BP's cap success leads experts to ask why it wasn't tried sooner

THE BIG READ 19

What investment banks hope to see in stress tests

HEARD ON THE STREET 22

THE WALL STREET JOURNAL.

VOL. XXVIII NO. 120 | EUROPE | Thursday, July 22, 2010

DOWJONES A NEWS CORPORATION COMPANY

europe.WSJ.com

Bahrain BD 1.50 - Egypt $1.75 (C/V) Jordan JD 2 - Kuwait KD 1 - Oman OR 2 Qatar QR14 - Saudi Arabia SR 14 £1.50

Clinton's vision for North Korea

Reuters

Hillary Clinton, left, and U.S. Defense Secretary Robert Gates look northward near the demilitarized zone separating the two Koreas. She said the U.S. will enact new economic sanctions on Pyongyang aimed at disrupting its weapons trade and the lifestyles of its elite. **Article on page 13**

Oil firms plan rapid system to fight spills

BY ANGEL GONZALEZ

Four of the world's largest oil companies are creating a strike force to stanch oil spills in the deep waters of the Gulf of Mexico in a billion-dollar bid to regain the confidence of the White House after **BP** PLC's disaster.

Exxon Mobil Corp., **Chevron** Corp., **Royal Dutch Shell** PLC and **ConocoPhillips** are expected to announce Thursday that they are forming a joint venture to design, build and operate a rapid-response system to capture and contain up to 100,000 barrels of oil flowing 3,000 meters below the surface of the sea. The BP-leased Deepwater Horizon has been leaking up to 60,000 barrels per day 1,500 meters below the surface.

The system, consisting of several oil-collection ships and an array of subsurface containment equipment, resembles the one developed by BP during three months of trial and error after the rig exploded April 20.

BP, which is still engaged in its prolonged effort to stop the resulting oil spill and clean it up, wasn't asked to join the strike-force consortium. "We don't want to distract them at all," said Rex Tillerson, CEO of Exxon, which is leading the new system's engineering and construction.

But BP, along with other companies operating in the Gulf, may be able to use the strike force.

The companies will make an initial investment of $1 billion in the nonprofit venture, which they are calling the Marine Well Containment Co. But the tab to build the system and have crews on perennial alert for years could run in the billions of dollars.

The containment system is expected to be ready within 18 months, Exxon said. The aim of the system will be to keep oil from gushing into the ocean in the event of a catastrophic blowout.

The response team should be able to start mobilizing within 24 hours of an oil spill, and be fully in place within weeks, said Sara Ortwein, vice president of engineering for Exxon Mobil Development Company.

The new plan aims to placate the intense official and public criticism of the oil industry. Despite significant technological breakthroughs that led to the exploitation of oil and gas trapped far below sea level, the industry was caught without an effective response to the Deepwater Horizon oil spill.

The new system "clearly would address" concerns about the industry's capability to deal with massive spills, even though Exxon and the oil industry maintains that such events are preventable, Mr. Tillerson said in an interview.

■ U.S. drills into BP; rig exodus doesn't happen.....Pages 17, 19

The Quirk

Jim Thorpe, Pa., considers life after its namesake, a Native American athlete. Page 33

World Watch

A comprehensive rundown of news from around the world. Pages 34-35

Editorial & Opinion

Will Obama heed Cameron's warnings on the costs of Keynesianism? Page 15

Computer virus attacks Siemens control systems

BY VANESSA FUHRMANS

Computer hackers have designed a virus that targets industrial control systems built by German engineering giant **Siemens** AG, activating malicious software that analysts say represents a growing corporate-espionage threat.

The virus, dubbed Stuxnet, is spread by devices plugged into USB computer ports and is programmed to try to steal data from computer systems that are used to monitor large automated plants built for anything from manufacturing to power generation to water treatment. Siemens is one of the world's largest makers of such industrial automated systems, though it doesn't break out its annual revenue from such sales.

Researchers analyzing the virus say that it first surfaced several weeks ago and that they are now seeing several thousand infection attempts daily, though the malicious software, or malware, is only activated if it lands on a computer running the Siemens systems software.

Siemens says so far it has learned of only one customer, a German manufacturer whose identity hasn't been disclosed, whose industrial control systems have been infected. The company said the attack was discovered over the past week and that so far no damage had been found.

Analysts warn, though, that the attack on the Siemens's systems marks an escalation in hackers' efforts to use malware for industrial espionage or sabotage purposes.

Smaller, more isolated virus attacks have been attempted before on such automated systems, known as Supervisory Control and Data Acquisition, or SCADA, systems. But this is the first such infection where malware is searching for SCADA systems to attack on such a large basis, said Pierre-Marc Bureau, a senior researcher in the virus lab of ESET, a privately held software-security firm.

Please turn to page 26

PAGE TWO

As Ocado the grocer wins praise, Ocado the stock deal earns catcalls

[Agenda]

By Martin Vander Weyer

There was a neat coincidence of timing this week in the pricing of **Ocado**'s closely watched IPO and the announcement of **Goldman Sachs Group**'s latest quarterly profits. The mighty investment bank reported an 83% fall in net income for the second quarter, to $453 million, after making provision for the U.K. bonus tax and the settlement imposed by the U.S. Securities and Exchange Commission related to subprime paper. The online grocer Ocado priced its issue at 180 pence per share, well outside the initial proposed range of 200-275 pence and valuing its business far below the billion-plus numbers initially bandied about by the company's advisers. The shares ended the day down 7.2% at 167 pence.

Both these pieces of news were met by Goldman critics with a certain self-righteous satisfaction. No one much loves "the giant vampire squid" (to quote Matt Taibbi in Rolling Stone) that is Goldman Sachs these days, other than its own employees and multimillionaire former partners. So a period of diminished earnings—even for a single quarter, and after paying out a barely diminished $3.8 billion in pay and bonuses—will be seen by its critics as suitably chastening. And those members of the investment community who had taken offense at the Ocado's decision to forge ahead with an issue that they felt was too early, too risky and way too expensive will be chanting "We told you so."

The link between the two news items is the fact that Ocado was founded with fortunes made at Goldman, and that Goldman is the lead manager of the public offering. The link between the reactions is the widespread mood of distaste for the arrogance of financiers. Ocado's story offers a parable of how capitalism is supposed to work, as well as how it gets led astray.

Bloomberg News

Ocado's grocery service is a hit with customers, but profits remain elusive.

There is something disappointing about the way Ocado's initial public offering has proceeded.

Jonathan Faiman, Tim Steiner and Jason Gissing, the trio who created Ocado, did so by reinvesting some of the bonuses they had collected while working for the investment bank in 1990s. They gave up their highly paid Goldman jobs, took an entrepreneurial idea that was ripe for its time, and bet their savings on it. They executed that idea brilliantly, building from zero a business with £400 million of sales out of a single customer fulfillment center at Hatfield, a handful of distribution spokes and a fleet of vans. Ocado has created 4,000 new jobs; it offers high-quality produce from Waitrose and under its own brand; and that brand has swiftly imprinted itself on the consciousness of Britain's most affluent consumer group, the middle classes of London and the Home Counties.

So far so good. In many ways, a triumph. In fact It would be hard to think of a better way of recycling Goldman Sachs bonus money, or to come up with a more vivid business-school case-study of how to launch a large-scale de novo consumer venture; Amazon.com is one of the few that outshines it. Early investors understood that Ocado would take a long time to come to profit. It is not to Ocado's discredit that it has yet to move into the black, having made its first grocery delivery as long ago in early 2002. On the contrary, it is to the credit of its backers and bankers that they have kept faith with the concept and enabled the business to grow as far as it has. It is clear too that the online grocery market has ample room for growth—even if there are huge competitive threats to Ocado from the supermarket groups (including Waitrose, with which its non-compete contract comes to an end in 12 months' time).

And yet, despite so much that is praiseworthy about Ocado, there is something disturbing and disappointing about the way its initial public offering has proceeded. With a line-up of advisers and bookrunners that included J.P. Morgan Cazenove, UBS Investment Bank, Barclays Capital and HSBC as well as Goldman, just about everyone who's anyone on the sell side of the City had their name on this prospectus.

Objections were brushed aside from serious professional investors such as Richard Buxton of Schroders; critics argued the indicative pricing looked far too aggressive in relation to a catalog of risk factors that ran to more than 20 pages of Ocado's prospectus.

As the bankers finally shoved the deal out into the public arena Wednesday, its low pricing and weak trading in its debut confirmed that the doubters had won the argument. The shares could languish for a long time to come, after such a troubled debut and with profits still over the horizon. But the management and underwriting fees will be collected all the same.

The online grocer has done itself no favors by coming to market the way it has. The timing looks wrong, the tone sounds wrong, and the price had to be slashed to get it done.

In this tale of two companies, it's hard to avoid the conclusion that the aggressiveness of the bankers has won out over the entrepreneurial spirit of Ocado.

—Martin Vander Weyer is a columnist for the Spectator.

What's News

■ **As the EU prepares** to prove how solid its banks are, data from around the euro area show its weaker members' dependence on the European Central Bank has never been higher. 4

■ **Chancellor Merkel** defended Germany's austerity measures, saying they are good for growth despite their unpopularity with voters and foreign governments. 6

■ **U.S. Fed Chief Bernanke** signaled that no moves were imminent to bolster the recovery despite a "somewhat weaker" economic outlook. 9

■ **Elan has become** the target of a shareholder's campaign to shake up its board and management, which he says has destroyed shareholder value. 21

■ **The euro's recent rally** might be short-lived as it reflects concerns about the U.S. economy more than improved sentiment toward Europe, some say. 21

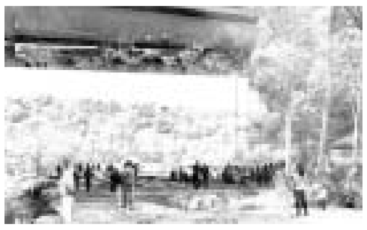
Inside

Heard this one? A lawyer walks into a comedy club **31**

In twist, Premier League embraces English footballers. **32**

ONLINE TODAY

Most read in Europe



1. Czech Politicians Star in Racy Calendar
2. Nokia Conducts Search for CEO
3. Are Designer Sunglasses Worth the Price?
4. Paris Isle, Deserted No More?
5. Goldman Profit Magic Missing

europe.WSJ.com

FREE daily access for every reader
First time users please register at:
wsj.com/accesstoday
Once registered, redeem future daily codes at:
wsj.com/accessrenew
Today's code is: **DJCOMPMO-aaabt0gw**

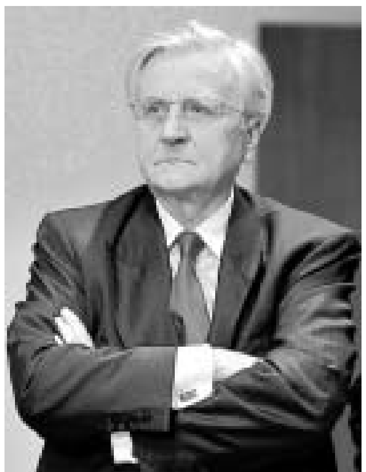
The Source

blogs.wsj.com/source

'It's a good thing Ocado is better at delivering groceries to its customers than selling shares.'

Margot Patrick on one of the worst first-day showings for a London IPO

Continuing coverage



Get analysis of the day's top news, including Heard on the Street columns, at **wsj.com/europeanalysis**

Question of the day

Vote and discuss: How many banks do you think are likely to fail the European stress tests?

Vote online and discuss your thoughts with other readers at **wsj.com/polls**

Previous results

Q: Do you expect stress tests to effectively gauge the health of Europe's banking sector?

Yes **25%**

No **75%**

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 9714280; 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 Basînevi.

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

Ceausescu exhumed in bid to solve mystery

Associated Press

BUCHAREST—Taking the country by surprise, forensic scientists on Wednesday exhumed what are believed to be the bodies of Romanian dictator Nicolae Ceausescu and his wife Elena to solve the mystery of where they are truly buried.

Ceausescu ruled Romania for 25 years with an iron fist before being ousted and executed during the 1989 anti-communist revolt in which more than 1,000 people were killed.

Some Romanians doubt that the Ceausescus were really buried in the Ghencea military cemetery in west Bucharest—including the couple's children. There is also some nostalgia for the communist period and regrets that the couple were executed on Christmas Day 1989.

The news of the exhumation, the latest development in a five-year court case, broke as most Romanians were asleep. Officials rapidly closed the cemetery as dozens of journalists began arriving. Journalists were barred from the exhumation but an Associated Press reporter entered the cemetery while the operation was taking place.

A team of pathologists and cemetery officials hoisted the wooden caskets of Ceausescu and his wife out of their graves Wednesday. They then took samples from the corpses and put them into plastic bags—a process lasting more than two hours—before reburying the coffins.

Ceausescu's alleged remains were better preserved than those of his wife, said Mircea Oprean, the couple's son-in-law who was present at the exhumation. "We are closer to knowing the truth," the couple's son Valentin Ceausescu, 62, said by phone.

Officials say it will take up to six months to determine the identity of the remains.

Cemetery worker Cornel Muntean, who stood meters from the exhumation, said that Ceausescu was dressed in a thick gray overcoat. An AP reporter saw a dirty cloth being removed from Ceausescu's remains and what looked like a thick gray fur hat at one end of the coffin.

Ceausescu was toppled Dec. 22, 1989, as Romanians fed up with years of draconian rationing and communist rule revolted. After a summary trial, Ceausescu and his wife were executed by a firing squad three days later.

Mr. Oprean's wife, Zoia Ceausescu, had sued the defense ministry in 2005, saying she had doubts that her parents were buried in the cemetery. She died of cancer in 2006 and her brother Valentin took up the case.

One woman at the cemetery said her family had suffered dearly under Ceausescu's rule.

"My in-laws were thrown out of their homes like dogs and their properties were sold. My husband was a political prisoner," said Aurelia Fuica.

But she had no disagreement with Wednesday's operation.

"There is a mystery that needs to be solved," she said.

EUROPE NEWS

Stressed banks dependent on ECB

BY GEOFFREY T. SMITH

FRANKFURT—As the European Union prepares to prove to the world how solid its banks are, new data from around the euro area show that its weaker members' dependence on the European Central Bank has never been higher.

The data make clear the mountain of work that governments and regulators still have to do to restore confidence in their respective banking systems when they release on Friday the results of "stress tests" on 91 of Europe's largest banks.

As reported, the banks must prove that they could sustain a 6% ratio of Tier 1 capital to assets by the end of 2011 even in the event of a fresh recession in the EU, and even if accompanied by an additional bout of volatility in government-bond markets similar to the one seen in May.

That makes the core metric of success or failure comparable to one of the two tests used by the U.S. in its own exercise last year. The EU is hoping that its test will do as much as the U.S. exercise did to dispel fears about the solvency of systemically important banks.

The Committee of European Banking Supervisors said this week that it intends to announce aggregated country results of its tests after the European markets close Friday, with national regulators following hot on its heels with a bank-by-bank breakdown for the 91 institutions. The goal was to allow markets 48 hours of relative calm to assess the data before trading on it.

However, many European banks also are listed in the U.S., exposing them to immediate market scrutiny that their non-U.S.-listed peers would escape.

People familiar with the situation said Wednesday that at least some regulators want to move the release up to before the start of trading in Europe instead. A final decision on the timing of the announcement is expected Thursday, possibly after a conference call of EU finance ministers.

Georges Gobet/AFP/Getty Images

European Central Bank President Jean-Claude Trichet met with top bankers Wednesday ahead of the stress-test results.

Switzerland's financial regulator, Finma, is following the EU's lead and will release results of its own tests on **UBS** AG and **Credit Suisse Group** AG this week, according to a person familiar with the situation.

Also Wednesday, top bankers—including the chief executives of **Intesa Sanpaolo** SpA, **Banco Bilbao Vizcaya Argentaria** SA, **UniCredit** SpA and **Commerzbank** AG—began gathering at the European Central Bank to meet with central-bank officials, including President Jean-Claude Trichet.

ECB officials regularly meet with senior bankers, but Wednesday's meeting is of particular interest because of the imminent publication of the test results. No postmeeting news briefing or statement has been announced.

The latest data from central banks underline how negative sentiment toward some European banks has become: Banks in Portugal, Ireland, Greece and—most of all—Spain increased their borrowings from the ECB to record levels in June as more institutions found their access to wholesale money markets barred.

"The reality of the situation is that a growing number of institutions have failed the market's own stress test," said Lena Komileva, head of market economics for the Group of Seven leading industrialized nations at Tullett Prebon.

Global banks have been reluctant to lend to banks in the euro area's weaker periphery all year. Figures published earlier Wednesday by the Bank for International Settlements showed that they reduced lending to Portugal, Ireland, Greece and Spain by $110 billion in the first quarter of the year. Another $81 billion was pulled from Italy.

But alarm bells really started ringing in May, when the ECB had to stem a general rout in southern European bond markets by buying tens of billions of euros of government debt. Wholesale money markets, where banks make up the difference between their loans to customers on the one side and their deposits and capital reserves on the other, have been effectively closed to many southern European and Irish institutions since then.

As such, ECB lending to the banking systems of Portugal, Ireland, Greece and Spain rose by €126 billion ($162.45 billion) in the first half of the year, accounting for almost all of an overall increase of €141 billion. Overall ECB lending volumes have fallen since June, with the repayment of €442 billion in 12-month funds. But by the end of June, these four countries accounted for 42% of the ECB's total lending of €870 billion, up from 33% at the start of the year. By contrast, those countries contribute only 13% of the ECB's capital.

To some degree, that development reflects a fear of country risk, rather than bank-specific risks. The public-debt dynamics of Greece and Portugal in particular have convinced many that a default or restructuring will be necessary before long. But it also reflects the fear that even sovereigns themselves won't be strong enough to save and recapitalize national banking systems that have suffered huge losses as real-estate bubbles exploded in their countries.

The goal of the stress tests was to assess how the 91 banks would stand up against pressure on their loans and assets in an economic downturn.

German Chancellor Angela Merkel said Wednesday the tests are being conducted on "very realistic" terms and should restore confidence in the financial sector.

—Ulrike Dauer and Nina Koeppen contributed to this article.

■ Heard on the Street: Tests unlikely to prompt equity raising 22

IMF sees euro-zone debt hobbling growth

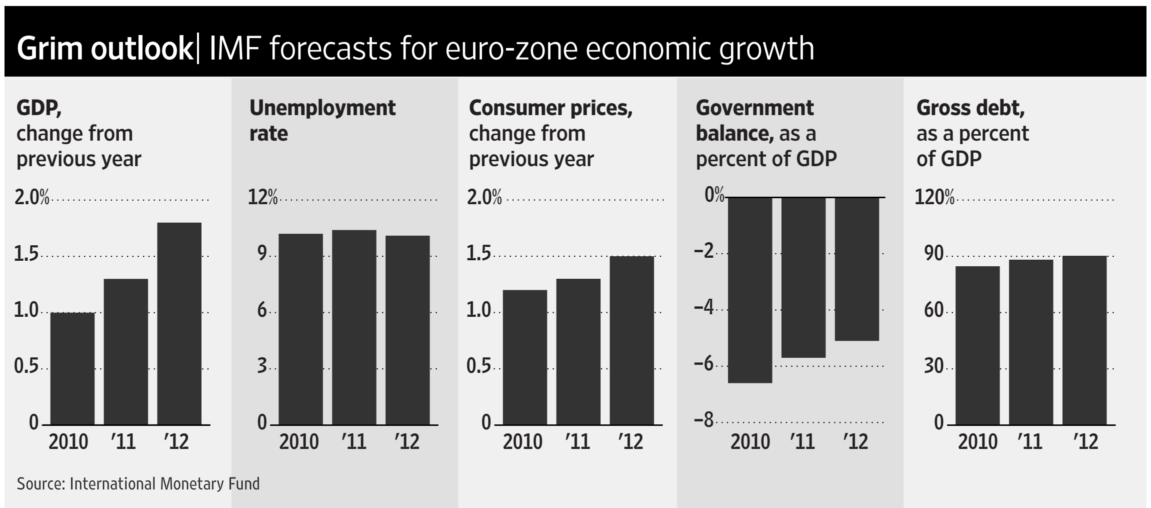
BY IAN TALLEY AND BOB DAVIS

WASHINGTON—Growth in the euro zone is expected to slog along at less than a 2% pace through 2012, the International Monetary Fund forecast, as many of the region's countries focus on getting their debt problems under control.

The IMF said three major areas need to be addressed to establish a durable recovery: tackling weaknesses in the banking sector, implementing ambitious fiscal-consolidation plans, and moving ahead with fundamental structural reforms such as entitlement programs and labor markets.

After the 16-nation euro zone sharply expanded its overall fiscal deficit in 2009 to fight the global recession, the IMF forecast that the euro zone would take a "neutral aggregate fiscal stance" in 2010, and would reduce its deficit somewhat over the following two years. The tighter fiscal stance would limit growth, the IMF said, but was necessary to stabilize the euro zone's debt.

The Greek financial crisis this year, with its threat of sovereign-debt default, has accelerated the effort by other heavily indebted euro-zone nations to limit spending.



"The crisis-management measures are expected to keep the sovereign crisis in check," the IMF staff reported. "Yet weakened confidence and the drag from fiscal adjustment" will limit potential growth.

As a result, the IMF forecast, unemployment in the euro zone, which was 7.6% before the global recession in 2009, is expected to average 10.2% this year and fall only to 10.1% in 2012.

One plus: The decline in the value of the euro over the past year should give exports a boost. The IMF said the euro is "now broadly in line with fundamentals." Luc Everaert, assistant director of the IMF's European department, said "the recovery in Europe will be helped a little bit by the euro staying in that range."

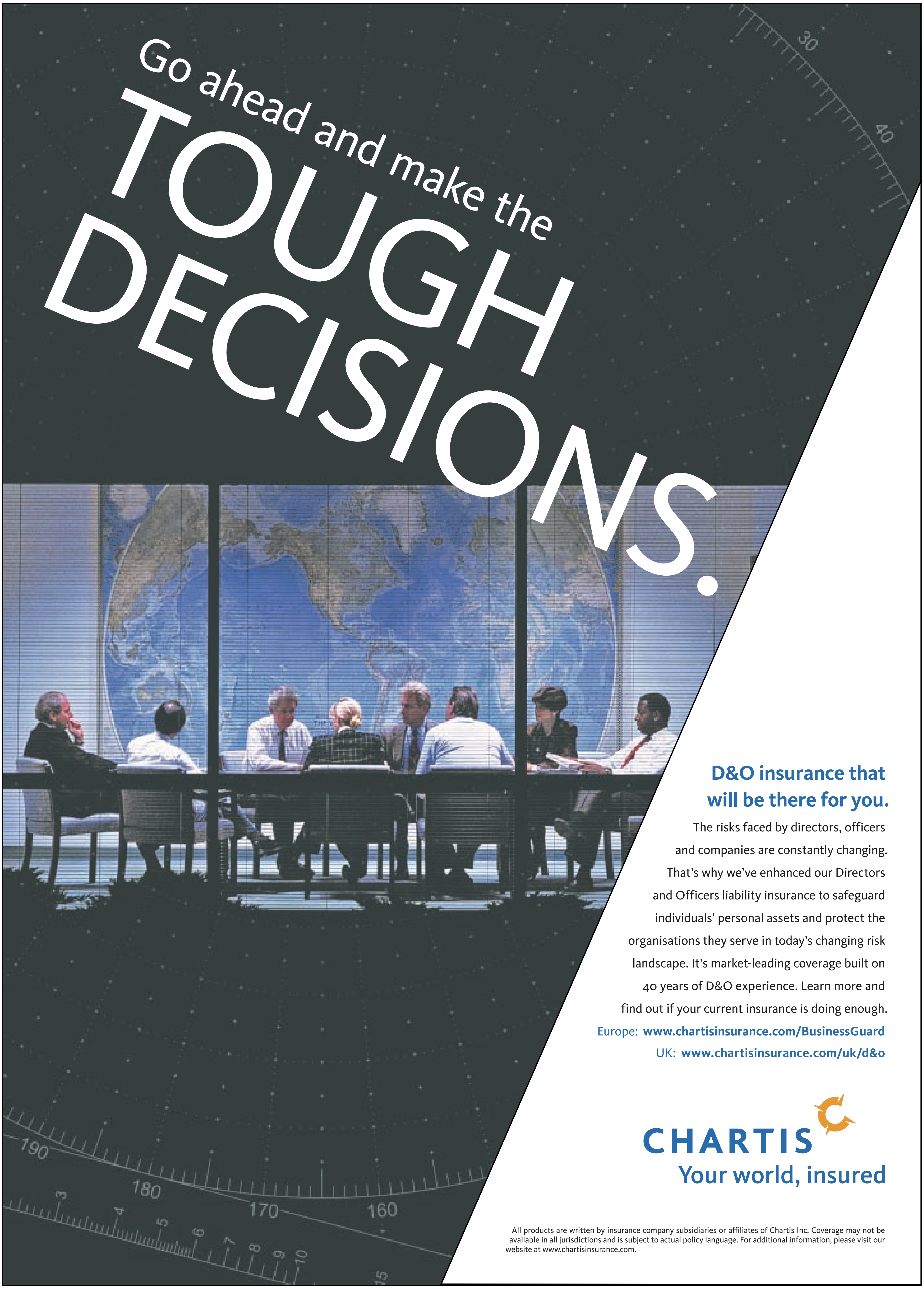
The deeper risk for Europe is a renewal of a credit crisis. A credit crunch on the scale of 2009, the IMF estimated, could reduce euro-zone gross domestic product by two percentage points from 2010 to 2011.

"The euro area is still affected by the sovereign crisis of some of its member countries, this creates the potential for an adverse loop between the financial system and public finances," Mr. Everaert said.

The IMF said that growth in the region depends on putting in place a host of structural reforms, and that progress in that area is sketchy.

Among the measures endorsed by the IMF was increasing the retirement age to encourage Europeans to work longer. Germany, the IMF said, needed to improve competition in its service sector. France should simplify firing laws, Italy should accelerate privatization, and Spain should reduce unemployment benefits to spur idled workers to seek new jobs, according to the IMF.

The IMF also said European Union institutions needed to be revamped so that countries took more seriously fiscal targets and reform efforts "Now is also the time to establish an effective economic and monetary union by strengthening the enforcement of sound fiscal and structural policies and completing the area-wide framework for financial stability," the IMF said.


Go ahead and make the
TOUGH
DECISIONS.
D&O insurance that
will be there for you.
The risks faced by directors, officers and companies are constantly changing. That's why we've enhanced our Directors and Officers liability insurance to safeguard individuals' personal assets and protect the organisations they serve in today's changing risk landscape. It's market-leading coverage built on 40 years of D&O experience. Learn more and find out if your current insurance is doing enough.
Europe: www.chartisinsurance.com/BusinessGuard
UK: www.chartisinsurance.com/uk/d&o
CHARTIS
Your world, insured
All products are written by insurance company subsidiaries or affiliates of Chartis Inc. Coverage may not be available in all jurisdictions and is subject to actual policy language. For additional information, please visit our website at www.chartisinsurance.com.

EUROPE NEWS

Merkel defends unpopular austerity

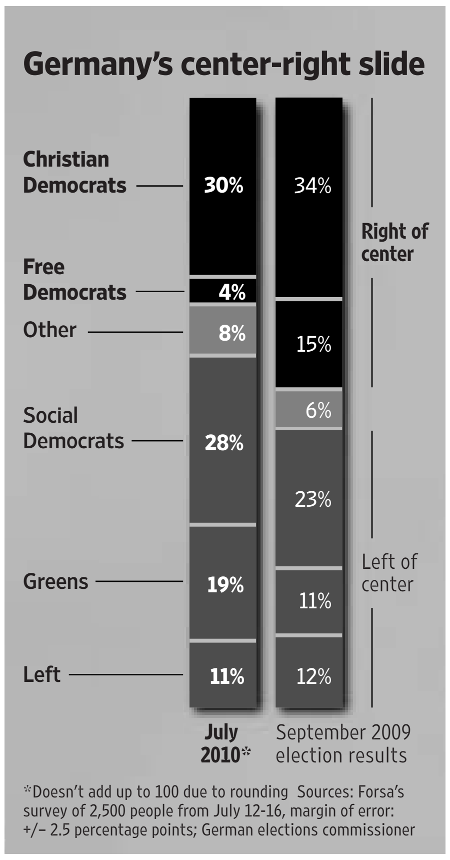
By Marcus Walker

BERLIN—German Chancellor Angela Merkel defended her government's austerity measures, saying they are good for economic growth despite their unpopularity with German voters and foreign governments.

Ms. Merkel told a news conference that Germany's falling unemployment shows her economic policy is on the right course, despite criticism from other leading economies including the U.S. and France, where policy makers want Germany to delay its planned budget cuts.

The chancellor played down differences with the U.S. over how to support the fragile economic recovery on both sides of the Atlantic, and dismissed concerns in Germany that her center-right government is losing its way amid sinking approval ratings and a string of resignations by leading conservative politicians.


German Chancellor Angela Merkel



*Doesn't add up to 100 due to rounding Sources: Forsa's survey of 2,500 people from July 12-16, margin of error: +/– 2.5 percentage points; German elections commissioner

A new opinion poll by the Berlin-based Forsa Institute showed that Ms. Merkel's conservative Christian Democrats and their partners, the pro-business Free Democrats, have tumbled to 34% support, far below the 48% of the vote they garnered in winning last year's elections. The poll showed Christian Democrats' support at its lowest since 1986, and put backing for the Free Democrats on only 4%, too low to win any seats in parliament if fresh elections were held now.

The German government said in June that it will slice €80 billion ($103.36 billion) off Germany's budget deficit by 2014, beginning next year with around €10 billion in cuts, equivalent to about 0.4% of gross domestic product.

"In Germany, consumer spending grows when the government pursues solid public finances, rather than when the government falls into debt," Ms. Merkel said. Many economists dispute that argument, saying spending cuts are unlikely to boost household spending. But some analysts say Ms. Merkel's budget cuts aren't drastic enough to derail the recovery, even if they aren't helping it.

Those budget cuts, and the potential cost of bailouts for struggling euro-zone countries agreed to in May, have forced Ms. Merkel's government to drop its goal of cutting taxes, a central pledge on which her conservative-led coalition won election in September.

French officials, among other critics, have called on Germany to cut taxes to boost consumer spending and reduce Germany's dependence on exports. Ms. Merkel suggested on Wednesday that tax cuts were unlikely in the rest of her four-year term, without ruling them out entirely.

In a show of unity, Germany and France called jointly on Wednesday for stricter enforcement of the euro zone's fiscal rules. German Finance Minister Wolfgang Schäuble and his French counterpart Christine Lagarde said financial sanctions should be enforced more quickly when countries run excessive budget deficits.

Germany wants penalties for deficit sinners to include the temporary loss of voting rights in European Union meetings. Ms. Merkel said the EU should amend its treaties if necessary—a thorny process that other countries are loath to embark on.

The chancellor played down differences between Berlin and Washington over fiscal policy, saying that she and U.S. President Barack Obama were in agreement that major economies need to unwind their fiscal-stimulus policies at some point. "The question is whether you do it half a year earlier or later," she said.

Ms. Merkel's handling of the euro zone's debt crisis, as well as constant bickering between her coalition allies, has contributed to a collapse in her government's popularity, leading some analysts in Germany to question whether it will see out its full term.

Ms. Merkel played down the opinion poll, saying her coalition would see out its term, but she conceded that squabbling among her colleagues has cost her government support.

The resignations, for varying reasons, of six Christian Democrat state premiers since last fall, as well as that of German Federal President Horst Köhler in May, have also fueled a sense that Ms. Merkel's party leadership is falling apart. In the latest blow, Hamburg Premier Ole von Beast announced his resignation on Sunday, explaining that he has had enough of his job.

Ms. Merkel said Wednesday that she is far from ready to step down, despite her sinking popularity. "I'm having fun," she told reporters, adding: "You can safely assume you'll see me after the summer holidays."

—Nathalie Boschat contributed to this article.

Russia power station attacked

By William Mauldin And Ira Iosebashvili

MOSCOW—Two carloads of assailants shot their way into a hydroelectric power station in Russia's restive Caucasus Mountains region early Wednesday, killing two guards and setting off bombs in a rare militant attack against the country's infrastructure.

The attack, in the republic of Kabardino-Balkaria, halted the station's power generation and left the state-controlled utility that owns the plant scrambling to boost security at five dozen other plants. The utility launched a centralized monitoring center amid a heightened level of terrorist threat.

"I'm afraid this may have been a rehearsal for something much larger," said Alexander Torshin, a member of the National Antiterrorism Committee, on Ekho Moskvy radio.

Prime Minister Vladimir Putin visited the nearby resort town of Kislovodsk this month, warning that extremists' time is "running out" and unveiling an economic-development program to cut chronic unemployment, which can bring on Islamic extremism. Violent attacks occur nearly daily in the Russian republics of Chechnya, Ingushetia and Dagestan, but most involve attacks on pro-Moscow police or troops rather than key infrastructure sites.

"The authorities of the region were very poorly prepared for situations like this," said Andrei Soldatov, head of the security-focused Agentura think tank. "In particular, they didn't pay attention to the statements that militants made following the explosion at the Sayano-Shushenskaya power station last year, when militants said they would attack such sites."

At the giant Siberian Sayano-Shushenksya plant, which like the power station attacked Wednesday is owned by OAO **RusHydro**, 75 workers were killed in August when a surge of water engulfed the main turbine hall. Mr. Putin restarted that plant this year after insisting on a safety survey of key infrastructure projects. Although militants claimed responsibility for the explosion, a government investigation found it was caused by a faulty turbine in the power plant's engine room.

Police believe Wednesday's attack was committed by four people. After shooting two policemen and seizing their weapons, the assailants broke into the plant's engine room, where they beat up four workers and laid homemade explosive devices before escaping, the antiterrorism committee said.


Reuters
The station's damaged turbine hall.

The first blast went off about an hour after the attack started and was quickly followed by two more. A fourth explosion occurred after police had arrived and were searching for additional bombs, local news agencies reported. Police disarmed a fifth device.

France allows police to question official

By David Gauthier-Villars

PARIS—The French government authorized police to question a senior cabinet member as prosecutors continue to look into allegations of illicit campaign financing and conflict of interest that have pressured President Nicolas Sarkozy and his administration for nearly two months.

The government on Wednesday said police can question Labor Minister Eric Woerth as a witness.

A prosecutor in the Nanterre suburb near Paris is looking into allegations that Liliane Bettencourt, heiress to the **L'Oreal** SA cosmetics empire and France's richest woman, helped support Mr. Sarkozy's victorious 2007 campaign with illicit cash donations, allegedly handed to Mr. Woerth in his capacity as treasurer of Mr. Sarkozy's UMP party.

Ms. Bettencourt has said her contributions were legal. Mr. Woerth has said the UMP received only legal donations.

The affair began three years ago, when Ms. Bettencourt's only child, Françoise Bettencourt-Meyers, filed a complaint with Nanterre prosecutors against a friend of her mother, saying he exploited Ms. Bettencourt's mental weakness to obtain lavish gifts.

The matter took a political turn when Ms. Bettencourt-Meyers, in legal filings, cited recordings of conversations between her mother and Patrice de Maistre, Ms. Bettencourt's financial adviser.

In the conversations—secretly recorded by a former butler of Ms. Bettencourt—Mr. de Maistre alludes to donations to Mr. Woerth and other UMP politicians. Mr. de Maistre has said all donations were legal.

Mr. Woerth said a week ago that he would resign from his UMP fund-raising post by the end of July.

The Nanterre prosecutor is looking into details of Ms. Bettencourt's donations to the UMP, as well as the role played by Mr. Woerth's wife, Florence.

Ms. Woerth, who police questioned Wednesday, was one of Ms. Bettencourt's money managers until she quit last month.

Prosecutors are trying to determine whether Mr. Woerth intervened to help his wife get a job with Ms. Bettencourt. Ms. Woerth has said she applied and obtained the post without his assistance.

A spokeswoman for Ms. Bettencourt said Ms. Woerth was recruited after meeting with Mr. de Maistre. She said Ms. Woerth's name wasn't on the short list that a headhunter had prepared, but declined further comment.

Mr. Woerth has denied helping his wife obtain the post, saying she "has her own career."

EUROPE NEWS

EU challenges WTO ruling against illegal Airbus subsidies

By Matthew Dalton
And John W. Miller

BRUSSELS—The European Union Wednesday appealed a World Trade Organization ruling against EU government aid given to Airbus, a subsidiary of **European Aeronautic Defense & Space** Co.

The U.S. government won a case three weeks ago against Airbus at the WTO, which ruled that the EU's support has helped Airbus take market share from **Boeing** Co. in the multibillion dollar passenger jet market. EU officials said then they had no intention of suspending the aid, and they hinted strongly at an appeal.

The EU move is also an attempt to recapture some momentum in a public contract battle. Both companies, and the governments that back them, are currently fighting over who will win a deal to build as many as 179 U.S. Department of Defense refueling tankers potentially worth $40 billion. EADS is offering a variant of its A330 passenger jet, which is one of the models the WTO ruled was subsidized illegally.

The legal fight at the WTO provides ready political and public relations ammunition. To the dismay of EU officials, the WTO earlier this month postponed a decision on an EU complaint against U.S. aid for Boeing until September.

EU officials said their appeal will challenge most of the ruling's key findings, which were made public last month and largely sided with the U.S. government in a complaint it brought in 2004.

The WTO's ruling, written by a panel of trade experts, said that about $20 billion in low-interest government loans and other subsidies used to develop six Airbus passenger jet models violated international trade laws on government aid to the private sector.

"This dispute is too important to allow the legal misinterpretations of the panel to go unchallenged," EU trade commissioner Karel De Gucht said in a statement.

U.S. trade representative Ron Kirk hailed the ruling three weeks ago as a "great victory for the U.S."

Wednesday's appeal disputes the WTO's finding that loans to launch the six airplane models—the A300, A310, A320, A330, A340 and A380—were provided at interest rates not available commercially, an illegal subsidy under WTO rules. The EU says the panel's calculation of hypothetical market interest rates assumes far too much risk from developing the planes.

Even if the loans are illegal subsidies, they aren't—as determined by the WTO—subsidies specifically designed to boost exports that must immediately be withdrawn, the EU argues. WTO law is specifically written to cover goods that are exported.

The EU is also disputing a WTO finding that infrastructure projects financed by the German and French governments are illegal subsidies. The EU contends Airbus paid market prices to use these facilities.

Bloomberg News

An Airbus A380 flies overhead on the third day of the Farnborough Airshow

Flying algae-powered planes

By Aude Lagorce

Forget about revolutionary lightweight composite materials: a four-seater propeller plane is more likely to hold the key to the future of aviation. Or at least that's the hope of European Aeronautic Defence & Space Co.

The group, which owns Airbus, is showing off an aircraft powered by algae juice at the Farnborough International Air Show this week. EADS is betting that the small plane, which completed its first successful flight last month in Germany, can help make air travel kinder to the planet.

As deadlines for the industry to cut its carbon emissions loom, plane makers and airlines alike are more eager than ever to find alternatives to their current fuels.

"We absolutely need to find a plan B for the replacement of kerosene," EADS Chief Technology Officer Jean Botti said in an interview on the sidelines of the air show.

"What we're doing on biofuels right now is a very promising way of getting to that point. The potential from the use of algae is the highest I have seen so far," he said.

Not everyone believes broad algal fuel adoption will come anytime soon.

Last month, the U.S. Department of Energy published a report on algal biofuels, acknowledging the technology holds promise to help meet the country's need for nonpetroleum fuels, but highlighting that it is at an early stage and will require years of development to reach commercialization.

While algae are familiar to most people as pond scum, the various varieties of algae contain oil which can be extracted by mechanical or chemical processes from the dried biomass. Each 100 kilograms of algae biomass can yield up to 21 liters of biofuel. It has been estimated that algae produces up to 15 times as much oil per square kilometer devoted to production as other biofuel crops such as soybeans.

Algae also don't compete with other crops for agricultural land and can even be grown in polluted water. Their production consumes large quantities of carbon dioxide, which is a big plus for an industry trying to become carbon-neutral by 2020. Also, algae can be blended with traditional kerosene without the engine or any pipes needing to be significantly modified.

And as a bonus, the byproduct of algae production is a high-protein mixture that could eventually be sold for use in pharmaceutical or cosmetic products, thereby helping make the whole project more commercially viable.

EADS would like to have a pilot program running within five years, perhaps on a route such as Paris-Toulouse, Mr. Botti said. His long-term hope is for 10% of the global fleet to run on pure biofuels, or a blend of them, by 2030.

For that to happen, however, other industry players need to get involved, in part because that will help bring down the cost of producing algae, which is perhaps the biggest obstacle to its wider use at the moment.

"The scientific evidence is there that biofuels can be used to power aircraft. Now the problem is the scale needed to make their use commercially viable," said Max Sukkhasantikul, an analyst in the commercial aerospace and defense practice of consultancy Frost & Sullivan.

"And from what I understand the supply of algae is more viable than any other alternative at the moment," he said.

EADS/Dannenberg

EADS flies a Diamond DA42 powered by algae juice in Berlin last month.

Qatar accelerates Dreamliner order

By Peter Sanders
And Kaveri Niththyananthan

FARNBOROUGH, England—Qatar Airways on Wednesday converted two options for Boeing 777 passenger jets into firm orders and said it would take delivery of its first 787 Dreamliners in the fourth quarter of 2011.

The Doha-based carrier already operates 19 777 jets and Wednesday's announcement at the Farnborough International Air Show increases the airline's firm 777 orders to 10. The new order is valued at $501 million, but it is likely the carrier negotiated a lower price, as is the norm with commercial aircraft sales. **Boeing** Co. had previously flagged Qatar's 777 order as coming from an "unidentified customer."

Qatar Chief Executive Akbar Al Baker said the airline had also negotiated earlier delivery slots for the first of its 30 787 Dreamliners on order. The airline hopes to take first delivery sometime in the fourth quarter of 2011 and have five Dreamliners in service by the end of the first quarter of 2012, according to a Qatar Airways statement.

The first production Dreamliner is scheduled to enter service with All Nippon Airways Co. by the end of this year, but Boeing executives in have cautioned that timetable could slip into early 2011.

Also on Wednesday, **RBS Aviation Capital**, one of the world's largest aircraft lessors, ordered a total of 95 narrow-body aircraft from Airbus and Boeing, in a deal valued at $7.6 billion at list prices.

It is the latest order from leasing companies that have dominated this year's Farnborough air show. Other substantial orders have come from Ireland-based start-up aircraft-leasing company Avolon and **Air Lease** Corp., formed by leasing pioneer Steven Udvar-Hazy.

The RBS Aviation Capital order consists of 52 Airbus A320-family narrow-body aircraft and 43 Boeing 737-family narrow-body aircraft.

Indonesian airline **Garuda** also ordered six Airbus A330-200 aircraft valued at $1.15 billion at list prices on Wednesday.

It is the first direct order that Garuda has placed with Airbus, a unit of **European Aeronautic Defence & Space Co.**, since 1989. However, Garuda has four leased A330-200 aircraft and six A330-300s. The new planes, due for delivery in the fourth quarter of 2012, will be powered by **Rolls-Royce** PLC Trent 700 engines.

RBS Aviation Capital is a unit of **Royal Bank of Scotland Group** PLC, which is majority-owned by the U.K. taxpayer. It already has Boeing and Airbus aircraft. It recently received its 145th plane belonging to the Airbus A320-family and its 125th plane of the Boeing 737-family.

"Both of these aircraft types have been instrumental in helping us to create a highly successful global business that has pioneered the strategy of owning and leasing narrow body, commodity aircraft types that are liquid, investor-friendly and easily tradeable," RBS Aviation Capital CEO Peter Barrett said at the trade show.

—Jonathan Buck contributed to this article.

Ousted governor decides against testifying at trial

By Danny Yadron
And Douglas Belkin

CHICAGO—Former Illinois Gov. Rod Blagojevich won't testify in his corruption trial, his attorney said Wednesday.

Mr. Blagojevich had promised repeatedly since federal agents arrested him in December 2008 that he would defend himself and clear his name in court. But it became clear Wednesday morning that he wouldn't take the stand.

"At this time, Rod Blagojevich will rest," defense attorney Sheldon Sorosky said in court. A trial that was expected to last all summer is now likely to be over within days.

"It is my decision, judge," Mr. Blagojevich said. "Under the advice of my attorneys, I made the decision freely and voluntarily."

Prosecutors also rested after a brief rebuttal against Robert Blagojevich, the former governor's older brother, who faces five counts of wire fraud, attempted extortion, extortion conspiracy and bribery conspiracy. He testified Monday and Tuesday.

The court will adjourn until 9:30 a.m. Monday, when closing arguments are expected to begin.

Rod Blagojevich faces 24 counts, including attempting to sell the Senate seat vacated by President Barack Obama. Both brothers have pleaded not guilty.

Mr. Blagojevich's decision not to testify robs the U.S. government of a wiretap-fueled cross-examination that some experts had predicted would offer a chance for prosecutors to seal their case against the ousted state leader.

The sudden twist in the case began to emerge Tuesday afternoon, when Mr. Blagojevich had been expected to take the stand. Instead, the court adjourned for the day and two of his lawyers, the father and son team of Sam Adam Jr. and Sam Adam Sr., publicly aired their disagreement over whether Mr. Blagojevich should appear.

Among other things, the sudden halt in the action means the Blagojevich team won't be calling a host of high-profile witnesses—including Rahm Emanuel, Mr. Obama's chief of staff; Valerie Jarrett, a senior White House adviser and Harry Reid, the Senate majority leader.

After Mr. Sirosky said the defense would rest, the jurors immediately began whispering among themselves. They looked confused.

A few minutes later during a break in the action but still inside the courtroom, Mr. Blagojevich signed autographs on the tickets issued to spectators at the trial.

He signed about five in a blue ballpoint pen until the court marshal ordered him to stop.

Charlie Harms, 27 years old, who will start law school next year and sat in on the last two days of the case, said he thinks Mr. Blagojevich is innocent and that the government didn't make its case.

"I think they needed him on cross to connect the dots," he said.

Getty Images

Former Illinois Gov. Rod Blagojevich poses for a picture as he arrives for his corruption trial Wednesday in Chicago.

Conrad Black is released in U.S. on bond

Associated Press

Former media mogul Conrad Black was released from a Florida prison Wednesday on $2 million bond while a U.S. federal judge decides whether to overturn his 2007 fraud conviction.

Lord Black's release came hours after U.S. District Judge Amy St. Eve set his bond and ordered Lord Black not to leave the country.

Lord Black has served two years of a 6½-year sentence for defrauding investors out of millions of dollars. He was released from prison after his friend, Roger Hertog, posted the $2 million bond.

Judge St. Eve ordered Lord Black to appear in court Friday to go over the conditions of his release. Lord Black's attorneys had asked that he be allowed to return to Canada, where he owns a home in Toronto. But Judge St. Eve said he must remain in the U.S. and that he shouldn't try to obtain a passport.

Lord Black's attorney, Miguel Estrada, said his client, a member of Britain's House of Lords, doesn't own a current passport, and that the Federal Bureau of Prisons issued him an ID that would allow him to appear in court in Chicago. Mr. Estrada said Lord Black would likely return to his home in Palm Beach, Fla., after his release.

Lord Black and three former Hollinger International Inc. executives were convicted in 2007 of defrauding shareholders out of $6.1 million. One of the prosecutors' arguments was that Lord Black deprived the company of his faithful services as a corporate officer, breaking the so-called "honest services" law.

Lord Black also was convicted of obstruction of justice after jurors saw a video of him carrying boxes of documents out of his offices, loading them into his car and driving off with them. The documents were sought by government investigators.

The U.S. Supreme Court last month limited the scope of the honest-services law, leaving it to the 7th Circuit U.S. Court of Appeals to determine whether to overturn Lord Black's conviction in whole or in part. The appeals court on Monday granted Lord Black's motion for bail as he appeals his fraud conviction.

The high court's ruling didn't affect the obstruction of justice count.

Hollinger International once owned the Chicago Sun-Times, the Daily Telegraph of London, the Jerusalem Post and hundreds of community papers in the U.S. and Canada.

New fields surface in budding California pot market

By Tamara Audi

Northern California's so-called Emerald Triangle, famous for marijuana farms that supply much of the U.S. with high-quality pot, is facing competition from hundreds of miles away—in Los Angeles County.

As this year's marijuana-harvest season gets under way, law-enforcement officials are focused on the Southern California county, which by some measures has bloomed into the nation's most productive pot garden.

Law-enforcement agents seized more than 734,000 pot plants in Los Angeles County last year—the highest number of seizures in the country for that year. The haul surpassed those even in California's most-prolific northern counties, with the biggest 2009 seizure coming from Shasta County at 629,000 plants.

Northern California as a whole still grows most of the nation's pot, according to law-enforcement officials. But the drastic spike in Los Angeles County pot-plant seizures has law-enforcement officials trying to figure out what is behind the increase and whether it represents a real shift in the lucrative pot trade.

"Is it that there are more grows out there, or are we getting better at finding them?" said Federal Drug Enforcement Administration spokeswoman Sarah Pullen of the pot-growing camps being set up in Southern California.

"Was last year an anomaly, or is there something different going on in the state?"

Ms. Pullen said it is still too early in this season to tell. And law-enforcement officials say that pot-plant seizures throughout the country are on the rise—with California, as it has in the past, leading the way.

Law-enforcement officials have seized 103,000 plants in Los Angeles County since April, according to the Los Angeles County Sheriff's Department, which takes the lead in pot seizures in the county.

Recent seizures in Los Angeles County have astonished even veterans of the state's long drug war. On a single Friday in late June, law-enforcement agents destroyed 19,000 plants with a street value of $39 million, Los Angeles County Sheriff's Department officials said.

Most of the county's marijuana plants are grown in the Angeles National Forest, a rugged wilderness stretching over 650,000 acres east of Los Angeles, according to U.S. Forest Service records. Forest Service and Sheriff's Department officials recently warned hikers about the presence of pot farms in the forest—along with the armed guards and booby traps that come with them.

Some in law enforcement believe tightened security along the Mexican border has curtailed drug smuggling and forced growers to cultivate closer to their U.S. market.

Not even last year's Station Fire—the forest's largest inferno ever recorded—slowed harvesting. "We thought the fire would really curtail this, and it didn't," said Ralph Ornelas, captain of the Los Angeles County Sheriff's narcotics bureau. "We came up with seizures at the end of the season that really surprised us. It's amazing. This tells you the abundance of outdoor grows that are here."

Some in law enforcement believe that tightened security along the Mexican border has curtailed drug smuggling and forced growers to cultivate their pot closer to their U.S. market.

Another possible reason: Angeles National Forest has become attractive to Mexican drug cartels because it offers remote open space, a perfect growing climate, little competition and a base close to home.

Law enforcement is working to get a better handle on the ownership of the Southern California crops. There is some recent evidence that Mexican cartels are running some of the U.S. farms, according to officials, but a lot of the plantations are operated by American gangs, some with ties to the cartels.

Much of the recent violence in Mexico is among cartels battling for planting territory, said Michelle Gregory, a special agent with the California Bureau of Narcotic Enforcement.

"They realized they can come to California and have a lot of open space, and they don't have to fight with anybody for it," she said.

While most of California's pot is exported to other states, the black market here could change drastically if residents vote in favor of a November state ballot measure to legalize marijuana. The measure would allow residents to cultivate and possess small amounts of pot. A recent analysis by The Rand Corporation think tank said the price of pot could drop to as low as $38 an ounce, compared with $375 an ounce today, if it passes.

Meanwhile, drug agents continue to hunt for pot plantations. The work involves hours of hiking to remote sites in the forest. When agents spot a growing area, they often find full campsites, complete with irrigation and acres of marijuana fields and armed guards.

Most of the time, the guards flee and agents destroy the plants. But a disturbing trend has emerged this year: "We're finding they're more apt to stick around and defend than take off and run," Ms. Gregory said.

U.S. NEWS

No signs of big change from Bernanke

By Tom Barkley
And Michael R. Crittenden

WASHINGTON—Federal Reserve Chairman Ben Bernanke signaled Wednesday that no moves were imminent to bolster the recovery despite a "somewhat weaker outlook" for the economy.

In his semiannual monetary policy testimony to the Senate Banking Committee, the Fed chief assured the panel that the central bank would remain flexible in light of the "unusually uncertain" economic outlook.

Even as the U.S. central bank continues to plan for an eventual return from ultra-accommodative policy, "we remain prepared to take further policy actions as needed to foster a return to full utilization of our nation's productive potential in a context of price stability," Mr. Bernanke said in prepared remarks.

"If the recovery seems to be faltering, then we will at least need to review our options," he said during the question-and-answer session. But he said there were no plans to consider such moves in the near term.

Potential options include changing the language of the policy statement, lowering the interest rate the Fed pays on reserves that banks hold at the central bank and increasing the size of its balance sheet once again, he said. The central bank could either reinvest maturing securities or buy more, he said.

"We have not come to the point where we can tell you precisely what the leading options are," said Mr. Bernanke, noting that each option would entail drawbacks and costs.

On sovereign-debt problems in Europe, Mr. Bernanke said conditions appear to be improving but require continued close monitoring. The return to debt markets by some governments that have been under pressure is "encouraging," he said, adding that financial markets seem less concerned. Dollar swap lines that the Fed reopened with several central banks helped to keep dollar funding markets liquid and reduced the risk to the U.S. economy, he said.

Associated Press

The Federal Reserve chairman, left, with former chief Paul Volcker just before the financial overhaul bill was signed.

Fed officials downgraded their economic forecasts at last month's monetary policy meeting, in the face of weakening consumer spending and labor market conditions, as well as concerns about a spillover from the European debt troubles. The economy is now expected to expand between 3% and 3.5% in 2010, down from an April estimate of 3.2% to 3.7% growth.

A few officials see a growing threat of deflation, minutes from the June 22-23 meeting showed, though Mr. Bernanke made no mention of that risk.

The recovery is continuing at a "moderate pace," he said, with expectations that private demand will help offset the impact of waning fiscal stimulus and a slowdown in inventory buildup. While overall inflation has been volatile, core prices have trended lower over the past two years, he said.

The soundness of the U.S. banking system has also improved significantly, he said, with loss rates on most loans likely peaking.

Mr. Bernanke and other members of the policy-making Federal Open Market Committee "expect continued moderate growth, a gradual decline in the unemployment rate and subdued inflation over the next several years," he said.

The deterioration in the outlook hasn't been sharp enough force policy-makers to consider additional stimulus. But the minutes from the last meeting showed a shift in the debate within the Fed, from trying to agree on a date to start selling mortgage debt bought up during the crisis, to raising the possibility of further accommodation.

Mr. Bernanke made no suggestion that additional stimulus measures may be needed, reiterating the message that has been conveyed for over a year that the Fed plans to keep short-term rates at record lows for "an extended period." His comments remained focused on how the central bank will need to tighten conditions to prevent inflation "at some point."

At least one lawmaker disagreed, with Banking Committee Chairman Christopher Dodd (D., Conn.) asking what more the Fed can do to expand output and employment.

"It looks like our economy is in need of additional help," said Mr. Dodd in his opening remarks.

Laying out the exit strategy, Mr. Bernanke said that instead of raising the key federal-funds rate at which banks lend to each other, the Fed will start lifting short-term rates by paying banks more on reserves.

To improve the effectiveness of that effort, the Fed will also drain a portion of the more than $1 trillion in excess reserves that banks have accumulated from central bank purchases of mortgage-backed securities and Treasurys, he said.

The Fed has recently started testing ways to drain liquidity. The central bank has carried out reverse-repurchase agreements, or reverse repos, in which banks lock up money by borrowing against the Fed's portfolio of securities holdings. Through several term deposit auctions, the Fed has also set up interest-bearing deposits to give banks an incentive to stash their money at the central bank instead of lending it out.

Over the longer run, the Fed plans to reduce its portfolio to more normal levels, said Mr. Bernanke. So far, the Fed has let the mortgage-related debt it acquired to mature or get paid off without reinvesting the proceeds, while rolling over its holdings of maturing Treasury securities into new Treasurys of similar maturity.

To shrink the portfolio, the central bank could reinvest proceeds from Treasurys into shorter-dated Treasurys, though no decision on that has been made, he said.

Fed officials broadly agree that the central bank should eventually sell some of the holdings of agency and mortgage-backed securities it bought up to shore up the housing market, said Mr. Bernanke.

Many economists don't expect the fed-funds rate to be lifted from the 0%-to-0.25% range it has held at since late 2008 until well into next year.

On a day when President Barack Obama signed into law the most sweeping regulatory overhaul since the Great Depression, Mr. Bernanke said "much work remains to be done" to implement the measures. But he said the bill, along with stronger capital and liquidity standards being developed, will minimize the risk of a repeat of the financial crisis.

Beating back congressional threats to its supervisory authority and independence in the law's framing, the Fed emerged with even greater powers than before the crisis. The central bank will oversee the largest, systemically important financial firms. Congress also stopped short of demanding the power to audit monetary policy decisions, instead agreeing to a one-time review of crisis lending activity.

Housing market hurt by economic worries

By Nick Timiraos
And Robbie Whelan

The U.S. housing market, whose collapse pulled the economy into recession in late 2007, is stalling again.

In major markets across the country, home sales are deteriorating, inventories of unsold homes are piling up and builders are scaling back construction plans. The expiration of a federal home-buyers tax credit at the end of April is weighing on the market.

On Tuesday, the U.S. Census Bureau said single-family housing starts in June fell by 0.7%, to a seasonally adjusted annual rate of 454,000. The U.S. started 1.47 million homes in 2006, before the housing bubble popped.

Future construction looks even weaker. Permits for single-family starts fell 3% in June, following big declines in both May and April. "We're hovering at post-World War II lows," said Ivy Zelman, president of Zelman & Associates, a research firm.

Economists aren't singling out one reason for the stalling housing market. A variety of factors have led to flagging confidence, they say, including sluggish labor markets, global economic turmoil and falling stock prices.

While the housing downturn dragged the economy into a recession nearly three years ago, now it is the economy that is pulling down housing, says economist Patrick Newport at IHS Global Insight. Without sustained job growth, the housing market likely won't improve.

That in turn will ricochet across manufacturing, retail and other trades dependent on home building and consumer spending.

The Wall Street Journal's quarterly survey of housing-market conditions in 28 major metropolitan areas shows that inventory levels have grown in many markets.

But inventory fell in some of the weakest ones, including several Florida markets, Atlanta, and Charlotte, N.C.

European Pressphoto Agency

A large home for sale in Potomac, Md., a Washington, D.C., suburb, on July 8.

At the end of June, inventory was up 33% from year-ago levels in San Diego, and by 19% and 15% in Los Angeles and Orange County, Calif., respectively, according to data compiled by John Burns Real Estate Consulting. Rising inventory can lead to price declines later.

Even falling interest rates aren't enough to whet consumer appetites for housing. Last week, the average rate on a 30-year fixed-rate mortgage was quoted at 4.57%, according to Freddie Mac, the lowest since its survey began in 1971. But demand for home-purchase mortgages sits near 14-year lows, according to the Mortgage Bankers Association, down 44% over the past two months.

The government last fall extended tax credits worth up to $8,000 to home buyers who signed contracts by April 30, causing sales to surge early this year. Those buyers had until June 30 to close their sales until Congress, concerned that the backlog of sales wouldn't close in time, extended the deadline through September.

Analysts long expected the withdrawal of a federal tax credit, which had juiced sales, to lead to a slower-than-usual summer.

"It's the magnitude that's been the issue," says Douglas Duncan, chief economist at Fannie Mae. "The drop-off in activity has surpassed expectations."

U.S. NEWS

Obama signs U.S. financial measure

By Victoria McGrane

WASHINGTON—President Barack Obama on Wednesday signed into law the most sweeping overhaul of U.S. financial-market regulations since the Great Depression, marking the conclusion of an effort to craft a legislative response to the 2008 financial crisis.

Mr. Obama pitched the measure as a major step toward correcting the problems that contributed to that crisis and the recession that followed.

"For years, our financial sector was governed by antiquated and poorly enforced rules that allowed some to game the system and take risks that endangered the entire economy," Mr. Obama said.

The new law, he said, would better protect consumers, empower investors and bring transparency to dark corners of the financial markets.

"The American people will never again be asked to foot the bill for Wall Street's mistakes," Mr. Obama said.

"There will be no more taxpayer-funded bailouts. Period."

The wide-ranging law will touch every corner of the financial universe, curtailing certain risky activities of the nation's largest financial firms, affecting how average Americans obtain credit cards and mortgages, and transforming the way regulators work to assess and respond to potential flash points in the economy.

But like most of the Obama administration's legislative victories, the financial-overhaul legislation succeeded with only narrow Republican support.

Mr. Obama specifically thanked three Senate Republicans—Scott Brown of Massachusetts and Olympia Snowe and Susan Collins of Maine—for their support in passing the measure.

Mr. Obama, who has had a contentious relationship with Wall Street, criticized "the furious lobbying of an array of powerful interest groups" against the measure. But he also acknowledged the key role played by the financial industry in economic growth.

Many in the financial industry, who lobbied against the bill on Capitol Hill, continued to criticize the legislation even as the president prepared to sign it.

"This is nothing more than a financial-regulatory boondoggle," said Thomas J. Donohue, president and chief executive of the U.S. Chamber of Commerce, which spent millions on a campaign to kill a new consumer watchdog.

The 400-person audience for the bill signing was dominated by Democratic lawmakers and consumer advocates.

Only a few recognizable industry faces could be seen in the crowd, including Citigroup Inc. Chief Executive Vikram Pandit and Cam Fine, the chief executive of the Independent Community Bankers of America.

Harvard Law School Professor Elizabeth Warren, a candidate to head the new Consumer Financial Protection Bureau created by the bill, had a front-row seat for the ceremony.

Rollout | Administration timeline for implementing the bill

Effective immediately
- Federal authority to seize systemically important firms on the brink of collapse
- Creation of federal insurance office at the Treasury Department

3 Within months
- Financial Stability Oversight Council meets for first time

6 Within months
- Rules governing nonbinding shareholder votes on executive pay

9 Within months
- Rules setting risk-retention requirements for securitized assets
- Fed writes rules on fees charged to retailers when customers use debit cards

1 Within year
- Consumer-protection bureau gets authority over consumer issues
- Office of Thrift Supervision merges with Office of the Comptroller of the Currency
- Derivatives rules completed, including clearing and exchange-trading requirements
- Hedge funds and investment advisers must register with the SEC

1 Beyond year
- Establish rules limiting banks' ability to invest in hedge funds and use their own capital to trade—the so-called Volcker Rule
- Establish rules limiting the size of large institutions to no more than 10% of aggregated liabilities
- Regulators begin writing rules requiring banks to hold a new form of capital, known as contingent capital
- Issue new streamlined mortgage-disclosure forms

Above: U.S. President Barack Obama signs into law the Dodd-Frank Wall Street Reform and Consumer Protection Act

Photo: Reuters

TARP lending programs to be curtailed

By Deborah Solomon

WASHINGTON—The Treasury Department, under congressional orders to shrink and end sooner the much-maligned Troubled Asset Relief Program, plans to curtail two programs originally intended to help consumer and small-business lending.

Treasury officials say they plan to end a long-delayed, never-utilized $30 billion program designed to boost small-business lending and cut the amount of money available for a Federal Reserve lending program.

The Treasury will also stop creating any new programs to stabilize the financial sector.

The moves are expected to have minimal impact since the programs were not being used to the extent originally envisioned.

The Fed's Term Asset-Backed Lending Facility, which provided financing to bolster issuance of consumer and business loans, was used less than anticipated after markets stabilized.

The Treasury's small-business program, which never got off the ground, is expected to be replaced by a $30 billion lending fund. The House has already authorized the fund and the Senate could vote this week.

The Treasury's steps stem from a provision of the recently passed financial overhaul requiring the Treasury to cut TARP's spending authority to $475 billion from $700 billion and cease spending on new any programs. The provision brings forward the end of the government's ability to use TARP to fund any new programs retroactively to June 25 from Oct. 3.

The early end of TARP was included during last-minute negotiations between House and Senate leaders as a way to help pay for the new financial regulation. The nonpartisan Congressional Budget Office estimates it will save the government $11 billion.

President Barack Obama signed the legislation into law Wednesday.

There is some concern inside and outside the administration that the government could be hamstrung if financial conditions were to worsen, since the Treasury would not have additional funds at its disposal.

A top Treasury official said the administration was willing to give up that flexibility to achieve a broad revamp of the nation's financial architecture.

"What we're really doing here is shifting from achieving financial stability through TARP to achieving it through regulatory reform and all the capacities now created through this legislation to deal with the crisis," said Herb Allison, Treasury's assistant secretary for Financial Stability.

Mr. Allison said the bill's passage will "accelerate the wind down of TARP" that has already been under way for about a year.

The Treasury has so far committed $535.5 billion of TARP's $700 billion to various programs. It will have to reduce those commitments by $60.5 billion to satisfy the new $475 billion limit.

Treasury can continue to operate existing initiatives, including its Capital Purchase Program, which invested $205 billion into hundreds of banks, programs to help struggling homeowners and efforts to help specific companies, such as American International Group Inc. Funds repaid or profits earned must be used to reduce the U.S. debt.

Republicans have assailed the move as a budget gimmick. In part, they cite the fact that the Treasury is allowed to reallocate funds among existing programs.

"TARP continues to exist...they can still spend the same pot of money, not for new purposes but on the old purposes," said Texas Republican Rep. Jeb Hensarling, who has long called for abolishing the bailout program.

Some TARP initiatives have already been shuttered and others reduced from their original size. More than $198 billion has been repaid, and the government expects the bailout to cost far less than originally envisioned—about $105 billion.

Tuesday, the Federal Reserve said the Treasury would reduce its commitment to backstop the Term Asset-Backed Lending Facility to $4.3 billion from $20 billion. The Fed originally authorized up to $200 billion in TALF loans but only $43 billion were outstanding when the program closed June 30.

The U.S. Treasury will also stop creating any new programs to stabilize the financial sector.

Douglas Elliott, a fellow with the Brookings Institution in Washington, D.C., said the financial sector has stabilized to the point that it is probably not an issue to end TARP early, although he added it could limit the administration's efforts to attack new problems.

"Governments are good at spending money that they are authorized to spend, so even though October doesn't sound that far away, this could actually cause a change in what they do, compared with what they could have done," he said.

Slimming down

Treasury must reduce its TARP commitments to $475 billion from $535.5 billion as a result of the financial-overhaul legislation recently passed by Congress. Here are the commitments for various TARP programs and how they will be affected:

Figures in billions

	Prior to law	Post-law	Reduction
Capital Purchase Program	$204.9	$204.9	—
Automotive Industry Financing Program	84.8	81.8	**$3.0**
AIG	69.8	69.8	—
Housing/HAMP	48.8	45.6	**3.2**
Targeted Investment Program	40.0	40.0	—
Public-Private Investment Program	30.4	22.4	**8.0**
Initiatives for Small Business Lending	30.0	0.0	**30.0**
Term Asset-Backed Lending Facility	20.0	4.3	**15.7**
Asset Guarantee Program	5.0	5.0	—
Small Business Adminstration 7(a) lending	1.0	0.4	**0.6**
Community Development Capital Initiative	0.8	0.8	—

Source: Treasury Department