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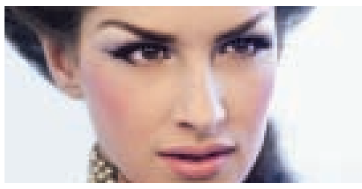

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WEEKEND JOURNAL

THE WALL STREET JOURNAL.

VOL. XXVIII NO. 68 | EUROPE | Friday - Sunday, May 7 - 9, 2010

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Dow plummets as fear spreads

By Peter A. McKay
And Andrea Tryphonides

Worries about Greece's debt crisis sent stocks reeling globally Thursday, with the Dow Jones Industrial Average tumbling almost 1000 points during the afternoon session.

In a flashback to the panicked trading of 2008, U.S. stocks dropped as selling built up and some indexes fell through key technical levels. In late New York trading, the Dow recovered somewhat, down 350.97 points, or 3.2%, to 10517.15.

Key short-term credit markets began to show signs of stress and corporate bonds plunged. The three-month London interbank offered rate, or Libor, the benchmark rate for billions of dollars in debt, shot to 0.42 percentage point from 0.37 percentage point, traders said.

"It's getting pretty ugly out there very fast," said Guy Lebas, chief fixed-income strategist at Janney Montgomery Scott. "There are definitely some major concerns that are escalating this afternoon."

The Standard & Poor's 500-stock index was down 3.3% at 1127.83, breaching the technical barrier of 1150.

"A lot of people thought we had support around that level, so there was some disappointment that it didn't hold," said Phil Roth, chief technical analyst at Miller Tabak.

Investors remain deeply worried about the unfolding drama of Europe's efforts to prop up Greece's finances. Despite boisterous street protests, Greece's parliament passed a bill with austerity measures that will give the country access to an assistance package jointly offered by the European Union and International Monetary Fund. Other EU members will vote soon in their respective parliaments to approve spending on the package. A first test is expected in Germany on Friday.

"A lot of traders are getting carried out of their seats. There are lots of liquidations, including hedge funds, out of riskier assets," said Michael Franzese, head of Treasury trading at Wunderlich Securities in New York. "No one was expecting this selloff in stocks and the euro, and a flight-to-quality trade is in full effect."

While the bailout is expected to pass in Germany and elsewhere, it remains unpopular among voters who don't want to see their respective countries' resources used to solve Greece's problems. Traders said that any hints of populist backlash could slow the package's implementation or lead to the dropping of elements needed to prevent global economic contagion.

Speculation about Greek-style sovereign-debt and banking-sector troubles migrated to Italy, with a wave of

Please turn to page 23

Take your partners: U.K. hopefuls head for the polling stations

From left to right: Getty Images; European Pressphoto Agency; Bloomberg News

The campaigning is over and the three candidates in the race to become U.K. prime minister went off to the polling station Thursday. From left, they are David and Samantha Cameron, Nick Clegg and Miriam Gonzalez Durantez and Gordon and Sarah Brown. **See related stories on pages 4 and 5 and updated news and analysis at WSJ.com.**

Blackstone in talks on biggest leveraged buyout since crisis

By Peter Lattman

Blackstone Group LP and other investors are in talks to acquire financial-data-processing company **Fidelity National Information Services** Inc., according to people familiar with the situation.

A deal for Fidelity National, which has a market capitalization exceeding $10 billion, would be the largest leveraged buyout since the credit crisis struck nearly three years ago. Other buyout shops teaming up with Blackstone on the deal talks include TPG and Thomas H. Lee Partners, according to people familiar with the matter. Fidelity National also carries about $3 billion in debt.

Exact pricing details for a transaction—which is at a sensitive stage and may still fall apart—could not be determined Thursday.

One worry for buyers is the fragile state of the stock and bond markets. The stock-market swoon on Thursday has brought a lurking fear that the credit markets could soon close, especially if conditions in Europe continue to deteriorate. That's why people involved in the transaction say there's a sense of urgency to get it done soon.

Though Fidelity National is not well known, it's one of the largest U.S. companies providing tech services to the banking industry. It helps banks process credit-card transactions and handle functions for money managers.

The Quirk

Open graves, open minds: have vampires become too American? Page 29

Editorial & Opinion

It's the Greek economy, stupid. Page 12

Oil hits shore in U.S.

A Wall Street Journal Roundup

Crews prepared Thursday to lower a massive box they hoped would cut off most of the crude spewing from a blown-out well in the Gulf of Mexico, the urgency of the task underscored by oil that started washing up on delicate barrier islands.

The concrete-and-steel box they plan to lower 1.6 kilometers into the ocean could collect as much as 85% of the oil that has been leaking from the ocean floor after the Deepwater Horizon drilling rig exploded April 20, killing 11 workers. The technique hasn't been tried before at that depth.

Oil from the sunken rig has washed up on the Chandeleur Islands of Louisiana, officials confirmed Thursday, the first time the oil has reached the shore.

It won't solve the problem altogether. Crews are drilling a relief well to take the pressure off the blown-out well at the site, and that could take up to three months. Other possible solutions are also in the works. Homeland Security Secretary Janet Napolitano

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THE WALL STREET JOURNAL.

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Item one on the curriculum for new U.K. prime minister: Greek lessons

[Agenda]

By Simon Nixon

Associated Press

Riot police stand guard outside the Greek parliament on Thursday.

"A new day has dawned, has it not?" Tony Blair declared almost exactly 13 years ago on winning the 1997 election. Well, another new day has certainly dawned in the U.K.—and it's unlikely to be one that anybody looks back on with any affection.

What will surely become apparent in weeks, if not days, is that the election campaign was one long holiday from reality—paid for through the generosity of the markets. As a result, Thursday night's dramatic slide in the markets will come as an almighty shock to voters who for the past four weeks have heard barely any discussion of the devastating crisis in Greece and the euro zone that has such huge consequences for the U.K. They will have woken on Friday to a world changed all right—in ways they never imagined.

Politicians were fortunate that for the best part of a year investors and rating agencies effectively suspended judgment on the U.K. It's unlikely the country would have retained its triple-A rating or been allowed to borrow at less than 4% on the basis if the market had not believed tough action on the deficit would be taken after the election.

It's only now the election is over that the real voting will begin—in the markets. The futures market opened at 1 a.m. Friday to allow investors to start trading as the election results came in. From now on, whoever emerges as prime minister will have his performance judged not by daily opinion polls but in real-time by the markets. And unless that performance is remarkably sure-footed, the judgment is likely to be brutal.

The new prime minister should not kid himself that the U.K. is somehow a special case, immune to euro-zone contagion. The U.K. may have a separate currency, an independent central bank and longer debt maturities than other troubled economies. But these will be of little use if the markets lose confidence. Greece also had long-term funding.

Orchestrating a multicountry euro-zone bailout is fraught with financial and political difficulties. But at least the euro zone has the aggregate fiscal capacity to backstop its banks and support Greece, Spain, Portugal and Ireland. Excluding these four countries, the rest of the euro area had a fiscal deficit last year of 5.2% of GDP and an outstanding level of gross debt of 81.5% of GDP, according to David Mackie of J.P. Morgan. The U.K., with gross debt of 72.9% of GDP and a deficit likely to reach 12.6% this year, the largest in the European Union, has no such capacity—and only the IMF to turn to for a bailout.

As Moody's points out in a new report, what makes the U.K. so vulnerable to a sovereign-debt crisis is the weakness of its banking system. Including private- and public-sector debt, the U.K. is one of the world's most leveraged countries: Its banks have assets equivalent to 400% of GDP and they are still highly dependent on wholesale funding, making them sensitive to market rates.

The new government will have to strike a very fine balance between cutting the deficit fast enough to satisfy the government-bond markets but not too fast to choke off growth. If it cuts too fast and tips the economy back into recession, the banks could be hit by a fresh wave of losses. But if it disappoints the gilt markets, banks could be hit by far higher funding costs, damaging their ability to lend—and triggering a fresh recession.

What cuts will be required to satisfy the gilt market isn't clear. What isn't in doubt is that investors will insist the deficit reduction starts immediately. In the parallel universe of the campaign, Gordon Brown repeatedly claimed no other country was cutting spending this year. Back in the real world, Greece, Portugal, Spain and Ireland are doing just that.

If the markets insist on cuts as deep as those countries—and the latest slide in the markets may force them to make deeper cuts still—then the new government really can expect, in the words of Bank of England Gov. Mervyn King, to become so unpopular it is out of power for a generation.

Raising the VAT will be the easiest decision the new chancellor ever gets to take. How about cutting public-sector pay by 15%, as Ireland has done? Or cutting child benefit by 10% as Ireland has done? Or raising the retirement age to 67, as Greece has done? The Tories proposed only to freeze public-sector pay for one year; to maintain benefits and raise the retirement age by just one year from 2016. Far tougher measures will be required to convince the markets the U.K. is serious.

The violence in Greece is a warning of what can happen when sudden cuts are imposed on an unsuspecting electorate. George Papandreou was elected prime minister on a platform of increased spending. Although all the U.K. parties acknowledged the need to cut the deficit, the lack of detail meant that the only policy commitments that resonated with voters were spending ones.

The euro zone does offer some clues as to what may be required of the new government. For example, until the latest slide, Ireland remained largely unscathed by the sovereign-debt crisis despite a wrecked banking system and a huge deficit, which demonstrates the credibility to be gained by taking tough actions early. And Wednesday's joint statement by both of Spain's main political parties on banking-sector reform underlined the need to seek as wide a national consensus as possible for tough measures.

Whoever tops the U.K. poll is unlikely to feel like a winner for long. Voters will return from their holiday from reality to find the house has been ransacked. A new dawn indeed.

What's News

■ **Alcatel-Lucent's net loss** widened to $660.3 million in the first quarter, and the telecom-equipment maker said a shortage of electronic components meant it couldn't fulfill some orders. **19**

■ **U.S. Treasury Secretary** Geithner told a panel that regulators could have done more to address the financial meltdown in 2008, but flaws in the regulatory system limited the ability to respond. **17**

■ **U.S. productivity rose** 3.6% in the first quarter, slowing from last year's breakneck pace. New claims for jobless benefits fell. **9**

■ **Hermès said** first-quarter sales jumped 19%, the latest luxury purveyor to unveil a strong rebound after last year's sales were knocked by the economic crisis. **18**

■ **France's navy determined** where to look for the black boxes from an Air France jet that crashed into the Atlantic Ocean in June. **8**

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Africa Dispatch

wsj.com/africa

"Nobody wants to miss the continent's economic takeoff when it happens."

Peter Wonacott reporting from the World Economic Forum on Africa

Continuing coverage

Who's moving into Number 10? Find out now, with detail and analysis, at **europe.wsj.com**

Question of the day

Vote and discuss: How low do you think the euro will go against the dollar this year?

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

Previous results

Q: Does the Greece aid avert a broader sovereign-debt crisis in Europe?

Yes **14%**

No **86%**

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NEWS

Most people carry Neanderthal genes

Team finds up to 4% of human genome comes from the extinct species, the first evidence it mated with Homo sapiens

By Robert Lee Hotz

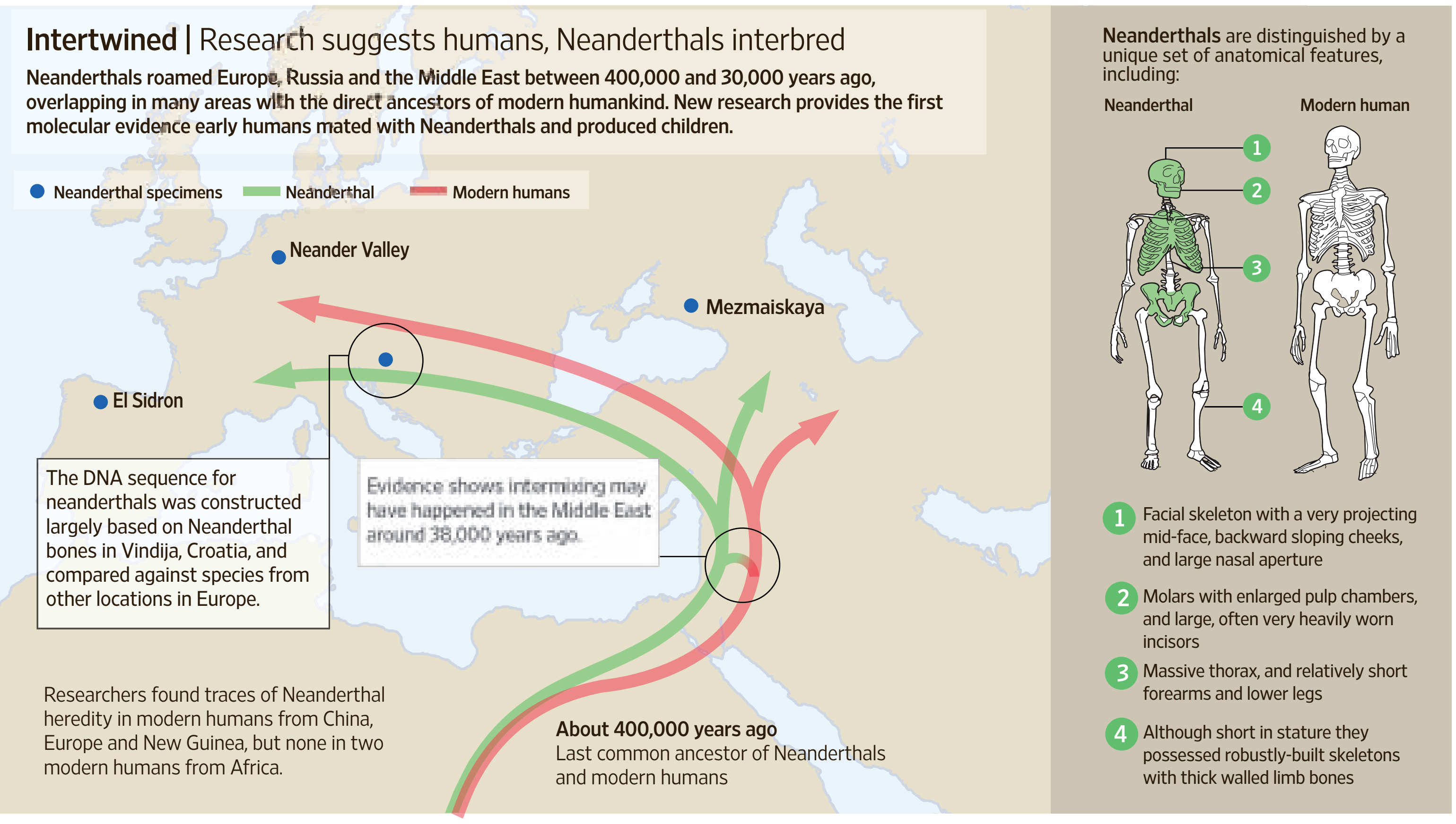
The burly Ice Age hunters known as Neanderthals, a long-extinct species, survive today in the genes of almost everyone outside Africa, according to an international research team who offer the first molecular evidence that early humans mated and produced children in liaisons with Neanderthals.

In a significant advance, the researchers mapped most of the Neanderthal genome—the first time that the heredity of such an ancient human species has been reliably reconstructed. The researchers, able for the first time to compare the relatively complete genetic coding of modern and prehistoric human species, found the Neanderthal legacy accounts for up to 4% of the human genome among people in much of the world today.

By comparing the Neanderthal genetic information to the modern human genome, the scientists were able to home in on hints of subtle differences between the ancient and modern DNA affecting skin, stature, fertility and brain power that may have given Homo sapiens an edge over their predecessors.

"It is tantalizing to think that the Neanderthal is not totally extinct," said geneticist Svante Pääbo at the Max Planck Institute for Evolutionary Anthropology in Leipzig, Germany, who pioneered the $3.8 million research project. "A bit of them lives on in us today."

The discovery is the climax of a vociferous scholarly debate over the fate of the Neanderthals, a big-brained and barrel-chested group who roamed Europe, Russia and the Middle East between 400,000 years and 30,000 years ago, overlapping in many areas with the direct ancestors of modern humankind. Their remains were the first human-like fossils ever found. For more than 150 years, most scientists have considered the species one of evolution's failed experiments, one that died out—or was killed off—when it could not compete with more advanced Homo sapiens.



Previous fossil DNA studies, based on more fragmentary genetic samples, showed no evidence that Neanderthals left any traces in the modern human genome, as the complete set of an organism's genetic inheritance is called.

The new findings arise from a technological revolution in the study of ancient biology. Researchers used high-speed, genome-sequencing machines from 454 Life Sciences and Illumina Inc. to resurrect the information entombed in fossil DNA.

For their analysis, Dr. Pääbo and his colleagues extracted DNA mostly from the fossil remains of three Neanderthal women who lived and died in Croatia between 38,000 and 45,000 years ago. From thimblefuls of powdered bone, the researchers pieced together about three billion base pairs of DNA, covering two-thirds of the Neanderthal genome.

In research published Thursday in Science, the researchers compared the Neanderthal DNA to the genomes drawn from five people around the world: a San tribesman from South Africa; a Yoruba from West Africa; a Han Chinese; a West European; and a Pacific islander from Papua, New Guinea. Traces of Neanderthal heredity turned up in all but the two Africans.

From that pattern, the researchers deduced that prehistoric humans encountered their Neanderthal mates in the Middle East as small human bands first migrated out of their African homeland. There may have just been a few encounters.

Based on these findings, several anthropologists questioned whether Neanderthals should continue to be considered a separate species. "I really think when you get up to 2%-to-5% genetic overlap, it is probably not wise to think of these as a separate species," said anthropologist Fred Smith at Illinois State University who studies Neanderthals.

In the long run, the researchers hope that they can use the Neanderthal genome as a yardstick against which they can measure evolutionary changes in more modern human genes that may have contributed to the success of Homo sapiens.

Despite its recent advances, the field of molecular anthropology is treacherous terrain. Bones are easily sullied as they decompose. Microbes so thoroughly infiltrated the Neanderthal bones that almost 99% of the DNA the researchers found actually belonged to bacteria and had to be painstakingly excluded. They also can be easily contaminated by modern human DNA when they are excavated and handled.

Indeed, Dr. Pääbo and his colleagues were publicly embarrassed when an earlier analysis of Neanderthal DNA turned out to be thoroughly contaminated by modern human genes from lab workers. To avoid such errors in the new study, they tagged each Neanderthal DNA strand with a unique molecular barcode, to distinguish it from any extraneous genetic material.

Oil hits shore in U.S. as push to contain leak advances

Continued from first page

said Thursday during a visit to Biloxi, Miss., that the spill was likely to be a long-term event.

Meanwhile, the cause of the explosion that sank **Transocean** Ltd.'s rig remained unknown, Chief Executive Steve Newman said Thursday.

"At this point we do not know the cause of the fire and explosion," Mr. Newman told investors and analysts in an earnings conference call. "We believe it is inappropriate to speculate on what may have caused the catastrophic failure of a cased and cemented well" before the investigation concludes, he added.

The executive said an acoustic control system to automatically shut down the well, which is required in drilling operations in places like the North Sea but not in the Gulf of Mexico, would just be "one of many alternative means" that are already in place to prevent a blowout. He said that it was unlikely that "adding an acoustic control system changes that picture meaningfully."

Mr. Newman said that the Discoverer Enterprise, a deepwater drillship, was prepared to mobilize to the spill site about 64 kilometers off the Louisiana coast under its existing contract with **BP** PLC. The drillship has oil-storage capacity and it could be used to store the crude captured by a dome that BP plans to place over the leaking well. The ship "is ideally suited to be able to undertake these kinds of operations," Mr. Newman said.

Addressing the issue of energy-industry regulation, Mr. Newman said, "I don't think that the administration is going to act rashly....The industry and the administration will implement whatever regulatory requirements are justified" after a thorough investigation of the incident, he said.

Transocean Chief Financial Officer Ricardo Rosa said that the company expected to receive $560 million in insurance proceeds, of which it already has received about $401 million.

About 5,000 barrels of oil a day is pouring from the well, creating a massive sheen that has been floating on the Gulf for more than two weeks. As the sheen moved closer to land, crews were frantically laying boom and taking other steps to prevent it from oozing into delicate coastal wetlands.

A pinkish oily substance was lapping at the shore of New Harbor Island, washing into thick marsh grass. Offshore, birds dove into the water amid lines of orange oil, but none appeared to be in distress. There were numerous dead jellyfish, some washing up on the shore. It is nesting time for sea gulls and pelicans and the danger is they may be taking contaminated food or oil on their feathers to their young.

At sea, some boats were using skimmers to suck up oil while others were corralling and setting fire to it to burn it off the surface.

The Joe Griffin, the ship carrying the containment box that will be lowered to the seafloor, arrived Thursday morning at the leak site. The waters were calm Thursday. Thick, tar-like oil with a pungent scent surrounded the boat as far as the eye could see.

Workers hoped to have the device down at the seabed by Thursday evening, but it will likely be Sunday or Monday before it is fully operational and they know if it is working. The semi-submersible drilling vessel Helix Q4000 was preparing to lift the box from the Joe Griffin with a crane and lower it to the seafloor. That was expected to happen later Thursday afternoon.

Oil has been leaking in three places since the explosion. One small leak was capped Wednesday. The containment box will be lowered over a much bigger leak in a pipe that is responsible for about 85% of the leaking oil.

The rest of the oil is coming from the blowout preventer at the well, a heavy piece of machinery designed to prevent blowouts that failed in the April 20 explosion.

The containment box has a dome-like structure at the top that is designed to act like a funnel and siphon the oil up through 1,500 meters of pipe and onto a tanker at the surface.

Homeland Security Secretary Janet Napolitano said at a briefing in Biloxi, Miss., that officials were planning for the worst even though they hoped the device would work. "If it does, of course, that will be a major positive development," she said.

BP engineers are also examining whether the leaking well could be shut off by plugging it from the top instead of drilling a relief well to cap it from the bottom. The technique—called a top kill—would use a tube to shoot specialized mud and concrete directly into the top of the leaking blowout preventer, BP spokesman Bill Salvin said.

The process would take two to three weeks, compared with the two to three months needed to drill a relief well. No decision has been made on whether to use the technique.

Separately, the dispersants used by BP to break up the oil will come under scrutiny next week when a Senate panel examines the federal government's role in protecting the ocean.

—Angel Gonzalez, Siobhan Hughes and the Associated Press contributed to this article.

BRITISH ELECTIONS

Next government has list of big challenges ahead

Victor will face deficit and sluggish economy, among other issues

By Natasha Brereton

LONDON—Whoever wins the British general election will enjoy a fleeting honeymoon. At the top of the to-do list: restoring the still-fragile economy while convincing investors that the government is serious about cracking down on its burgeoning budget deficit.

U.K. Election 2010
WSJ.com/UKElection

That task has been made all the more pressing by the turmoil in Greece, where harsh austerity measures have sparked strikes and protests that turned violent Wednesday, leaving three people dead in a firebomb attack on a Greek bank.

The parallels with Greece shouldn't be overdrawn.

As Bank of England Gov. Mervyn King has stressed, the maturity structure of U.K. public debt is much longer than that of other economies—almost twice that of any other country, in fact.

While international ratings agencies have threatened to cut the U.K.'s triple-A credit rating if the next government doesn't take aggressive steps to put its finances on a sustainable path, the top political parties have prepared the public for major belt-tightening.

But, whether he said it or not, Gov. King's reported comment that the winning party will be out of power for a generation because of the austerity measures does strike a chord.

"To take the ax to public spending on the scale required would be tough in normal times, but it is even harder now because politicians are so universally distrusted," said Jonathan Hopkins, senior lecturer in comparative politics at the London School of Economics.

In a warning of what is to come, the European Commission said Wednesday that the U.K. will have the largest budget deficit in the 27-member European Union in the 2010 calendar year, and that it will have to borrow more than it expects this fiscal year and next.

The Labour Party has promised to reduce the structural deficit by two-thirds by 2015, but the rating agencies have criticized it for moving too slowly.

The Conservatives have pledged to eliminate most of the shortfall over the next Parliament, which can stand until 2015 at the latest.

One factor that should help the next administration in its task may, ironically, be the investments the government made in the U.K.'s struggling banks during the dark days of the credit crisis. It now holds an 84% stake in **Royal Bank of Scotland Group** PLC and a 41% stake in **Lloyds Banking Group** PLC.

If shares in those two banks double in price over the next couple of years, as some analysts predict, that could yield the government a profit of some £60 billion (about $90 billion).

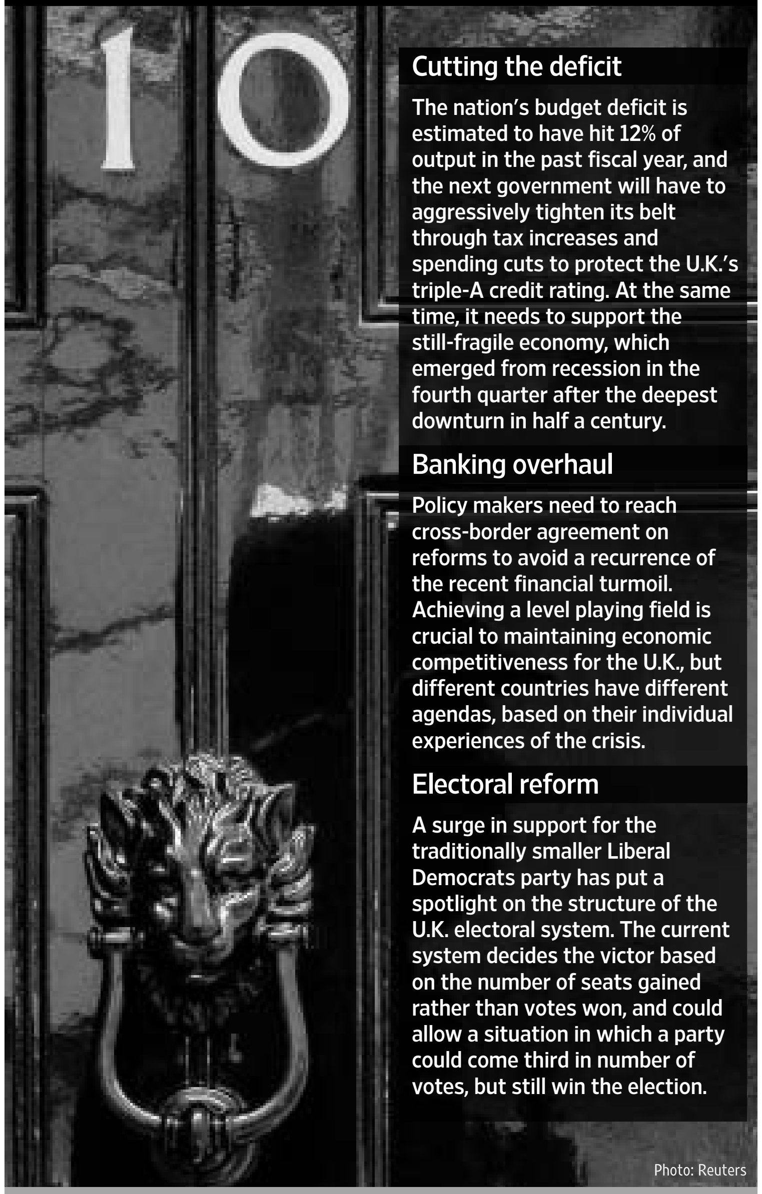
But the legacy of the turmoil will continue to pose significant challenges.

Officials are striving to reach cross-border agreement on ways to make the financial system less risky, even though every country endured its own unique version of pain from the crisis.

International policy makers are working on a multitude of measures to avoid a repeat of the crisis, ranging from limiting the activities of deposit-holding banks to creating so-called living wills that aim to prevent contagion if a systemically important financial institution gets into trouble.

But because every country experienced the crisis in its own way, the solutions to their woes themselves will also be unique, making a universal set of rules problematic.

Prime headaches | Challenges ahead for the PM



Cutting the deficit

The nation's budget deficit is estimated to have hit 12% of output in the past fiscal year, and the next government will have to aggressively tighten its belt through tax increases and spending cuts to protect the U.K.'s triple-A credit rating. At the same time, it needs to support the still-fragile economy, which emerged from recession in the fourth quarter after the deepest downturn in half a century.

Banking overhaul

Policy makers need to reach cross-border agreement on reforms to avoid a recurrence of the recent financial turmoil. Achieving a level playing field is crucial to maintaining economic competitiveness for the U.K., but different countries have different agendas, based on their individual experiences of the crisis.

Electoral reform

A surge in support for the traditionally smaller Liberal Democrats party has put a spotlight on the structure of the U.K. electoral system. The current system decides the victor based on the number of seats gained rather than votes won, and could allow a situation in which a party could come third in number of votes, but still win the election.

Photo: Reuters

10 Downing Street in London

Traders bet on winner's ability to cut debt

By Neil Shah

As Britain went to the polls Thursday, investors were betting that the winner of the U.K. election will be able to tackle the country's massive fiscal problems and prevent a Greek-style debt crisis.

Britain's financial markets have improved in recent weeks, despite the country experiencing its tightest election race in nearly two decades. Prices of U.K. government bonds have rallied significantly, allowing the British government to borrow at a lower cost from private markets.

Pressure on the next government to reduce the nation's debt will also intersect with the competing concern to keep the tentative economic recovery on track.

And the U.K. pound has been surprisingly resilient, though it swooned Thursday afternoon amid worries about Europe's debt woes and pre-election jitters. It now buys $1.4846, compared with a low of $1.4817 in late March. The euro has dropped nearly 4% this year against the pound.

Given the unpredictability of Britain's election outcome, many City banks were staffing desks overnight and investors were set to come to work early Friday. Philip Laing, investment director for government bonds at Standard Life Investments, planned to get in around 4 a.m. or 5 a.m., along with other traders on his team. Trading of futures contracts tied to U.K. government bonds kicks off at 1 a.m. Friday.

But it is likely that many investors will simply hold their fire and wait for what type of minority or coalition government emerges from any hung Parliament scenario. "The election result might be a false dawn," said Standard Life's Mr. Laing.

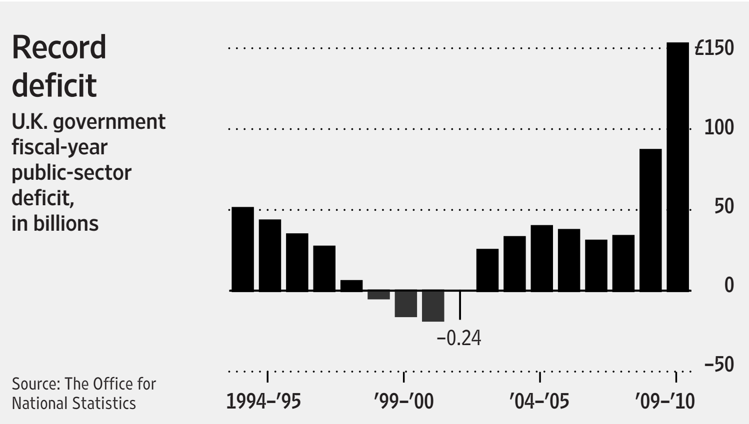
Britain's blue-chip FTSE-100 stock index, meanwhile, may not move that much at all on Friday, given that many of its component companies do a lot of their business overseas, making them more linked to the global economy than Britain's.

Investor sentiment surrounding the U.K. election has become mildly more upbeat in the past few months as traders have grown more comfortable with the notion of a so-called hung Parliament, where no political party has a majority.

Opinion polls point to such an outcome, but traders think a working coalition could still deal reasonably well with Britain's burgeoning deficit, which stands at around 12% of gross domestic product and is among the highest in the industrialized world.

Such action is crucial, since ratings agencies have warned that the U.K. risks losing its top-notch triple-A credit rating if it doesn't take credible steps to get its fiscal position under control.

A cut to Britain's credit rating would rattle investors across the globe and push the country's cost of borrowing higher at a time when its debt load, which equals some 70% of GDP, is already high and rising. By contrast, Greece's debt-to-GDP ratio is above 100%.



Pressure on the next government to reduce the nation's debt will also intersect with the competing concern to keep the tentative economic recovery on track. Britain's economy grew just 0.2% in the first quarter of this year. While recent figures on the U.K.'s manufacturing sector and exports have been encouraging, other parts of the economy remain weak. Figures on Thursday showed that the expansion of Britain's key services sector slowed unexpectedly in April.

In the markets, fear of a hung Parliament has also given way to other fears, chiefly the euro-zone's Greece-fed debt crisis.

In the past few weeks, investors have flocked to the British government-bond market in search of safety. That has pushed the interest rate on Britain's benchmark 10-year bond, which moves inversely to its price, down to 3.79% from above 4% last week. That is far below the 4% to 5% average that Britain has paid to borrow over the past five to 10 years.

"The markets have convinced themselves that something will be done," said Colin Harte, director of fixed income and currencies at Baring Asset Management in London. "But I think there is still some room for disappointment."

The most likely outcome is for Britain's opposition Conservative Party, which leads in the popular vote, to form a coalition government with other parties to secure a bigger foothold in Parliament.

In this scenario, the pound could fall in the near term, possibly sharply, but then eventually rise as investors express relief over the formation of a new government. Conservative leader David Cameron is pushing for faster and deeper public-spending cuts to fix Britain's finances. Baring's Mr. Harte expects a Conservative coalition to push sterling up to about $1.55.

But there is still plenty of room for surprises that could roil the financial markets.

For one thing, many British voters have stayed undecided until now. That increases the chances of unexpected outcomes.

If Mr. Cameron wins a clear majority of seats in the House of Commons, the pound could jump to $1.60 or $1.65 as confidence grows in Britain's ability to fix its finances, investors say.

Another risk is if the winner of the most seats in Parliament ends up taking a long time to forge an alliance with other parties, such as the Liberal Democrats, traditionally Britain's third-largest party.

A protracted period of horse-trading could test investors' resolve, sparking a loss of confidence and perhaps a selloff of U.K. assets or at least prompting spikes of market volatility.

The Conservatives might also end up forging a coalition with Britain's tinier parties—or try to go it alone as a minority government. Both scenarios are considered more "fragile" than a coalition with the larger Liberal Demcorats and economists would see the pound weakening, perhaps falling to $1.35 or $1.40 in such cases.

"There are going to be trading opportunities in this," said John Stopford, co-head of fixed income at Investec Asset Management in London. "We're sitting in a kind of no-man's land."

BRITISH ELECTIONS

Close call | Possible outcomes of the U.K. election

In U.K. elections, one party typically wins a majority of seats in the House of Commons and the leader of that party becomes prime minister.

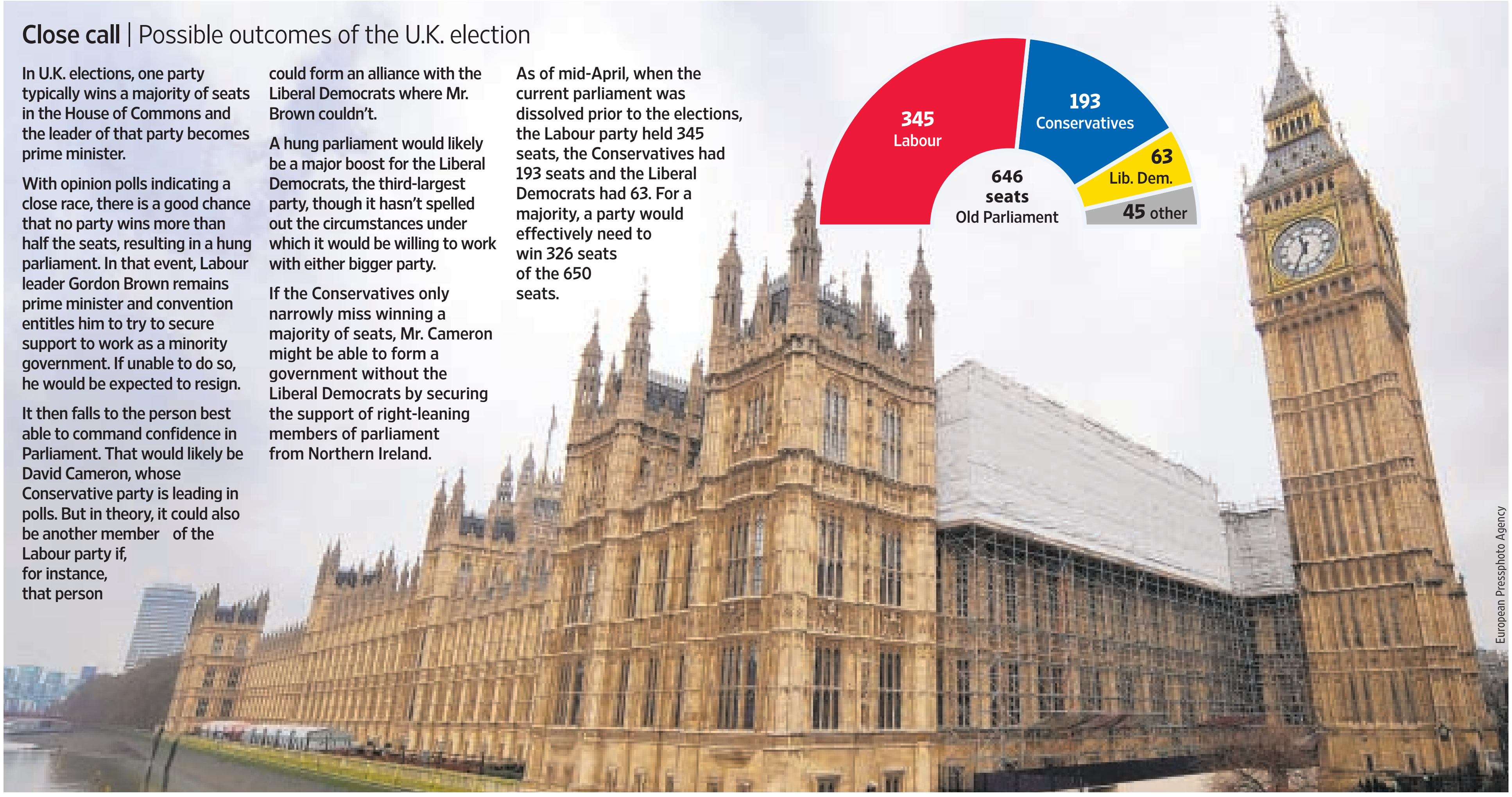
With opinion polls indicating a close race, there is a good chance that no party wins more than half the seats, resulting in a hung parliament. In that event, Labour leader Gordon Brown remains prime minister and convention entitles him to try to secure support to work as a minority government. If unable to do so, he would be expected to resign.

It then falls to the person best able to command confidence in Parliament. That would likely be David Cameron, whose Conservative party is leading in polls. But in theory, it could also be another member of the Labour party if, for instance, that person could form an alliance with the Liberal Democrats where Mr. Brown couldn't.

A hung parliament would likely be a major boost for the Liberal Democrats, the third-largest party, though it hasn't spelled out the circumstances under which it would be willing to work with either bigger party.

If the Conservatives only narrowly miss winning a majority of seats, Mr. Cameron might be able to form a government without the Liberal Democrats by securing the support of right-leaning members of parliament from Northern Ireland.

As of mid-April, when the current parliament was dissolved prior to the elections, the Labour party held 345 seats, the Conservatives had 193 seats and the Liberal Democrats had 63. For a majority, a party would effectively need to win 326 seats of the 650 seats.



European Pressphoto Agency

Voters go to the polls in a tight race

People express frustration and a desire for change in districts around the country, but many remain undecided

U.K. voters went to the polls Thursday after one of the closest and most unpredictable campaigns in memory, in an election that itself could have a cliffhanger result.

*By **Alistair MacDonald, David Enrich** And **Jeanne Whalen***

The opposition Conservative Party and its leader, David Cameron, were long favored to defeat Prime Minister Gordon Brown's ruling Labour Party and return to power for the first time in 13 years. But the Conservatives slid in the polls this spring as Mr. Cameron's economic message failed to resonate.

Then last month, the race became a multifront war when Britain's No. 3 party, the Liberal Democrats, surged after leader Nick Clegg's star-making turn in televised debates. Mr. Brown, meanwhile, took a hit when a live microphone caught him referring to a voter he had just met as "bigoted," prompting a humbling round of apologies from the prime minister to the 65-year-old woman he insulted.

In the home stretch of the campaign, the Tories' lead solidified, and a final round of polls heading into the ballot indicated that the Conservatives were in position to win the largest share of the vote. But the Tories could still fall short of winning the 326 seats needed to win a majority and avert a so-called hung Parliament, in which it would need to seek support from other parties to govern.

That had campaign watchers bracing for a long night and uncertain outcome on Thursday. Generally mild weather across the U.K.—and even sunshine in London—raised the prospect of a strong turnout across the country, which observers say favors Labour. Election workers at several locations described turnout as strong.

The election is coming down to the wire in Richmond, an affluent district on the western outskirts of London. The district is represented by a Liberal Democrat, Susan Kramer. But a Conservative candidate, Zac Goldsmith, is threatening to grab the seat and hustled for votes in the city center in a blue Conservatives windbreaker branded "I back Zac."

At the Richmond Lending Library, Mary Chapler, an 87-year-old retiree, said she voted Conservative out of disgust with 13 years under Labour and the bleak state of the U.K.'s public finances.

Alfred Dawson, a 75-year-old retiree, voted for the Liberal Democrats for the first time out of frustration with the two larger parties. "The other two have been in so often and never seem to get anything done," said Mr. Dawson. "It's time for a change."

Underscoring the uncertain nature of this election, many voters across Britain were undecided even on Election Day.

In Leyton and Wanstead, a working-class east London constituency that is a Labour stronghold, Simone Henriques hadn't made her mind up as she headed into the polling booth. Ms. Henriques, a Labour supporter, had been impressed by the performance of Mr. Clegg. But highlighting some analysts' belief that the Liberal Democrats could fade at the ballot box, Ms. Henriques, a manager of a wine bar, was considering voting for Labour. "I'll make my mind up when I get into the booth," she said.

Another toss-up constituency is Gillingham and Rainham in the county of Kent in southeast England, where Labour narrowly beat the Conservatives in 2005.

Several voters leaving a polling station in Gillingham said they voted for the Liberal Democrats because they wanted change.

In Leytonstone subway station, Sirag Khan has charted the election through the front pages of the newspapers he sells. The 50-year-old can't remember an election where parties' fortunes have waxed and waned as much as this one.

First, Mr. Cameron was virtually crowned the next prime minister by the media, then Mr. Brown made a comeback, and more recently the upstart Mr. Clegg was splashed on front pages. Now papers are leaning toward the Tories, but Mr. Khan believes they are still unsure.

WSJ.com

Bloomberg News

- Live updates as key battlegrounds are decided and the new U.K. government takes shape.
- See complete results on our U.K. election map.
- Political analysis from Iain Martin on his U.K. politics blog.
- The Source blog track reactions from global financial markets and business leaders.
- See the latest photos, videos and graphics.

EUROPE NEWS

Contagion fear hits euro

Shared currency collapses to $1.2510; 'cavalry is not coming yet'

By Tom Lauricella

The euro collapsed and European bond and stock markets sold off sharply as investors reacted with disappointment to the failure of the European Central Bank to signal any heightened concern about the spiraling debt crisis.

Even as the Greek parliament approved the €110 billion ($141 billion) package from the European Union and International Monetary Fund, the common currency was falling, eventually hitting $1.2510, its lowest level since last March against the U.S. dollar. It also slid sharply against the Swiss franc as traders said the Swiss National Bank appeared to abandon months-long efforts to prevent their currency from rising, at least for the time being.

Bearish sentiment against the euro has been building for months, with traders and longer-term investors, such as mutual funds, placing bets that the euro would decline against backdrop of the Greek debt crisis.

But the dam broke Thursday following a meeting of the ECB's governing council, when, in the eyes of market participants, ECB President Jean-Claude Trichet, seemed to focus on potential future inflation issues rather than the sovereign-debt crisis. In particular, Mr. Trichet said the ECB council didn't discuss the possibility of stepping in and buying European government bonds as a way to help stabilize the markets.

As far as the ECB is concerned, the day's news suggested "the cavalry is not coming yet and [the crisis] might have to get worse to prompt assertive action," said Sophia Drossos, co-head of global foreign-exchange strategy at Morgan Stanley.

"Investors were hoping that President Trichet would give some sense of taking extraordinary measures for trying to contain the contagion," Ms. Drossos said. "Instead he gave the impression that the ECB is going to reactive rather than proactive and that hurt sentiment" toward the euro, she said.

European bond markets also reacted with big price declines for heavily indebted countries, sending yields soaring.

Adding to the nervousness was a report from Moody's Investors Service reinforcing the idea that the crisis in Greece won't be contained to that country.

The spiraling sovereign debt crisis has started to create a funding crisis for European banks, because investors that have traditionally lent banks short-term funds fear those banks could be hit by large losses on their holdings of bonds issued not just by Greece, but also Portugal and Spain, which have high debt levels.

The euro was at $1.2624 late Thursday in New York, down from $1.2821 late Wednesday. The dollar was at 90.01 yen, from 93.76 yen a day earlier, while the euro was at 113.63 yen, down from 120.20 yen on Wednesday.

Agence France-Presse/Getty Images

A protester shouts antigovernment slogans in front of the Greek parliament in central Athens on Thursday.

Greek parliament clears bill

By Nick Skrekas
And Alkman Granitsas

ATHENS—Greece's parliament on Thursday passed the three-year €30 billion ($38 billion) package of austerity measures, as had been expected. The bill passed by 172 votes, surpassing the 151 votes needed for approval. Votes against totaled 121.

The vote followed an all-day debate against the backdrop of a mass protest and general strike Wednesday against the measures, which erupted into violence leading to the deaths of three people in a firebomb attack on a bank. Several thousand people gathered outside parliament to protest against the austerity measures.

The demonstration began peacefully but descended into clashes with police as protesters hurled water bottles, other objects and, later, Molotov cocktails in several small-scale episodes of violence. The police responded by firing tear gas and stun grenades to disperse the protesters.

Under the austerity measures, Athens will cut public-sector wages and pensions, freeze public- and private-sector pay, liberalize Greece's labor laws, and raise some taxes.

The government, facing spiraling borrowing costs and a debt payment this month that it can't meet, scrambled to pass the legislation for the three-year austerity program as part of an €110 billion loan deal with the European Union and the International Monetary Fund.

The socialist government already had 160 votes assured from its parliamentary majority but was joined by the far-right LAOS party. Some conservative-party parliamentarians broke ranks and voted for the bill.

Prime Minister George Papandreou said "we will not allow the country to fall into bankruptcy, or allow speculators to destabilize us and we will not fail to live up to our responsibilities because of political cost." He warned all parties not to vote against the bill, asking what would happen to pensions, wages and deposits if the country falls into bankruptcy. The main conservative opposition party voted against the bill, arguing the measures would lead to deeper recession and more austerity measures.

Will U.K. leader have room to move on deficit?

[Brussels Beat]

By Stephen Fidler

Whoever is sitting in 10 Downing Street on Friday after the U.K. general election will be hoping that what starts in the euro zone stays there. Britain, which looks like a candidate for the financial contagion that started in Greece, has so far escaped it.

That is despite the fact that it is now running the largest budget deficit in relation to the size of its economy in the entire 27-nation European Union as Olli Rehn, the European economy commissioner, pointed out on Wednesday. At a forecast 12% of gross domestic product this year, the deficit is larger than Greece's and Ireland's.

To cover this deficit and to repay £29 billion ($43.79 billion) of maturing bonds, the government has to continue to issue debt at levels unprecedented in peacetime: £187 billion of new gilt-edged securities this year. By the end of 2011, the European Commission forecasts U.K. debt will hit 87% of GDP, double what it was at the end of 2007.

With new debt growing at those proportions, the prime minister will have his work cut out to reduce deficits in order to stop the debt from snowballing. Bill Gross, the chief investment officer of Pacific Investment Management Co., the world's biggest bond fund, in January described the U.K. government bond market as "sitting on a bed of nitroglycerine."

With this sort of nervousness abroad, the U.K.'s so-far relatively smooth ride with the financial markets raises two questions: Why has it avoided the worst so far and can it last?

One obvious answer is that investors can't run from every financial asset at once: They have to put their money somewhere. What's happening now in the euro zone has led to a strong revision of investor views about the quality of euro assets and the strength of the European common currency.

That's in part because of the way the European Central Bank is reacting to the Greece crisis. The ECB has already reversed itself and said it will accept Greek government bonds as collateral for loans even if they are downgraded by rating agencies to junk. Now, speculation is growing that the ECB will start buying up euro-zone government bonds in the secondary market. All this suggests monetary policy could be looser than investors expected.

Stephen Jen of BlueGold Capital Management, a London-based hedge fund, estimates the 10% depreciation of the euro this year has cost central banks around the world €300 billion ($384.6 billion) in valuation losses. That threatens the euro's aspirations as a reserve currency, he suggests, and will lead to a reconsideration of the euro diversification strategy, he says.

The dollar has been the main beneficiary of this. But maybe the pound, despite its Election Day battering, has benefited too. Bank of England data show foreigners piled into U.K. government debt in March, buying £14.4 billion of gilts and £4.4 billion of treasury bills, more than in any month since the start of 2009.

Foreign buying though is a two-edged sword. The more foreigners buy into your government-bond market, the more prone you are to capital flight. This is why, when the International Monetary Fund assembles its indicators of sovereign-debt vulnerability, it looks at the proportion of it that's held abroad. For Greece, that figure is close to 80%. For the U.K., it's 23%—the lowest of the major EU economies.

With nervousness abroad, why has the U.K. avoided the worst so far and will this last?

The reason for that is the demand for gilts from the City of London's important financial institutions, in particular its insurance companies and pension funds. These institutions are also largely responsible for another factor reducing Britain's debt vulnerability: its average maturity, which is the longest in the world. The average maturity of the debt fell last year, but at 13.5 years, it is still twice that of France, Germany and Italy and three times that of the U.S.

In this, the government has benefited from a large-scale switch by investment institutions from equities toward long-dated gilts in order to better match their liabilities—personal pensions and life-insurance policies—with their assets. This goes back five years, says Steve Whiting, a spokesman for the U.K.'s Debt Management Office. It consulted with its investors, who said they had liabilities stretching out 30 years and beyond and asked it to issue ultra-long-dated gilts. "That's what we started doing in 2005," he said. In October and February, the DMO sold a total of £11.5 billion of gilts that mature in 2060. The only other country to issue 50-year paper since the start of 2009 is France.

There's another way to overcome a heavy debt burden: grow out of it, like the U.S. did after World War II. Britain, unlike Greece, Portugal, Spain, Italy and Ireland, controls its own monetary policy, which gives it leverage over its own exchange rate. That flexibility may help the U.K. avoid the deflation that now appears to be the only exit from the crisis for those countries locked in the euro.

A flexible exchange rate, a bond market in a good technical condition and a strong domestic investor base won't stave off a debt crisis forever if debt keeps rising, as Thursday's panic suggests. But it may provide a little more breathing space to reduce the deficit before the financial markets force his hand.

ECB forgoes bond buying

Bank leaves rates unchanged, doesn't discuss 'nuclear option'

By Terence Roth
And Geoffrey T. Smith

FRANKFURT—The European Central Bank's monetary council withheld its strongest weapon for stopping the Greek debt crisis from spreading to weaker euro-zone financial markets, but ECB watchers don't rule out a later deployment.

Called the ECB's "nuclear option" in the markets, the procedure would involve the purchase of government bonds in the secondary market. Rumors that it could be activated as early as Thursday were flatly dismissed.

"We did not discuss this option," ECB President Jean-Claude Trichet said Thursday at a news conference.

The ECB again left interest rates unchanged at its policy meeting in Lisbon, but attention in financial markets has been focused on what else the ECB can do to reassure investors and stanch the contagion effect of Greece's turmoil.

European credit markets, stocks and the euro all reacted negatively to the news that the ECB was taking no further action to contain the contagion threat. The cost of insuring Western European sovereign debt against default using credit-default swaps continued to rise after Mr. Trichet's address, with fiscally vulnerable countries Greece, Portugal and Spain particularly affected. The euro, meanwhile, fell to a fresh 14-month low against the dollar of \$1.2695, and bank stocks came under pressure.

The idea of the ECB buying government bonds is deemed the strongest means of putting to rest investor fears that government-bond issuance would no longer find buyers because of perceived default risk. Knowing that the ECB would step in might put a cap on speculation, but it also would be a huge undertaking and would amount to monetizing debt, which no central bank likes to do because it raises inflation risk.

The European Union treaty forbids primary purchases of bonds directly from national treasuries, but leaves room for indirect purchases of securities that have already gone on the market.

Bond purchases would slow or even reverse the run-up in premiums that fiscally weak governments have to pay on their debt, and also cap the rising price of insuring that debt against default. But analysts say the fallout could be devastating for the 16-nation euro currency and the primary institution behind it, the ECB. For that reason, it is a last-ditch measure that the ECB really hopes to avoid having to use.

"There is probably nothing more frustrating for policy makers [than] to see that the Greek program is already being brushed aside by the market, which is now entirely concentrated on a full-blown contagion across euro-area countries and euro-area asset classes and spilling over to global markets," analysts at the Royal Bank of Scotland wrote in a research note Thursday.

"Our belief that such a radical policy response is not going to be announced imminently [or today, for example] is based on the fact that most policy makers are still focused on the Greek issue as being the source of all the problems," RBS said.

Moody's Investors Service, the ratings agency, echoed that warning in a report Thursday, saying the potential contagion of sovereign risks to banking systems could spread to other countries such as Portugal, Spain, Italy, Ireland and even the U.K., which is outside the euro zone.

Those fears weighed on sovereign-debt markets, with the annual cost of insuring \$10 million of five-year Spanish government debt rising to \$260,000 after Mr. Trichet spoke, from \$230,000 immediately after a successful Spanish bond auction. Greece's insurance costs on \$10 million of five-year debt shot up to \$875,000 from \$815,000. Portugal's rose to \$455,000 from \$430,000 beforehand.

Credit-default swaps function like default-insurance contracts for debt. If a borrower defaults, the protection buyer is paid compensation by the protection seller.

"Trichet is going for the 'crisis, what crisis?' approach," said Gary Jenkins, head of fixed-income research at Evolution Securities. "I am not convinced that this denial of the problems facing European sovereigns is healthy. It is also difficult to believe that they didn't even discuss the possibility of buying government bonds," he said.

At the very least, the trouble in Greece is likely to stop in its tracks the ECB's gradual return to a "normal" monetary-policy stance.

Mr. Trichet, in his otherwise exhaustive opening remarks, didn't mention the bank's intention to withdraw surplus liquidity from the market, a goal it set in November.

Associated Press

ECB President Jean-Claude Trichet shades his eyes during a news conference following a meeting of the bank's monetary council in Lisbon on Thursday.

Reuters

Jürgen Rüttgers of the Christian Democrats shakes hands with his challenger Hannelore Kraft of the Social Democrats.

German elections loom

Polls in key state show Merkel's alliance falling behind the left

By Laura Stevens

DÜSSELDORF—Just three days before Germany's most populous state elects a new government, a new opinion poll showed Chancellor Angela Merkel's center-right alliance is falling behind left-leaning opposition parties.

Sunday's election in the state of North Rhine-Westphalia is seen partly as a referendum on Germany's federal government, a conservative-led coalition, and Ms. Merkel, who has come under fire for her handling of the economic crisis in the euro zone.

Only 43% of voters say they will back Ms. Merkel's Christian Democratic Union or its junior partner, the pro-business Free Democratic Party, in the regional election, according to opinion-polling institute Forsa. The center-left Social Democrats and Greens are ahead on 47%, while the radical Left stands at 5%, according to the poll.

If Sunday's vote mirrors that and other recent polls, the center-right will lose power in North Rhine-Westphalia, giving way to a left-leaning or bipartisan coalition. That would make it harder for Ms. Merkel's federal government to push through its economic policies such as tax and health-care reform, since it relies on the votes of North Rhine-Westphalia in Germany's upper house of parliament.

The regional election is due to take place just after Germany's national parliament in Berlin votes on a controversial €22.4 billion ($28.7 billion) rescue package for Greece on Friday, part of a €110 billion bailout by euro-zone governments and the International Monetary Fund.

The national parliament is expected to back the bailout, but opposition parties have used the Greek issue to accuse Ms. Merkel of failing to show leadership in the euro zone's escalating debt crisis.

The Social Democrats have accused Ms. Merkel of dragging her feet on the Greek bailout, thereby worsening the European crisis, in order to limit voter losses in North Rhine-Westphalia. Surveys show most Germans are unhappy about stepping up to cover what they see as Greece's irresponsibility. Ms. Merkel has denied any connection between the election and her stance on Greece.

In North Rhine-Westphalia, support for the Social Democrats or SPD has risen to 37%, according to Forsa, up four percentage points from two weeks ago, and pulling level with Ms. Merkel's CDU.

The SPD would celebrate such a result on Sunday as a sign of its revival after the party was heavily defeated in national elections last October. A strong SPD showing could turn the party's regional leader in North Rhine-Westphalia, Hannelore Kraft, into a figure of national importance. Failure to beat the SPD would cast doubt on the political future of the regional CDU leader and state premier, Jürgen Rüttgers.

Mr. Rüttgers has tried to rally support by warning of a radical government composed of the SPD, Greens and the anticapitalist Left. Together the three left-leaning parties could well achieve a majority in the state legislature, surveys show.

Kiev cool to Putin's gas plan

By Richard Boudreaux
And Alessandro Torello

MOSCOW—Ukrainian President Viktor Yanukovych responded coolly Thursday to a Russian proposal to merge the two countries' gas companies, saying even his Kremlin-friendly administration might ignore the idea.

His remarks signaled that Ukraine's leadership, after a flurry of agreements with Moscow during its first three months in office, is pondering limits on how far it will go to accommodate the country's powerful neighbor, especially in the sensitive field of energy.

The politically audacious proposal last week caught the government in Kiev off-guard. "It was an unexpected step," Mr. Yanukovych told reporters, according to his press service. "It does not mean that this question will be considered by Ukraine and resolved."

After years of strained relations, Ukraine is ready for closer ties with Russia, he added, but "our main policy is the protection of national interests."

Analysts say a merger would let Russia's OAO **Gazprom**, the world's largest gas firm, gobble up its much-smaller Ukrainian counterpart, **Naftogaz**, dominate Ukraine's domestic gas supplies and control a lucrative pipeline network that delivers one-fifth of Europe's gas.

The proposal, raised by Russian Prime Minister Vladimir Putin, stirred outrage among Ukraine's nationalist-led opposition just days after parliament erupted in a brawl while narrowly ratifying a 25-year extension of Russia's naval base lease in Crimea. Ukraine, battered badly by the economic downturn, got sharply lower prices for Russian gas in return.

Chris Weafer, chief strategist at UralSib Capital, a Moscow investment bank, said Mr. Putin apparently realizes that the merger proposal will not prosper but is paving the way for a more politically viable joint venture that would control Ukraine's pipelines.

"Putin was most likely 'flying a kite' with the suggestion of a full merger, to gauge the reaction in Kiev and Brussels and as a distraction in order to make Plan B, a joint venture ... more palatable," he said.

Mr. Yanukovych, in his first comments on the merger proposal, said Wednesday that the European Union should be part of any talks if Ukraine decides to consider it.

But the European Commission, the EU's executive arm, said Thursday any merger decision must come from Kiev and Moscow.

—William Mauldin contributed to this article.

Searchers near Air France 'black-box'

By David Gauthier-Villars
And Daniel Michaels

PARIS—Almost a year after an **Air France** jetliner crashed into the Atlantic Ocean, the French navy said it has determined where to look for the black boxes," devices that could provide essential information to understand what caused the accident.

Air France said if the new calculation was confirmed, it would be 'excellent news' in the process to establish the cause of the crash.

Since Flight AF447 crashed on June 1, 2009, killing all 228 people onboard, efforts to locate the flight-data and cockpit-voice recorders have been fruitless. The digital devices, which stopped emitting a beacon signal roughly 30 days after the accident, when their batteries ran low, are presumed to still be with the plane's wreckage deep under water, somewhere between Brazil and Senegal.

The French navy said Thursday that, after a lengthy analysis, it has concluded that signals recorded by one of its submarines during a search last summer had been emitted by the black boxes of the Airbus A330 plane.

Using the signals, the navy said it was able to significantly narrow down the search zone to a circle six miles in diameter.

"We recommend that authorities in charge of search operations focus on this area," navy spokesman Hughes d'Argentrê said.

Capt. d'Argentrê cautioned that recovering the black boxes remained a challenge because the area is still quite large—roughly the size of a city like Paris—and the terrain of the seabed is very mountainous.

France's Bureau d'Enquêtes et d'Analyses, or BEA, which is in charge of conducting the probe into the AF447 crash, said Thursday that a ship it has chartered to handle the ocean search was sailing near the area and would begin exploration as early as Friday.

Air France said in a statement that if the new calculation was confirmed, it would be "excellent news" in the process to establish the cause of the accident.

An Airbus spokesman said narrowing down the black boxes' location would be "a positive development." Airbus is a unit of **European Aeronautic Defence & Space** Co.

"We need to get the black boxes to learn more about why the tragic accident happened," the spokesman said.

The BEA has said the chain of events that brought down the plane remains unknown.

An early focus of the investigation into the crash has been the possible malfunctioning of the plane's speed sensors, or pitot tubes, which have a history of freezing and giving faulty speed readings on certain models of Airbus planes.

Iceland arrests ex-CEO of Kaupthing Bank

Associated Press

REYKJAVIK, Iceland—Icelandic authorities arrested the former chief executive of collapsed bank Kaupthing on Thursday—the first high-profile banker to be detained in the wake of the tiny Nordic country's financial crisis.

The special prosecutor tasked with investigating the Icelandic banking crash of October 2008 said that Hreidar Mar Sigurdsson is suspected of falsifying documents and breaking laws on stock trading for personal gain.

Mr. Sigurdsson is being held in police custody until a bail hearing Friday at the Reykjavik District Court. Prosecutor Olafur Thor Hauksson said he planned to ask that the former banker be kept in custody for two weeks to prevent the possibility of his tampering with evidence or interfering with the continuing investigation. Mr. Sigurdsson can appeal to the Supreme Court if the prosecutor's request is granted in the district court.

Mr. Hauksson was appointed by the Iceland's post-crisis government to investigate whether there was any criminal activity in the lead up to the banking crash that crippled Iceland's economy, sending its currency into a tailspin, frightening off foreign investors and forcing out the country's former leaders.

Britain's Serious Fraud Office is still carrying out its own investigation into suspected fraud at Kaupthing, with a focus on efforts by the bank to attract British investors to its "high yield" deposit account, Kaupthing Edge. About 30,000 British individuals, companies and organizations made an investment.

When it opened the investigation in December, the British agency said it would work with the Icelandic special prosecutor as it also looked closely at a series of decisions that appear to have allowed substantial value to be extracted from the bank in the weeks and days before its collapse.

The demise of Kaupthing, one of several Icelandic banks to collapse, sparked a political row between Reyjkavik and London because it failed after the British government invoked antiterrorist legislation to freeze the U.K. assets of another collapsed Icelandic bank, Landsbanki.

Britain's Treasury said the move was necessary to ensure the money that British savers had placed in the bank wouldn't be whisked back to Iceland. But Iceland's prime minister at the time, Geir Haarde, blasted the move as an "unfriendly act" and blamed the decision for inspiring panic that led to the subsequent collapse of Kaupthing.

A cross-party committee of British lawmakers was later critical of London's handling of the situation, saying that the government's statements on the ability and willingness of Reykjavik to compensate non-Icelandic account holders was "ultimately unhelpful."

Governor's setback at home may boost presidential bid

[Capital Journal]

By Gerald F. Seib

It's been a bad week for Minnesota Governor Tim Pawlenty. Of course, it's also been a good week for Republican Presidential Contender Tim Pawlenty.

Like every governor, Mr. Pawlenty has been locked in a struggle to make ends meet in the wake of a national economic crisis that has left states, even more than the federal government, strapped for cash, fighting deficits and straining to pay bills.

In Minnesota, Mr. Pawlenty has followed a single-minded strategy of dealing with the crunch by finding ways to cut state spending, rather than raise taxes. That's won him admiration in national conservative circles, but also has led to frequent battles with his Democratic-dominated state legislature and bouts of statehouse drama.

Pawlenty has followed a strategy of dealing with the crunch by cutting spending, rather than raising taxes.

Then, on Wednesday, the Minnesota Supreme Court threw out Mr. Pawlenty's boldest attempt to single-handedly cut spending. The court ruled, 4-3, that the governor improperly used a technique called "unallotting," under which he unilaterally reduces funds allocated for a specific program.

Minnesota has a law allowing unallotment, though it wasn't often used before. The court, led by a chief justice the governor himself appointed, ruled that by cutting money from a nutrition program for low-income residents, Mr. Pawlenty had exceeded his authority under that law. The decision calls into question not just the cuts in the nutrition program, but $2.5 billion in other cuts Mr. Pawlenty made in the same fashion.

That would be bad news for any governor. And indeed, it produces a mini-crisis, because the governor and the legislature now have to figure out how to deal with a funding hole in less than two weeks, before the legislature adjourns May 17. The governor and legislative leaders began negotiating Thursday over how to handle that.

On the other hand, all this may not be bad news if you are—as Mr. Pawlenty is—a potential 2012 Republican presidential contender establishing your credentials as a fiscal conservative. Pawlenty partisans note that, in the long run, the Minnesota Supreme Court ruling will stand as a graphic illustration that the governor has tried every means possible, and then some, to hold down spending as a way to attack the state's deficit problems.

And that, of course, has national significance at a time when the country faces a federal budget topping $1 trillion, which will compel voters to decide, this year and in the presidential election of 2012, who is best able to handle the red ink. In an interview just before the state court ruling, Mr. Pawlenty wasn't shy about warning that the travails states face now are a dress rehearsal for those the country will face in coming years.

"It's sort of a preview of coming attractions if we don't get this under control," he said.

On both the state and federal level, and regardless of which party is in charge, Mr. Pawlenty maintains, government's revenue and services simply don't match up any more. "The day of reckoning is coming," he says. "If you put aside political rhetoric you will see that this isn't a matter or right or left. It's a matter of junior high mathematics....There has to be a significant restructuring of government in the country."

Those are the grounds on which Mr. Pawlenty criticizes the health-care overhaul bill just signed into law by President Barack Obama. "It defined the problem as expanding access, not controlling costs," he said. And as such, he argues, it's out of step with the national mindset.

That thought leads Mr. Pawlenty to tick off his single favorite statistic: In Minnesota, from 1960 (the year he was born) until 2003 (when he took office), the state budget increased by an average of 21% every two years as the state legislature put together its biennial budget.

Mr. Pawlenty has brought that down to less than 2% per year. And now, spending actually is decreasing in real terms for the first time in the 152-year history of the state, his office says.

That has come at a price, sometimes a steep one. Mr. Pawlenty precipitated a 44-day strike by Minneapolis-St. Paul bus drivers in a dispute over retirement benefits a few years ago. He raised hackles by rejecting the recommendation of a health commission he appointed when it proposed raising tobacco taxes to cover health costs.

On the national stage, the advantage this creates for Mr. Pawlenty, at a time when Republicans are devoid of an obvious Washington figure to lead them into the next presidential election cycle, is that it gives him a stark narrative of fiscal restraint, somewhat in contrast to his soothing personality and low-key style.

Democrats will counter that there's no defining Pawlenty achievement, and no significant animating idea behind this record. Simply put, "there's nothing big that he's done," says Blois Olson, a leading Democratic consultant.

In sum, this week's events define what Mr. Pawlenty is: a classic, fiscally conservative Midwestern Republican governor. In a period of voter discontent, Republicans have two years to decide whether that's the right stuff for the times.

Productivity gains persist

Growth, at 3.6%, slows from last year in sign hiring may be picking up

By Sara Murray

U.S. productivity continued to surge in the first quarter, but growth slowed from the breakneck pace notched last year.

Separately, new claims for jobless benefits fell last week as the labor market gradually showed improvement.

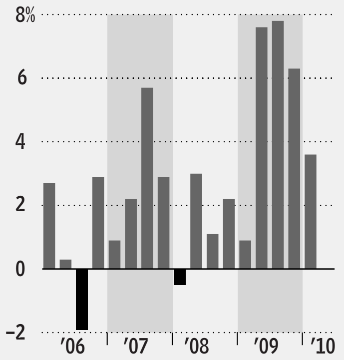
Nonfarm business productivity grew at a 3.6% seasonally adjusted annual rate in the first three months of the year, down from the 6.3% pace in the fourth quarter of 2009, the Labor Department said Thursday. Productivity growth is still exceeding historical averages, but experts said it was likely that the massive gains, which ranged from 6% to 7% for much of last year, were over. Over the past year, productivity has risen 6.3%, the largest gain in nearly half a century.

"Companies are still trying as hard as they can to achieve output gains without adding to their work forces," said Nigel Gault, an IHS Global Insight economist. "It's getting more difficult to do that."

While productivity growth is a boon for profits, it restrains employment and incomes. At a certain point, economists say, soaring productivity has to slow as companies step up operations that may not be essential in the short term but that affect the company in the long run, such as research and development or marketing strategy.

Output sliding

Quarterly change in output per hour at a seasonally adjusted annual rate



Source: Labor Department

Output rose 4.4% in the first quarter and hours increased 0.8%. Unit labor costs fell 1.6%, an indication that there is still little threat of inflation in the economy.

The manufacturing sector, which has been recovering fastest from the recession, offered the most obvious example that it was getting tougher for businesses to do more with less: Productivity at factories rose at a 2.5% annual rate in the first quarter, while output climbed 7.5%. However, hours also went up 4.9% as firms accelerated hiring to sustain this increase in output.

"Today's report provides the underlying fundamentals of why manufacturers finally returned to hiring workers early this year," said David Huether, chief economist for the National Association of Manufacturers.

With productivity still surging at a fairly high rate overall, the labor market is in for a slow recovery. Jobless claims are falling only gradually as employers have shied away from widespread hiring.

Initial jobless claims fell by 7,000 in the week ended May 1, to a seasonally adjusted 444,000, the Labor Department said Thursday. The four-week moving average, designed to smooth volatility in the data, fell by 4,750 to 458,500.

Continuing claims also dropped. Those claims—drawn by workers for more than one week—declined by 59,000 to 4.6 million for the week ended April 24.

This latest decline comes a day after a report by payroll giant Automatic Data Processing Inc. found that private-sector jobs grew by 32,000 in April while layoff announcements fell to a nearly four-year low.

The report by ADP only includes private payrolls, but on Friday the Labor Department is due to release its monthly jobs report for April, which will also include government hiring.

Economists are predicting that nonfarm payrolls will rise by 180,000. But in a sign that workers are still having trouble securing work, experts also expect the unemployment rate to remain at 9.7%.

U.S. NEWS

Fears rise U.S. is next

Greece crisis would likely spread in Europe before crossing Atlantic

By Bob Davis
And Mark Gongloff

Associated Press
Foreclosures have rocketed in the U.S. amid the economic crisis.

Investors and policy makers are starting to worry that the economic crisis in Greece could cross the Atlantic and undermine the U.S. economic recovery, in the same way that U.S. housing woes in 2008 battered Europe.

"What we have seen is that contagion"—economist-speak for a spreading crisis—"has gone global," says Harvard University economist Jeffrey Frankel.

Since late last year, Greece has presented several austerity plans to pare its debt burden, and is working through details of a €110 billion ($143 billion) rescue by fellow euro-zone nations and the International Monetary Fund. However, the promise of aid hasn't calmed European markets or investors.

U.S. Treasury officials have been quietly urging their European and IMF counterparts to move more quickly on the rescue plan to contain the damage, say U.S. officials. Lobbying was especially heavy during the IMF meeting in Washington in late April.

There are a number of ways that a crisis in Greece can spread to the U.S., say economists, though most would require Greece's problems to jump first to larger European countries, such as Spain.

By itself, Greece is far too small to have much effect directly on the U.S. Its economy is about 2% the size of the U.S.'s and takes in less than 0.1% of U.S. exports. But Europe as whole has powerful ties to the U.S. through trade, investment and finance. U.S. banks hold more than $1 trillion of European debt, according to the Bank for International Settlements.

Those ties can become weaknesses in bad times. One big surprise of the U.S. housing crisis was how many European banks held securities tied to worthless U.S. mortgages and how much they lost. A recession in Europe followed quickly on the heels of one in the U.S.

Even before the Greek crisis, the IMF estimated that the euro zone, whose economy contracted 4.1% in 2009 would grow just 1% this year. Anything short of that could curb U.S. exports and weaken what is expected to be a humdrum recovery.

Perhaps the biggest wild card is uncertainty itself. Some fear that Greece's problem with a heavy debt load will be mirrored in the U.S., U.K. and other wealthy countries.

Losses on loans to Greece and other weaker nations could produce big losses for European banks, which borrow from U.S. banks, causing a general panic and freezing lending.

Kandahar is key in Afghan plan

By Yochi J. Dreazen

FORT CAMPBELL, Ky.—The Army brigade that will lead the coming U.S.-led offensive in Kandahar began deploying to Afghanistan this week, signaling the final preparations for what is expected to be a pivotal battle of the Afghan war.

Hundreds of soldiers from the 1st Battalion of the 101st Airborne Division's 2nd Brigade Combat Team—a unit that parachuted into Normandy on D-Day—are en route to bases just north of Kandahar, the Taliban's home.

The rest of the brigade's roughly 3,200 soldiers will deploy in waves over the summer, suggesting that a large-scale offensive once thought to kick off this month won't start until June at the earliest.

U.S. military commanders say they want thousands of Afghan soldiers to join the push, but the Afghan brigade that has been earmarked for Kandahar is still being trained and equipped, contributing to the delay.

Gen. Stanley McChrystal, the top allied commander in Afghanistan, has said protecting the residents of Kandahar is the coalition's top battlefield priority this year.

Kandahar is southern Afghanistan's most populous city and was the Taliban's seat of power until it was displaced from the country by the U.S. in 2001.

In recent years, the armed group's fighters infiltrated the city, and set up networks of shadow courts and local-government institutions.

U.S. commanders see the coming offensive as a chance to test their new strategy for the war, which calls for protecting the Afghan people from Taliban intimidation, in an effort to diminish popular support for the group.

Current plans call for U.S. and Afghan troops to work on flushing Taliban fighters from villages and towns surrounding Kandahar and gaining control of the main routes in and out of the city.

Most Western forces will be housed in bases on the city's outskirts, according to officers familiar with the planning.

But U.S. forces also plan to build small outposts in many of Kandahar's neighborhoods—a tactic first used in Iraq.

"The plan is to live in the population centers in each district," said Col. Arthur Kandarian, the brigade commander.

"It's not a bumper sticker. The mission is to secure the people of Kandahar," he said.

Col. Kandarian, an Army Ranger who won a Silver Star in Iraq, said his soldiers expect a tough fight in Kandahar.

Violence has been on the rise there recently, with the Taliban assassinating local Afghan officials and bombing military, police and government targets throughout the city. "I think it's going be pretty hot," Col. Kandarian said.

Col. Kandarian's unit recently completed three deployments to Iraq.

Initially, the unit had been slated to deploy to Iraq to help wind down the war there.

Instead, Col. Kandarian and his troops got word just before Christmas that they would be heading to Afghanistan as part of the Obama administration's escalation of the conflict there.

The White House decision set off a frantic few months for the unit. Nearly 400 soldiers from the brigade began crash courses in Dari and Pashto, Afghanistan's main languages.

In February, Col. Kandarian and his top aides flew to southern Afghanistan to scout locations for new bases and to meet other senior commanders.

The following month, the entire brigade went to the military training facility at Louisiana's Fort Polk for exercises—complete with Afghan role players—designed to simulate the counterinsurgency fight in Afghanistan.

Soldiers from the brigade, many of whom have done combat tours, said they took the switch to Afghanistan in stride.

"It's sort of like when you build a house," said 33-year-old Sgt. First Class Nathan Stone.

"You may switch the rooms up a bit, but the foundation stays constant," he added.

The unit's history includes a famed bayonet charge against German positions in the French town of Carentan shortly after D-Day in World War II.

Kandahar is southern Afghanistan's most populous city and was the Taliban's seat of power until it was displaced from the country by the U.S. in 2001.

A short time ago, Col. Kandarian invited four World War II veterans to Fort Campbell to address his soldiers, many of whom had never met anyone who fought in the conflict.

One veteran told the soldiers that "it's amazing you guys just keep going back" for multiple tours in the war zones, Col. Kandarian recalled.

On an overcast day late last week, hundreds of soldiers from the brigade, along with their spouses, parents and children, crowded a parade ground at Fort Campbell for the 1st Battalion's so-called casing ceremony.

Lt. Col. Johnny Davis, the unit's commander, rolled up the unit's flag, draped with ribbons marking each of its earlier combat deployments, and placed it inside a camouflage case.

The flag will be unfurled in coming daysat the battalion's new base in the Zhari district of Kandahar province.

Lt. Col. Davis told his soldiers that they were deploying early as part of "the main effort" of the coming Kandahar offensive.

Army Spec. Jeffrey Cole, a radio operator on his second tour to Afghanistan, said he was aware of the dangers of a combat tour but eager to get under way after so many months of training.

"I'm looking forward to serving with this unit, ready to deploy and looking forward to making it home," he said.