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WEEKEND JOURNAL.

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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 166 EUROPE Friday - Sunday, September 24 - 26, 2010

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French unions take to the streets

Reuters

Workers in Marseille demonstrate Thursday against plans to raise France's retirement age to 62 from 60. President Nicolas Sarkozy has said he won't budge on the issue. Another one-day strike is seen as likely, but analysts say it wouldn't be enough to derail Mr. Sarkozy's plan. **Related article on page 5.**

Ireland's GDP unexpectedly declines 1.2%

Ireland's economy contracted in the second quarter, startling investors worried about the country's banks and fueling fears that Prime Minister Brian Cowen's government may need even tougher austerity measures to tackle a massive budget deficit.

*By **Neil Shah** in London and **Quentin Fottrell** in Dublin*

On Thursday, Ireland's Central Statistics Office said gross domestic product, a broad measure of the value of goods and services produced by the economy, dropped 1.2% from the first three months of the year. Economists had forecast a 0.5% growth rate, which would have extended a brief expansion of the Irish economy that began in the first quarter.

Financial markets responded poorly to Thursday's much weaker-than-expected report, though pressure on Ireland has been building for days. The euro drifted lower, falling 0.3% to $1.335 against the dollar, while prices of Irish government bonds plummeted. To borrow from the capital markets, Ireland now pays an interest rate that is 4.25 percentage points higher than Germany, the euro zone's benchmark—the highest so-called risk premium since the introduction of the euro in 1999.

In recent weeks, some investors have begun to fear a Greece-style bailout for Ireland, though most observers say it is unlikely for now, in large part because Ireland has financed its budget until the middle of next year.

Ireland's small, export-fueled economy is notoriously volatile, economists said. Before surging 2.2% in the first quarter, the country's output contracted 2.5% in the fourth quarter of last year.

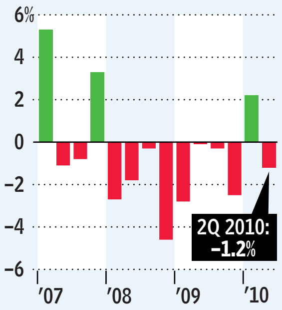
Ireland's deepening troubles raise doubts about the wisdom of the stringent fiscal austerity measures that the former Celtic Tiger and other European countries have put in place, which effectively hamper consumers and take cash out of the economy.

"There's a gap between political imperatives and economic reality, and economic reality is going to rear up and bite the politicians," says Stu-

Please turn to page 5

Back in the red

Ireland's GDP, change from the previous quarter



Source: Ireland Central Statistics Office

Europe to halt sales of Glaxo's Avandia

By Jennifer Corbett Dooren

U.S. regulators said **Glaxo-SmithKline** PLC can keep its diabetes drug Avandia on the U.S. market but added restrictions that are likely to curtail sales sharply, while European regulators recommended sales of the drug be suspended.

The two decisions, announced at simultaneous briefings Thursday, mark a conclusion to one of the biggest drug-safety debates in recent years. Critics said Avandia, which works by lowering blood sugar, posed an unacceptable risk of heart attack and stroke, while Glaxo said the drug was a valuable option for some patients.

Reflecting the tough choice, the world's two most important drug regulators came to different conclusions, although they said they shared a similar view of the drug's problems.

"The benefits of rosiglitazone no longer outweigh its risks," said the European Medicines Agency, using Avandia's scientific name. The agency said it was recommending a suspension of marketing of Avandia and two other drugs that contain rosiglitazone.

In the U.S., the Food and Drug Administration said it expects use of Avandia to fall significantly because of the new restrictions. Doctors will have to fill out paperwork showing their patients couldn't be treated with any other drugs for diabetes, while patients will have to acknowledge they understand the risks of Avandia.

Steven Nissen, a Cleveland Clinic cardiologist and leading critic of Avandia, said the FDA's decision was a "reasonable course of action and compromise. It will limit 99% of its use."

Some critics said the FDA should have acted with Europe and removed the drug altogether. Sidney Wolfe of the watchdog group Public Citizen, who has called for tougher steps on drug safety, said the FDA "made progress highlighting the risks of using Avandia" but "again caved to industry pressure."

Glaxo said it will work with the regulators. The company said it "continues to believe that Avandia is an important treatment for patients with type 2 diabetes." It said Avandia and the rosiglitazone-containing medicines Avandamet and Avandaryl will remain available in the U.S.

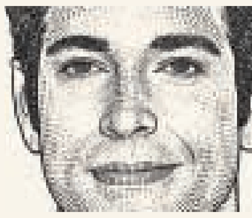
The FDA said its restrictions "are in response to data that suggest an elevated risk of cardiovascular events, such as heart attack and stroke, in patients treated with Avandia."

The FDA also ordered a halt to a study Glaxo was conducting comparing Avandia to Actos, a similar drug made by Takeda Pharmaceutical Co.

In July, the majority of an FDA advisory panel voted to keep Avandia on the market,

Please turn to page 20

The Quirk



Latest prize in celebrity auctions is a tweet, not a meet-and-greet. **Page 29**

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THE WALL STREET JOURNAL.

PAGE TWO

Fall arrives early for the euro zone

[Agenda]

By Terence Roth

It looked good all summer. But growth in the euro zone is faltering, complicating the fiscal repairs and again alerting financial markets to hazards in European debt markets.

Clear as the dangers are, political Europe has to sweat in silence as the clearly slowing recovery complicates an elaborate and costly comeback from a near miss for the euro project in Greece this past May. Changing message now could alarm financial markets and make matters worse.

As governments worry and wish-think, the euro zone's custodians such as the European Central Bank are quietly taking stock and readjusting. The exit strategies from stimulus programs charted earlier in the year, when the recovery was seen sustaining its trajectory, are being redrawn.

When ECB President Jean-Claude Trichet said in public remarks that the region's central bank will adjust policies when appropriate, the bias in the statement likely now is geared more toward contingency planning for flattening growth.

Sobering reports from the economy prompt expectations that the ECB will extend its existing special supports for the banking sector into next year and even add special dispensation for banks in weaker economies when they ask for ECB funds.

For governments, the agreed line remains that the worst of Europe's debt crisis is over, deficit-reduction plans are on track, and that the good of it was that the experience brought the 16-country currency bloc closer together.

New pledges have been sealed, greater regulatory powers have been given to the European Commission and new pan-euro-zone agencies to bear down on fiscal miscreants and financial industry high jinks. All probably for the good and certainly overdue.

Press Association

Finance Minister Brian Lenihan saw a sudden contraction in the Irish economy.

But it's woefully different at the ground level. European economies keep growing further apart and politicians' declarations of triumph over malicious financial markets are ringing a tad hollow. Spanish Prime Minister José Luis Rodriguez Zapatero, who presides over a country with a 20% jobless rate, declared in an interview with this newspaper earlier in the week that Europe's debt crisis is over.

The debate over the wisdom of keeping Europeans in a fiscal star chamber will have to be settled in history.

Not two days later, one of the euro zone's frailest economies teetered back into crisis mode after an unexpected contraction in the Irish economy reinforced doubts expressed by its own central bank that the government can consolidate its budget deficits as planned This week the cost of insuring Irish government debt against default soared to a record high and investors demanded still higher interest rates on Irish bonds. A week of negative vibes out of Dublin quickly rolled over into other euro-zone government bond markets.

In financial markets, where it matters, the crisis is emphatically not over. Signs of a faltering economic recovery also are heaping up, spelling a lot of disappointed projections on growth-driven increases in tax revenue for stretched treasuries.

The pace of the slowdown in the region's September manufacturing and services sector was a chilling reminder that the euro zone's export-driven economic recovery was only as solid as the overseas economies behind it. With domestic demand still tepid in most of Europe, the latest string of economic news is sure to revive speculation of a double-dip recession.

Critics of severe austerity plans imposed by European governments to rein in their deficits might soon see themselves vindicated in their warnings that the rush to fiscal virtue could stop recovery in its tracks.

So, time for a sobering reality check inside European cabinet rooms? That answer was provided by France when its government recently pared back growth expectations, with obvious implications for tax intake and deficit reduction.

The warning from the European Commission remains that signs of wavering, for example, in Ireland, Greece or Spain, could pull the euro-zone debt markets and even the euro currency back to the brink.

The doctrine must remain restoring growth through restoring confidence in government finances in financial markets and business investors. So that means continuing to suck huge amounts of cash out of the economy in the hope this will be rewarded with lower borrowing costs, more investment and economic rebound.

The debate over the wisdom of keeping Europeans in a fiscal star chamber will have to be settled in history. Right now the ECB is watching and waiting.

Most governments shot off their ammunition with fiscal stimulus plans over the past year, and anyway are restrained by more severely imposed EU restrictions.

After the ECB is another firewall. The EU created a €440 billion ($586 billion) European Financial Stability Facility after the Greek debacle to support European governments who are no longer able to access credit markets to fill borrowing requirements.

The good news is that the facility, which would guarantee debt for stricken countries, just received a triple-A rating from the big credit-rating agencies. The real thinking was that it would never be activated, that its existence alone would be enough to reassure investors in government debt.

If the economic and fiscal headwinds worsen, Europe's summertime remodelers will have to take a second look at their firewalls.

What's News

■ **The euro zone's** private-sector output growth slowed to a seven-month low in September and is likely to decelerate further in the fourth quarter, a survey showed. The data drove up the price of German government bonds and pushed the euro down. 4

■ **Standard Chartered's CEO** said global bankers view the U.S. as an arena of "uncertainty" and that the West, in general, poses certain "risks" as economic recovery stutters in some countries. 17

■ **A Madrid court dismissed** charges of copyright infringement against Google's YouTube brought by Spanish TV broadcaster Telecinco. 17

■ **Obama used** a speech at the U.N. to publicly press Israelis and Palestinians to forge a Mideast peace deal within the next year. 9

■ **U.S. existing-home sales** increased 7.6% in August, but the housing market still faces a long recovery. 8

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Formula 1 is racing to bridge the gap with its fans. **28**

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NEWS

Liverpool fans launch digital attack

By David Enrich
And Gregory Zuckerman

In the old days, English football hooligans settled scores with knives and broken bottles. As Texas billionaire Tom Hicks is learning this week, the weapons of choice these days—camera phones, Twitter and spam emails—can be almost as scary.

Mr. Hicks, co-owner of England's hallowed Liverpool FC, is on the run from a mob of angry fans who blame him for the team's tailspin. The 118-year-old club was one of England's best when he bought it in 2007. Since then, the crippling debt load he took on to buy Liverpool has strained the team's finances and contributed to its woes on the pitch.

Now, Liverpool faithful are waging a fierce campaign to evict the U.S. owner. Their strategy: Scare away banks and other financiers who might throw Mr. Hicks a lifeline, starving him of cash and forcing him to sell. To do that, they are using the tools of the digital age to track Mr. Hicks's efforts to drum up money, then bombard would-be lenders with thousands of irate emails, phone calls and Tweets.

On Tuesday afternoon, Mr. Hicks learned firsthand what it's like to be the prey in a digital hunt. Around 3:40 p.m., as Mr. Hicks sat on a sidewalk bench in midtown Manhattan, he was spotted by Liverpool native Paul Wilson. It occurred to Mr. Wilson, a 35-year-old financial consultant, that the offices of Deutsche Bank AG and J.P. Morgan Chase & Co. were on the same street. He guessed that Mr. Hicks and his son, Tom Hicks Jr., might be visiting the banks to plead for funds.

So Mr. Wilson whipped out his BlackBerry, snapped some photos, and zapped the images to his wife, Erin McCloskey. Then he trailed Mr. Hicks walking into the lobby of the building that houses Deutsche.

"I didn't throw my coffee on him, but the thought did cross my mind," Mr. Wilson said Wednesday.

Ms. McCloskey quickly posted the photos on Twitter and explained the circumstances.

Over in Liverpool, the Hicks sighting was like an open-net goal for Alan Kayll, a 40-year-old cab driver who is a ringleader of the anti-Hicks campaign. Mr. Kayll quickly penned a form letter to J.P. Morgan and Deutsche officials urging them not to help Mr. Hicks refinance roughly £200 million ($313 million) that is owed to Royal Bank of Scotland Group PLC, stemming from his purchase of the team.

"If you join Tom Hicks in raping and pillaging Liverpool Football Club, then you will be making a very powerful enemy," his letter read in part. "You are facing an energized, well-informed mass of Liverpool fans from around the world."

He posted the letter online, along with the email addresses of executives at Deutsche and J.P. Morgan. An hour later, a senior J.P. Morgan executive had already received 30 emails from Liverpool fans. "It's totally viral right now," the executive said, deleting the emails as they arrived. Public-relations staff at Deutsche said they eventually received hundreds of emails.

Agence France-Presse/Getty Images

Tom Hicks, co-owner of Liverpool FC; Malcolm Glazer, owner of Manchester United; and billionaire Stephen Schwarzman

Spokesmen for both banks say they aren't in talks with Mr. Hicks. Through a spokesman, Mr. Hicks declined to comment on the events of Tuesday or his stewardship of the team. The team's financial woes have hurt its performance. Liverpool finished last season in seventh place, a disaster for fans accustomed to being in England's top four. A team official said this week that the cost of servicing the debts incurred by Mr. Hicks's acquisition is depleting club resources. Fans argue that makes it tougher to recruit top players.

In Manhattan, the melee was just beginning. Adam Eljarrah, an 18-year-old Liverpool fan attending New York University, saw Ms. McCloskey's Twitter messages. He showed up outside Deutsche's skyscraper on Park Avenue, hoping to confront Mr. Hicks. The pre-med freshman carried a poster, popular among Liverpool supporters in England, declaring that Mr. Hicks and his co-owner are "Not Welcome ANYWHERE."

Mr. Eljarrah says he loitered outside the building for about 45 minutes, hoping for his moment. Around 6:30 p.m., Mr. Hicks emerged from the building. According to a person familiar with the incident, the younger Mr. Hicks spotted Mr. Eljarrah—identifiable in his red-and-white Liverpool scarf—and told a nearby cop: "This guy is trouble." As the officer intercepted Mr. Eljarrah, he says, he waved his sign and yelled, "Get out of our club!"

Liverpool fans aren't the only ones lashing out at American ownership. Manchester United fans have mounted a campaign against the family of American businessman Malcolm Glazer, which owns the team and has loaded it with debt. Fans there have ditched United's official red-and-black scarves and adopted a gold-and-green color scheme to show their allegiance to a group of British businessmen trying to mount a bid for their team.

In Liverpool, fans who are angling to remove Mr. Hicks are sporting scarves bearing a "Thanks But No Yank$!" slogan.

Lately, financial institutions have borne the brunt of Liverpool's rage. Fans have been flooding RBS with letters and phone calls urging the bank to seize the club and give Mr. Hicks the boot.

A few weeks ago, some fans started a Facebook page encouraging people to boycott RBS. "The threat of mass, simultaneous withdrawal of funds" from the bank "is much more powerful than any individual boycott," the page says.

Mr. Kayll, the cab driver, drew up lists of financial institutions that Mr. Hicks is believed to have approached, posting them to a website he helps run that urges fans to help oust Mr. Hicks. The site features an image of a blood-drenched RBS logo. Its motto: "We will go as far as we need to." An RBS spokesman declined to comment.

Executives at the 15 or so hedge funds targeted by the Liverpool devotees initially were amused by the emails, which began as a trickle last week. Since then, however, emails surged in volume, topping 1,000 over the weekend at some firms.

The campaign hit Stephen Schwarzman, the billionaire co-founder of Blackstone Partners, whose GSO Capital Partners hedge fund considered participating in a deal to help Mr. Hicks refinance the RBS loan. By Monday, GSO had backed out of the talks.

A Blackstone spokesman, Peter Rose, said the emails (including thousands aimed at Mr. Schwarzman) didn't affect GSO's decision not to participate in the deal.

That wasn't the message Mr. Kayll got. Driving his cab in Liverpool Tuesday morning, he says he received a call from London-based GSO executive Michael Whitman. Mr. Kayll says he pulled his beige Ford Mondeo to the side of the road and listened as Mr. Whitman assured him that his firm wasn't about to ride to Mr. Hicks's rescue.

Mr. Kayll says Mr. Whitman told him GSO lost interest in part due to the campaign. "He said, 'We understand the passion of Liverpool supporters and obviously took that into consideration,'" Mr. Kayll says.

Mr. Whitman didn't respond to requests to comment. Blackstone acknowledges that Mr. Whitman and Mr. Kayll spoke, but denies he said the email campaign forced GSO out of the deal.

Still basking in victory hours later, Mr. Kayll was euphoric when the Hicks photos from New York dropped into his lap. He crowed: "We know his every move."

—Sara Schaefer Muñoz and Dan Fitzpatrick contributed to this article.

Libya's stakes in bank touch a nerve in Italy

By Stacy Meichtry

The ouster of **UniCredit** SpA Chief Executive Alessandro Profumo after his courtship of Libyan investment shows the growing sensitivity in Italy to its former colony's involvement in the Italian economy.

Alessandro Profumo resigned Tuesday after years of feuding with UniCredit shareholders over a variety of issues. But the trigger for his departure was his defense of the Libyan investors in Italy's largest bank who supported his decisions as CEO which appeared to strengthen his control over UniCredit.

Libyan institutions now hold 7.6% of UniCredit's shares. Though tighter business relations have improved Libya's standing in Italy, Mr. Profumo appears to have underestimated the public's lingering doubts over the former pariah state. Such concerns were eventually used by politicians and shareholders to undercut support for him at the bank, analysts say.

"A big Libyan stake was too cumbersome," said Stefano Manzocchi, an economist at LUISS University in Rome. "It's not like having the Spanish or Germans inside the bank. The average Italian on the street is embarrassed over these Libyan ties."

Mr. Profumo wasn't reachable to comment on Wednesday.

Italian Foreign Minister Franco Frattini has defended Libya's purchases of UniCredit shares, saying the government will monitor the investment.

Libya is flush with oil wealth, which has given its sovereign fund, the **Libyan Investment Authority**, or LIA, a cash pile of more than €60 billion (about $80 billion). Its young population gives it significant growth potential.

But Libya is held back by Western suspicion of the government's erratic application of law, its poor human-rights record, and its recent history of connections to terrorism. That makes it hard to attract the foreign investment and expertise needed to kick-start its economy.

Italy could provide a bridgehead in Europe for Libyan interests. Italy is one of Europe's largest economies, but its population is aging and its struggling manufacturing industries have an appetite for Libyan capital.

Libya was an Italian colony in the early part of the 20th century, but Italy continued to do business with it after Italian rule ended in 1951. In the 1960s, Italian oil giant **Eni** SpA cut deals to develop Libya's oil reserves, making the North African country one of Italy's largest sources of oil.

After Col. Moammar Gadhafi's coup d'état in 1969, other Western countries cut ties with Libya. Italy didn't, and in the 1970s, Libya bought and later sold a large stake in automaker **Fiat** SpA with the blessing of the Agnelli family, which controls Fiat.

In 2008, Italy and Libya signed a "friendship" treaty, in which Italy pledged to pay €5 billion in reparations to Libya for its brutal colonial rule from 1911 to 1951. Col. Gadhafi's son, Sayf al-Islam Gadhafi, led a delegation to Rome in October 2008, hunting for investments. In July 2009, Libya awarded Italian defense conglomerate **Finmeccanica** SpA a €541 million contract to develop the Libyan railway system.

The 2008 treaty paved the way for Italy and Libya to "augment" their economic ties, said Shokri Ghanem, chairman of Libya's National Oil Co. and a former prime minister. "Libya is very important to Italy," he said.

UniCredit has branches throughout Central and Eastern Europe, and Libya hopes its investment in UniCredit will help lure European companies to Libyan shores, according to Mehdi Haroun, a Paris-based lawyer at law firm Herbert Smith who has negotiated Libyan oil contracts for western oil companies. "There's an excess of cash and [Libya] needs a way to leverage it," he says.

The first Libyan investment in UniCredit was a 4.9% stake acquired by the Central Bank of Libya at the end of 2008, when the Milan-based bank was reeling from the financial crisis. Since July, the LIA, the Libyan sovereign fund, has acquired a 2.6% stake. That gives Libyan institutions a collective combined stake of about 7.6%.

Libyan stakeholders have been supporters of Mr. Profumo from the start. In 2009, he proposed a €6.6 billion-capital strengthening plan, including dividend cuts and a €3 billion capital increase. Some major UniCredit shareholders—the so-called banking foundations that fund local charitable activities and are controlled by local politicians, and that together control more than 11% of UniCredit shares—opposed the plan, but the Libyan central bank backed Mr. Profumo.

In May 2009, Farhat Omar Bengdara, governor of the Central Bank of Libya, joined UniCredit's board as deputy chairman.

He became a reliable ally of Mr. Profumo, who earlier this year was fighting over the bank's strategy with the banking foundations. In particular, Mr. Bengdara voted in favor of a controversial plan of Mr. Profumo's to centralize many of the bank's activities and eliminate the regional oversight boards that had protected local jobs.

Meanwhile, Mr. Profumo has pushed Libya as a business proposition. In June, he talked up investment opportunities at the Italian Senate during a presentation of a memoir by Col. Gadhafi about his travels in Italy. In July, UniCredit announced plans to expand its operation into Libya, becoming one of the first foreign banks to do so.

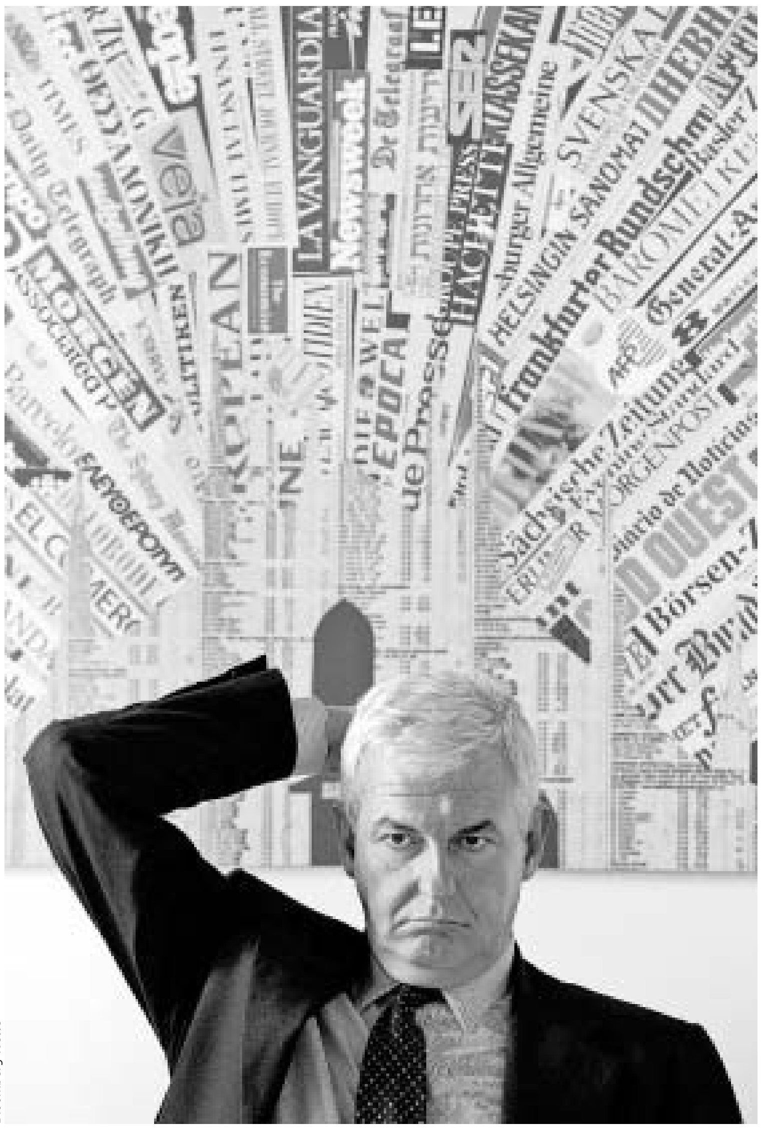
Mr. Bengdara has now come under the scrutiny of Italian regulators. They are carrying out a preliminary investigation into whether he has breached UniCredit's internal statutes, which limit any one investor from having more than 5% of voting shares, according to a person familiar with the inquiry. Regulators are probing to see whether Mr. Bengdara holds sway over both the LIA's and the Central Bank of Libya's stakes in UniCredit, this person said.

Attempts to reach Mr. Bengdara to comment weren't successful.

Libya's central bank didn't return calls and emails requesting comment, but issued a statement Monday describing its investment in UniCredit as "long term" and stressing its independence from the government.

The LIA declined to comment.

—Tahani Karrar contributed to this article.



Bloomberg News

Alessandro Profumo resigned from his post as CEO ofUniCredit late Tuesday. The trigger for his departure was his defense of Libyan investors in the bank.

European Pressphoto Agency

Gadhafi, left, and Italy's Berlusconi

Euro-zone private-sector expansion slows

By Nicholas Winning

LONDON—The euro zone's private-sector output growth slowed sharply to a seven-month low in September and is likely to decelerate further in the fourth quarter, a survey showed Thursday.

The flash euro-zone composite-output index, a measure of private-sector activity based on about 85% of replies from a monthly survey of firms, dropped to 53.8 in September from 56.2 in August, according to preliminary results from financial-information company Markit.

The reading above the neutral 50 level indicates output is growing. Economists were expecting a drop to 55.9 in September.

"Although the survey suggests that [gross domestic product] will have risen by around 0.6% for the third quarter...the weak September reading sets the scene for a further slowing in the final quarter of the year to a pace more in the region of 0.3%," said Chris Williamson, Markit's chief economist.

German output growth slowed to an eight-month low in September while France decelerated to a six-month low, Markit said.

"However, outside of these two countries, double-dip recession fears will be heightened by a renewed contraction of economic activity and accelerating job losses in September," Mr. Williamson said.

The data surprised market participants, driving up the price of German government bonds and weakening the euro against the dollar.

Still, economists said any concern that the 16-nation currency area was heading for a double-dip slump was premature.

The price of the December bunds future contract rose about half a point to 131.39 in Europe, while the euro eased against the dollar to $1.3338 from $1.3393 late Wednesday in New York.

Markit said that although the drop in the composite PMI in September was the largest since November 2008, the average of the third quarter was the second-strongest growth rate since the third quarter of 2007, when the global credit crisis began to bite.

"A growth slowdown is now baked in the cake," Martin van Vliet, an economist at ING, said in a note.

"That said, for now the index is still quite a distance from double-dip territory. Indeed, on the face of it, the composite index is consistent with quarterly gains in GDP of around 0.3%," he added.

The euro-zone economy grew 1% in the second quarter after a 0.3% quarterly expansion in the first three months.

The breakdown of the data showed the purchasing-managers' index for the euro zone's manufacturing sector fell to an eight-month low of 53.6 from 55.1 in August. The services business-activity index fell to a seven-month low of 53.6 in September from 55.9 in August.

Economists were expecting the manufacturing PMI to drop to 54.8 and the services index to ease to 55.5.

Inflows of new orders rose at the slowest pace for 10 months in September, with manufacturers reporting the weakest rise in export orders since November.

The forward-looking manufacturing new orders-to-inventory ratio dropped to its lowest level since June 2009, but confidence about the year ahead in the services sector hit a five-month high.

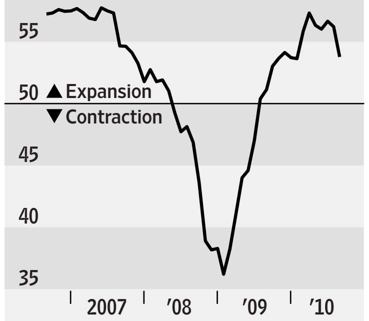
Employment rose for a fifth consecutive month, but the pace of job creation was subdued and weaker than in August, Markit said. The latest official data show the euro zone's unemployment rate was stable at 10% for a fifth consecutive month in July.

Input prices rose for a 12th straight month, but output prices increased only marginally due to strong competition—a sign that companies' profit margins remain under pressure.

"We keep seeing euro-zone GDP growth slowing to 0.4% quarter-on-quarter in 3Q, with a further easing in 4Q and in early-2011," Marco Valli, chief euro-zone economist at UniCredit Research, said in a note. "In our view, fears of a double-dip recession remain exaggerated,"

Growth slowing

Euro zone's composite Purchasing Managers Index



Note: Seasonally adjusted
Source: Markit

EUROPE NEWS

French unions strike over pension changes

By Nathalie Boschat

PARIS—French unions staged a major showdown with the government Thursday, with demonstrations and strikes taking place across the country to protest a pension overhaul that will raise the retirement age to 62 years old from 60.

French President Nicolas Sarkozy recently described pension changes as one of the most important issues for France. He has staked his government's financial credibility on it as France has embarked on a cost-cutting drive aimed at bringing its public deficit to 3% of gross domestic product in 2013—the maximum allowed under euro-zone treaties—from a projected 8% this year.

Despite significant disruptions in the transport system, particularly in train and air travel, the action was showing some signs of fatigue around midday with fewer workers on strike than at a previous demonstration against the pension revamp on Sept. 7.

Around 20% of civil servants working for the French central administration were on strike around midday, compared with nearly 25% at the earlier protests, according to the French Civil Service Ministry. That rate reached 23.6% for civil servants working in the public-education system, fewer than the 27% of strikers at the beginning of September. The Interior Ministry had counted just under 410,000 demonstrators at 110 rallies across the country, compared with 450,000 people at 114 rallies on Sept 7.

European Pressphoto Agency

French workers burn flares during a demonstration in Marseille Thursday.

The eight unions driving the action were hoping to muster more people on the streets than during the previous demonstrations, when between 1.1 million and 2.7 million people took to the streets, according to rival estimates produced by the Interior Ministry and unions.

The unions demand the retirement age be kept at 60, and hope to weigh in on debate over the bill, which starts in the Senate on Oct. 5, amid record-low popularity ratings for Mr. Sarkozy's government. The bill was adopted last week by the National Assembly.

As protest marches started in Paris around lunchtime, Bernard Thibault, leader of the communist-leaning union Confédération Générale du Travail, or CGT, described the action as having "roughly the same scope" as the previous one, adding the government risks facing a new phase of conflict if it doesn't budge on the pension overhaul.

The government has remained intractable on a move it has said will save €20 billion ($26.79 billion) by 2020 and will balance the books of the pension system by 2018.

Labor Minister Éric Woerth said Monday the financial equilibrium of the overhaul rests on raising the basic retirement age to 62 and the age for full entitlements to 67, but said he was open to some concessions.

The eight unions plan to meet on Friday to decide whether and how to continue their protest campaign.

Ireland's GDP falls unexpectedly

Continued from first page

art Thomson, portfolio manager at Ignis Asset Management in Glasgow, Scotland, who says he believes Ireland's austerity measures will hurt its economy.

At the same time, Ireland's gloomy prospects mean the government may have to make even deeper cuts this winter to reduce its budget deficit, which is expected to surpass 25% of GDP this year, the biggest in the 16-nation euro area by that measure. The possible doubling in the deficit—now about 12% of GDP—is due largely to the cost of bailing out Anglo Irish Bank Corp.

Ireland's disappointing economic performance also highlights a major problem in the euro zone: the widening gulf between strong economies such as Germany and weaker links such as Ireland and Greece. Ireland's performance, which lags behind the euro zone's 1% second-quarter growth, will make it harder for the European Central Bank to set monetary policy for the bloc as a whole.

Ireland's "economy is going to stagnate over the next couple of years," said Ben May, European economist at Capital Economics in London. "That is going to make it more difficult for the government to reduce its deficit in line with its current goals without implementing significant austerity measures."

A surge in imports into Ireland likely hammered its economy in the second quarter, skewing its performance. With Irish imports surpassing its sales of goods abroad, Ireland's trade subtracted roughly 1.8% from its GDP, after pumping in 3.5% in the first quarter, according to Capital Economics.

Irish consumers also remain reluctant to spend given the country's weak labor market and expectations of further austerity measures. But rising imports suggest healthier levels of domestic demand, and there were improvements in the country's construction and agriculture sectors.

Ireland is struggling to recover from one of Europe's messiest real-estate busts, which has left its banks awash in souring loans to property developers that likely won't be paid. The International Monetary Fund expects Ireland's economy to contract 0.5% this year, before growing 2.3% next year. Further headwinds could be in the cards. Exports fuel about 50% of Ireland's economy, but signs of slowing recoveries have grown in the U.S. and Britain, two of Ireland's biggest trading partners. The euro's appreciation in recent months also could hurt Irish trade.

The danger is that Ireland's economic woes will amplify its fiscal and banking problems. A weaker economy means less tax revenue, making it harder for the government to meet its goal of cutting the deficit to Europe's limit of 3% by 2014. As the economy weakens, Irish borrowers will also find it harder to repay their loans, saddling Ireland's banks with more bad loans. That, in turn, could force the Irish government to provide more financial assistance, eroding its own creditworthiness.

Even before Thursday's figures, the cost to insure Ireland's sovereign bonds against default jumped to a record as investors fretted over the government's plans for winding down Anglo Irish.

It now costs roughly $475,000 a year to insure $10 million of Irish bonds for five years, according to data provider Markit. Earlier Thursday, Ireland's credit-insurance costs hit $500,000 for the first time. Before October, Ireland's central bank is expected to provide more details on plans to split Anglo Irish into a deposit-holding bank and an "asset recovery" bank that would be wound down over time.

Of particular concern to investors is the fate of roughly €2.4 billion ($3.2 billion) of riskier bonds issued by Anglo Irish. Of that, €1.7 billion will no longer be protected by the government once a key guarantee expires at the end of the month.

On Thursday, Finance Minister Brian Lenihan said Ireland's poor second quarter was partly due to a "surge in imports" and that the country's exports continued to perform well.

Mr. Lenihan has already signaled that Ireland may push for more than the €3 billion of additional cuts expected when he unveils the 2011 budget on Dec. 7.

Why a sovereign default remains on the table

[Brussels Beat]

By Stephen Fidler

It is costing some governments in Europe more than ever to raise money from the bond markets. This week, the gap between yields on government bonds issued by Portugal and Ireland and those issued by low-risk Germany rose to their highest levels since the introduction of the euro.

Yet until Wednesday, when signs of Irish economic weakness and the general frailty of the private-sector recovery in Europe provided a jolt, the markets have been calm and the euro remains close to a five-month high against the dollar.

Wednesday's market jitters have served as a reminder that worries of a sovereign default haven't disappeared, despite the big rescue packages lined up for Greece and other shaky euro-zone economies.

In a paper this month, staffers at the International Monetary Fund argued that sovereign default in advanced economies is "unnecessary, undesirable and unlikely."

But among those who beg to differ is Willem Buiter, Citigroup's chief economist. In a report last week, he dismisses the IMF claim as "based on bad economics and simplistic political economy."

He says no government credit is safe from the risk of default because it is harder than ever to rein in budget deficits. That's for three main reasons:

—Demand for public spending has grown in most advanced economies faster than the capacity to tax. Apart from building public resentment, higher taxes risk damaging incentives to work, educate oneself, save and invest.

—Politics in many countries have become highly polarized, making it harder for political systems to work out who should suffer the pain of government retrenchment. Prime examples of such polarized societies? Greece and the U.S.

—Tax administration has become less effective. Tax avoidance and evasion appears to have grown everywhere in Europe and the U.S. since World War II as has the gray economy, encouraged by globalization. The further one moves to the south and east in Europe, as a general rule, the bigger share of economic activity takes place in the informal sector.

It's not that governments can't pay. But some may be unwilling or unable to inflict on their populations the economic pain required to ensure debts are repaid in full and total debt reduced to sustainable levels.

"The country most at risk is, in our view, Greece, followed by a sizeable gap and then a small cohort of countries including Ireland, Portugal, and Spain, followed by another large gap and then Italy, Belgium, Austria, Japan and, at horizons longer than five years, the U.S.," Mr. Buiter says in the report.

Analysts say investors may be distinguishing increasingly among borrowers. "The fact is that there is a lack of contagion. ... The worries are being confined to the peripheral four, with some differentiation between Spain and the others," says Janet Henry, chief European economist at HSBC in London.

With Spain being less of an immediate concern—it has reported the biggest improvement in government revenues of any of the four, along with the largest reduction in its budget deficit—it's the small economies of Greece, Ireland and Portugal that have been the focus of worries, rather than their larger neighbors.

That may have lifted some of the anxieties about the euro that were prevalent earlier in the year. But there is another development bolstering the common currency: the prospect that the U.S. Federal Reserve could embark on a fresh round of quantitative easing, injecting cash into the faltering U.S. economy by buying more government bonds.

That spells weakness for the U.S. dollar, a trend that the Bank of Japan is seeking to offset by intervening in the foreign-exchange market to depress the yen. With the Bank of England viewed as having few qualms about following the Fed's example, should it be seen as necessary, that leaves the European Central Bank as the least likely to embark on quantitative easing among any guardian of a major currency.

"The euro, at the moment, seems to be the only hard currency in the world," says Ms. Henry.

Photos, left to right: Agence France-Presse/Getty Images, Bloomberg, Reuters

Chief of Staff Rahm Emanuel, left, may leave, joining high-profile departures Christina Romer and Lawrence Summers.

Exodus could shift tone of White House strategy

By Jonathan Weisman
And Elizabeth Williamson

White House Chief of Staff Rahm Emanuel is likely to resign in a matter of weeks, hastening a remake of the Obama White House that could lead to a lower-key, more cooperative approach after the November midterm elections.

In recent days, Mr. Emanuel has met with two Chicago Democrats who, like him, are mulling mayoral runs, according to Reps. Danny K. Davis and Mike Quigley, congressional aides and an official close to Mr. Emanuel. Mr. Emanuel also discussed his potential run with Wall Street Democrats last week, according to two people familiar with his conversations.

"He is very close to a decision and from every indication, that decision will probably be to run," said Mr. Davis, an African-American who added the two discussed how they could both run for mayor without dividing Chicago along ethnic and racial lines.

Mr. Emanuel's departure could come even before the exit of National Economic Council director Lawrence Summers, who is returning to Harvard University at the end of the year.

David Axelrod, President Barack Obama's long-time political adviser, is expected to depart next year to assemble Mr. Obama's re-election campaign. Defense Secretary Robert Gates has said he would step down in 2011. And National Security Adviser James Jones is widely expected to step aside.

Such waves are common after the first two years of a presidency, but with Republicans expected to make big gains in November and possibly capture at least one chamber of Congress, Mr. Obama must decide whether to remake his White House to accommodate a more Republican Congress or to fight it.

"He'll be dealing with very narrow margins," said Steve Elmendorf, a long-time Democratic strategist in Washington. "He's going into his reelect. That means a different approach to Congress."

The president could stack his administration with fighters prepared to deal with government shutdowns, veto threats and gridlock. Many Republicans running under the banner of the tea party have pledged an uncompromising stand on spending and efforts to roll back Mr. Obama's health-care law.

Or, as senior White House officials have said, the president could concentrate on finding common ground on deficit reduction, education and immigration, while guarding his achievements, from health care to student lending to financial re-regulation.

One clear intention: The White House wants to use some openings to address concerns among executives and the business lobby about the lack of corporate experience in Mr. Obama's economic inner circle. Aides also want to remedy the lack of women following Christina Romer's resignation from a top economic post earlier this month.

So far, the president appears to be toning down his administration with technocrats who shy from the limelight.

Vote on tax cuts likely to wait

By Martin Vaughan

WASHINGTON—A U.S. Senate vote on extending tax cuts scheduled to expire is now seen unlikely before the November elections, Senate lawmakers and aides said Thursday.

Asked whether senators ought to be given a chance to vote on extending middle-class tax cuts that expire at the end of the year, Sen. Richard Durbin (D., Ill.) told reporters, "I can see the value in that, but because of the short time frame, it may be difficult."

The Senate is expected to adjourn at the end of next week until after the Nov. 2 elections.

Senate Majority Leader Harry Reid (D., Nev.) and Democratic campaign consultants had argued for a pre-election vote. Some felt that such a vote could help Democrats in the fall by showing support for protecting middle-class tax cuts while painting Republicans as willing to protect the wealthy.

But other Senate Democrats argued privately to postpone the vote, believing that Republicans could use a pre-election vote to argue that Democrats want to increase taxes on small businesses.

Meanwhile, some senators are pushing for votes on legislation to discourage companies from moving jobs offshore and on a Supreme Court decision that relaxed restrictions on campaign financing. Senate aides said that those initiatives have moved ahead of the tax-cut vote on the list of items likely to be addressed in the coming week.

Tax cuts enacted under former President George W. Bush, affecting people at all income levels, are slated to expire at the end of the year. President Barack Obama has proposed extending tax cuts only for people with less than $200,000 in income, or $250,000 for married couples filing jointly.

Republicans charge that allowing tax rates to rise on higher-income taxpayers amounts to a small-business tax increase because many small-business owners pay taxes as individuals.

Senate Finance Committee Chairman Max Baucus (D., Mont.) is drafting a bill that is expected to track closely with Mr. Obama's plan. He also expressed uncertainty that the Senate would vote, given the little time left before the Senate adjourns.

"I just don't know, people wanted to leave town by the end of next week," he told reporters Thursday. "It depends on what all we can fit in."

Mr. Baucus didn't say whether he would still introduce the bill before the election if the Senate doesn't hold a vote. "I just think a bill to extend the tax cuts should pass, so I'm going to do what I can to make that happen," Mr. Baucus said.

Mr. Durbin said that even if the Senate did vote, it was unlikely Congress would be able to complete work on the bill prior to the election, given that the House hasn't yet acted on it.

More steps are required to mend ties with business

[Capital Journal]

By Gerald F. Seib

At a room in the gleaming Newseum building on Pennsylvania Avenue last week, maybe—just maybe—the strained relationship between the Obama administration and the business community took a baby step on the road to recovery.

Over breakfast, Austan Goolsbee, the new chairman of President Barack Obama's Council of Economic Advisers, met with 18 chief executives of the Business Roundtable, an organization of business leaders that has had an up, and then decidedly down, relationship with the administration. Mr. Goolsbee's message, according to one in attendance, was simple: Let's start at the beginning.

Specifically, Mr. Goolsbee asked to hear more about one of the CEOs' biggest complaints, Democratic proposals to eliminate tax provisions that allow multinationals to defer paying taxes on income earned overseas until the money is brought to the U.S. The government sees an end to tax deferrals as a way to bring investment home and gather badly needed revenue. Big companies see it as a dire threat to international competitiveness. Tell me why you feel that way, Mr. Goolsbee told the CEOs; let's dig deeper.

That seemed to go down well. "The meeting with Austan Goolsbee represented a fresh start for the administration on economic matters," says Johanna Schneider, a Roundtable executive director.

A small step, and perhaps a symbolic one, given that Mr. Goolsbee has been in a lesser White House role all along, and surely has heard the arguments before. Yet the meeting was one indication that a turnover of administration personnel is providing an opening to revisit a bad relationship. How far this therapy actually goes, however, ultimately depends not on any presidential aide but on the man in the corner office—in this case, the Oval Office.

The idea that a change in White House aides offers an opening isn't entirely logical. The most high-profile departure that has been announced is of Larry Summers, the president's chief economic adviser, who isn't leaving until year's end, and who has hardly been an enemy of the business community. He is attacked most frequently from foes on the left, who see him as too moderate to Wall Street.

Similarly, if White House Chief of Staff Rahm Emanuel leaves to run for mayor of Chicago, as widely speculated, that also won't remove an enemy of the business community. Mr. Emanuel is a political centrist who actually has been a pipeline for businesses into the administration.

Still, the prospect of those changes, plus the recent departure of Christina Romer, Mr. Goolsbee's predecessor as head of the Council of Economic Advisers, and Peter Orszag as budget director, has created a sense of a possible fresh start.

Certainly one is needed, for there is plenty of bad blood on both sides. Businesses complain that the administration has consistently demonized them with its rhetoric, turned a deaf ear to its pleas for tax changes that foster U.S. competitiveness, created a monster in the new consumer-protection agency for the financial system, and hobbled them with draconian health and environmental mandates.

For their part, administration officials complain that businesses either begged or cheered for the financial bailouts started under President George W. Bush, as well as the for the Obama team's economic-stimulus bill and auto-company rescue, and also pleaded for health-care reform—but then left the administration twisting in the wind once those measures became controversial.

A turnover of administration personnel is providing an opening to revisit a bad relationship.

Both sides have their points, but the argument has become sterile and circular. Worse, it has a real impact, because business leaders consistently grumble that a lack of certainty about regulatory and tax policies is impeding investment.

Administration aides think that's merely an excuse, but in any case everybody seems to want to clean the slate—though that may not really be possible until after election-season rhetoric subsides. Mr. Goolsbee's nascent dialogue with CEOs is one starting point, despite some lingering business wariness of the new chief economist. So were recent Obama proposals to make the research and development tax credit permanent.

Business leaders also are pushing the president to replace Mr. Summers atop the National Economic Council with a chief executive. A token CEO might do more harm than good, but one capable of moving back and forth across the political/business frontier would fill a genuine void.

Ultimately, though, the task of closing the administration-business rift falls to one man: Mr. Obama himself. Talk to enough business people, and you'll soon conclude that the most basic problem isn't politics or even policy; it's psychological. Business leaders acknowledge that they have had pretty good access to the White House, but fear the president simply isn't comfortable with them and their work. They tend to view him as someone at home in academic and political debate but distant from the business world.

That view frustrates White House officials, but it's real—and ultimately can be changed only by the president himself.

Republicans outline agenda

By Naftali Bendavid

STERLING, Va.—U.S. House Republicans unveiled a new agenda at a small lumberyard outside Washington on Thursday, seeking to show that they were in tune with voter discontent and have crafted legitimate alternatives to unpopular Democratic initiatives.

At a news conference on the warehouse floor of Tart Lumber Co., Republicans led by House Minority Leader John Boehner (R., Ohio) offered some longtime GOP priorities, such as extending the tax cuts enacted under former President George W. Bush, as well as proposals that echo the language of the tea-party movement, like a requirement that every law include a line citing its constitutional authority.

The setting, with stacks of lumber on shelves beside the lawmakers, was chosen to emphasize Republican support for small business, a constituency both parties have been courting aggressively. Later Thursday, the House passed a $42 billion bill to aid small business, which Republicans said they opposed, in part because it would ship money to banks to make small-business loans. The Republicans agenda would give small businesses a tax deduction equal to 20% of their business income.

Although the election is fewer than two months away, Republicans insisted it wasn't a campaign platform but a "governing agenda" that could be implemented right away. Still, the document attacks Democrats repeatedly, and the likelihood that a Democrat-controlled House would consider the vast majority of them is virtually nil.

Thursday's event was designed to show that Republicans have heard and understood the anger voiced by voters, especially over government spending. "We heard you loud and clear, and we assure you there is nothing more inspiring than the common voice of the common man," said Rep. Kevin McCarthy (R., Calif.).

The GOP framed the 43-page "Pledge to America" as the culmination of a months-long process, called "America Speaking Out," which solicited ideas from voters. A number of the proposals, however, reflected longtime Republican goals.

Democrats—and some conservatives—wasted little time attacking the agenda. They said it pledged both to reduce the deficit and continue expensive tax cuts, and offered few details on Medicare and Social Security.

"Whatever the Republicans may call their plan, if implemented, it would inflict a 'Plague on Americans,' " said Rep. James Clyburn (D., S.C.), saying the plan would cut taxes for the wealthy and privatize Social Security, as well as repeal President Barack Obama's health overhaul. "Our country is just starting to get well again. We can't afford to suffer the same failed ideas of the past."

But Republicans said it was the Democrats' policies that had failed, and they cited polls to suggest the public felt the same way. "We've been listening to our constituents' frustrations," said Rep. Shelley Moore Capito (R., W.Va.). "They are exhausted and they are tired of what they are hearing from Washington, D.C."

The event came at the end of a lengthy debate in which Republicans argued over how much of an agenda, or platform, they should unveil ahead of the election.

The agenda would require congressional approval for any regulation that costs the economy $100 million or more, and it provides that all government programs terminate, or "sunset," at a specific time, so Congress could decide whether they deserve to continue. It would cancel remaining funds from the stimulus program and would end the Troubled Asset Relief Program, or TARP.

"With this pledge, Republicans will save the American dream as it drowns in a sea of red ink," said Rep. Jeb Hensarling (R., Texas). The Republicans said they would impose caps on federal spending, as well as a hiring freeze on "nonsecurity" federal employees.

Mr. Boehner declined to provide more specifics on how Republicans would tackle Social Security and Medicare. "I've made it pretty clear—it's time for us as Americans to have an adult conversation with each other about the serious challenges that face our country," the minority leader said. "I don't have all the solutions."

A major Democratic line of attack during the campaign has been that Republicans would gut these popular programs. Mr. Boehner said the plan didn't purport to end the deficit in one step. "We don't underestimate how difficult this is going to be," he said. "What we intend to do is take first steps."

■ For Boehner, business ties cut both ways 14-15

Reuters

House GOP leader John Boehner outlined the 'Pledge to America' on Thursday.

Associated Press (2)

Students at the Robert Treat Academy charter school in Newark, N.J., on election day last November.

Facebook founder to give $100 million to schools

By Barbara Martinez
And Geoffrey A. Fowler

Mark Zuckerberg, the 26-year-old founder and chief executive of Facebook Inc., plans to announce a donation of up to $100 million to Newark, N.J., schools this week, in a bold bid to improve one of the country's worst performing public school systems.

Newark spends about $22,000 a year on each of its 40,000 pupils, but only about half of its students graduate. Of those who do, only one-fifth go on to four-year colleges. More than 85% of the Newark students at community colleges need remedial help in math and English.

The state took control of the troubled Newark system in the 1990s, and this month Gov. Chris Christie informed the city's superintendent that his contract wouldn't be renewed after June 2011. Mr. Christie has vowed to implement forceful changes, portending an agenda that includes stronger teacher evaluations and merit pay.

Mr. Zuckerberg is setting up a foundation with $100 million of Facebook's closely held stock to be used to improve education in America, with the primary goal of helping Newark.

Mr. Zuckerberg has had a longstanding interest in education, particularly teachers' low salaries, according to a person familiar with the discussions. Over the last year, he had a series of meetings with people involved in education and developed a relationship with Newark Mayor Cory Booker.

Mr. Zuckerberg attended public high school in Ardsley, N.Y., before transferring to the private Phillips Exeter Academy in Exeter, N.H.

The donation comes at a time when foundations and wealthy investors are increasingly funneling large amounts of money to public education—but with strings attached. In Washington, D.C., this year foundations pledged millions of dollars to pay for an increase in teacher pay that is tied to teachers' abilities to show they can help students improve.

Facebook founder Mark Zuckerberg

While Mr. Zuckerberg has made charitable donations in the past that have not been widely reported, this is by far his largest and represents his debut as a major philanthropist. According to the person familiar with the discussions, Mr. Zuckerberg decided he did not want to wait until he was near his career's end before getting involved in major philanthropy.

The announcement of the gift has been planned for Friday on "The Oprah Winfrey Show" show, which has been using this week to draw attention to education. The timing of the announcement was driven by the Mr. Christie and Mr. Booker, over the objections of Facebook executives, said the person familiar with the discussions.

Mr. Zuckerberg's pledge comes as the company he founded confronts a Hollywood film's scathing depiction of the executive. "The Social Network," which opens in wide U.S. release Oct. 1, suggests Mr. Zuckerberg may have stolen the idea for his social-networking site

Mr. Zuckerberg was not available, a spokeswoman for Mr. Christie couldn't be reached, and Mr. Booker declined to comment.

A $100 million donation to a school district is rare, but not unprecedented. The Bill & Melinda Gates Foundation, which has pumped almost $5 billion into K-12 education, awarded to Tampa' Hillsborough County School District $100 million last year to overhaul how teachers and trained and evaluated.

No plans have yet been finalized on how the gift to Newark will be spent. Mr. Booker is supposed to draw up those plans and get community support for them, said the person familiar with the discussions.

The donation has the potential to be matched by another $100 million that Mr. Booker has been working on raising from private foundations and others. The $200 million that could be raised would amount to more than 20% of Newark's budget of $940 million.

Under terms of the understanding between Mr. Zuckerberg, the Republican Mr. Christie and the Democratic Mr. Booker, the mayor would become the governor's representative to devise plans for the schools. according to a person familiar with the announcement

Mr. Booker plans to make education the focal point of his second term, just as he made crime the centerpiece of his first

Mr. Zuckerberg will fund for the foundation with his private stock in Facebook, and will arrange for a transaction on the secondary market for the foundation to turn the shares into cash as needed, said the person familiar with the discussions. The move will represent a relatively small dilution in his stake in the company, the person said.

Facebook has over 500 million users world-wide. Investors value the company at more than $20 billion. Mr. Zuckerberg owns more than a quarter of Facebook's stock, say people familiar with the matter.

—Stephanie Banchero contributed to this article.

Stalemate persists in housing market

By Nick Timiraos
And Sara Murray

For months, home buyers and sellers have been stuck in an unusual standoff, with sellers reluctant to lower prices and buyers staying on the sidelines.

New data suggest that standoff eased slightly last month, as sales of existing, or previously owned, homes rose 7.6% from July, according to figures released Thursday by the National Association of Realtors.

But while the housing market may have halted a slide that began in April after federal home-buyer tax credits expired, it still faces a long recovery, and buyers remain scarce. The inventory of unsold homes fell 0.6% in August to 3.98 million, but it would still take 11.6 months at the current sales pace to clear that.

"The only way to sell a home in this environment is to drop the price," said John Burns, a housing consultant based in Irvine, Calif.

The housing numbers have prompted a debate among economists about how much further prices need to fall to resuscitate sales. Home prices are likely to fall another 2.2% this year, according to the consensus estimate of 114 economists and housing analysts surveyed this month by MacroMarkets LLC, a provider of hedging products.

The picture varies from region to region. Home prices in several Florida and Nevada markets are likely to fall at least another 5%, while parts of Texas and Oklahoma could post modest gains over the next year, said Eric Fox, vice president of statistical and economic modeling at in Santa Ana, Calif.

Nationally, prices in July fell by 0.5% on a seasonally adjusted basis, according to figures this week from the Federal Housing Finance Agency. The S&P/Case-Shiller home-price index will issue its report on July prices next week.

Consequently, sellers face a difficult decision: get off the market or cut the price. Sonja Brisson decided to get out. After listing her home for three months, she began interviewing prospective renters on Tuesday. Ms. Brisson, who is moving to live with her fiancé, will lose money renting out her Seattle town home, but said it was better than competing with distressed sales going for 30% less than what she paid for her property.

Renting the home is "just a total crapshoot," she said. "Nobody saw this coming, and nobody can see the end of it."

Weak demand in the housing market comes amid other signs that the economy is improving, but at a painfully slow pace. An index of leading economic indicators, which aims to help predict where the economy is headed, rose 0.3% in August after increasing 0.1% in July, the Conference Board said Thursday.

Much of the lingering weakness is linked to sluggish improvements in the job market. Some 465,000 unemployed workers filed new claims for jobless benefits last week, up 12,000 from the week before, the Labor Department said Thursday.

Without jobs, families are still relying on tactics they employed during the recession—such as households doubling up—to make ends meet. That's pulling down demand for housing and, in turn, prices and construction.

"As those jobs get created, people who have been doubling up will start moving out of those homes and demand will pick up," said Patrick Newport, an IHS Global Insight economist. "As that happens—it's going to happen very slowly—the glut will start coming down."

The weak economy is just one reason why buyer psychology remains depressed. The housing market also faces a "shadow inventory" of four to five million potential foreclosures that have not yet come to market but could put pressure on prices once they do.

"Why do you rush out today to buy something when you think there are going to be millions more for sale soon," said Michael Feder, chief executive of real-estate data firm Radar Logic Inc. The question, he said, is "how much lower do prices have to go to attract the buyers?"

Even investors, who have been active over the past year buying homes at what they believed were big discounts, are pulling back. "They think everything will be cheaper next year," said Mr. Burns.

As prices fall, more sellers could find themselves in Patrick Minton's shoes. He's already dropped the price on his Seattle home to $400,000, which is less than what he owes. He'll already have to pay transaction costs out of pocket.

'Why do you rush out today to buy something when you think there will be millions more for sale soon?'

The home hasn't received any offers, and he isn't willing to cut the price anymore unless his bank agrees to a short sale. Mr. Minton, a 42-year-old software developer, listed his home in July after getting divorced and said he'd stay if the bank would let him refinance at current rates.

While 11 million borrowers are under water, or owe more than their homes are worth, another 2.5 million will join them if prices fall just another 5%, according to CoreLogic Inc., a real-estate analytics firm.

"They're between a rock and a hard place," said Glenn Kelman, chief executive of Redfin Corp., a real-estate brokerage that operates in nine states. "They'd capitulate if the bank would let them."

That is suffocating the market because those sellers are also would-be buyers. "Right now, we have investors and first-timers in control of the market, and until that changes, we will never be on the mend," said Mark Hanson, an independent housing analyst in Menlo Park, Calif.

The housing market will eventually need more buyers like Robert Gifford, who spent six months with his wife scouring their Beacon Hill neighborhood in Seattle before pulling the trigger on a sale in July.

When it came time to sell their smaller home this month, they didn't dawdle. They cut the listing price by around 10% to $334,000 earlier this month, and it quickly went to contract. "We didn't want to become an involuntary landlord," said the 31-year-old engineer.

WORLD NEWS

Obama promotes peace talks

By Jay Solomon


Reuters
U.S. President Barack Obama dedicated a significant portion of his U.N. speech Thursday to promoting Mideast peace.

UNITED NATIONS—U.S. President Barack Obama used his annual speech to the U.N. General Assembly to publicly press Israelis and Palestinians to forge a Middle East peace agreement within the next year, in a bid to resolve one of the world's most enduring conflicts.

Mr. Obama called during his 40-minute speech on Israeli Prime Minister Benjamin Netanyahu to extend a construction freeze in the disputed West Bank that is set to expire next week.

The American president said Israel's building moratorium "has made a difference on the ground, and improved the atmosphere for talks."

Mr. Obama also pressed the Arab states to more publicly support the idea of an independent Palestinian state and to lend more financial support to the government of President Mahmoud Abbas. The U.S. leader said the Arab leaders need to do more to prepare their populations to accept a Jewish state in the heart of the Middle East.

"It should be clear to all that efforts to chip away at Israel's legitimacy will only be met by the unshakeable opposition of the United States," Mr. Obama said. "And efforts to threaten or kill Israelis will do nothing to help the Palestinian people—the slaughter of innocent Israelis is not resistance, it is injustice."

Earlier Thursday, Mr. Obama sat down with Chinese Prime Minister Wen Jiabao. In comments before the press, the two leaders focused on the positive. Mr. Obama, standing by Mr. Wen, said cooperation between the U.S. and China "has been absolutely critical" to easing the financial crisis. He praised Chinese leaders for working with the U.S. on economic, nuclear nonproliferation and Asian security issues.

Mr. Obama's devotion of a large portion of his U.N. speech to the Arab-Israeli conflict illustrates the extensive political capital he has invested in the Mideast peace process.

The U.S. president has identified solving the conflict as central to his broader efforts to stabilize the Muslim world nearly a decade after the terrorist attacks on New York and Washington.

Any breakdown in the peace process heading into November congressional elections in the U.S. will likely be used by Republican candidates to attack the Obama administration's foreign-policy record.

During this week of U.N. meetings in New York, American diplomats have pressed Israeli and Palestinian officials to move beyond the standoff over West Bank settlements to push ahead with the broader peace process, according to U.S. officials.

Mr. Abbas has threatened to walk out of the talks if Israel doesn't extend its building freeze. Members of Israel's ruling coalition, meanwhile, have said they will pull their support for Mr. Netanyahu's government if the moratorium is extended.

Mr. Abbas has illustrated flexibility on the settlement issue in recent meetings, said U.S. and Palestinian officials, but made clear that he needed concessions from Israel to sell the peace process to his people.

U.S. and Israeli officials have said they have been seeking a formula that could see a partial freeze of building in the West Bank and an initiative to extend more powers to Palestinian security forces in disputed territories. U.S. officials have also pressed Israelis and Palestinians to immediately negotiate the borders of a future Palestinian state in order to minimize the importance of Israeli construction activities.

"We believe that the moratorium should be extended. We also believe that talks should press on until completed," Mr. Obama said. "Now is the time for the parties to help each other overcome this obstacle."

Mr. Obama also used his speech before world leaders to outline what he described as his administration's successes.

He said financial measures pursued by the U.S. over the past 18 months have helped the global economy pull "back from the brink of a depression," and he touted recent international efforts to combat global warming and other environmental threats.

Mr. Obama also outlined his government's commitments to promoting democracy internationally and to combating the spread of weapons of mass destruction.

The U.S. president repeated a message made by other world leaders in recent days to Iran, stressing that the international community remains committed to negotiations aimed at ending Tehran's nuclear activities.

"The door remains open to diplomacy should Iran choose to walk through it," Mr. Obama said. "But the Iranian government must demonstrate a clear and credible commitment, and confirm to the world the peaceful intent of its nuclear program."

Leaders add weight to Sudan vote

International officials, including the U.S. president, are scheduled to meet Friday at the United Nations to lend support for two referendums in Sudan that could either complete a peace process or return the nation to civil war.

*By **Joe Lauria** at the United Nations and **Sarah Childress** in Nairobi, Kenya*

In the first vote, scheduled for January, Sudan's autonomous southern region—which holds most of the nation's oil—will decide whether it should secede from the country. In the second, residents of the tiny, oil-rich region of Abyei, which lies along the north-south border, will vote on whether to join a newly independent south or remain with the north.

Uncertainty that the referendums will be held as planned in January has heightened tensions between the two sides, and drawn greater engagement from the international community.

The leadership of the south says Sudanese President Omar al-Bashir's government has neglected to distribute oil wealth in their impoverished region. Southern officials have made clear they will vote to secede, and U.N. and foreign government officials expect the population will follow. It is likely that residents of Abyei would follow the south's lead.

The president of the autonomous southern region, Salva Kiir, has suggested the south would go to war to secure their independence if they believe the referendum won't be held fairly or on time.

But Mr. Bashir is reluctant to relinquish his hold on power or control of the nation's oil wealth. Officials from Khartoum recently stressed they still hope to persuade the south to remain part of Sudan.

"There is a belief that if the referenda are not held, and got postponed indefinitely, then there might be a unilateral declaration of independence by the South...and therefore violence," a senior Western diplomat said. "If the result is not credible or adhered to then again, there will be violence. It is a very delicate time."

African heads of state and top officials from Britain, Turkey, Egypt, and several other nations will attend the three-hour discussion, which will focus on how to guarantee smooth, timely votes.

Sudan's two vice presidents, Ali Osman Taha, who represents the north, and Mr, Kiir, are scheduled to attend. Mr. Bashir is wanted by the International Criminal Court on charges of genocide and war crimes connected to the conflict in the northwestern Darfur region of Sudan, and is unable to travel to the U.S. for fear of arrest.

"This could not be a more critical time in the life of Sudan," said Samantha Powers, President Barack Obama's special assistant and senior director of multilateral affairs. "The parties need to move very, very briskly and responsibly to ensure that these votes take place on time."

The referendums mark the culmination of a peace agreement, signed in 2005, between the north and south to end a decades-long civil war.

But the votes are fraught with logistical complications, starting with voter registration. Southerners, the only people allowed to vote in the south's referendum, are scattered across the country and abroad. For the vote to be considered legitimate, the law requires 60% turnout.

Sudanese law requires a three-month grace period between registration and the vote. But officials haven't even begun to register voters, a process that might not begin until November and could take an entire month.

Even if the votes are held on time, the two sides still haven't settled questions essential to a transition to an independent south, including a precise demarcation of the north-south border and whether and how the south will continue to refine and export oil in the north—contentious issues that could lead to violence.

China faces challenges in remaking health care

By Shirley S. Wang

NEW YORK—The ambitious overhaul of the Chinese health-care system is a challenge that won't be solved by money alone, says China's minister of health, Chen Zhu.

Now in the first phase of its $125 billion plan to provide affordable medical care for the entire population by 2020, China is striving by the end of next year to offer basic medical coverage to more than 90% of its residents. It also aims to improve the primary-care system and equalize public-health services across the nation.

"Health-care reform is by no means an easy job for [any] country, particularly for a country of 1.3 billion people," said Dr. Chen in an interview in New York on the sidelines of the United Nations General Assembly. The Chinese government "has always put the people's health on the top agenda," he said.

It has made some headway: In spending more than $10 billion over the past year, the government is expanding basic medical coverage—reimbursement for health-care expenses of up to 60%—to 833 million people, an improvement in a country where many have had to bear the majority of medical costs and save for years in case of serious illness.

But it still has to figure out how to further advance medical care in rural areas and tackle entrenched reimbursement schemes, such as revenue earned by hospitals and doctors for prescribing medicines, said Dr. Chen, a Paris-trained hematologist.

That many hospitals are paid a commission based on the cost of drugs prescribed has led in part to patients being given drugs that they don't need. "We knew that to change the system of the reliance on drug prescriptions as revenue of hospitals, it's not an easy job," said Dr. Chen.

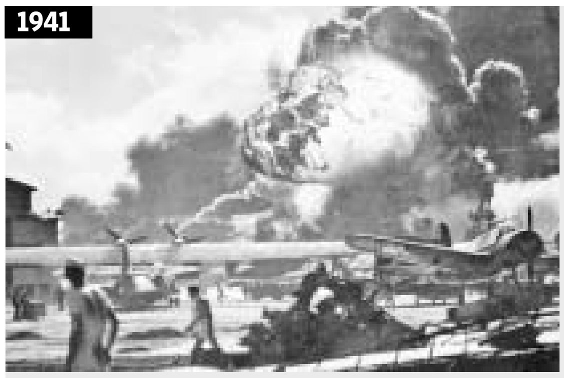
The government is implementing a so-called essential drug-list system. It has identified some 300 medicines as critical for common illnesses and diseases, saying they should be made available to all patients. For medicines on the list, prices are fixed and no commission is paid for their prescription. Already the prices for these drugs have come down by 30% to 50%, which has also reduced the cost of inpatient and outpatient care, Dr. Chen said. The list will be expanded this year. Many of the drugs are made by domestic companies.

It isn't clear how hospitals will cope with the resulting reduction in income. "We are struggling about it," said the health minister. He said prescription reform hasn't begun yet in city hospitals.

Hospitals are often overburdened and the focus needs to shift away from emergency care and serious illness toward primary care, including health promotion and education and disease prevention, he said.

The health minister also sees a continued role for multinational health-care companies in China. He said he "welcomes" private insurers to offer and expand supplementary health insurance for those who want a higher level of medical care.

WORLD NEWS



Rough neighborhood | Eight decades of fraught relations

1931: Japan invades Manchuria as the first step in its occupation of China.

1941: Japan attacks Pearl Harbor, prompting the U.S. and U.K. to declare war on Japan.

1945: World War II ends and Japan gives up claims on China. The Senkaku/Diaoyu islands are later placed under U.S. control, along with Okinawa.

1972: The U.S. returns Okinawa to Japan. Around the same time, Japan, China and Taiwan all claim Senkaku/Diaoyu. Japan and China restore diplomatic relations.

1930s 1940s 1950s 1960s 1970s 1980s 1990s 2000s

2001: Japanese Prime Minister Junichiro Koizumi's visit to Yasukuni, a shrine to Japan's war dead, sets off protests in Beijing.

2004: Seven Chinese activists land on one of the Senkaku/ Diaoyu islands, where they're arrested by Japanese authorities.

2005: Japan issues new textbooks that play down its wartime atrocities, triggering protests and boycotts of Japanese goods in China.

2007: Wen Jiabao becomes the first Chinese prime minister to address Japan's parliament.

2008: Japan and China agree to jointly develop gas fields in the East China Sea.

2009: Two Chinese survey ships enter the disputed waters around Sankaku/ Diaoyu.

April 2010: Ten Chinese military vessels are spotted near Okinawa; a helicopter from one flies close to a Japanese destroyer, prompting a protest from Tokyo.

Sept. 7: After a Chinese trawler collides with Japanese Coast Guard boats in the disputed waters, the captain is arrested and held.

Source: WSJ reporting Photos: Getty Images (1941, 2007), Agence France-Presse/Getty Images (2001)

China row tests new Kan government

BY YUKA HAYASHI

TOKYO—A confrontation over a Chinese sea captain's arrest that has quickly escalated into the worst Tokyo-Beijing dispute in years is testing the ability of Japan's new ruling party to manage relations with its increasingly powerful neighbor.

After detaining the captain of a Chinese fishing trawler that collided with Japanese coast guard vessels in disputed waters in the East China Sea, Tokyo has repeatedly rejected Beijing's demand for his return. That has set off a series of retaliatory steps from China, including the rejection of a bilateral summit meeting and the cancellation of cultural-exchange programs. On Thursday, a senior Chinese official said at a regional tourism conference held in Japan that Tokyo was solely responsible for a "very serious problem" between the two nations. He then warned of more repercussions on Chinese tourism in Japan, unless Tokyo takes decisive steps.

China's Commerce Ministry Thursday denied a New York Times report that China had halted exports of rare-earth elements to Japan. Several industry executives and government officials in Japan and China said they had seen no evidence of such a ban.

The response from Prime Minister Naoto Kan's three-month-old government to the dispute has surprised many foreign-policy experts. His Democratic Party of Japan emphasizes closer ties to China, while its leaders, unlike their predecessors, haven't visited a controversial shrine devoted to the war dead, a source of bitter arguments between the two nations in the past. Still, the government's calm but stern reaction to China this time has set itself apart from Tokyo's past behavior during territorial skirmishes, where it has tended to make compromises early on to avoid full-fledged confrontation.

"One thing that is very clear is Japan said, 'No, we are not going to put up with it,'" said Sheila Smith, senior fellow for Japan Studies at the Council on Foreign Relations, a U.S. think tank. "Japan drew a red line and drew it at a moment of political change, when many people were wondering whether or not the government was fully functioning."

There have been occasional flare-ups of tension over the disputed islands since the early 1970s when the U.S. ended the occupation of Okinawa, which, by the Japanese definition, includes the islands known as Senkaku in Japan and Diaoyu in Chinese. But the tension has rarely risen this high. There have been a number of skirmishes, usually involving Chinese or Taiwanese ships entering the disputed areas and the Japanese ships chasing them off. On one occasion in 2004, Japan arrested seven Chinese activists after they landed on the chain's main island. They were released a few days later as their offense was deemed a violation of immigration law, which usually results in simple deportation.

This appears to be the longest detention by Japan for a Chinese national entering the territory.

"In the past, Japan hasn't dealt with these cases properly," said Tsuneo Watanabe, senior fellow at the Tokyo Foundation, a think tank. "This time, Japan must reach a legal conclusion while explaining patiently to China that we don't have political motives and try to gain their understanding."

Japanese officials say their response isn't more forceful than in the past, but rather, that Chinese behavior has turned more aggressive. They say they have tracked increased Chinese naval activities near or in the Japanese waters that alarmed the Japanese, including the passing of a flotilla of 10 naval vessels in the high seas between two main islands of Okinawa, that came with a provocative action of a Chinese helicopter coming in close proximity to a Japanese destroyer.

In recent months, the number of Chinese trawlers operating near the disputed areas has risen gradually, according to Japanese officials, reaching as many as 250 a day in August.

Until the collision on Sept. 7, the Japanese coast guard had warned the trawlers to leave, and they obliged, said Japanese officialson condition they not be identified. Japan has also quietly, but repeatedly, launched complaints with Beijing to keep control of these vessels, citing the risks of collisions.

The Sept. 7 crash was the first such collision—and Japanese officials call it an "isolated" incident. The crash between the trawler and two Japanese coast guard patrol vessels took place near the area that Japan considers its territory. Japan maintains that the Chinese boat maliciously rammed its ships after being warned to leave what Japan considered its territory. Having arrested its captain for alleged obstruction of official duties, Japan says it is handling his case according to its domestic law.

China says the Japanese ships' chasing of the trawler led to the collision and has focused on Japan's "illegal interception" of the Chinese vessel in its territory, known for its rich deposits of natural gas.

"We were praying this could be avoided," said a Japanese government official speaking on the condition of anonymity. "We knew what this would entail but it was a process that we couldn't avoid."

Having extended the captain's detention period Sunday, Japanese prosecutors are required to decide whether or not to indict him by Sept. 29.

Some say an indictment is likely, given that Japan has a video of the collision—which Japan hasn't made public in order to use it as evidence in case of indictment.

While obstruction of official duties isn't considered a serious offense that requires imprisonment, an indictment would mean weeks and possibly months of keeping the captain in Japan for court proceedings. That would likely escalate the confrontation further.

Japan may be moving to seek a solution. After Chinese Premier Wen Jiabao urged Japan on Wednesday to "immediately and unconditionally" release the captain, Japanese Chief Cabinet Secretary Yoshito Sengoku said: "It is desirable if we could hold a high-level meeting as early as possible for discussions that will also cover broader and strategies issues."

The U.S. on Thursday urged Japan and China to quickly resolve the dispute.

State Department spokesman P.J. Crowley said Secretary of State Hillary Clinton told new Japanese Foreign Minister Seiji Maehara that good China-Japan ties are crucial to Asia's prosperity.

Separately, Reuters reported that Defense Secretary Robert Gates said the U.S. will fulfill its alliance responsibilities to Japan. "We are watching that tension very, very carefully," Mr. Gates said, according to Reuters. "And we would fulfill our alliance responsibilities."

Japan's move to spur lending falls short

BY ATSUKO FUKASE

TOKYO—The Bank of Japan earlier this month took the unorthodox step of providing funds to financial institutions in a bid to kick-start perennially sluggish lending. But the effort hasn't been a hit: Many banks say they don't expect a dramatic improvement in loan demand.

The central bank has made up to three trillion yen ($35 billion) available to commercial banks at a rock-bottom 0.1% interest rate. In return, the banks are required to make new low-interest loans to companies in growth sectors the central bank has designated, such as environment-related businesses and nursing care.

Although banks are eager to lend and some companies have tried to draw on the program, many firms remain reluctant to tap banks for funds because of their concerns about the economic downturn and a strong yen.

The central bank's move was considered a last resort designed to spur lending, which has been declining year on year for nine consecutive months. The Bank of Japan was also facing pressure from the government to take action to help bring the economy out of deflation.

The central bank hoped the low-cost funds would act as a catalyst to stimulate economic growth.

The one-year Tokyo interbank offered rate, or Tibor, a benchmark for financial institutions' borrowing rates, hovers around 0.5%, compared with the 0.1% offered by the Bank of Japan.

But banks themselves remain skeptical. "Loans with the 0.1% rate are surely attractive, but the rate itself wouldn't help boost corporate loan demand," an official at a regional bank said.

The yen's strength is damping companies' willingness to make capital investments. Unless the economy recovers, firms won't spend cash or seek loans for capital investment, analysts and lenders said.

There is also a concern about a possible increase in bad loans. The Bank of Japan won't take credit risk, so if the economy worsens and loans default, that may weigh on banks' credit costs, said Nana Otsuki, an analyst at UBS Securities.

Still, some banks have been working on specific projects eligible for the loans. Sumitomo Mitsui Banking Corp. has set up funds in the areas of environment-related businesses and medical care, as well as targeting companies that plan to expand or start operations in China.