News in Depth: A foreclosure sale for Fed chief's boyhood home

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THE WALL STREET JOURNAL.

U.K. downturn inflates Lloyds fears

As economy continues to sour, greater loan losses could push bank closer to nationalization

By Sara Schaefer Muñoz And Alistair MacDonald

LONDON—With **Lloyds Banking Group** PLC and the U.K. government seeking to calm fears that the bank will be nationalized, they face a problem that Lloyds can't control: the souring U.K. economy.

Lloyds' shares fell 8.1% Monday after falling 32% Friday, the day it disclosed that it expects to post a £10 billion ($14.4 billion) pretax loss for 2008. The losses stem from souring loans related to Lloyds' recent acquisition of U.K. mortgage lender HBOS PLC.

That deal was struck on the fly last year in a bid to rescue HBOS; now the large losses have revived concerns that Lloyds, already 43% government-owned, will fall under government control.

Over the weekend and on Monday, government officials were quick to say that while nationalization was always an option there was no active consideration of such a move for Lloyds Banking Group. Lloyds shares dropped more than 20% at one point Monday, but finished the day at 56.40 pence (81 cents).

Like other banks, Lloyds' £660 billion loan book consists of loans to individuals and corporations, whose ability to pay them back hinges on the severity of unemployment and economic contraction in this recession.

Lloyds already cited those factors in disclosing Friday's losses. The problem now is that no one knows whether more of the combined Lloyds-HBOS loan portfolio will continue to go sour, beyond what already has been disclosed.

"The issue for Lloyds is how deep and how long [the downturn] goes on for," said Bruno Paulson, an analyst at Sanford Bernstein in London.

Lloyds spokesman Shane O'Riordain declined to comment on whether the bank would need to go back to the government for capital. But he said: "We have capital reserves significantly in excess of regulatory requirements, a strong business model and significant cost synergies to come from the [HBOS] acquisition."

Worries about Lloyds come as views on the U.K. economy

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Shackled on the high seas

Sarah Childress/The Wall Street Journal

UNDER ARREST: Suspected pirates apprehended last week are brought to the detention center aboard the U.S.N.S. Lewis and Clark. The U.S. and Britain have signed legal agreements with Kenya in which the African country has agreed to try suspected pirates plucked from the Gulf of Aden. **Page 8**

Japan's GDP slump is worst in 35 years

By Yuka Hayashi

TOKYO—Japan's economy contracted at its fastest pace in nearly 35 years in the final quarter of 2008—and is likely to underperform other major nations early this year as demand for its goods collapses.

Japan's gross domestic product shrank by 3.3%, or an annualized pace of 12.7% during the quarter, the government said Monday, a steeper decline than contractions of 3.8% reported for the U.S. and 5.9% in the euro zone for the period. The world's second-largest economy was slowed by a staggering 14% decline in exports and diminished capital spending by companies.

Japan's economy is facing "without a doubt, the worst crisis since World War II," said Economy Minister Kaoru Yosano.

Economists expect the contraction to continue. Exporters including **Toyota Motor** Corp., **Nissan Motor** Co., **Sony** Corp. and **NEC** Corp. have warned of hefty losses for the fiscal year ending in March, and unveiled restructuring plans that collectively would eliminate tens of thousands of manufacturing jobs over coming months. That could further crimp consumer spending.

Economic data already signal more deterioration. Industrial output is expected to drop by around 20% in the first quarter, a government survey says. After tumbling by a record 35% in December,

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4 p.m. ET

	CLOSE	PCT CHG
DJIA	7850.41	Closed
Nasdaq	1534.36	Closed
DJ Stoxx 600	188.67	-1.36
FTSE 100	4134.75	-1.31
DAX	4366.64	-1.06
CAC 40	2962.22	-1.19
Euro	$1.2798	-0.77
Nymex crude	$37.51	Closed

LEADING THE NEWS

Santander sweetens deal for some Madoff-hit clients

By Jose de Cordoba
And Thomas Catan

MADRID—**Banco Santander** SA, Europe's second-largest bank by market value, has sweetened a compensation deal for selected private-banking clients who lost money in Bernard Madoff's alleged Ponzi scheme, according to people familiar with the matter.

In January, Santander became the first—and so far, the only—bank to offer to return some of the money lost by clients in the alleged fraud. The bank said it would give victims the value of their original investments in the form of preferred stock paying an annual interest rate of 2%. But lawyers representing some of the clients affected have dismissed the offer as inadequate.

Now, in an effort to close the door on the affair, the bank's representatives have been offering a series of incentives to their best clients to get them to sign up for the deal.

Some wealthy clients are being given the possibility to use the preferred shares as collateral for a loan charging 3% annual interest. The loan, which can amount to 85% of the clients' original investment in Madoff funds, can be taken by clients in cash or reinvested in bonds paying 6% interest, said investors who have received the revised offer.

Santander also has offered another sweetener: It sent a letter to Madoff-affected clients saying they no longer would have to maintain their bank accounts in Santander in order to be eligible for the preferred-stock swap, offered as part of the January package, the people familiar with the matter said. About three-quarters of clients already have signed up for the offer, and the bank hopes to get the overwhelming majority to agree by the end of this month, these people said.

A Santander spokesman said Monday that the bank's original January compensation offer is non-negotiable.

Santander had the largest exposure to Madoff's funds of any commercial bank. Its clients had €2.33 billion ($3 billion) invested through its Geneva hedge fund, **Optimal Investment Services** SA. The bank's own, direct exposure to the alleged fraud was €17 million.

About 70% of affected clients are in Latin America, according to people familiar with the situation. Many of those clients also control companies with which Santander has a relationship, making bank executives worry that they could pull their business, too.

"The fact that Santander has been slowly improving their offer shows their fear of lawsuits," said Ernesto Canales, a Mexican lawyer who is advising a group of 15 Santander clients.

In the original offer made in January, Santander said it would swap out the shares in its stricken hedge funds on the condition that customers renounce their right to sue and pledge to maintain their current level of business with the bank. The bank told investors that it would redeem the shares in 10 years' time and that the shares would be listed on an exchange, though it hasn't committed to either of those things in writing.

Lawyers representing some victims have warned the shares would fetch as little as 20% of their face value on the secondary market. Santander argues they will fetch closer to 40% today, according to people familiar with their thinking.

Santander said Monday that it has asked market regulators to allow it a two-year suspension of redemption requests for a real-estate investment fund.

Irish reassess Lisbon Treaty

Iceland's experience causes many to back more EU integration

By Charles Forelle

BRUSSELS—The financial crisis may have a silver lining for Europe: It is spurring the Irish to support a European Union treaty that they vetoed only last year.

A new opinion poll shows a swing in favor of the EU's Lisbon Treaty, which would give the 27-nation bloc a permanent president and diplomatic service, among other changes.

In June, Irish voters rejected the treaty by 53% to 47%. In a poll released Sunday by the Irish Times, 51% of respondents said they would vote for a new version of the treaty, with 33% against. The balance were undecided. Ireland's government has said it aims to call a repeat referendum by the end of October.

An important reason for the shift, analysts say, is that Ireland's voters can see what happened to another island nation, Iceland, which suffered a currency collapse and effective bankruptcy as a result of the financial crisis.

The primary difference saving Ireland from the same fate is its membership in the euro, Europe's common currency. Iceland's overstretched banks borrowed euros and pounds, and its central bank couldn't convert kronur into those currencies to bail them out. That isn't an issue for Ireland, even though Irish banks also have liabilities that far exceed the country's gross domestic product.

"I think the dominant factor here is just fear," said Gavin Barrett, a Europe expert at University College Dublin's law school. "Everyone here is very well aware of what happened in Iceland."

After a decadlong boom, Ireland's economy is in disarray. Real-estate prices are plummeting, the budget deficit is growing and banks are struggling. In recent days, the price of insuring Ireland's sovereign debt and the debt of the country's banks against default has ticked up, indicating investors think the risk of a default is growing. Buyers of credit-default swaps on the sovereign debt paid 3.51 percentage points for the insurance on Friday, according to data provider Markit, up from around 0.30 percentage point in early September.

Blocking the Lisbon Treaty doesn't affect Ireland's euro membership. However, concerns over what would befall Ireland if it weren't in the euro zone are bolstering arguments in favor of closer integration with the EU.

"There has been a growing realization that isolating ourselves from Europe is very, very dangerous, and of course the economic downturn has emphasized that," Dick Roche, Ireland's minister for European affairs, told state broadcaster RTE on Monday.

Boosters of the Lisbon Treaty have always said Ireland needs the economic advantages that come with being part of the EU's common market—particularly the euro. Last year, however, before the financial crisis struck home, that message was drowned out by worries that the EU would impinge on areas where Ireland values its sovereignty, such as military neutrality and corporate taxation.

Monday's Irish Times poll found that 80% of respondents believe it is better to be a part of the EU "in the current crisis." Thirteen percent said it would be better not to be a part. The poll was conducted by the Dublin firm TNS mrbi. The margin of error was plus or minus three percentage points.

Ireland was the only nation to hold a referendum on the Lisbon Treaty and the decision surprised other EU governments. All 27 countries must ratify the treaty for it to take effect. The bloc can function without the treaty, but the holdups have become a symbol for faltering efforts at integration. France has said it would prevent the EU from expanding until the treaty is adopted.

Ireland's leaders have since negotiated concessions, including a provision that every country gets to keep one representative at the European Commission, the bloc's executive arm. The treaty had proposed paring the number of commissioners in the name of greater efficiency—a proposal that didn't sit well with small countries.

Khodorkovsky faces new charges

Associated Press

MOSCOW—Russian prosecutors said Monday new embezzlement and grand-theft charges have been filed against oil tycoon Mikhail Khodorkovsky, who is serving an eight-year prison sentence on charges his defenders say are politically motivated.

The latest charges are a further signal that authorities are determined to keep Mr. Khodorkovsky—once Russia's wealthiest man—behind bars after his first sentence ends in 2011. The Prosecutor General's office alleged in a statement that Mr. Khodorkovsky schemed with a group of investors at his company Yukos to bilk a Siberian oil company of 3.6 billion rubles ($104 million) and billions of more rubles from other companies.

Mr. Khodorkovsky was arrested in 2003 and sentenced in 2005 to eight years in prison on fraud and tax-evasion charges. He has served most of his sentence, which began from the time of his arrest, at a Siberian prison colony, and a court in August rejected his request for parole.

Similar new charges also are being filed against Mr. Khosorkovsky's business associate Platon Lebedev, who has been sentenced to eight years in prison. Defense lawyers had warned last year that new charges were being prepared.

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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

Air France, Singapore Air slice costs

Delays considered on plane deliveries; capacity cuts are set

By A.H. Mooradian And Ruth Bender

PARIS—Scrambling to cut costs in the face of a deepening recession and falling demand, **Air France-KLM** SA and **Singapore Airlines** Ltd. are considering delaying deliveries of previously ordered aircraft.

Singapore Airlines plans to cut capacity by 11% in the fiscal year ending March 31, 2010, while Air France-KLM is aiming for a 2% capacity cut beginning this summer.

The moves show the global economic crisis is battering even airlines that are in relatively strong financial shape. Several European carriers have yet to report for the October-December period, but they are suffering the same combination of recession, high fuel costs and diminished demand.

British Airways PLC last week said it swung to a loss in the first nine months of its fiscal year and said it continues "to review every aspect of the business to control costs while at the same time improving the customer experience and operation."

Air France-KLM's U.S. partner, **Delta Air Lines** Inc., posted a loss for the final three months of last year and plans to remove 40 to 50 mainline aircraft from its fleet to eliminate fixed costs associated with its capacity cuts of 6% to 8%.

Franco-Dutch carrier Air France-KLM, Europe's largest airline by market value, on Friday swung to a fiscal-third-quarter loss and disclosed plans to defer, though not cancel, plane deliveries. It also intends to cut capacity, trim jobs through attrition and reduce capital spending. In addition, the carrier aims to cut fuel costs and unwind costly fuel hedges.

The airline on Monday said it will seek to delay taking delivery of some aircraft by two to three years. The delays would affect about six aircraft, including **Boeing** Co.'s 777-300 planes, Boeing 777 cargo planes and Airbus planes, a spokesman said. Delivery of the Airbus superjumbo A380 is still planned for the end of the year. Airbus is a unit of **European Aeronautic Defence & Space** Co.

Singapore Airlines said Monday it will decommission 17 aircraft over the year, rather than the four planes initially planned. The company last week posted a 42% decline in net profit for its fiscal third quarter. A spokesman in Singapore on Monday said the company can't rule out delaying deliveries on orders.

"The drop in air transportation has been sharp and swift," Singapore Airlines Chief Executive Chew Choon Seng said in a statement. "Given the falls of over 20% that we have seen recently in air-cargo shipments, and the tradition of demand for air travel following closely behind trends on the cargo side of the business, we have to face the reality that 2009 is going to be a very difficult year," he added.

Air France-KLM, too, has been suffering a sharp decline in cargo haulage, though its passenger business has been holding up better.

AFP

Singapore Airlines has been steadily reducing flights since late last year. Above, a carrier at Changi Airport.

Two executives depart Satyam; auction is sought

By Romit Guha And Satish Sarangarajan

BANGALORE—**Satyam Computer Services** Ltd. said two executives had resigned, the first to leave since a government-appointed board took control in mid-January.

"More such resignations in Satyam are likely to follow," a person closed to the matter said.

The software company said Monday that it had requested the resignation of Anil Kumar, senior vice president of the company's financial-services operation. Mr. Kumar couldn't be reached for comment.

Satyam also said Subbu D. Subramanian, head of its manufacturing and automotive-services division, had resigned Friday to pursue personal interests. He will be succeeded by Keshav Panda, who will continue as head of Satyam's European operation, a Satyam spokeswoman said. Mr. Subramanian couldn't be reached for comment.

Meanwhile, Corporate Affairs Minister P.C. Gupta told local television channel NDTV Profit that the government had handed over the probe of the Hyderabad, India, company to the Central Bureau of Investigation.

Separately, the **Spice Group** of companies, which has expressed an interest in buying Satyam, has written to the software company's board seeking an online auction, Spice Group Chairman B.K. Modi said. "Everything has to be in a transparent manner," Mr. Modi said in an interview. If Satyam isn't sold to the highest bidder, "then there is no transparency," he said.

—Sunil Raghu in Mumbai contributed to the article.

CORPORATE NEWS

Bargain-hunting gamers try new tactics

Sites help enthusiasts save money by renting, swapping titles and finding bargains; SwitchBot the matchmaker

By Jamin Brophy-Warren

Last year, Chris Cardona wanted to get his hands on the newest version of Microsoft's Xbox 360 game system. So he headed to his local GameStop near Winter Haven, Fla., to trade in his old model. There, he says, the retailer offered him about a third of the price that he bought the system for, though it was hardly a year old. And, he says, GameStop would offer him only in-store credit; if he wanted cash, he would have to accept 20% less.

In a search for better trade-in terms, Mr. Cardona discovered **Switch Games**, a Web site, devoted to trading consoles and videogames, that launched late last year. His first trades: his old Xbox for a new Xbox 360 and an old PlayStation 2 for a Nintendo Wii. The trades were free—he paid only for postage.

"Whenever you don't have a lot of money, you try to come up with other means to swap," says Mr. Cardona, who is 30 years old.

Like Mr. Cardona, an increasing number of gamers are bypassing the big videogame outlets and looking at the secondary market for videogame releases. In the past, swapping options were limited. The dominant player has long been **GameStop** Corp., which has more than 6,100 stores world-wide. Since 2000, the Grapevine, Texas, company has been selling used games. Last month it reported a 32% increase in its used-game and console sales over the holidays. The store pays about $20 for trade-ins of recently released items and guarantees that swapped hardware and software will work.

Chris Gash

But recently, a host of new options have cropped up to serve avid swappers. Some Web sites act as game-trading brokers. Others help gamers find bargains on titles and consoles, while still others provide game rentals for a small fraction of the cost of buying new. New digital services that deliver games electronically through the computer or videogame console have arrived as well, offering low-cost alternatives to big-budget titles and access to older games titles that are no longer available.

GameStop Chief Executive Dan DeMatteo says his company's deep selection and quality guarantees set his company apart from the others. "It's a very labor-intensive process to buy back and inspect games and have refurbishment capabilities," he says.

Still, the upstarts tout their trade-in terms as competitive. Jason Crawford, 39, created Switch Games after trying to trade in the popular shooting game Halo. In 2005, he built the Web site to swap games among his friends. Last year, he dived into Switch Games full time and raised money from friends and family to build his new business.

In addition to 1:1 games trading, Switch Games has a social network that allows users to barter with one another informally and an automated matching system called SwitchBot that pairs users who want games with users who have them. The site hopes to make money through advertising and with a premium service that will guarantee transactions and place trades in escrow to ensure that they're on the up and up.

Tom Booth signed up for games-trading site **Goozex** about a year and a half ago and says he has saved more than $2,500 on his more than 300 game trades.

On Goozex, users trade items on the site and then receive points that are redeemable for other traded games. Points are assigned according to a Goozex system based on factors like the retail price, age of the game and its popularity. "We can give a fair market value," says Mark Nebesky, the site's co-founder.

Mr. Booth says he doesn't need to buy new games anymore since he can just trade items that are a few months old. "I want to play so much—more than I can afford," the 35-year-old says.

Consumers wanting a test drive can rent games from **GameFly**, an online service that, starting at $15.95 a month, allows users to keep games as long as they like. The service has more than 6,000 game titles available from its four distribution centers across the U.S. The Los Angeles company also allows users to purchase any game that they've rented. Savvy users are renting games just after their release date and then buying the title mostly new at a discounted price.

Consumers are also looking for good deals on vintage videogames. Last year, Polish videogame publisher **CD Projekt** launched a service called Good Old Games that targets fans of older, hard-to-find PC titles. Members can purchase for download one of the site's about 40 releases—with more titles added each week. It's similar to the service offered by another site, GameTap, which has 1,700 downloadable titles. But with CD Projekt, there's no additional software to install.

Several years ago, David Abrams became obsessed with finding bargains online, often buying cheap electronics, such as fax machines, simply because they were inexpensive. An avid videogame player, Mr. Abrams launched www.cheapassgamer.com to help other consumers find deals from retailers. Now residing in Tokyo, the former New Yorker is adding a videogame-deals search engine to streamline the process. The site also has a community of more than 200,000 users who offer tips about finding the best deals online. The site makes money through a commission collected from online retailers for referral sales, he says.

Videogame publishers let users download new content

By Yukari Iwatani Kane

Just as sales of music, movies and television shows have gone online, videogame sales are now headed onto the Internet, too.

While games for consoles such as **Microsoft** Corp.'s Xbox 360 and **Nintendo** Co.'s Wii are sold mostly as packaged software in retail stores, game publishers are now increasingly making games available through online downloads. On Tuesday, **Take-Two Interactive Software** Inc. is to release a new "episode" of its urban-action game "Grand Theft Auto IV" online—the most extensive download-only content yet for a major game title.

In "GTA IV," users play the character of Niko, a European thug who becomes entangled in gangs and crime while exploring the fictional American city Liberty City. In the new download-only game, "The Lost and Damned," players get to know more about the same city from the vantage point of Johnny, a motorcycle-gang member who was a side character in the main game.

PC games have been widely available for download, but downloadable games for consoles such as the Xbox 360 and **Sony** Corp.'s PlayStation 3 have only become possible in the past few years. That is because unlike older consoles, the current machines have hard drives and access to robust Internet networks. With these connections, consumers can easily download games by accessing online stores.

For consumers, downloading a game may be more convenient than having to go to stores to pick up a product. Many downloadable games are also set to be cheaper than regular console games, because publishers can save on packaging and marketing costs.

The GTA episode, which will be available exclusively on Microsoft's Xbox Live network, will cost $20—versus $50 or $60 for a typical console game. Though gamers will need to have "GTA IV" to play the episode, it offers 20 hours or more of additional game play. Nintendo and Sony also offer downloadable games for the Wii and PS3, respectively, for $5 to $15, on average.

The growth of download-only games also gives consumers greater choice. Because making a downloadable game is significantly cheaper than creating a console game that is sold in stores, publishers have more flexibility in launching new kinds of games or new chapters to popular games. Microsoft, for example, started a community-games feature in November that allows hobbyists and aspiring game developers to offer games that can be downloaded to the Xbox 360 for $2.50 to $10.

In the past, download-only game offerings for consoles were limited to older titles, simpler or experimental games, and add-on features such as new songs for music games. For gamers, playing "The Lost and Damned" is similar to the experience of playing the regular "GTA IV" game. That is because technology has advanced to the point that the quality of graphics delivered online is now the same as for packaged software.

Bigger games take longer to download, however. And users can't download too many games onto their consoles; the devices tend to have hard drives that are smaller than those on personal computers.

How well the new GTA episode does will be watched closely. Many videogame makers want to move away from selling through traditional retailers, which have become more selective about the titles they carry as they themselves are squeezed by the overall decline in consumer spending. New downloadable episodes that expand the story of popular games are also a cost-effective way for publishers to keep players interested in a game longer and generate additional revenue.

Many game publishers also want to explore new ways of increasing their business. While videogame sales rose 13% to $1.3 billion in January, according to market-research firm NPD Group, analysts say sales growth in the core gaming market has been stagnating. A vibrant used-game market, driven by specialty retailer **GameStop** Corp., also has

Rockstar Games

A new episode for the videogame 'Grand Theft Auto IV,' from Take-Two Interactive Software, will be available only via download from the Internet.

taken revenue away from publishers.

"A lot of people are looking at this [download-only] model very closely," says David Cole, an analyst with industry research firm DFC Intelligence. "If it works, it can be a big boon for the overall industry." DFC estimates that revenue from downloaded console games will rise to $2.6 billion in 2013 from about $200 million in 2008.

Analysts estimate "The Lost and Damned" could sell millions of copies, making it a bestseller. "GTA IV," available on the Xbox 360 and PS3, has sold more than 12 million copies world-wide since its launch last April.

According to analysts' estimates, Microsoft paid Take Two's Rockstar Games unit $50 million to create "The Lost and Damned," as well as a second episode that will likely be available later this year or in 2010. Microsoft and Rockstar declined to comment on the figure.

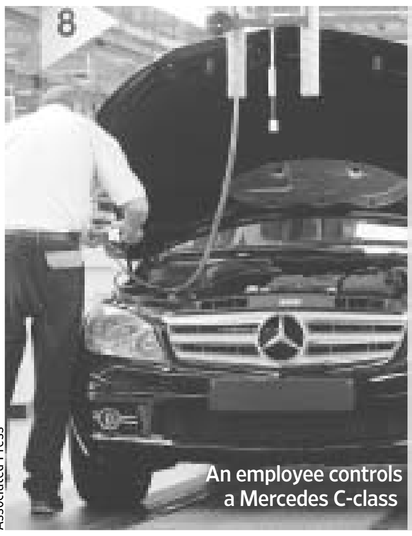
Dan Houser, Rockstar's vice president of creative, who leads the division with his brother Sam, says that Rockstar had toyed with the idea of doing episodes before, but that the technology hadn't caught up. This time, Rockstar came up with the framework for the episodes before "GTA IV" was finished. That allowed the developers to plant plot points into the main game that would allow them to tie in the additional content from a narrative standpoint.

CORPORATE NEWS

Luxury-car makers suffer

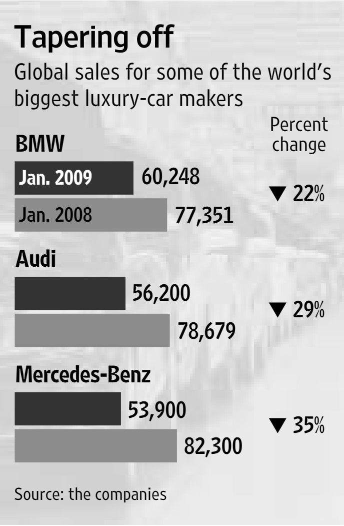
European companies adjust strategies as consumers shift

By Christoph Rauwald



An employee controls a Mercedes C-class

Associated Press



FRANKFURT—Once envied for generating the industry's highest profit margins per car, the world's top three makers of luxury cars are facing a sea change triggered by imploding demand amid a broader trend toward smaller, less-profitable vehicles.

Analysts say they don't expect the record earnings reaped in recent years by **BMW** AG, **Daimler** AG's Mercedes-Benz division and **Volkswagen** AG's Audi unit to return anytime soon.

Sanford Bernstein analyst Max Warburton says the vast majority of profits in recent years have come from high-powered cars bought in the U.S. and the U.K. as well as newly wealthy customers in oil-producing countries. "One could argue these consumers—at least the Americans and Brits—are going to have their spending power constrained for a long time," he says.

Even though the three German car makers appear to have more muscle to steer through the current industry gloom than most of their rivals, thanks mainly to higher cash reserves and relatively low debt levels, coming quarters are set to be bumpy.

Auto makers around the globe have been hit hard as major markets deteriorated in the second half.

"All of the luxury producers are likely to cancel product-development programs, cut capital spending, cut marketing spend and ultimately cut head count. But when your top line is down 25% to 30% these measures will not restore the business to profitability," Mr. Warburton says, "Losses will be substantial."

BMW, the world's biggest seller of premium cars, posted a 22% drop in global sales last month at its core brand to 60,248 vehicles. The world's No. 2 luxury-car maker, Mercedes-Benz, saw sales come in at 53,900 cars, down 35% from a year earlier. Audi reported that sales fell 29% to around 56,200 cars.

An incentive plan in Germany to pay €2,500, or about $3,200, to consumers who scrap old cars and buy new ones is expected to spark demand mainly for small cars rather than for luxury vehicles. "Examples in Spain and Italy show that these plans lead more to market distortion than sustainable stimulation," Commerzbank analyst Daniel Schwarz says.

Credit Suisse estimates that European auto makers burned through €12 billion in the last quarter of 2008. But "hefty cash burn need not be disastrous and should ease from the first quarter on, if accompanied by tight inventory control and sufficient liquidity sources," Credit Suisse says.

Spokesmen for BMW, Mercedes-Benz and Audi say their companies are seeking to preserve profit margins as far as possible as they focus on profitability rather than sales volume. All three companies are slashing production to avoid the buildup of inventory, streamlining cost structures and pushing for improved efficiency.

"But of course you need a certain volume for the plants' utilization," a Mercedes-Benz spokesman says.

BMW has launched an overhaul of its U.S. strategy in order to boost the profitability of each model line by raising prices and lowering incentives. The company tries to steer consumers away from leasing into financing deals through better credit offerings. A BMW spokesman says the portion of leased cars has been reduced to below 50% in the U.S., BMW's biggest single market.

Mercedes-Benz has just launched a new version of the E-Class, a key model, and aims to lure buyers with state-of-the-art technology, including a system alerting drivers when they are getting tired. Mercedes-Benz says features like that don't require huge investment but bring a noticeable benefit for the customer.

Audi says that in Germany it is scaling down business with car-rental companies and cutting employee vehicles in a bid to reduce the number of relatively young used cars in the residual market to stabilize values. Audi says that as a long-term target, it wants to make its smaller models as profitable as its flagship cars.

Analysts see the ability to create profits with smaller cars as crucial for premium auto makers.

"That suggests Audi—with VW's [economies of scale] and the very profitable A3—is best positioned. Next BMW—its Mini and 1 series are very low-margin at best but at least have a market niche," says Sanford Bernstein's Mr. Warburton. "Mercedes-Benz looks most exposed of all. But honestly, they're all in trouble and are all set to lose lots of money," he said.

BMW said Monday it would shed 850 jobs at a U.K. plant where it makes the compact Mini cars.

Task force replaces 'car czar' idea

By Deborah Solomon

WASHINGTON—The Obama administration has abandoned the idea of naming a "car czar" to help oversee the U.S. auto industry's restructuring, instead creating an interagency task force to deal with the issue, according to senior administration officials.

U.S. Treasury Secretary Timothy Geithner and Lawrence Summers, who heads the National Economic Council, will jointly oversee the task force, with Mr. Geithner managing the $17.4 billion in federal loan agreements between the auto makers and the U.S. government.

As a condition of receiving government aid, **General Motors** Corp. and **Chrysler** LLC are required to submit extensive restructuring plans and concession commitments from unions and bondholders by Feb. 17 to a presidential designee, commonly dubbed the czar.

The administration has decided to forgo naming one individual to oversee the process. The Treasury Department is expected to bring in Ron Bloom, a special assistant to the president of the United Steelworkers union and a former investment banker, as a senior adviser to help handle auto-related issues, these people said.

The hiatus in which the industry awaited the car czar slowed progress in restructuring talks between auto makers, bondholders and the United Auto Workers union, according to people familiar with the matter. Without someone firmly in charge, the stakeholders haven't felt compelled to come to the bargaining table, these people said.

Even without a car czar, GM and Chrysler have been in daily talks with White House officials about issues related to the loans they received, and are getting guidance on the restructuring plans they are crafting, according to people involved in the process.

The auto companies were given the loans as bridge financing to help them through tough economic times and their own missteps while working on plans to make the industry more viable for the long term. Government officials think both GM and Chrysler may soon need more money.

GM is expected to tell the government that it needs billions of dollars more in bailout money to fund the company's operations or federal assistance as part of a bankruptcy filing, said people familiar with the matter.

It isn't clear whether the administration may ultimately appoint financier Steven Rattner, who was a leading contender to become the car czar, to some position in which he is involved in the auto issue. Mr. Rattner, a lead player at private-equity firm Quadrangle, had been involved in policy discussions with the administration, according to people familiar with the matter.

UAW President Ron Gettelfinger and other union leaders have expressed concern about the delay in naming an auto czar and its impact on the companies' restructuring plans, said a person familiar with the matter.

The czar had been expected to be in place by the middle of February and work with experts to analyze the restructuring plans submitted by GM and Chrysler.

L'Oreal profit falls 29% as sales weaken in U.S.

By Max Colchester

L'Oréal SA, the world's biggest cosmetics company, reported a sharply lower profit for 2008, dragged down by weak sales in the U.S. and restructuring charges.

L'Oréal, whose brands include Garnier shampoo, Lancome skin cream and Giorgio Armani perfume, reported net income of €1.95 billion ($2.51 billion) in 2008, down 27% from a year earlier. Sales rose 2.8% to €17.5 billion, with Eastern Europe and Asian markets growing rapidly even as Europe stagnated and the U.S. shrunk.

The company said the lower net profit was in part because of €115 million in charges related to closing a plant in Monaco, restructuring a site in Wales, and the acquisition of perfume maker YSL Beaute.

Analysts expressed concern that L'Oréal missed its sales targets; the company reported 3.1% growth on a constant-currency basis, while analysts were expecting a 4% increase.

"These are disappointing results," says Cederic Besnard, an analyst at HSBC. "Their cost structure is not flexible enough."

Jean-Paul Agon, L'Oréal's chief executive, said slower consumer spending combined with negative currency effects and the increase of the cost of raw materials damped sales growth. Sales in the U.S fell 6.6%, but increased 16% in Asia and 20% in Eastern Europe.

The company's skin creams continued to sell well, boosted by the L'Oréal Paris line. "Demand for skin products is not cyclical," Mr. Besnard said. "It's hair care and fragrances that are suffering."

Sales of products to professional salons fared poorly, edging up 0.1% in the fourth quarter. Sales fell at the Body Shop, which specializes in natural cosmetics. The company said that the slowdown was hitting its higher-end categories—which includes Kiehl's and Lancome—especially in the fourth quarter.

In December the company announced plans to cut 500 jobs in the U.S. L'Oréal didn't announce any further job cuts.

Cosmetics are generally viewed as relatively resistent to downturns, as consumers look for affordable pamperings. This recession has proven tougher, though.

Other cosmetics makers have reported disappointing earnings as consumers rein in spending and switch to less-expensive brands. **Estée Lauder** Cos., the owner of the Clinique and MAC brands, said sales fell 12% to $2.04 billion for the second quarter ended Dec. 31. For the same period, **Elizabeth Arden** Inc. recorded a 60% fall in net profit to $13.6 million.

Microsoft to answer Apple with mobile-system upgrade

By Nick Wingfield And Kathy Sandler

Microsoft Corp. said a new version of its operating system for mobile phones will be available by year end as part of a plan to strengthen the company's offerings in the consumer market.

Steve Ballmer

The Redmond, Wash., company's new operating system, Windows Mobile 6.5, is designed to incorporate enhancements that are becoming common on sophisticated smart phones, for example, better Web browsing and the ability to operated phones with touch-sensitive screens using a single thumb. Microsoft Chief Executive Steve Ballmer announced the new products Monday in his keynote speech at a mobile-industry conference in Barcelona.

The improvements are important for Microsoft to stay competitive in a category that has experienced significant investment and innovation in the past two years from rivals like **Apple** Inc. and **Google** Inc. Microsoft executives have conceded that the company has focused too much in recent years on the business market for mobile phones, while neglecting features that have started to catch on with consumers through products like Apple's iPhone.

Microsoft will create an online service, called Windows Marketplace for Mobile, that will let mobile users wirelessly download software from independent developers directly to their handsets. A similar service from Apple, the App Store, has become a popular method for iPhone users to download everything from games to social-networking software.

"It's a highly competitive market, because what happens in the next three years is going to define what the industry looks like in the next 10 years," Andrew Lees, senior vice president of Microsoft's mobile-communications business, said in an interview.

The overhaul includes a redesign of the Windows Mobile home screen with big icons, instead of the more traditional look that borrows from its Windows desktop ancestry. The company has widened menus so that users of touch-sensitive phones can navigate them with their fingertips rather than a stylus.

Handset makers say they remain committed to using Windows Mobile. South Korea's **LG Electronics** Inc., the world's third-largest handset maker, agreed to make Windows Mobile the primary operating system for its mobile phones.

CORPORATE NEWS

Bounty softens its alarm

In new ads, spills produce less tension; attitude is 'bring it'

BY ELLEN BYRON

ADVERTISING

The quicker picker-upper is getting a pick-me-up. This week, Bounty paper towels, made by **Procter & Gamble**, plans to unveil an ad campaign designed to reflect what P&G says is today's more cavalier attitude toward household messes.

For nearly 20 years, Bounty ads stuck to the theme of "Little Kids, Big Spills and Messes," usually featuring a child's messy mishaps, a mother's panicked gasp, and then a Bounty paper towel coming to the rescue. "There were tense moments about the spill, and Bounty was there to help resolve the tensions that she had," says Eric Higgs, P&G's Bounty brand manager.

Bounty's new marketing effort embraces the thrill of the spill. Centered on the phrase "Bring It," the ads depict a happy, relaxed mother cleaning up the mess from an erupting volcano she and her daughter have built in the kitchen as a science project.

"She's looking to be in a proactive role [rather] than a reactive role," Mr. Higgs says. Bounty's ads focus on mothers because women make up the majority of the brand's consumers, he says.

P&G researchers, studying the attitudes of mothers for nearly five years, concluded that today's Bounty users are more relaxed about household spills, or at least aspire to be calmer about them. "Most moms really want to be that mom who says 'bring it,' " says David Corr, executive creative director for Publicis New York, the **Publicis Groupe** unit that created the ads.

Bounty's marketing push, which still employs its nearly 40-year-old "quicker picker-upper" slogan, comes as cash-strapped shoppers try to shrink their grocery bills, with many opting for less-expensive paper towels or none at all.

In a TV spot for Bounty paper towels, mother and daughter build a volcano as a science project. The volcano 'erupts' and makes a mess, but mom keeps her cool.

Spending on household towels and facial tissues is a little more discretionary than on some other products. "If you run out at home, it goes on the list, but if you're out of paycheck, it may wait until the next purchase cycle," said Thomas Falk, chief executive of Viva and Scott brand towel maker **Kimberly-Clark**, on a conference call last month.

Meanwhile, competition from private-label paper towels is intensifying. "It's a very vulnerable category," says Thom Blischok, president of consulting and innovation for market-research firm Information Resources Inc.

Persuading shoppers to pay more for paper towels by adding or improving features is a tougher sell in a down economy, analysts say. "Consumers aren't moving away from paper towels, but they are moving down to less-expensive options," says Lynn Dornblaser, director of trend insights at market-research firm Mintel International. "They're not paying extra for the paper towels that are specially perforated, or have pretty designs, or even for the leading brand that has all this enhanced functionality."

So far, market-leading Bounty has held its own, bolstered by its bargain-priced Bounty Basic line, launched in 2004. P&G's U.S. paper-towel sales totaled $1.08 billion last year, up 7.6% from the year before.

P&G says its emphasis on the strength of Bounty's individual sheets has helped sway consumers seeking value, especially with ads touting how a sheet can be reused for multiple jobs. Indeed, the new Bounty ads ask, "Why use more when you can use less?" and introduce an upgrade to the company's core Bounty paper towels, which now promise a 25% thicker sheet.

"You'll see a conversation about how one sheet keeps working, and one sheet of Bounty being compared to two sheets of a bargain brand," Mr. Higgs says.

Genome is tool for beauty firms

BY ELLEN BYRON

As scientists worked toward sequencing the human genome, many researchers embraced an exciting new tool that might offer insight into diseases. At **Procter & Gamble** Co., researchers saw an additional benefit: new ways to develop dandruff shampoo, skin cream and toothpaste.

Ten years ago, P&G began using genomic tools in a laboratory near its Cincinnati headquarters to learn how skin reacts at the molecular level to factors such as product ingredients or environmental changes, and to use that knowledge to improve its consumer staples and health-care products. Now, those efforts are starting to hit store shelves, most recently with last month's launch of Olay Pro-X, a line of skin creams sold through drugstores and other mass-market retailers.

In the increasingly competitive realm of beauty-product innovation, bragging rights are important, particularly with antiaging treatments. P&G claims to be one of the first consumer-products companies to use the gene chip, a tool that allows scientists to analyze how gene activity changes in response to stimuli.

P&G's chief beauty competitor, **L'Oreal** SA, says its Lancôme Genifique is the "first to apply protein testing to skin care," based on the analysis of 4,400 genes. **Estée Lauder** Cos. uses gene-expression technology and collaborates with prominent scientists in genomics, a company spokeswoman says.

Of course, as genetic data become more accessible to more product developers, so does the potential for exotic claims. "Overall, it seems that the marketing tends to be ahead of the science," says Alan Guttmacher, acting director of the National Human Genome Research Institute, an arm of the National Institutes of Health.

With Olay Pro-X, P&G used its genome laboratory to detect the differences between young and old skin. That helped it better determine which active ingredients to use in trying to spark the molecular responses that makes old skin act younger. "We now understand at the gene level what's happening during aging, and that makes us better equipped to intervene," says Greg Hillebrand, a P&G principal scientist.

In 2007, a team of P&G researchers published the results of using genetic technology to sequence the genes of malassezia globosa, after identifying the fungus as something that grows on everyone's scalp but causes dandruff on those who have an inflammatory response to it. Focusing on active ingredients that curb the fungus, P&G's Head & Shoulders brand reformulated its shampoo to improve its performance. Meanwhile, researchers are comparing human-genome sequences against that of the fungus to better understand how the two interact.

"We can look at how the scalp responds to the fungus by changing its gene expressions, as well as how the fungus changes when it's on the scalp," says Jay Tiesman, a P&G scientist who heads the company's genomics lab.

So far, P&G hasn't advertised the genomic research behind its products, but it serves as an important tool for recruiting scientists who might not otherwise be drawn to a career spent developing products like deodorant and laundry detergent.

Among P&G's latest targets: the gum disease gingivitis. The company recently completed a study in collaboration with the University of North Carolina that studies how gene activity changes when gums develop gingivitis and then recover from it.

"That's important for Crest [toothpaste] and Oral B [toothbrushes] to help pinpoint the way we should go about fighting gingivitis," says Mr. Tiesman. "At a molecular level, you can get some novel insights into how to combat it."

China Minmetals makes offer for OZ Minerals

BY RICK CAREW

China Minmetals Corp. is leading its home country's latest push to secure natural resources abroad, launching a takeover bid for Australian miner **OZ Minerals** Ltd.

On Monday, Minmetals offered to buy OZ Minerals for 2.6 billion Australian dollars (US$1.71 billion), or 82.5 Australian cents per share. That's a 50% premium to the stock's last price before trading was halted Nov. 27 amid negotiations with lenders over the miner's A$1.1 billion of debt.

OZ Minerals—one of the world's largest producers of zinc—has been struggling to refinance US$560 million of loans by a Feb. 27 deadline. With the company facing the prospect of being forced into receivership, its directors are unanimously recommending the Minmetals deal, which will see the Chinese group take on all of OZ's debt.

Many Australian miners made large investments or acquisitions as demand from China and India pushed up global prices, and took on a lot of debt in the process. Now, they are struggling to repay those loans.

OZ Minerals, which has substantial copper assets in addition to zinc, is symbolic of the fallen Australian miners. The company, which resulted from the merger of two smaller miners in June 2008, inherited a debt burden from its predecessor Oxiana, which borrowed to cobble together a network of mines.

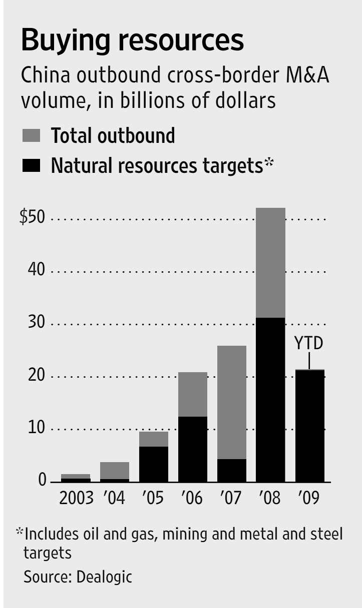
Chinese companies have seen a buying opportunity. The OZ Minerals offer follows on the heels of **Aluminum Corp. of China**'s US$19.5 billion deal last week to invest in **Rio Tinto**, a global supplier of iron ore, copper and coal.

China Development Bank, which provided the bulk of the funding for Chinalco's two-stage combined $33.5 billion investment in Rio Tinto, is also funding the OZ Minerals deal.

Minmetals itself struck a deal last week to buy a 70% stake in Toronto-listed Macarthur Minerals Ltd.'s Australian iron-ore project for 100 million Canadian dollars (US$81 million).

China already has significant domestic supplies of zinc, which is most often used in anticorrosive coatings for steel. China's demand for steel has soared in recent years as the country's urbanization has picked up steam.

Founded in 1950, Minmetals operates a sprawling empire of subsidiaries that import and export commodities but also engage in other businesses; one, for example, owns the Shangri-la Hotel in Beijing. Led by Chairman Zhou Zhongshu, the company is moving to broaden its business globally by investing in mines from Peru to Australia.



In 2007, Minmetals had revenue of US$21.8 billion and earned a profit of 7.1 billion yuan (US$1.04 billion), according to its Web site.

Minmetals also boasts close ties to the Chinese government, operating under the direct supervision of the State Council, China's highest administrative body. In 1999, Minmetals was listed as one of 44 "key enterprises with a great bearing on national security and economic life," according to its Web site.

In 2005, Minmetals launched a C$6 billion bid for Noranda Inc., Canada's biggest mining company by sales at the time. The deal for the copper and zinc producer fell apart in 2005 after competing bidders entered the picture and opposition to a deal arose from some Canadian politicians.

In December 2007, Minmetals succeeded in buying Canadian-listed Northern Peru Copper Corp. in a joint bid with Jiangxi Copper Co. for C$455 million.

The OZ Minerals takeover offer will face scrutiny from Australian regulators, in particular the Foreign Investment Review Board overseen by Australian Treasurer Wayne Swan. The board also will examine Rio Tinto's deal with Chinalco.

While OZ Minerals' assets are of less national importance to Australia than Rio Tinto's, the government will have to wrestle with the fact that if it rejects the Minmetals deal, the company could fold, resulting in job losses.

UBS AG advised Minmetals. Caliburn Partnership and Goldman Sachs JBWere advised OZ Minerals.

—Alex Wilson in Melbourne, Australia, contributed to this article.

Team drops from Gatwick bidding

A consortium comprised of **3i Group** PLC's infrastructure business, Teachers' Pension Plan and Canada Pension Plan has stopped working on a bid for London's Gatwick Airport, people familiar with the situation said Monday.

Airport operator BAA Ltd., a unit of Spain's **Grupo Ferrovial** SA, put Gatwick on the block in September after the U.K.'s competition watchdog suggested BAA sell three of its seven airports.

Remaining bidders include Gatwick Future Partnership, which comprises **Deutsche Bank** AG unit Rreef Alternative Investments and Australia's **Babcock & Brown Capital** Ltd.; Global Infrastructure Partners, which includes **General Electric** Co. and **Credit Suisse Group** AG; and Lysander Gatwick Investment Group, a consortium comprising a **Citigroup** Inc. infrastructure fund, Vancouver Airport and John Hancock Life Insurance Co., people familiar with the matter said.

CORPORATE NEWS

Acer spies opportunity

Firm sees downturn benefiting market for low-end laptops

By Ting-I Tsai
And Ian Johnson

Bloomberg News/Landov

Acer Chairman J.T. Wang, seen above in 2006, said he expects some computer makers to fold in the current industry downturn.

TAIPEI—Boosted by strong sales of low-end notebook computers and the launch of a smart phone, Taiwan computer maker **Acer** Inc. hopes to benefit from the economic downturn and looming industry consolidation, and to expand its market share.

In an interview Monday, Acer Chairman J.T. Wang said the company, which is neck-and-neck with **Dell** Inc. for second place in the market for notebook personal computers, after No. 1 **Hewlett-Packard** Co., aims to take over the top spot in that market by 2011, or possibly even next year.

Mr. Wang also said he expects some computer makers to fold during the current slump, leaving only four to five profitable computer makers over the next few years.

"In the process of consolidation, we are gaining a favorable position," Mr. Wang said. "This is an opportunity."

Mr. Wang's goal is an aggressive one, but Acer has grown more quickly than its rivals in recent years. Its PC shipments increased 31% in the fourth quarter of 2008 from a year earlier, giving it 12% of the overall PC market, compared with 13% for Dell and 19% for H-P, according to technology-research company Gartner Inc. Acer's share of the notebook PC market is larger than its overall market share.

Mr. Wang said U.S. and Japanese computer makers have underestimated the demand for mininotebooks, or netbooks, lighter portable PCs that generally offer fewer features but also cost less. Acer introduced its first mininotebook in July, making it one of the first major PC makers to do so, although rivals have since introduced their own. Mininotebooks now account for about 30% of Acer's notebook PC sales, Mr. Wang said. Acer expects global sales of mininotebooks in 2010 to be between 25 million and 35 million units a year, or 15% to 20% of the company's total PC sales, he said.

"We found out that our American competitors are not aggressive in [the netbook] segment," said Mr. Wang, "but we think this segment is very big."

Meanwhile, Acer is branching out into the phone business. The company plans to introduce its first smart phone, timed to the start of the Mobile World Congress Monday night in Barcelona. Mr. Wang said Acer expects sales of such handsets could account for 10% of Acer's revenue within three years, adding that it will be sold initially in 12 countries.

Acer is one of several computer makers entering the crowded but fast-growing market for smart phones, which can provide such services as Web browsing and email, in addition to voice calling.

Rival PC and smart-phone brands, including **Asustek Computer** Inc. and **High Tech Computer** Corp, are also scheduled to launch new smart-phone models at the Barcelona trade show. HTC is scheduled to introduce both its Touch Diamond 2, aimed at the consumer market, and the Touch Pro 2, aimed at business users, there Monday. Dell is expected to launch its first smart phone soon.

Mr. Wang said Acer hopes to distinguish its smart phones by seamlessly integrating them with its PCs, allowing users to transfer data from one product to the other. He said smart phones could one day surpass notebook PCs as a way for consumers to access the Internet.

"If we don't enter the market, then the cellphone makers will enter our market within three years," Mr. Wang said.

Bird may have led to copter crash

By Andy Pasztor

U.S. investigators increasingly suspect that a collision with a bird led to the crash last month of a widely used Sikorsky helicopter model that killed eight people in the Gulf of Mexico, according to industry officials and safety experts.

The Jan. 4 crash of the Sikorsky S-76C chopper, manufactured by a unit of **United Technologies** Corp., initially had stumped crash investigators, who had previously ruled out engine, transmission, electrical or hydraulic failures. The National Transportation Safety Board, which is heading the probe, also said the chopper didn't run out of fuel, hit some other aircraft or suffer a problem with its rotors. Now, investigators think a bird strike destroyed the windshield, which somehow resulted in nearly turning off the engines.

It is too early to say whether the latest theory will hold up. But the initial difficulty in determining a cause raised widespread safety concerns. The Sikorsky chopper is a workhorse for many offshore-oil operations, emergency-medical transport firms and other commercial services world-wide, and there are about 700 of the models in operation. The chopper was being used by **Royal Dutch Shell** PLC's U.S. unit to transport workers to offshore facilities in the Gulf of Mexico. After the crash, Shell temporarily grounded its entire fleet of S-76C choppers.

If a bird strike is ultimately determined to be the cause, the chopper crash would be the second instance in less than two weeks in January that bird strikes caused high-profile aviation accidents in the U.S. A crippled US Airways jetliner ditched in New York City's Hudson River in mid-January after birds seriously damaged both of its engines, but there were no fatalities.

The NTSB initially had said it didn't find any evidence of a bird strike in the helicopter crash. But investigators have since changed their focus, according to people familiar with the details. The NTSB has sent material taken from inside the cockpit to wildlife experts at the Smithsonian Institution in Washington to determine whether it came from a bird, a board spokesman confirmed over the weekend. The spokesman also said the board is examining the center post of the windshield. That is near the suspected point of impact with a bird.

Analysis of the sounds captured by the cockpit voice recorder reveal a sudden loud bang followed by an intense rush of wind, according to people familiar with the details. The board has said that one second later, power from both of the helicopter's engines simultaneously dropped to almost nothing. Airspeed decreased slightly for the next 10 seconds, according to the board, while the helicopter descended and ultimately crashed.

One theory is that a remnant of the windshield, or some other force created by the impact, retarded the throttles and nearly shut off the engines.

Other signs point in the same direction. Sikorsky, the manufacturer of the helicopter, appears poised to issue a letter warning operators about the potential dangers of installing certain kinds of acrylic windshields. Such windshields are sometimes retrofitted in helicopters in order to save weight, but the crash has raised questions about the strength of some of them.

A spokesman for Sikorsky didn't have any comment. A spokesman for **PHI** Inc. of Metairie, La., which operated the helicopter, has declined to take questions on the crash or the investigation.

The crash happened in clear weather while the helicopter was cruising at roughly 225 kilometers per hour at an altitude of 213 meters. At such a low altitude, the pilots would have had little time to respond to a near-shutdown of engines.

GLOBAL BUSINESS BRIEFS

Hennes & Mauritz AB

Fashion chain posts 1% fall in January same-store sales

Hennes & Mauritz AB of Sweden reported a small decline in January sales from stores open at least a year, as consumers reduced their spending. H&M, the world's third-largest fashion chain by revenue behind Gap Inc. of the U.S. and Inditex SA of Spain, said January same-store sales fell 1% from a year earlier. It was H&M's smallest drop in same-store sales in six months. The retailer's total January sales, which include sales in new stores, rose 9%. As of Jan. 31, H&M had 1,741 stores world-wide, up 14% from 1,524 a year earlier. Evli Bank analyst Anders Wiklund cautioned against viewing this as the start of a recovery for the fashion-retail market. "It's too early to say you can see things brightening," he said.

TNT NV

TNT NV reported a 60% fall in fourth-quarter net profit, hit by sharp volume declines at its international express unit and charges.The Netherlands-based postal-services company declined to give an outlook for 2009, saying that the year will be challenging and volumes are expected to remain under pressure. TNT said net profit fell to €59 million ($76 million) from €148 million a year earlier. The results were weighed down by lower volumes at the company's troubled express unit as well as €152 million in restructuring and impairment charges. The charges are related to decommissioning part of TNT's air fleet, 1,000 job cuts and the revamp of both the mail and express businesses. The bottom line in the year-earlier period was also hit by a €110 million restructuring charge. Revenue fell 2.4% to €2.93 billion from €3 billion. TNT warned that it expects 2009 revenue at the express unit to fall because of lower fuel surcharges and lower volumes.

Brambles Ltd.

Global logistics firm **Brambles** Ltd. said it will book up to $169 million in restructuring costs and that a dramatic slowdown in key U.S. and European markets means it is unlikely to achieve full-year earnings forecasts. Shares in the world's largest supplier of pallets fell to a record low Monday after it also reported a 28% drop in net profit to $212.8 million for the six months ending Dec. 31, from $293.7 million a year earlier. Profit after tax from its continuing operations, but before significant items fell 8% to $270.5 million. Brambles operates in over 45 countries, generating more than 80% of its revenue and earnings from its CHEP pallet-pooling businesses, which leases around 300 million pallets and plastic containers. The company said that since its annual meeting in November "there has been a further sharp deterioration in trading conditions around the globe."

ING Groep NV

Dutch bank and insurance company **ING Groep** NV won't renew its sponsorship of **Renault** SA's Formula One auto-racing team after the 2009 season. The move is part of cost cutting at ING, which has reported multibillion-euro losses and received a bailout from the Dutch government as a result of the financial crisis. ING said last month it would reduce spending on F1 by 40% this year and review participation after 2009. The company's total F1 budget was about €75 million ($96.7 million) before the cut.

Air Liquide SA

French industrial-gases company **Air Liquide** SA unveiled an 8.6% increase in full-year net profit and said it is stepping up cost cutting to help ensure earnings growth in 2009. Net profit rose to €1.22 billion ($1.57 billion) from €1.12 billion a year earlier, as revenue was up 11% at €13.1 billion from €11.8 billion. Air Liquide, the world's leading supplier of industrial gases, is seen as a strong performer in a market downturn as many of its products are indispensable to industry and it usually operates long-term, take-or-pay contracts. "In 2009, our priorities are going to be cash management, increased efforts in cost containment, and greater selectiveness in our investments," Chief Executive Benoît Potier said in a statement. The company has raised its 2009 cost-savings target above €250 million, he said. The company achieved €230 million of savings in 2008. Shares in Air Liquide were up 5.3% in afternoon trading, making it the leading gainer on a CAC 40 index down 1.6% overall.

Premiere AG

Pay-television broadcaster **Premiere** AG of Germany on Monday posted a wider fourth-quarter net loss as revenue fell and operating costs rose. The broadcaster's net loss widened to €114.3 million ($147.3 million) from a loss of €23.5 million a year earlier, while revenue declined 10% to €236.1 million. Premiere, which holds the live broadcast rights for soccer games from Germany's top league, failed to gain customers in the crucial holiday period, but said it expects to do so from the third quarter of this year. It said it lost 12,000 customers on a net basis in the fourth quarter, partly because it discontinued its prepay offer from November. The company said it expects to be unprofitable until the end of 2010 because of higher program and marketing costs. Shares in Premiere fell 14%, or 40 European cents,to €2.37. **News Corp.**, which owns Wall Street Journal publisher Dow Jones & Co., has a 29% stake in Premiere.

Alandsbanken Abp

Finnish bank **Alandsbanken** Abp will pay 414 million Swedish kronor ($49.5 million) to acquire parts of Icelandic bank Kaupthing's Swedish arm. Alandsbanken—the leading bank on Aland Island, Finland's smallest autonomous province—said it will take over the subsidiary's private banking, asset management and capital-markets operations. The deal will enable the bank to repay a five billion kronor credit line Sweden's central bank provided Kaupthing Bank Sweden AB to stave off a domestic financial crisis in October last year.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Agreement clears way for piracy trials

U.S. is set to open a test case for the prosecution in Kenyan courts of 16 suspects arrested in the Gulf of Aden

By Sarah Childress

ABOARD THE USS VELLA GULF—More than a dozen suspected pirates captured in the Gulf of Aden this past week will become part of a test case in a new legal arrangement between the U.S. and Kenya that officials hope will result in trials, jail time and, eventually, fewer pirates.

Naval officials have long said they can't stop piracy with ships alone, and maritime lawyers have said jurisdiction issues make bringing pirates to justice difficult. But now, the U.S. and Britain have signed legal agreements with Kenya—essentially extradition treaties for the high seas—in which Kenya has agreed to try suspected pirates.

The 16 men apprehended by U.S. ships will be the first case under the agreement, signed January 16.

Since the start of 2008, governments world-wide have deployed forces to counter a surging number of attacks in one of the world's most important sea lanes. Ransoms were paid earlier this year for the release of two vessels: a Ukraine-owned cargo ship seized in September loaded with tanks and weapons bound for Sudan, and a Saudi Arabian oil tanker captured in November.

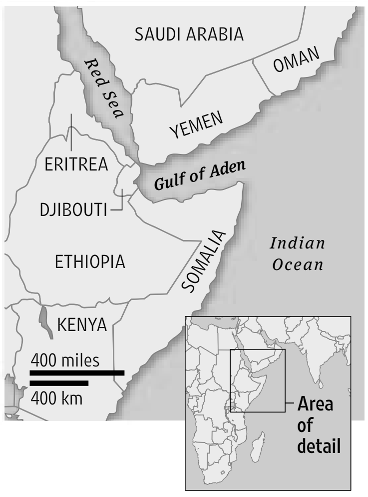
Just last month, Washington created a special task force dedicated to fighting pirates. Britain, Denmark, Turkey and Singapore have since joined in, U.S. officials said. Meanwhile, Chinese and Russian navies have been providing escorts for their national shipping interests in the region. The European Union has its own naval task force.

All this firepower has resulted in several thwarted attacks. On Wednesday, a U.S. guided-missile cruiser apprehended seven suspected hijackers who had slapped a ladder to a merchant ship. The next morning, an American destroyer rescued an Indian-flagged merchant ship and grabbed nine more suspected hijackers.

Catching these pirates is just half the battle. International law makes piracy a crime, but nations have struggled to figure out where to send suspects and how to gather evidence for cases that occurred in international waters. In September, a Danish ship captured 10 alleged pirates, but ended up landing them back onshore in Somalia.

U.S. Navy

Two dinghies containing U.S. Coast Guard and Navy team members apprehend suspected pirates last week. The 16 men apprehended by U.S. ships will be the first case under a new agreement between the U.S. and Kenya.



"The big holdup was finding someone who would prosecute international piracy," said Coast Guard Lt. Greg Ponzi, an officer on the task force who usually pursues drug runners in U.S. waters.

Bogeta Ongeri, the spokesman for the Kenyan Ministry of State for Defense, said Kenya is eager to cooperate with other nations to combat piracy. But his country is wary of having its courts overwhelmed. "We have taken the lead, but that doesn't mean all pirates will be tried in the Kenyan courts," he said.

Kenya has agreed to take only a limited number of cases. Mr. Ongeri said he couldn't comment on the recent arrests, but that the government would decide which cases to try in part based on where the alleged crimes took place. Kenya has provided the Navy with a checklist of evidence required to prosecute, U.S. officials said.

Still, Kenya enjoys a good relationship with the U.S. and the U.K., and has a strong court system.

Initially, U.S. Navy officials were reluctant to enter the fray. Without fundamental improvements in largely ungoverned Somalia, pirate havens are likely to flourish, they said. Officers said the size of the Gulf of Aden and surrounding waters make it impossible to respond to every attack.

Now, flush with some success, commanders seem optimistic. "The task force won't be the final answer but it's one of the key things," said Rear Adm. Terrence McKnight, the U.S. task force commander. "I think we've made significant headway."

On Wednesday last week, the Vella Gulf, a U.S. task-force ship, picked up a distress call from a merchant ship and dispatched a helicopter and chased down the skiff with the seven suspects aboard.

At 3:30 a.m. Thursday, a second distress call came in on an open, international radio channel. Navy Ensign Ian Townsend was on watch on the bridge of the destroyer USS Mahan when the Premdivya, an Indian-flagged merchant vessel, radioed that it had been shot at by pirates, and that the skiff was gaining on them.

The Mahan, about 17 kilometers away, closed in, and the pirates abruptly sped off. While the crew of the Premdivya continued its voyage, the Vella Gulf, a guided-missile cruiser equipped with a helicopter, sprang to the aid of the Mahan in pursuit of the fleeing skiff.

The Vella Gulf was an hour or more from the Premdivya, so it launched a helicopter from its deck to scan for the fleeing boat in the moonlight. Just as the chopper was about to head back, Petty Officer Second Class Jason Fariss saw a speck flickering on the helicopter's radar screen. The Mahan launched an unmanned aerial drone to take footage of the boat, capturing images of a large ladder.

The helicopter crew then fired warning shots across the bow. The suspects cut their motor and started dumping objects, including the ladder, over the side, according to members of the helicopter crew.

The Vella Gulf and Mahan converged and launched dinghies to apprehend the suspects. Keith Allen, a Mississippi-born federal investigator, sped out to the skiff with Lt. Ponzi to help gather evidence. The veteran detective found weapons: a rocket-propelled grenade, three rusty AK-47s, two heavier guns, a semiautomatic pistol, and a stash of ammunition and spent shell casings.

The alleged pirates were taken in pairs back to the Vella Gulf, then flown Thursday afternoon to the Lewis and Clark, a civilian-manned Navy supply ship, where all 16 were seen being led into an area secured with concertina wire, dressed in white jumpsuits with their hands shackled together. They were processed, and allowed a shower and hot meal before being secured below decks. They are awaiting extradition and, the military hopes, a court date in Kenya.

Data point to Spanish downturn

By Santiago Perez
And Jonathan House

MADRID—Fewer home sales and further signs of weakness in the banking sector on Monday pointed to a deepening economic downturn in Spain, with the government saying it doesn't see a revival in the housing sector soon.

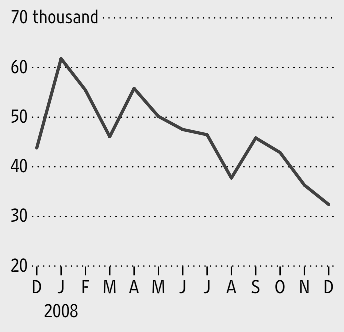
Spanish savings bank Unicaja is in talks to take over smaller rival Caja Castilla-La Mancha, in what could be the first rescue of a troubled Spanish financial institution.

A merger between the two unlisted banks "is possible, and could even be likely," José María Barreda, president of the Castilla-La Mancha regional government, said Monday. "This is a time in which decisions must be made."

Unicaja officials declined to comment. A spokesman for Caja Castilla-La Mancha didn't return calls seeking comment.

Free fall

Spanish home sales transactions fall sharply at end of housing boom



Source: Spain's National Statistics Institute

Regional governments control savings banks, which are now suffering from a steady rise in bad debt that is more severe than the asset deterioration reported by listed rivals.

The Spanish central bank, meanwhile, said local banks held €63.1 billion ($81.32 billion) in bad debt in December, nearly four times the amount they had a year earlier and representing 3.4% of total credit. Much of Spain's economic problems arose from the collapse of its once-flourishing construction sector following the outbreak of the global financial crisis.

Spain's National Statistics Institute said Monday that home sales fell 26% in December from a year earlier. Largely as the result of a sharp drop-off in housing investment, Spain's economy fell into recession in the second half of 2008 after several years of near-4% growth.

— Christopher Bjork contributed to this article.

Problems continue for Japan's Aso

By Takeshi Takeuchi

TOKYO—The latest setback for embattled Prime Minister Taro Aso: his finance minister's slurred speech and sleepy demeanor during an important news conference.

Finance Minister Shoichi Nakagawa on Monday apologized for his poor behavior at a Group of Seven news conference late Saturday in Rome.

"My conduct at the press conference was the result of medicine and some wine. I apologize for it," he said. He said he would resign if Mr. Aso wanted him to, but later told reporters Mr. Aso asked him to stay in his post.

Television news videos of the conference showed that Mr. Nakagawa at one point mistakenly took a reporter's question about interest rates meant for Bank of Japan Gov. Masaaki Shirakawa, who was also present.

"Hmm? What? Can you say that again?" Mr. Nakagawa asked the reporter. He also tried to grab a glass placed in front of Mr. Shirakawa instead of the one right before him.

"We received expl ... explanation on the U.S. measures," Mr. Nakagawa said at another point, stumbling.

Mr. Nakagawa couldn't locate a reporter asking him a question and said, "Where is he?" Mr. Shirakawa and an aide pointed out the reporter.

A number of media reports had speculated that he was under the influence of alcohol. Mr. Nakagawa, 55, denied that his behavior was due to "heavy drinking," but said he had drinks on the flight bound for Rome as well as at a G-7 luncheon.

Takeo Kawamura, chief cabinet secretary, said at a news conference he understood Mr. Nakagawa's behavior was caused by taking too much cold medicine. But he added: "It wouldn't be true if we said he didn't drink any alcohol."

U.S. seeks a coordinated fiscal response

Clinton cites China's 'robust' moves as type of action required

By Jay Solomon

TOKYO—U.S. Secretary of State Hillary Clinton said she will seek to develop a coordinated response to the global financial crisis between the U.S. and Asia's economic powers during her four-nation regional tour.

Mrs. Clinton cited China's stimulus package as the type of action the Barack Obama administration hopes to see from Asian nations in an effort to re-energize the global financial system.

"I will be discussing with [Asian countries] the approaches that they'll be taking" to stimulate their economies "and seeking greater cooperation," Mrs. Clinton told reporters aboard her flight to Asia. "The Chinese have a very robust stimulus plan. ... They are taking internal steps."

Mrs. Clinton arrived in Tokyo Monday evening. Later this week she will travel to Indonesia, South Korea and China.

Mrs. Clinton is using her first overseas trip as secretary of state to press the administration's message of cooperation and engagement as the necessary tools to tackle international challenges like climate change and nuclear proliferation.

"I have come to Asia on my first trip as secretary of state to convey that America's relationships across the Pacific are indispensable to addressing the challenges and seizing the opportunities of the 21st century," she said in Tokyo.

Mrs. Clinton held out the hope of closer U.S. interaction with Russia and North Korea after years of sometimes open tension. Mrs. Clinton said Washington stands ready to normalize relations with Pyongyang if its leadership makes good on its pledge to verifiably dismantle North Korea's nuclear-weapons program.

"We have a great willingness to work with" North Korea's government and its people, Mrs. Clinton said. "But it requires the North Koreans to commit to denuclearization and nonproliferation."

Mrs. Clinton described her trip as primarily a listening tour to learn more about how Washington can develop partnerships to combat key economic, security or environmental issues. She will meet with religious readers, university students, and business leaders across the region. She said the information she gathers will feed into the Obama administration's review of its Asia policy.

"We have a very broad agenda to deal with when it comes to China," Mrs. Clinton said. "This first trip will be intended to find a path forward."

Mrs. Clinton said she will raise human-rights issues in China when she takes part in a townhall meeting in Beijing.

As Ms. Clinton's trip began, China sounded a positive note on ties with Washington. The state-run China Daily newspaper, citing a spokesman for China's Ministry of National Defense, said the U.S. and China will resume military-to-military discussions this month. China froze those contacts last fall to retaliate for the Bush administration's decision to sell billions of dollars of weapons to Taiwan. Beijing considers the self-ruled island part of its territory.

China reiterated its opposition to "Buy American" provisions in the recently adopted U.S. stimulus legislation—reflecting the likelihood that trade policy will remain an area of friction between the two countries. At a routine news conference, Ministry of Commerce spokesman Yao Jian told reporters Monday that China is "deeply worried" that "some countries" will give preference to locally made products in their stimulus plans. Mr. Yao didn't specify, but the remarks were clearly aimed at the U.S.

On Saturday, a commentary published by the official Xinhua news agency blasted the "Buy American" provisions. "History and economics have told us, facing a global financial crisis, trade protectionism is not a solution, but a poison to the solution," the editorial said.

Meanwhile, North Korea on Monday issued a statement declaring its "right" to experiment with rockets for a "space program" and said the U.S. and other countries are creating a "grave challenge" by questioning its intentions.

"This is a vicious trick to put a brake on the wheel of not only [North Korea's] building of military capabilities for self-defense but also scientific research for peaceful purposes," North Korea said in a statement transmitted by the official Korean Central News Agency.

The statement is viewed as a prelude to a test of military rockets and missiles and is similar to statements the North has made before previous tests. In recent weeks, military and intelligence analysts in the U.S. and South Korea, using satellite photography, have monitored increased activity at a missile-launch site in northeast North Korea.

Mrs. Clinton said the Obama administration is placing a priority on ending Pyongyang's production of plutonium. She noted that there are still concerns that North Korea was also seeking to develop nuclear weapons through the enrichment of uranium. But she said that the American intelligence community didn't have a unified position on just how far Pyongyang has progressed on this track.

"There is a debate inside the intelligence community about the extent" of North Korea's highly enriched uranium program, she said.

The administration of former U.S. President George W. Bush scrapped a nuclear-freeze agreement with North Korea in 2002 over allegations that Pyongyang abrogated the pact by exploring uranium-enrichment activities.

Mrs. Clinton said the U.S. action was a mistake as it allowed North Korea to expel international inspectors and begin reprocessing plutonium "with a vengeance."

—Jason Dean in Beijing contributed to this article.

AFP

U.S. Secretary of State Hillary Clinton arrives at Tokyo's Haneda Airport on Monday night, kicking off a weeklong tour of Asia.

Obama rolls the dice with economic-stimulus package

By Gerald F. Seib

CAPITAL JOURNAL

A giant political gamble begins when U.S. President Barack Obama signs the economic stimulus plan into law Tuesday—and the fate of that gamble rests heavily on the shoulders of the man doing the signing.

Much as the success of the Reagan Revolution a generation ago depended on the resilience and credibility of the president who authored it, so too will the Obama Offensive rise or fall in voters' eyes on the resilience and credibility of the president now putting his stamp on it.

In the 1980s, the real economy was so awful that Ronald Reagan's supporters for almost two years looked in vain for proof that his gamble of a giant tax cut and a big increase in defense spending would work. Mr. Reagan signed his economic plan into law in August 1981, and unemployment promptly began to rise, and continued to do so for a year and a half. Three years later, it still was higher than when the Reagan plan was enacted. So nervous was his party in Congress that it decided to take back some of that Reagan tax cut a year after it was passed.

Only the personal popularity and sheer optimistic resolve of Mr. Reagan—the fabled Great Communicator—saw his party through the economic darkness and political turbulence and into the light that followed.

And thus it is today. Because the economy is so bad, gauging the success or failure of the stimulus will be hard to do for a long time. It's likely that much of the argument on behalf of the stimulus in coming months won't be that it has made things better, but that it has stopped things from getting even worse—a tough political argument to make.

Under those conditions, the public's faith in the great experiment—and its political impact—will turn almost entirely on how much Mr. Obama is trusted. We are about to see whether we have the Great Communicator II.

It didn't have to turn out this way. The politics of the economy would look vastly different if Republicans had bought into the Democrats' economic stimulus plan, making it a joint undertaking, with political blame or credit spread more broadly and thinly as the months ahead unfold.

Instead, Republicans have stood in nearly unanimous opposition to the stimulus plan, and say they have rediscovered their voice and philosophical bearings by doing so.

White House aides, meanwhile, say Republicans have made a political mistake of historic proportions by opposing an economic rescue effort and appearing partisan in the process.

Obviously, both sides can't be right. Just as obviously, neither side can know for sure right now. All that is certain is this: As a result of those diametrically opposed partisan calculations, the economic stimulus package now represents one of the biggest rolls of the dice of recent times.

Part of the outcome depends on whether there are glimmers of evidence that $787 billion in stimulus spending is having a real effect. The danger for the president and his party is that any such glimmers could be obscured by larger waves of bad news that Mr. Obama himself warns are still coming. In that sense, Republicans will have the easier case to make.

Part of the political equation will be determined by how effectively the two sides go about convincing the country of the virtue of their position. Already liberal groups have been pounding Republicans for standing in the way of recovery, and the Republican message machine has been in full attack mode against the stimulus package as an example of liberal ideology run amok.

Part of the political equation will be determined not by the stimulus plan at all, but by the effectiveness of that other big Obama initiative—the effort to spend more than $300 billion in remaining financial-rescue funds to stabilize the banking system and get credit flowing again.

And part of the outcome of this gamble depends on whether voters perceive Republican opposition as a principled stand against pointless spending, or an example of simple obstructionism. On that front the evidence is mixed, and Americans' verdict may depend as much on how the two parties behave going forward as on anything in the past. For its part, the White House insists that it intends to reach out to Republicans so it isn't seen as the cause of a breakdown in comity. "We are going to kill them with kindness," says one senior Obama aide.

But ultimately, the partisan nature of the stimulus debate means Mr. Obama himself will do more than any statistic or maneuver to shape views of the great experiment. He starts with some significant assets. His job approval rating, despite recent rough sledding, continues in the mid-60% range, slightly above where Mr. Reagan's was when he signed his economic package into law. The president has more credibility with voters than does Congress or either party.

But the sledding won't be smooth. Mr. Reagan's popularity dropped steadily through the year after his program was enacted, and his party lost 26 House seats in the next election. Have faith, Mr. Reagan asked his party and his country. Mr. Obama is about to try to make the same request, under conditions that are even more trying.

Chávez gains big victory

Venezuelan voters clear president's way to hold office for life

By John Lyons

Reuters

Supporters of President Hugo Chávez celebrate after he won a referendum allowing him to stay in power for as long as he keeps winning elections.

CARACAS—Venezuelan President Hugo Chávez removed an obstacle to his plan to remain in office for life, convincing voters to approve constitutional amendments designed to allow indefinite re-election.

In a national referendum Sunday, 54% of voters favored the plan, electoral officials said.

The outcome is a victory for Mr. Chávez, who has been on an electoral losing streak since voters rejected a first attempt to do away with term limits 14 months ago. Mr. Chávez, who took office in 1999, left little to chance this time, leading mass marches and papering the capital with posters and billboards.

"The spirits were higher this time," said Alicia Tsehaik, who sells tomatoes and peppers from a small stand in the hard-scrabble Caracas neighborhood of Petare and voted for the amendments. "The marches were beautiful."

Hugo Chávez

Mr. Chávez, 54 years old, framed the vote as a referendum on his 10-year-old effort to lift the poor and bridge Venezuela's deep income gap by spreading "21st Century Socialism." Opposition leaders say Mr. Chávez is a budding authoritarian who has weakened institutions and permitted the spread of crime and corruption.

Moments after the results were announced, Caracas exploded into a frenzy of fireworks and Mr. Chávez, dressed in an untucked red shirt, appeared on the balcony of the presidential palace and led a crowd in singing a national hymn, TV images showed.

"It was a great victory," Mr. Chávez said after singing the hymn. "It was a clear victory for the people. A clear victory for the revolution."

The results underscored the inability of Chávez opponents to build a viable national organization despite coming out on top in the December 2007 referendum, and in November 2008 local elections, when Chávez opponents won in a number of races.

Although Mr. Chávez isn't up for re-election until 2012, he sought to amend the constitution now, likely because the economy is expected to take a hit from plunging oil prices, taking a toll on Mr. Chávez's popularity, analysts said. The OPEC nation relies on oil for 93% of its hard currency and about half of government spending. Economists expect the economy to slam to a halt this year after years of fast growth.

Falling oil prices—down at least $100 a barrel in recent months—are likely to force Mr. Chávez into a series of tough decisions in order to preserve the free health care, food subsidies and welfare payments that have helped his popularity. Already, Mr. Chávez has been forced to delay or scale back foreign aid programs, including constructing refineries and selling cut-rate oil to allies.

Economists at several investment banks are predicting that falling oil prices will force Mr. Chávez to raise taxes and devalue the "strong bolivar"—a currency he introduced as part of a bid to lift confidence.

Devaluation would exacerbate the nation's soaring inflation rate, already the fastest in the Americas at around 35%. Venezuela imports most of the food and other goods that it consumes. Devaluation would make these goods far more expensive in local currency terms.

Missile strike kills 26 in Pakistan

A WSJ News Roundup

A suspected U.S. missile strike killed at least 26 people, many of them Taliban militants, in Pakistan's Kurram tribal region on the Afghan border on Monday, Pakistani intelligence officials said.

The missiles, believed to have been fired by a pilotless drone aircraft, hit a school once used by Afghan refugees' children before militants moved in around two years ago, according to villagers.

"Afghan Taliban were holding an important meeting there when the missiles were fired," one intelligence official in the area told Reuters.

'The target was in a mountainous northwestern region called Sarpul, on the outskirts of Baggan village. A militant in Kurram put the death toll lower, but said Afghan and Pakistani Taliban were among those killed.

The attack was the first in the Kurram tribal region and came two days after a missile strike in the South Waziristan tribal region killed at least 25 mostly Central Asian fighters believed to have al Qaeda links.

It wasn't known if there were any senior Taliban or al Qaeda figures among the dead at Kurram.

This was the fourth attack since U.S. President Barack Obama took office last month, showing there has been no change in policy since the last year of the Bush administration, when drone attacks against militant targets on Pakistani soil multiplied. Pakistan's civilian government, elected a year ago, and its army have complained that the U.S. missile strikes are counterproductive and have fanned an Islamist insurgency across northwest Pakistan.

The U.S. Central Intelligence Agency declined to comment.

Also on Monday, the Pakistani government confirmed that it has agreed to impose Islamic law and suspend a military offensive across a large swath of northwest Pakistan, in the Swat Valley, in concessions aimed at pacifying a spreading Taliban insurgency there.

The announcement came after talks with local Islamists, including one closely linked to the Taliban. The Taliban in Swat said Sunday they would observe a 10-day cease-fire in support of the peace process. They welcomed Monday's announcement, which didn't mention any need for the militants to give up arms.

The move will likely concern the U.S., which has warned Pakistan such peace agreements give al Qaeda and Taliban operating near the Afghan border time to regroup. Regaining the Swat Valley from militants is a major test for the Pakistani government. Unlike the semiautonomous tribal regions where al Qaeda and Taliban have long thrived, the former tourist haven is supposed to be under full government control.

Speaking in India, U.S. special envoy to Afghanistan and Pakistan Richard Holbrooke said the unrest in Swat is a reminder the U.S., Pakistan and India face "an enemy which poses direct threats to our leadership, our capitals and our people."

Marketplace

Travel alert

The U.S. reconsiders its strategies for airline security > **Page 28**

Russia's industry slows far faster than expected

By Lidia Kelly

Russian industrial production plunged in January, signaling the economy is flagging faster than expected and putting the Kremlin's hopes for a recovery later this year in doubt.

Industrial output fell by a massive 16% last month from a year earlier, nearly triple the pace of contraction the government has forecast for this year, data released by Federal Statistics Service, or Rosstat, showed Monday. The output numbers exceeded market expectations of a 10% to 12% decline.

The January data threaten the government's forecast for 5.7% contraction in production output for the whole year, economists said.

"December was only the beginning, it seems," said Elina Ribakova, chief economist with Citigroup Inc. in Moscow. "At this stage it will all depend on the government's policy, but it might be difficult to achieve the target."

January's industrial production fell 20% from December, the steepest month-to-month decline this decade, but economists said the annual drop is more worrisome as it isn't affected by seasonal factors.

Most industry sectors saw declines as global demand retreated and investments were halted. The most severe slumps were recorded in steel, cement and automobile production—major contributors to Russia's robust industrial growth in recent years. Automobile manufacturing was halted at a number of plants during the month.

Industrial production fell 10% in December from a year earlier—a rate alarming enough to prompt assurances from the Kremlin that the numbers wouldn't get worse in the coming months. Many officials even talked about Russia's overall economy recovering somewhat by the end of 2009.

The once-vigorous emerging market, earlier driven by exports of a basket of commodities—chiefly oil—and short-term capital inflows, is now poised to stagnate at best. The Ministry of Economic Development sees gross domestic product declining by around 0.2% this year. This contrasts sharply with a growth rate above 5% in GDP for all but one year of the decade so far. In 2002 GDP grew 4.7%.

There is no consensus among economists about the country's fortunes this year, as most are unwilling to make predictions on oil prices. Many see contraction in GDP of as much as 3%, but some remain optimistic.

"As production growth has quite sharply decelerated in recent months, the economy is clearly operating at below capacity [including available labor], meaning that a recovery could be fast once a proper macroeconomic environment is established," Evgeny Gavrilenkov, chief economist at Troika Dialog in Moscow, wrote in a recent note, suggesting that even 3% growth in GDP is possible.

But the series of discouraging data—on deepening wage arrears, rising unemployment, falling consumer confidence, plummeting sales and continued threats to the ruble—paired with the continuing global economic downturn have tempered the Kremlin's optimism.

In his most somber remarks on the subject yet, President Dmitry Medvedev said over the weekend that the tasks in front of the officials are tough.

"I believe that those in authority are duty bound to talk openly and frankly about this, about the decisions that we're taking to overcome the crisis and about the difficulties that we're facing," Mr. Medvedev said in a television interview, according to a transcript provided by the Kremlin.

The key policy for Russia is the revision of its budget for this year. The first projections from last summer were based on oil prices averaging $95 a barrel throughout the year. Earlier this year Prime Minister Vladimir Putin ordered the budget to be amended and based on oil prices of $45 a barrel.

But the Duma, Russia's lower house of the parliament, is yet to see a new budget, because a heated debate between fiscal conservatives and the Kremlin's populist wing has emerged about needed cuts in state spending and the allowable budget deficit. The latest statements from Arkady Dvorkovich, the Kremlin's chief economic adviser, suggest a deficit of around 8% of GDP.

"We are making certain changes to the budget," Mr. Medvedev said over the weekend. "Yes, this is a difficult budget, a budget in which we had to run a deficit." He added, however, that Russia's amassed oil wealth should cover most of the proposed spending in the next couple of years.

One of the oil funds Russia manages, the Reserve Fund—which amounts to 10% of GDP—is specifically earmarked to replenish budget deficits in times of a crisis. At the beginning of the month, the fund stood at $137.34 billion.

Pakistan to ask IMF for more funds

Dow Jones Newswires

ISLAMABAD—Pakistan will seek an additional $4.5 billion loan from the International Monetary Fund in April to accelerate the pace of economic growth and shore up foreign-exchange reserves, said Shaukat Tarin, an adviser to the prime minister.

The South Asian nation, which was on the brink of an economic collapse after the balance-of-payments deficit widened to a record level, received $3.1 billion from the IMF in November as the first part of its planned $7.6 billion rescue package.

Pakistan will ask the IMF to increase the size of the package, spread over 23 months, to $12.1 billion, said Mr. Tarin, who is also the de facto finance minister. "I will ask the IMF board [for the additional loan] at its April spring meeting," he added. "By then we would have completed the first review successfully."

On Saturday, Pakistan and the IMF started review talks in Dubai for releasing the second part of the plan, valued at $775 million. Mr. Tarin is set to arrive in Dubai on Feb. 26 just before the conclusion of the talks.

IMF aid typically is made conditional upon the recipients putting into place an economic-stabilization package, which usually involves cuts in spending, higher taxes and removal of subsidies.

According to central-bank data, Pakistan's foreign-exchange reserves were $10.288 billion in the week ended Feb. 7.