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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 216 | EUROPE | Friday - Sunday, December 3 - 5, 2010

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Snow and freezing temperatures again slam Europe

Associated Press

In Berlin, workers shovel snow in front of the Brandenburg Gate. The unseasonably cold and snowy weather caused travel chaos across Northern Europe as airports closed and motorists stayed off the roads, while the Balkans were hit by flooding. **Article on page 7; updates and photos at europe.wsj.com**

ECB moves to shore up rattled credit markets

By Brian Blackstone

FRANKFURT—The European Central Bank redoubled its efforts to shore up the credit markets of vulnerable euro-area countries through government bond purchases, even as it resisted pressure to take even bolder action to help stem the region's debt crisis.

Rejecting pleas from some economists and European officials that the central bank intervene in the markets on a grand scale, ECB President Jean-Claude Trichet pressed governments to beef up their own rescue capabilities and suggested European leaders may need to consider increasing the size of the region's €750 billion ($985.3 billion) bailout fund.

"We call on all authorities to be up to their responsibilities," he said.

Nevertheless, Mr. Trichet reiterated that the ECB was prepared to make use of its seven-month-old bond purchasing program to support weak euro-area members, and traders reported that the ECB was actively acquiring the debt of Ireland and Portugal even as he spoke.

"We are constantly alert, we are constantly looking at the situation of the markets and at the acute tensions," Mr. Trichet said.

The news of ECB intervention buoyed the euro as well as the debt of euro-zone periphery countries, despite initial disappointment among investors that the ECB wasn't adopting more robust measures.

The ECB has purchased about €67 billion of debt since May. It discloses the scale of its purchases once a week but doesn't provide a country breakdown.

Mr. Trichet, speaking at a news conference after the ECB's monthly meeting, also confirmed the central bank would extend unlimited loans to commercial banks during the first quarter of 2011.

The loans are a lifeline for troubled banks in Europe's periphery, particularly Ireland.

Officials, as expected, left the ECB's key policy rate unchanged at 1%, where it is expected to remain well into 2011.

Markets have been on edge in recent weeks amid signs that the euro-zone crisis is leaping from one periphery country to the next. Investors worry that absent bolder action by EU leaders and the ECB, the contagion could reach Spain and Italy, two of the region's largest economies.

The ECB's refusal to make large-scale asset purchases sets it apart from other central banks like the U.S. Federal Reserve and Bank of England, each of which has bought large quantities of bonds to keep interest rates low and to spur growth. Mr. Trichet said the ECB isn't engaging in such a policy, known as quantitative easing, because it absorbs equal amounts of money from banks as it buys in bonds to keep the money supply constant.

The ECB fiercely guards its independence, and any big announcement on bond buying could have been perceived as caving to political pressure.

Despite the ECB's willingness to keep the emergency measures in place, Mr. Trichet's message to governments and financial markets was clear: The solution to Europe's fiscal problems rests with governments, not the ECB.

"The ECB has come to the conclusion that [the debt crisis] is not their task and they cannot solve it," said Carsten Brzeski, economist at ING

Please turn to page 4

Madoff trustee launches new suit

J.P. Morgan Chase & Co. was sued for more than $6 billion by the trustee seeking money for victims of Bernard Madoff's Ponzi scheme.

The complaint, filed in federal bankruptcy court in Manhattan on Thursday, claims the bank enabled Mr. Madoff's multibillion-dollar fraud and seeks the return of nearly $1 billion in profits and fees, as well as additional damages of $5.4 billion.

J.P. Morgan said it has shared significant information with the trustee and addressed his questions since the fraud was disclosed and that any suggestion it supported Mr. Madoff's fraud is "utterly baseless and demonstrably false."

The lawsuit is the latest salvo by Irving Picard, who has filed a flurry of cases in recent days seeking to claw back profits from the fraud. Mr. Picard has a deadline of Dec. 11 to bring the lawsuits to recover assets for victims.

World Cup

England and U.S. lose out with bids to stage football's World Cup. Page 28

Losing a halo

Heard on the Street: the changing face of German Bunds. Page 18

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The bailout that Europe can't afford. Page 12

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PAGE TWO

ECB chief Trichet is still not blinking

[Agenda]

By Simon Nixon

There have been times in the past couple of weeks when even hardened veterans of the financial crisis admitted to a sense of déjà vu. The euro-zone sovereign crisis appeared to be heading the way of the Lehman crisis: a slow inexorable slide to a catastrophic outcome that policy makers seemed powerless to prevent.

Perhaps a strong two-day rally in the markets will have helped steady nerves. But anyone hoping that European Central Bank chief Jean-Claude Trichet would ride to the euro zone's rescue Thursday with a bold new policy initiative will have been sorely disappointed. The euro-zone crisis is far from over—and European leaders need to work fast to prove the doomsters wrong.

The truth is that the ECB is engaged in serious brinkmanship with European political leaders—and the situation is going to have to get a lot more serious before Mr. Trichet blinks.

The next big test for the markets will come early next year when some of the highly indebted peripheral countries such as Portugal and Spain are forced to roll over large quantities of existing debt. That is likely to become much harder since the Irish bailout, which showed that it is no longer possible to distinguish between government and bank debt in crisis-hit countries, since both are de facto obligations of the sovereign.

As a result, Spain's debt to GDP ratio of 64% rises to 119% of GDP when bank debt is included, of which €70 billion ($92 billion) needs to be refinanced next year, with almost half due in April alone, according to Barclays Capital. Belgium and Italy also look weak on this basis. The snag is that credit risk worries have a tendency to become self-fulfilling.

Agence France-Presse/Getty Images

ECB President Jean-Claude Trichet at a news conference in Frankfurt, Thursday.

For a euro-zone country with a debt to GDP ratio of 100% and government spending to GDP ratio of 50%, every 1% rise in borrowing costs requires a 2% rise in public-spending cuts to offset the increased interest expense. At the same tine, the EU's latest proposals to impose "collective action clauses" making it possible for all bonds issued after 2013 to take losses makes it likely that borrowing costs will rise even further in the future.

The truth is that the ECB is engaged in serious brinkmanship with European political leaders.

Some argue the ECB should solve the crisis. Perhaps it will eventually, but it would be an act of desperation. In common with other central banks, the ECB has massively expanded its balance sheet during the crisis; it now has assets of €1.9 trillion. But it is the composition of this balance sheet that alarms ECB officials.

Although it does not break down numbers by geography, it has €520 billion of repo exposure to peripheral euro-zone banks which, although collateralized and subject to haircuts, could present credit risk to the ECB in the event of a default. Similarly, it has €128 billion of outright purchases of peripheral euro-zone bonds on its balance sheet. It would not require much of a haircut on these assets to eat into the ECB's €78 billion of capital and reserves.

For the moment, the ECB continues to justify its bond purchases by reference to the European Council's statement in May that it would take all steps necessary to stabilize the euro. This was taken as an indication it would not allow a government to default on its debt, a message reinforced during the Irish bailout.

But there is a limit to how long the ECB can credibly stick to this line at a time when Irish and Greek government bond yields of 8.9% and 11.8%, respectively, clearly indicate the market believes a haircut on this debt is inevitable. To do what the market has been demanding—switching the balance of its monetary policy from providing liquidity against collateral to outright purchases of bonds—would surely require much greater reassurance on credit quality.

Besides, reassurances from European leaders aren't worth anything if European voters decide to boot out their leaders and support an alternative policy. Already there are powerful voices in Ireland, albeit outside the mainstream parties, advocating a default and devaluation rather than accept a bailout package likely to beggar an entire generation, which would seem the inevitable consequence of an interest rate of close to 6%.

But any repudiation of Irish debt would have a devastating impact on the euro zone—and even global—economy. That's not just because of the immediate losses inflicted on the euro-zone banking system; the danger is that any attempt arbitrarily to subordinate bank debtholders to other senior unsecured creditors would lead at best to a huge rise in funding costs for other euro-zone banks and at worst the closure of the bank debt market.

But just because the result would be disastrous doesn't mean it can be ruled out. That is why the solution to this crisis has to come at a political level.

Only the fiscal authorities in the euro zone can resolve the common currency's fundamental flaw: the possibility of a sovereign default. Now that credit risk has entered the market's calculations, the only way to remove it is for the EU governments effectively to offer an explicit guarantee against default on all euro-zone sovereign and bank debt with the aim of reducing borrowing costs for highly indebted countries.

One option would be to use an existing European institution such as the European Financial Stability Fund, which can raise up to €450 billion in bonds, to provide government and bank debt guarantees rather than lend direct to governments. That would give the EU a lot more bank for its euro.

Of course, that would be a huge step toward a full fiscal union, carrying the risk that member states become responsible for each other's losses.

That would make it politically very hard to deliver.

But the euro zone has already taken several large steps toward fiscal union with its intrusive new rules on fiscal oversight announced in May. And besides, the alternative is sure to be far, far worse.

What's News

■ **PepsiCo agreed to buy** Russia's Wimm-Bill-Dann, valuing the juice and dairy firm at $5.4 billion, its largest-ever acquisition outside the U.S. The deal is a sign that recent Kremlin efforts to woo foreign investment are yielding results. 17, 18

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'[The ECB] must be prepared to stay for the long haul, until all the wagons are moving again. The very long haul.'

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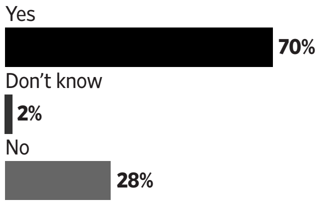


THE WALL STREET JOURNAL EUROPE
(ISSN 0921-99)
Commodity Quay, East Smithfield,
London, E1W 1AZ

SUBSCRIPTIONS, inquiries and address changes to: Telephone: +44 (0) 20 3426 1234. Calling time from 8 a.m. to 5 p.m. GMT. E-mail: subs.wsje@dowjones.com. Website: www.services.wsje.com

ADVERTISING SALES worldwide through Dow Jones International. Frankfurt: 49 69 29725 390;
London: 44 203 426 1111; Paris: 331 40 17 17 01.

Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Baslnevi.

Registered as a newspaper at the Post Office.

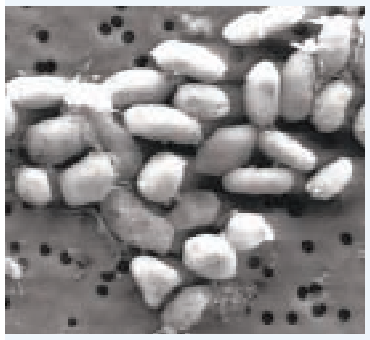
Editeur responsable: Patience Wheatcroft M-17936-2003.
Registered address: Boulevard Brand Whitlock, 87, 1200 Brussels, Belgium

NEWS

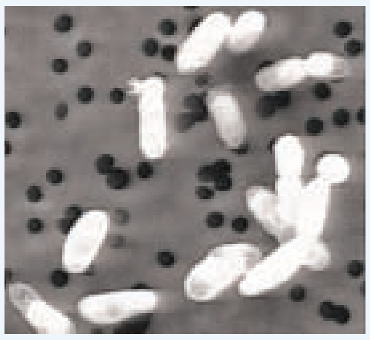
Arsenic-based life form is bred in lab

By Robert Lee Hotz

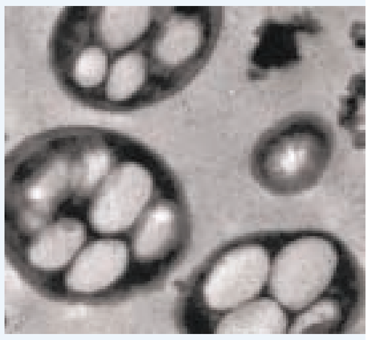
Poison as life force | Scientists have created microbes that 'very likely' incorporate arsenic into their DNA



A scanning electron micrograph of the bacterial strain known as GFAJ-1, which subsists almost entirely on arsenic and 'very likely' incorporates it into its DNA.



In contrast, this scanning electron micrograph shows the thinner, normal, phosphorus-reliant microbes.



A transmission electron micrograph of the arsenic-reliant bacteria shows its internal structures. The microbes are a living demonstration of the exotic substances that alien biochemistry might—in theory at least—utilize on other worlds.

Photos: Science/AAAS

Researchers on Thursday said they had bred microbes that "very likely" use arsenic in their DNA in place of phosphorus, in what may be the first exception to the formula long thought to govern the basic chemistry of life.

Force-grown in the lab, the bacteria use the notorious poison to replace molecules of the element phosphorus in critical parts of their working biology, including in the spiral backbone of DNA, which is a crucial component for all known life, the researchers said. By depending on an element so toxic to normal life, the microbes are a living demonstration of the exotic substances that alien biochemistry might, in theory at least, use on other worlds.

"It is building itself out of arsenic," said geo-microbiologist Felisa Wolfe-Simon at NASA's **Astrobiology Institute** and the U.S. Geological Survey, who led researchers from eight federal and university laboratories conducting the experiment. "All life we know is the same biochemically, and this is a little different. It is suggesting there is another way to be alive."

The researchers conceded, however, that by themselves these odd microbes don't prove yet that there is a fundamentally different basis for life on Earth. "It is beginning to open the door a crack to possibilities," she said.

Several independent experts were convinced that these unusual organisms were not so far out of the ordinary. "This is an interesting curiosity, a novel discovery but not a paradigm-breaking one," said New York University chemist Robert Shapiro, an authority on DNA and the origin of life who was not involved in the project. "It is a cousin of known living things that has some peculiar habits."

To be sure, life on Earth knows few bounds. Microbes can be found in rocks a mile underground and in clouds overhead. Some bacteria thrive in toxic waste or survive in brine five times as salty as the sea. Many species of single-cell creatures readily grow in the absence of oxygen, warmth and light.

Until now, however, they were all thought to share a biochemistry based on the same six elements—oxygen, hydrogen, nitrogen, sulfur, carbon and phosphorus—to build proteins, fats and DNA. Even the synthetic cells made in the laboratory, as announced earlier this year, rely on the same six elements. Phosphate is an essential building block for various macromolecules present in all cells, including nucleic acids, lipids and proteins.

If the new finding holds up, scientists will have to add arsenic to the elemental construction kit for existence.

"They made their case, and it is quite remarkable," said geo-microbiologist Clara Chan at the University of Delaware, who has studied the findings. "But it remains to be seen how common it is."

The scientists published the research in the journal Science and were scheduled to discuss their work at a NASA news conference Thursday.

Their finding comes as the hunt for Earth-like planets accelerates. With 22 space-based observatories and 100 ground telescopes, researchers are scanning tens of thousands of stars for evidence of a planet that could support life like that on Earth.

Scientists have speculated an alternative scheme of biochemistry could give rise to other kinds of life in the solar system or on one of the 504 planets astronomers have discovered around other stars. In forms too strange to readily recognize, exotic life might thrive in seas of liquid methane, in plumes of exotic gases or in caverns of nitrogen ice.

Indeed, rumors about the pending announcement this week fueled a fever of anticipation among space enthusiasts, with rounds of speculation about the discovery of life elsewhere in the solar system. But the researchers made it clear that their discovery was entirely down-to-earth.

"It probably has large implications for the evolution of life on Earth," said USGS microbiologist Ronald Oremland, a senior scientist on the project. "We want to see if there are more kinds of microbes that can do this, and we are trying to find that out."

They are testing at least 19 other species of microbes to see if they also use arsenic as an essential element.

The bacteria were dredged from the briny sludge of California's Mono Lake, where the water is richly laced with arsenic and with bacteria that can survive in it. In the lab, the researchers grew the bacteria in Petri dishes in which phosphate salt normally essential for life was gradually replaced by arsenic, until the bacteria could grow without needing phosphate.

They confirmed their finding through a battery of tests with mass spectrometers, radioactive tracers, X-rays and conventional genetic screening.

They weren't able to entirely eliminate all traces of phosphorous, leaving open the possibility that these bacteria were still eking out their existence in a normal way, the researchers said. "There does seem to be a low level of impurity," Dr. Wolfe-Simon said. The traces of phosphorus were so minute, the researchers said, that no normal microbes could have survived.

Famed Hong Kong club faces bribe scandal

By Shai Oster

EPN/Agence France-Presse

Scandals at the Jockey Club have cast an unflattering light on the prestigious Hong Kong institution.

HONG KONG—For decades, the Hong Kong Jockey Club has been at the peak of politics, business and society in one of the world's richest cities. But a scandal over allegations some were willing to bribe their way into the club is casting an unflattering light on the prestigious institution.

In this status-obsessed city, clubs are at the center of high society. But the Jockey Club, established in 1884 under British rule, stands apart from the pack as a money-making machine. Through a government-granted monopoly on horse racing and lotteries, the club, a nonprofit organization, is Hong Kong's single-biggest taxpayer, accounting for roughly 8% of the government's revenue, according to the organization's annual report.

At least officially, no amount of money is supposed to open the Jockey Club gates and special elevators that lead to the exclusive champagne and fine dining of the members-only rooms away from the crowds below. The only way in is through an introduction and voting by a group of 200 members.

But last month, anticorruption authorities announced a sting operation, code-named "Pilot," that led to the arrest of 29 people on suspicion of involvement in an influence-peddling ring selling access to the club. No charges were filed, and all 29 people, who weren't identified, were released. According to Hong Kong's Independent Commission Against Corruption, a government agency, a Jockey Club member was suspected of building a network of middlemen and voting members to rig the vote in favor of people who paid him bribes to join.

The Nov. 17 arrests have been the talk of the town, though few are willing to speak publicly about them.

The club "is very powerful. It's definitely more than just horse racing," said Emily Lau, a legislator and member of Hong Kong's Democratic Party. "It does a lot of charity work; its members are the most influential people." In a statement, the Jockey Club said it "will not tolerate any dishonest individuals." The club declined to comment further.

In the year ended in March, customers bet a total of 116.9 billion Hong Kong dollars, roughly US$15 billion. About 82% was returned as dividends and payouts to winning bettors. The club earned about US$2.7 billion from its betting and lottery revenue, paying 64%, or HK$1.75 billion, to the government.

That is one of the highest tax rates for the industry, observers say, and part of bargain struck decades ago when the government legalized betting. The organization says it spent an additional US$193 million on charity and employed 26,291 full- and part-time employees, making it one of the biggest private employers in the territory.

By comparison, the entire U.S. horse industry, which includes more than just racing, contributed US$1.9 billion in taxes at all levels of government in 2005, according to the American Horse Council, a U.S. lobby group.

Nearly every Wednesday night, thousands flock to Hong Kong's famous Happy Valley Racecourse, built on a patch of drained malarial swamp in 1841, soon after the British first arrived.

Most bettors get the cheap seats and crowd around the track clutching betting forms, beer and stir-fry, while club members enjoy champagne from exclusive rooms above the stands.

Last year, the volume of betting from 767 races on two race tracks was US$9.7 billion—almost as much as the US$12.97 billion turnover from all 49,368 races in North America, the horse council says.

This isn't the first time club members have been accused of abusing their power. In 1998, a club member and a businessman were charged with accepting a US$51,700 bribe in exchange for endorsing a membership application. And in June 2009, another club member was sentenced to two years in prison for accepting US$58,064 in bribes from applicants.

Not every club in Hong Kong is as exclusive as the Jockey Club. Some allow memberships to be transferred or sold. That has created a thriving market with its own brokers and speculators buying memberships, hoping prices go up.

EUROPE NEWS

Zapatero is facing obstacles

BY SARA SCHAEFER MUÑOZ
AND JONATHAN HOUSE

With markets increasing pressure on Spain, Prime Minister José Luis Rodriguez Zapatero is running out of the political capital necessary to force through difficult reforms that could ease investor concerns.

The Socialist prime minister is facing obstacles on two fronts. Conservative opponents, which control key regional governments, are calling for national elections, while the Socialist government's traditional backers, such as labor unions, are souring on Mr. Zapatero's leadership.

Meanwhile, in the wake of Ireland's €67.5 billion ($88.7 billion) bailout, sovereign-debt concerns have risen in Spain and Portugal. Pressure is building on Mr. Zapatero to slash the country's big pension system, accelerate the overhaul of the troubled savings-bank sector, and generally reassure the international community that Spain isn't another Greece or Ireland.

"He is between two rocks and a hard place," said Sebastian Balfour, emeritus professor of contemporary Spanish studies at the London School of Economics. "It is going to be very difficult to carry through on the kind of austerity the markets are demanding."

The stakes for Mr. Zapatero are high: Analysts say any fiscal intervention from the European Union would almost certainly trigger advance elections, which he would be unlikely to win.

Mr. Zapatero may have a reprieve after the European Central Bank said Thursday it would continue to buy European bonds and extend some emergency programs due to end Jan. 1. Spanish sovereign-debt—and the debt of other struggling euro-zone countries—rallied strongly. Also, the Spanish Treasury on Thursday sold €2.468 billion of three-year bonds in a deal that went relatively well, analysts said. Spain has another big bond sale later in the month.

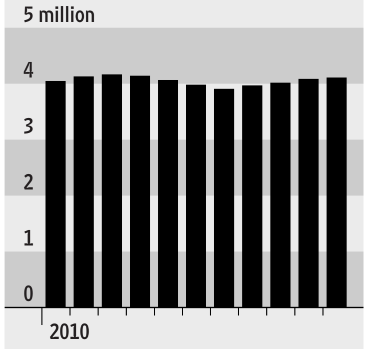
Spain had to pay sharply higher yields to attract sufficient investor interest. Even with the day's rally, Spanish 10-year bonds yield 5.2%, 2.3 percentage points more than similar German bonds. Similar Irish bonds yield 8.95%, underscoring how Spain is still in better shape than Ireland.

Associated Press

Spain's Prime Minister José Luis Rodriguez Zapatero arrived at the Parliament for a plenary session in Madrid, on Wednesday.

Shedding jobs

Spain's unemployment numbers are rising again, after a summer dip



Source: Spanish Labor Ministry

Mr. Zapatero has been adamant that Spain doesn't need a bailout. He said during an interview with U.S. business channel CNBC on Thursday that "Spain isn't going to have to tap any EU fund." He urged investors to see Spain as "an attractive country in the long term."

In another bid to calm markets, Mr. Zapatero on Wednesday announced plans to privatize parts of the country's airport authority and lottery company to pay down debt, and said he would cancel unemployment benefits for the long-term unemployed.

At home, his efforts to reassure investors have generated criticism from opposition politicians, who see the moves as insufficient.

"Every time the markets start getting nervous, investors wonder what the Spanish government is going to come up with next," says Alvaro Nadal, an economics spokesman for the conservative Popular Party.

Meanwhile, the left-wing base of his Socialist Party has been riled by Mr. Zapatero's austerity measures. Unions called a nationwide strike in September, and have threatened further action, as the government tries to cut costs in the face of a struggling economy.

According to new data Thursday, Spanish jobless claims rose again in November from October, by 24,318, or 0.6%, to 4.1 million, while data earlier in the week from the European Union's statistics agency showed Spain had an unemployment rate of 20.7%, twice the average rate of the 16 countries that use the euro currency.

Spain will hold widespread regional and local elections in the spring, and Mr. Zapatero must call a national election before March 2012.

"He will try to hang on until the regional elections," said Emilio Lamo de Espinosa, sociology professor at Madrid's Complutense university. Then if, as expected, the Socialist Party fares poorly, Mr. Zapatero might announce he won't stand for election in the national poll, he said.

ECB moves to beef up steps aiding debt markets

Continued from first page

Bank in Brussels.

Responding to a question about whether European governments should increase the size of the euro-zone's bailout program, Mr. Trichet said: "In the first episode of the turbulences it was very clear that we had the capacity to contain the pressure. We have to reinforce and consolidate the authority of the public authorities."

Mr. Trichet was upbeat about economic prospects, suggesting the ECB is unlikely to engage in large-scale stimulus. He voiced some frustration that the debt crisis in the periphery, which accounts for only a small share of euro-zone output, appears to have overshadowed what has so far been a surprisingly good recovery in Europe.

"We are losing, perhaps from time to time, sense of what's happening in the real economy," Mr. Trichet said, noting "more surprises to the upside than to the downside."

The euro zone expanded 1.5% in the third quarter, at an annualized rate, following growth of 4% in the second quarter, according to calculations based on data Thursday from the EU's statistics agency. ECB staff economists expect 1.7% growth in 2010 and 1.4% in 2011. That is about all the currency bloc can muster without stoking inflation, based on productivity and demographics. The ECB expects inflation to average 1.8% next year, close to its target of just under 2%, and 1.5% in 2012.

Extending emergency loans into next year marks a reversal of sorts for policy makers anxious to unwind those programs amid signs of rising inflation.

But the recovery masks deep divergences among the member states.

Germany and others in northern Europe enjoy rapid recoveries, southern Europe and Ireland remain mired in economic stagnation and soaring unemployment. That puts more pressure on those governments to take painful steps to cut deficits, because they lack the rising tax revenues and falling social spending that usually coincide with recoveries.

Whereas Greece, Spain and Ireland have double-digit deficits as a share of their economies, Germany's could fall to the EU's 3% limit next year, its finance ministry said Thursday.

Extending emergency loans into next year marks a reversal of sorts for policy makers anxious to unwind those programs amid signs of economic recovery and rising inflation.

As recently as two weeks ago, ECB board member Jürgen Stark said "the phasing out of our liquidity support measures will continue after the end of the current quarter."

—Mark Brown and Bernd Radowitz contributed to this article.

Euro-zone economy slows down

BY NICHOLAS WINNING
AND ILONA BILLINGTON

LONDON—The euro-zone economy slowed sharply in the third quarter as business investment ground to a halt, an indication that despite surveys showing an improvement in confidence, companies aren't sure enough of the recovery to commit more capital.

However, euro-zone producer prices rose again in October, with the pace of both the monthly and annual gains accelerating, data from European Union statistics agency Eurostat showed Thursday.

The combined gross domestic product of the 16 countries that share the euro grew 0.4% from the second quarter and 1.9% from last year's third quarter, Eurostat said. Euro-zone quarterly GDP grew 1% and by an increased estimate of 2% on an annual basis in April to June.

"While the euro-zone economy appears to be weathering the sovereign-debt crisis reasonably well for now, there are still good reasons to be concerned about the outlook over the coming quarters," Jonathan Loynes, chief European economist at Capital Economics, said in a note.

The figures showed that although quarterly growth in household and government expenditure picked up, gross fixed-capital formation stalled after rising 1.7% in the second quarter. That lack of investment is likely to fuel concerns about the economic recovery's strength.

The contribution to the quarterly growth rate from the change in inventories also came to naught in the third quarter, after contributing 0.4 percentage point in the second quarter and 0.8 percentage point in the first.

The euro-zone economy got a significant boost in the early stages of the recovery as companies restocked after running down their inventories during the severe recession.

Household expenditure grew 0.3% in the third quarter after increasing 0.2% in the previous three-month period, while government expenditure increased 0.4% after rising just 0.1% in the second quarter.

Net trade also contributed to quarterly growth as exports grew 1.9% on a quarterly basis in July to September, outpacing a 1.7% increase in imports.

Growth also varied widely across the shared-currency area, making it difficult for the European Central Bank to deliver monetary policy that will suit all of the countries that use the euro.

Larger countries at the core of the euro zone continued to perform better than nations on the periphery, many of which are under severe pressure from tough austerity measures designed to cut their bloated budget deficits.

Quarterly growth in Germany, the currency area's economic powerhouse, slowed to 0.7% in the third quarter from 2.3% in the second, while France slowed to 0.4% from 0.7%, and Italy grew just 0.2% after expanding 0.5% in the second quarter.

In contrast, Spain stalled after growing 0.3% in the second quarter and Greece contracted 1.1% in the third quarter.

Euro-zone producer prices rose 0.4% on a monthly basis in October and were 4.4% higher compared with the year-earlier period.

The monthly increase was the largest since a 1% rise in April, while the year-to-year gain was the largest increase since October 2008, when prices rose 6.1%. In September the producer price index rose 0.3% on a monthly basis and by 4.3% annually.

The annual increase was originally reported as 4.2%.

IMF to gain firepower to address Europe crisis

BY BOB DAVIS

WASHINGTON—The International Monetary Fund expects to double its lending capacity to $450 billion over the next few months, giving it additional firepower to deal with the sovereign-debt crisis engulfing Europe, according to IMF officials and documents.

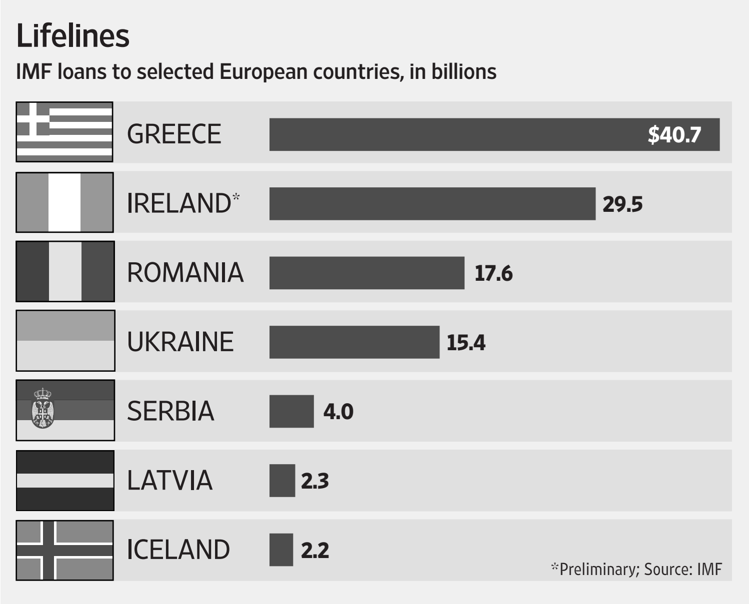
Whether that will be sufficient depends on how deeply the problem spreads. The IMF currently has $202 billion in basic resources and an additional $41 billion it can tap in times of acute international financial distress, for a total of $243 billion, according to IMF financial documents. But that is less than the amount that the euro zone is now counting on the IMF to provide for troubled European countries.

Under a European rescue plan announced in May after the bailout of Greece, the IMF would make available $325 billion. Ireland is the first country to receive a loan under the rescue fund, and its $30 billion IMF loan will leave the fund with $295 billion in commitments—less than the IMF has on hand. IMF officials regularly point out, however, that the IMF didn't formally commit to the full $325 billion. Rather, the IMF approves the loans on a case-by-case basis, and doesn't need to set aside any money until individual rescue loans are approved. So the fund believes that even now it has plenty of room to maneuver.

The Group of 20 industrialized and developing nations, which has relied on the IMF to provide crucial financing, committed in April 2009 to add to the institution's lending chest. Since then, about 20 countries have lent the IMF a total of $248 billion, which the IMF, in turn, can lend to financially troubled countries. Without that money, the IMF would now be operating in the red, according to IMF documents.

Under the G-20 initiative, those loans will be subsumed in a new lending pool that will replace the $41 billion kitty and add about $250 billion of new money. Seven European countries have yet to ratify the lending program—Austria, Belgium, Italy, Switzerland, Luxembourg, Norway and Sweden—but are expected to get parliamentary approval in the first quarter of 2011. That will boost the lending capacity of the IMF to $450 billion.

The U.S. has approved the increase and is pledging about $106 billion to the new kitty—about 10 times what it committed to the old one. The U.S. and Japan each have enough votes in the fund to veto its activation. When the IMF makes a loan—under any of its lending arrangements—each of its members is responsible for a certain percentage of the loan. Generally, the U.S. portion is somewhat higher than its 17% ownership stake in the IMF. The fund boasts that it rarely fails to get repaid, though it sometimes waits so long for repayment that a commercial bank would have to classify a loan as nonperforming.



IMF Managing Director Dominique Strauss-Kahn at a central banking conference last month.

Should the European crisis escalate quickly, said Edwin Truman, a former Obama Treasury official now at the Peterson Institute for International Economics, those countries will come under pressure to finish their ratification faster. Italy has a special incentive; it is seen as one of the countries in Europe that might eventually need IMF help.

On Wednesday, Reuters in Brussels reported that the U.S. would back an increase in IMF funding for the European rescue package. But in Washington, a U.S. official with knowledge of U.S.-European talks said such an increase wasn't now a subject of discussion. U.S. Treasury Under Secretary Lael Brainard is now in Europe meeting with her counterparts.

"The fund is in a strong position to meet its members' needs as necessary," said IMF spokeswoman Caroline Atkinson.

Should the Europeans decide to boost the size of the rescue fund, though, it isn't clear the IMF would have sufficient funds, even with the bolstered resources. Some in the European Commission have discussed doubling the amount of the total European rescue fund, which would imply another $325 billion commitment of IMF resources. The purpose of a larger fund would be to reassure markets that there is plenty of money available to bail out larger euro-zone countries such as Spain and Italy should that become necessary.

"Ammunition has a stabilizing effect," said Harvard University economist Ricardo Hausmann, who has long experience dealing with Latin American debt crises. "You have more chips to play with; more degrees of freedom to go forward."

But others in the European Commission argue that a bigger rescue fund could backfire and spook markets by signaling that the problems are deeper than thought and spreading. So far, Germany has successfully opposed expanding the fund. The European Commission denies it has been in expansion discussions.

Romania's GDP declines 2.5%

BY JOE PARKINSON

Romania's deepest recession in 60 years worsened in the third quarter, as austerity measures needed to keep the economy's €20 billion ($26 billion) bailout package on track sapped demand and erased gains made from rising exports.

Data released Thursday by Romania's national statistics institute showed that gross domestic product fell 2.5% on a yearly basis, following a 0.5% decline in the second quarter. The leu was little moved on the news, which confirmed the preliminary estimate released Nov. 12.

But economists said the details of the release, which showed growth figures flattered by a temporary boost in inventories, would feed fears that the recession could deepen further in the months ahead.

That, economists warn, could endanger the country's emergency bailout package and aggravate mounting social unrest against painful spending cuts and tax rises.

"The details show that the picture is worrying....Without a positive contribution from inventories, GDP would have contracted by 3.5%," said Nicolae Alexandru Chidesciuc, senior economist at ING in Bucharest. "As long as we don't see a fast pickup in consumption—which is unlikely given the austerity legislation—then the risks are very high that the economy will continue to contract heavily."

Real wages are falling and lending activity is weak, while the EU newcomer has struggled to raise leu debt because of concerns over whether it can cut its budget deficit.

Why bailouts may yield more harm than good

[Brussels Beat]

BY STEPHEN FIDLER

The trillion-dollar bailout that European governments assembled last spring in a shock-and-awe effort to halt the sovereign-debt crisis has failed. The crisis has enveloped Ireland and threatens Portugal, while Spain and Italy wait in trepidation.

Why didn't dangling such an enormous sum of money in front of bond investors work to calm their nerves? Rather than banishing the anxieties of investors, some experts argue that bailouts have served only to heighten investor worries.

The bailout structure "destabilizes the market," says Paul de Grauwe, professor of economics at the University of Leuven in Belgium.

Much of the problem lies with the conditions placed on the rescue funds to make them palatable to German taxpayers, experts say.

First, the rescues come very late in the day, with the government seeking help close to death's door. In the case of the €110 billion ($145 billion) Greek rescue, Athens could request aid only when it lost access to market funding—and had reached the point of no return. In Ireland's case, yields on the country's bonds rose to levels that would have made new debt financing unsustainable.

By the time the rescue is mounted, therefore, bond investors across the euro zone are spooked and looking out for the next domino whose debt dependence makes it vulnerable to higher market interest rates.

(Even trying to soothe markets by expanding the bailout funds to cover Spain and Italy is problematic, European officials say. First, Germany would consider it only as a last-ditch solution. Second, even mentioning the idea of enlarging the rescue package could frighten investors into thinking that these two economies' debt problems are worse than they may have thought.)

But that's only the start. The tough conditions attached to the bailouts—again as the price of support from Germany—raise questions about the sustainability of debt burdens for the rescued countries. Once interest rates have ratcheted up, they don't come back down.

The weight a debt burden imposes on a society relates to the proportion of economic output that must be devoted to servicing it. That's a function of three things: output, or gross domestic product; the size of the debt; and the interest rate being paid.

On none of these three counts does the current bailout fund provide comfort. First, it sets economic terms that suggest that economy is more likely to shrink than to grow. "The conditions that are attached in terms of austerity are too tight," says Mr. Grauwe. Governments are forced to cut spending, which risks setting off a further downward economic spiral.

Second, even with the optimistic economic assumptions that have accompanied the Greek and Irish economic programs, debt-to-GDP ratios are still growing. (That's because budget deficits, although shrinking, will for years hence be bigger than the growth of nominal GDP.)

Third, the interest rates charged on the European bailout funds are high—over 6%, though less-pricey International Monetary Fund loans bring down the average rate. This means that debt that the Irish government issued at low interest rates in the boom years is being replaced by higher-cost debt.

The criticism was summed up trenchantly this week by Barry Eichengreen of the University of California, Berkeley. (The article that appeared in the German newspaper Handelsblatt is available in English on the Irish Economy blog.)

Much of the problem lies with conditions placed on the rescue funds to make them palatable to Germany.

"The Irish 'program' solves exactly nothing—it simply kicks the can down the road. A public debt that will now top out at around 130% of GDP has not been reduced by a single cent. The interest payments that the Irish sovereign will have to make have not been reduced by a single cent, given the rate of 5.8% on the international loan. After a couple of years, not just interest but also principal is supposed to begin to be repaid. Ireland will be transferring nearly 10% of its national income as reparations to the bondholders, year after painful year."

Thus, the European bailout arrangements designed to halt the debt crisis have managed, in the opinion of many analysts, only to make it worse.

Willem Buiter, Citigroup chief economist, argues in research published this week that Ireland, with the financial system now owned by the government, is "de facto insolvent." So is Greece. Portugal, he says "is less dramatically, but quietly, insolvent too."

If this is right, the only way out of the sovereign-debt trap for these countries—and possibly Spain as well—is either lots of low-cost money that other governments don't appear willing to provide or a substantial reduction in their debts through the imposition of losses on bondholders.

If so, it is not really Germany's much-criticized plan to push through a post-2013 insolvency procedure that has scared bond investors over recent weeks—but what many see as the realistic prospect for a series of post-2013 sovereign-debt restructurings.

Agence France-Presse/Getty Images (3); Bloomberg News

Clockwise from top: Commuters try to board a packed train in Ostkreu, Germany; a passenger waits at London's City Airport and drivers check a high speed train near Paris and a truck. in western France.

Europe battles through cold snap

A Wall Street Journal Roundup

LONDON—Freezing temperatures and heavy snowfall disrupted land and air transport, caused fuel shortages and sent energy demand soaring Thursday as Europe struggled to cope with a bitter cold snap.

In Poland, the freezing weather claimed 10 more lives, bringing the overall number of deaths from the Arctic blast to 18, Polish police said.

Severe weather in the U.K. disrupted the fuel-supply chain, leading to fuel shortages at 500 retailers, mostly in rural areas, the RMI Independent Petrol Retailers Association said. Road tankers in northern England were unable to leave the main terminals from the **Total** refinery at Lindsey and from the Jet refinery at Killingholme, operated by **ConocoPhillips**, the group said.

"We are close to a critical point in what is fast becoming a fuel crisis as well as a weather crisis," RMI Petrol Chairman Brian Madderson said. "By the end of the weekend, tens of thousands of motorists could have no fuel to go about their daily lives."

U.K. natural-gas network operator **National Grid** PLC estimated that demand would rise to 458 million cubic meters Thursday, almost a third higher than the seasonal norm and close to the record high of 465 million cubic meters hit on Jan. 8 this year.

"To get so close to these levels coming out of November into December is very unexpected," said a trader at a U.K. utility. "Supply is coping," but prices are at their highest level since the winter of 2008, the trader said.

The unusually cold conditions prompted French Industry and Energy Minister Eric Besson to urge state-controlled utility **Electricité de France** SA to ensure more of its nuclear reactors are available to cope with sudden surges in electricity demand.

"Exceptional" weather conditions such as the early cold snap currently freezing the country appear to be occurring more frequently, Mr. Besson said while visiting a power-control center. Instead of the 51 reactors out of 58 currently available, "we could have hoped for" 53 or 54, he said. The government will review the issue with EDF, he said. Mr. Besson also urged consumers to eliminate unnecessary power usage to reduce pressure on the network, particularly in northwest France where supply and demand are particularly tight.

However, the chief executive of France's power-grid company, **Reseau de Transport d'Electricité**, said the risk of power cuts had subsided as temperatures weren't quite as cold as RTE had feared.

London Gatwick Airport, Britain's second-busiest, was closed for a second straight day, with another 600 flights canceled as conditions continued to deteriorate. Edinburgh Airport and London's City Airport were also closed until late evening, according to the Eurocontrol agency's website. The agency also reported significant delays at London Heathrow, Paris's Charles de Gaulle, Amsterdam's Schiphol, Berlin's Tegel and Düsseldorf airports.

Travelers hoping to fare better by road or rail were equally stymied as snow continued to fall across the U.K. and most of Germany, leaving thousands of motorists stranded in freezing temperatures.

London Gatwick Airport, Britain's second-busiest, was closed for a second straight day.

Some 3,000 rail passengers also were stranded overnight in their trains, German railway operator Deutsche Bahn said. About 200 passengers in Frankfurt spent the night in parked trains after hotels filled up. Nothing was moving along many of the nation's high-speed train links, such as between Nuremberg and Leipzig in the south and east, or between Hamburg and the Danish capital Copenhagen in the north.

Parts of Denmark also were badly hit, and heavy snowfalls and icy winds severely hampered road and rail traffic across much of the country. The Danish army was mobilized to help emergency vehicles, using tracked armored personnel carriers to help ambulances and other emergency vehicles cut their way through mounds of snow.

Thousands of homes in Poland were left without electricity or heat as temperatures sank to around minus 10 Celsius. Several Romanian villages suffered a similar fate, while severe ice caused delays to traffic across the nation.

On many German roads, meanwhile, traffic was chaotic with hundreds of minor accidents caused by heavy snowfall. Police in Berlin alone counted 121 accidents Thursday morning, spokesman Burkhardt Opitz said.

The heavy winter weather claimed at least two lives in Germany, a 73-year-old in Lower Saxony who was struck by a train while trying to clear snow and an 18-year-old driver in Baden-Württemberg who lost control of his vehicle on an icy road and crashed head-on into a truck.

The cold also took a solid grip over Sweden, with the lowest temperatures overnight Thursday measuring minus 29.6 Celsius in Lillhardal in the center of the country. Electricity prices in the country remained well above average as problems at nuclear plants compounded the effects caused by the weather.

State-owned energy producer **Vattenfall** AB's nuclear plant Ringhals, which accounts for one-fifth of overall Swedish electricity production, is operating at approximately 75% of full capacity. On Wednesday the plant failed to start one of its four reactors that had been shut down for maintenance, because of a technical error. **OKG** AB, which operates three nuclear-reactor units, was at 57% of full capacity as it postponed the restart of its third and largest reactor on Wednesday.

The high price for electricity has caused trouble for some energy-intensive companies in Sweden. On Tuesday, paper-pulp producer **Rottneros** AB temporally halted some of its production of pulp because of the high electricity price. Chief Executive Ole Terland put the blame on Swedish energy politics and the deregulation of the energy sector that took place in the mid-1990s.

"When electricity prices reaches these levels our production becomes unprofitable," he said. "A large part of Swedish base industry is affected by this."

In southeastern Europe, meanwhile, Bosnian authorities declared a state of emergency and ordered evacuations after heavy rainfall caused severe flooding on the Drina River. Schools closed, half of the town has no electricity and city water is no longer drinkable. In nearby Gorazde, the federal army had to help evacuating people.

Bank-run proposal is opposed

By Sebastian Moffett
And Max Colchester

PARIS—Bankers and politicians warned against a plan inspired by French former football star Eric Cantona to spark a bank run next week, saying that such a move would be counterproductive.

The plan—which calls on depositors to remove their money from banks on Tuesday—has attracted increasing attention in recent days, drawing comments from French financial leaders.

"The recommendation to withdraw deposits is totally irresponsible," said **BNP Paribas** CEO Baudoin Prot. It also went "completely against anything that could assure the functioning of the economy," he told reporters Thursday.

Mr. Cantona said in an October video interview that regular means of protest, such as street demonstrations, had become ineffective. Instead, he said, it would be better for a large number of people to withdraw their money from banks at the same time. "The system is built on the banks," Mr. Cantona said in an Internet video. "So if you bring those down, the whole system collapses."

Geraldine Feuillien, a screenwriter in Belgium, helped to set up a website and Facebook page to promote the idea.

"What Eric Cantona said, I had been thinking for a while," she said. By Thursday, more than 30,000 people had pledged to withdraw their money.

Mr. Cantona couldn't be reached to comment.

His brother and agent, Jean-Marie Cantona, said he was acting in a film about bank robbers.

U.S. NEWS

Military retirees resist cuts

By Nathan Hodge

Greg Bishop joined the U.S. Army 21 years ago with this promise from recruiters: Serve for two decades and you'll get health care for life. Now, Mr. Bishop, who retired from active duty in September, is worried the government may be "moving the goalposts."

At issue are possible changes to the military health-care system, known as Tricare. As part of a raft of debt-reduction measures, President Barack Obama's bipartisan fiscal commission recommended looking at Tricare as part of a top-to-bottom review of federal health-care spending. Secretary of Defense Robert Gates wants to overhaul the military health system, too.

Veterans groups and military retirees are mobilizing to fight back, in anticipation that the Pentagon will recommend higher Tricare premiums as part of the president's 2012 budget plan.

"The heavy lifting [for this nation] is being done by the military," said Norbert Ryan, a retired Navy admiral who is president of the Military Officers Association of America. "They should be the last ones to give. Don't ignore the service and sacrifice that has earned them that benefit. Don't confuse it with Social Security. Don't confuse it with Medicare and Medicaid."

The Republicans' ascendancy after the midterm elections and the size of annual budget deficits have focused minds in Washington on U.S. fiscal woes. In that climate, the deficit panel's report could lead to a grand bargain next year between the White House and Congress.

Before that happens, a retinue of powerful backers will fiercely defend targeted programs and tax benefits. Realtors and the construction industry are rallying to protect tax deductions on mortgage interest. Liberal activist groups and AARP want to beat back Social Security changes.

As part of the social contract between the nation and the all-volunteer military, Tricare is one of the touchiest targets, particularly in a time of war.

The deficit panel report issued Wednesday was short on specifics, but a series of draft recommendations called for raising Tricare fees for retirees, a move that would save the Pentagon about $6 billion in 2015. They noted that around 57% of the people who use Tricare are retirees and their dependents, not active-duty service members.

European Pressphoto Agency

Defense Secretary Robert Gates, shown before the Senate Thursday, wants to overhaul the military health-care system.

Mr. Bishop, a partner in Musa Entertainment Consulting Inc., a veteran-owned business in Los Angeles that helps entertainment companies secure Pentagon cooperation, said access to Tricare "was a major factor in my decision to go off on my own" in a small business. Without that, "it would have been a tougher decision."

Tricare includes plans that cover uniformed service members, retirees and their dependents, in the U.S. and overseas. Coverage for active-duty troops is largely free. The Department of Veterans Affairs, which provides care for wounded veterans no longer on active duty, or who have service-related disabilities, has a budget separate from the Department of Defense.

The cost for a military retiree to enroll his family in Tricare Prime, which is similar to a health maintenance organization, is $460 a year, a rate that has not changed since 1995. According to the Kaiser Family Foundation, the average annual premium currently paid by private-sector workers is around $4,000 a year.

In the past decade, the military's health-care budget has more than doubled, ballooning from $24 billion a year to more than $50 billion. Mr. Gates has complained health-care costs are "eating the department alive."

In 2008, medical care ate 6% of the Department of Defense's funding, according to the Congressional Budget Office. By 2026, these costs are expected to more than double to 13% of spending.

Tricare took a shot across the bow in August, when retired Marine Corps Maj. Gen. Arnold Punaro decried "GM-style fringe benefits" in a speech at the Center for Strategic and International Studies in Washington. Mr. Punaro singled out health-care costs for retired personnel as the primary culprit.

The speech rippled through the retired-military world. In an interview, Mr. Punaro joked that he was "probably burned in effigy five or six times."

The Defense Department has previously attempted moderate increases in premiums and co-pays, but has been met with a furious response from Congress and veterans groups.

That coalition may be on less solid ground now. The arrival in Congress of lawmakers with a mandate to rein in spending has some veterans' advocates nervous, especially after key pro-military members of Congress lost their seats in November.

"A lot of people who understood our issues, who are our biggest champions...are gone," said Steve Strobridge, the director of government relations for the Military Officers Association of America.

For Mr. Bishop, Tricare is not simply an employee benefit, but something earned in return for service. "I understand the fiscal situation our country is in," he said. "I understand that everyone needs to do their share." But, he added: "I feel that veterans have already given something."

New jobless claims rose last week

By Sudeep Reddy

New jobless claims climbed last week, damping hopes for a quickening improvement in the labor market. But a sharp gain in an indicator of future home sales offered a positive sign for the beleaguered housing market.

Initial claims for unemployment compensation rose 26,000 to a seasonally adjusted 436,000 in the week ended Nov. 27, the Labor Department said Thursday. The latest jump erased most of the prior week's substantial decline, a move that had suggested a rapid turn toward stronger employment.

Still, jobless claims are making slow progress toward healthier levels. The four-week moving average of claims, a measure used to smooth weekly volatility, stood at 431,000, the lowest since August 2008. Initial claims were close to 300,000 in the months before the recession started in late 2007.

Continuing claims, drawn by unemployed individuals for more than a week, climbed 53,000 to a seasonally adjusted 4.27 million in the week ended Nov. 20. The figure could drop later this month after an extension of unemployment benefits—to as long as 99 weeks—expired this week. As a result, some two million people could lose their benefits by year's end unless Congress passes a new extension.

A housing-industry index that tracks pending sales of existing homes increased 10.4% in October, suggesting a jump in sales at least for November.

Meanwhile, a housing-industry index that tracks pending sales of existing homes gained 10.4% to 89.3 in October from a month earlier.

The National Association of Realtors index, which tracks home contracts that have been signed but not closed, indicates transactions coming in the following two months. It suggests a jump in overall existing home sales at least for November.

The October increase followed a 1.8% drop in September. Coming in a month in which some banks halted foreclosure sales, the gain offered hope that troubles with foreclosures wouldn't derail the overall market.

Still, the index remained more than 20% below its October 2009 mark. And its latest boost only brought it back to the level seen before a federal tax credit for home buyers drew buyers into the market and boosted sales.

"In absolute terms these remain very depressed levels, and there is considerably more territory to cover in order to call the move anything more than a rebound from a post-tax credit air pocket," said Joshua Shapiro, U.S. chief economist at MFR Inc., a consultancy.

Home prices in the U.S. are falling, which, along with a weak economy, hurts demand. Home prices nationally were down 2% in the third quarter compared with the second quarter, according to the S&P Case-Shiller national price index released this week.

While lower prices mean more people can afford homes, a downward trend in prices discourages some would-be buyers as they opt to wait for a better deal.

Panel sees big revamp of drilling regulator

By Siobhan Hughes

WASHINGTON—A panel appointed by President Barack Obama appears likely to recommend a restructuring of the U.S.'s offshore-drilling regulator that is broader than the overhaul already being implemented by the administration.

The staff of the National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling on Thursday proposed that a new agency with an independent chief be established solely to focus on safety and the environment. The agency would remain within the U.S. Interior Department and have only a loose connection to the Interior secretary.

The move appears to be designed to prevent conflicts that may arise when a single official holds the ultimate responsibility for overseeing competing priorities such as safety, environmental protection and generating revenue from leasing.

The panel was established by Mr. Obama in the wake of the Gulf of Mexico oil spill, the worst offshore oil spill in U.S. history. It is scheduled to issue a final report on Jan. 11. The Interior Department had no immediate comment.

Earlier Thursday, the commission said **BP** PLC's management policies failed to ensure that decisions made to cut costs in its deep-water drilling operations didn't undermine safety. BP "did not have policies and systems in place" to "ensure that decisions made to reduce costs and improve efficiency do not increase risks or diminish safety," the staff of the commission said in a report.

Without such policies, "financial pressures will likely bias decisions in favor of time and cost savings," the staff report said.

"The series of decisions that doomed [the] Macondo well evidenced a failure of management, and good management could have avoided a catastrophe," William Reilly, a co-chairman of the panel, said at the start of a final, two-day round of the commission's public deliberations.

The commission staff's criticism of BP management follows earlier statements by the panel's chief counsel, Fred Bartlit, that his team had uncovered no evidence that any workers on the rig consciously made a decision to put cost cutting ahead of safety.

The April 20 Deepwater Horizon explosion killed 11 workers and launched an undersea gusher that ultimately spilled 4.9 million barrels of oil into the Gulf.

Management failures went beyond BP, the commission staff said.

"Most of the mistakes and oversights that led to the blowout were the result of management failures by BP, **Halliburton** Co., and **Transocean** Ltd.," the staff concluded.

The staff found that BP, Transocean and Halliburton "failed to communicate adequately."

BP "did not share important information with its contractors, or sometimes even within its own team," and "contractors did not share important information with BP or with each other," the commission staff said.

WORLD NEWS

Japan's Kan struggles to keep power

By Yuka Hayashi

TOKYO—Japanese Prime Minister Naoto Kan appears to be carrying on the tradition of political turmoil that brought down his predecessors as he struggles, after less than six months in office, to manage a divided parliament and contain a growing fissure within his own ruling party.

Opposition parties have become increasingly hostile toward Mr. Kan amid criticism over the government's handling of recent territorial disputes with China and Russia. At the same time, plunging approval ratings and signs of a split within the ruling Democratic Party of Japan have emboldened critics ahead of critical discussions of next year's budget, scheduled for January.

"We are seeing the beginning of an end as it is painfully clear parliament will come to a deadlock sooner rather than later," said Makiko Tanaka, a senior lawmaker in Mr. Kan's own party, the DPJ. "Rather than trying to buy time, he should step down." Ms. Tanaka wants Mr. Kan to overhaul his cabinet or resign with the cabinet to pave the way for general elections.

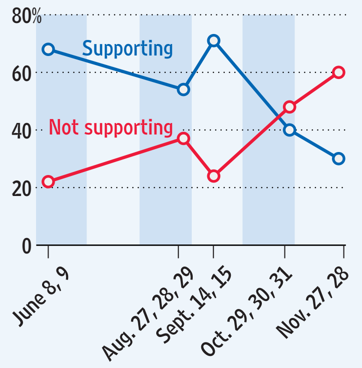
In reminders of final-day scrambles experienced by short-lived predecessors, Mr. Kan's government has faced repeated setbacks in parliament.

Opposition parties have rejected the government's $57 billion spending package and filed censure motions against key members of the administration—efforts that were overturned by the DPJ-controlled lower house but that ultimately cost Mr. Kan political capital.


Japan's Prime Minister Naoto Kan at a budget committee meeting last month

Sour turn

Public opinion of Mr. Kan's cabinet, according to polls



Sources: Nikkei Research; Associated Press (photo)

In the past, similar maneuvers often foreshadowed the fall of a prime minister.

Sharp declines in approval ratings for the prime minister are exacerbating divides within the DPJ—a party formed just 14 years ago and made up of a mix of conservative rural politicians, big-city liberals and former union leaders.

Worrying Mr. Kan, in particular, is the stirring among lawmakers such as Ms. Tanaka who are loyal to Ichiro Ozawa, a party power broker who fought a tough battle against the prime minister in a party leadership election in September. Some 50 freshman lawmakers sympathetic to Mr. Ozawa last week formed a new intraparty group, setting off speculation Mr. Ozawa might leave the party.

Much of the dissatisfaction with the government centers on its handling of foreign-policy issues.

The government was accused of caving in to pressure by Beijing with the release of the captain of a fishing trawler that in September crashed into Japanese coast guard vessels in disputed waters in the South China Sea. That was followed by Russian President Dmitry Medvedev's visit to a group of islands claimed by the two nations since World War II.

According to polls published Monday by the Nihon Keizai Shimbun daily, the approval rating for Mr. Kan's cabinet has plummeted to 30%, down 10 points from a month earlier and a far cry from a high of 71% in September. Of the 60% of the respondents expressing disapproval, the most common reasons cited were Mr. Kan's weak leadership and "lack of diplomatic sense."

Opposition parties already are flexing their muscles to challenge next year's budget—Mr. Kan's first, and one that is supposed to show off his signature policies, such as beefing up of maritime security amid rising tension in East Asia.

Some feel the DPJ would fare better under a new leader as it prepares for nationwide elections for prefectural governors and assembly members in April.

Often mentioned as potential successors are foreign minister Seiji Maehara and secretary-general Katsuya Okada.

Mr. Kan inherited some problems from his predecessor, Yukio Hatoyama, who ousted a long-serving conservative party last year with promises to usher in change, but soon gave up amid a harsh reality.

Japan's bilateral relations with the U.S., for example, had been strained due to Mr. Hatoyama's promise to overturn an existing agreement to build a new U.S. military facility in Okinawa. Mr. Kan, as a result, is now stuck with a toxic combination of unbending demands from the U.S. and renewed opposition from angry Okinawans.

Still, other problems are of his own making. In addition to the foreign-policy controversies, the opposition has criticized the DPJ for not allowing questioning of Mr. Ozawa at parliament over a campaign-funds scandal, for which the senior lawmaker is expected to be indicted.

"Japanese people are looking at the government with increasingly critical eyes," said Nobuaki Koga, secretary-general of Rengo, an umbrella organization for labor unions and a key support base for the DPJ. "The government needs to realize it is a crisis and heed their voices seriously."

Attack on campaign in Ivory Coast kills 4

Associated Press

ABIDJAN, Ivory Coast—Armed men attacked a presidential candidate's office in Ivory Coast overnight, provoking fear and uncertainty on Thursday, the day after the electoral commission missed a deadline to issue results from a tight presidential runoff.

Unidentified men armed with automatic weapons attacked an office of presidential challenger Alassane Ouattara overnight, despite a curfew, killing four people and wounding 14 others in the Abidjan district of Yopougon, said local party security chief Coulibaly Diomande.

Mr. Ouattara's party accuses incumbent President Laurent Gbagbo—whose mandate expired five years ago—of trying to steal the long-awaited ballot. Mr. Gbagbo loyalists, apparently fearing they don't have enough votes for victory, have prevented the commission from announcing results, saying tallies from at least four of the country's 19 regions should be canceled. Millions hoped the vote would restore stability to the world's top cocoa producer. International observers have declared the vote free and fair.

Ivory Coast's electoral code stipulates the commission has three days to issue provisional results, and the constitutional council then has seven days to consider appeals before making those results official. The Ivorian constitution states that in the case of extraordinary circumstances the council—whose president Paul Yao N'Dreo is a member of Mr. Gbagbo's ruling party—has 24 hours to decide if the electoral process should be stopped.

"Authority now passes to the constitutional council," said Alain Mosso, a law professor at the University of Bouake. "The council decides which results to announce and which results to throw out."

On Thursday morning, traffic was unusually scarce in the normally bustling lagoon-side city of Abidjan as nervous residents were hesitant to leave home. The presence of security forces on the streets has steadily increased since Sunday's election, and pickup trucks with machine guns mounted on their beds and small tanks took up positions on the main arteries Wednesday night.

The West African nation has been under nationwide curfew since Nov. 27—a measure that Mr. Gbagbo extended by five days Wednesday.

In commodities markets, the price of cocoa futures surged on concerns the political tensions would disrupt supply. March cocoa futures on NYSE Liffe's London exchange jumped more than 5% to hit a month-high of £1,944 ($3,035) a metric ton, while cocoa prices on New York's ICE Exchange reached a high of $2,920 a ton. The Ivory Coast provides about 40% of world output of cocoa.

The vote was the first in 10 years following a brief civil war that split the country in two, leaving the northern half in the hands of rebels sympathetic to Mr. Ouattara who have yet to disarm.

WORLD NEWS

China's shadow lending strains limits

By Dinny McMahon

BEIJING—Lending by lightly regulated financial companies outside China's formal banking system has ballooned this year, causing increasing headaches for the government in its efforts to manage the economy and control inflation, observers say.

China's government has traditionally used its control of the largely state-owned banking sector to regulate the country's pace of economic growth, directing it to pump out cheap credit in good times and restricting the volume of new loans to prevent overheating. But controlling credit has become more difficult as the financial system gets more sophisticated, analysts say, complicating Beijing's efforts to bring the economy in for a smooth landing in coming months.

China has a long history of gray-market financing flowing from small, informal and unregulated groups, to sectors not well covered by banks. A number of formally incorporated entities, including trust, leasing and guarantee companies, have also emerged, with the scope to provide alternative financing. As banks labor under stricter limitations on how they can lend, they have been looking to trust companies in particular to trim their balance sheets and regulatory burden.

In a report Thursday, Fitch Ratings estimated that China's banks already have blown past the 7.5 trillion yuan ($1.126 trillion) limit that regulators set on new local currency lending for this year and extended more than three trillion yuan in credit that hasn't been recorded on their balance sheets.

In total lending, that is largely unchanged from 2009, when China's banks led a massive expansion of credit—roughly doubling the volume of new loans from a year earlier—as part of a stimulus program to keep the economy humming during the global financial crisis.

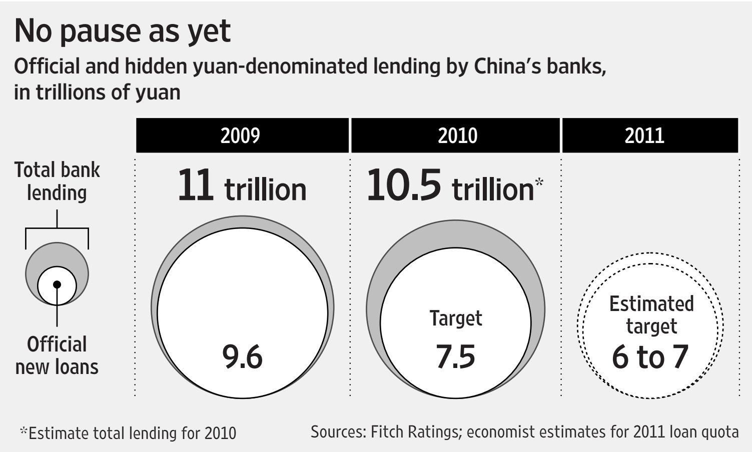
"Lending has not moderated, it has merely found other channels," Fitch said in the report. That "helps explain why inflation and property prices are still stubbornly high, why [third-quarter] GDP growth was stronger than expected, and why Chinese authorities have voiced so much concern about further quantitative easing in the U.S."

The China Banking Regulatory Commission, China's bank regulator, couldn't be reached to comment.

The amount of loans treated this way is unclear because nobody centrally collates the data, and Fitch says its three trillion yuan estimate for off-balance-sheet credit is rough.

Even as Beijing has tried to ratchet back on its stimulus, China's consumer-price index rose 4.4% in October from a year earlier and food prices surged 10.1%. China's gross domestic product rose 9.6% from a year earlier in the third quarter.

"The official [loan] quota is often undermined by China's shadow banking system," said Standard Chartered economist Stephen Green. "Hopefully next year's will be more strictly enforced."



When Beijing moved to exit the stimulus program at the end of last year and regulators started pressuring banks to ease up on issuing credit, banks started looking for more creative ways to lend. Fitch says bank lending—including both the 9.6 trillion yuan formally lent and off-balance-sheet lending—was about 11 trillion yuan last year.

"With so much activity under way in the nonbank sector, adjusting the amount of lending in the economy is no longer as simple as handing out quotas to banks and monitoring their compliance," the report said.

Informal lending has long been an important source of credit for many of China's firms, particularly during credit tightening. But more-sophisticated financial institutions are starting to fill that role, exemplified this year by trust companies.

"Trusts are opportunistic in nature and are very good at filling gaps left open by the banking system," said Simon Gleave, regional head of Asia Pacific for financial services at KPMG.

Trusts—which are investment vehicles unique to China with little in common with Western-style trust firms—enabled banks to stay below their loan quota by using an informal type of securitization to repackage bank loans as investment products. With banks' deposit rates so low—at 2.5% for one year, the rate is below the level of inflation—banks had no trouble finding investors seeking a higher return.

Banks generally take those loans off their books even though they agree with the trusts to repurchase the loans any time between a few weeks and a few years later, analysts say.

China's bank regulators have been working to curb bank off-balance-sheet lending. In August, the CBRC told banks that loans moved off their balance sheets must be returned by the end of next year.

Trusts have also become a major player in property development after bank lending to the sector was curtailed by regulators wary of a bubble forming. According to data from the trusts' industry association, trust companies directed 320 billion yuan toward the property sector in the first three quarters of this year. That would add significantly to the 1.72 trillion yuan that banks have already lent to the sector, according to central bank data.

In some ways the move toward trust lending works in the interests of the central government.

"Having property developers turn to trusts should act as a limit on overheating of the real-estate sector simply because the higher cost of capital leaves them with less options," said Mr. Gleave.

Regulators in early November warned the trust companies of risks in the real-estate sector. Some trust companies have already curtailed their real-estate lending.

The Fitch report also identified another avenue of large-scale "credit leakage" whereby banks use a type of repurchase agreement to avoid recording discounted bills—a type of trade finance—on their balance sheets.

Australian executive is charged in China

By Cynthia Koons

SYDNEY—Australian businessman Matthew Ng, detained in southern China's Guangdong province, was charged with embezzlement, the Australian Department of Foreign Affairs and Trade said Thursday.

The agency classified the charges against Mr. Ng, the founder and chief executive of Chinese travel company **Et-China**, as "very different" from those brought against Australian national Stern Hu, the former Rio Tinto PLC executive who was arrested in China last year.

"The Australian government is monitoring developments closely to ensure due legal process is followed," a spokeswoman for the department said.

She added, "The Australian Consulate-General in Guangzhou has raised the Australian government's strong interest in the case at senior levels of the Guangdong [provincial] government."

Mr. Ng, 44 years old, was detained Nov. 16 on suspicion of embezzlement and was charged Nov. 30, DFAT said.

A representative from Et-China couldn't be reached to comment. The company said on its website last week that Mr. Ng was being held by Guangzhou police.

Officers from the consulate visited Mr. Ng in detention on Nov. 18 and plan to visit again Dec. 7. The consulate is providing assistance to Mr. Ng and his family in China and will continue to monitor him, the spokeswoman said.

Mr. Ng's detention is being closely watched in Australia, partly because of the case involving Mr. Hu, now in a Chinese prison serving a 10-year sentence. Detained in July 2009, the Rio Tinto executive was found guilty of accepting about $935,000 in bribes from steelmakers and stealing commercial secrets that undermined China's steel industry. It was a politically sensitive case in which Canberra butted heads with Beijing.

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Mr. Ng's business, Et-China, was founded in 2000 and has a strategic partnership with **China Southern Airlines**, according to its website.

Through the joint venture, Et-China is the exclusive provider of China Southern e-ticketing sales and services until 2018. Et-China also owns a 50.6% stake in **GZL**, a leisure-travel company in Southern China.

Mr. Ng earlier worked as an investment banker in Australia, New Zealand and Southeast Asia and for **Commonwealth Bank of Australia**, according to Et-China's website.