Corporate News: Diageo, Coke forge new battleground in sub-Saharan Africa

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Obama arrives in Saudi Arabia

Associated Press

REACHING OUT: King Abdullah, right, walks with the U.S. president at King Khalid International Airport in Riyadh on Wednesday. They are set to discuss vexing Middle East matters. Page 8.

U.K.'s Brown struggles to stay afloat

By Alistair MacDonald And Laurence Norman

U.K. Prime Minister Gordon Brown, beset by scandals and sniping from within his own party, on Wednesday faced a battle for political survival just two years after ascending to the country's top post.

Mr. Brown's fortunes, which had already faded in recent months amid Britain's deep recession, have spiraled downward in recent days amid a series of political nightmares. Some top officials in the government of Mr. Brown's ruling Labour Party have been caught up in embarrassing revelations about dubious expenses claimed by U.K. politicians of all stripes.

Gordon Brown

In the last two days, four government ministers have resigned, including two Cabinet members. The latest blow came Wednesday when Communities Secretary Hazel Blears stepped down from her Cabinet-level post, a sign of the growing disarray that now threatens Mr. Brown's position as his party's leader.

The defections have created the impression that Mr. Brown's government is no longer merely deteriorating slowly, but rather melting down.

"This is unprecedented," said Mark Wickham-Jones, a professor of political science at the University of Bristol and an expert on the Labour Party. "My sense is that potentially the party could go into freefall."

Leaders of opposition parties taunted Mr. Brown in Parliament on Wednesday. "The government is collapsing before our eyes," said David Cameron, leader of the Conservative Party.

Mr. Brown faces two immediate challenges in his quest to stay afloat politically. The first: elections on Thursday for local offices and seats in the European Parliament. Typically ignored by voters, those elections are suddenly seen as bellwethers of Mr. Brown's future—and recent polls don't offer much solace for the prime minister.

Indeed, Mr. Brown faces the possibility of leading his party into the worst set of local and European election results in its modern history. A poll from Ipsos MORI Monday showed support for the main opposition Conservative Party at 40%, with Labour and the Liberal Democrats tied on 18%. Labour is down 10 percentage points in the month and could suffer the hu-

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EU Parliament vote is a poll on recovery

By Charles Forelle And Marcus Walker

As Europeans across the Continent begin voting in elections to the European Parliament on Thursday, the outcome in many countries will be seen as a referendum on governments and leaders struggling to cope with the impact of the economic downturn.

Elections to Europe's 700-plus seat parliament in Brussels are fought by national political parties on mainly domestic issues. Analysts say the results are likely to encourage opposition parties in many countries, including some on the extreme right.

But with the exception of the U.K., the European election result appears unlikely to have any immediate impact on national politics.

For Germany, the European election comes just months ahead of national elections in September. Chancellor Angela Merkel's conservative Christian Democrats and her rivals, the Social Democrats, will both spin Sunday's results as a sign of strength, analysts say. About 39% of voters say they will back Ms. Merkel's party, against about 26% for the Social Democrats, according to a recent opinion poll by Infratest Dimap.

In reality, though, analysts say, the expected low turnout and a tendency by smaller parties to perform differently in

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DJIA	8676.20	-0.74
Nasdaq	1825.92	-0.59
DJ Stoxx 600	209.94	-2.01
FTSE 100	4383.42	-2.09
DAX	5054.53	-1.74
CAC 40	3309.65	-2.02
Euro	$1.4180	-0.87
Nymex crude	$66.12	-3.54

LEADING THE NEWS

Bernanke urges U.S. to reduce deficits

Fed chairman calls for 'fiscal balance' as rates move higher

By Jon Hilsenrath And Brian Blackstone

Federal Reserve Chairman Ben Bernanke warned Congress and the White House that the U.S. economy will suffer if they don't move soon to rein in the federal budget deficit, which already has been blamed for the upward pressure on long-term interest rates.

Mr. Bernanke, who offered an important voice of support earlier this year to the Obama administration's $787 billion fiscal stimulus plan, told Congress Wednesday, "Even as we take steps to address the recession and threats to financial stability, maintaining the confidence of the financial markets requires that we, as a nation, begin planning now for the restoration of fiscal balance."

The deficit is confronting the Fed with a dilemma. Yields on long-term Treasury bonds have been rising despite the Fed's efforts to push them down by purchasing Treasury securities. The Fed wants Treasury yields lower because they are a benchmark for many other private-sector interest rates—such as rates on mortgages or corporate bonds.

But worries about the deficit are complicating that campaign. "Concerns about large federal deficits," Mr. Bernanke said, are one cause of the unwanted rise in yields. The wider the deficits, the more the Treasury borrows and the higher rates go. Wider deficits also stir inflation fears, which also push Treasury yields up.

Deficit concerns, in other words, could be starting to work against the Fed's own efforts to revive the economy. A decisive step by Congress and the White House to attack the deficit would reduce bond yields. Mr. Bernanke is "trying to nudge the political process in the direction of doing more on medium-term budget deficits," said Tom Gallagher, a Washington-based analyst with ISI Group, a Wall Street research firm.

The Fed must decide, perhaps as soon as its June 23-24 meeting, whether to increase its purchases of Treasury bonds. It is on course to buy $300 billion worth of bonds by September.

If investors perceive the Fed's actions as an effort by the central bank to facilitate bigger deficits, they could conclude inflation is coming and flee Treasurys, pushing interest rates up. Mr. Bernanke's comments were aimed at thwarting that perception.

Associated Press

Federal Reserve Chairman Ben Bernanke told the House Budget Committee that worries about the deficit are complicating the campaign to cut Treasury yields.

His admonition to politicians came seven months before his term as Fed chairman expires. Mr. Obama will have to decide later this year whether to reappoint Mr. Bernanke, and any sign of disagreement between the Fed chairman and the White House will be seen as a sign of tension. But, so far, Mr. Bernanke's deficit lecture is close to the one that the president and his budget director have delivered, although the Fed chief—more than the White House—emphasized the "difficult choices" that lie ahead and mentioned the possibility of raising taxes if spending isn't restrained sufficiently.

"Unless we demonstrate a strong commitment to fiscal sustainability in the longer run, we will have neither financial stability nor healthy economic growth," Mr. Bernanke said in prepared testimony to the House Budget Committee.

The White House estimates the budget deficit will exceed $1.8 trillion this year and shrink to about $900 billion by 2011. That, the Fed chairman said, would push debt to 70% of gross domestic product by 2011—which would be the highest level since the early 1950s—from 40% of GDP before the financial crisis began.

"Fiscal sustainability," he said, means "a situation in which the ratios of government debt and interest payments to GDP are stable or declining, and tax rates are not so high as to impede economic growth." That requires that "spending and budget deficits be well controlled," he added.

The retirement of the Baby Boom generation will place even more of a burden on entitlement programs like Social Security and Medicare, and "we will not be able to continue borrowing indefinitely to meet those demands," he said.

U.S. companies slashed jobs at a slower pace during May

By Justin Lahart

The U.S. job market isn't deteriorating as much as earlier this year, but companies continue to cut workers at a rapid clip.

Private employers cut 532,000 jobs in May, according to a report Wednesday from payroll company Automatic Data Processing Inc. and forecasting firm Macroeconomic Advisers, compared with a cut of 545,000 jobs in April.

With government jobs continuing to expand, the report, which is based on payroll data for roughly 24 million employees, suggests that Friday's government payroll report will show a loss of 546,000 jobs, close to April's 539,000 jobs lost. January was the steepest month for job losses, with payrolls dropping 741,000.

The job market "is still very weak, but not as weak as before, so hopefully the momentum is shifting," said Jim O'Sullivan, an economist at UBS.

Rising confidence measures, an upturn in home sales and stable retail sales suggest that the recession is winding down. Federal Reserve Chairman Ben Bernanke told Congress Wednesday that the central bank expects the economy will bottom out and begin to recover by the end of the year.

"We expect that the recovery will only gradually gain momentum and that economic slack will diminish slowly," Mr. Bernanke said. "In particular, businesses are likely to be cautious about hiring, and the unemployment rate is likely to rise for a time, even after economic growth resumes."

Outplacement firm Challenger, Gray & Christmas Inc. said employers announced 111,182 job cuts last month, down from 132,590 in April. January was the peak month, with layoffs for 241,749 workers announced.

Purchasing-manager surveys from the Institute for Supply Management this week showed that firms continued to cut employment, though not as sharply as earlier in the year.

A separate report from the Labor Department highlighted how economic pain remains worst in areas such as the West and Midwest, where the recession originated.

Unemployment increased in all U.S. metro areas in April versus a year ago, according to the report, with a quarter of those areas having unemployment rates greater than 10%.

Some of the highest rates were in California's inland areas, which have been among the hardest hit by the housing bust. California's Riverside metropolitan area had a 12.6% unemployment rate, while smaller inland areas such as Merced and Yuba City had rates greater than 18%. The other hardest-hit areas have been in the Midwest, such as Elkhart, Ind., and Detroit, which have lost manufacturing jobs, such as those tied to the beleaguered auto industry.

Meanwhile, orders for manufactured goods increased 0.7% in April, following a 1.9% decline in March, the Commerce Department said. Manufacturing shipments fell 0.2%, the ninth decline in a row. In March, shipments fell 1.8%. Manufacturers cut their inventories 1%, versus a 1.2% inventory drawdown in March. The combination of rising orders and falling inventories will, if they continue, eventually prompt manufacturers to increase production.

—Conor Dougherty contributed to this article.

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

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INDEX TO PEOPLE

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

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

LEADING THE NEWS

Kickback probe expands

Bahrain investigates alleged payments by Japanese firm

BY CHIP CUMMINS

DUBAI—Bahraini prosecutors are probing $8.7 million in alleged kickbacks by a large Japanese commodities-trading firm into bank accounts controlled by then-employees of Bahrain's state-run aluminum producer, according to documents filed with a Bahraini court.

Aluminum Bahrain BSC identified the alleged payments made by two affiliates of energy and commodities-trading heavyweight **Sojitz Group** to two Alba employees between 1998 and 2004, according to the documents. Alba alleges the payments were made in exchange for unauthorized, discounted prices for aluminum, according to the documents.

Sojitz, which hasn't been named by prosecutors, declined to comment.

The two employees, who have left the company for reasons that couldn't be determined, have been charged in a Bahrain court with money laundering. The employees and their lawyers said the employees did nothing wrong.

Bahrain's Public Prosecution office didn't respond to emails seeking comment.

Alba declined to comment.

The case is unusual for the secretive Persian Gulf, where kickbacks to executives or officials in exchange for favorable business have long been a way of doing business. Typically, alleged malfeasance, when it's uncovered, is quietly settled outside the courts.

But Bahrain's government, which owns Alba, has recently embarked on a full-court press against former employees and international companies it accuses of wrongdoing.

Last weekend, Alba announced an out-of-court settlement with Swiss commodities trader **Glencore International** AG, ending what Alba described as a probe into payments connected to a Glencore agent. The Wall Street Journal reported in March that prosecutors in the U.S. and Bahrain were examining about $4.6 million in alleged payments by employees of Glencore to bank accounts controlled by the former Alba employees who were charged with money laundering.

As part of the weekend settlement, Glencore agreed to pay Alba more than $20 million, according to a person familiar with the situation. Alba didn't disclose settlement details.

A Glencore spokesman declined to comment on specifics of the settlement and the alleged payments. It was unclear if the U.S. and Bahraini probes are continuing into the Glencore-related payments.

Bahraini prosecutors in March filed money-laundering charges against the two former Alba employees who have been accused of receiving payments from Sojitz. Prosecutors didn't name any companies that allegedly paid the employees.

—Miho Inada in Tokyo contributed to this article.

Merck begins sale process for animal-health assets

BY JEANNE WHALEN AND DANA CIMILLUCA

U.S. pharmaceutical company **Merck** & Co. has started contacting potential buyers for parts of its animal-health business as it determines what to sell after its planned $41 billion acquisition of **Schering-Plough** Corp., according to people familiar with the matter.

Merck in recent days has circulated information on two assets: its 50% stake in its Merial joint venture, which could be valued at roughly $5 billion, and Schering-Plough's animal-health business, called Intervet Schering-Plough Animal Health, which could fetch $6 billion to $8 billion, the people said.

Merck plans to sell one asset in part to avoid concerns from antitrust regulators that an acquisition of Schering would make it too dominant in the animal-medication business. Possible buyers of one of the businesses include **Sanofi-Aventis** SA, **Novartis** AG, **Bayer** AG, **Eli Lilly** & Co. and **Boehringer Ingelheim** GmbH, according to people familiar with the matter. Merck will decide which of the businesses to sell based on the levels of interest they generate.

Merck spokeswoman Amy Rose confirmed that the company is exploring the possibility of selling one of the businesses, but said no decisions have been made. Ms. Rose said Merck considers animal health a "strong and valuable" business, and that the company plans to keep a foothold in it. Ms. Rose declined to comment on whether regulatory authorities have told Merck it needs to sell one of the businesses.

Sanofi, which owns the other half of the Merial joint venture, is seen as the most likely buyer of Merck's 50% stake should Merck decide to sell it. Sanofi has said in recent months that the company is interested in boosting its business in animal health. A Sanofi spokesman declined to comment further. Officials at Schering-Plough, Novartis, Bayer, Lilly and Boehringer Ingelheim declined to comment.

—Jonathan D. Rockoff and Avery Johnson contributed to this article.

In Kenya, soft-drink war isn't over cola

After brewer's non-alcoholic beverage becomes a hit, Coke launches its own version, backed by marketing firepower

By Sarah Childress

NAIROBI, Kenya—In March 2008, East African Breweries, a unit of London-based spirits maker **Diageo**, introduced Alvaro, a non-alcoholic, light malt drink. A quirky, bare-bones ad campaign helped make the beverage a sensation.

ADVERTISING

Eight months later, **Coca-Cola** responded by launching its own malt drink, Novida, backed by a major media blitz.

It's too soon to tell which brand will come out on top in what has become Kenya's version of the cola wars fought between Coke and **PepsiCo**. But the battle, among other things, underscores the growing importance of a once-neglected consumer market: sub-Saharan Africa.

The global recession is expected to damp consumer demand across the continent, as it has elsewhere. But Africa's population is growing faster than any other major region's, according to the United Nations. And nearly a decade of economic growth has helped foster a middle class that still has money to spend. Kenya's market for soft drinks, for example, grew 71% from 2000 to 2008, according to Euromonitor International.

Before Alvaro and Novida entered the market, there were plenty of soft drinks, including Coke and its sister brands, but none of these beverages was aimed specifically at adults. That left a niche that East African Breweries sought to fill.

According to the brewer's research, about 70% of Kenya's predominantly Christian population doesn't drink alcohol. But in this cosmopolitan city of three million people, much of the socializing, particularly among young professionals, revolves around the pub scene. And many nondrinkers frequent bars to be with their friends. They became Alvaro's target market.

As the pioneer in its category, Alvaro had the advantage, says Ndirangu Maina, managing director for Kenya of market-research firm Consumer Insight Africa. "It was a fantastic coup d'etat. The non-alcoholic business was owned by Coca-Cola. It's amazing that an alcoholic company would think of that before Coke."

East African Breweries markets Alvaro—which comes in two flavors, pear and pineapple—as an alcohol alternative for sophisticates. In its first six months on the market, the company spent only about $600,000 to promote the drink, which is packaged in a distinctive green-glass bottle.

The brewer bought ads on billboards, local radio and in print. As a gimmick for the product's launch, it hired limos to drive around the city towing skateboarders, who handed out the green bottles. It also offered chilled samples of the drink at big sporting events.

Though its ad spending was limited, it was enough to create a buzz around Alvaro, which was amplified by word of mouth. People ordered it in bars and looked for it in grocery stores, which was traditionally Coke's territory. The drink wasn't distributed very widely, which sometimes made it hard to find. That only added to its cachet.

At the time, Coke, whose cola is the dominant non-alcoholic beverage brand in Kenya, was also developing a non-alcoholic malt drink.

When Alvaro hit the market, Coke moved up the launch of its drink, Novida, by around 12 to 18 months, says Roger Gauntlett, Coke's marketing director for East and Central Africa. Novida arrived in November, in a curvy green bottle and a choice of apple, pineapple and tropical-fruit flavors.

In the three months following its introduction, Coke spent about $1.5 million on TV, radio and print ads to promote Novida. Since the market was already primed for malt beverages, the company focused more on what the drink could do. Its pitch: Novida gives you a lift. It's the drink that will refresh you after a long, hard day at work.

The company kept up its "lift" theme, decorating taxi cabs with its ads, and homing in on neighborhoods with bars and restaurants, normally strongholds for East African Breweries, which owns all of Kenya's major beer brands. In response, the brewer began buying TV ads for Alvaro in December, though Coke has continued to outspend it, according to marketing-research firm Synovate.

Coke declined to provide sales figures, so it's difficult to measure either brand's success. Mr. Maina, the market researcher, doesn't think there's room in Kenya for two drinks in the same niche at the same price: about 30 cents for 10 ounces. "But it's still too early," he said. "Who will win the battle can't be said at this stage."

Coca-Cola Co. (left); East African Breweries (right)

Ads for Novida, Coke's non-alcoholic, light malt drink, left, and East African Breweries' Alvaro, right, which hit the market first.

Court holds up Chrysler-Fiat deal

A U.S. federal court late Tuesday agreed to hear an appeal related to the bankruptcy of **Chrysler** LLC, potentially extending the auto maker's stay in Chapter 11 proceedings by at least several days.

*By **Alex P. Kellogg, Chad Bray** and **David McLaughlin***

The Second U.S. Circuit Court of Appeals in New York said it would hear an appeal by a group of Indiana pension funds challenging the sale of most of Chrysler's assets to its proposed partner, **Fiat** SpA of Italy. Oral arguments in the appeal will begin Friday, according to the court's order.

Chrysler had hoped to exit bankruptcy as soon as this week.

The circuit court's acceptance of the appeal is a small victory for Chrysler, however. Any appeals normally go first to a lower, district court. Going directly to the circuit court allows Chrysler to skip a step and speed up the process if the company prevails.

The deal must close by June 15 or Fiat can potentially walk away from it, Chrysler has said.

"We are pleased that the Court of Appeals, in setting this schedule, has recognized the sense of urgency Chrysler has to preserve and protect its going-concern value," Chrysler said.

Indiana Treasurer Richard Mourdock said he was pleased the appeals court would hear the case. "Indiana retirees and Indiana taxpayers have suffered losses because of unprecedented and illegal acts of the federal government," he said in a prepared statement.

The sale to Fiat was approved early Monday by U.S. Bankruptcy Judge Arthur Gonzalez in Manhattan.

He found that the sale order should be heard by the Second Circuit, saying that skipping the district-court level "is appropriate because this case involves a matter of public importance, and an immediate appeal may materially advance the progress of this case."

The pension funds hold about $42 million of Chrysler's $6.9 billion in secured debt. Secured debt is backed by the borrower's assets and normally puts the lender at the front of the line for repayment.

The Indiana pension funds—the Indiana State Teachers Retirement Fund, the Indiana State Pension Trust and the Indiana Major Moves Construction Fund—have argued the sale of Chrysler is unconstitutional, saying the plan upends the rights of senior lenders to be paid off before junior creditors.

The Indiana funds also contend that the U.S. Treasury Department doesn't have the authority to lend bankruptcy financing under the Troubled Asset Relief Program because Chrysler isn't a financial company.

Under Chrysler's plan, Fiat would initially own 20% of the new company, though it would have the option of increasing its stake to as much as 51%. The United Auto Workers union would initially get a 55% stake, while the U.S. and Canada, which are lending Chrysler $4.9 billion during the bankruptcy, would own 8% and 2%, respectively.

Senior lenders owed $6.9 billion would receive $2 billion, giving them a recovery of about 29 cents on the dollar. The Indiana funds say that, under Chrysler's plan, creditors with less seniority, specifically the UAW, would see a better recovery.

Personal Technology

Call and response

Walter S. Mossberg tries Palm's challenger to the iPhone—the Pre > **Page 27**

Lukoil returns to a profit amid higher crude prices

By Jacob Gronholt-Pedersen

MOSCOW—Russian oil producer OAO **Lukoil Holdings** on Wednesday said its first-quarter net profit fell 71% from a year earlier, hurt by a drop in crude prices.

However, the earnings represent a turnaround from the net loss posted for the fourth quarter of 2009, and analysts said Lukoil's return to profitability could signal a broader recovery for the Russian oil industry.

Lukoil, Russia's second-largest oil company, follows a trend set last week, when larger rival OAO **Rosneft** beat earnings forecasts.

Lukoil, 20%-owned by U.S.-based **ConocoPhillips**, reported a first-quarter net profit of $905 million, down from $3.16 billion a year earlier. Revenue fell 41% to $14.75 billion, mainly because of lower oil prices.

But the company said it was able to return to a profit in the first quarter from a loss in the fourth quarter thanks to lower taxes, higher crude prices, a weaker ruble and lower capital spending. The fourth quarter of 2009 was the worst in its history, the company said.

Last year, lobbying efforts by Rosneft and Lukoil led to a government decision to lower the so-called mineral-extraction tax and impose tax holidays for certain production regions. Lukoil said the cuts led to a $300 million reduction in taxes in the first quarter.

The company said its earnings before interest, taxes, depreciation and amortization halved to $2.41 billion in the first quarter from a year earlier, though they came in above analyst expectations thanks to significant cost savings.

"This trend has been seen in Rosneft's first-quarter results already—still positive—implying Lukoil is very competitive and is on the way to higher efficiency amid a weaker ruble and lower service prices," said Lev Snykov, an analyst at VTB Capital in Moscow.

Lukoil cut its capital spending by 39% from a year earlier to $1.47 billion. "The decrease was in compliance with our plan to reduce capital expenditures in 2009 because of the economic downturn," Lukoil said.

Despite an improved operating environment, some analysts say the industry still faces challenges. Since the beginning of this quarter, taxes have gone up with the oil price, while the ruble has appreciated—opposite developments compared with those that helped the company's profitability in the first quarter.

Union slams China tires

U.S. steelworkers say manufacturers hurt by cheap imports

By Kris Maher

The United Steelworkers is trying to use a case involving tire imports as the centerpiece of its push for tougher enforcement of trade laws, especially involving China, at a time when all types of U.S. manufacturing are reeling from the recession and a steep drop in car sales.

The union alleges that China unfairly flooded the U.S. market with car and truck tires from 2004 to 2008, leading to closures at U.S. tire plants and the loss of at least 5,000 jobs. Chinese imports surged 215% during that four-year span, according to the union, while domestic production fell 25%.

Associated Press

The United Steelworkers union says Chinese tire imports have led to plant closures. Above, a closed Goodyear plant in Tyler, Texas

In a hearing Tuesday at the U.S. International Trade Commission, 10 members of Congress from both parties testified on behalf of the union and urged the commission and President Barack Obama to aid the domestic industry.

"The data make clear that American workers are getting crushed by a surge in imports from passenger-car and light-truck tires from China," said Sen. Sherrod Brown (D., Ohio). Rep. Robert Aderholt (R., Ala.) noted that a B.F. Goodrich plant in Opelika, Ala., employing 1,100, said in April that it would close.

About a dozen tire importers and distributors, most of which are based in the U.S., testified at the hearing that the imports are necessary. They contend the Chinese tires simply filled a gap in the market that was created when U.S. tire producers shifted away from producing lower-priced tires, which have narrower profit margins.

"Our guys were really cut off. They were forced to find other sources," said James Jochum, an attorney representing a coalition of seven companies that has formed the American Coalition for Free Trade in Tires.

The steelworkers union argued that the U.S. should implement an import quota on China of 21 million consumer tires a year, the 2005 level, with an increase of 5% in each of the next three years. The union represents 15,000 workers at 13 tire plants in nine states, which account for about half of the domestic industry's 2008 ouput capacity. "With a short period of relief, we can start to build a sustainable foundation for the future of the American tire industry and its workers," said Leo Gerard, the union's president.

Since 2002, the trade commission has called for remedies in four out of the previous six petitions filed under the same section of trade law as the steelworkers' petition. The Bush administration didn't impose remedies in any of the cases, which had alleged that a surge in China imports had harmed domestic manufacturers. In the current case, the commission is expected to send its report to Mr.Obama in July, who would then be expected to make a final decision in September.

On Tuesday, U.S. Trade Representative Ron Kirk said the U.S. would seek to resolve any trade issues through dialogue when possible, but wouldn't hesitate to take punitive measures if necessary.

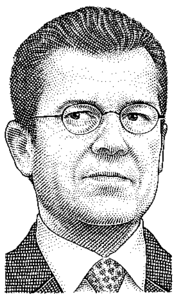
—Tom Barkley contributed to this article.

Arcandor state aid hopes weaken

By Andrea Thomas and Kirsten Bienk

BERLIN—Edging closer to an insolvency deadline, Germany's **Arcandor** AG retail and tourism group saw its hopes for state aid diminish Wednesday.

German and European Union authorities said it failed to meet key criteria that would allow it to tap a special German aid fund for struggling businesses. German Economics Minister Karl-Theodor zu Guttenberg Wednesday said the company was already in trouble before July 1, 2008—the date the government has set for companies applying for guarantees and loans from the government's €115 billion ($164.9 million) Germany Fund. This condition "would fundamentally stand in the way of Arcandor qualifying for guarantees or loans as part of the Germany Fund," Mr. zu Guttenberg told reporters.



Karl-Theodor zu Guttenberg

Arcandor has applied for €650 million in state-backed guarantees from the German government, saying it needs the guarantees by June 12 to prevent looming insolvency.

Arcandor said it remains convinced that it fulfills the criteria to access government-backed guarantees from the special fund, and will pursue its application.

"State-backed guarantees are still the preferred option," said Chief Executive Karl-Gerhard Eick.

Mr. zu Guttenberg said he told Mr. Eick earlier Wednesday that the government will try other means of aiding Arcandor, but that this would also have to be notified to the European Commission and that such help is linked to "very strict criteria."

Such conditions could include "drastic capacity cuts, which would go hand in hand with a very high cut in jobs," he said.

Arcandor separately said talks with rival **Metro** AG on a possible tie-up of their respective Karstadt and Kaufhof department store chains will resume, but declined to reveal the date.

Arcandor's major shareholders may now be pressed to step in to rescue the company. Its shareholders must "assume responsibility," said German Finance Minister Peer Steinbrueck Wednesday, adding that putting up collateral and asset sales will need to be discussed.

Private bank Sal. Oppenheim Jr. & Cie. S.C.A., which holds nearly 30% of the company, confirmed Tuesday that it was in talks with the government about taking on a stronger role in Arcandor's bailout.

Putting its stock up as collateral to secure the state guarantees was one option under consideration, said a bank spokesman, but he declined to comment on other possibilities.

—Erin Fines contributed to this article.

Chery raises $425 million in China

By Rick Carew

HONG KONG—China's **Chery Automobile** Co. on Wednesday said it has raised 2.9 billion yuan, or about $425 million, in capital from domestic investors.

The auto maker said the investment will help fund its development and showed confidence in its strategy. Investors included **Bohai Industrial Investment Fund Management** Co., **CDH Investments**, **China Huarong Asset Management** Co. and a Shenzhen-based investment fund, Chery said. Chery didn't specify the total stake sold or over what time period the capital was raised.

The Wall Street Journal, citing a company spokesman, reported Tuesday that Chery in recent months had raised about two billion yuan by selling a 20% stake to investors. People familiar with the matter said the investors included the Bohai fund and CDH.

China's auto industry—including Chery— is facing tough times as a global slowdown is hitting vehicle demand.

Cavalli to sell a stake in fashion house to fund

By Sofia Celeste and Marietta Cauchi

ROME—Designer Roberto Cavalli and Italian private-equity fund **Clessidra SGR** SpA have signed a letter of intent to sell a minority stake in Mr. Cavalli's namesake fashion house to the fund.

Under the terms of the nonbinding letter, Clessidra could buy 30% of **Roberto Cavalli** SpA and begin searching for an executive to run the fashion house, according to representatives for both companies. The potential sale marks the latest chapter in Mr. Cavalli's drawn-out search for investors to give his company a financial boost.

Roberto Cavalli

Even in good economic times, the designer courted potential investors, hoping to cash in on a soaring luxury-goods market. Although a large chunk of the closely held fashion house's sales were made up of goods produced and sold under license, Mr. Cavalli argued that his business was valued at more than €1 billion ($1.43 billion) before the financial crisis.

A souring luxury-goods market, however, has forced Mr. Cavalli to take a more measured view.

In February, cash-strapped clothing manufacturer **IT Holding** SpA, which manufactures Mr. Cavalli's Just Cavalli line under license, entered bankruptcy protection. That move left Mr. Cavalli without many of the lucrative royalty payments that fund his business.

IT Holding's financial woes "got us on our knees and shattered our dreams," Mr. Cavalli told Italian financial daily Il Sole 24 Ore in an interview on Tuesday that was confirmed by a company spokeswoman.

In the interview, Mr. Cavalli said the potential deal with Clessidra valued his company at "higher than €300 million."

Mr. Cavalli said he is now on the hunt for a chief executive who can take over from his family, which continues to call the shots within the fashion house.

Finding an executive who can square Mr. Cavalli's creative ego with the fashion house's bottom line won't be easy. Many professional executives have recently run afoul of the families that own high-profile fashion houses, including Prada and Versace.

Mr. Cavalli has also wavered in the past over whether to bring in investors and professional management. Just last week, Mr. Cavalli said he didn't think his company and Clessidra would reach an agreement in the near term and he was no longer sure that he wanted to sell. A spokesman for the fashion house said the two sides disagreed on corporate-governance and management issues.

Roberto Cavalli posted sales of €238 million for 2007. The company said it didn't have sales figures for 2008.

German auto sales rise 40%

Associated Press

BERLIN—Auto sales in Germany showed another sharp rise thanks to a popular car-scrapping bonus, while tentative signs of stabilization in foreign markets also offered cheer, an industry group said Wednesday.

New-car registrations, which mirror car sales, were up 40% in May from a year earlier to 384,600—the highest level for the month since Germany's post-reunification boom in 1991, car-makers group VDA said.

Over the first five months of the year, new-car registrations were up 23% to about 1.6 million.

Germany's bonus of €2,500 ($3,580) for people who scrap cars that are at least nine years old and buy new ones was introduced earlier this year in an effort to boost the auto industry, a key part of the economy.

The country, which is in a deep recession as the global crisis pushes down demand for a wide range of exports, is home to car makers **Daimler** AG, **Porsche Automobil Holding** SE, **Volkswagen** AG and **BMW** AG.

German car makers' exports were down 24% in March to 246,000 vehicles from a year earlier, VDA said. That was an improvement, compared with the 48% decline seen in April and the 38% fall in the year so far.

Orders from abroad were down 17% in May from a year earlier, but saw a 10% improvement over April in month-to-month terms, the group said. It said, however, that the good news for auto makers at home failed to compensate entirely for the slump in exports.

Delphi plans bankruptcy exit

By Peter Lattman

Buried under the news of **General Motors** Corp.'s historic bankruptcy filing Monday was the unveiling of a new plan by former GM unit **Delphi** Corp. to emerge from its stay in Chapter 11 bankruptcy protection.

The auto-parts maker's revised plan includes the sale of most of its operations to **Platinum Equity** LLC, a Beverly Hills-based private-equity firm. Platinum said it lined up $3.6 billion to bring Delphi out of bankruptcy.

The company, which operates the firms it acquires, hasn't said where it expects to obtain the financing. Platinum recently closed on a $2.75 billion private-equity fund. Typically a buyout fund will invest no more than 15% of a fund into a single deal. Using that benchmark, Platinum's maximum capital commitment would be about $413 million.

The balance of the investment, about $3.19 billion, is likely coming from GM or the federal government, though neither would say on Tuesday how much they may be contributing to the restructuring plan.

Spokesmen for the U.S. Treasury Department, GM, Platinum and Delphi declined to comment.

CORPORATE NEWS

GM roils TV-ad bazaar

Bankruptcy filing puts price pressure on commercial spots

BY SUZANNE VRANICA
AND SAM SCHECHNER

NBC Universal

Advertisers are seeking price cuts in network TV's upfront ad market, where ad inventory on shows like '30 Rock,' above, is sold for the coming season.

ADVERTISING

Monday's bankruptcy filing by **General Motors** sent chills down Madison Avenue as the car maker disclosed what it owed advertising and media agencies. But some ad executives will try to use the big spender's filing to their benefit.

The filing comes at a critical time for network TV, as it conducts its upfront market, in which it sells as much as 80% of its ad inventory for the coming season. The tradition took root in 1962, when ABC launched all its programs just after the Labor Day holiday in early September, the week new-car models from GM and its rivals were unveiled.

GM went on to become a major player, typically spending about $300 million in the upfront sales season, says a person familiar with the matter. Another person, close to GM, says the car maker was planning to slash its upfront ad commitments this year but that the decision will be left up to the bankruptcy court.

Now, that expectation will be woven into the brinksmanship that's typical of the upfront. "Agencies will use GM's bankruptcy [filing] to get better pricing," says Steve Lanzano, chief operating officer of MPG, a unit of French ad company **Havas.**

More fallout is expected, as GM begins to drop some of its well-known brands, including Pontiac, Hummer, Saturn and Saab, and closes dealerships. Executives close to GM's ad business estimate that when the car marker emerges from bankruptcy, its ad spending, which topped $2 billion last year, according to TNS Media Intelligence, will be cut back sharply.

A GM spokeswoman declined to comment.

GM's financial woes and the recession have already helped tip the balance of power toward marketers by softening demand for ad space. Advertisers such as **Procter & Gamble** have said they are benefiting from cheaper media rates in part because of the cutbacks by auto makers.

It's sobering news for an upfront marketplace that so far hasn't seen a lot of deal making. Two weeks after the networks unveiled their fall schedules in presentations in New York, some network executives say marketers have yet to indicate how much they are planning to spend during the annual bazaar, a practice known as registering budgets. It's a far cry from some years in which billions of dollars of ad time were sold in as little as 72 hours.

Negotiations between media buyers and TV networks this year have more or less stalled, according to media buyers and network executives. Media buyers are under pressure from the advertisers they work for to get price cuts, while some network executives are seeking increases. The networks say time may be on their side, betting the economy will rebound and advertisers will worry about being left out.

Even before GM's filing, Wall Street had a bearish outlook on this year's rite of spring. Jessica Reif Cohen, an analyst with Merrill Lynch, is forecasting that the five major TV networks will see their upfront take plunge 13% to $6.87 billion. While some network executives dismiss such predictions, others agree that type of decline is possible.

This year's upfront "is going to be incredibly difficult," Ms. Cohen says. The GM filing and the recession "will put pressure on everything," she says. She points out that the courts recently slashed **Chrysler**'s request to spend $134 million on ads over the next nine weeks by half.

Questions about GM's upfront plans come after the car maker disclosed that it owed ad and marketing firms at least $167 million as of May 31, according to court documents. One of GM's biggest creditors, Starcom MediaVest, the media-buying unit of **Publicis Groupe** of France, is owed $121.5 million, most of it from media purchases made on GM's behalf.

The recession and auto crisis have taken a bite out of the TV business. National networks have cut staff and budgets for new and existing TV series. Local stations, which rely heavily on auto ads, have slashed spending on syndicated series, cut staff and, in some cases, filed for bankruptcy.

Local media, TV stations and newspapers will likely continue to take the brunt of GM's cuts, say people familiar with the matter. But national media will also be hit. Ad executives close to the company say more dollars will be put into digital ads to move unsold inventory, and fewer into big-ticket TV spots for big branding efforts.

Softer signals

Upfront commitments in ad spending for major TV networks

Network	2009/'10 season estimate (billions)	Change from a year ago
NBC	$1.00	–34%
FOX	$1.63	–12%
ABC	$1.90	–10%
CBS	$1.99	–2%

Source: Bank of America-Merrill Lynch Research estimates

CORPORATE NEWS

More study of drug urged

Doctor says trials should use lower dose of blood thinner

BY JENNIFER CORBETT DOOREN

WASHINGTON—A doctor who was involved in early clinical studies of prasugrel, an anticlotting drug being developed by **Eli Lilly** & Co. and **Daiichi Sankyo** Co., said the U.S. Food and Drug Administration should stop its review of the product and require the companies to conduct additional studies of a lower dose.

The doctor, Victor Serebruany of Johns Hopkins University in Baltimore, outlined his concerns, including bleeding risks, in a letter sent to FDA Commissioner Margaret Hamburg on Wednesday.

Dr. Serebruany said the proposed 10-milligram dose of the drug causes excess bleeding and that a 5-milligram dose should be tested. He also questioned data that showed prasugrel was better than another drug, Plavix, at cutting heart-attack rates.

The FDA review of prasugrel has dragged on for more than a year. An FDA spokeswoman confirmed the agency received the letter but said federal law prohibits the agency from commenting on the status of drug applications pending at the agency. In February, an FDA panel recommended the agency approve prasugrel after a generally positive review from FDA staff.

The letter was also signed by two doctors from the consumer-advocacy group Public Citizen, including Sidney Wolfe. Dr. Wolfe is the director of Public Citizen's health-research group and also serves on the FDA's drug-safety advisory panel.

In a statement, Lilly and Daiichi Sankyo said the companies remained "confident in the overall benefit-risk profile of prasugrel and stand behind the clinical trial design and results." The companies said they were in the final stages of the drug-review process with the FDA but couldn't speculate on the outcome.

The main clinical trial, involving more than 13,000 patients, submitted to the FDA in support of prasugrel, showed it was better than Plavix at preventing life-threatening blood clots in heart patients, but it was also associated with a higher risk of dangerous bleeding in some patients.

The FDA review of the study showed that, compared with Plavix, which is co-marketed by **Bristol-Myers Squibb** Co. and **Sanofi-Aventis** SA, prasugrel would prevent an additional 20 heart attacks and two cardiovascular-related deaths but would likely result in two fatal bleeding events and four life-threatening bleeding events. An agency reviewer said the drug carried a "worthwhile risk-benefit profile."

Dr. Serebruany raised several concerns about how prasugrel and Plavix were given to patients in the trial and whether it offered a fair comparison between the drugs. He also wrote that the benefit of prasugrel at reducing heart attacks was driven by a reduction in nonfatal heart attacks and noted the definition of certain types of heart attacks has changed since the trial was conducted.

Last month, investigators for the prasugrel trial reanalyzed the data according to the new heart-attack standards and found prasugrel still cut heart-attack rates compared to Plavix, although at somewhat lower rates than originally seen. Lilly has said it is studying a lower dose but the study won't be complete until 2011.

Williams-Sonoma leans on pillows

BY ELIZABETH HOLMES

Williams-Sonoma Inc. posted a first-quarter loss due to markdowns and a 22% decline in sales as it outlined plans to pitch more lower-priced goods, like pillows, to consumers.

Home furnishing retailers have been particularly hard hit, as illustrated by the store liquidations of Linens 'N Things and Bombay Co.

Williams-Sonoma has been introducing lower prices across its store brands, including its namesake outlets as well as Pottery Barn and West Elm. Among the best-selling merchandise, the company said, are inexpensive goods such as pillows that can easily update a room.

The San Francisco-based retailer also is lowering prices on bigger-ticket items such as furniture to entice shoppers. The starting price of a sofa at its Pottery Barn stores has dropped to $999 from $1,299. At its value-oriented West Elm stores, it reintroduced the basic futon, furniture that can convert from a sofa to a bed.

Howard Lester, chairman and chief executive of Williams-Sonoma, said on a conference call with investors, "People's homes are still one of their most material assets, and they will invest in them over time. And when they do, our brands will be well-positioned."

Laura Alber, president, said the company has been focused on the "world domination of pillows." She added, "We're also seeing that spill over into our bedding business and some of the decorative-accessory area where you get a lot of update for your money."

Williams-Sonoma earlier this year laid out aggressive plans to cut costs for fiscal 2009. In January, it disclosed plans to eliminate 1,400 workers, or 18% of its staff, close a call center in Pennsylvania and a distribution center in Tennessee.

The company, which sees more than 40% of its revenue from direct-to-consumer sales, including catalog and Internet channels, is also reducing its advertising spending. It said it will shrink the circulation and page count of its catalogs by a percentage in the "high teens" and target customers with smaller, more specific catalogs and direct emails. Prepaid catalog expenses for the quarter decreased 31% to $37 million from $54 million.

For the quarter ended May 4, Williams-Sonoma reported a net loss of $18.7 million, or 18 cents a share, compared to net income of $10.5 million a year earlier.

Revenue for the latest quarter decreased nearly 22% to $611.6 million, from $781.8 million a year earlier. Williams-Sonoma ended the quarter with 630 stores, a net increase of three stores.

NetApp matches EMC bid for data firm

BY JERRY A. DICOLO

NetApp Inc. raised its offer for **Data Domain** Inc. to $30 a share, matching the bid from rival **EMC** Corp. as the two data-storage providers spar over one of the fastest-growing companies in the sector.

The revised offer, which remains a combination of cash and stock, comes after EMC this week topped NetApp's initial $25-a-share offer for Data Domain with a bid of nearly $2 billion, all in cash. Last month, Data Domain agreed to accept NetApp's offer.

Data Domain shares were up 3% to $32.55 in 4 p.m. trading Wednesday on the Nasdaq Stock Market as investors positioned themselves for a potential final agreement above the current $30 bids. Analysts say both NetApp and EMC are likely willing to go higher.

EMC wasn't available to comment. Data Domain declined to speak on the matter.

NetApp Chief Executive Dan Warmenhoven said Wednesday, "Our strategic rationale remains the same, and we firmly believe that the combination of our two companies will provide a greater opportunity and risk-adjusted value for Data Domain shareholders, customers and partners."

While such takeover fights have been scarce in the technology sector, Oracle Corp. recently outbid International Business Machines Corp. in its effort to win Sun Microsystems Inc. Analysts have said depressed prices for small companies and cash hoards at big companies may lead to more competitive deals in the sector.

Data Domain specializes in technology for "deduplication," or avoiding repeated storage of the same data. The technology can reduce demand for storage devices, and it is a selling point at a time when corporate computer chiefs are trying to cut hardware costs and save floor space and electricity use in computer rooms.

The company has churned out strong growth amid the recession, more than doubling revenue to $274 million in 2008 from the prior year. Currently, analysts on average expect 2009 revenue of $367 million, according to Thomson Reuters.

Data Domain remains a relatively new player in the data-storage sector and lacks the distribution networks and massive sales squads of its larger competitors. By teaming with EMC or NetApp, the company would gain access to a much wider array of customers and markets, offering a chance at even faster growth.

Jefferies analyst Bill Choi estimated that NetApp could push the price as high as $35 a share, though EMC could go further to acquire the company. "In the hands of someone else, it's certainly worth a lot more," Mr. Choi said.

GLOBAL BUSINESS BRIEFS

Siemens AG

Ex-executive's wife, child jailed in bribery case

The wife and eldest daughter of a fugitive former executive at the Greek branch of German industrial giant **Siemens** AG were jailed Wednesday pending trial for alleged complicity in money laundering, court officials said. An investigating magistrate allowed Christos Karavellas's two other daughters, who face the same charges, to walk free on bail of €1 million ($1.43 million) each. Mr. Karavellas has been charged with bribery and money laundering over a 1990s state telecommunications contract. A family lawyer has described the arrests as irrational.

British Airways PLC

British Airways PLC said it filled proportionately fewer seats in May despite aggressive capacity cuts. Total traffic, measured in revenue passenger kilometers, last month fell 6.5% from a year earlier, while the number of passengers dropped 7.3% to 2.8 million. Premium traffic was down 17%, as non-premium traffic declined 4.2%, the U.K. carrier said. A 5.3% cut in capacity still couldn't match shrinking demand and BA's passenger load factor, which measures how many seats an airline fills, fell one percentage point to 75%. Meanwhile, **Iberia Líneas Aéreas de España** SA's finance chief said the carrier doesn't rule out merging with airlines other than BA as negotiations between the two airlines are being slowed by the global financial crisis and by BA's pension deficit of more than £1.7 billion ($2.8 billion). Separately, budget airline **Ryanair Holdings** PLC said it carried 5.51 million passengers in May, up 9% from a year earlier, as its load factor rose one percentage point to 81%.

Porsche Automobil Holding SE

Porsche Automobil Holding SE said it would seek an additional €1.75 billion ($2.51 billion) in credit to help pay for shares of **Volkswagen** AG. The German auto maker expects to apply for the loan from the state-owned KfW development bank by the end of the week. Porsche started acquiring VW shares in 2005 and, as of January, owned nearly 51% of the Wolfsburg-based company's stock. In March Porsche took out €10 billion in loans from a consortium of banks, and last month it borrowed a further €750 million. The most recent loan will bring the total to €12.5 billion. Porsche is Volkswagen's largest shareholder, and the companies have said in recent weeks they aimed to form an integrated company as the sports-car maker struggles with €9 billion in debts.

OAO Mechel

Russian coal and steel company OAO **Mechel** said its full-year net profit was up 25% as high demand in the first three quarters offset a poor performance in the fourth quarter. Mechel, the last of Russia's major steel companies to report full-year earnings, said its net profit rose to $1.14 billion in 2008 from $913 million in 2007. Revenue was up 49% at $9.95 billion. The company didn't comment on its expectations for 2009, but said that its short-term debt soared at the end of 2008 when it breached covenants on longer-term loans. The company's short-term debt rose to $5.15 billion at the end of December from $1.14 billion a year earlier. Mechel shares fell 14% in New York trading Wednesday.

Aon Corp.

U.K. football team Manchester United will shed the **American International Group** Inc. brand from its jerseys starting next year, but will pick up sponsorship from another U.S.-based insurer, **Aon** Corp. AIG, which was rescued by the U.S. government last year, said in January that it wouldn't renew the sponsorship deal, which expires next May. "While we are delighted that our brand will be showcased to the over 330 million fans of Manchester United ...we also are extremely excited about the opportunity to maximize the value of this partnership globally," said Aon President and Chief Executive Greg Case. The deal takes effect at the start of the 2010-11 season and will run for four years. Terms weren't disclosed. AIG's four-year deal is valued at £56.5 million ($93.8 million). English's top football association, the Premier League, has been dealing with falling ticket prices, ailing corporate sponsors and financially distressed owners.

Petroliam Nasional Bhd.

Malaysia's national oil company **Petroliam Nasional** Bhd., or Petronas, said it has signed a production-sharing agreement with a unit of **Exxon Mobil** Corp. to develop seven oil fields located off the east coast of the Malaysian peninsula. Petronas said it signed a deal with ExxonMobil Exploration and Production Inc. for the development of the oil fields. The Exxon Mobil unit and Petronas' upstream unit Petronas Carigali Sdn. will commit a combined minimum of $2.1 billion to the project.

Toll Brothers Inc.

Toll Brothers Inc. reported another quarterly loss but the results showed improvement from a year ago, as write-downs were smaller. The luxury home builder said lower home prices and attractive interest rates are luring at least some customers back into the market, although its fiscal second-quarter revenue was down 51%. The Horsham, Pa., company reported a loss of $83.2 million, or 52 cents a share, for the three months ended April 30, compared with a year-earlier loss of $93.7 million, or 59 cents a share. Toll in the latest quarter booked pretax write-downs of $119.6 million, or 48 cents a share, down from $288.1 million in the year-earlier period. In late May, management had forecast write-downs in the range of $90 million and $160 million. Revenue fell to $398.3 million from the prior year's $818 million. The company declined to offer a profit outlook, citing uncertainty in the housing market.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Europeans prepare for Obama's visit

Leaders of France and Germany plan talks with president as well as ceremonies commemorating World War II

Forget trans-Atlantic tensions over how best to handle the economic crisis: U.S. President Barack Obama will get a warm welcome in Europe this week when he visits historic sites for commemorations of World War II.

*By **Marcus Walker** in Berlin and **David Gauthier-Villars** in Paris*

Meetings with the leaders of Germany and France as well as visits to a former Nazi concentration camp and the D-Day beaches of Normandy are designed to broadcast a message to both sides of the Atlantic. The new U.S. leader is rebuilding America's standing with its traditional allies following the tension of the George W. Bush presidency.

Mr. Obama's second trip to Europe since April is part of an attempt "to reintroduce the U.S. to not only Europe but the world, and to say 'We're back—to the way we used to be, and the way you like us,' " says Simon Serfaty, a foreign-policy scholar at the Center for Strategic and International Studies in Washington.

European officials and analysts emphasize that talk of a new beginning in U.S.-European relations is somewhat exaggerated. Relations had improved considerably in the later years of the Bush administration after earlier clashes over the U.S. invasion of Iraq.

But U.S. policy on a range of issues, such as tackling climate change and seeking engagement with Iran and Russia, has converged further with European preferences under Mr. Obama, who also remains highly popular among ordinary Europeans, unlike his predecessor.

After delivering a speech in Cairo Thursday on America's relations with the Muslim world, Mr. Obama is due to visit the eastern German city of Dresden—a symbol of wartime destruction, postwar rebuilding and German reunification—for talks with Chancellor Angela Merkel.

The two leaders will then tour the site of the former Nazi concentration camp at Buchenwald, also in Germany's former Communist east, a visit that U.S. officials say has a personal significance for Mr. Obama: His great-uncle helped liberate one of its subcamps as a U.S. infantryman in 1945.

On Saturday, Mr. Obama will hold talks with French President Nicolas Sarkozy in Normandy, France, before joining representatives of the U.K. and other wartime allies to commemorate the 65th anniversary of the U.S.-led invasion of Nazi-occupied Europe.

Planning both legs of the Europe trip has sparked diplomatic flaps, showing the complexity of venturing into Europe's history and national sensitivities.

France initially didn't invite the British royal family to the D-Day ceremonies, a departure from the 60th anniversary of the landings, when Queen Elizabeth II attended, along with her husband Prince Philip and son Prince Charles.

British media interpreted the French non-invitation as a slight, while the French government said it was up to the British government to decide who would represent the U.K. The Queen herself "wasn't offended by not being invited," her spokeswoman said.

Adding to the confusion, Mr. Obama's spokesman Robert Gibbs said on Monday the U.S. was working to get the Queen invited. On Tuesday, Prince Charles's office announced he had received an invitation from Mr. Sarkozy and would go to Normandy as the Queen's representative.

Mr. Obama's trip planners also ruffled German feathers by cutting short his visit to Germany's east. Ms. Merkel's advisers had hoped the president would also visit Weimar, a shrine of German literary culture whose proximity to the Buchenwald concentration camp underscores the high and low points of German history.

But Mr. Obama decided instead to tour the U.S. air base at Ramstein and to visit wounded U.S. troops at the Landstuhl military hospital on Friday afternoon. Last year Mr. Obama drew criticism from Republicans for canceling a planned visit to Landstuhl while on a trip to Germany as a presidential candidate.

U.S. President Barack Obama on the steps of Air Force One
Photo: Associated Press

Pressing reset

Issues where U.S. policy under President Obama has converged with European preferences:

- Comprehensive civil-military strategy for Afghanistan
- Engagement with Iran
- New push for progress in Israel/Palestinian conflict
- Stronger effort to counter climate change
- Engagement with Russia
- Closing Guantanamo

Issues where U.S. authorities and Europeans have disagreed recently:

- U.S. desire for more fiscal stimulus measures in Europe
- German criticism of loose U.S. monetary policy
- U.S. support for Turkey joining the EU, opposed by Germany and France
- U.S. desire for more European troops in Afghanistan

The president's talks with Ms. Merkel and Mr. Sarkozy are expected to focus on international security as well the economy.

Mainland Europe, led by Germany, has resisted U.S. calls for greater efforts at economic stimulus.

Germany's government fears too much policy activism to fight the recession could lead to excessive inflation and public debt, and potentially a new financial crisis. In a speech on Tuesday, Ms. Merkel launched a broadside against expansionary monetary policies by the U.S. Federal Reserve as well as Europe's leading central banks.

On foreign and security policy, however, the new U.S. administration's quest for a new diplomatic engagement with adversaries or troublesome governments such as Iran or Russia are in tune with European thinking.

Some French and German officials are concerned that Mr. Obama might go too far in courting Iran, and that the overtures could backfire if Iran doesn't respond positively or change its nuclear ambitions.

"Obama has set out some principles for his (Iran) policy, but principles are not a strategy," said Eckart von Klaeden, a lawmaker in Ms. Merkel's Christian Democrat party. But Mr. von Klaeden praised other U.S. initiatives, including "the decision to push for Middle East peace now rather than postponing the effort."

The U.S. leader's high standing in Europe has prompted Mr. Sarkozy to try to emulate his popular touch—with mixed results.

Last month, in footage reminiscent of Mr. Obama playing with his Portuguese water dog Bo, Mr. Sarkozy posted a video on his Facebook page in which he introduced two of his three dogs: Clara and Dumbledore.

—Aaron O. Patrick in London and Laura Meckler in Riyadh contributed to this article.

Obama meets Saudi king for talk on Mideast peace effort

BY LAURA MECKLER

RIYADH, Saudi Arabia—President Barack Obama arrived in Saudi Arabia on Wednesday for meetings with the Saudi king aimed at addressing vexing issues for the U.S. and the Mideast, but it was unclear what progress was in the offing on the toughest matter, the Israeli-Palestinian conflict.

Mr. Obama has made that conflict a priority in the opening months of his administration, and he was looking for help from Saudi King Abdullah, who has taken a leadership role in the past. Also on the agenda were relations with Iran, a complex problem for both nations. Energy prices were also expected to come up in the nation that is the world's leading oil producer.

"I thought it was very important to come to the place where Islam began and to seek his majesty's counsel, and to discuss with him many of the issues that we confront here in the Middle East," Mr. Obama told reporters before heading into a bilateral discussion. "I am confident that working together, that the United States and Saudi Arabia can make progress on a whole host of issues of mutual interest."

Both Mr. Obama and King Abdullah spoke of the longstanding friendship between their nations. Mr. Obama said he was struck by the king's "wisdom and his graciousness," and the king said he wanted to express his best wishes "to the friendly American people who are represented by a distinguished man who deserves to be in this position."

The streets of Riyadh were lined with U.S. and Saudi flags to welcome the president. At the airport, Mr. Obama greeted King Abdullah with a light embrace and a cheek-to-cheek touch on both sides. They shared a cup of coffee inside the airport before departing to the king's horse farm, a royal retreat, for a reception, dinner and bilateral talks.

At the retreat, King Abdullah presented the president with a large gold medallion, which he placed around Mr. Obama's neck, and also gave him a certificate. Mr. Obama wore the medallion for a few pictures before he took it off, saying that was for "safekeeping."

Mr. Obama, making his first trip to the region as president, will be in the Saudi kingdom for less than a day. He departs next to Cairo, where he will deliver a much-anticipated speech aimed at reaching out to the Muslim world.

Osama bin Laden attempted to blunt Mr. Obama's expected message in Cairo that Washington wants a new dialogue with the Muslim world. The al Qaeda leader said recent fighting in Pakistan between the Pakistani government and local followers of the Taliban was a new American crime against Muslims.

"He [President Obama] has followed the steps of his predecessor in antagonizing Muslims ... and laying the foundation for long wars," Mr. bin Laden said in a tape released shortly after Mr. Obama arrived in Saudi Arabia.

The trip to Saudi was a late addition to the schedule, added as Mr. Obama has engaged more deeply in the Israeli-Palestinian conflict. The U.S. would like Saudi Arabia to take a leadership role, as it has in the past, in the effort to reach a peace deal. One U.S. official said Mr. Obama planned to ask the king to support confidence-building measures toward Israel, such as opening direct air or telephone links or a business-interests section.

In 2002, then-Crown Prince Abdullah—now the king—offered a peace plan that became known as the Arab Peace Initiative. The Saudis have been among the Palestinians' staunchest supporters, but their plan called for a two-state solution and was seen as a potential breakthrough in the impasse.

Fulfilling a promise not to wait until the end of his term to get involved, Mr. Obama has had leaders of Israel and the Palestinian Authority to the White House and appointed former Sen. George Mitchell as an envoy to the region. But Israel has overtly rejected his call for a halt on settlements, and Prime Minister Benjamin Netanyahu has declined to formally endorse the creation of an independent Palestinian state, making it less likely the Saudis will agree to open ties with Israel. At the same time, there has been no sign of progress with Hamas, an organization that the U.S. has labeled terrorist and which controls the Gaza Strip.

The Saudis are nervous about U.S. outreach to Iran and the threat posed by that country, which sits just across the Persian Gulf, analysts say. There has long been tension between the Saudis and the Iranians, so U.S. efforts at diplomacy with Tehran make them nervous.

"They [the Saudis] are really worried he's going to cut some deal behind their backs and leave them with a powerful Iran that is going to dominate regional politics," said Tamara Cofman Wittes, senior fellow at the Saban Center for Mideast Politics at the Brookings Institution, a Washington think tank.

At the same time, while Iran's suspected effort to acquire a nuclear weapon makes them anxious as well, they don't want to see a U.S. military strike on Iran, either.

—Jay Solomon contributed to this article.

U.K. sees a small sign of growth

Stimulus measures revive services, boost consumer optimism

By Joe Parkinson

LONDON—The U.K.'s all-important services sector started growing again in May, as economic-stimulus measures helped stir new business and consumer optimism.

The purchasing managers index for Britain's service sector rose to 51.7 in May from 48.7 in April, research group Markit Economics said Wednesday. The index climbed above 50, indicating that the sector is expanding for the first time since May 2008.

In the euro zone, the services sector continued to contract, although at a slower pace, with the PMI rising to 44.8 in May from 43.8 in April.

On Wednesday, the European Commission took steps to deal with the joblessness that has become acute amid the recession. The commission, the EU's executive body, said it is proposing setting aside €19 billion ($27 billion) to create jobs, upgrade worker skills and increase access to employment throughout the European Union.

The economic news out Wednesday "puts the U.K. ahead of the U.S. and euro zone in being the first of the major industrialized nations to register a PMI reading above 50," said Peter Dixon, an economist at Commerzbank. "The main reason is that the foot is more firmly to the floor with fiscal and monetary policy than in Europe—all the things that could be done to stimulate the economy are being done, and then some."

The rise in the services PMI for the U.K. was propelled by a surge in new business and the most optimistic outlook since October 2007. In response, sterling soared against major currencies, continuing a recent run that has pushed it to a seven-month high against the dollar.

The credit crunch plunged the U.K. into its most severe recession in decades, with gross domestic product contracting 1.9% in the first quarter of 2009, its biggest drop since 1970.

The U.K. government announced a fiscal-stimulus package valued at £20 billion ($33.19 billion) in November, and has taken other measures to protect jobs and support businesses.

Between October and March, the Bank of England cut its benchmark interest rate to 0.5% from 5%, and last month said it would increase the amount of new money it is injecting into the economy by buying government and corporate bonds to £125 billion from £75 billion.

The encouraging economic signs come on the eve of Thursday's rate decision by the Bank of England, and may offer relief to Prime Minister Gordon Brown, whose popularity has tumbled amid the recession and a parliamentary-expenses scandal.

The services PMI is among recent figures that suggest antirecessionary measures may be bearing fruit.

A survey released Wednesday by the Nationwide Building Society showed U.K. consumer confidence strengthening in May, buoyed by a more-optimistic assessment of the outlook for the economy and the jobs market over the next six months.

Some economists caution that the economy is being propped up by massive stimulus, and emphasized that the data show little about whether any recovery can be sustained. "A big question mark remains over whether this will turn into a sustained recovery," said Vicky Redwood, an economist at Capital Economics.

"It is quite possible that after a quarter or so of positive growth, the economy starts to contract again, as the recent stimulus from falling energy prices, the fiscal giveaway and lower interest rates starts to fade," she added. "We are not out of the woods yet."

Separately, the EU's statistics agency said Wednesday that the euro zone's economy contracted more sharply in the first quarter than initially reported.

The combined GDP of the 16 countries that use the euro was down 4.8% in the first three months of 2009 from a year earlier, Eurostat said. Last month, the statistics agency estimated that first-quarter GDP had dropped 4.6%. The figures constituted the biggest economic contraction since records began in 1995.

Meanwhile, the Organization for Economic Cooperation and Development said Wednesday that the annual rate of inflation across developed economies was at its lowest level in at least 38 years in April.

Consumer prices in the OECD's 30 members rose 0.6% in the 12 months ended in April, the lowest level since records began in 1971. The previous record low was the 0.9% rate of inflation recorded in March.

As recently as July 2008, the OECD inflation rate stood at an 11-year high of 4.8%.

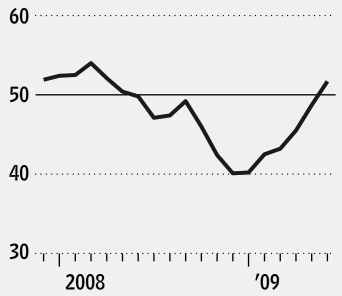
The continued drop in the annual rate of inflation in April will reinforce fears that developed economies may be headed for a period of deflation, even though there are indications that the most severe period of contraction has passed.

With the global economy set to contract this year for the first time since the end of World War II, prices for a wide range of goods and services may fall.

The risk is that a period of deflation could become self-reinforcing, trapping the global economy in a long contraction. The danger is that consumers will expect prices to continue to fall, and will therefore postpone purchases of infrequently replaced goods, such as consumer durables, in the expectation that they will get a better deal later.

Bouncing back

U.K. purchasing managers index for the service sector



Note: Reading above 50 indicate expansion; below 50, contraction
Source: Markit

Associated Press

People gather at the cathedral of Notre Dame in Paris for a service for families of the passengers of Air France Flight 447.

Crash cause looks elusive

Flight recorders will be tough to find, investigators say

French air-accident investigators said salvage crews may never find the "black boxes" from an Air France jetliner that crashed in the Atlantic Ocean early Monday, making their task of determining what downed the plane unusually difficult.

*By **Daniel Michaels, Andy Pasztor** and **Max Colchester***

The realization that the two black boxes—which record flight data and cockpit conversations—may not be retrieved could renew the aviation industry's interest in developing broadcasting systems that allow critical safety data to stream automatically from a troubled plane to receivers on the ground.

"If an aircraft has big problems, this would give it the capability to instantly downlink data" from the flight-data recorder, said Robert Francis, a former member of the U.S. National Transportation Safety Board who is among the safety experts advocating for new systems. "I am sure the idea will be explored after this crash."

At a news conference near Paris on Wednesday, Paul-Louis Arslanian, director of France's Bureau d'Enquêtes et d'Analyses, or BEA, said there were no indications of problems before Air France Flight 447 took off from Rio de Janeiro for Paris with 228 people aboard.

Brazilian military officials on Wednesday reported finding four areas of debris in the Atlantic Ocean off the country's northeast coast, including "various objects" spread over 75 square kilometers and an oil slick 20 kilometers long. On Tuesday, they had reported the first sign of debris, which they said almost certainly came from the Airbus A330.

Investigators will now try to determine where the two-engine plane hit the water and where its wreckage is on the sea bed.

A priority for searchers will be finding the plane's two digital recorders, which could be crucial in determining why the plane lost contact and crashed after flying through storms and turbulence.

But considering the ocean depth and rough undersea terrain in the area being examined, investigators said retrieving the units could be hard.

"I am not optimistic," Mr. Arslanian said. "The sea [bed] is not only deep but mountainous," he added.

Without the flight recorders, investigators could have difficulty determining why the plane crashed. Passengers, airlines, regulators and Airbus itself want to know if the jetliner plunged because of a one-time event, fundamental design flaws, terrorism, or something else. Airbus is a unit of **European Aeronautic Defence & Space** Co.

Mr. Arslanian said black boxes aren't always necessary to establish the cause of a crash. Without them, however, investigators probably need to examine significant amounts of physical evidence, including wreckage, which could also be difficult to retrieve.

Adding to urgency is the recorders' limited ability to signal their location.

Adding to the urgency is the recorders' limited ability to signal their location. Each has a beacon that can be detected from many thousands of meters away, according to their manufacturer, **Honeywell International** Inc. Mr. Arslanian said the range could be only 1,000 meters. Adding to the problem: The boxes have only enough battery power to last around 30 days.

Investigators haven't faced comparable challenges in finding and retrieving black boxes since the mid-1980s. Following some jetliner crashes in deep water, it took experts months to recover black boxes and wreckage even after they were located.

As a result, Monday's crash has sparked discussion of a new way to use on-board information to enhance safety: transmit real-time operational data to the ground in emergency situations.

Planes such as the Air France Airbus already relay routine maintenance information to operations centers at headquarters, which allow ground staff to fix systems quickly and reduce delays. Such messages were the final transmissions sent from the plane shortly before it disappeared Sunday night.

The messages came over a span of three minutes, Mr. Arslanian said. Safety experts say that means the plane didn't immediately break up in the air and would have had ample time to transmit safety data, had it been equipped to do so.

Now, safety officials propose doing that, by using existing systems to beam crucial flight-data recorder measurements—such as engine parameters, pilot commands or acceleration forces. Installing the systems into planes, they say, might require only software adjustments.

The idea isn't just theory: Engine makers including **General Electric** Co. and **Rolls-Royce** PLC already use live streaming data to monitor the performance of their jets. A number of helicopter operators also use advanced satellite communication systems both to track the location of their choppers and to gather data signaling potential mechanical or electrical problems

Dick Healing, another former NTSB board member, said Wednesday that a burst of real-time data transmitted in emergency situations "is a very good idea" and "technically, it's totally possible today."

Potential obstacles to the plan include the cost of changing the software and the possible need for more satellite-transmission capacity, which can be expensive. Monitoring and handling information as it arrives would also require more sophisticated systems than those used now for maintenance updates.

—Antonio Regalado contributed to this article.

CAPITAL ▪ DAVID WESSEL

Inflation fears are overstated, except under certain conditions

NOT SO LONG ago, we were warned about the prospect of devastating deflation, a widespread decline in wages and prices. Today, we hear equally dire warnings of an outbreak of inflation. It's like preparing for an epochal drought and suddenly being told, "Never mind! Get ready for a flood of Biblical proportions."

As recently as mid-March, minutes of Federal Reserve deliberations show, several Fed officials thought "inflation was likely to persist below desirable levels." But at the end of April, Fed officials concluded, with a sigh of relief, that "the risk of a protracted period of deflation had diminished," thanks to massive government spending and tax cuts and aggressive central-bank lending. Now Fed officials find themselves on the defensive, accused of doing so much to avert deflation and depression that inflation is nearly inevitable.

An immediate outbreak of inflation is improbable. Consumer prices in industrialized countries have risen less in the past year (0.6%) than in any 12 months since the Organization for Economic Cooperation and Development began keeping records in 1971. In the U.S., unemployment is at 8.9%, and forecasters see it hovering above 9% into 2011. American industry is operating further from full capacity than at any time since the Fed began keeping track in 1948. It's hard to see companies easily raising prices or workers winning raises. The standard ingredients of inflation—too much money chasing too few goods—aren't in evidence.

The bigger question is what's ahead. Markets are anxious. The bond market has pushed up yields on Treasury debt. Gold is nearing $1,000 an ounce again. Commodity prices are rising. It's easy to cite historical precedents for heavily indebted governments accepting inflation as a way to lighten the burden of repayment or for central banks overdoing whatever they're doing.

But what would have to happen for inflation to soar above the 2% target that most Fed officials set for their favorite gauge?

A miscalculation. The Fed and President Barack Obama's economists could be worrying too much about avoiding 1937-38 (when prematurely tightening plunged the U.S. economy back into recession) and not enough about 2004 (when the Fed may have kept short-term rates too low too long). Or there could be less slack in the economy than appears on the surface, a view held by some inside the Fed. Or the prospect of 10% unemployment at the time of congressional elections in November 2010 could prompt Democrats to push another round of fiscal stimulus—or another set of corporate bailouts—that proves unneeded and doesn't spur the Fed to raise interest rates. A miscalculation would produce big inflation only if the Fed failed to see and react to it.

A failure of will. The Fed could lack the fortitude to raise rates and drain credit, a worry among some Fed insiders who complain, "There is no exit strategy." The problem is human and political. To avoid inflation, the Fed must move sooner than citizens and politicians will like. Fed Chairman Ben Bernanke vows to be tough, but he hasn't been tested on this side of the monetary mountain—and his term expires in January 2010. He or his successor may find Fed lending so intertwined with the Treasury's bailouts that the Fed lacks the flexibility and independence it needs. Or he may find tightening tough while Congress is contemplating changes to the Fed's governance and powers. Or the budget deficit may be so large that the Fed is unwilling to curtail its bond buying and raise rates sufficiently to offset it. The Fed is mighty, but its leaders human—and prone to failures of courage as well as wisdom.

A victim of circumstance. Plenty of indebted emerging-market countries have seen currencies collapse as global lenders flee. A falling exchange rate pushes up the prices of imports and can produce inflation even while unemployment remains high. The U.S., still the keeper of the world's most popular currency, is not Argentina. But its addiction to borrowing from abroad makes it more like an emerging market than ever. A collapse in the dollar could push up oil prices (which rise when the dollar falls) and other import prices. Even if that didn't spark inflation, it could prompt an untimely increase in interest rates. Reducing this risk means moving soon to restrain the long-term budget deficit so creditors are less likely to bolt.

A self-fulfilling fear. Unemployment may be high and the Fed vigilant, but if consumers, workers, businesses and investors all expect inflation, they could realize their fears—by pushing up prices and demanding higher wages in a mania that defies the assertions of economists and Fed officials that there's no reason for inflation. Inflation expectations are not always tethered to objective economic reality. Mr. Bernanke's repeated vows to maintain price stability are aimed at keeping those expectations under control.

In late 1970s, central bankers printed so much money that we got the Great Inflation. That ended painfully in the deep recession of the early '80s and taught everyone a never-again lesson. During the Great Panic of our time, the Fed and its counterparts did whatever it took to prevent depression and deflation. The question now is whether central bankers and the rest of us will remember the lessons of the late '70s and do whatever it takes to avoid inflation. Or whether each generation has to learn the lesson anew.

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