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THE WALL STREET JOURNAL.

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Trouble flares in France

Reuters

Arcelor Mittal steelworkers dressed in protective suits demonstrate over pension reforms in Marseille, Tuesday, as France faced its sixth day of nationwide strikes and protests in two months. Unions want the French government to back down over the reforms. **Full article on page 3.**

China's move to raise rates jars markets

By Andrew Batson

BEIJING—China surprised investors by raising interest rates Tuesday, sparking a global selloff in stocks and commodities as investors reassessed their assumptions about economic growth in the emerging markets.

Currency markets reacted swiftly, with countries that depend on Chinese demand for their commodities seeing the biggest impact. The U.S. dollar rose 2% against the Canadian dollar and 1.65% against the South African rand. The Australian dollar, seen as the closest proxy for China's economy, fell 2.79% against the greenback in afternoon trading. The euro was also weaker Tuesday afternoon.

The impact was also felt in the commodity markets, where China's demand plays a significant role in setting prices. Gold, which set a record high last week, fell $36.10 per troy ounce, or 2.63% to $1335.10. Oil also slid, with Nymex November crude down 4.32% to $79.49 a barrel Tuesday afternoon.

It was China's first interest-rake hike since it emerged from the financial crisis, a surprise move that highlights the widening gap in the world economy between economically vibrant developing countries and the rich nations trying to fend off stagnation.

The People's Bank of China said Tuesday that it increased the benchmark one-year interest rate on loans and deposits by a quarter of a percentage point. The move is the first adjustment to interest rates since December 2008, when the central bank cut them by 0.27 percentage point as part of a stimulus package to combat the effects of the global financial crisis. The last rate rise was in December 2007, when inflation was over 6%.

The move came days before finance ministers and central bankers from around the world are to gather in South Korea, but didn't appear to have any direct link to that meeting, nor is it likely to relieve pressure on China to continue to let the yuan rise. Economists said the move was mainly domestically focused, aimed at heading off a property-price bubble and taming inflation.

With the rate increase, China joins other rapidly growing developing countries, including India and Thailand, who have shifted their economic policies to reflect how they have bounced back from the lows of the financial crisis. "Asia is leading the global recovery and is moving swiftly back toward normal policy conditions," the head of

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No elected government can unravel the welfare state without losing power. **Page 15**

U.K. unveils sweeping cuts to military amid deep deficits

The U.K. government announced sharp reductions in all of its military services, in a bet that it can cut defense spending by 8% without jeopardizing the country's continued place among the world's biggest military powers.

"Britain has traditionally punched above its weight in the world and we should have no less ambition in the decades to come," Prime Minister David Cameron told Parliament on Tuesday.

Late Monday, Mr. Cameron had shared details with U.S. President Barack Obama in a phone call, hoping to assure the White House that Britain will still be equipped to fight alongside the U.S. on missions overseas—such as Iraq and Afghanistan.

The military cuts came a day ahead of Wednesday's Comprehensive Spending Review, the broad blueprint for cutting the U.K.'s deficit, with deep cuts planned. After a battle between the Treasury and Ministry of Defence, the government has kept the defense cuts well below the 25% reductions it is set to ask other departments.

Mr. Cameron announced that the British army will lose 7,000 of its 103,000 personnel by 2015. Naval manpower will fall by 5,000 to 30,000 and the Royal Air Force will lose 5,000 of its 38,000 positions. An additional 25,000 civilian jobs will be lost.

The U.K. will also slash its order of the Joint Strike Fighter to about 40, with an option to buy more later, one person familiar with the matter said. That is down form the 138 that the U.K. was once set to buy.

Mr. Cameron also set plans to withdraw the 20,000 British troops stationed in Germany some 10 years earlier than planned. He promised to invest in special forces and cyber warfare.

The U.K. is also retiring both its Harrier jet fleet and its flagship carrier, the Ark Royal. The upshot is that the British will have no carrier-strike capability for a number of years.

Ed Miliband, the leader of the opposition Labour party, said this will leave Britain with "aircraft carriers without aircraft."

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Cameron's defense cuts reveal a U.K. that is preparing to do less with less

[Agenda]

By Iain Martin

David Cameron is usually calmness and confidence personified. He rarely looks uncomfortable. But when the prime minister went to visit armed services personnel at U.K. Joint Operations HQ on Tuesday morning, ahead of delivering his Strategic Defense Review to Parliament, there was a distinctly awkward moment. Mr. Cameron was explaining that economic circumstances and the size of the deficit make tough choices and cuts to defense spending inevitable

With the cameras rolling, one warrior spoke up: "I am a Harrier pilot and I have flown 140-odd missions in Afghanistan, and I am now potentially facing unemployment. How am I supposed to feel about that, please, sir?"

It was a well aimed question, and note the polite "please, sir" on the end. Speaking out was 37-year-old Lt. Cdr. Kris Ward. His father is Cdr. Nigel "Sharkey" Ward, a celebrated Harrier pilot who led missions during the Falklands conflict against Argentine forces in 1982. The Harrier, introduced in a jump jet format in 1969, has a special place in British affections because of its role in that war in the South Atlantic.

Mr. Cameron took a deep breath, thanked the younger Ward for all his efforts and praised the Harrier fighter jet to the skies. But Mr. Cameron's answer had a hole in it.

The Harrier is to be scrapped in the defense cuts program. That means that, astonishingly, Britain will soon have two new aircraft carriers—both ordered by the last government in better times at a cost of £5.2 billion ($8.1 billion)—but no planes to fly from their decks for almost 10 years.


Reuters

Prime Minister David Cameron announces the U.K. defense cuts on Tuesday.

U.K. forces will have to wait until the Harrier's replacement arrives from the U.S. in the shape of the Joint Strike Fighter in 2020. Until then the new carriers can tootle around carrying helicopters, but as instruments of power projection they will be about as much use as a chocolate fire-guard. One may be sold.

As instruments of power projection the carriers will be about as much use as a chocolate fire-guard.

Aircraft carriers without aircraft counts as a proper mess. The prime minister was lucky not to be put under more pressure on this when he unveiled his cuts to the House of Commons.

Mr. Cameron responds to any criticism by saying he has little choice and that he and the Defence Secretary Liam Fox are doing their best to sort out a mess left behind by Gordon Brown's government. On the Harrier, he was faced, he claimed, with the option of keeping either it or the RAF Tornado for Afghanistan. In reality, of course he had a bigger choice: His party ring-fenced spending on the National Health Service and the budget for Overseas Aid, so that it could not be accused by Labour during the election of being uncaring. He could have chosen other priorities instead, such as defense of the realm, and not ended up with plane-free aircraft carriers.

The Harriers were just the standout cut on Tuesday. The decision on renewing Trident, Britain's nuclear deterrent, will be delayed until 2016—as expected. Troop numbers will come down to such an extent that Britain will no longer be able to deploy a force of 45,000, as it did in Iraq. The prime minister admits that only 30,000 troops could be assembled if required for a future operation. The Nimrod reconnaissance planes are also to be scrapped and overall U.K. defense spending is being cut by 8%.

Beyond trying to save money, what is Mr. Cameron up to? Clear away all the rhetoric about the U.K. remaining a power of considerable influence with strategic heft after the cuts, and it becomes clear that this defense review amounts to a considerable downsizing of British ambitions. The liberal-interventionist aims of the Blair years are being abandoned by a prime minister who never bought the neo-conservative analysis of threats and how to deal with them.

The emphasis in the National Security Strategy, the document that accompanied the defense review, is on cyberwarfare, terrorism and the need to maintain Britain's position as a small nation with a long and successful history of trading its way to prosperity. There are nods to increased cooperation with Europe (the French and the British are discussing forging closer links on the defense front) and a commitment to the trans-Atlantic alliance and NATO. But this is what a British government is expected to say when it is publishing such papers.

The real driving force is Mr. Cameron's pragmatism, and his view that Britain is going to have other priorities in the next decade and beyond. Hence the lack of planes on the new aircraft carriers: He calculates they won't be needed anytime soon.

The gamble is that after the departures from Iraq and Afghanistan and the heat of conflict, there will be a considerable cooling. During this period he wants to concentrate on dealing with Britain's deficit and hopes prosperity will follow.

On Wednesday, Chancellor George Osborne will unveil the results of the Comprehensive Spending Review, laying out the cutbacks in other government departments designed to get spending down.

But unexpected threats to security have a habit of creeping up on you. Gamble on the world being a dull place for a while, and the risk is of an unavoidable conflict flaring up suddenly.

Hemmed in by the deficit and a difficult inheritance, Mr. Cameron can only hope that doesn't happen this time.

ONLINE TODAY

Most read in Europe

1. Facebook in Privacy Breach
2. Apple Profit Muscles Past IBM
3. Using iPad for Speech Therapy
4. Democrats Pin Hopes on Obama
5. The Lakes, England

Most emailed in Europe

1. Facebook in Privacy Breach
2. The Secret to Turning Consumers Green
3. U.S. Seeks Billions in India Deals
4. Japan Calls for Currency-Market Cooperation
5. Merkel Enters Immigration Fray

The Source

blogs.wsj.com/source

'Spain is finally getting a benefit out of its World Cup victory. It's only €40 million, tops.'

David Roman on the relatively small World Cup victory premium

Continuing coverage

Follow the latest news and analysis on the U.K. spending review today at **europe.wsj.com**

Question of the day

Vote and discuss: Do you think the U.K. defense cuts have gone too far?

Vote online today at **wsj.com/polls** and for more U.K. news visit **wsj.com/uk**

Previous results

Q: Would an AOL/Yahoo deal make sense?

Yes **29%**

Possibly **22%**

No **49%**

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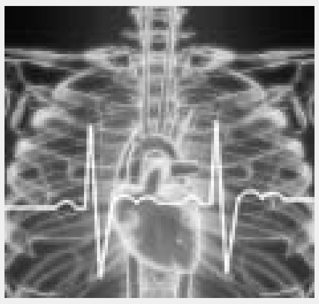

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NEWS

French nationwide strikes intensify

By David Gauthier-Villars

PARIS—French labor unions vowed to keep demonstrating in the streets, thwarting gasoline supplies, flights and public transport, as rolling strikes against President Nicolas Sarkozy's pension overhaul enter their second week.

The protests—which are the biggest resistance to economic-austerity measures across the European Union but which Mr. Sarkozy has vowed won't derail the government plans—could tarnish the leader's presidency, fewer than two years before the next elections.

French people so far have shown sympathy for worker protests, according to several opinion polls. But as the strikes continue and become more crippling, with sporadic violence, the tide may turn in favor of Mr. Sarkozy. Political analysts said the French president's intransigence could eventually become an asset. Many of Mr. Sarkozy's predecessors have backed down in the face of public protests.

"The more radical the protests get, the better for Mr. Sarkozy," said François Miquet-Marty of French polling group Viavoice. "French people don't like it when strikes disrupt their everyday life."

The confrontation with unions is proving a major test for Mr. Sarkozy, who has said he won't give in to street protests, and repeated on Tuesday that he aimed to press ahead with the pension overhaul.

"The biggest problem would be if I failed to do my duty, to make sure that we can pay for today's and tomorrow's pensions," Mr. Sarkozy told journalists during a briefing in the northern French city of Deauville.

Mr. Sarkozy says French people can't afford to retire earlier than people in most of their EU neighbors, which have cut pension benefits or raised future retirement ages in accordance with rising life expectancies. To bridge a growing shortfall in France's state-run pension funds, he has proposed increasing the standard, minimum retirement age to 62 years old from 60.


European Pressphoto Agency

Firefighters extinguish burning cars during protests in Lyon by high-school students Tuesday. As many as 10% of classes were disrupted or canceled nationwide.

On Tuesday, unions organized a sixth day of nationwide marches in two months, saying they want the standard age to remain at 60. They caused disruptions, notably in the public-transport and education systems.

Between a third and half of flights to and from Paris's main airports were canceled. In Lyon and in the Paris suburbs, several cars were burned when youths clashed with riot police. Classes were disrupted or canceled at between 5% and 10% of France's high schools, according to the Education Ministry and student unions.

The main cause of crippling disruption is refinery workers, who have been on strike for more than a week. French motorists are struggling to fill their tanks as about a third of France's 12,500 gas stations have run dry, the government said.

Prime Minister François Fillon said Tuesday that the government would step in to unblock fuel depots and promised the gasoline supply would return to normal within four or five days.

French government officials said they expected protests would wane when the pension bill is approved by Parliament, possibly later this month, and when many people go on vacation next week.

But some union leaders said they were determined to protest further.

"We won't go back quietly to our rooms," Charles Foulard, a delegate with the CGT union at the Grandpuits refinery near Paris, said in a telephone interview. "Perhaps that is what Mr. Sarkozy is hoping for but it won't happen."

Social-welfare bills have crippled governments in the past. In 1995, newly elected President Jacques Chirac indicated he might call into question the special pension benefits of some workers, such as train drivers, who could retire at 50 or 55. In response, transport workers brought France to a three-week halt, and Mr. Chirac didn't try to enact other major changes to benefits in his next 12 years in office.

Other EU countries have in recent years increased their retirement ages and cut pension payments to respond to slow growth and longer life spans. In 2007, Germany opted to gradually increase its standard retirement age to 67 from 65. Last year, Italy pegged future retirement ages to rising life expectancy.

France reduced the minimum retirement age to 60 from 65 in 1983 under Socialist President François Mitterrand. Unions saw this as a major social victory, ranking alongside five weeks of annual vacation, a minimum wage and the 35-hour workweek.

More recently, France has reduced some pension benefits. But in its effort to avoid cutting monthly payments to pensioners, it has also piled up debt. If no changes are made to the system, the annual deficit of state-run pension funds could exceed €45 billion ($62.7 billion) by 2020, according to a council advising the government.

China rate increase rattles global markets

Continued from first page

the International Monetary Fund, Dominique Strauss-Kahn, said Monday in Shanghai.

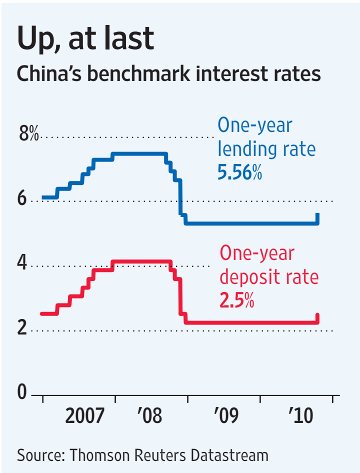
In the U.S., Europe and Japan, meanwhile, interest rates remain stuck at historic lows. With the recovery so far having done little to repair the economic damage from the crisis, policy makers are looking for ways to push them even lower in hopes of giving growth more of a boost. That divergence in economic fortunes is showing up in both trade tensions, most notably with the U.S. and Europe pushing China to let its currency rise, and rapid flows of investor money into emerging markets. Those strains threaten to overshadow the summit of the Group of 20 major economies next month.

China's central bank, as is its usual practice, didn't elaborate on the reasons for its interest-rate move, which came two days before economic data for September and the third quarter are due to be published. But economists see stubbornly high housing prices as one of the main drivers of its decision. Since April, Chinese authorities have taken numerous measures to curb speculative purchases and make housing more affordable for average citizens, taking aim at a problem that leaders have said could threaten social stability.

But those policies produced few solid results: While sales cooled, housing prices were flat for just three months, on official figures, before they started rising again in September. According to real-estate agency Soufun, prices jumped 13% from August in the eastern city of Hangzhou, and 45% in the southern resort town of Haikou. That likely strengthened the argument for tougher measures to deal with the problem, economists said.

With returns on bank savings low—the benchmark one-year deposit rate will rise to just 2.50% after Tuesday's move—Chinese households have a strong incentive to put their money into assets that promise a better return.

Broader measures of inflation have been picking up, with consumer prices in August up 3.5% from a year earlier, further eroding the gains to savings. So the only way to "puncture the housing bubble" is to get rates higher, said Standard Chartered economist Stephen Green.



The interest-rate move marks a shift in strategy by authorities, which had previously relied on administrative controls such as limits on bank lending and changes in required mortgage down payments. "Today's decision to hike rates suggests that Beijing feels these earlier, more targeted measures are no longer enough to keep the economy on an even keel," said Royal Bank of Canada economist Brian Jackson.

World Bank economists have for several months been arguing that it would be beneficial for Chinese policy makers to use more market-based measures such as interest rates, rather than old-style quotas.

"This is largely a question of efficiency and of better allocation of financial resources," World Bank economist Louis Kuijs told reporters in Beijing on Tuesday, at a briefing before the rate hike was announced.

The same arguments have also been used to encourage China to let the yuan follow market pressures to appreciate. China has done that to a limited extent—its currency is up 2.5% against the dollar since a June pledge of exchange-rate flexibility—but continues to intervene heavily to restrain the exchange rate. But higher interest rates and a stronger exchange rate both tend to cool down the economy, and policy makers may be reluctant to risk too sharp of a slowdown by using both.

So the interest-rate increase lowers the chances of a large rise in the Chinese yuan, said Royal Bank of Scotland economist Ben Simpfendorfer. China "typically avoids hiking through multiple policy instruments simultaneously," he said, and "will more likely wait to see the impact of today's hike, including its impact on capital inflows, before allowing the currency to appreciate at a more rapid pace."

It is less clear how the interest rate move will affect inflows of foreign investment, which have been picking up in recent months and drawing concern from Chinese officials worried about additional upward pressure on the exchange rate.

Nicholas Lardy, a China specialist at the Peterson Institute for International Economics, said the higher rates will attract more money into China, which would require authorities to buy more dollars to restrain the yuan.

"They're going to have to work harder to keep the yuan from rising," he said.

But China tightly controls flows of capital across its borders, meaning it isn't easy for investors to make trades to take advantage of the interest-rate differential. And if authorities successfully cool down housing prices, real estate could become a less tempting target and thus reduce such inflows.

—David Wessel in Washington and Owen Fletcher and Liu Li in Beijing contributed to this article.

Retreat | The U.K. is cutting thousands of military jobs in a bid to reduce the deficit

British Army soldier of C Squadron

Harrier jet of 1(F) Joint Force Squadron

Royal Navy ship HMS Ark Royal

Ministry of Defence building, London

Army

Britain's army will be cut by 7,000 troops to 95,500 by 2015.

Tanks and heavy artillery numbers to be reduced by 40%.

Air Force

Nimrod reconnaissance aircraft program will be canceled.

Manpower at the Royal Air Force will be cut by 5,000 to 33,000 by 2015.

U.K.'s Harrier jump jets will be removed from service in 2011.

Navy

Naval manpower will be cut by 5,000 to 30,000 by 2015.

Two new aircraft carriers will be built, though one will be mothballed.

HMS Ark Royal aircraft carrier will be decommissioned four years early.

Civilian personnel

The Ministry of Defence will cut its civilian staff by 25,000 by 2015.

Photos: Reuters (soldier, building); Getty Images (Harrier jet, ship)

Cameron unveils defense cuts

By Alistair MacDonald

LONDON—The debt-strapped U.K. government announced an 8% spending cut in its military budget, betting that it can axe personnel and military hardware without jeopardizing the country's continued place among the world's biggest military powers.

The cuts announced Tuesday by British Prime Minister David Cameron mark the biggest one-off reduction at Britain's Ministry of Defense since World War II. The prospect of sharp reductions in the military services of the U.K—the biggest military ally of the U.S.—has spurred worry in Washington.

The cuts are the result of a strategic defense review ordered up by the U.K.'s new Conservative-led coalition government shortly after it took office. It is the first such review in over a decade, and one primary impact will be major personnel reductions.

Mr. Cameron announced that the British army will lose 7,000 of its 103,000 personnel by 2015. Naval manpower will fall by 5,000 to 30,000. The Royal Air Force will lose 5,000 of its 38,000 positions. Another 25,000 civilian jobs will be lost.

All of the services will also lose equipment. The British navy that once claimed to rule the seas will lose four frigates and battleships, while the Royal Air Force will lose the Harrier aircraft that was a source of British pride for 40 years. The U.K. will also postpone replacing its seaborne nuclear deterrent until after the next election in 2015.

In a cut that isn't spelled out in the review, the UK. will slash its order of the Joint Strike Fighter—a new high-tech jet being jointly developed with the U.S. and mainly built by Lockheed Martin Corp.—to about 40, with an option to buy more later, one person familiar with the matter said. The U.K. was once expected to buy 138 of the jets.

U.S. Secretary of State Hillary Clinton raised concerns about the looming cuts during a visit to Europe last week. Seeking to allay concerns, Mr. Cameron on Monday phoned President Barack Obama to reassure him that the U.K. will remain a big military power.

On Tuesday, Mr. Cameron predicted the cuts would spare the military's core functions and predicted that spending would begin to increase again after 2015. He said that even after the cuts, Britain's military budget would be the world's fourth-largest and the country would be able to meet its commitment to the North Atlantic Treaty Organization of spending over 2% of gross domestic product on defense.

"Britain has traditionally punched above its weight in the world and we should have no less ambition in the decades to come," he told parliament Tuesday.

Many political observers said the cuts could have been worse. On Wednesday, Mr. Cameron will release his broader blueprint for cutting the U.K.'s record deficit. After a battle between the Treasury and Ministry of Defence, the government has kept the defense cuts well below the 25% reductions it is expected to seek from other departments.

"This is muddling through, carrying on doing everything but with less money," said Dr. Paul Cornish, from the think tank Chatham House. "But at least it is not a Treasury-led slash-and-burn operation."

Frank Miller, a former member of George W. Bush's National Security Council, said U.S. officials would be pleased that the U.K.'s defense review didn't go farther. The capabilities the U.S. values in the U.K.—including a nuclear deterrent, special forces, intelligence-gathering and the ability to deploy a brigade overseas—remain in place, he said.

But the cuts follow a longer-term trend that has accelerated since the end of the Cold War and could herald further squeezes in the future. "These cuts don't push the U.K. past the tipping point, but it brings it dangerously close to that tipping point," said Thomas Donnelly, a director of the Center for Defense Studies in Washington.

The new military budget is also aimed at repositioning the U.K. for what Mr. Cameron calls the "age of uncertainty," in which Cold War fears of conventional state-on-state conflicts are replaced by terrorist threats, insurgencies and cyber warfare.

To that end, Mr. Cameron announced 40% cuts to tanks and heavy artillery and plans to withdraw the 20,000 British troops stationed in Germany some 10 years earlier than planned. He promised to invest in special forces and cyber warfare.

For long the world's dominant armed force, the U.K. military still managed to remain relevant even after being eclipsed by the U.S. and Russia after World War II. Britain's active military and nuclear deterrent has given the country heft on the global stage even as its comparative economic size fell.

Mr. Cameron blamed the need for cuts on the overspending and mismanagement of programs by the previous Labour regime, which government auditors say left a €37 billion black hole. One project being axed is the Nimrod reconnaissance plane, which was eight years late and 200% over budget.

Arguments on the defense budget have proved the most heated within the U.K.'s spending review in a country whose self identity is tightly bound with its military history.

Like many ex-service personnel, Stuart Tootal took the afternoon off work to hear Mr. Cameron's statement. "Anyone who has served is going to feel the pain of this," said Mr. Tootal, a former paratroop commander in Afghanistan. Mr. Tootal said he worried the cuts may affect morale of soldiers set to deploy to Afghanistan, where 340 British soldiers have died.

One of the most controversial decisions involved whether the U.K. should continue building two multi-billion-pound aircraft carriers, even as it was cutting costs and concluding that threats to the U.K. were less likely to come from conventional warfare.

On Tuesday, the government announced that it is going ahead with the construction—but with delays and odd consequences.

One carrier will be completed—and then immediately put on "extended readiness," or mothballed, to save costs; it may be sold to another country later. The other carrier will be delayed so it can be fitted with new technology that allows a wider variety of planes to land on it, including the U.K.'s version of the Joint Strike Fighter, a plane that is being developed with the U.S.

The moves come as the U.K. is also retiring both its Harrier jet fleet and its flagship carrier, the Ark Royal. The upshot is that the British will have no carrier-strike capability for a number of years.

Ed Miliband, the leader of the opposition Labour party, said this will leave Britain with "aircraft carriers without aircraft."

The government argues that the country has been without carrier-strike capability before and that the delay allows one carrier to be fitted with so-called "cat and trap" technology, which will allow it to fly carrier variety of the Joint Strike Fighter. This is significant because it allows Britain to buy a cheaper version of the JSF and allows the U.S. and France to land their jets on the ship, the government argues.

Big spenders | Top world–wide military states, 2009

Country	Spending, in billions	Spending, per capita	World share
U.S.	$661.0	$2,100	43.2%
China	100.4	75	6.6
France	63.9	1,026	4.2
U.K.	58.3	946	3.8
Russia	53.3	378	3.5
Japan	51.0	401	3.3
Germany	45.6	555	3.0
Saudi Arabia	41.3	1,603	2.7
India	36.3	30	2.4
Italy	35.8	598	2.3

Source: U.K. Office for National Statistics

Note: At current prices and exchange rates

Reductions may hit growth, group warns

By Paul Hannon

LONDON—With the U.K. government set to present a nervous nation with the details of impending budget cuts Wednesday, a respected economic research institute cautioned that the reductions by the center-right coalition may push the economy back into recession.

The National Institute of Economic and Social Research issued a study showing the chances are one in five the spending cuts will cause the economy to contract next year. If that happens, the government will have to put austerity on hold and provide some stimulus to growth, NIESR said.

"If the economic situation worsens noticeably, then the government should make it clear it stands ready to undertake a temporary fiscal stimulus," NIESR said. "This could be based on a temporary national insurance holiday or temporary tax rebates."

Even if the economy continues to grow, the institute said, it will do so at a slower pace than forecast by the Office for Budget Responsibility. In that case, tax revenues will increase less rapidly than the OBR expects, putting the government's five-year timetable at risk.

In its budget outlined in June, the government called for eliminating its structural deficit by the fiscal year ending March 2015. Having spent the months since then looking for ways to achieve that goal, the government is expected to announce deep, across-the-board spending cuts Wednesday.

One of the U.K.'s oldest and most respected economic research bodies, the NIESR is aided by the Bank of England, the U.K. Treasury and the Office for National Statistics, among others. Its former director, Martin Weale, is the newest member on the BOE's Monetary Policy Committee.

NIESR said it expects the economy to grow by 1.6% this year and next. In July, it forecast growth of 1.3% this year, and 1.7% next. A double-dip recession is unlikely, NIESR said. Its forecast for growth in 2011 is much lower than that of the OBR, which said in June that it expected gross domestic product to increase by 2.3% next year.

EUROPE NEWS

EU softens plan on debtors

By Charles Forelle

BRUSSELS—European Union finance ministers moved late Monday to water down a proposal to tighten sanctions on countries that run big deficits, suggesting that Europe may wind up with a softer package of fiscal reforms than was pledged when the Continent was in the throes of a sovereign-debt crisis this spring.

Many outside observers—and many European policy makers—have insisted that the 16-member euro zone needs new tools to rein in overspending nations that have run up towering debts. As a cornerstone to that effort, European policy makers have for months pushed a regime of sanctions and fines that kick in with minimal political interference.

But the finance ministers agreed Monday on procedures that in certain cases would give governments a chance to step in and effectively block the sanctions—leaving in place structural flaws that have prevented punishment from being meted out in the past.


EPA
Germany's Angela Merkel, with France's Nicolas Sarkozy Monday, softened her stance on sanctions after a French push.

Three weeks ago, the European Commission, the bloc's executive arm, proposed a system under which countries that breach the union's debt and deficit limits would be hit immediately with sanctions. The disciplinary process would begin with the country posting a deposit of 0.2% of gross domestic product to an escrow account and end with the money forfeited as a fine. The sanctions would kick in under a "reverse voting" scheme: They would be activated within 10 days unless a country mustered votes to veto them, a difficult proposition.

EU finance ministers—whose countries would be the ones paying the fines—appear less aggressive. Their agreement, along with that of the European Parliament, is needed to pass any commission proposal into law.

In their discussions Monday, ministers concluded that countries in breach of EU budget thresholds—an annual deficit of no more than 3% and total debt of no more than 60% of gross domestic product—should get up to six months to show adequate progress fixing the problem before the sanction system starts. Critically, the countries themselves will determine adequate progress.

The softer stance came after an aggressive push by France, whose president, Nicolas Sarkozy, met with German Chancellor Angela Merkel on Monday. Germany has been a supporter of tough sanctions. The two leaders issued a joint statement lending their support to the six-month trial notion.

That disappointed other budget hawks in the union. Swedish Finance Minister Anders Börg said Tuesday that he was "a little bit surprised that we did not have 100% backing for fiscal discipline from Germany."

The softening comes as worries about the EU's fiscal health continue to simmer. On Tuesday, Greece's finance minister said his country would post a bigger deficit than previously thought this year and would revise upward its 2009 figure. A Greek newspaper reported that the 2009 deficit would be changed to 15.5% of GDP from 13.8%.

And a study by U.K. bank Barclays Capital released Tuesday found that investors and companies have little faith that the European sovereign-debt crisis is over. In the Barclays survey, 82% of nearly 600 clients, including hedge funds, bank trading desks and companies, said they still expect to see either a full-blown euro-zone crisis, a debt restructuring or a default from a euro-area government borrower.

—Matthew Dalton and Eva Szalay contributed to this article.

Animal-cloning ban moves closer

By John W. Miller

BRUSSELS—The European Union moved a big step closer toward a ban on cloning farm animals and a prohibition of imports of cloned livestock and their meat and milk, which would be another stumbling block for the powerful U.S. farm biotechnology industry.

The European Commission, the EU's executive arm, proposed the ban Tuesday. It is expected to be approved in coming months by the European Union's 27 members and the European Parliament.

EU food and agriculture policies designed to keep out so-called Frankenfoods have continuously thwarted U.S. biotech firms.

"This decision turns a blind eye to global scientific agreement that foods from livestock clones and their offspring are completely safe to eat," said David Edwards, director of animal biotechnology for the Biotechnology Industry Organization, a Washington-based lobby group.

The EU already bans the planting of all genetically modified crops except for one kind of corn, keeping U.S. companies like **Monsanto** Co. and **DuPont** Co. out of the EU's $7 billion-a-year seed market. The EU, which bans imports of factory-farm meat, bought only $94.6 million of meat from the U.S. last year, compared with $2.6 billion purchased from New Zealand and Brazil. Cloned livestock are the next frontier in biotech farming.


Associated Press
Spain's first cloned fighting bull, named Got, was born in May.

The technology, pioneered with the famous birth of Dolly the sheep in 1996, is still clunky and expensive. Cloned animals cost $15,000 to $20,000 to breed. Fewer than one out of five clones survives past the first few days of life. But when cloning works, as it increasingly does, it can replicate star beefy bovine and plump pigs. Farmers in the U.S. have cloned several thousand cows and pigs, said U.S. and EU officials.

In January 2008, the U.S. Food and Drug Administration, after five years of research and deliberation, approved cloned animals and their offspring for consumption.

The commission proposed allowing cloning only for practices such as saving species from extinction, making pharmaceuticals or breeding performance animals like racehorses or fighting bulls.

Clones, the commission concluded, "are for researchers, not butchers."

Its justification wasn't food safety but animal welfare. "The scientific opinion is that [meat from cloned animals] cannot be differentiated in any way from food from normally bred animals," conceded John Dalli, the EU's health commissioner.

Cloned animals, while they develop inside the uterus, tend to grow so much that they become extremely painful for their surrogate mothers. They also have high mortality and abnormality rates, he said.

The commission left a loophole. Importing embryos and semen from cloned animals, or meat and milk from the offspring of clones, wasn't banned. They don't pose any special health risks and such a ban would be too hard to regulate. The EU imported $27.7 million of bovine semen from the U.S. last year. "We're not going to regulate for the world," Mr. Dalli said.

The U.S. companies at the forefront of the fledging cloned-livestock business, such as Austin, Texas-based **ViaGen** Inc., Pennsylvania-based **Cyagra** Inc. and Iowa-based **Trans Ova Genetics**, lashed out at the proposed ban.

"Today's report from the European Commission is disheartening to those who understand and realize the true value and potential of this very powerful technology," said Mark Walton, ViaGen's president.

Other governments need to be careful, Mr. Walton added, not to let the EU "make de facto short-term political decisions that hinder the ability of the world's farmers and ranchers to access this safe technology."

Ministers reach deal on rules for funds

By Matthew Dalton
And Nicholas Winning

LUXEMBOURG—European Union governments reached agreement on rules for hedge funds and private-equity firms, adding small changes to ease French concerns the new rules would allow offshore funds to operate in the EU without adequate legal scrutiny.

If approved by the European Parliament, the rules will require hedge funds, private-equity firms and other investment vehicles for sophisticated investors to register with national authorities.

National regulators and the European Securities and Markets Authority, the new pan-EU regulator, will have the power to order funds to limit the amount of borrowed money they use to boost returns if a risk to financial markets or the economy is seen.

The rules will also create a "passport" allowing funds to operate throughout the 27-nation bloc. The passport will first be available in 2013 to funds based in the EU and then in 2015 to funds from outside Europe.

Most funds that are managed from London and other EU financial centers are actually based in the Cayman Islands or other offshore tax havens. When the legislation was proposed by the European Commission almost 18 months ago, the requirement to get a passport and other provisions sparked fears from the hedge-fund industry that non-EU funds could be blocked from raising funds in Europe.

But the Alternative Investment Management Association, the EU's main hedge-fund lobby group, expressed relief at Tuesday's agreement. "The impact will be far less severe than if something close to the original proposal had been agreed," the group said.

The changes sought by France give more powers to the ESMA to supervise funds operating in the EU.

"It is indeed a compromise," said French Finance Minister Christine Lagarde at a meeting of finance ministers here.

The U.K., home to most of the EU's hedge-fund managers, was the toughest critic of the proposed rules for most of the lengthy debate, but it endorsed Tuesday's deal.

"The agreement represents a significant advance from the situation in May, when member states were on the verge of voting through an agreement that would have closed the EU market to funds from third countries, undermining competition and closing off a source of investment to the EU economy," U.K. Financial Secretary to the Treasury Mark Hoban said in a statement.

For a fund based outside the EU to get a passport, the country in which it is based must satisfy three requirements. First, it must have passed tax laws based on models from the Organization for Economic Co-operation and Development. Next, laws to prevent money-laundering and terrorist-financing should be in place. And finally, the country must have a deal to share information with the EU country that grants the passport.

Kevin McCarthy, a top GOP House recruiter, left, with Oregon candidate Scott Bruun.

Some experienced GOP hopefuls

Photos: Associated Press; iStockphoto (index card)

Republican House leaders seek to avoid mistakes of '94

By Naftali Bendavid

PORTLAND, Ore.—Republicans on the campaign trail are bashing the president and his agenda and some are vowing to shut down Washington if they don't get their way. Behind the scenes, key party members are talking a different game.

A number of House Republicans, including some who are likely to be in the leadership, are pushing a post-election strategy aimed at securing concrete legislation, with the goal of showing they can translate general principles into specific action.

Among the ideas is to bring a series of bills to the floor, as often as once a week, designed to cut spending in some way. Longer term, GOP leaders say they recognize they may have to compromise with Democrats in tackling broader problems.

If they recapture the House, Republicans say they are wary of following the example of the class of 1994, which shut down the government in a standoff with President Bill Clinton. Top Republicans contend that passing legislation, or at least making a good faith effort to do so, will earn them more credibility with voters than refusing to waver from purist principles.

"It's pretty clear the American people expect us to use the existing gridlock to create compromise and advance their agenda," said Rep. Darrell Issa (R., Calif.). "They want us to come together [with the administration] after we agree to disagree."

GOP leaders stressed that this depends on the willingness of President Barack Obama to compromise as well. And some say if the post-election atmosphere is especially toxic, such compromises may be difficult.

The approach stands in contrast to the Senate, where Republican nominees including Kentucky's Rand Paul and Nevada's Sharron Angle more clearly represent the anti-establishment instincts of the tea-party movement. This would be a role reversal of sorts—the Senate was designed by the founding fathers to be the more sober institution.

Under the leadership of Rep. Kevin McCarthy, a rising star, the GOP has recruited a slate of House candidates with an array of political experience, suggesting they know how to work within the strictures of government. In many cases, these aspirants boast of their record of working with Democrats.

The GOP roster doesn't fit the image of an invading revolutionary force. Of the Republicans' 89 "Young Guns," as the party's top House candidates are called, 55 have political experience. Five are former congressmen seeking their old seats back, such as former Rep. Steve Chabot, who served 14 years in the House. The rest are mostly state legislators, a typical path to Congress. Of the 34 newcomers, many are relatively mainstream candidates or aren't expected to win.

On a trip last week to encourage candidates in the Northwest, Mr. McCarthy visited a number of relatively traditional GOP candidates. Among them were Jaime Herrera, a Washington state legislator and former congressional aide. Mr. McCarthy appeared with Oregon State Rep. Scott Bruun, a legislator known for working with Democrats. And he held a breakfast fund-raiser in Portland for Rob Cornilles, a political novice and underdog in a Democratic district.

House Republican leaders including Mr. McCarthy have reached out to the tea-party movement, attended rallies, crafted a "Pledge to America" that reflects the movement's anti-establishment sensibilities and emphasized their sympathy with activists' anger at Washington. The incoming Republican caucus intends to move swiftly on key conservative priorities including spending, taxes and deficits.

But the party is also aware it may have a brief shot at convincing voters it has changed since the last time it held power, under President George W. Bush. Most Republicans now say the party strayed in matters such as spending and ethics.

"If we Republicans get a second chance and screw it up, we'll be put in the wilderness for a generation," Mr. Bruun said.

Rep. Bob Inglis of South Carolina, who lost his Republican primary to a challenge from the right, compared the GOP candidates to surfers using a tea-party wave to reach the shore. Once they arrive, he said, many will act like the lawmakers they replaced.

"Not every candidate that wins this November with tea-party support will be a tea-party partisan," Mr. Inglis said.

Mr. McCarthy, 45 years old, will play a key role in navigating this new landscape. The California lawmaker led the charge to recruit candidates and is racing around the country offering last-minute pep talks and fund-raising, packing protein shakes and bars in his suitcase to keep down his weight.

In talking to voters, Mr. McCarthy makes much of a youthful stint as owner of a deli called Kevin O's (his middle name is Owen). But much of his career has been in politics. In college, he was a leader of the California Young Republicans. He was an aide to former Rep. Bill Thomas (R., Calif.), chairman of the House Ways and Means Committee. He was elected to the California State Assembly and became minority leader before winning his House seat in 2006.

Should the Republicans recapture the House, Mr. McCarthy is seen as a strong candidate to be the third-ranking House Republican after John Boehner of Ohio and Eric Cantor of Virginia.

In touting the Republican candidates, he talks frequently about Stephen Fincher, a cotton farmer and gospel singer from Frog Jump, Tenn., who has never run for office before. But equally important is Rick Berg, who served in the North Dakota legislature for more than 25 years and may knock off longtime Rep. Earl Pomeroy.

Mr. McCarthy takes the view that a House Republican majority would indeed be a potent force of change. As he sped in a Chevrolet Silverado to campaign events, he contended this season's GOP candidates are relatively unorthodox, noting that fewer candidates come from state legislatures than in previous elections. "Also, these are not 20-year established people," he said. "They've been serving a couple terms. And some of them are serving part-time."

—Janet Hook, Brody Mullins and Neil King Jr. contributed to this article.

Home building perks up

By Justin Lahart And Jeffrey Sparshott

U.S. home construction rose last month, suggesting that the lull in the housing market that followed the expiration of home-buyer tax breaks in the spring has ended.

September construction starts on single-family homes rose 4.4% from August, an annual rate of 468,000, the Commerce Department said Tuesday. Overall housing starts, which include groundbreakings on apartment and other multifamily buildings, increased 0.3% to a seasonally adjusted annual rate of 610,000.

Even though the level of monthly housing starts is up from an average of 530,000 in the first quarter of 2009, by the standards of the past 50 years it is still low, noted New York Federal Reserve Bank President William Dudley in remarks to reporters Tuesday.

"One reason why so little housing is being built is that many existing homes stand vacant," he said. "We estimate that there are roughly three million vacant housing units more than usual. And more vacancies are added daily as the foreclosure process moves homes from families to mortgage lenders."

Bank of America Corp., after imposing a moratorium on foreclosures earlier this month because of documentation concerns, reopened more than 100,000 foreclosure actions Monday.

The combination of weak demand and the large supply of vacant homes for sale will leave housing starts subdued for several years, said Paul Dales, economist at Capital Economics. "We doubt that housing starts will reach one million before 2015," he said.

Regionally, housing starts in September increased 4.8% in the South and 2.9% in the Northeast. They fell 8.2% in the Midwest, and 3.6% in the West.

Building permits for single-homes, seen as an indicator of future construction, edged up to 405,000 in September from 403,000 in August. But weighed down by a drop in permits for multifamily homes, overall permits fell by 5.6% to 571,000.

Associated Press

Builders work on a house in Omaha, Neb., last month.

U.S. NEWS

Republicans poised for major gains

BY JONATHAN WEISMAN

WASHINGTON—A furious Democratic counteroffensive has failed to diminish resurgent Republicans' lead among likely voters, leaving the GOP poised for major gains in midterm congressional elections two weeks from now, according to a new Wall Street Journal/NBC News poll.

The survey of 1,000 registered voters taken Oct. 14-18 found that 46% favor a Democratic-controlled Congress, compared with 44% who want Republican control.

But among likely voters, Republicans have a 50% to 43% edge, up from a three-percentage-point lead a month ago. And in the 92 House districts considered most competitive, the GOP's lead is 20 points.

"It's hard to say Democrats are facing anything less than a category four hurricane," said Peter Hart, the Democratic pollster who conducts the Journal poll with Republican pollster Bill McInturff. "And it's unlikely the Democratic House will be left standing."

Mr. McInturff said the Republican lead among likely voters, if it stood, probably would yield a pickup of 52 or 53 seats in the House, easily enough to win control. Republicans need a net gain of 39 seats to claim the majority.


Getty Images
Democrats target Obama's base.

The heightened energy among Republican-leaning voters has been a stable feature of public opinion for months. "A good chunk of [the Democrats'] base is disillusioned by what they've done, and Republicans believe the policies have taken us in the wrong direction," said Scott Jennings, a former Bush White House political operative now in Kentucky monitoring heated political campaigns there. "They've spawned a great conservative awakening."

Some Democrats say the numbers may overstate those potential gains. Democratic leaders in Washington and in the states accept that the "enthusiasm gap" between the parties is real, but they are trying to counter it with tens of millions of dollars aimed at getting people to vote, said Celinda Lake, a Democratic pollster working on a number of House races.

"Generic Republicans in these broad polls are more popular than individual Republicans," she said, citing policy positions that some in the party hold, such as adding private accounts to Social Security.

Democratic attacks on the GOP in recent weeks have solidified the party's hold on President Barack Obama's core voters, especially African Americans and young women, while softening up the Republican advantage among senior citizens, the poll found. In the battleground Midwest, Democrats now lead 47% to 42% among registered voters who were asked which party they want to control Congress, a reversal of fortune since August.

Mr. Obama taped a radio advertisement, released Tuesday by the Democratic National Committee, aimed at bringing Democrats to the polls. The ad will run largely on nationally syndicated talk shows aimed at black audiences, and regionally in the battleground states of Ohio, Florida, Missouri, Illinois, Pennsylvania and Wisconsin.

"We can't let this country fall backwards because the rest of us didn't care to fight," he said in the ad, ahead of a major campaign swing through Washington State, California, Nevada and Minnesota that begins Wednesday.

Mr. Obama and first lady Michelle Obama also recorded a video message, distributed to supporters Tuesday, encouraging them to volunteer for get-out-the-vote efforts.

But such moves come as views of the president are hardening. In August, 27% of voters said their vote would be a signal in support of the president, while 29% said their vote signaled opposition to him. Now, 35% say their vote is a signal of support for Mr. Obama while 34% say it's a signal against him.

While both political parties are unpopular, the Democrats have entered dangerous territory, Mr. McInturff said. Among likely voters, Republicans are seen negatively by 42%, while Democrats are seen negatively by 50%. The Republican edge in intensity of support fell from a 19-point lead in August to a 14-point lead in September, but is now at 20 percentage points.

"After seven weeks of a powerful counteroffensive, the dynamics haven't changed," Mr. McInturff said of Democratic efforts to diminish GOP momentum.

Tea-party supporters now make up 35% of voters likely to turn out Nov. 2. Among that group, Republicans lead 84% to 10%.

China signals rare-earth cuts

By James T. Areddy

SHANGHAI—Chinese officials are signaling plans to further reduce rare-earth exports next year, sustaining its controls of the metals—key ingredients in high-technology batteries and defense products—that have already severely frustrated foreign governments.

"Reducing the export quotas is under consideration, but it's too early to talk about any reduction rate," Lin Donglu, secretary-general of the Chinese Society of Rare Earths, said in an interview on Tuesday. The state-run English-language China Daily quoted an unnamed Commerce Ministry official suggesting that cuts of as much as 30% from already-trimmed 2010 levels are possible. A Commerce Ministry official declined to confirm the report and the ministry didn't reply to faxed questions Tuesday.

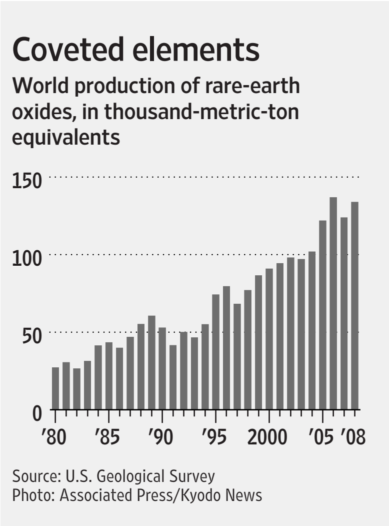
Speaking at a conference on rare-earth elements in southeastern China, Chinese officials, including a Commerce Ministry deputy director, Jiang Fan, highlighted their concern about aggressive development of the country's resources, attendees said.

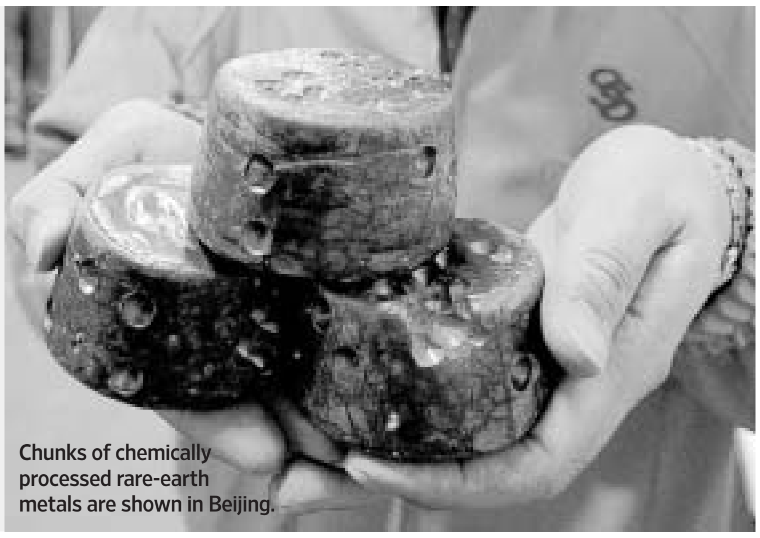
One official there suggested China, by far the world's largest producer and consumer, could even become an importer.

"Their main thrust was China needs to work to protect its rare-earth industry," said Nigel Tunna, managing director of Metals Pages Ltd., host of the conference.

China's decision in recent months to impose tougher quotas on rare-earth metal exports has sparked outcry from Tokyo to Washington.

China, which uses around half of its output of the elements and produces around 97% of world supply, says its limits—which this year aim to cut exports around 40% from 2009—reflect its growing environmental awareness, are perfectly legal and won't be used as a policy tool.





Chunks of chemically processed rare-earth metals are shown in Beijing.

Yet, importers worry reductions are designed to lift their metals import costs, undermine their high-technology industries and unnerve their defense departments.

The metals—17 chemically similar and expensive-to-mine elements—are critical to the manufacture of products from iPhones to smart bombs.

Asked at a news conference Tuesday whether limits have been imposed on export of rare-earth metals to Japan—the world's biggest importer and recently embroiled in a diplomatic spat with Beijing—Ministry of Foreign Affairs spokeswoman Ma Zhaoxu sidestepped the question, saying the government rare-earth controls are "not only for China's development, but for the world's development."

In an interview, a local official in one of China's rare-earth processing regions said a cut in China's output toward 100,000 metric tons in 2011 from about 120,000 tons this year would be in line with the country's official policy.

China dominates global production of rare earth, but it hasn't always done so. During the 1990s, the Chinese government pursued a policy to expand its industry, at a time when many Western producers were succumbing to high costs and tightening environmental controls.

Deposits of the elements are found in numerous places and mining, technology, defense and investment companies are now scrambling to establish alternatives to increasingly uncertain imports from China, sparking something akin to a mini-gold rush. The activity has hastened after Beijing's latest quota was announced in July.

The effects of China's latest cuts began being felt especially in the past few months. Japanese companies have said shipments became severely restricted late last month. Japan plans to allocate 100 billion yen ($1.2 billion) this fiscal year to improve rare-earth supplies.

MolyCorp. Inc. Chief Executive Officer Mark A. Smith told Tuesday's conference, according to a text of his presentation, that his Colorado-based company is on track and within budget to deploy a manufacturing supply chain by the end of 2012 that includes production of nine of the "most commercially significant" rare earths.

Fresh mining at MolyCorp's Mountain Pass, Calif., mine—once the world's largest rare-earth producer—will begin next year, Mr. Smith said, with output of 20,000 metric tons of rare-earth oxides expected by the end of 2012.

A further increase to 40,000 tons would take as much as an additional 18 months and cost as much as $200 million, Mr. Smith said.

"There is little question that it will take many nations and many producers doing their best to increase production if we are to meet rising demand in the clean energy, high-tech, defense and pollution-control sectors," Mr. Smith said.

—Yajun Zhang in Beijing contributed to this article.

Japan lowers economic outlook

By Takashi Mochizuki

TOKYO—The Japanese government officially downgraded its view on the economy for the first time since February 2009, as a strong yen and lower demand from elsewhere in Asia begin to cut into the core industrial sector.

"The economic momentum appears to be entering a lull," the government said in its monthly economic report, issued Tuesday. Briefing reporters on the results, Minister of State for Economic and Fiscal Policy Banri Kaieda cautioned that "the October-December period will be difficult."

Though officials contend Japan's export-dependent economy remains on a modest growth path, the report is the latest indication of weakness.

"Shipments have been weakening recently, and the latest data clearly showed industrial output has worsened," one official said. Japanese authorities have become increasingly fretful about the economy during the yen's rise against the dollar. Up 14% since early June, the yen is near a high of 79.75 to the dollar.

"If the strong yen persists for a comparatively long period of time, that would be a very serious problem," Mr. Kaieda said. Government officials, the Bank of Japan and private-sector corporate leaders have warned that the yen's strength will have a serious impact. Not only does it undercut the competitiveness of Japanese exporters, it also reduces the value of overseas earnings when brought back to Japan.

Finance Minister Yoshihiko Noda noted again Tuesday the government's readiness to intervene in the currency market and urged global leaders to work together to stabilize exchange rates. In mid-September, Tokyo set a single-day record by selling an estimated two trillion yen ($24.64 billion).

"Our stance is unchanged," Mr. Noda said at a news conference as the yen hovered around 81.30 to the dollar, close to 15-year highs. "We will continue to watch market developments with great interest and, if we find it necessary, we will respond decisively."

To ensure the recovery of the global economy, he said, the international community must devote itself to stabilizing the currency market. Finance ministers and central bankers from the Group of 20 advanced and developing nations will meet in South Korea on Friday and Saturday to prepare for a summit of G-20 leaders next month.

Some observers expect that a key theme will be how to prevent a destabilizing global race among countries to push down their currencies in hopes of bolstering exports.

The Bank of Japan has joined the government in the effort to hold back the yen, introducing new easing measures designed to push down interest rates and so make the yen a less-attractive investment.

It also launched a five-trillion-yen fund to purchase government bonds.

—Takashi Nakamichi and Kosaku Narioka contributed to this article.

Israel's bank chief defends interventions

By Charles Levinson

JERUSALEM—Israel's influential central bank chief Stanley Fischer defended his aggressive attempts to keep a lid on the shekel, saying his long-running currency intervention has successfully protected Israel from the worst of the global economic and financial crisis.

His defense, in an interview, comes as other countries, including Japan and Brazil, have more recently moved to keep their own currencies in check to stimulate exports and, by extension, broader economic growth.

That has roiled currency markets in recent weeks, triggering a debate on the need for new global accords to better regulate exchange-rate policy. Mr. Fischer's weak-shekel policy predates the current turmoil, and hasn't generated much fuss because of the relatively small size of Israel's economy.

But Mr. Fischer commands an outsized voice in global financial markets, in part because of his role tamping down the Asian financial crisis in the late 1990s, when he was the International Monetary Fund's second-in-command.

"The prime reason we're continuing to intervene is we want to protect, we want to not penalize the export sector excessively" from exaggerated currency fluctuations, he said.

Israel's central bank under Stanley Fischer has been buying dollars since 2008.

Complicating efforts to keep the shekel's value in check, Mr. Fischer has steadily raised interest rates amid a real-estate boom. But by doing so, he adds upward pressure on the shekel by luring investors.

Mr. Fischer shrugged off the competing challenges. "It's rare in central banking that you're not engaged in an act of trying to balance various conflicting factors," he said.

Israel's challenge is similar to that of many other export-dependent economies that have struggled to keep their currencies relatively weak and their exports competitive as global investors—in search of higher yields—pour money into their markets.

Mr. Fischer began buying up dollars in March 2008, the first intervention by the Israeli central bank in currency markets in over a decade. The global financial crisis was starting to snowball, and the buying was aimed at bolstering Israel's then-low foreign reserves for tough times ahead, as well as depressing the shekel to help ailing exporters, who account for between 40% and 45% of Israel's economic output.

From mid-2008 to mid-2009, the bank snatched up $100 million a day. It has continued at a furious pace, adding over $7 billion to its reserves so far this year.

In mid-2008, the dollar was fetching about three shekels before strengthening against the Israeli currency amid the intervention. Through most of 2010, the dollar was buying just under four shekels, through it has fallen back again to around 3.6 shekels in recent weeks.

The dollar buying equals roughly 3% of gross domestic product. Foreign reserves stand at nearly $70 billion, up from $29 billion before Mr. Fischer began his dollar binge.

Mr. Fischer has faced criticism for his aggressive interventions both at home and abroad. The Organization for Economic Cooperation and Development has urged a halt, warning interventions could increase inflation and damage the bank's credibility. Mr. Fischer's two predecessors and Finance Minister Yuval Steinitz have all publicly questioned the policy.

But the move appears to have helped exports. Since exports bottomed out in the first quarter of 2009, they have steadily rebounded, nearly returning to precrisis levels.