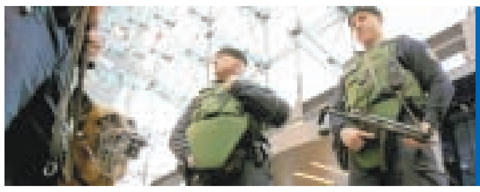

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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 205 | EUROPE | Thursday, November 18, 2010

DOWJONES
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EU mulls help, as Dublin resists

By Charles Forelle
And Marcus Walker

Associated Press

Irish Finance Minister Brian Lenihan, in Brussels on Wednesday, and other Irish officials are being pressured to accept a bailout for the country's banks.

BRUSSELS—European officials are pressing to recapitalize Ireland's wounded banks with money from an international bailout fund, indicating that the contours of an aid package to the country are taking shape even as Dublin insisted it didn't need help.

A team of officials from European institutions and the International Monetary Fund is heading to Ireland for talks that begin Thursday to assess the country's financial needs. Banks will be at the top of the list.

Ireland already has said it will commit as much as €50 billion ($67 billion) to put new capital into five wounded banks. Those funds replace money devoured by losses on bad property lending. Ireland says that is enough, but European officials—including some at the European Central Bank—aren't so sure, according to people familiar with the matter.

The talks this week will assess which of Ireland's banks might need more capital. The European experts will analyze "what kind of reorganizations are needed in Ireland," said Didier Reynders, the Belgian finance minister who leads the European Union's council of finance ministers.

Olli Rehn, the EU economy commissioner, reiterated that Ireland hasn't asked for help but said it would be possible for money from EU rescue facilities to flow to the Irish government with "a very strong emphasis on the restructuring of the banking sector."

When the EU and the IMF designed their €750 billion rescue funds in May, one problem they didn't foresee was an indebted country refusing to ask for help. A request for aid is needed to trigger a bailout. The expectation was that cash-strapped euro-zone nations would be only too happy to tap the bailout facility, and that Germany and other lenders would have to hold them back.

Instead, the euro-zone majority has been urging Ireland to take out loans, while Ireland's government is holding out because of the political stigma attached to asking for a bailout.

Germany, France and other euro governments have been pressing Ireland to accept help because they fear that the longer Ireland's crisis festers, the greater the risk that investors will also flee the bonds and banks of Portugal and Spain.

Signs on Wednesday weren't promising.

Fresh data showed that Spain's timid economy recovery stalled in the third quarter. Gross domestic product was flat from the second quarter, due to slumping investment and meager growth in exports.

Still unclear after meetings of finance ministers in Brussels on Tuesday and Wednesday was how large a package of aid to Ireland would be, and what it would cover.

A block of money for bank recapitalization would do little to address the Irish government's very real cash deficit, expected to run €16 billion next year. Ireland also has €6 billion in Treasury bills coming due from January to April, and it needs to retap debt markets to roll those over.

Please turn to page 4

The Quirk

World Watch

Editorial & Opinion

U.S. plans new review of stress-tested banks

By Deborah Solomon

WASHINGTON—The Federal Reserve will require all 19 banks that underwent "stress tests" during the height of the financial crisis to undergo another review of their capital base and their ability to absorb potential losses.

The Fed, in guidance issued on Wednesday, said the 19 banks must submit capital plans by early next year showing their ability to withstand losses under a set of conditions to be determined by the central bank, including "adverse" economic conditions. The central bank also issued a road map for banks that want to raise dividends or buy back stock, with regulators saying firms must show they have adequate capital in the next two years and demonstrate an ability to satisfy new global capital requirements.

Government officials said the new capital reviews weren't triggered by any particular concern about the health of banks but are instead part of the Fed's efforts to step up supervision in the wake of the financial crisis.

Unlike the first round of stress tests, which took place last year, the results of the new capital reviews won't be made public. Regulators made the first round public in large part to help assuage investor fears about the extent of losses at the nation's largest financial firms.

Concerns about the health of most large institutions have decreased, though investors remain somewhat nervous about the extent of losses banks may face if they are required to repurchase flawed mortgages.

In 2009, U.S. regulators tested 19 major bank-holding companies. At the time, they found that 10 of the firms required a total of $75 billion to reinforce their balance sheets. The stress tests and subsequent capital raisings were seen as helping the U.S. pull out of the financial crisis.

THE WALL STREET JOURNAL.
£1.50
Bahrain BD 1.50 - Egypt $1.75 (C/V)
Jordan JD 2 - Kuwait KD 1 - Oman OR 2
Qatar QR14 - Saudi Arabia SR 14
46
9 770921 986948

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Look east for economic 'super-cycle'

[Agenda]

By Patience Wheatcroft

While Ireland hovers on the brink of a bailout, Greece spells out yet more cuts and Portugal lurks in the wings of the euro-crisis drama, it takes a degree of chutzpah for a European institution to proclaim that "the world is in a super-cycle once again."

But, however gloomy it currently feels in the West, there is no denying that the world is going through "a period of historically high global growth," and if that should last for a generation or more, as this one seems set to do, then that would probably constitute a super-cycle in any economist's book.

Standard Chartered is the bank that has just produced a hefty tome documenting the scope of this phenomenon. The reason why it feels able to produce such an upbeat study at a time when Europe is beset by difficulties is perhaps not unconnected with the fact that this is a bank that has deliberately concentrated its efforts elsewhere in the world. For unlike the previous two super-cycles which it describes—the first from 1870 to 1913 and the second from 1945 until 1973—the current one is led by Asia.

That fact will hardly be a cause for surprise, given the excitement already occasioned by the rise of the BRIC countries—Brazil, Russia, India and China. Nevertheless, the speed at which Standard Chartered sees this cycle racing is remarkable, for it believes that by 2020 China will have overtaken the U.S. as the world's largest economy, significantly ahead of most projections.

This is not to underestimate the pace of progress in India: By 2030, the report estimates that Mumbai and Delhi will be established as two of the largest five global cities.

Agence France-Presse/Getty Images

Beijing shops and shoppers are experiencing the effects of inflation.

While the previous two super-cycles were restricted to the West, and the beneficiaries were a small proportion of the world population, this time round, the effects could benefit as many as 85% of the global populace. The good news for those currently contemplating the economic ills of their home territory is that the massive increase in world trade that is currently under way and set to gather steam should benefit the West.

The challenge for the West is to find the most effective means of benefitting from the trend east.

Peter Sands, the Standard Chartered chief executive, recently returned from the business summit that ran alongside the G-20 meeting in Seoul, is optimistic about the potential benefits for some developed nations in this changing world balance. Over the 20 years to 2030, the report estimates that the 27 countries currently in the EU will average annual growth of 2.5%. China, however, is put at 6.9%, with India achieving 9.3%. Those rates will mean that the relative shares of global GDP change dramatically, with the EU almost halving, to 14% from 27%, India growing to 10% from 2% and China soaring to 24% from 9%.

The overall cake, however, will have grown and the best of the West should be able to take full advantage of the potential new opportunities. But Mr Sands' message is that businesses that want to sell, particularly to China and to India, have to realize that "this isn't a sprint. Relationships in these territories are built up over a long time."

That is particularly true for the financial sector. No wonder that Standard Chartered can look at the mushrooming demand for financial services in these regions and feel optimistic about the future. **Prudential**'s plan to buy **AIG** in Asia, aimed at capitalizing on just that market but thwarted by its investors, may yet be seen as one of the big lost opportunities for a U.K.-based business to enjoy the fruits of this super-cycle.

The dramatic change in the shape of the world by 2030 is illustrated in a graphic showing the growth in the middle class in the next 20 years. That of Asia Pacific expands to the extent that it way exceeds that of the rest of the world. Sheer scale of population becomes one of the main driving forces as education and innovation enable that work force to generate wealth.

There will be hiccups along the way. Although Mr. Sands is confident that China's growth will be genuine, not like the bubble-driven expansion that has characterized the past few years in the West, he accepts that growth on the scale now being experienced in Asia will "create froth" along the way. He believes, though, that the underlying growth will be solid and lasting.

While China will be the biggest beneficiary of this super-cycle, the potential benefits for parts of Africa are possibly being underestimated. China is, somewhat controversially, already gathering up vast tracts of the continent's natural resources and Standard Chartered's own profits from the region have been growing significantly over the past year. But while Nigeria and Mozambique, for instance, appear to have bright prospects, the social problems that still dog so much of the region will continue to limit growth.

Such drastic changes as there are set to be in the relative wealth of the world will bring problems. Mr. Sands acknowledges that "such a polarized growth dynamic creates quite a difficult political dynamic." Some of the language that has recently been heard on the subject of currency exchange rates may just be the early vestiges of that and cries for protectionism may get louder.

But the trend east is under way and has unstoppable momentum. The challenge for the West is to find the most effective means of benefitting from it. That means first putting in the groundwork, however painful, to strengthen their own economies while endeavoring to equip their businesses to compete in these rapidly growing markets.

As the report points out, the literacy rate in China is now almost 100%, a boast that the U.K. would be hard-pressed to make with any confidence.

What's News

■ **Roche and Novartis** accelerated their cost-cutting programs, as the Swiss pharmaceutical companies cope with drug-development setbacks, patent expirations and an increasingly strict regulatory environment. **17, 32**

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David Cottle on the U.K. pledging to support Ireland should the need arise

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Previous results

Q: Should Ireland accept financial help from the EU and IMF?

Yes **40%**

No **60%**

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

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

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

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

Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003.

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

NEWS

Bush puts bookend on presidency

By Ana Campoy

DALLAS—George W. Bush and 3,000 fans celebrated his return to the spotlight this week during a ground-breaking ceremony at Southern Methodist University, where plans to build his presidential library have divided the campus.

Mr. Bush, who left office with low approval ratings and spent two years in relative seclusion, has recently worked to burnish his image, giving interviews to Oprah Winfrey and the Today Show's Matt Lauer to promote his book "Decision Points."

"Staying out of current affairs and politics does not mean staying out of policy," Mr. Bush said Tuesday to the crowd gathered under a large white tent. "I strongly believe that the principles that guided our service in public office are the right principles to lead our country in the future."

Mr. Bush said a public policy institute attached to the library would promote those principles, as well as improve free markets, global health, political freedom and education.

Former Vice President Dick Cheney, who used a cane to climb to the dais, made a dig at the Obama administration, calling the presidential center "the only shovel-ready project in America," drawing laughs. The president's wife, Laura Bush, an SMU graduate, also attended, as did former Secretary of State Condoleezza Rice and ex-Colombian President Alvaro Uribe.

Meanwhile, at a nearby corner of the campus of Georgian-style brick buildings, dozens of protesters waved such signs as, "Impeach Bush" and "Library or Lie-Bury?"

"We're here to hold up a big mirror to him to show the world that we have not forgotten the wrongs he committed," said Gerry Fonseca, a Vietnam veteran who traveled from Eureka Springs, Ark. Mr. Fonseca said Mr. Bush should be held accountable for the Iraq invasion and for approving the use of waterboarding on prisoners, which Mr. Fonseca called war crimes.

Universities and cities often angle to be the site of presidential libraries—part of a national network of repositories to hold records of past presidencies. Besides their prestige, they draw scholars and visitors to museums often built alongside.

Texas will now have three presidential libraries, the most of any state. Texas A&M houses the George Bush Presidential Library and Museum, and the University of Texas at Austin is home to the Lyndon Baines Johnson Library & Museum.

SMU officials welcomed the Bush presidential library and the archive of materials, but some professors complained that the university's independence would be threatened by the Bush Institute, fearing that it would be too partisan in its research. Officials at his center say they will make all documents from the presidency, which include more than 200 million emails, available so that scholars and historians can reach their own conclusions.

The center, a $137 million, three-story 226,565 square-foot building covered in Texas limestone and solar panels, is scheduled to be finished by 2013. The understated building, which Mrs. Bush has said is meant to be a showcase but not a monument to her husband's presidency, was designed by Robert A.M. Stern Architects. It will include a 67-foot-high tower capped with glass to be called Freedom Hall.

Associated Press

From left, Condoleezza Rice, George W. Bush, Laura Bush and Dick Cheney during the ground-breaking ceremony in Dallas on Tuesday.

Executive edition

Most recent presidential libraries: locations and opening years

2013	George W. Bush Library, Dallas
2004	William J. Clinton Library, Little Rock, Arkansas
1997	George Bush Library, College Station, Texas
1991	Ronald Reagan Library, Simi Valley, California
1990	Richard Nixon Library, Yorba Linda, California
1986	Jimmy Carter Library, Atlanta
1981	Gerald R. Ford Library, Ann Arbor, Michigan*
1979	John F. Kennedy Library, Boston
1971	Lyndon B. Johnson Library, Austin, Texas

*Museum portion located in Grand Rapids, Michigan
Sources: National Archives; WSJ research

How the Apple deal finally came together

By Ethan Smith

After years of litigation and ill will, it took two men just a couple of hours to hammer out the basic terms that would finally bring the Beatles' music to the iTunes Store.

The deal was outlined by Jeff Jones, chief executive of the Beatles' corporate entity, **Apple Corps** Ltd., and Roger Faxon, CEO of **EMI Group** Ltd., which owns and distributes the band's recordings. The meeting took place at EMI's London headquarters this past July 14, less than a month after Mr. Faxon took the reins at EMI.

Under the terms, **Apple** Inc.'s digital media store is the Beatles' exclusive online retailer at least until January, Mr. Faxon said in an interview Tuesday, after the much-awaited deal was announced. It marks the first time that Beatles songs have been available for digital-download sales.

"Jeff and I sat down shortly after I arrived" as CEO of EMI, Mr. Faxon recalled. "We agreed this really was the moment to do this. After that it was very easy to cut a deal." They code-named the initiative "Bastille," as it coincided with Bastille Day.

The next four months were spent on the details of a final agreement between band and record label, then nailing down terms with Apple Inc. and iTunes.

Mr. Faxon had previously served for many years as a senior executive at EMI's music-publishing division, where he won a reputation as a low-key but effective executive, in an industry filled with outsized egos.

Though EMI owns the Beatles' master recordings, the band retains veto power over new uses of the "masters," as they are known in the industry. It exerts that power through Apple Corps, whose board comprises band members Paul McCartney and Ringo Starr, as well as Yoko Ono and Olivia Harrison, the widows of the late Beatles John Lennon and George Harrison.

Conventional wisdom has long held that the Apple Corps board members were too obstinate or too antitechnology to allow the Beatles' music to be sold online, but that wasn't the case, particularly in the past three years, according to people familiar with the situation.

Though the Beatles engaged in decades of trademark litigation with the Cupertino, Calif., computer company over the Apple name and logo, those matters were resolved by a 2007 settlement. Following the resolution of the trademark dispute, people familiar with the situation say that the Apple Corps board was eager to start selling music on iTunes. But the bandmembers and their heirs were unhappy with the terms demanded by the principals at the private-equity firm that had taken over EMI.

In 2007, EMI Group was taken private by British investor Guy Hands and his private-equity company, **Terra Firma Capital Partners LP.** The leveraged buyout left the music company saddled with £3 billion ($4.7 billion) in debt, even as sales of music were continuing a years-long plunge.

Neither the terms of the agreement with iTunes nor the terms initially sought by Terra Firma and EMI could be learned. But in various corporate prospectuses, Terra Firma occasionally pointed to future revenue from online Beatles sales as an untapped source of wealth at the company.

Mr. Faxon declined to comment specifically on previous negotiations. "Were there errors about the way this catalog was handled?" he asked. "I don't think anybody can say there were."

Mr. Jones of Apple Corps couldn't be reached for comment.

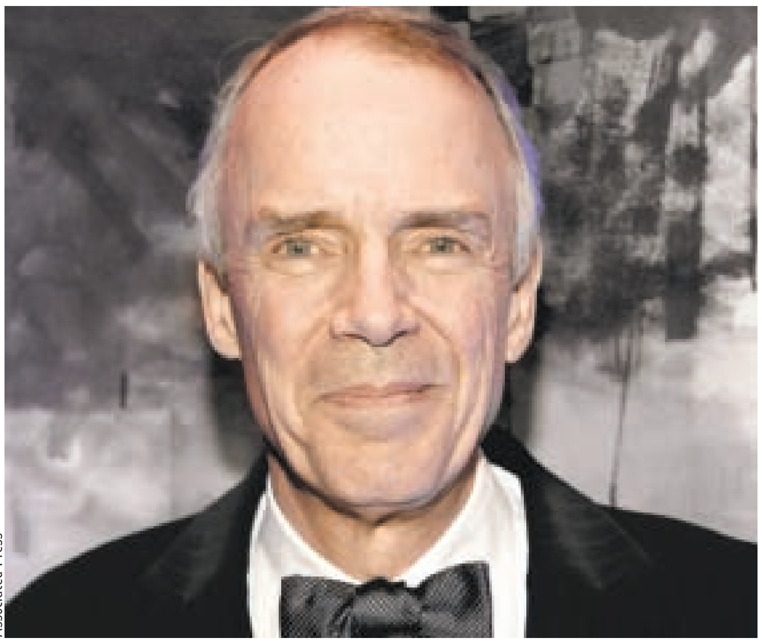
Mr. Faxon said that record label and band alike wanted to wait until after the release of remastered CD versions of the Beatles' albums before putting the music out via iTunes. That decision helped the Beatles sell more than 3.3 million CDs in the U.S. after the remastered discs came out last fall.

Prepping for a promotional push, a few weeks ago Apple began reserving prominent advertising space in Wednesday editions of major newspapers, telling the sales departments little except that the ads would be delivered in time to make print.

Within hours of the catalog's appearance Tuesday morning on iTunes, rival **Amazon.com** Inc. cut the prices on Beatles CDs. For instance, Amazon dropped the price of a boxed set released last fall to $129, from more than $150 earlier that morning. The price on iTunes is $149.

Toward the end of their first day on iTunes, albums by the Beatles occupied more than a dozen slots on the download service's chart of best sellers. The highest ranking, at No. 12, was "Abbey Road." The lowest, "Beatles for Sale" was No. 61.

Mr. Faxon declined to discuss financial terms of the iTunes arrangement, including whether the band was paid a cash advance, or how proceeds from the sales would be divided. "We're always in partnership with our artists," Mr. Faxon said. "That is the entire predicate of this deal with the Beatles."



Associated Press

Roger Faxon, CEO of EMI, said the initiative was code-named 'Bastille.'

EURO-ZONE CRISIS

Ireland braces for bank exam

By David Enrich

DUBLIN—Seven weeks after Irish officials declared they had a handle on the country's banking crisis, an international panel is putting the country's financial sector under the microscope—and very likely will find that things have gotten worse.

A team from the International Monetary Fund, the European Central Bank and the European Commission is set to arrive here Thursday to conduct the exam, seen as a prelude to a multibillion-euro bailout of Ireland that Europe is pushing on a resistant Emerald Isle.

The widespread expectation is that such a lifeline is necessary, given the banking sector's deepening woes. Just a few weeks ago, on Sept. 30, Irish officials said they had scrutinized the banks themselves and drawn a line under the country's two-year-old banking crisis, which has shredded Ireland's economy and investor confidence. The result was an expanded government aid package for the banks that totaled about €34 billion ($46 billion).

But fresh problems are bedeviling Irish banks.

Concerns that the banks are sitting on deeper-than-disclosed losses have made it hard to fund their daily operations. In recent months, jittery depositors have bolted, leaving the banks strapped for the short-term funds that are their lifeblood. Bank executives say they are effectively frozen out of the debt markets, a traditional funding source. Increasingly, financial institutions have turned to the ECB for funds.

Meanwhile, investors have become concerned that the Irish banks' main problem—tens of billions of euros in losses on bad commercial-property loans—is spreading to the country's home-mortgage sector and could cause further trauma for big players such as **Allied Irish Banks** PLC.

The team of examiners will arrive as markets receive a snapshot of the latest bank travails. Allied Irish is expected to issue a "trading update" on its third-quarter performance by the end of the week. A spokesman declined to comment on when the update will be issued.

The drag on deposits is apparent even at **Irish Life & Permanent** PLC, one of the country's healthier banks. It said Wednesday that corporate deposits declined about 11% during the third quarter, although they have since stabilized.

Meanwhile, as of Sept. 30, Irish Life had borrowed €11.7 billion from the ECB, up from about €8 billion three months earlier.

The Bank of Ireland spooked investors when it reported similar signs of liquidity trouble last week.

The situation is unsustainable, partly because the ECB is growing edgy about how much it has loaned to the Irish banks.

"I'm quite confident that it would be very difficult for the ECB to go further than now in the providing of liquidity to some banks in different member states, and maybe first in Ireland," said Didier Reynders, the Belgian finance minister and head of the European Union's council of finance ministers, at a news conference in Brussels on Wednesday afternoon.

Irish banks lately have found it tougher to borrow from the ECB. The Frankfurt-based central bank has been imposing stricter limits on the types of securities that banks can put up as collateral in order to receive ECB funds, rendering swaths of some Irish banks' assets ineligible, according to senior Irish banking officials.

The Central Bank of Ireland has partly filled the void by accepting some assets that the ECB won't, the officials say.

A spokeswoman for Ireland's central bank declined to comment on its lending to local financial institutions. But one sign of that shift is that the "other assets" category on its balance sheet—which includes liquidity support to Irish banks—rose to €34.6 billion as of Oct. 29. A month earlier, that figure was €21.2 billion; it was €14.4 billion in late August.

On Wednesday, Irish Finance Minister Brian Lenihan insisted that the country's banks aren't facing liquidity problems.

"The European Central Bank stands fully behind the Irish banking system," he said on a morning radio broadcast. "And there are no funding difficulties in the Irish banking system."

Belgium's Mr. Reynders, however, said: "There is a liquidity problem in the banking sector in Ireland."

Ireland's banks are also under pressure from a rising tide of losses on home loans.

The Central Bank of Ireland reported Wednesday that more people are falling behind on their mortgage payments.

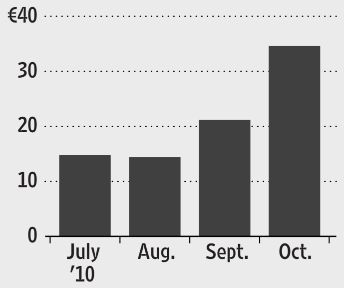
About 5.1% of home loans were more than 90 days past due at the end of the third quarter, up from 4.6% at June 30. That number has been steadily climbing for more than a year, and some experts believe it represents a major vulnerability for Ireland's banks.

—Charles Forelle and Brian Blackstone contributed to this article.

Bloomberg News

Emergency supplies

The Central Bank of Ireland has stepped up loans to the country's cash-strapped banks. Such loans come from the central bank's 'other assets.' In billions



Source: Central Bank of Ireland

Irish banks are facing new problems despite a raft of government aid. At left, a branch of Anglo Irish Bank in Dublin.

Aid package starts to take shape ahead of EU talks

Continued from first page

If EU and IMF money is used—as it is for Greece—to help Ireland patch its budget gap without having to borrow from hostile markets, the sum required would be substantially larger than if cash were committed for the banks alone.

Ireland is keen to avoid the larger sum, which would be an admission of fiscal-policy failure. More acutely, Dublin is worried that the price of budgetary aid would be a surrender of taxation policy to the IMF and the EU, which has made clear it thinks Ireland's ultra-low corporate tax rate should be raised.

But a smaller aid package designed to shore up Irish banks might not be enough to restore investor confidence in Ireland's solvency, some European officials fear. Failure to address Ireland's problems in full might result in a second bailout for the country, these people say.

Ireland needs to improve the underlying balance of its budget, excluding debt-service costs, by about 12 percentage points of gross domestic product—a turnaround even bigger than Greece needs to achieve in the next few years, according to David Mackie, economist at J.P. Morgan in London. "The Irish journey looks to be the most challenging" of all the euro members which need to repair their budgets, Mr. Mackie wrote in a research note.

Even if Ireland gets a bailout, that fact may do little to block contagion elsewhere in Europe. Financial markets might also simply turn their attention to Portugal.

And even if Ireland gets an aid package, that fact may do little to block contagion elsewhere in Europe. Financial markets might be appeased—but they might also simply turn their attention to Portugal, creating pressure for a bailout there too.

"This is all about psychology and perceptions. You can't create a firewall," says Daniel Gros, director of the Center for European Policy Studies, a Brussels think tank.

Even if an Irish bailout brings some short-term calm to the euro-zone periphery, "investors will probably take a second look at Portugal later," Mr. Gros says.

Separately, Greece reached an agreement Wednesday with its international lenders on the final draft of next year's budget after adopting up to €4 billion in additional austerity measures, a senior government official with knowledge of the talks said.

A delegation of officials from the European Commission, the International Monetary Fund and the European Central bank was in its third day of talks in Athens on how Greece could achieve its 2011 deficit target of 7.6% of gross domestic product.

—Emese Bartha, Jonathan House and Costas Paris contributed to this article.

Portugal's borrowing costs surge

By Emese Bartha

FRANKFURT—Worries that Ireland's intensifying debt crisis will highlight Portugal's fiscal gaps were borne out Wednesday by a surge in the government's borrowing costs at its latest debt auction.

The average yield paid by Portugal on its auction of €750 million ($1.01 billion) in 12-month Treasury bills rocketed to 4.813%, nearly 50% more than the 3.260% paid at the previous auction two weeks ago.

"The sharp rise in borrowing costs highlights the impact Irish concerns have on yields in other euro-zone peripherals, and if Ireland gets an aid package, markets are likely to sooner or later push for a deal on Portugal," Brown Brothers Harriman said in a note to clients.

Investors often refer to a group of heavily indebted euro-zone nations as peripherals because of their geographic location on the region's rim. Often, risk aversion spreads across their debt markets if one or the other government is seen to be in difficulty.

Some market watchers believe that quick aid for Ireland, whose deficit this year will exceed 30% of gross domestic product, could nip contagion in the bud. Others believe that once Ireland is in the safe hands of the European Union and the International Monetary Fund, market attention on Portugal will increase.

The focus on Portugal takes into account the government's heavy funding needs early next year and how its debt-refinancing costs are spiraling dangerously higher. It still has two more T-bill auctions scheduled for this year on Dec. 1 and Dec. 15.

Portugal is considered to be the euro zone's weakest link after Greece, which received an EU and IMF aid package earlier this year, and Ireland.

Spain also is on investors' worry list. Spain on Thursday will auction €3 billion to €4 billion of bonds maturing in October 2020 and July 2041. Its economy stagnated in the third quarter, and the country has two further bond auctions and two more T-bill auctions scheduled before the end of the year.

The European Central Bank has been supporting weaker national government by purchasing their bonds in the secondary market, but the central bank has indicated a desire to wind down its bond-purchasing program as it normalizes monetary policy.

Economists at Intesa Sanpaolo calculated this week that Portugal will need to raise around €12 billion in the first quarter of 2011 to cover the deficit and the repayments, so it will be crucial for the country to have access to the primary market from the start of the new year.

"The sharp rise in 12-month bills is obviously adding to the massive pain for Portugal," said David Schnautz, strategist at Commerzbank AG in London.

Natixis bank analysts said in a note that until Ireland's banks have been adequately recapitalized, uncertainties about Ireland won't dissipate, and there is a risk that this wariness could spread along the euro zone's periphery.

"This time around, the European authorities are keen to act swiftly to avoid another Greek-style scenario," they said. "The market's major concern is that Portugal, and especially Spain, will be engulfed, which would expose the entire euro zone to a systemic risk."

"[Thursday's] Spanish auction will be closely watched after the increasing pressure on small [euro-zone] peripherals," said Annalisa Piazza, an economist at Newedge.

Growing wider

Spread between Portuguese 10-year government bonds and comparable German bonds, in percentage points

Source: Thomson Reuters

EUROPE NEWS

Germany warns of terror attack

By David Crawford

BERLIN—Germany warned its citizens of plans for an imminent terrorist strike that intelligence officials believe may involve a Mumbai-style attack by Islamic extremists in the country by the end of the month.

German Interior Minister Thomas de Maizière said that federal police and other authorities would step up security measures around the country, and that the threat represented "reason for concern but not for hysteria."

"The indications are concrete," Mr. de Maizière said at a news conference. "But there hasn't been an incident, and there won't be an incident."

Details of the new intelligence are unclear, but Mr. de Maizière said the November threat is based in part on information obtained from a partner service outside Germany in late October or early November.

Germany, France and the U.K. have been saying for weeks that they believe they are the targets of upcoming attacks. U.S. authorities last month disclosed similar information about terrorist sleeper cells in Europe that they said were close to being activated.

But unlike Germany's previous warnings, which were vague about the location of potential attacks, German officials say they now have evidence that the country is a target. Mr. de Maizière said Germany had new actionable information and new leads to follow. That marks a sharp transition for Mr. de Maizière, who last month played down U.S. and British warnings of possible imminent attacks as too vague to warrant a change in Germany's counterterrorism posture.

Associated Press

Officers guard Berlin's main train station Wednesday, as Germany's interior ministry announced stepped-up security.

Mr. de Maizière didn't reveal how or where the attack might occur, but said he ordered federal police to beef up security at Germany's airports and train stations.

The new leads are from "multiple independent sources," a person familiar with Germany's investigation of the plot said. This person said the intelligence indicated that an attack similar to a 2008 terrorist assault in Mumbai's city center appeared to be in the works. In the Mumbai raid, terrorists staged a commando-style attack with small arms and killed more than 160 people.

Germany's investigation, which this person says is driven by U.S. intelligence, is focusing on a man of unknown age and background that intelligence officials say goes by the name Mauritani. This person says intelligence reports indicate Mauritani leads a group of trained fighters, somewhere in Europe. Investigators are scrambling to identify Mauritani's team members, the official said. Because of the suspect's name, European investigators suspect Mauritani may originally be from somewhere in North Africa, the official said.

Mr. de Maizière said German investigators are pursuing leads including on suspected homegrown German terrorists who have traveled to Pakistan seeking military training in terrorist camps.

Several suspected terrorists from Germany have been killed since September in Pakistan as U.S. drone aircraft have attacked suspected terrorist safe houses. At least one of the Germans killed by drone-fired missiles in Pakistan had been under investigation in Germany since 2001, according to German court records, when investigators noticed his correspondence with members of a terrorist cell in Hamburg that provided three pilots to lead the Sept. 11, 2001, attacks in the U.S.

A person familiar with the German investigation said security has also been increased at football stadiums where thousands of fans congregate on weekend afternoons for German league games.

Intelligence reports in recent weeks, indicating terrorist threats could be targeted at urban centers in Europe, have others are acting as well. Britain has been on high alert and believes itself to be a prime target for terrorists.

Since January, the country's threat level has already stood at "severe," which means that a terrorist attack is "highly likely." The only higher threat level, critical, means an attack is expected imminently.

Germany's response to any threat will include both visible and invisible measures, Mr. de Maizière said. While Germany's uniformed police will strengthen security at public places, a person familiar with activities at Germany's police investigative service, known under its German acronym BKA, said "we are the invisible element," along with Germany's domestic intelligence agencies. According to this person, German investigators have intensified their effort to investigate an increasing flow of information.

Russia expands NATO routes

Russian President Dmitry Medvedev will sign an agreement with the leaders of the NATO alliance on Saturday aimed at expanding the use of supply routes through Russia into Afghanistan, as part of an effort to improve ties between the former antagonists.

*By **Stephen Fidler** in Brussels and **Gregory L. White** in Moscow*

The leaders of the 28 North Atlantic Treaty Organization nations, including U.S. President Barack Obama, will also agree with Russia at a meeting in Lisbon to investigate ways in which they can cooperate on defenses against the dangers posed by ballistic missiles.

The effort to warm relations threatens to be set back by delays in the U.S. in ratifying the key START arms-control treaty, which is aimed at reducing numbers of the two countries' strategic nuclear arsenals. A key Republican senator, Jon Kyl of Arizona, said Tuesday that he wouldn't support ratifying the treaty this year, delivering a blow to a central White House foreign-policy objective.

Despite this, Russia and NATO signaled this week they wanted to enhance ties that reached a recent low point after Russia's August 2008 invasion of Georgia.

"We want this summit to turn the page on the NATO-Russian relationship," said Dmitry Rogozin, Russia's ambassador to NATO, in an interview. Russia needs predictable relations with the world's largest political-military alliance, he said.

NATO Secretary-General Anders Fogh Rasmussen said the summit would mark a "fresh start in our relationship with Russia."

"The time has come to stop worrying about each other...and to work together, and we will," he said.

The NATO-Russia meeting comes after an alliance summit that begins Friday, where NATO members are expected to agree to a new strategy for the alliance.

Diplomats said the alliance is expected to sign off on a plan to convert a U.S. missile-defense program into a NATO project aimed at defending all alliance territory in Europe and Turkey. Although the system is initially aimed to deal with what they see as a potential threat from Tehran, the leaders won't name Iran. They note that more than 30 countries are developing ballistic missiles capable of reaching NATO territory.

On Saturday, there will also be a summit of the 49 nations involved in the NATO mission in Afghanistan. The leaders are expected to sign off on a plan to begin handing over security to Afghan forces next year and ending the alliance's combat role in the country in 2014.

The transit agreement with Russia will expand the goods that can be sent on rail routes through Russia to include armored cars, such as U.S. MRAPs, according to NATO officials. Some 4,000 containers have passed through Russia to Afghanistan since 2008, according to NATO and Russian officials, and the number of shipments has accelerated since June.

Supplying Afghanistan from the north is 90% cheaper than airlifting in supplies, and less hazardous than transporting them by truck through Pakistan.

Mr. Rasmussen said Russia also is expected to permit goods to be shipped out of Afghanistan through its territory. At the moment, rail cars return empty from the border with Afghanistan, so that change could be a big help as the alliance reduces its combat role in the country. Mr. Rasmussen said only nonlethal materials would be allowed to go through Russia.

Mr. Rogozin indicated that, despite the expected agreement on possible missile-defense cooperation, Russia had continuing concerns that the system could be directed against it. "Why, if you want to hunt a rabbit, do your guns have the caliber to kill a bear?" he asked.

He said the alliance should put restrictions on the missile-defense system's "geography, quality and quantity." The current U.S. plan, particularly in its later phases, "is nothing to do with the threat," he said.

Reuters

NATO Secretary-General Anders Fogh Rasmussen and Russian President Dmitry Medvedev at a meeting in Moscow earlier in November.

He said Mr. Medvedev would nonetheless suggest a plan for possible cooperation, including sharing information about missile programs in third countries, joint use of reconnaissance information and, possibly, sharing technical information and technology.

Russian officials expressed hope that any delay in ratification wouldn't scuttle the treaty or derail the improvement in U.S.-Russian relations.

U.S. NEWS

Bloomberg News

A man shopped near New York City's Herald Square in October. Consumer prices haven't moved much since July.

Inflation remains muted despite energy-price rise

By Luca Di Leo
And Tom Barkley

U.S. consumer prices continued to rise modestly in October as gasoline prices surged, but underlying inflation hit its lowest level in more than 50 years, supporting the Federal Reserve's recent move to try to boost the economy.

The seasonally adjusted consumer-price index last month rose 0.2% from September, the Labor Department said Wednesday. It was the fourth consecutive month that higher energy costs helped to push prices up.

But the so-called core inflation rate, which is more closely watched by the Fed, was unchanged as the price of new and used cars fell.

Taking out energy and food prices, which can be volatile from month to month, underlying consumer prices haven't moved since July.

Compared with October 2009, the annual underlying inflation rate hit 0.6%, the lowest level since records began in 1957. That is well below the Fed's informal inflation target of 1.5% to 2%.

The low inflation shown in government reports in recent months was one factor in the Fed's controversial decision this month to try to stimulate the economy by printing money and buying government bonds.

Some Fed officials expressed concern that unless they took action to charge up the economy, the U.S. was at risk of deflation, a spiral of falling prices and wages. But others remain concerned that the recent surge in commodity prices could eventually translate into higher consumer prices.

Economists surveyed by Dow Jones Newswires ahead of the release expected consumer prices to rise by 0.3% and the core CPI to rise by 0.1% in October.

"While not a base case, outright deflation in the core has to be viewed with greater probability now," said Jay Feldman, an economist at Credit Suisse, in a note, adding that he is looking for a "rousing defense" from Fed Chairman Ben Bernanke on Friday.

Fed officials have been fighting growing criticism of the central bank's plan to buy $600 billion in U.S. Treasurys through June, saying the weak economy and low inflation warranted the move. Republicans say the bond purchases could lead inflation to surge and hurt the U.S. dollar.

German and other foreign officials say the Fed is deliberately trying to push down the value of the dollar, an accusation the U.S. Fed officials have rejected. Mr. Bernanke will speak at a European Central Bank conference in Frankfurt on Friday.

Construction of single-family homes, which represent more than 80% of housing starts, declined 1.1% to 436,000, after rising a revised 2.1% in September.

Wednesday's report showed that, compared with October 2009, overall U.S. consumer prices are up 1.2%.

Higher energy prices have also driven up inflation in the euro zone, with consumer prices there rising an annual 1.9% in October. That is the highest level since November 2008, but still in line with the European Central Bank's inflation target of close to, but below, 2%.

Looking at the monthly changes in the U.S., energy prices rose 2.6% in October, the fourth consecutive monthly increase. Gasoline prices rose 4.6% last month after increasing by 1.6% in September.

Food prices were also higher, although the 0.1% increase was more modest than the previous two months. The index for dairy and related products posted the largest increase in the food-at-home index, rising 1.1% in October. Fruits and vegetables posted the biggest declines, falling 0.7%.

Other categories showed significant declines in prices. Used cars and trucks fell 0.9%, the biggest decline since March 2009. New-vehicle prices fell 0.2% last month.

Without rounding, the report showed that consumer prices rose 0.232% in October. Excluding food and energy items, consumer prices were actually down 0.007% unrounded.

In a separate government report showing the U.S. economy's continued weakness, housing starts fell 11.7% to a seasonally adjusted annual rate of 519,000. Building permits, a gauge of future construction, increased 0.5% to 550,000.

Economists surveyed by Dow Jones Newswires expected overall housing starts to fall 1.6% to 600,000. Starts in October fell to the lowest level since 477,000 in April 2009. The results were driven by a 43.5% decline in multifamily construction, a volatile part of the market.

Single-family-home construction, which represents more than 80% of all starts, declined 1.1% to 436,000, after rising a revised 2.1% in September.

The mood is glum among home builders, which face a litany of troubles.

While mortgage rates are low, unemployment is elevated, scaring off would-be buyers. Sales of new homes in September were down 21.5%, compared with a year earlier, the latest government data say.

Inventories relative to sales are high. Previously owned homes are cheaper. Builders say they aren't making progress securing financing to start new projects.

"The housing market's pulse is clearly faint," Weiss Research analyst Mike Larson said.

—Jeff Bater and Alan Zibel contributed to this article.

Fed, deficit panel challenge today's gridlock mentality

[Capital]

By David Wessel

Call it the revolt of the wonks.

The conventional wisdom in Washington is that nothing can be done.

Yes, the argument goes, the economy is growing so slowly that, at best, unemployment will remain above 9% for another year and won't fall below 6% until 2014, if then. But administering tax cuts or spending increases to prod the economy is—pick your argument—unwise or useless or politically impossible. And, yes, the Federal Reserve did help pull the economy from the abyss of depression by printing money earlier, but doing more of that now is—pick your argument—unwise or useless or politically risky.

Nothing can be done. Sigh.

Yes, the argument goes, the U.S. government has made spending promises that it cannot afford to keep. Yes, it is imprudent to expect to continue borrowing billions of dollars a day from abroad at low interest rates forever. But—pick your argument—this isn't the right time to talk fiscal belt-tightening. Or voters will turn out of office politicians who vote to raise taxes, yank away tax breaks, eliminate popular spending or dilute promised benefits. Or gridlock and partisan warfare prevent meaningful compromise.

Nothing can be done. Sigh.

Ben Bernanke, Janet Yellen, Bill Dudley, Erskine Bowles, Alan Simpson and Bruce Reed didn't get the memo.

At the Fed, Chairman Bernanke and lieutenants Ms. Yellen, the new vice chair of the Fed board, and Mr. Dudley, president of the Federal Reserve Board of New York, overcame the reservations of several colleagues and defied skepticism from much of the public, the U.S. business elite and many in financial markets and said: Something should be done.

So the three economists—with Ph.D.s from MIT, Yale and Berkeley, respectively, none of whom seems by personality to be a big risk taker—launched the most controversial move by the Fed since it let Lehman Brothers go under two years ago: printing $600 billion to buy long-term U.S. Treasury debt. Unable to cut short-term interest rates below zero and unwilling to wait for Congress and the president to come to the rescue, they are hoping to push down long-term rates, push up stock prices, let the dollar fall and give the economy a boost.

Neither the extremes nor the establishment are enthusiastic. Fans say it's unlikely to do much good—and those are the fans! Foes warn that this "quantitative easing," or QE, as it's known, may lead to too much inflation, a collapse of the U.S. dollar or a bubble in stocks or commodity prices.

And a fair number of fans and foes alike fear this could make the Fed look impotent (if QE is seen by the public to have had as little impact as President Barack Obama's fiscal stimulus) or could renew threats to the Fed's independence from politicians just a few months after it successfully fought them off.

For Mr. Bernanke and his small, and perhaps shrinking, cadre of like-minded monetary wonks, this was a close call. But worried that unemployment is as likely to rise as fall, they decided trying something beats doing nothing.

On the deficit, Mr. Bowles, a sober financier, former Clinton White House chief of staff and university president; Mr. Simpson, a wise-cracking 79-year-old retired Republican senator; and Mr. Reed, a Rhodes Scholar who is blowing on the embers of the Democratic Party's centrist movement, have changed the conversation.

The next moves belong to the president and the newly powerful Republican leadership in Congress.

Two weeks ago, deficit-fearing policy wonks talked mainly to each other. They despaired that even with deficits larger than hardly anyone imagined a few years ago, political gridlock meant nothing would be done until after the 2012 election. And politicians, with a few notable exceptions, condemned deficits with vehemence and shied away from talking truth to the voters about what it would take to reduce the deficit.

Messrs. Bowles and Simpson, co-chairmen of a commission appointed by the president that was widely seen as doomed to failure, and Mr. Reed, their staff chief, called the bluff of the Washington establishment. They put out a plan that adds up, leaves no ox ungored and should shut up anyone who says the deficit can be contained by cutting waste, fraud, abuse and foreign aid.

Suddenly, the talk inside the Beltway is about whether this is the best way to reduce the deficit. Specifics are being debated, and alternatives drafted. "Our recent political debates have been marked by a great deal of silly and irresponsible rhetoric," says Isabel Sawhill, a deficit hawk at the Brookings Institution who has doubts about some of the plan's specifics but admires the effort. "In this steamy environment, the commission draft is a blast of cold but refreshing air."

A few blunt policy wonks with a calculator and a PowerPoint presentation cannot break the gridlock in Washington. The next moves belong to the president and the newly powerful Republican leadership in Congress. All could fizzle out.

But Messrs. Bowles, Simpson and Reed refused to accept premature reports of their impotence. They decided to try to do something.

It's almost enough to make one optimistic.


What happens when China
catches up with China?
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U.S. NEWS

Another deficit plan targets taxes

By Damian Paletta

A panel of Democrats, Republicans, economists and other experts said Wednesday that a complete overhaul of the U.S. tax code is the best way to address the nation's fiscal problems—a new and likely controversial idea aimed at tackling the growing deficit.

The report, co-authored by Democratic budget veteran Alice Rivlin and former Sen. Pete Domenici (R., N.M.), follows a separate proposal last week by the two chairmen of President Barack Obama's deficit commission. The many similarities between the two offer a window into the types of proposals that might win backing as Washington launches into what is likely to be a protracted debate on deficit cutting.

The most recent report, put together by a group called the Bipartisan Policy Center, calls for a one-year payroll-tax holiday in 2011 that it says will create between 2.5 million and 7 million jobs.

The plan would lower income and corporate tax rates and offset them with a 6.5% national sales, or "consumption," tax as well as an excise tax on sugar drinks like soda.

The Bipartisan Policy Center was created in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole and George Mitchell with the aim of finding solutions to major national issues.

Last week's proposal, from Democrat Erskine Bowles and Republican former Sen. Alan Simpson, also called for an overhaul of tax and spending programs. Other similarities include:

■ Changing the formula for social-security taxes so that they are levied against 90% of all wages, compared with the current system, which caps the tax at a certain income level.

■ Major cuts in discretionary spending. Both singled out a government policy that allows military retirees to collect full benefits after 20 years.

■ Cuts to farm subsidies and either eliminating or limiting certain politically popular tax breaks, such as the mortgage-interest tax deduction.

Democrats and Republicans are largely in agreement that the U.S. debt is on an unsustainable path, and ideas are pouring in from both sides. Rep. Jan Schakowsky (D., Ill.), a member of Mr. Obama's commission, offered her own proposal Tuesday, calling for $110.7 billion in defense spending cuts in 2015 and raising $132.2 billion in revenue by closing certain tax loopholes for companies that she said ship jobs overseas.

Mr. Domenici, in an interview, said, "In some ways, [the debt] is a silent killer, eating away at our future."

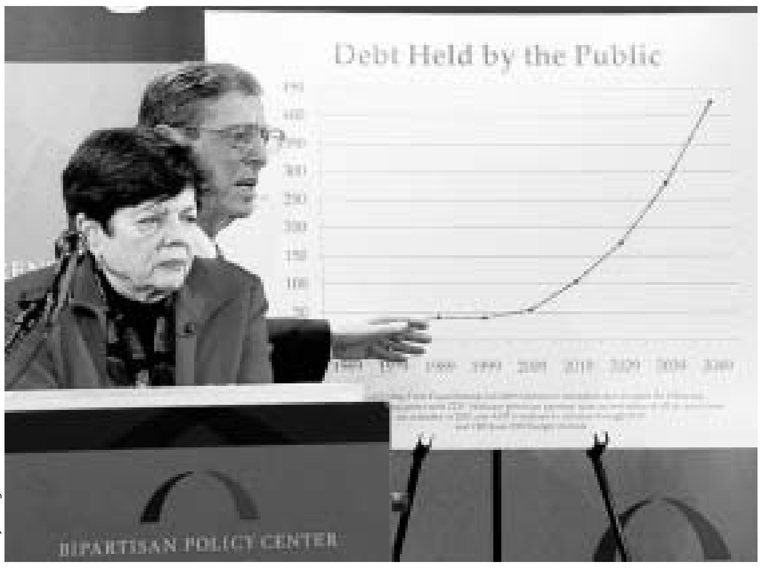
Because the proposals touch so many key parts of the economy, from taxes to spending, they have triggered opposition. The latest came Tuesday, when Defense Secretary Robert Gates said the proposal by Messrs. Bowles and Simpson to cut $100 billion from defense spending would have a "catastrophic" impact on national security.

Those cuts are "math, not strategy," he said at The Wall Street Journal's CEO Council in Washington.

Mr. Domenici, who spent 36 years in the Senate, called for a four-year freeze on defense spending as part of his report and said Pentagon officials should be less resistant. "Everybody must sacrifice, and our military leaders...must bear their share to get [the debt] under control," he said.

The Rivlin/Domenici proposal is likely to attract the most attention for its proposed 6.5% Debt Reduction Sales Tax, which some will liken to a value-added tax that exists in some parts of Europe.

Rep. Eric Cantor (R., Va.), who is likely to become House majority leader in January, said Tuesday that many lawmakers wouldn't support VAT-type tax because its ties to Europe might make it politically poisonous in Washington.



Getty Images

Alice Rivlin and Pete Domenici in January speaking about the U.S. debt.

Common ground

Highlights of recommendations from two deficit-reduction panels:

	DEFICIT COMMISSION DRAFT REPORT	BIPARTISAN POLICY CENTER DEBT REDUCTION TASK FORCE
SPENDING	Cut $100 billion each in discretionary spending on defense and domestic programs by 2015	Freeze discretionary spending for four years on domestic programs and five years for defense
TAXES	Cut income taxes and simplify to three brackets; eliminate most deductions; gradually increase gas tax	Cut income taxes and simplify to two brackets; eliminate most deductions; establish national sales tax
SOCIAL SECURITY	Raise retirement age to 69 by 2075; use a more accurate inflation index; raise cap on wages subject to payroll tax	Index benefit levels to growth in life expectancy; use a more accurate inflation index; raise cap on wages subject to payroll tax

Americans oppose budget proposals

By Peter Wallsten

Americans broadly dislike the package of deficit-trimming ideas laid out by the chairmen of President Barack Obama's fiscal commission, a new Wall Street Journal/NBC News poll has found.

The survey found that 13% of adults are comfortable with three major components of the proposal—raising the Social Security retirement age, raising taxes on items such as gasoline, and cutting spending on programs such as Medicare and defense. One in four Americans called the overall plan a "good idea."

The results suggest political challenges for Mr. Obama and Democrats who run the Senate, as well as for the new GOP majority in the House. All have vowed to make deficit-cutting a priority but now face the realities of following through.

"Everybody wants to cut the deficit and cut the spending, but at the end of the day everybody wants a choice that doesn't affect their well-being," said Democratic pollster Peter Hart, who co-directs the survey with Republican pollster Bill McInturff.

The co-chairmen of Mr. Obama's deficit panel, former Sen. Alan Simpson, a Republican, and former White House Chief of Staff Erskine Bowles, a Democrat, released their proposal last week.

The survey shows Republicans are more negative than Democrats on the commission leaders' formulation for trimming $4 trillion over the next decade. The leaders have proposed a combination of spending cuts and tax increases.

Nearly half of Republicans call the plan a "bad idea," compared with about a third of Democrats who see it that way. Twenty-eight percent of Democrats said it was a good idea, compared with 17% of Republicans.

Murkowski wins Alaska seat

JUNEAU, Alaska—Sen. Lisa Murkowski on Wednesday became the first Senate candidate in more than 50 years to win a write-in campaign, emerging victorious over her tea party rival following a weeklong count of hand-written votes.

The victory completes a remarkable comeback for the Republican after her loss in the GOP primary to Joe Miller.

Her victory became clear when Alaska election officials confirmed they had only about 700 votes left to count, putting Ms. Murkowski in safe territory to win re-election.

It wasn't clear how Mr. Miller will proceed. He and his advisers have vowed to take legal action over what they contend is an unfair tally in Ms. Murkowski's favor, but Mr. Miller has maintained he will stop fighting if the math doesn't work in his favor.

WORLD NEWS

Israel agrees to withdraw in Lebanese-border plan

BY CHARLES LEVINSON AND JOSHUA MITNICK

GHAJAR, on the Israel-Lebanon border—Israeli forces will withdraw from the northern half of this village straddling the Israeli-Lebanese border, the Israeli government said Wednesday, accepting a two-year-old United Nations proposal that will bring the last Israeli soldiers home from Lebanon following the 2006 war against Hezbollah.

U.S. officials have long pressed Israel to accept the U.N. proposal. Such a withdrawal, U.S. officials argued, would bolster the political standing of Lebanese political parties that oppose the militant Shiite Hezbollah. They said it would demonstrate that the Lebanese could better liberate their lands through peaceful negotiations instead of armed resistance, thus undermining Hezbollah's principal argument for continuing to arm itself.

A senior Israeli official said the government approved the U.N. proposal only after certain changes were made but declined to specify what those changes were.

Israel's decision comes amid growing concern that Lebanon's tense status quo is on the verge of coming unhinged. A U.N. tribunal is expected to announce indictments in coming weeks of senior Hezbollah officials implicated in the assassination of former Lebanese Prime Minister Rafiq Hariri.

Many observers fear the indictments could spark a showdown between the country's rival political blocs or that a cornered Hezbollah could try to provoke another conflict with Israel. The Israeli withdrawal from Ghajar could strengthen Israel's hand diplomatically in the event of future conflict.

"Israel is telling the international community: If there is any attack by Hezbollah, it will be against international law and Israel will have full right to defend itself," said Nawaf Kabbara, a Lebanese political analyst.

A Hezbollah official said Wednesday it would withhold judgment on the Israeli plan until after Israel implements its withdrawal. But Hezbollah has indicated in the past that it is unlikely to accept the terms of the current U.N. plan.

The U.S. welcomed the announcement. State Department spokesman Philip J. Crowley said in a statement that the U.S. "encourages Israel and the UN to complete the technical details necessary to implement this proposal rapidly."

The Israeli decision also comes as Israel's hard-line government is coming under growing international criticism over its inability to unite behind a viable strategy for pursuing peace with the Palestinians.

"The government is paralyzed on the Palestinian track and this is a politically painless way for this government to show that it's doing something to advance peace in the region," a senior Western diplomat said.

For decades, Ghajar's residents have occupied an awkward place along the seams of the Arab-Israeli conflict. Village residents are members of Syria's minority Alawite sect and identify as Syrian. When Israel conquered Syria's Golan Heights in 1967, it captured the village, too.

In 1978, Israel invaded southern Lebanon and established a buffer zone along the border. Ghajar expanded northward into Lebanese territory. Ghajar's residents accepted full Israeli citizenship. When Israel withdrew from southern Lebanon in 2000, Israel and Lebanon both agreed to accept a U.N. demarcated border—known as the "blue line"—between the warring states.

The U.N. drew the line through the middle of the village, leaving Israeli soldiers on one side and Hezbollah bunkers on the other. It became a notorious crossing point for drug smugglers and a base of operations for Hezbollah militants plotting cross-border attacks on Israeli soldiers. In 2006, when Israel again went to war against Hezbollah, it reoccupied the village's northern half.

Many of the village's 2,300 residents are fearful of being turned over to Lebanese sovereignty. Under the U.N. proposal Israel approved, residents of Ghajar's northern half will remain Israeli, but will technically live on Lebanese territory.

A senior Israeli official said U.N. forces would deploy along the village's border to keep Hezbollah militants and drug smugglers out. Who exactly would provide basic services, such as emergency care, still has to be worked out, the official said.

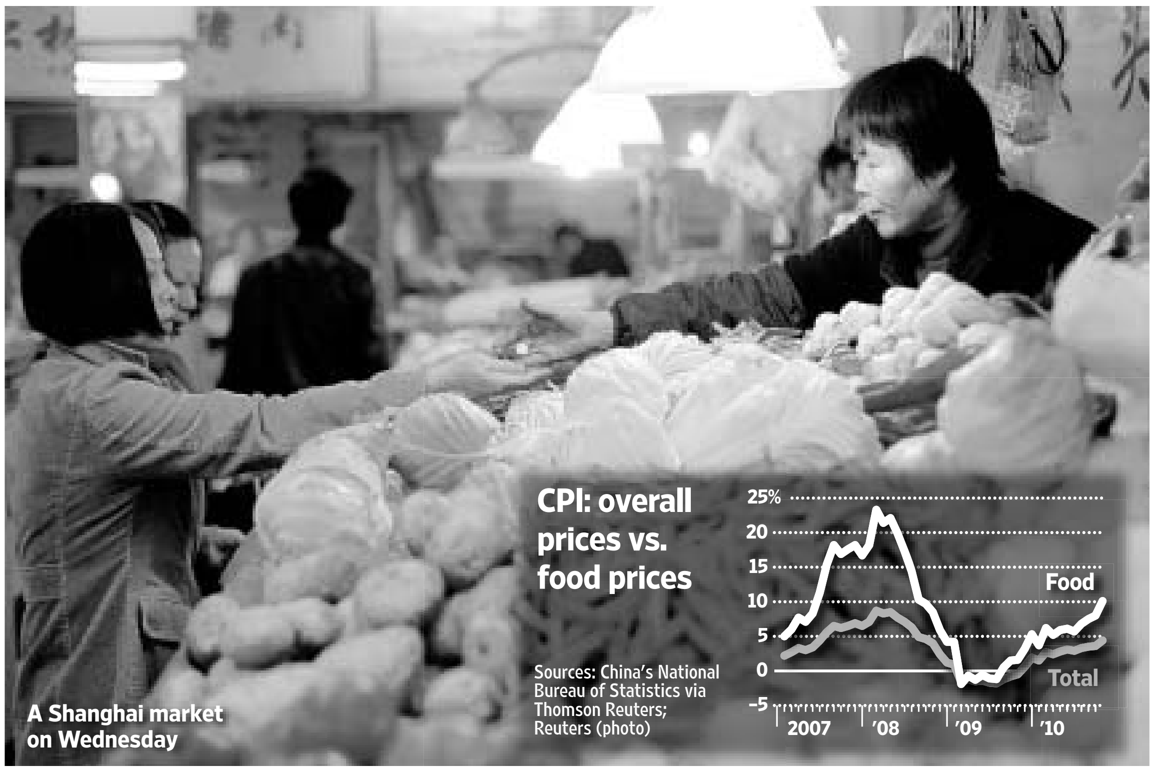
—Nada Raadin in Beirut contributed to this article.

Polaris

An Israeli soldier patrols in Ghajar, a village straddling the Israel-Lebanon border.

China to curb food, fuel prices

By Andrew Browne And Alex Frangos



A Shanghai market on Wednesday

Sources: China's National Bureau of Statistics via Thomson Reuters; Reuters (photo)

BEIJING—China said it is ready to clamp price controls on daily necessities to bring down inflation, dusting off a measure from socialist central planning in a new sign of alarm by Chinese leaders who have been striving to cool economic growth through more conventional means such as raising interest rates.

A statement from the State Council Wednesday pledging to use administrative measures to tame rising prices of food and energy, and to cushion the poor with higher welfare payouts, appeared mainly to reflect government concerns that inflation could trigger social unrest.

Accelerating food prices— the biggest single component of China's inflation, now running well above the government's target of 3% for the year—are hurting China's neediest households, and their plight could get worse as the country heads into what is forecast to be an unusually cold winter that threatens to disrupt transport and bring new fuel shortages.

Some economists interpreted the statement as a signal that the government was more concerned about the political fallout of inflation than with economic overheating in general. The last time Beijing resorted to price controls was when inflation spiked in 2008.

Still, the measures feed into anxieties among investors that China will roll out increasingly stringent anti-inflation measures that will put a sudden brake on its growth.

The State Council said the government would intervene "when necessary" to impose temporary controls on the prices of "important daily necessities and factors of production." It promised to crack down on speculators who have been driving up the price of agricultural commodities. And it outlined moves to boost the supply of diesel, used for farm vehicles, and control energy prices.

Talk of price controls has worried investors for several days and has helped to send China's stock markets swooning. The benchmark Shanghai Composite Index has lost 10% in the past four trading days, including a 2% drop Wednesday.

That China sees it necessary to use price controls has signaled that policy makers have been too reactive to the inflation threat, instead of getting ahead of the problem, says Li-Gang Liu, head of China economics for ANZ Bank in Hong Kong.

"If they use too harsh monetary policy to tighten credit supply in the remainder of the year, it's quite likely we will see some sort of hard landing," Mr. Liu says.

Supermarkets and restaurants across China are passing on rising agricultural prices to their customers. **McDonald's** Corp. on Wednesday blamed growing costs for a decision to increase prices at its more than 1,100 China outlets by up to one yuan, or 15 U.S. cents, on a range of items, including Chicken McNuggets, pies, and ice cream.

A Chinese hard-landing scenario has helped roil international markets at a time when investors are consumed with European debt problems and rising bond yields in the U.S. China is seen by investors as having played a major role in reflating the global economy, and a bruising inflation fight could mean the world's fastest growing large economy could become weighed down.

Expectations that China will curb its voracious appetite for commodities has sent prices lower for everything from crude oil to soybeans.

Since Nov. 11. when China published a surprisingly high 4.4% October consumer-price reading, Nymex crude oil for December delivery has fallen 7%. Soybean prices traded at the Chicago Board of Trade have fallen 9%. On the Shanghai Futures Exchange, copper and zinc both fell 5% Wednesday, triggering circuit breakers that limit one-day moves.

The urgency for Chinese officials to address rising inflation may have been increased by the U.S. Federal Reserve's plan to resume buying government bonds to drive interest rates lower. In recent weeks, numerous Chinese officials have said that policy threatens to spur inflation and capital inflows to emerging economies.

Economists point out that the Fed's looser monetary policy should only be inflationary for China if it tries to keep its currency effectively pegged to the U.S. dollar. So the increased worries about inflation could be another incentive for China to continue, or perhaps accelerate, the recent appreciation of its currency, which has been rising about 1% a month against the U.S. dollar since September.

While a stronger yuan puts pressure on China's exporters, it also lowers the price of imports, especially raw materials that are generally priced in dollars. "China has to allow [the yuan] to appreciate faster to dampen the effect of imported inflation," says Mr. Liu of ANZ.

Price controls are arguably the sixth tool Chinese policy makers have unveiled this year to fight inflation. The others include increases in bank reserve requirements, lending curbs against property, tightening capital controls, an interest-rate increase in October, and modest currency appreciation.

—Victoria Ruan and Andrew Batson contributed to this article.

Afghan auditor faces U.S. inquiry

By Nathan Hodge

Associated Press

Pressure is mounting on Arnold Fields.

WASHINGTON—The top U.S. official charged with rooting out corruption in Afghanistan is expected to face tough questions this week, as a congressional panel examines his track record as the government's chief Afghanistan watchdog.

Over the past several months, Special Inspector General for Afghanistan Reconstruction Arnold Fields has faced a crescendo of bipartisan criticism in Washington, with several senators calling publicly for his ouster over what they say is poor performance. But the embattled inspector general has dug in his heels, saying his organization, known as Sigar, until recently lacked the resources to do its job properly.

On Thursday, Mr. Fields is expected to appear before the Senate Homeland Security and Governmental Affairs subcommittee on contracting oversight. Senators are expected to grill Mr. Fields on what they perceive to be key missteps.

Thursday's hearing may accelerate calls for Mr. Fields's removal. But it may also serve as an object lesson in the difficulty of tracking U.S. taxpayer dollars in a war zone.

The hearing is also likely to draw comparisons between Sigar and its sister organization, the Special Inspector General for Iraq Reconstruction. Stuart Bowen, the top Iraq watchdog, is also slated to testify.

Since it was created in 2008, Sigar has delivered 34 audits. It has recovered more than $2 million in payments and has issued fines of around $4.5 million. Its investigations have yielded four criminal convictions. In nearly seven years of existence, the Special Inspector General for Iraq Reconstruction has produced 177 audits, 171 assessments and evaluations, saved or recovered $151 million, and challenged $38 million in payments. Its criminal investigations have led to the convictions of 44 individuals.

Sigar employs a staff of 123. Its criminal investigators and auditors are tasked with tracking waste, fraud and abuse in Afghanistan.

In an interview last month, Mr. Fields and top deputies painted a picture of an organization that had been forced to stand up without adequate funding and staff, and that faced severe recruiting challenges and logistical hurdles.

Mr. Fields has been under fire for months. A memorandum circulated last year by Capitol Hill staffers blasted the quality of Sigar audits. This summer, the Council of the Inspectors General on Integrity and Efficiency, an independent oversight body, issued a damning performance appraisal, and the agency came close to losing law-enforcement authority.

Mr. Fields said Sigar had addressed most of the concerns raised by the review—"We have more than turned the corner on this," he said—and said he hired the firm of Joseph Schmitz, a former Department of Defense inspector general, on a two-month contract to oversee compliance with the oversight council's recommendations.

The decision to hire Mr. Schmitz, who left government service in 2005 to work for the Prince Group LLC, the parent company of the private security company formerly known as Blackwater, infuriated congressional critics.

Mr. Schmitz defended his work. "The nature of what I did allowed IG Fields to focus on his statutory mission," he said.

Madagascar authorities vow to end rebel coup

By David Gauthier-Villars And Peter Wonacott

Madagascar authorities vowed Wednesday to thwart a mutiny orchestrated by a small group of army officers, but the apparent absence of any arrests among the mutineers suggested leaders were locked in a contest for control of the resource-rich island nation off Africa's southern coast.

A group of about 20 officers claimed Wednesday that it had toppled Madagascar leader Andry Rajoelina, a former radio disc jockey and self-proclaimed president who took power in a military coup last year.

"We are dissolving the existing regime and setting up a military leadership to seize power," Col. Charles Andrianasoavina, a rebel leader who had backed the 2009 revolt, told news channel France 24.

In a statement later Wednesday, Prime Minister Albert Camille Vital rebutted those claims. He said the situation in the island was calm and urged the mutineers to return to their barracks. "The rule of law applies in Madagascar; nobody is above the law," he said, according to spokeswoman Hanitra Andriamalala.

Local media quoted Mr. Rajoelina, the island leader, saying he would take action to quash the mutiny.

Government officials said it was too early to say the coup attempt had failed because, as of late Wednesday, part of the group of mutineers was still entrenched in a military base located near the airport of Madacascar's capital city, Antananarivo.

There were no outward signs of a coup—no military occupation of buildings or television stations. While scuffles broke out between police and protesters, they were mainly confined to the area around the airport, where the group of soldiers made their declaration about a change of government.

Still, tensions have been steadily rising for weeks.

The attempted coup came the same day voters in Madagascar cast ballots on a new constitution. Mr. Rajoelina, a former mayor, has repeatedly promised and then postponed elections. He is now supporting changes to a constitution seen as solidifying his political grip.

Among proposed changes would be the lowering of the minimum age for president to 35 from 40. Mr. Rajoelina is 36 years old.

Madagascar's ousted president, Marc Ravalomanana, has been living in exile in South Africa, officials say. The former president couldn't be reached to comment.

Mr. Rajoelina's apparent bid to stay in power has alienated foreign donors and clouded the country's future, says a Western diplomat in the country. "Things are getting heated," he said. "What happens next is really hard to say."

In the absence of much aid and with the halting of some preferential trade treatment, Madagascar's economy has been hit hard. Some say the government has resorted to murky mining and logging deals with foreign companies to raise revenue, opening rifts in the military.