Leading the News: Pension funds in Asia passed Europe's last year

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Breaking news at europe.WSJ.com

President Obama goes back to school

Getty Images

CLOSE WATCH: Manhattan students listen to the National Address to Students on Educational Success on Tuesday. The speech had earlier sparked controversy. Page 11.

Bankers back big bonuses in Germany

By Madeleine Nissen And Eyk Henning

Bloomberg News

Josef Ackermann called for an even playing field for bank pay.

FRANKFURT — Top German bankers defended bonuses Wednesday as a necessary reward for talent and a lesser factor in the global economic crisis than politicians have made out.

"Banks can't let star performers slip through their fingers by being tight-fisted," said Deutsche Bank AG Chief Executive Josef Ackermann.

Referring to a survey that said 81% of Germans don't believe banks have learned anything from the crisis, Mr. Ackermann said the lessons regarding compensation weren't the most important. "I dare say that the other criteria [such as risk management, stress tests and liquidity management] are substantially more important," he said. "There is no clear link or pattern between a good or bad bank based on their business model or the size of bonuses they awarded."

Other bankers gathered for a conference the week before the anniversary of Lehman Brothers' collapse were careful to stress that bankers couldn't be motivated solely by greed, and said that not all bankers had been.

Germany's debate over bankers' bonuses has largely revolved around banks' moral duties to society. "The clever ones know that ethical behavior ultimately leads to success in business," said Friedrich von Metzler, partner at Bankhaus Metzler.

Karl-Georg Altenburg, chief executive of J.P. Morgan in Germany, Austria and Switzerland, said pay couldn't exceed certain bounds. "Success can only be measured when it is sustainable," he said. But Mr. Ackermann stressed banks were under pressure to pay competitive packages. "The war for talent is in full swing."

Rival U.K. parties clash over spending

By Laurence Norman

LONDON—The U.K.'s two main parties clashed over public spending Tuesday, with the governing Labour Party saying it could avoid deep cuts and the opposition Conservatives charging that the government is facing a debt crisis that could stifle an economic recovery.

The dispute will likely escalate, as the two parties prepare for their annual party conferences and work to frame the critical economic-policy debate ahead of the next general election, due to be held by June. Labour has won the past three elections in part because it convinced voters it would better protect public services, but the party faces an uphill battle to retain power.

Chancellor of the Exchequer Alistair Darling acknowledged the need for cost savings and some cuts, but didn't give any specifics on what he said were the "difficult decisions" the government would face.

"Some seem in a hurry to cut services. We are focusing on cutting costs," he told business leaders in Wales.

Conservative leader David Cameron, in a speech in London, meanwhile stressed that significant spending cuts were needed to consolidate a yawning fiscal deficit as the U.K. emerges from recession. But he also provided few details

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Power outage

A Russian tycoon's fall sparks a money hunt
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	CLOSE	PCT CHG
DJIA	9497.34	+0.59
Nasdaq	2037.77	+0.94
DJ Stoxx 600	237.89	+0.29
FTSE 100	4947.34	+0.29
DAX	5481.73	+0.33
CAC 40	3660.96	+0.22
Euro	$1.4514	+1.24
Nymex crude	$71.10	+4.53

Switzerland tops U.S. as most competitive

By Joe Parkinson

The deterioration in financial markets and economic instability have helped to push the U.S. out of its top spot as the world's most competitive economy and into second place after Switzerland, according to this year's survey by the World Economic Forum.

The U.S. had taken first place in the Global Competitiveness Index since the Geneva-based think tank introduced the GCI in its current form in 2004.

In this year's survey, in the ranking of trust in a country's banks, the U.S. fell to 108th position—just behind Tanzania—from 40th last year. The soaring American budget deficit, which now tops $1 trillion, pushed the U.S. ranking for economic stability down to 93rd from 66th.

Please turn to page 35

Competitiveness index

Country	2009 rank	2008 rank	change in rank
Switzerland	1	2	▲
U.S.	2	1	▼
Singapore	3	5	▲
Sweden	4	4	--
Denmark	5	3	▼
Finland	6	6	--
Germany	7	7	--
Japan	8	9	▲
Canada	9	10	▲
Netherlands	10	8	▼

Source: World Economic Forum

THE WALL STREET JOURNAL.

LEADING THE NEWS

Asian pensions overtake Europe's

A low taste for risk helped Asian funds avoid worst of 2008

By Mark Cobley

Europe's biggest pension funds weathered the financial crisis better than their North American counterparts last year, according to new research. But Asia's pensions savings actually grew during 2008, and total funds under management by Asian-Pacific pension funds surpassed Europe's for the first time.

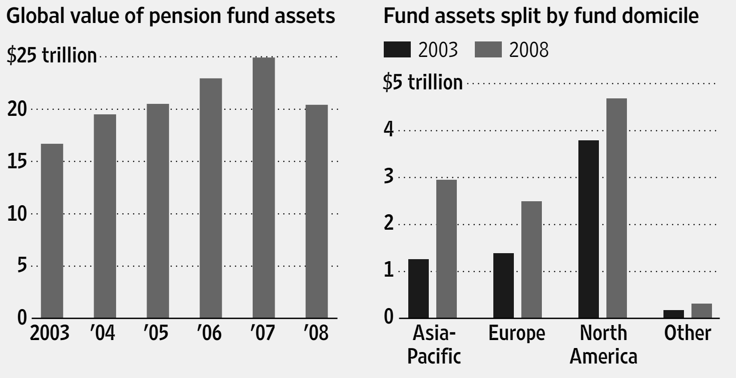
According to an annual ranking prepared by the consultancy Watson Wyatt, $1.5 trillion was knocked off the value of the world's 300 biggest pension funds during the 12 months to Dec. 31, 2008. The funds declined in size by 12.6% to $10.4 trillion—with $4.7 trillion of those assets being in North America, $3 trillion in Asia and $2.5 trillion in Europe.

Some of Europe's giants had a particularly bad year—the Dutch civil servants' fund ABP declined in value from $315 billion to $243 billion, though it held on to its place as the world's third-biggest pension fund overall. And the world's second-biggest fund, the Norwegian Government Pension Fund, shrank by $32 billion. Its investment losses were much steeper, but since it is funded by tax receipts on the Nordic nation's oil production, it continued to receive new income.

But there was good news for Danish pensioners. Their national pension scheme ATP, regarded as one of Europe's most professional investors, grew in size during 2008 from $84 billion to $110 billion—and entered the top 20 global funds for the first time, at 14th. This was partly because of a large allocation to fixed income, the hedging of its equity portfolio using financial instruments, and the strengthening

Rising out of the crisis

In 2008, pension funds in the Asia-Pacific region ended up managing more assets than European funds, better weathering an overall drop in asset values.



Source: Watson Wyatt

of the Danish kroner against the U.S. dollar, in which currency the ranking is calculated.

Structural factors helped Asia's rise. Many funds in the region are newer than in Europe, with contributions from working members outweighing pensions paid to retirees.

Big pension plans in North America generally shrank last year.

In Australia, where mandatory payments into a national system of pension funds began in the early 90s, the pension funds have been growing by an average 13% a year for the past five years—the world's second-fastest behind Taiwan.

Heavy fixed-income allocations, at least in comparison with the U.S. and U.K., coupled with a generally weakening dollar also contributed to the rise.

Emblematic of Asia's comparative rise, meanwhile, is the world's biggest retirement fund, the Japanese Government Pension Investment Fund. This giant swelled by more than $200 billion to $1.28 trillion during 2008. It is largely invested in government debt, one of the few assets to do well last year—and Japanese funds were also buoyed by the strong yen.

Larger funds generally did well—with the top 20 falling by only 4% on average. "They have also used their size to their advantage by ensuring their various activities add up to a value proposition for beneficiaries" said Carl Hess, global head of investment consulting at Watson Wyatt.

Most of the few that did get bigger last year were Asian funds, which are growing fast and tend to be more heavily committed to fixed-income assets.

Taiwan's Postal Savings Fund grew from $129 billion to $154 billion, which took it from 14th to eighth in the ranking. Singapore's Central Provident Fund grew from $95 billion to $104 billion, and climbed six places to 16th. Malaysia's $99 billion Employees Provident Fund also entered the top 20 at 19.

In contrast, big pension plans in the U.S. and elsewhere in North America generally shrank last year, as big losses in equities markets made themselves felt. The California Public Employees' Retirement System, known as Calpers, started 2008 with $255 billion and ended it with $214 billion, though it held onto its fourth place in the size table. Its sister fund Calstrs fell from $176 billion to $147 billion and surrendered its global seventh place to a Japanese fund.

Canadian pension plans did even worse—the Ontario Teachers Pension Plan and the Canada Pension Plan both fell out of the top 20 after losing 34.4% and 30% from their investments, respectively. The pension plan for telecoms group AT&T, together with the New York State Teachers pension plan, also dropped out of the top 20.

The Watson Wyatt ranking, which is prepared in association with U.S. investment newspaper Pensions & Investments, is being altered by the faster growth rate of several Asian nations' savings funds. Japan is the best-performing, with its biggest schemes growing by 21.3% a year between 2003 and 2008—though Denmark is in second place.

Watson Wyatt's report observed: "Of particular interest are Denmark, Singapore and Malaysia, all of which now have one fund in the top 20. Each of these funds have had above-average performance, gaining positions year after year."

However, Watson Wyatt's rankings have some limitations because of the reluctance of some large funds to release figures. For example, a sharp decline in the Korean National Pension Service's assets is based on an estimated figure for 2007, Watson Wyatt said. Meanwhile, the figures for many Japanese and U.K. pension funds aren't directly comparable to most others around the world because they only provide figures as of March 31 each year.

—For more, visit efinancialnews.com

EBRD increases plans to support emerging nations

By Joe Parkinson

LONDON—The European Bank for Reconstruction and Development voted to raise its investment in emerging economies to a record €8 billion ($11.5 billion) in 2009, reflecting the continuing effects of the financial crisis and increased demand for financing.

The move, which follows calls from the Group of 20 leading economies for international organizations to use their full capacity to ease the crisis, brings the EBRD's lending target for the year 52% higher than what it invested in 2008.

"The economic environment continues to pose a challenge for many in our region, but the EBRD is well equipped and ready to continue to provide support where it is most needed," EBRD President Thomas Mirow said. "Our investments so far this year underscore that commitment."

The funding boost, which will extend credit lines across Eastern Europe, the Caucasus and Central Asia, particularly to small businesses, will be financed from the bank's reserves.

From the Baltic Sea to the Black Sea, the once fast-growing ex-communist economies have been hammered by collapsing demand and vanishing foreign-investment flows. The downturn has already claimed governments in Latvia, Hungary and Bulgaria. Many states in the region have turned to the International Monetary Fund for emergency financial aid.

Economists said the EBRD's move signals that an economic recovery remained a distant prospect for most Eastern European states. "The balance sheet of the region is still weighed down with a lot of external debt," said Timothy Ash, head of Central and Eastern Europe research at the Royal Bank of Scotland, adding, "It will be a slow and painful recovery."

When it was established in 1991, the EBRD was conceived of as a new kind of development institution, one that encouraged private-sector financing. But the long-term consequences of the financial crisis will reduce the amount of private capital available to the region.

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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

Germany's industrial output falls

Vulnerability shown as stimulus spending is being phased out

By Christopher Emsden

German industrial production declined in July, highlighting the threats to the euro area's economy as various government stimulus measures fade out.

Contrary to expectations, data from the German economics ministry showed that industrial output fell 0.9% in July from June, mirroring the trend in Spain and other euro-zone trading partners. The German data damped hopes the euro zone might be led out of recession by its largest economy and most prolific exporter.

Economists said sustainable growth will require stronger domestic demand, which is unlikely given weak labor markets and jammed credit markets. Economists will be watching for more indications of a possible relapse in output this fall.

European government and central-bank officials have warned that rising unemployment, scarce access to credit and protectionism could stifle the recovery if policy makers are complacent.

The economic contraction may be slowing or even on the mend, "but the new reality is that gross domestic product in most places will not regain early-2008 levels for a decade," said Carl Weinberg, senior economist for High Frequency Economics.

"Depression is just beginning," he added, specifying that by depression he meant a lengthy period in which the level of economic activity doesn't support full employment. Barring a "supernormal" growth surge, full employment won't be back in the euro area for six years, he estimated.

Output levels in some parts of the euro zone were particularly grim in comparison with what was seen a year ago. German industrial production in July was 17% below July 2008's reading. And Spain's National Statistics Institute said that industrial production in July was down 17.4% on the year, a steeper fall than reported in June.

The U.K., by contrast, reported its best manufacturing output data in three years, with output up 0.9% on the month in July, twice as much as expected. But the figures were overwhelmingly influenced by a 10.4% monthly jump in automobile production, thanks to a program that subsidizes the purchases of new cars.

A similar program in Germany accounted for all of the 2.1% quarterly industrial output gain that country posted in the second quarter, when it managed to boost its GDP and usher in hopes the recession was already over, said Sylvain Broyer, an economist for Natixis in Frankfurt.

Auto and other subsidies also helped industries in emerging Europe mitigate losses earlier this year.

In Romania, where **Renault** SA produces its low-cost and suddenly popular Dacia, industrial production fell by 6.99% in July from July 2008, a steeper rate than previously reported. New orders—a proxy for future production—fell even faster, down 21% compared with 16.2% in June.

In Turkey, which like Germany had been expected to emerge soonest from recession, industrial production fell 9.2% from July 2008, more than expected. Demand-sensitive sectors are losing momentum as tax incentives subside, and a recovery without an uptick in domestic demand doesn't look sustainable, said Citigroup economist Ilker Domac in Istanbul.

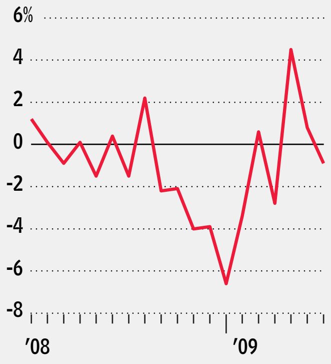
The same applies to Germany. New orders did pick up in July, but would have contracted if it weren't for a one-time order of 405 tanks by the German military. Foreign orders fell 2.3% from June.

German exports grew for the third month in a row in July, which augurs well for that country's third-quarter GDP. But it bodes less well for the euro zone as a whole, as Germany's robust trade surplus makes it harder for its main trading partners to grow without relying on greater amounts of debt or pushing down domestic wages.

—Nina Koeppen and Joe Parkinson contributed to this article.

Bumpy road

German Industrial production month-to-month percentage change



Source: German Statistics Office

With exports low, Czech economy has record drop

By Sean Carney

PRAGUE—The Czech economy contracted a record 5.5% from a year earlier in the second quarter, the largest-ever annual fall in the history of the republic, data from the Czech Statistics Office, or CSU, showed Tuesday.

The decline in gross domestic product was a full percentage point more than the 4.5% annual contraction the central bank had forecast and also exceeded the 4.9% drop the CSU had reported previously.

The export-reliant Czech Republic has been hit hard by a sharp decline in demand from Western Europe for its locally produced cars and electronics over the past 10 months. In addition to its shrinking GDP, the recession is fueling Czech unemployment and pushing the country's fiscal deficit to new heights.

In August, the country's unemployment rate rose to 8.5% from 8.4% in July, the Czech labor ministry said Tuesday. Later this week, the country's finance minister will submit a 2010 budget to parliament, projecting a deficit of 7.4% of GDP.

Exports from the Czech Republic fell by a marked 16.6% in the second quarter while imports dropped 17% from a year earlier. Fixed capital formation slid an annual 7.2% as overall gross capital formation fell 21.5%.

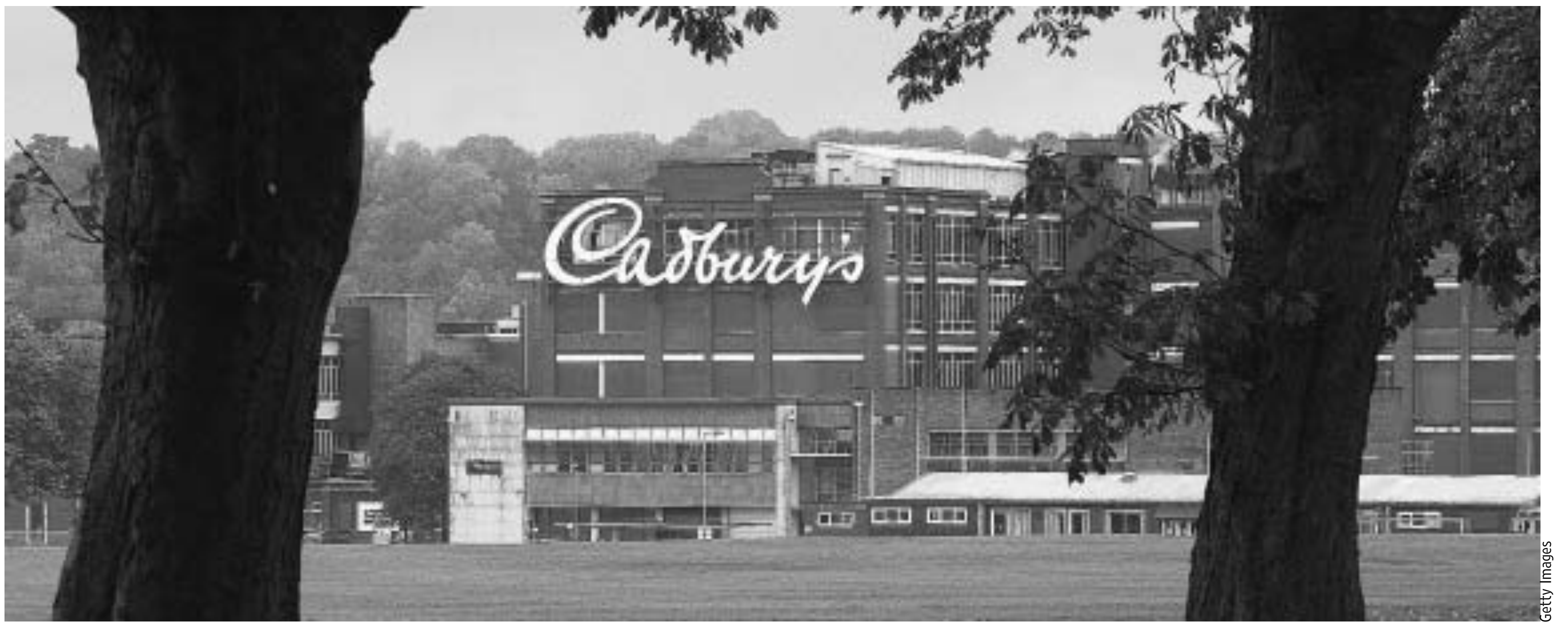
The only segments to post annual growth were government and household spending, which rose 2.7% and 1.6% respectively.

LEADING THE NEWS: KRAFT BIDS FOR CADBURY

Small town is sweet on Kraft's Cadbury bid

U.K. factory workers say potential deal could save their jobs

By Cecilie Rohwedder And Neil Shah



Getty Images

Cadbury is planning to close this U.K. facility and move its 500 jobs to Poland. Kraft, in its letter to Cadbury outlining its bid, said it believes the factory could be kept open.

KEYNSHAM, England—A "Save Cadbury's" campaign is thriving in this small town, which is home to a red-brick factory that makes candy bars for Britain's iconic chocolate company. But the effort doesn't target foreign aggressor **Kraft Foods** Inc. and its surprise attempt to take over beloved **Cadbury** PLC.

This campaign is trying to save the factory from Cadbury itself.

Cadbury is planning to close the facility and move its 500 jobs to Poland. Kraft, in its letter to Cadbury management outlining its takeover bid, said it believed the factory, called Somerdale, could be kept open. Indeed, the letter from Kraft Chief Executive Irene Rosenfeld said the deal would result in more jobs in the U.K.

And that has led local factory workers to embrace a foreign takeover of their company. "If Kraft are true to their word, then they are our savior," said Janet Chick, 43 years old, who has worked on Cadbury's Somerdale production line for five years, ensuring that Cadbury Fudge bars are packaged correctly. Cadbury runs in the family: Her sister has worked at the plant for 30 years, and her mother and many other family members worked there too.

Cadbury is the last survivor among a trio of proud and historic chocolate brands that generations of Britons have grown up with. All three—Cadbury, Fry's and Rowntree—were founded by Quakers, who often became businessmen because they were barred from many other professions and who often had a taste for chocolate because they didn't drink alcohol.

Fry's was founded in nearby Bristol in 1838. Cadbury's roots date back 185 years, when Quaker John Cadbury opened a small shop in Birmingham. Rowntree was launched in York. There has been plenty of corporate upheaval over the years. Fry's merged with Cadbury in 1919, though its name still appears on some Cadbury products. Much later, in 1988, Rowntree was bought by Swiss food group **Nestlé** SA.

Keynsham, between Bristol and Bath, has long been at the center of Britain's confectionery tradition. The plant here, which dates back to 1919, was originally a Fry's facility. Local residents, who say chocolate flows through their veins, still often refer to the plant as Fry. They also frequent the Fry Club, built by the company on factory grounds and still a popular place to play soccer and tennis or get married.

But two years ago, Keynsham's place in the chocolate universe was threatened. Cadbury announced in fall 2007 that it would close the Somerdale chocolate factory by 2010. The move was part of a sweeping turnaround plan by U.S.-born Chief Executive Todd Stitzer to boost Cadbury's profitability by closing factories, reducing the number of product variations and reducing the work force by about 15%.

Somerdale, the company said, was old and was working below capacity. Cadbury spokesman Tony Bilsborough declined to comment on Kraft's plans to reverse the decision.

Cadbury's plan wasn't seen as an empty threat by local residents. The company already makes Cadbury Mini Eggs at its new plant in Poland, and 100 jobs in Keynsham are already gone.

So townspeople fought the move. They marched on Cadbury's headquarters and the Houses of Parliament in London. They protested with help from the trade union, a bishop and even James Bond actor Roger Moore, who said he had always enjoyed Cadbury products. They also wrote to Britain's prime minister, boycotted Cadbury's products and admonished Cadbury for supporting cocoa farmers in Africa and London's Olympic bid instead of Somerdale workers.

Richard Hutton, 35, who has worked at the factory for the past nine years, said Tuesday night that the Kraft deal "gives us a chance to keep our jobs, and keeps a British product in Britain."

If Kraft is "honest and sincere, they will keep Somerdale open," said Amoree Radford, founder of the "Save Cadbury's" campaign aimed at preserving the plant. Ms. Radford, whose husband and daughter work at the factory, isn't concerned about an American takeover. "People don't realize that Cadbury has been run by American millionaires already."

So around Keynsham, a lot of people are rooting for Kraft, not the hometown company.

"This is the last red-brick industrial complex in Bristol," said John Vincent, an engineer and contractor who provides services to Cadbury and also worries about his future. "People have lived here for five generations, their fathers worked there, they even met their wives there," he said.

One prominent Kraft fan is Royston Staddon, chairman of the Town Council in Keynsham, which is too small for a mayor of its own. "If Kraft wins the takeover bid, as long as they keep the factory open and create work for Keynsham residents, we are completely behind it," he said.

Nestlé and Hershey could be left in a sticky situation

Kraft Foods Inc.'s bid for **Cadbury** PLC could put **Nestlé** SA and **Hershey** Co. in a not-so-sweet spot if the latter two don't assemble a deal separately or together.

By Julie Jargon, Deborah Ball and Ilan Brat

On Monday Cadbury publicly rejected Kraft's $16.73 billion unsolicited takeover offer. The British gum-and-candy maker is aiming to either maintain its independence, hold out for a higher price from Kraft or seek a friendly bidder. Kraft Chief Executive Irene Rosenfeld reiterated on a conference call with investors Tuesday that Kraft aims to enter friendly negotiations with Cadbury. Kraft shares fell Tuesday, suggesting investors may be wary of the food giant raising its bid by much.

Considered the last major acquisition target in the candy industry, Cadbury could help Switzerland's Nestlé regain some of the top share positions it lost when **Mars** Inc. merged with Wm. Wrigley Jr. Co. last year. For Hershey, Cadbury offers the kind of global reach the Pennsylvania company needs to remain competitive.

A person familiar with Hershey's thinking already has said the company "is likely to make some response." That has spurred speculation that Hershey could team with Nestlé. But Hershey's relatively small size and its organizational structure could complicate a bid. Hershey is governed by an outside trust that has insisted on maintaining control.

A Hershey spokesman declined to comment Tuesday. Hershey shares rose 1.3%, or 50 cents, to $39.13 in New York Stock Exchange composite trading Tuesday.

Nestlé Chief Executive Paul Bulcke said Monday that the company is always "open to acquisition opportunities if they fit strategically," but that its appetite is limited.

"In terms of transformational deals, [buying Cadbury] would be it" for Nestlé, said Neil Saunders, consulting director of Verdict Research in London. If Nestlé doesn't win Cadbury, he added, "they will just have to work harder with what they've got."

The Mars-Wrigley merger knocked Cadbury out of the No. 1 position in the global confectionery business. That deal allowed Mars to join Cadbury as the only other candy company with commanding presences in all three confectionery categories: chocolate, gum and sugar candies.

For Nestlé, the world's No. 3 player in confections, the Mars-Wrigley tie-up quickly highlighted weaknesses. Nestlé had three No. 1 or No. 2 positions in the top 15 candy markets, but after the merger, it had only one, according to Sanford C. Bernstein research.

When Mr. Bulcke became Nestlé's CEO last year, he made reviving the confectionery business a priority, Nestlé executives say. Now, a combined Kraft-Cadbury would challenge Nestlé in some key geographic markets. For instance, Kraft's Milka chocolate is strong across continental Europe, providing a base to launch Cadbury brands, which have been weak there.

In addition, Kraft's No. 2 position in Latin American chocolate—particularly in Brazil, where Kraft enjoys a 30% market share—would be bolstered by Cadbury's dominant gum business there. Nestlé's largest confectionery market is Brazil.

A combined Kraft-Cadbury could have its biggest impact by consolidating the chocolate industry in Western Europe. A combined company would become the market leader that highly fragmented market, with about 21% of sales, according to Barclays Capital analyst Andrew Lazar.

A Kraft-Cadbury combination would be even more challenging for Hershey, which relies almost solely on the U.S. market for sales and profits. That new combination would make Hershey a distant No. 4 in the global confectionery market.

Without an international partner like Cadbury, "Hershey is going to be uncompetitive in many global markets," says Stifel Nicolaus analyst Christopher Growe. "If you spend a million dollars to develop a new product, you can get a much better return on your investment if you're selling it in 150 countries rather than in just one."

Hershey has a long-term contract to market Cadbury products in the U.S. that dates to the 1980s. Neither Cadbury nor Hershey would say whether the contract contains a "change in control" provision that would be triggered by another company purchasing Cadbury.

Because Hershey has little presence outside the U.S. and wouldn't reap as much cost savings from a Cadbury purchase, Mr. Growe says a deal effectively would cost the maker of Reese's peanut butter cups and Hershey's kisses more to acquire Cadbury than it would cost Kraft. Kraft has said it expects it could trim $625 million in costs after acquiring Cadbury.

Hershey, which had been a laggard among the largest packaged-food companies, has been resurgent. It has been raising its prices as consumers have traded down to cheaper chocolates and has gained some market share. After falling for several quarters, its operating income has risen in the last nine months. Hershey's sales in the second quarter grew 6% to $1.171 billion while its net income grew 46% to $147 million.

For consumers, any further consolidation could mean higher candy and gum prices. Candy companies already have been raising prices due to higher costs for ingredients.

In August of 2008, Hershey said it would raise prices by 10%. Holiday candy prices already had been set by retailers by that time, so this coming Halloween and Christmas is when Hershey consumers will see higher-priced fall and winter holiday candy prices.

"There will be a lot of attention paid to how consumers respond to those prices and that will set the tone for how much wiggle room there is for further price increases," says Erin Swanson, an analyst at Morningstar Inc. Ms. Swanson adds, though, that if candy makers duke it out for market share, they could lower prices at some point.

Analysts say they don't think another big candy industry merger will portend further consolidation in the broader food industry.

—Anjali Cordeiro contributed to this article

LEADING THE NEWS

India warns of inflation

Reserve Bank of India Governor Duvvuri Subbarao, shown in December, said in an interview this week that inflation has arrived sooner than he had expected.

Associated Press

Central-bank chief suggests rising prices may increase rates

BY NATASHA BRERETON

BASEL, Switzerland—The Reserve Bank of India may have to reverse its easy monetary policy sooner than most other countries as inflationary pressures mount, the head of the central bank said.

"Inflation has come upon us sooner than we had expected," Reserve Bank of India Governor Duvvuri Subbarao said in an interview this week. "The debate about exit policies all around the world is a debate in India, too. But the contours of the debate are different, because we may have to decide on this sooner than most other countries."

India's strong fundamentals, which helped to drive its rapid growth before the global financial crisis, remain intact and will accelerate any future upturn, Mr. Subbarao said.

His remarks are the RBI's most specific warning to date about a possible rise in interest rates. Late last month, the central bank signaled growing discomfort with rising prices, saying that a loose monetary policy could engender inflation, which could constrain economic growth "in the medium term."

Mr. Subbarao also reiterated that India's surge in government borrowing for its economic stimulus, which amounted to 3.8% of gross domestic product, was necessary but that it could boost inflationary pressures.

The RBI chief was in Europe to attend a meeting of finance ministers and central bankers from the Group of 20 emerging and industrialized economies in London, and meetings at the Bank for International Settlements in Basel. He said the mood among world central bankers is more upbeat than before, but they are cautious about early signs of a global recovery, which may be very gradual. G-20 finance officials agreed over the weekend to develop "cooperative and coordinated" exit strategies but said the scale, timing and sequencing of action would vary across countries.

The RBI has cut its benchmark lending rate by 4.25 percentage points since October and reduced the ratio of deposits that banks must set aside by four percentage points. It is expected to be one of the first major Asian central banks to begin unwinding its easing. In July, the bank raised its inflation forecast for the fiscal year through March to 5%, from 4% previously.

Many analysts predict the RBI will start to withdraw liquidity in the October-December quarter and raise rates in the first half of next year. Macquarie Securities forecasts the first rate increase will be in April, while Bank of America-Merrill Lynch expects rate increases to start in January.

Mr. Subbarao declined to comment directly on such views, but he was clear about the need to return to more-standard monetary conditions. "The current expansionary fiscal-policy stance and monetary accommodation does not constitute the steady state," he said. "We need to go back to a steady state."

In judging the appropriate timing for doing so, the RBI will be looking primarily at inflation, especially in the manufacturing sector, using the wholesale and consumer price indexes, and disaggregated inflation. It will also monitor credit growth, capital flows and conditions in agriculture and industry, he said.

India's economic growth of 6.7% last fiscal year gave rise to optimism, but that positive sentiment has somewhat eroded in the past few weeks, Mr. Subbarao said.

That reflects the fact that the expansion was mainly on the back of large government stimulus, but private consumption and investment have slowed, and concerns about rising inflationary pressures have stirred. Another concern is a lack of rain, especially in India's food-growing areas, with the monsoon currently 3% below its long-term average overall. Farm output accounts for around 18% of the country's GDP.

—Subhadip Sircar in Mumbai contributed to this article.

Triac's Peltz prods Cadbury, reaps rewards over and over

BY PETER LATTMAN

Cadbury PLC has been very sweet to Nelson Peltz.

The billionaire investor made a killing when the U.K. chocolate maker bought his Snapple beverage business nearly a decade ago. He then acquired a big chunk of Cadbury and pushed the company to spin off its beverage business, creating a compelling acquistion target for **Kraft Foods** Inc. or perhaps another suitor.

Nelson Peltz

Mr. Peltz's Trian Fund Management owns 3.5% of Cadbury, having accumulated its stake in 2007. Last year Cadbury succumbed to pressure from Trian when it became a pure confectionery company by spinning off its Dr Pepper soft-drinks business.

That spinoff included Snapple and other brands that Cadbury had acquired from Mr. Peltz's **Triarc** Cos. in 2000 for $910 million.

Mr. Peltz had long argued that the breakup of Cadbury would enhance value by removing the distractions of the U.S. soda business, which also owns 7-Up and Clamato beverages. That strategy worked as Cadbury management increased the profitability of its candy and chewing-gum business, which includes brands such as Dentyne and Bubblicious.

Trian also owns a stake in Cadbury's suitor Kraft. Since accumulating Kraft shares in 2007, Trian has quietly pressed the company to pare its large portfolio of brands and expand its global reach with an acquisition. In November 2007, Kraft appointed two independent directors approved by Mr. Peltz and his partners. Trian, in turn, assented to a standstill agreement in which it wouldn't make any noise for two years. That pact expires in October, according to people familiar with the situation.

A spokesman for Trian declined to comment. But in an interview last year, Mr. Peltz said, "if you look at the best food companies in the world, they are all very focused."

A major player in consumer products companies, Trian also controls large stakes in ketchup maker **H.J. Heinz** & Co., jeweler **Tiffany** & Co. and fast-food chain **Wendy's/Arby's** Group. It also retains a large stake in **Dr Pepper Snapple** Group.

Mr. Peltz and his partners at Trian, Peter May and Edward Garden, are known for working with the management of the companies in which they invest rather than ousting executives. Indeed, the investors bristle at the "activist investor" label often pinned on them and prefer to think of themselves as "constructivist" investors. While they sometimes seek board seats at companies—as they did at Heinz—they don't always publicly agitate for change.

The son of a New York fruit-and-vegetable distributor, the 67-year-old Mr. Peltz has long had a soft spot for food and other branded-products companies. In the 1980s he became known as one of the original junk-bond kings, building packaging giant Triangle Industries through heavy borrowings financed by Michael Milken's Drexel Burnham Lambert.

Trian recently returned to its debt-market roots by recruiting two former Drexel bankers to help launch a credit-investment fund. That fund, which began investing this year, has benefited from the sharp rally in the bond markets.

CORPORATE NEWS

Chinese auto sales grew 90%

Lower tax on small cars boosts August results, but raises worries about 2010 demand

By Patricia Jiayi Ho

BEIJING—China's auto industry continued to post strong growth, with sales of passenger vehicles rising 90% in August. Some industry watchers see growth slowing dramatically next year, however.

Passenger-vehicle sales in China rose to 858,300 units in August, up 90% from a year earlier, the China Association of Automobile Manufacturers said in a statement Tuesday. China's overall auto sales rose 82% in August to 1.14 million units, CAAM said. It didn't provide the year-earlier figures.

China looks likely to hold on to its position as the world's largest auto market this year, helped by a recovering economy and a push to encourage small-car purchases. Overall auto sales in the U.S. totaled 1,261,97 in August, topping China's, but they were boosted by the federal government's "cash for clunkers" program.

Many expect a drop-off in China. China's sales have been boosted by a halving of the purchase tax on smaller cars, to 5%. Analysts say this pulls forward future demand and sales may collapse when the full tax is reinstated at the end of 2009.

"Everyone is worried about next year," said Zhang Xin, an auto analyst with Guotai Junan Securities. "You can't continue to rely on government policy."

China's passenger-vehicle sales in the January-August period rose 37% to 6.23 million units, CAAM said. Total vehicle sales during the eight-month period rose 29% from a year earlier to 8.33 million units.

Manufacturers and dealers have been offering price cuts on their vehicles, in some cases equivalent to a 5% purchase tax cut, to encourage consumers to buy larger models and meet sales targets, Mr. Zhang said.

Agence France-Presse/Getty Images

Tax incentives aided strong Chinese auto sales last month. Customers beside a Ford Fiesta at a Beijing dealership in July.

Last week, a senior minister from China's economic planning agency warned of excess capacity arising in the next few years.

"The outlook for growth in China's auto industry is still uncertain," said Chen Bin, head of the National Development and Reform Commission's Industry Coordination Department, state-run Xinhua news agency reported Saturday.

He added that the industry faces challenges as the impact of government policy wear off and environmental concerns grow. According to an NDRC survey, "capacity will greatly exceed demand" in the coming years.

Capacity utlization rates are "reasonable" now, but could later fall below 70%, Mr. Chen said, according to Xinhua.

Market-research firm J.D. Power and Associates forecasts passenger vehicle sales to grow 2% in 2010 to 7.54 million units, followed by 10.2% growth in 2011 to 8.31 million units.

"While growth in 2009 is expected to be high, some of that is drawn from 2010," it said in a report. "Growth in 2010 is at best expected to be moderate."

Other observers' views are for a less drastic slowdown.

Tony Liu, senior vice president of Sinotrust, a market information provider, forecasts growth of 10% to 20% in China's auto industry next year, as he believes the foundation for vehicle demand has been laid.

While in the U.S., 70% to 80% of vehicles are bought to replace other vehicles, about 70% of customers in China are first-time buyers.

"There is a very solid need," he said, as cars are increasingly perceived as a household item.

Mr. Liu said he expects sales of small cars to continue to outperform the industry, even after the purchase tax cut incentive ends at the end of the year. "Customers right now are becoming younger," he said. They only need and can only afford smaller cars, he said.

As the breakneck pace in sales growth eases, it will help to spur consolidation in China's auto industry, which currently has more than a hundred vehicle manufacturers, Mr. Liu said.

Indian auto sales increased 26% in August

By Nikhil Gulati
And Santanu Choudhury

NEW DELHI—Car sales in India rose 26% in August as auto makers such as **Maruti Suzuki** India Ltd., **Hyundai Motor** Co. and **Tata Motors** Ltd. continued to dispatch more cars from their factories to meet an expected spurt in demand for new vehicles during the festival season.

Sales climbed to 120,669 cars in August from 96,082 a year earlier, according to data issued by industry lobby group the Society of Indian Automobile Manufacturers.

The gain in August—the seventh straight month of increases in local car sales—follows July's 31% rise, which was the biggest percentage gain since February 2007.

Higher loan rates and banks' reluctance to lend for buying vehicles last year forced customers to defer purchases of new cars, motorcycles and trucks in Asia's third-biggest automobile market.

However, a slew of federal government stimulus packages, including tax cuts, earlier this year to lift a slowing economy, along with several lending rate cuts by the central bank, have improved credit availability, encouraging people to buy new vehicles.

"With an improvement in the external environment, higher availability of finance and under-control inventory, the outlook for volumes is improving," Jinesh Gandhi, an analyst at Mumbai-based Motilal Oswal Securities Ltd., said in a recent note. "This, coupled with new product launches and a change in emission norms, would aid volume growth in the second half of this fiscal year."

The analyst said, however, that the impact of weak monsoon rains on the farming sector and a hardening of interest rates could affect vehicle sales between October 2009 and March 2010.

Auto makers are gearing up to meet increased demand during India's festival season, which starts this month.

Honda Motor Co. was set to introduce Tuesday an upgraded version of its Civic sedan , while **Ford Motor** Co. is likely to unveil a refurbished Endeavour sport-utility vehicle this week.

Meantime, Tata will set up a factory to assemble electric vehicles in the U.K., Spain or Norway, Clive Hickman, chief executive of Tata's European technical center, said Tuesday.

The facility will be operating by year end and is set to initially assemble 5,000 electric cars a year.

—Bernd Radowitz contributed to this article.

Toyota plans to add 800 workers in Japan as sales pick up

By Yoshio Takahashi

TOKYO—**Toyota Motor** Corp. said it will recruit about 800 temporary workers in October in Japan to coincide with a recovery in once-stagnant auto sales.

The move marks the auto maker's first new hiring, other than recent graduates, in 16 months. It underlines the effect of the pickup in auto sales in key markets fueled by tax breaks and subsidies to spur demand.

The world's biggest car maker by sales reduced its domestic temporary production staff by two-thirds in the last fiscal year as it cut production in response to the economic crisis.

The latest hiring represents 0.2% of Toyota's total work force of around 320,800 employees.

Following last week's news of its first domestic sales increase in 13 months in August, taking on new staff is the latest sign that the worst has passed for Toyota.

The firm aims to return to profitability in the next fiscal year following a projected 450 billion yen ($4.84 billion) net loss for the year to March 2010.

Toyota follows **Mitsubishi Motor** Corp. in resuming recruitment for domestic production, in a country where the unemployment rate hit a record high of 5.7% in July. Mitsubishi plans to hire 650 temporary workers this fiscal year, representing 2% of its staff of around 31,900.

Toyota is idling production lines to cut costs and address its excessive capacity, but it has decided to recruit production staff to meet demand for its Prius hybrid, whose Japan sales have benefited from government incentives to buy fuel-economy cars.

Luxury-car sales slip as market is soft in Europe

By Christoph Rauwald

FRANKFURT—The world's three largest luxury-car makers reported weaker sales in August as a soaring Chinese market failed to offset anemic demand on the companies' home turf in Europe.

BMW AG said sales last month at its core brand declined 11%, compared with a year earlier, to 75,689 cars, but the the world's top seller of premium autos voiced hope that market conditions would ease in coming months.

"We are heading in the right direction—since April we have continually regained ground month-on-month," said BMW executive-board member Ian Robertson in a prepared statement. "In August the trend continued," he added.

"I am cautiously optimistic that we will be back on our growth path in the months ahead," Mr. Robertson said.

Sales at the Munich-based company fell 18% in the year's first nine months to 679,893 cars, compared with the same period last year.

Government-backed scrapping incentives to trade in old gas guzzlers for new, more fuel-efficient vehicles in many countries revived demand mainly for small vehicles, leaving manufacturers of big and powerful luxury cars to fend for themselves.

Demand for new cars collapsed toward the end of last year, and the market weakness spilled over into 2009. A time frame for a broad recovery remains uncertain.

Daimler AG's Mercedes-Benz brand, the world's No. 2 luxury nameplate, said sales dropped 12% in August, compared with a year earlier, to 66,200 cars.

In the January-to-August period, the brand's sales fell 18% to 632,700 vehicles.

"We expect sales to be on a higher level in the coming months, in part because of the new E-Class station wagon," said Mercedes-Benz sales chief Klaus Maier. He said the Stuttgart-based auto maker expects to gain further momentum from the revamped flagship S-Class model.

"In August, we also introduced the vehicle in China," Mr. Maier said. He added that China is the world's biggest market for the S Class.

After eking out sales increases in June and July, Audi AG said sales in August fell 2.7% from a year earlier to about 65,900 cars. For the January-to-August period, sales at the **Volkswagen** AG premium brand declined 7.5% to about 616,850 cars.

Audi has narrowed the gap with its two larger German rivals in recent months, thanks partly to a strong footprint in China, relatively small exposure to the troubled U.S. market and the launch of new models such as the small Q5 sport-utility vehicle.

"We set ourselves a sales target of 900,000 cars this year...This target we are certain to reach," said Audi executive-board member Peter Schwarzenbauer. He added that the Ingolstadt-based auto maker expects to "emerge from this crisis as the strongest premium brand."

CORPORATE NEWS

RBS moves ahead with asset sale

Bank hires Goldman to find a buyer for aircraft-leasing arm

BY SARA SCHAEFER MUÑOZ

LONDON—**Royal Bank of Scotland Group** PLC has hired **Goldman Sachs Group** to find a buyer for its aircraft-leasing business, said people close to the matter, taking a step forward in a disposal process amid a glut of similar assets on the market.

The RBS unit has assets valued at about $8 billion, these people said. But any sale would likely bring in much less for the bank.

RBS is moving ahead with the sale as demand for aircraft has decreased.

The unit also could face competition from **American International Group** Inc.'s aircraft-leasing business, International Lease Finance Corp. After almost a year of trying to sell ILFC, AIG hasn't found a buyer and has paused the sale process, though ILFC's chairman and chief executive has discussed purchasing part of the portfolio. ILFC's fleet is valued at a little more than $40 billion.

Bloomberg News

Stephen Hester, the chief executive of the Royal Bank of Scotland Group, designated the aircraft-leasing unit as a noncore asset in February.

The sale process for RBS could take several months, as Goldman will first review the business and prepare it for sale, people close to the matter say. Also, RBS doesn't want to sell the unit at a discount, says one person close to the matter.

The Dublin unit leases aircraft to more than 100 airlines in 38 countries and has loans secured against roughly 300 commercial aircraft, according to the bank.

In February, Chief Executive Stephen Hester designated the unit as a noncore asset, among a group that he plans to run down or sell as he restructures the troubled bank.

RBS is 70%-owned by the U.K. government after a bailout last autumn. Mr. Hester took over when the bank was on the brink of collapse, and part of his turnaround strategy is to shed most nonbanking activities.

As part of the reorganization, RBS also is trimming operations abroad.

Last month it sold commercial and retail operations in Taiwan, Hong Kong, Singapore and Indonesia as well as some wholesale operations in the Philippines and elsewhere to Australia & New Zealand Banking Group Ltd. for $420 million.

It also completed the sale of RBS Pakistan to MCB Bank Ltd. for $87 million, and is working on a deal to sell assets in China and India, valued at several hundred million pounds, to U.K. bank Standard Chartered PLC.

Air France may trim some business-class seats

BY DAVID PEARSON

PARIS—In a move to improve profitability, **Air France-KLM** SA said Tuesday it could cut business-class seats on some routes and eliminate some destinations as part of a broad restructuring of its medium-haul network and operations.

Like other airlines, Air France has been hit by a slump in demand for premium-class travel as companies and institutions pare back operating expenses in the tough economic environment.

A spokesman for the airline said eliminating business-class seating areas was one of the options to improve yields on routes to Europe and North Africa. In recent years, Air France has eliminated premium-class cabins on its short-haul operations inside France, the spokesman said.

Presenting the airline's first-quarter results at the end of July, Air France Chief Executive Pierre-Henri Gourgeon told analysts the airline would revamp its medium-haul operations both in terms of the network and products.

The spokesman said strategic decisions would be made by year end for implementation early next year.

Apart from the decline in premium-class travel, from which airlines derive a large chunk of their profits, Air France has been suffering from competition from low-cost airlines, notably **easyJet** PLC, and from high labor costs relative to its peers.

EasyJet has been making inroads at Air France's hub at Roissy-Charles de Gaulle airport in recent years, taking customers away from the Franco-Dutch airline and forcing it to trim its margins to remain competitive.

Air France-KLM on Tuesday reported a 2.9% drop in August passenger traffic, but said load factor, which measures how full its planes are, improved 1.1 percentage points to 84.8% as the airline cut capacity 4.2%.

Air France-KLM is "at greater risk from low-cost competition" than either Deutsche Lufthansa AG or British Airways PLC, Deutsche Bank said in a report Tuesday, noting that the easyJet was targeting Air France's high-yield business routes such as Paris-Milan. Air France-KLM gained 6.3% Tuesday.

—William Horobin contributed to this article.

Kingfisher forced to release results early following leak

BY ANITA LIKUS

LONDON—**Kingfisher** PLC released some financial results more than a week early on Tuesday, after the company accidentally sent draft data to analysts.

Europe's biggest home-improvement retailer was scheduled to release interim results on Sept. 17. But some information was sent to analysts Monday afternoon. "It has come to our attention that, due to an administrative error, some draft figures were circulated externally," the company said in a statement Tuesday.

In its partial update released Tuesday, the company said it expects adjusted pretax profit in the range of £285 million to £290 million ($466 million to $474 million), for the six months ended Aug. 1. That is up from the £214 million reported in the first-half ended Aug. 2, 2008, driven by improved trading at the retailer's biggest division, B&Q, in the U.K., as well as cost cutting during the economic downturn.

Kingfisher said it expects retail profit in the range of £345 million to £350 million, with contributions broadly made up of £148 million from the U.K. and Ireland, £146 million from France and £53 million from other international centers. That represents a big improvement on the year-earlier interim retail profit— which the company defines as continuing operating profit before central costs, exceptional items, amortization of acquisition—of £277 million, helped by recent warm weather, renewed enthusiasm for do-it-yourself activities and cost cutting. No other figures were released by Kingfisher.

The figures haven't yet been formally approved by Kingfisher's audit committee and board, so they could be subject to change, according to the company. Still, analysts welcomed the range, saying that the profit forecast was ahead of expectations.

"Good news comes early," said Pali International analyst Nick Bubb, adding that the new range might spark upgrades to consensus figures.

Kingfisher said it "will provide more detail on the first half of the year, along with an outline of its plans for the balance of the year, in what is expected to be a challenging trading environment."

Mr. Bubb said Kingfisher's cautious comment, that it operates in a challenging environment, is nothing to worry about, adding that they just "don't want people to get carried away." Mr. Bubb has a "buy" rating on the company.

—Lilly Vitorovich contributed to this article.

Roche appoints Genentech chief to lead drugs unit

BY JULIA MENGEWEIN

ZURICH—**Roche Holding** AG on Tuesday named new heads for its pharmaceuticals and diagnostics divisions, in a largely expected shakeup that underscores the importance of recently acquired Genentech Inc. to the Swiss drug maker's future.

Pascal Soriot, who has overseen Genetech's integration into Roche in recent months, will take over as head of Roche's pharmaceutical division. He follows long-serving William Burns, who will be nominated to the company's board next year. Mr. Burns's retirement as pharmaceuticals chief was announced in April.

Dr. Soriot, a Frenchman trained as a veterinary surgeon, will oversee global commercial operations and marketing, as well as some aspects of developing new drugs. He had been appointed as the chief executive of Genentech earlier this year, after Roche took full control of the U.S. biotechnology company in a $47 billion deal.

Roche acquired all of Genentech to get full control of the company's lucrative cancer drugs.

The Swiss company also named a new head of its smaller diagnostics division, which makes machines and other tools that diagnose and monitor disease. Daniel O'Day, currently a senior executive in that unit, will take over as head of the division, following Jürgen Schwiezer, who is retiring at the end of the year.

—Jeanne Whalen in London contributed to this article.

GLOBAL BUSINESS BRIEFS

TUI Travel PLC

Firm pares pact with Air Berlin

TUI Travel PLC, Europe's largest travel company, Tuesday said it had abandoned cross-shareholding plans with German airline **Air Berlin** PLC following talks with Germany's Federal Cartel Office. However, TUI said the decision doesn't affect other commercial agreements between the companies announced in March and the benefits of transferring TUIfly's scheduled-flights business to Air Berlin. TUIfly is TUI Travel's German aviation unit. TUI Travel will now either buy a 9.9% stake in Air Berlin for €33.5 million ($54.8 million), selling the stake over a period of time, or pay Air Berlin €15 million. Nick Batram, an analyst at KBC Peel Hunt, emphasized that the core component of the deal was still in place.

Ford Motor Co.

Ford Motor Co. launched production of its new Transit Connect model in Romania on Tuesday, two years after the company took over a state auto maker in the country. The Transit Connect, a compact van, will sell for €14,000 to €15,600 ($20,000 to $22,000) in Romania and the U.S. Ford plans to build 300,000 automobiles in Romania in the next four years, and said it will hire an extra 3,000 employees throughout the country. It currently employs about 4,000 people. Romania's government said in March it would grant €143 million in aid to Ford. The state aid, spanning until 2012, will support production at the factory in Craiova in southern Romania.

China Mengniu Dairy Co.

China Mengniu Dairy Co. said its first-half net profit rose 14% from a year earlier as sales gradually recovered after last year's tainted milk scandal. The Inner Mongolia-based dairy producer said its net profit was 661.9 million yuan ($96.9 million) for the six months ended June 30. Revenue fell 12% to 12.1 billion yuan. Mengniu said that both the up and downstream parts of the industry were showing signs of recovery from the milk scandal in September last year. China's dairy industry was rocked by disclosures about the illicit use of the industrial chemical melamine in Chinese milk products, including exported ingredients. Mengniu was among the firms found to be at fault in the scandal.

Pioneer Corp.

Pioneer Corp. said it won't pay an interim dividend this fiscal year as it braces for a sixth consecutive year of loss. The electronics company, which forecasts a net loss of 83 billion yen ($892.8 million) for the business year ending March 2010, said it will decide later whether to pay a dividend for the fiscal second half. Pioneer is shifting focus to in-car electronics devices and away from flat-panel televisions, and plans to raise about 40 billion yen, mainly from business partners and banks to facilitate the switch. It is also considering applying for public funds, while also taking steps to pare operations, including closing production facilities at home and abroad and reducing its work force.

—Compiled from staff and wire service reports.

Karzai gains, on cushion of suspect votes

Preliminary Afghan election tally gives president a majority, but officials say tainted votes pushed him across

BY MATTHEW ROSENBERG AND ANAND GOPAL

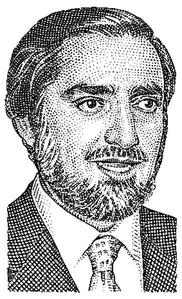
KABUL—Afghanistan's government-appointed election commission released a preliminary tally that gives President Hamid Karzai enough votes for re-election without a runoff but, against U.S. wishes, includes votes tainted by fraud charges.

Hamid Karzai

If those suspect votes were excluded, Mr. Karzai would likely have less than the absolute majority needed to avoid a second-round run-off, though not all votes have been counted.

With results in from almost 92% of polling sites in the Aug. 20 presidential election, Mr. Karzai has 54.1% of the votes; his main challenger Abdullah Abdullah has 28.3%, according to the Independent Election Commission, or IEC.

A spokesman for Mr. Karzai's campaign said they had won "the right to celebrate," but added: "Obviously, there is controversy surrounding these results."



Abdullah Abdullah

Dr. Abdullah rejected the results. "We have been saying from the beginning that the IEC has been proceeding in an illegal manner and we won't accept it," said Dr. Abdullah's campaign spokesman.

The U.S. and its allies have continued to back Mr. Karzai's government while pushing it to investigate charges of electoral fraud to help raise the credibility of a flawed election. The U.S. has pressed election officials to disqualify tainted votes before announcing results, and encouraged Mr. Karzai not to claim victory based on those votes.

Afghanistan's security woes, with the Taliban pressing into once-peaceful parts of the country, have exacerbated the political crisis.

On Tuesday, a suicide bombing outside the gates of Kabul's main airport killed at least three civilians and wounded six, the latest in a series of assaults on the capital this summer. The same day, four U.S. soldiers were killed in an ambush in the northeastern province of Kunar, said Capt. Elizabeth Mathias, spokeswomen for U.S. forces here. U.S. deaths have spiked this summer, and August was the deadliest month for troops since the war began in 2001.

Amid the heightened violence from the Taliban insurgency, Afghan and Western officials have been trying to sort out a troubled presidential election.

Afghanistan's election commission has flagged 10% to 15% of votes in Tuesday tally as highly suspicious, according to Western and Afghan officials. The commission has set aside results from about 650 of the roughly 25,500 polling stations for further investigation.

That stand sharply contrasts with the position of the United Nations-funded election watchdog in Afghanistan that rules on issues of fraud and misconduct. On Tuesday, the Electoral Complaints Commission, which is run by a Canadian, ordered that ballots from all of the suspicious polling stations be recounted and audited.

Associated Press

Afghans cycle past an election poster in Kabul, Tuesday. The U.N.-backed complaints commission ordered a recount of some votes.

Officials from Afghanistan's election commission said that they wanted further clarification on which polling stations should be audited before they take action.

The order from the ECC applies to polling stations where more than 100 people voted and in which one candidate received more than 95% of the vote, or where there were more votes than registered voters, or both. The investigation would include hundreds of thousands of votes, and take weeks or months to sort out, Afghan election officials said.

Interviews with Western and Afghan officials indicate the election commission had decided against throwing out tainted ballots partly due to political pressure from Mr. Karzai's camp.

The commission said it didn't have the legal authority to exclude the votes. Many Afghan and Western officials in Kabul said that's not the case.

Zakari Barakzai, the deputy chief electoral officer of the commission, said there also was political pressure on the commission, although he wouldn't say who it came from.

"A certain political candidate informed us that this was against the law," Mr. Barakzai said, referring to excluding suspected votes. He also said the results are tainted: "The results we have so far are only half clean."

In the meantime, said a senior Western diplomat in Kabul, Afghanistan has a sitting president whose term has now expired and whose time in office has been extended by evidence of fraud on his behalf.

"Obviously, that raises a very serious question of his legitimacy in the interim," the diplomat said.

Dubai opens commuter rail under cloud of growing debt

BY STEFANIA BIANCHI

DUBAI—Dubai's ruler will open a 32-mile, single-line urban railway Wednesday, after just four years of planning and construction, at what has turned out to be an inauspicious time.

The city-state has been pummeled by the global financial crisis and economic downturn. Real-estate prices have tumbled and some of the emirate's most ambitious development projects have been halted.

Dubai has vowed to spend through the downturn, announcing its first forecast budget deficit in years to support infrastructure projects such as the rail system. Unlike some of its neighbors, however, Dubai doesn't have much oil and financed much of its recent, explosive growth with debt.

Dubai's government and its many related companies are estimated to have debts of almost $85 billion, more than double the city-state's gross domestic product, according to investment bank EFG-Hermes.

That figure doesn't include the cost of the Dubai Metro, which is primarily elevated railway with a small underground portion. Construction costs on the project have soared to 28 billion dirhams ($7.62 billion) from the 15.5 billion dirhams originally estimated, according to the emirate's Road & Transport Authority, or RTA.

Dubai's ruler, Sheik Mohammed bin Rashid Al Maktoum, who is prime minister of the United Arab Emirates, said Tuesday that the emirate can meet its debt obligations. Bankers have expressed concern about whether Dubai can repair or restructure two bonds, totaling about $4.5 billion, that are due by the end of the year.

"I don't blame them," he said, referring to decling confidence. "I assure you that we're all right, that the United Arab Emirates is all right."

The RTA has said it expects the metro will generate $4.6 billion over the next 10 years. To raise cash, it has offered naming rights for 23 of the planned 47 stations, as well as the two planned metro lines. So far, about $490 million has been raised from the sales.

The new line will be the first urban rail among the Persian Gulf's Arab states. Across the Gulf, Iran already operates a metro in Tehran.

Agence France Presse/Getty Images

A handout image from Dubai's Road and Transport Authority shows an August test run of the emirate's new metro network.

A crucial challenge will be weaning the emirate's drivers out of their air-conditioned cars. Motorists in the sheikdom benefit from inexpensive fuel subsidized by the government, and no tax on vehicles. Ticket prices for the metro will range between 49 cents and $1.80 depending on the distance traveled.

The RTA expects 200 million passenger journeys a year, reducing road congestion by as much as 17%.

—Margaret Coker and Andrew Critchlow contributed to this article.

Merkel urges restraint on airstrike details

German leader cites contradictory reports on civilian casualties

Associated Press

BERLIN—Chancellor Angela Merkel said the world should reserve judgment on whether civilians were killed in a German-ordered airstrike in Afghanistan, even as the North Atlantic Treaty Organization said it believed civilians died in the attack.

The NATO-led force announced Tuesday that it believed after a preliminary review that civilians had been killed and wounded along with insurgents in Friday's strike on two hijacked tanker trucks in the northern province of Kunduz. It said the top U.S. and NATO commander in Afghanistan, Gen. Stanley McChrystal, had appointed a Canadian major general to lead an investigation along with officers from the U.S. Air Force and the German military.

Ms. Merkel asserted in a nearly simultaneous speech to Germany's parliament that reports about civilian victims were still contradictory.

"It will not be possible for us to clear that up precisely here this morning," she said. "We will not accept premature judgments."

Ms. Merkel said she had given the same message to NATO Secretary-General Anders Fogh Rasmussen.

"I say this very clearly after what I have experienced in the last few days: I will not tolerate that from whoever it may be, at home as well as abroad," she told parliament.

European Pressphoto Agency/Belga

German Chancellor Angela Merkel addresses the lower house of parliament at the Reichstag in Berlin on Thursday.

She didn't address any details of the airstrike or the events that led to it.

Ms. Merkel pledged German support for a thorough investigation of the airstrike and didn't discount the possibility that civilians had been killed.

"We will not gloss over anything," she told lawmakers. "Every innocent person who dies in Afghanistan is one too many—we mourn every single one."

Gen. McChrystal ordered commanders in June to be sure any targets were clear of civilians before calling in an airstrike, hoping to reduce the growing number of Afghan civilian deaths, which have damaged the credibility of international troops.

Germany had been one of the harshest critics of using airstrikes as part of the mission. But a recent jump in attacks on their troops have resulted in a change in tactics. Earlier this year, the government changed the army's rules of engagement, allowing them to open fire, instead of waiting to be attacked.

Germany has been criticized by some of its NATO partners for calling in Friday's strike by a U.S. jet and for initially insisting that it appeared only militants were among the dozens who died. Only later did Germany officials acknowledge that civilians might have been killed.

German officials have backed their commanders since the airstrike, citing worries that the tankers could have been used in a suicide attack against their troops.

The Afghan government's director of criminal investigation, Mirza Mohammad Yarmand, said on Tuesday that the Taliban hijacked the tankers "to use as a rolling bomb against the government or government forces.

"Or they would have sold the gas in the tankers to fund their equipment and ammunition," he said.

The 4,200-troop German mission in Afghanistan has become increasingly unpopular at home, with polls showing a majority now opposed to it. But the airstrike doesn't appear to be poised to affect a Sept. 27 national election. Public outcry has been muted and none of the main political parties have wavered in their support of the mission.

Ms. Merkel said the Afghan mission remains necessary and helps protect "the life and limb of people here in Germany against the evil of international terrorism."

India's sugar-cane crop wilts in a protracted drought

By Arpan Mukherjee

SITAPUR DISTRICT, India—Deepak Singh's neighbor's sugar-cane stalks barely reach his waist—a vivid sign, he says, of the drought that has hurt local incomes and forced the world's largest sugar consumer, India, to buy sweetener from other countries.

"By now, the crop should have been taller than me," the six-foot farmer says.

Instead, fields of cane here in the northern state of Uttar Pradesh have turned pale yellow, from normal green, because of the dry weather.

During June through August, Uttar Pradesh traditionally receives about 27 inches of rain. This year, the state received 14.4. Meteorologists in India recorded the dryest June in 83 years. Monsoon rains came shortly thereafter, but were followed by a dry spell, with devastating effects. The rains, which normally continue at least until the middle of September, resumed in the third week of August, too late to redeem most crops.

Uttar Pradesh officials say they expect the state's area of cultivated sugar cane to shrink 16% for the year ending in March 2010. Amid the lean harvest, India is slated to import about five million tons of sugar by March, with demand driving up prices of sugar in India as well as prices of foreign sugar futures.

Sugar cane isn't the only crop suffering. The lack of rain has left a host of staples exposed to north India's sun, dramatically shrinking yields for rice, oilseeds and legumes, such as peas and beans. The result has been rising prices for consumers and soaring debt for farmers.

Among the places hardest hit by the drought is Uttar Pradesh, a state about the size of the United Kingdom with three times its population. The state alone contributes about a third of the rice in federal emergency grain reserves.

Uttar Pradesh is also the country's second-largest sugar producer. The government recently declared a drought in 58 of its 71 districts—the worst in decades.

The drought's effect has been amplified by the state's antiquated agricultural sector. Rain is usually the only means of sustaining summer-sown crops such as sugar cane, rice, oilseeds and legumes, largely because an irrigation network of canals is often dry due to poor maintenance. Uttar Pradesh also suffers from frequent power cuts, limiting the possibility of pumping ground water to fields.

India's national government has repeatedly outlined ambitious plans to revamp the irrigation network in its budgets, but little gets done at the state level. New Delhi recently attempted to slow surging prices for some commodities by limiting the amount of legumes that traders can store, and relaxing import restrictions on sugar.

Sanjit Das for The Wall Street Journal

A farmer plows his farmland in Uttar Pradesh, India. The state has been hit hard by a severe drought.

Despite these efforts, global sugar prices are climbing with increasing Indian demand. "The difficulty with such a large country is that whatever India does, either export or import, the quantity is so significant that the world market and sugar prices get affected," said Sharad Pawar, the federal farm minister.

While the prices of rice and wheat haven't surged—because the federal government has ample stocks of both—prices of sugar and legumes have risen between 30% and 40% in the past six months. Traditional Indian meals consist of rice, wheat and legumes.

Some analysts worry that surging commodity prices could weigh on consumer demand, just as the Indian economy is showing signs of shrugging off the global malaise. After hovering below 6% growth for months as consumer spending slowed during the global recession, India's economy grew by 6.1% in the April-June quarter.

This year, in Sitapur district, outside the state capital of Lucknow, swathes of farmland have been left unsown with many farmers deciding not to plant crops because of the drought.

Some hard-hit farmers here have become day laborers to support their families. As in past years, mounting debt has driven many farmers to despair. At least three debt-burdened farmers in Uttar Pradesh have committed suicide because of failed crops, according to Indian media reports.

A late spate of rain in mid-August has been too little, too late, for many farmers, falling after many had switched to crops that require less water, such as oilseeds and coarse cereals. Sugar needs about two years to grow, so farmers don't usually switch from sugar cane to other crops mid-season.

Brij Mohan, a farmer in the Rampur village of Rai Bareli district, is among those who switched to oilseeds from rice because of scant rain.

He and other farmers have taken emergency loans of as much as $100—more than a month's earning—to cushion their finances. But drought has hurt his latest crop, too.

To add to his woes, herds of wild antelope have wandered into his fields at night. The animals munch what remains of the oilseed, one of their favorite foods.