates the Xinjiang region of northwestern China.

China's official Xinhua news agency said police have evidence that the separatist World Uyghur Congress, led by Mrs. Kadeer, masterminded Sunday's rioting. The report said police in recent days had intercepted telephone calls from Mrs. Kadeer to her younger brother predicting, "something will happen in Urumqi."

In a telephone interview Monday from Washington, where she has worked since being exiled from China after her release, Mrs. Kadeer said she champions self-determination for the Turkic-speaking Muslim minority, but did nothing to foment unrest.

"I consider myself as the voice of the voiceless Uighur people in the West," Mrs. Kadeer, a 62-year-old grandmother who wears her hair in two thick gray braids that drape to her waist, said in a high-pitched tone, speaking through an interpreter. "It is a new cause, a new thing."

Mrs. Kadeer says that as Muslims, Uighurs have a difficult time winning sympathy in the West, and she expressed regret that no government has officially endorsed her cause. After the 2001 terrorist attacks on the U.S., former President George W. Bush accepted Beijing's contention that one Uighur group, the East Turkestan Islamic Movement, should be labeled a terrorist organization.

"This created a negative impression. We have many difficulties in introducing ourselves," Mrs. Kadeer said. Mrs. Kadeer did meet twice with Mr. Bush, including in July 2008 shortly before he traveled to Beijing to attend the Olympics.

Far less scrutinized internationally than China's thorny rule over the Tibetan region is its control of the massive Xinjiang territory where Urumqi is located and which is home to Uighurs and other ethnic minorities.

Though the territory is steeped in history as the crossroads between China and Western Europe known as the Silk Road, Uighurs have little of the mystique of the Dalai Lama with his Buddhist people.

"There's no such myth around the Uighurs," says Andrew Nathan, a political science professor at Columbia University.

In the U.S., the ethnic group may be best known for the political headache Washington found recently in handing a group of Uighurs freed from the detention facility in Guantanamo Bay and once suspected of terrorism. Washington concluded the Uighurs could face trouble in China if they were returned home, but it was also unwilling to allow them to settle in the U.S., and instead reached a deal to send a group to Bermuda.

Two decades ago, Mrs. Kadeer looked like just another Chinese entrepreneur making it big. She had opened a major department store in Urumqi that introduced stylish clothes to a remote province better known for raisins and desert.

Associated Press

Rebiya Kadeer at a Uighur leadership seminar in Berlin in April 2008.

By her own estimate, Mrs. Kadeer was soon China's wealthiest woman. The Communist Party embraced her success by offering her official positions.

Yet when Mrs. Kadeer was granted the rare opportunity in 1997 to speak to an official assembly in Beijing's Great Hall of the People, she took the risky step of highlighting the plight of her fellow Uighurs, from taxes to political prisoners, according to her new autobigraphy.

"I'm quite sure that the president and the delegates in this hall aren't accurately informed about the true conditions I've spoken of. The right to self-determination in our Autonomous Region should be put into action," she recalls in the book.

While she was admonished by some officials for her frank remarks, Mrs. Kadeer says she was encouraged by others. And she remained in political favor until two years later, in August 1999, when she was blocked from meeting a U.S. delegation during its trip to Urumqi.

Mrs. Kadeer was then jailed for over five years and claims in her book that she was tortured during that period.

Under pressure from Washington, Chinese authorities released Mrs. Kadeer in 2005, and she was immediately exiled. When she ignored instructions to keep quiet in exile by speaking widely in the U.S., her adult children were arrested and at least two remain in prison, she says.

Today, Mrs. Kadeer operates from offices on Pennsylvania Avenue, a short stroll from the White House. She heads various Uighur groups, including the World Uyghur Congress and the Uyghur American Association. The National Endowment for Democracy says it supports some of her groups with grants totaling around $600,000 annually. "Her mind is always going forward, not back," said Louisa Greve, director for East Asia at the National Endowment for Democracy.

The Property Report

Building momentum

A German purchase marks a sea change in London's commercial sector > **Page 29**