Sweet times are turning sour for business ventures in China
THE BIG READ 14-15

SEC chief admits oversight of Lehman case fell short
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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 34 | EUROPE | Thursday, March 18, 2010

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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

THE WALL STREET JOURNAL.

The wearing of the green—and much more

Associated Press

Revelers celebrate during the St. Patrick's Day parade in Belfast, Northern Ireland, Wednesday.

FSA beefs up staff, takes aim at banks

By David Enrich

The U.K. Financial Services Authority intensified its assault on the banking industry, with its chief executive announcing plans to rev up bank supervision and its chairman calling for tougher restrictions on financial institutions, including hedge funds.

The FSA on Wednesday published its annual business plan for the forthcoming year, featuring a beefed-up budget for fighting financial crime and a goal of hiring several hundred employees to police U.K. banking and finance companies.

Hector Sants, the FSA's chief executive officer, said the regulatory agency's bank examiners are aiming for a "more confrontational" approach with the companies they oversee. The number of examiners permanently stationed at each of the U.K.'s major banks will swell to as many as 15, up from a previous maximum of six, he said. Even after the increase, however, the number of examiners at each bank would be modest compared with the dozens of on-site inspectors at the largest U.S. banks.

"If society wants a more proactive approach, it must accept that it will have a larger and more expensive regulator," Mr. Sants said as he called for the agency's budget to grow by 9.9% over last year, to £454.7 million ($693.8 million). The bigger budget will be financed partly by requiring the largest financial institutions to pay higher fees to the agency, he said.

The bulk of the FSA's budget increase will fund what Mr. Sants described as a crackdown on financial crimes such as insider trading. He said the agency expects to file criminal charges in a growing number of cases in the next year and also plans to seek hefty penalties against firms and individuals accused of wrongdoing.

The FSA's tough stance comes as the agency faces an uncertain future. The Conservative Party has criticized the FSA for not doing more to prevent the financial crisis. It hopes to fold the agency into the Bank of England if the party wins control of Parliament in national elections likely to be held in early May.

Mr. Sants, who became CEO in July 2007 and plans to step down sometime after the election, defended the FSA's record, saying it had made a clean break from the *laissez-faire*, "light touch" attitude that had defined the FSA's approach.

"The FSA is a wholly different organization than it was three years ago," he said.

But Mr. Sants acknowledged that doubts about whether the FSA will remain

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The Quirk

Perking up the Passover plagues: One rabbi turns to Twitter. **Page 29**

World Watch

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Editorial & Opinion

French statism can't be reformed. It must be replaced. **Page 12**

Judge in Milan orders trial of foreign banks on derivatives

By Alessandro Mocenni and Gilles Castonguay

MILAN—A Milan judge ordered **UBS** AG, **J.P. Morgan Chase** & Co., **Deutsche Bank** AG and Depfa Bank PLC, now a unit of **Hypo Real Estate** AG, to stand trial for the alleged fraudulent sale of €1.68 billion ($2.31 billion) in derivatives.

The banks are accused of having earned about €100 million in "illicit profits" from irregularities in the sale of derivatives linked to a bond issue by the City of Milan, conducted between 2005 and 2007. "It is the first time in the world that banks have to stand trial for the sale of derivatives to municipalities," Alfredo Robledo, the prosecutor bringing the case against the banks, said in a telephone interview.

Judge Simone Luerti has ordered the banks and 13 individuals—11 current bank employees and two former city employees—to stand trial, a person familiar with the case said. Hearings start May 6.

In April 2009, assets valued at more than €476 million were seized by Italian tax police from the banks as part of an investigation that lasted more than two years.

In separate statements, the banks denied any wrongdoing and said they would defend themselves. "We are...confident that the strength of our legal position will be demonstrated through the judicial process," J.P. Morgan said. "The J.P. Morgan employees involved in the transactions acted with the highest degree of professionalism and entirely appropriately."

UBS said it didn't commit any fraud. "No illicit profit was earned by the banks, since the intermediation costs applied were fully legitimate and were not hidden from the City," it said.

Deutsche Bank said it was confident its employees involved in the transactions acted with integrity. A spokeswoman for Depfa, which was acquired by Hypo Real Estate in October 2007, said the bank was convinced it hadn't violated any law or regulation.

—Sabrina Cohen in Milan contributed to this article.

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PAGE TWO

Lessons learned from two retailers

[Agenda]

By Patience Wheatcroft

What's the difference between Amancio Ortega and Stephen Marks? Superficially, the two have much in common. Both started out as clothing manufacturers. Mr. Marks opened his first store in 1972, and Mr. Ortega became a shopkeeper three years later. Each remains at the helm of the business he founded.

Yet the fortunes of the two have radically diverged, as news this week has made all too clear. Mr. Ortega now presides over the biggest fashion retailer in the world. His 4,600 stores made a net profit of €1.31 billion for the year to Jan. 31. As he now sets about driving his brands across Asia, that figure looks set to continue growing.

Mr. Marks, however, now sits atop a business that had a loss of €27.4 million for the same 12-month period and is being forced to cut back its ambitions. It is parting with its upmarket Nicole Farhi brand, closing stores in Japan and the U.S. and planning to focus on the 123 stores and concessions it operates in the U.K. and Ireland.

While Mr. Ortega's Inditex is conquering the world, Mr. Marks's French Connection is reduced to concentrating on its home market. As governments across Europe strive to define a route out of recession, a need to drive exports is high in their priorities. In place of the various working parties and commissions that are being set to work on devising schemes to encourage industry, perhaps a study of Mr. Ortega's methods might yield some more useful lessons.

Rapid response to customer demand is key to the success of Inditex. Unlike many companies, whether dealing in fashion, footwear or furniture, the business does most of its manufacturing in Europe, much of it in its own factories in Galicia, northern Spain. Changing trends can be quickly acted upon: Last year, 30,000 different models went into its various stores.

Reuters

A worker at the Zara factory of Inditex group in Arteixo, northern Spain

Ensuring that the right mix of garments gets to each store is a military operation over which Inditex exercises fierce control. No matter where the goods are eventually headed, they all pass through one of the nine distribution centers in Spain. These are highly automated and on a massive scale: The distribution center beneath the head office extends to 280,000 square meters.

> Get the right product in the right place and at the right price and customers will be induced to buy

Investment in the business has been constant, not something that is commonplace in clothing manufacturing. There has also been a steady flow of new brands added to the original Zara label. Carefully targeted formats appealing to different tastes have enabled the group to gradually grow market share. Adding homewares to the mix has provided further scope for expansion.

Last year saw the group open 343 stores but, when the world is your market place, saturation is a long way off. In May, Inditex will open its first stores in India and the plan is for 40% of openings this year to be in Asia.

French Connection, by contrast, has expanded via licensing and franchising its name to others, so lessening its control over the brand. A year ago, Mr. Marks was talking of expanding his retail operations in Europe, North America, Japan, Hong Kong and China. Now, that has all had to be put into reverse. Like so many retailers before him, Mr. Marks discovered that venturing into foreign territories requires careful groundwork and the team to turn grand ideas into reality. Inditex has more than 70,000 employees implementing a strategy that Mr. Ortega, now Spain's richest man, still watches over daily from head office.

Surprisingly for a group that makes so much use of technology, Inditex has yet to go live with an online store, but that omission will be rectified in the autumn. Mr. Ortega has, perhaps, been slow to embrace the net because he regards his shop windows as his best advertising, hence the group spends relatively little on marketing.

That is the greatest contrast with French Connection. The latter became better known for its designed-to-shock advertising than for its clothing. Mr. Marks has now abandoned the tacky slogans that appealed to teenagers and is in search of a more sophisticated image for his ranges.

But there may be a lesson there, as manufacturers ponder how best to invest what cash they can afford. Get the right product in the right place and at the right price and customers will be induced to buy without the need of gimmicky advertising.

Get thee gone

Fighting talk from Germany's Chancellor Angela Merkel yesterday. Voicing the thoughts of most of her countrymen, she suggested a country that perpetually broke the rules of the euro zone should be expelled from the single-currency area.

Quite how that would be implemented is something the creators of the euro omitted to specify when they drew up the ground rules for their new currency. But even if Greece does manage to find a way through its current difficulties, it may only be a short-term solution. The country will have to do more than upset a few pensioners and public-sector workers if it is to be able to reduce the debt that it is busily accumulating on top of its existing massive borrowings.

While Ms. Merkel is on the rampage, she might profitably turn her attention to the European Commission and its lax way of monitoring the accounts of member countries. Greece isn't the only country to have taken advantage of accounting sleight of hand to flatter its numbers. The authorities should have been ringing warning bells long before deficits reached such unwieldy levels.

There is little point in the euro zone drawing up the tough new regulations that Ms. Merkel is demanding unless they are going to be properly policed. And even then, regulations will simply paper over cracks that can only be cured by a common fiscal regime for the euro zone.

What's News

■ **The Dow Jones** Industrial Average closed at a 17-month high, and European shares climbed as investors took heart from the Federal Reserve's pledge to keep interest rates low. **23**

■ **Merkel steered Berlin** toward a collision course with euro-zone partners. The German chancellor called for delinquent members of the currency area to be expelled. **4**

■ **Bernanke said** that keeping short-term interest rates too low for too long may spark inflation, but he added the U.S. economy wasn't under such a risk. **8**

■ **A French court launched** a probe into whether France Télécom should face trial over a worker's suicide. **17**

■ **A judge dismissed** a suit from Fiat patriarch Gianni Agnelli's daughter that challenged the valuation of his estate and could have placed an agreement regarding control of Fiat in doubt. **21**

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ONLINE TODAY

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"Given the political stakes at home, Merkel isn't shying from putting Greece in the balance."

Terence Roth on Merkel's address to Germany's lower house of parliament

Continuing coverage

See analysis of the day's news, including our Heard on the Street column, at **wsj.com/europeanalysis**

Question of the day

Vote and discuss: Should countries that threaten the euro zone's stability be expelled from the bloc?

Vote online and discuss with other readers at **wsj.com/dailyquestion**

Previous results

Q: Do you think Tiger Woods will win another major golf tournament?

Answer	Result
Yes	84%
No	16%

THE WALL STREET JOURNAL EUROPE
(ISSN 0921-99)
Stapleton House, 29 - 33 Scrutton Street, London, EC2A 4HU

SUBSCRIPTIONS, inquiries and address changes to: Telephone: +44 (0) 207 309 7799. 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: 44 207 842 9600; 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 Basinevi.

Registered as a newspaper at the Post Office.

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Editeur responsable: Patience Wheatcroft M-17936-2003.

Registered address: Boulevard Brand Whitlock, 87, 1200 Brussels, Belgium

NEWS

Hong Kong has sizzle

Price of $36 million for townhouse shows high-end market still hot

By Joyce Li

A luxury townhouse with sweeping views of the downtown Hong Kong skyline has sold for 280 million Hong Kong dollars (US$36 million), the latest sign that the city's market for high-end property continues to sizzle amid abundant liquidity and limited supply.

The three-story, 432-square-meter house in the prestigious Peak area of Hong Kong is part of the Severn 8 development on Severn Road, named one of the 10 most expensive streets in the world by Wealth Bulletin last year. Also on that list were New York's Fifth Avenue and London's Kensington Palace Gardens; Avenue Princesse Grace in Monaco was named the world's most expensive street.

Wealth Bulletin is published by eFinancialNews Ltd., a unit of Dow Jones & Co. Dow Jones, which is owned by News Corp., publisher of The Wall Street Journal.

The 22 houses in the Severn 8 development overlooking Hong Kong's Victoria Harbour were completed in 2005 by **Sun Hung Kai Properties** Ltd., which says their design was inspired by four eminent Italian hotels. The development has a 20,000-square-foot clubhouse with a swimming pool and aroma spa, as well as an elaborate security system to protect the privacy of residents.

Buyer **Sino Tech International Holdings** is paying HK$60,215 per square foot for the town house, one of the highest prices ever paid for a property in Hong Kong. A duplex apartment in the Mid-Levels district was sold in October for HK$71,280 per square foot, a residential record in Asia at the time, according to Henderson Land Development Co., a developer controlled by billionaire Lee Shau-Kee.

Sino Tech, a Hong Kong-listed electronics-component maker, said Tuesday that it is buying the town house as an investment.

Demand for ultra-luxury property in Hong Kong has been growing strongly in the past few years, pushing prices to dizzying levels because of a scarcity of supply and the rising wealth of buyers in mainland China looking to invest.

Luxury-property prices in the city soared about 50% last year, compared with a nearly 30% rise in the overall residential market.

According to Wealth Bulletin, the overall value of prime residential property on the most expensive streets in the world fell about 12% last year. Hong Kong's Severn Road slipped to the eighth spot, down from second place in 2008.

Some of the mainland Chinese buyers who are thought to be driving up the price of luxury property in Hong Kong are also having an impact on high-end property further afield. Super-rich people from China are particularly active in the London markets, attracted by depressed property values and the decline in the value of sterling.

Earlier this year, Hong Kong billionaire Joseph Lau, chairman of Chinese Estates Holdings, paid US$54 million for a six-story mansion in London's Belgravia district.

— Duncan Mavin contributed to this article.

Golden streets

The top 10 most expensive streets in the world in 2009, in dollars per square meter

Street	Price
Avenue Princesse Grace, Monaco	$120,000
Chemin de Saint-Hospice, Cap Ferrat, France	$100,000
Fifth Avenue, New York	$72,000
Kensington Palace Gardens, London	$65,000
Avenue Montaigne, Paris	$54,000
Via Suvretta, St. Moritz, Switzerland	$45,000
Via Romazzino, Porto Cervo, Sardinia	$42,000
Severn Road, The Peak, Hong Kong	$40,000
Ostozhenka Street, Moscow	$35,000
Wolseley Road, Point Piper, Australia	$28,000

Source: Wealth Bulletin

CB Richard Ellis

The Severn 8 development is on Severn Road, which the Wealth Report named one of the world's 10 most expensive streets in 2009.

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Associated Press

German Chancellor Angela Merkel, speaking at the German Federal Parliament in Berlin Wednesday, appeared to be trying to shift the discussion over Europe's debt woes back to profligate member states.

Merkel floats euro-zone expulsion

German leader's 'last resort' step against delinquent members comes as she warns against 'rash' Greek bailout

By Patrick McGroarty
And Matthew Karnitschnig

BERLIN—German Chancellor Angela Merkel steered Berlin toward a collision course with its euro-zone partners on Wednesday, calling for delinquent members of the currency area to be expelled.

"We need to have an agreement under which, as a last resort, it's possible to exclude a country from the euro zone if again and again it doesn't fulfill the requirements," said Ms. Merkel, referring to euro-zone deficit and debt rules, in an address to Germany's lower house of parliament.

Observers quickly dismissed the proposal as political theater, aimed at shifting the debate away from Germany's role in the debt crisis.

The type of change Ms. Merkel outlined would require the unanimous approval of the 27 European Union members, including those with the worst fiscal track records, making it extremely unlikely that the idea could ever be realized.

Greek Prime Minister George Papandreou responded to Ms. Merkel's suggestion by saying there was no possibility that Greece would leave, whether a legal barrier to exit existed or not. Ms. Merkel characterized the expulsion plan as a longer-term reform goal that wasn't targeted at Greece.

European Central Bank President Jean-Claude Trichet told a French magazine in an interview conducted before Ms. Merkel's comments but published late Wednesday that the notion of expelling a euro-zone member was "absurd."

"It is not a membership that can be adapted to suit the circumstances," Mr. Trichet told Le Point. "It is about sharing a common destiny with other countries."

The European Central Bank released a paper in December that said kicking a member out of the euro zone would be nearly impossible under EU law, and that a country leaving the currency bloc voluntarily would probably also have to quit the EU altogether.

"I don't see such a treaty change ever being agreed," said Simon Tilford, chief economist at the Center for European Reform, a London think tank. "Other member states will not accede to this in the absence of any recognition on the part of the Germans that they will need to amend their economic strategy if the stability of the euro zone is not to be compromised."

Ms. Merkel's sharp rhetoric comes as Berlin finds itself increasingly isolated over how to respond to Europe's debt crisis. Germany has resisted pressure from its partners to clearly articulate a rescue plan for Greece, preferring instead to reiterate vague promises of support.

Ms. Merkel cautioned Germany's EU partners again on Wednesday not to make a "rash decision" in bailing out Greece.

France and other European countries, meanwhile, have begun to suggest that Germany's export dependence is partly to blame for the crisis, and its refusal to stimulate domestic demand more through spending or structural reforms is making it harder for other countries to recover.

German officials have reacted angrily to the criticism this week, saying that Germany shouldn't be criticized for the competitiveness of its economy.

Ms. Merkel sought to end the debate on Wednesday, insisting that "Germany will not forfeit its export strength." Indeed, in Wednesday's speech, Ms. Merkel appeared to be trying to shift the discussion over Europe's debt woes away from Germany and back to profligate member states themselves.

So far, however, her efforts have done little to stifle the criticism. French Finance Minister Christine Lagarde, who broke a taboo earlier in the week by publicly questioning German economic policy, repeated her call on Wednesday for Berlin to change its ways.

"Germany could perhaps ... lower taxes to encourage internal consumption. An improvement of internal consumption could notably help our exports to the country," Ms. Lagarde said in a French radio interview.

"Those with deficits need to reduce them ... and those with a surplus should accept considering the idea of moving beyond a single source of growth to find other sources of growth," she added.

Pope faces pressure over German scandal

German Chancellor Angela Merkel called Wednesday for a full accounting of alleged sexual abuse by Catholic priests in Germany, intensifying the pressure on Pope Benedict XVI to address a scandal that has torn through his homeland.

*By **Stacy Meichtry** in Rome and **Vanessa Fuhrmans** in Berlin*

"We can all agree that sexual abuse of children is a despicable crime," Ms. Merkel said in an address to Germany's Parliament, her first major remarks on the scandal that has grown to involve more than 200 cases of alleged abuse, some dating back 50 years. "There is only one way for our society to come to terms with [the scandal], and that is truth and clarity about everything that has happened."

Ms. Merkel added that there should be a full discussion on whether to extend statutes of limitations on prosecuting such cases and how best to compensate victims. "We shouldn't simplify the issues," she said. Confronting and rectifying cases of abuse, she said, "is a test for our entire society."

New reports of alleged abuse are emerging in Germany daily. More than 160 people with stories of alleged abuse have come forward since January to attorneys who have been appointed by the Jesuit order to handle charges, according to these attorneys. A total tally of allegations from German media reports exceeds 200 this year.

Last week, Pope Benedict's former archdiocese of Munich-Freising disclosed the case of a priest, known to Church officials as a sex abuser, who was returned to active ministry at the archdiocese in the 1980s when the pope was archbishop. The cleric was later convicted of child sexual abuse. The Vatican has said the pope wasn't aware of the priest's situation. The archdiocese's then-administrative deputy has taken full responsibility.

So far, the 82-year-old German pontiff hasn't publicly addressed the spate of allegations in his native land. A Vatican spokesman didn't return phone calls Wednesday seeking comment on Ms. Merkel's remarks.

European Pressphoto Agency

The pope at a general audience Wednesday, where he addressed Irish abuses.

Roman Catholic priests are facing allegations beyond Germany's borders. In Brazil, authorities are investigating allegations that three priests sexually abused altar boys, following the emergence of a video that allegedly showed an 82-year-old priest having sex with a 19-year-old altar boy, the Associated Press reported. In Ireland, government-backed investigators have documented sexual abuse and coverups that spanned decades and involved thousands of children.

On Wednesday, Cardinal Sean Brady, a top-ranking Irish cleric, used part of his St. Patrick's Day homily to apologize for his role in the scandal. On Tuesday, the Irish Bishops Conference confirmed media reports that Cardinal Brady took part in investigating allegations of sexual abuse of two minors without reporting them to police. "I want to say to anyone who has been hurt by any failure on my part that I apologize to you with all my heart," he said.

The pope addressed the sexual-abuse scandal in Ireland on Wednesday, before Ms. Merkel delivered her address.

Pope Benedict said he was "deeply concerned" over the cases in Ireland, which he said had "severely shaken" the Church. He also announced plans to sign a letter Friday that will address the Irish scandal. "I ask all of you to read it for yourselves, with an open heart and in a spirit of faith," he told a general audience in Vatican City. "My hope is that it will help in the process of repentance, healing and renewal."

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U.K. unemployment declines

By Joe Parkinson
And Natasha Brereton

LONDON—British unemployment fell unexpectedly in February at its fastest monthly pace in more than 12 years, offering a boost for Prime Minister Gordon Brown ahead of national elections that must be held before June.

But political gains for the governing Labour Party may not reflect the real state of the U.K. economy, as Wednesday's data also revealed signs of persistent weakness that could hobble the recovery.

The Office for National Statistics said Wednesday that the widely watched claimant-count measure of unemployment dropped by 32,300 in February, the largest monthly decrease since November 1997. That decrease, which compared with a downwardly revised gain of 5,300 in January, lowered the jobless rate to 4.9% from 5% the previous month.

The better-than-expected news was seized on by government ministers, who cautioned that opposition Conservative Party plans to cut public spending immediately could undermine the economic recovery. "The fall in unemployment for the third month in a row is very welcome," Work and Pensions Secretary Yvette Cooper told BBC television. "We shouldn't have big public-sector spending cuts right now," she added. "That would be very bad for jobs."

Economists, who had forecast a modest rise in the claimant count, cautioned that the figures masked structural weakness in the U.K. labor market: The number of people in work fell to its lowest level since 1996, while the number of people who are inactive soared to a record high.

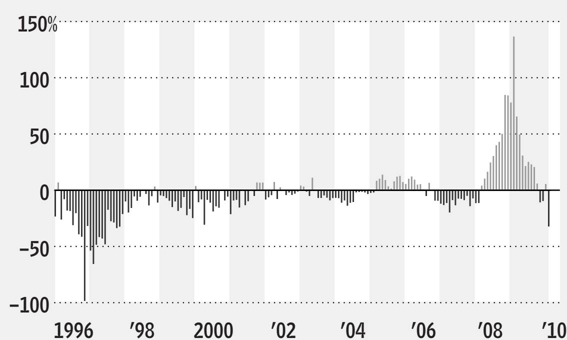
"We still think that the labor market will be a significant constraint on the wider economic recovery," said Vicky Redwood, an economist at Capital Economics.

A woman walks by a recruitment agency in London

Mixed signals

U.K. unemployment fell at its fastest pace since 1997, but the number employed also fell to its lowest level since 1996

Change in jobless claimant count, in thousands, monthly figures, seasonally adjusted



Employment rate, quarterly figures

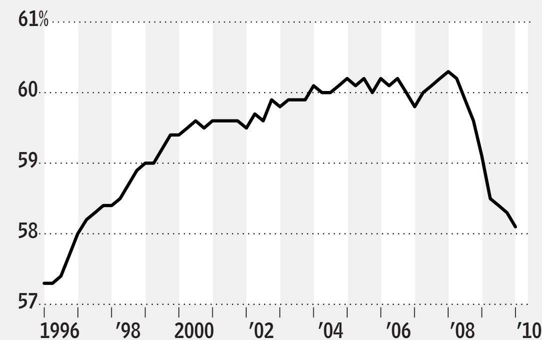


Photo: Associated Press Source: U.K. Office for National Statistics

Euro-zone growth in wages is slowing

By Paul Hannon

LONDON—Growth in wages in the 16 countries that use the euro slowed sharply in the three months to the end of December, contributing to a significant easing in labor costs but ensuring consumer spending will remain weak for months.

That is likely to help persuade the European Central Bank that it doesn't need to raise its key interest rate soon to clamp down on inflationary pressure. The ECB currently has its main refinance rate set at 1%.

European statistical agency Eurostat said total labor costs in the fourth quarter of 2009 were 2.2% higher than in the year-earlier period, a smaller increase than the 3% recorded in the third quarter.

Other labor costs, which include taxes on employment paid by businesses, rose 2.7%, again a significant reduction from the 3.5% rate of growth recorded in the third quarter.

Figures released Monday by Eurostat showed the number of people in work in the euro zone fell 347,000 in the fourth quarter, after declining 712,000 in the third.

The slowdown in wage growth was led by Germany, where pay in the fourth quarter was just 0.6% higher than in the year-earlier period. French wage costs grew 1.5% in the fourth quarter.

That disparity may fuel a simmering dispute between the euro zone's two largest economies about the role that Germany's big trade surpluses have played in holding back growth in other parts of the currency area.

Critics of Germany's economic policies have argued that its industries have boosted the competitiveness of their exports over the past decade in part by keeping wages flat.

That has helped German exports, which account for about 40% of the country's economy. Critics say the wage dynamic has depressed spending by German consumers, hurting other European countries' exports to Europe's biggest economy.

Labor costs rose most rapidly in the construction sector, where they were up 3.7%, while labor costs gained 2.4% in the services sector and 1.4% in industry.

Within the 27-member EU as a whole, labor costs increased 2.4% from the fourth quarter of 2008 while wages rose 2.2%.

Wages slow

Wage growth in the euro zone, year-to-year percentage change

*Includes taxes on employment paid by businesses
Source: Eurostat

EU criticizes member budget plans

By Carolyn Henson
And Stephen Fidler

BRUSSELS—Plans drawn up by European Union governments to reduce their spiraling budget deficits are overly optimistic and short on detail, the European Commission warned Wednesday.

Budget deficits in Europe have expanded sharply because of the financial crisis and the economic downturn, and the commission is pressing for governments to start reining them in next year in order to reduce them in coming years to the EU threshold of 3%.

After scrutinizing the strategies of 14 countries, including Germany, France, Italy, the U.K. and Spain, Commissioner for Economic and Monetary Affairs Olli Rehn criticized the majority, saying their budget projections were based on "favorable macroeconomic assumptions after 2010 that may not materialize."

The commission also expressed concern that many governments' stated plans to reduce deficits starting next year weren't specific enough, raising questions about their implementation.

The commission, the EU's executive arm, makes these assessments as the policeman of government budget deficits in the 27-nation bloc. Its aim is to ensure that governments adhere to the 3% budget deficit limit and take actions to reduce government debt to 60% of gross domestic product. But the commission is toothless in forcing governments to toe the line, an institutional weakness that the Greek debt crisis has exposed. Fines can be levied on errant governments, but only by fellow EU governments, and none has been imposed since the euro was born more than a decade ago.

Of the 14 countries scrutinized, only Bulgaria and Estonia plan to keep their budget deficits within the EU 3% target over the next four years, the commission said.

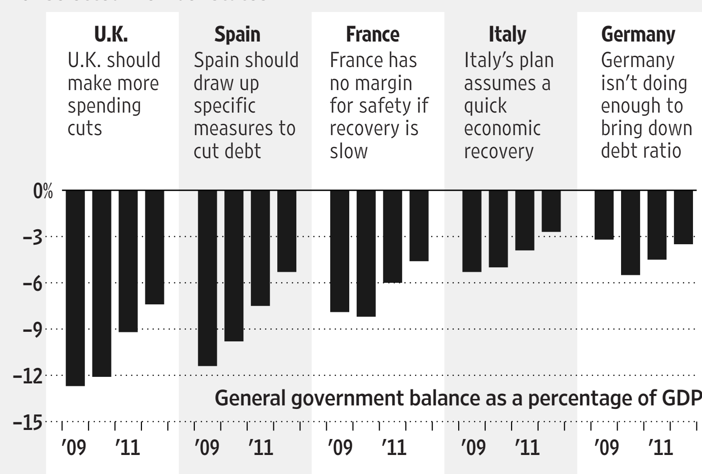
Even Germany, regarded as a hawk on budget stringency, was basing its projections on "slightly favorable" economic projections, the commission said. Germany's budget deficit could turn out to be bigger than expected because its budget consolidation wasn't specific enough after this year and because announced tax cuts hadn't been reconciled with budget reductions.

The German deficit is forecast to expand to 5.5% of gross domestic product from 3.2% in 2009. "The budgetary strategy is not sufficient to bring the debt ratio back on a downward path," the commission said.

Spain, Italy and France also have made "favorable" assumptions for economic recovery next year, the commission said. Public debt in Spain is expected to swell to 55% of GDP in 2009 and to 74% by 2013. But Spain may find there is a "lower contribution of economic growth to fiscal consolidation than envisaged," Mr. Rehn warned, adding that this could mean the Spanish government will have to take further steps to ensure it can pare its deficit from 11.4% of GDP last year.

Grading the budgets

European Commission assessment of fiscal policies and budget planning for selected member states



Source: European Commission

Latvia coalition collapses

Largest party withdraws, distancing itself from austerity measures

A Wall Street Journal Roundup

RIGA, Latvia—Latvia's government teetered on the verge of collapse Wednesday after the largest party pulled out of the center-right coalition over disputes about how to handle the country's recession—the deepest in the European Union.

The right-wing People's Party announced that it was recalling its five ministers from the government and moving into the parliamentary opposition after Prime Minister Valdis Dombrovskis refused to back the party's economic-rescue plan.

The party pulled out to distance itself from unpopular tax rises and drastic public sector pay and welfare cuts in the run up to an October election, according to some analysts, who said the defection was part of People's Party efforts to boost its low ratings before the election.

Analysts said the political woes could cause market jitters and raise questions about the government's ability to take decisions to keep on track a €7.5 billion ($10.3 billion) bailout led by the International Monetary Fund.

Mr. Dombrovskis, a member of the center-right New Era, the third-largest ruling party, said the People's Party's plan was "populist" and earlier on Wednesday called on the party to act "responsibly" while Latvia, a country of 2.3 million, struggles to overcome the worst economic crisis since it broke away from the Soviet Union in 1991.

Agence France-Presse/Getty Images
Prime Minister Valdis Dombrovskis

Laila Dimrote, a spokeswoman for New Era, said the government would continue with a minority in Parliament. "This is not a big deal. Latvia has had many minority governments in the past, and often this is the case prior to elections," she said.

Ms. Dimrote said that it wasn't clear how the government would divide the five vacant ministries, including the crucial Foreign Ministry, and that over the next few days the coalition would try to gauge the level of cooperation it could count on from the opposition.

Latvia's economy has undergone the steepest fall in the 27-member EU—gross domestic product fell 18% last year. It barely averted bankruptcy in 2008 after a group of international lenders led by the International Monetary Fund and the EU approved a €7.5 billion bailout plan for the Baltic state. In its most recent review of the plan, IMF officials praised Latvia's government for efforts in cutting budget expenditures and implementing painful reforms.

The political instability isn't expected to affect the IMF plan since there is a consensus among Latvian leaders that without it the country would be forced to make even more painful cuts.

Latvia's government will now control up to 47 seats in the 100-member Parliament, and opposition parties said they would be willing to cooperate on certain issues. Lawmakers are unwilling to topple the government given that only six months remain until parliamentary elections.

Mr. Dombrovskis said he would aim to make sure the bailout continued to win backing in the country.

Announcing the People's Party's withdrawal from the government, its head, Andris Skele, said: "Contrary to what the head of the government says, the economic slide continues and more than 200,000 people are out of work."

Reuters
Hector Sants, chief executive of the Financial Services Authority, pictured in London last year.

U.K. snaps whip in finance area

Continued from first page
an independent agency are complicating efforts to lure employees from investment banks and other financial institutions.

"Undoubtedly, institutional uncertainty is not helpful for staff morale," he said. "It's not helpful to recruiting or retaining staff."

Meanwhile, FSA Chairman Adair Turner planned to use a speech Wednesday evening to reiterate calls for tougher capital requirements on banks and for new restrictions on hedge funds.

"Speculative trading activity can cause harm, even when it poses no threat to commercial bank solvency," Mr. Turner said in prepared remarks for a lecture at London's Cass Business School. "If necessary, highly leveraged hedge-fund speculation should be constrained by leverage limits."

Mr. Turner also said a tax on financial transactions should be on the table as a possible way for regulators and policy makers to deter unhealthy financial speculation.

In the text of the lecture, which runs to 59 pages, Mr. Turner takes aim at the banking industry's oft-cited arguments that forcing banks to hold more capital as a percentage of their assets or as a share of their trading positions will impede lending and deprive the financial system of much-needed liquidity.

Mr. Turner argues that higher capital requirements would primarily discourage types of financial activities—including risky forms of speculative lending, asset securitization and trading—that have limited benefits for the economy as a whole.

A veteran of the banking industry, Mr. Turner warned that policy makers shouldn't "fall into the trap of believing that ever more complex innovation is beneficial because it completes more markets, or that an increased aggregate supply of credit is a valid argument in favor of innovation and light regulation."

France prepares a menu for its national identity

[Letter from Paris]

By Christina Passariello

PARIS—Over a feast of foie gras, crispy pig ears and white Burgundy, a group of epicurean French politicians recently added a new twist to a debate over national identity: You are what you eat. By that definition, being properly French means dining on croissants, brie and duck confit.

The call is a sign of rising culinary nationalism amid fears that the pre-eminence of French cuisine has evaporated. It has also reframed the continuing question of what it means to be French: Couscous and other foreign foods cooked by the country's millions of ethnic and religious minorities aren't on the menu.

"We must protect the products from our land," preached the dinner's co-host Alain Suguenot, deputy mayor of Beaune, a town in Burgundy, and co-president of the Club de la Table Française, which counts 280 food-loving members of Parliament from across the political spectrum. "It's for our heritage. It's part of our French identity."

Last fall, President Nicolas Sarkozy revved up for France's continuing regional elections by defending the idea of a specific national identity—a topic that in France is seen as anti-immigration and plays to far-right voters. Leading members of Mr. Sarkozy's center-right party, the Union pour un Mouvement Populaire, have suggested banning the full-body burqa some Muslim women wear, flying the tricolor flag at every school, and requiring new citizens to sign a charter pledging to uphold French values. France has the largest Muslim population in Europe, estimated at about six million, or 10% of the population; large communities from former colonies such as Algeria, Vietnam and Senegal have settled here.

So far, the national-identity debate hasn't translated into a boost for Mr. Sarkozy's party. In the first round of voting this past Sunday, his center-right UMP came in second behind the opposition Socialists; the far-right National Front voters Mr. Sarkozy was wooing stuck with their party. This Sunday, the French head back to the voting booth for the second round and polls indicate the UMP will flop, showing how unmoved most people are by the debate.

France has long resisted becoming a melting pot. Four years ago, rioting by youths—many of them minorities—in poor suburbs around Paris highlighted the difficulties they face in integrating into French society. Managerial ranks are still overwhelmingly dominated by white men from mostly affluent backgrounds.

National identity met food at this year's Salon International de l'Agriculture, an annual fair on the outskirts of Paris where the parliamentary food-lovers club dinner took place. The Salon, which ran for nine days in February and March, is an obligatory stop for politicians to connect with their agricultural constituents and mug for photos with prize-winning cows. Mr. Sarkozy used the occasion to promise €800 million ($1.1 billion) in aid to farmers.

European Pressphoto Agency
Nicolas Sarkozy at this year's Salon

Upstairs from where the cows rested, politicians, farmers and food-industry officials gathered at the Club de la Table Française dinner to discuss how to protect French gastronomy. The dinner was a showcase for traditional eating habits and food raised within France's borders. According to a survey conducted by the club, 86% of its members say the art of setting a table—with its array of silverware, wine glasses and porcelain—is a fundamental part of French identity.

The *pièce de résistance* was a medium-rare roast beef, cooked under a crust of salt from Brittany and served with Princesse Amandine potatoes. The one foreign spice was vanilla flown in from the Indian Ocean island of Réunion—officially part of France.

Club members say French cuisine is under threat. Grocery stores are increasingly importing cheaper cheese and meats from other European countries, threatening local producers.

The club threw its support behind an initiative Mr. Sarkozy launched two years ago to gain United Nations recognition for French cuisine as an intangible cultural treasure. Yet the French have had to lower their ambitions. The initial project was too broad: It envisaged an abstract classification comprising raw ingredients, recipes, cooking techniques and wines. The proposal that was recently submitted argues more narrowly in favor of the "French meal."

"Ninety-nine percent of the French think it's an essential part of our culture, even if people don't take as much time to cook," said Jean-Robert Pitte, who headed the project and expects a response from Unesco by September. He noted the need to emphasize everyday cooking: "carrots, soup, good bread."

The marathon of delicacies came to an end with a chocolate dessert. Waiters delivered small cups of coffee, for which the dinner's organizers thanked sponsor Nespresso, part of Swiss giant Nestlé SA. Swiss coffee at a dinner celebrating French gastronomy?

"That's globalization," quipped club member and member of Parliament Gilbert Le Bris.

Associated Press

Former Fed Chairman Paul Volcker supported the Fed's case to oversee smaller banks in testimony on Capitol Hill.

Bernanke faces critics

Fed chief defends low rates, warns against narrowing bank's focus

By Luca Di Leo
And Sudeep Reddy

WASHINGTON—Federal Reserve Chairman Ben Bernanke said that keeping short-term interest rates too low for too long may spark inflation, but he added the U.S. economy wasn't under such a risk.

The U.S. central bank chief, in testimony before the House Financial Services Committee on Wednesday, said that rates were being kept at record-low levels near zero to help spur job creation and consumption.

Mr. Bernanke was being challenged by long-time Fed critic Rep. Ron Paul (R., Texas), who argued the Fed was responsible for the recent financial crisis by leaving rates too low for too long. Mr. Paul asked Mr. Bernanke what damage could come from ultralow rates another time.

"One possibility is that...you get inflation," Mr. Bernanke replied, adding that "every central banker wants to be sure that prices remain stable." The Fed chairman went on to say, however, that rates were so low because the economy remained weak.

The Fed on Tuesday kept its benchmark federal-funds target rate close to zero and said it expected the rate to stay exceptionally low for "an extended period."

"Central banking is an art and we need to balance our dual mandate" of maximum employment and stable prices, Mr. Bernanke concluded.

Mr. Bernanke also pushed back against a Senate proposal to strip from the Fed oversight of smaller banks by warning House lawmakers that it would narrow the central bank's focus to giant firms.

"It makes us essentially the too-big-to-fail regulator," Mr. Bernanke told lawmakers. "We don't want that responsibility. We want to have a connection to Main Street as well as Wall Street."

The legislative proposal released this week by Senate Banking Committee Chairman Christopher Dodd would make the Fed the supervisor of bank-holding companies with assets greater than $50 billion. About 35 firms fall into that group.

Mr. Bernanke said Fed officials were "quite concerned" by the proposal because they wanted to have an understanding of firms of all sizes and at all levels. "Smaller and medium-size banks are very valuable to us," providing information for monetary policy, for understanding the economy and for financial stability. He reminded lawmakers that small institutions were part of prior financial crises, such as those in the 1930s and in the savings-and-loan failures of the late 1980s.

Former Fed Chairman Paul Volcker, also testifying at the hearing, called the $50 billion barrier arbitrary and warned of the risks from separating out those firms. "We don't want to single out some institutions as too big to fail. We want a system particularly where nonbank institutions can fail," he said.

Mr. Volcker later called the $50 billion threshold "much too low in my opinion" in determining which firms really would need to be saved.

While the Fed gains new powers in the proposal, the reduced authority over smaller institutions hasn't sat well with regional Fed bank presidents or the Treasury Department. Treasury officials are expected to push against the provision in favor of letting state-chartered banks be able to continue choosing whether they should be overseen by the Fed or the Federal Deposit Insurance Corp. Critics have said such an arrangement allows banks to gain advantage by shopping for regulators. House legislation passed in December keeps their supervision with the Fed.

Oversight of those smaller institutions is especially important to 12 regional Fed banks scattered across the country. Presidents of the regional Fed banks have been lobbying lawmakers in recent weeks to preserve their powers. Roughly 18,000 of the Fed's 20,000 employees are at the regional banks.

—Michael R. Crittenden contributed to this article.

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Drug cocktails gain

By Mark Schoofs

The U.S. Food and Drug Administration is devising guidelines that could accelerate testing and approval of multidrug regimens for some of the world's deadliest diseases.

At least two pharmaceutical consortia are poised to take advantage of the policy: a group of 10 drug companies and several nonprofit organizations convened by the Bill and Melinda Gates Foundation to develop medicines to fight tuberculosis; and **Merck** & Co. and **AstraZeneca** PLC, which are jointly testing two anticancer agents.

Many diseases, such as AIDS, TB and cancer, require multidrug combinations. Such drug cocktails can prevent the development of drug resistance in patients.

Traditionally, the FDA has required each new drug to be tested and approved individually.

After a long road, banks find change is coming

[Capital]

By David Wessel

Two years after the Federal Reserve's $30 billion rescue of Bear Stearns and 18 months after the market-churning bankruptcy of Lehman Brothers, Congress is lurching toward legislation to renovate the financial-regulatory system to reduce the risk of another devastating crisis.

Finally.

The unveiling of a 1,336-page bill by Sen. Christopher Dodd, the Connecticut Democrat who chairs the Senate Banking Committee, was significant. The move showed he is determined to move a bill through the committee despite his inability to get even a few Republicans to sign on.

The details illustrated that on financial reform, if not on much else, Democrats are closing in on a consensus. On key points, Mr. Dodd is moving toward his House counterpart, Massachusetts Democrat Barney Frank, who shepherded a bill through an unruly committee and the full House three months ago.

The substance demonstrated the influence that Treasury Secretary Timothy Geithner and Fed Chairman Ben Bernanke are exerting. On nearly every big issue, Mr. Dodd is moving closer to their positions.

The Fed isn't sidelined, as Mr. Dodd initially proposed, but gets a central role in supervising big banks and the financial system. A mechanism, albeit clunky, is created so the Fed and Treasury can take over a big failing financial firm instead of choosing between bankruptcy (Lehman) or bailout (**American International Group**). Banks can't shop for the softest regulator. Regulators get *lots* of discretion and authority to restrain financial firms. An agency largely independent of bank regulators is created to regulate consumer finance.

All that lifts the odds that President Barack Obama will mark the third anniversary of the onset of the crisis in August by signing a bill that makes the biggest changes to U.S. financial regulation since the 1930s.

Mr. Dodd plans to push a bill through committee on a party-line vote before Congress breaks for two weeks on March 26, and then try—again—to cut a deal with enough Republicans to get a bill through the full Senate this summer. Without Republican partners, Mr. Dodd had to move left; to get the Republican votes he needs on the Senate floor, he'll have to move right.

Like so much else in Washington these days, though, the fate of financial regulation is linked to the fate of health-care legislation. If that fails and already bitter partisan bickering intensifies, Republicans are more likely to stick to a "just say no" strategy. If a health-care bill passes, financial regulation is more likely to pass, too.

"The politics are different than health care," says Douglas Elliott, a former investment banker now at the Brookings Institution think tank. "The public really wants something to get done, though they don't know what. And they hate bankers. That'll make it harder for Republicans to filibuster."

Bankers realize there are "substantially worse things that could happen than a bill like this," Mr. Elliott adds.

Indeed, if financial regulation flops, Congress is likely to impose Mr. Obama's fee on banks later this year. On that bill, they may attach some things bankers hate, leave them with another year of uncertainty over the rules of their game and create an opening for Europe to move on financial regulatory changes before the U.S.

As Morgan Stanley analysts said in an instant analysis of the Dodd draft: "Certainty over these issues should be a positive for bank stocks over time."

The White House and congressional Democrats see a no-lose proposition: Either they get enough Republicans to pass a bill or they bash Republicans for defending the big bad bankers.

Like so much else, the fate of financial regulation is linked to the fate of health-care legislation.

But Republicans are good at the message game. They'll say the Democrats' bill is too easy on banks, too reliant on regulators who failed, too silent on Fannie Mae and Freddie Mac and too close to "perma TARP" (by building a kitty that would avoid the need to go to Congress for something like the Troubled Asset Relief Program if a big financial institution stumbled).

A lot depends on whether Sen. Richard Shelby of Alabama, the top Republican on the banking committee, and Sen. Mitch McConnell of Kentucky, the minority leader, decide to deal.

If they do, the question becomes: Will the new rules and regulatory framework prevent another big financial crisis? The short answer is: No. We will have another one. At best, the changes will reduce the frequency, severity and side effects of a crisis.

The longer answer is: It depends. The outlines of a new regulatory regime are emerging. But business and bank lobbying is intense. Congressional deal-making needed to get a bill passed can produce loopholes, carve outs, inconsistencies and stupidities.

Ultimately, the details—and the Dodd bill is far from the last word on those—will determine if the right balance is struck between markets and regulatory guardrails, between encouraging financial innovation and avoiding excess leverage, between hoping newly empowered regulators do better than their predecessor and writing rules and limits into law.

The prosperity of the U.S. economy over the next 25 to 50 years is at stake.

WORLD NEWS

BOJ renews effort to beat deflation trend

By Tomoyuki Tachikawa and Megumi Fujikawa

TOKYO—The Bank of Japan decided Wednesday to put new money into a lending facility created late last year to fight deflation, heading in the opposite direction from the Federal Reserve and other central banks that are moving to exit their stimulus strategies.

It may not be enough to satisfy critics, who want Japan's central bank to do more to pump up the economy. But further moves are complicated by divisions within the BOJ.

While politicians have been pressing the BOJ to step up stimulus efforts for the coming months, two of the banks' seven board members voted against the Wednesday action, arguing the move wasn't needed.

Specifically, the bank's policy board said it will offer 10 trillion yen ($111 billion) in three-month cash to financial institutions, in addition to the 10 trillion yen it offered in December. Officials also voted unanimously to keep short-term rates at 0.1%.

Easing through a rate cut is considered out of the question, but the BOJ could take other steps to pump more liquidity into the economy. Analysts said the central bank could extend the duration of fixed-rate loans to six months from the current three months, to push down long-term interest rates.

It also could take more-radical easing steps, such as increasing outright purchases of government bonds. That is considered unlikely, because of the bank's concern that such moves could lead to a breakdown in the government's fiscal discipline—Japan's gross public debt, near 200% of gross domestic product, is already the highest in the industrialized world.

"The government may put pressure on the BOJ, but bold BOJ actions won't be able to lift the economy from deflation," said Kyohei Morita, chief Japan economist at Barclays Capital. If the BOJ does take radical steps due to government pressure, "the world will lose confidence in the government and the BOJ."

The moves came as prominent government officials have called on the central bank to do more to stop deflation, saying a persistent fall in prices could hurt the nascent economic recovery.

Finance Minister Naoto Kan has said he wants deflation to end this year. After the BOJ's decision Wednesday, Mr. Kan told reporters the policy decision "brought [the BOJ] one further step forward in the direction of overcoming deflation."

Prices have been dropping in Japan for much of the past decade because of weak domestic demand.

The BOJ has said that it doesn't tolerate deflation, but that it expects no letup in the price declines for the next couple of years. Core consumer prices in Japan declined for the 11th straight month in January, according to government figures.

After the so-called Lehman shock in 2008, "demand and supply conditions worsened significantly across the globe," BOJ Gov. Masaaki Shirakawa said after Wednesday's meeting. "We should recognize that it will take a long time for prices to return to their appropriate levels."

Nigeria's cabinet is dissolved

Acting president Jonathan moves to reshape government amid ailing president's absence

By Will Connors

LAGOS, Nigeria—Acting President Goodluck Jonathan on Wednesday dissolved Nigeria's cabinet, his spokesman said, in a move to reshape a government that has been left largely rudderless amid the absence of its ailing president.

After a meeting Wednesday, the acting president asked his top officials to hand over work to departmental secretaries, according to departing Minister of Information Dora Akunyili. The cabinet members were appointed by Nigerian President Umaru Yar'Adua, who is in poor health and hasn't been seen in public in more than three months. Mr. Jonathan was named acting president by the national assembly last month and has since made a series of personnel changes to try to calm the country's political turmoil.

Mr. Jonathan "felt that he could not wait any longer," an aide close to the acting president said. He is expected to name successors in the next couple of weeks.

While aides say Mr. Jonathan doesn't have designs on the presidency, he is keen to overhaul the government ahead next year's elections. "Goodluck feels that the Nigerian people and history will not forgive him if he allows the government to become dormant," the aide said.

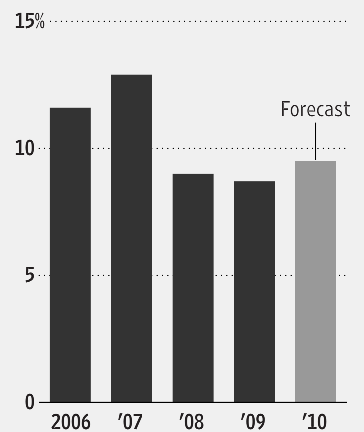
Associated Press

A file image of Acting President Jonathan, center, and President Yar'Adua, right.

Mr. Jonathan is unlikely to run for president in 2011 because of an informal pact in the ruling party that rotates power between northern and southern politicians. Because of Mr. Yar'Adua's illnesses, the northerners' term in power has been cut short, meaning many will advocate for a longer period for one of their own in the presidency. Nigeria's next presidential elections are expected to take place in January or April of 2011.

The country is going through a stretch of instability, from militant attacks on pipelines to deadly sectarian violence near the capital in the north city of Jos. On Monday, two bombs exploded outside a government conference in the city of Warri in the oil-rich Niger Delta region. No one was killed in the bombing, which injured several people. A prominent militant group claimed responsibility for the attack. On Wednesday, 13 people died when Muslims attacked a village near the city of Jos, according to Gregory Yenlong, information commissioner of Plateau State. Jos is the capital of Plateau State.

In his few weeks running the country, Mr. Jonathan, a former fish biologist, has been unafraid of making political enemies. He demoted the attorney general, amid complaints of corruption, and dismissed the national security adviser.



Sources: World Bank, Agence France-Presse/Getty Images (photo)

Left: People shop for food at a market in Beijing.

China's growth to accelerate

By J.R. Wu and Andrew Batson

BEIJING—The World Bank urged China to take more measures to cool its economy and head off inflation, as the bank expects the country's economic growth to accelerate to 9.5% this year.

In its quarterly report on China's economy, the World Bank raised its forecast for China's growth this year from the 8.7% increase the bank projected in November. It suggested Beijing use interest rate rises and a stronger yuan to avoid inflation and the formation of asset bubbles in the domestic property market.

Beijing has been gradually exiting the stimulus measures put in place during the financial crisis. The central bank has twice ordered banks to keep a bigger portion of deposits on reserve this year to curb loan growth after a big increase in lending last year, and Premier Wen Jiabao stressed the importance of price stability in his annual work report to the nation's legislature.

China's stated growth target for this year is around 8%, following an 8.7% expansion in 2009.

"We do observe other macroeconomic risks that are in part an outcome of the stimulus as it was implemented last year," said Louis Kuijs, senior economist with the World Bank. He said rising property prices should be contained as "price rises on the property market could reach a level that is not healthy."

The World Bank recommended that China's macroeconomic policy stance needs to be tighter than in 2009, adding that Beijing must adopt different policy measures than most other major economies because it is growing so much faster. The bank said the case for using interest rates to tighten policy and allowing a more flexible exchange rate is growing.

"Inflation expectations can be contained by a tighter monetary policy stance and a stronger exchange rate," it said. "Relatively low interest rates contribute to the overinvestment and speculation that the government is trying to limit."

The bank said the inflation rate in China is unlikely to rise too high this year, but it expects the consumer-price index to rise 3.7% in 2010 before moderating to 2.8% in 2011.

China's government has estimated CPI will rise around 3% this year after falling 0.7% last year.

The World Bank's recommendation that China use the exchange rate to help rebalance the economy isn't new, but it follows repeated calls from other countries for Beijing to let the yuan appreciate. Critics say the yuan is undervalued, which gives Chinese goods a competitive edge in export markets.

China defends its currency policies, which has kept the yuan effectively pegged to the dollar since the government halted the Chinese currency's gradual appreciation in mid-2008. On Sunday, Mr. Wen said the yuan isn't undervalued and suggested that calls for yuan appreciation amount to trade protectionism.

The World Bank said it expects China's current-account surplus to grow to $304 billion this year and to $341 billion next year. Last year, China's current-account surplus was $284 billion.

The bank said it expects China's foreign-exchange reserves, the world's largest at $2.4 trillion at the end of 2009, to exceed $3 trillion in 2011. It projected China's foreign-exchange reserves would reach $2.818 trillion at the end of this year and $3.289 trillion at the end of 2011.

The bank said another risk are strained finances of local governments, but it suggested the problem could be controlled. "Given China's solid macro position, we think the local government problems are not large enough when you put them together to cause systemic stress on China's economy," Mr. Kuijs said.

Congress's key bills stall in India

Ruling party finds passage of legislation—on women and the U.S. nuclear pact—difficult despite election victory

By Vibhuti Agarwal

NEW DELHI—India's ruling Congress party is finding that a commanding election victory doesn't necessarily translate into smooth passage for its landmark pieces of legislation.

On two fronts recently, the government has been stymied in its plans to push through laws that are important to its agenda in its second term, having handily won re-election last year. A bill to establish a quota of women legislators in New Delhi is stalled, and the government earlier this week backed away from introducing a bill that is crucial to the implementation of the 2008 civil nuclear accord signed with the U.S.

The government expected smooth passage of the historic women's bill, but it was foiled by government allies who want the quota applied only to Muslim and other minority women.

European Pressphoto Agency

Politicians shout slogans against the proposed Women's Reservation Bill outside Parliament. The bill aims to boost the participation of women in India's democracy

With its allies in the United Progressive Alliance, Congress holds 322 of 543 seats in the lower house of Parliament. But recent experience shows that the government can still be thwarted by recalcitrant allies or a united opposition. Congress itself holds 206 seats.

Professor Chintamani Mahapatra at New Delhi's Jawaharlal Nehru University says the support of allies is crucial since the Congress itself doesn't have majority in the lower house of the parliament. "Emotive issues like the women's quota and the nuclear liability bill need political trading," Mr. Mahapatra said.

The historic women's bill now appears in jeopardy, with any passage at least months away. The government expected smooth passage through both houses of Parliament and the legislation was passed in the upper house. But it was foiled by government allies who want the quota applied only to Muslim and other minority women. With members of the Trinamool Congress, a Congress party offshoot that is part of the coalition, opposing the bill along with two other government allies, the future of the bill now seems uncertain.

The chief whip of the Congress party, Paban Singh Ghatowar, has declined to specify a time frame for introducing the bill in the lower house, saying "it will be introduced only after completion of the debate." Parliament heads for a monthlong recess at the end of this week, meaning the soonest it could be revived would be in mid-April, when it is likely to face similar opposition.

Congress spokesman Manish Tiwari says the government is focusing on consultation. "The legislation has not been stalled. It is a process that requires time," Mr. Tiwari said.

The government in its first term from 2004 to 2009 was hamstrung by the constant threat that left-wing allies would leave in opposition to proposed reforms and market liberalizations. The new term was supposed to be different as the government formed a mandate without its Leftist partners. But now hopes, particularly among foreign investors, that the government would have the power finally to push through overhauls and bold policies may be dashed.

The government, for instance, has long talked about opening up the insurance and retail industries to greater foreign investment. Many Indian executives had expected action at least on insurance by the time Finance Minister Pranab Mukherjee delivered his budget at the end of last month. But the budget made no mention of the initiative.

Even the government's signature civilian nuclear technology agreement with the U.S., which was passed by the Parliament in the summer of 2008, is running into roadblocks.

On Monday, the government deferred introduction of a bill capping liability for any nuclear damage amid stiff resistance from opposition parties.

The enactment of the liability law is crucial to bring into operation the U.S.-India agreement and allow the entry into India of private U.S. nuclear-power companies, which have already been assigned land for nuclear plants.

India's science and technology minister, Prithviraj Chavan, said Wednesday, "The moment the issue of any likely foreign participation comes up there is a red flag," according to the Press Trust of India.

Defense analyst Rajiv Nayan at the New Delhi-based Institute for Defence Studies and Analyses said leaving in limbo the controversial nuclear liability bill will delay the entry of U.S. companies in India's nuclear market.

He added that the government isn't in a position to bulldoze over the minority view and should consult all parties and groups before taking a decision.

IMF upbeat on India's outlook for growth

By James Glynn

SYDNEY—An upbeat assessment of India's growth outlook from the International Monetary Fund, coupled with a warning on the need to anchor inflation expectations, is likely to lend weight to market expectations for near-term monetary tightening by the country's central bank.

The IMF, in its latest Article IV consultation paper issued Wednesday, said India's economy is recovering well, with conditions now in place for a gradual tightening of monetary policy. It also indicated there is room for the rupee to rise without compromising a recovery.

"India's economy is rebounding strongly ahead of most countries in the world, bringing policy trade-offs to a head earlier than in other countries," the IMF said.

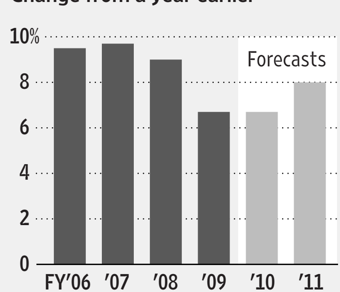
The comments highlight the dilemma for policy makers in India as they confront an economy picking up steam with inflation pressures starting to build, at a time the country's fiscal position remains weak.

Indian government officials have been fretting over the current surge in inflation to a 16-month high of 9.89% in February. The finance ministry's chief economic adviser, Kaushik Basu, said this week the headline inflation rate could accelerate further in March.

Economists increasingly expect the Reserve Bank of India to become more aggressive in tightening policy, possibly raising interest rates at its next meeting in April.

At its most recent meeting at the end of January, the RBI left lending and borrowing rates on hold but increased the cash reserve requirement for banks by 0.75 percentage point.

The process of tightening macroeconomic policy settings should start with monetary policy, the IMF said.



Note: Fiscal years end March 31 of the year shown
Source: International Monetary Authority

"Moving early would also mitigate the risk of inflation expectations becoming unmoored, and thus would require a smaller overall adjustment. Initial steps could be to sequester most of the excess liquidity through increases in the cash reserve ratio," it added.

The IMF forecasts India's economic growth to accelerate to 8.0% in 2010-11 from 6.75% in 2009-10. That compares with the government's forecast for growth in 2010-11 of 8.5%.

"With India's long-term prospects remaining strong and private sector balance sheets sound, we expect growth to be back at potential in 2010-11 even if advanced economies grow below trend," the agency said.

Allowing the rupee to gain wouldn't necessarily result in reduced competitiveness, it added. The rupee is up 1.9% against the U.S. dollar since the start of the year, and some analysts believe the central bank may step up intervention to slow the rise and protect exporters, in line with similar moves elsewhere in Asia.

"Given low interest rates in advanced economies and India's high relative growth, capital inflows are likely to be substantial. With the rupee still below its 2008 peak, there would be room for appreciation without concerns about eroding competitiveness," the IMF said.

Other policy options, especially prudential measures, may be appropriate if asset price bubbles are a threat, it added.

However, straightforward capital controls should be used "only as a last resort," given India's dependence on foreign inflows to sustain investment.

The IMF sounded a warning note about the country's fiscal health, calling for a reduction in India's 2010-11 budget deficit.

"With the recovery becoming entrenched and India's high debt, the risk of premature withdrawal of fiscal stimulus is low. Introducing reforms to underpin lasting consolidation will be of paramount importance," it said.