WEEKEND JOURNAL.

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THE WALL STREET JOURNAL.

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Associated Press

French President Nicolas Sarkozy, visiting an Airbus plant Thursday, reiterated that the euro's strength against the dollar is hurting euro-zone firms' competitiveness.

Euro surges as Trichet takes hawkish stance

By Brian Blackstone

FRANKFURT—ECB President Jean-Claude Trichet scrambled to counter an unexpected rise in euro-zone inflation, signaling that he won't hesitate to raise rates if recent signs of price pressures become firmly entrenched.

In his monthly news conference, Mr. Trichet also appealed to European leaders to move quickly to increase the size and flexibility of a rescue fund aimed at stemming contagion from the currency bloc's widening debt crisis, saying "there is a sense of urgency."

But it was his inflation warning that created the biggest stir in financial markets. Money-market rates rose during Mr. Trichet's news conference, and the euro jumped above $1.33 against the U.S. dollar, as investors reassessed their ECB forecasts.

The ECB kept its main policy rate at a record-low 1%, where it has stood since the height of the global recession May 2009. But Mr. Trichet's remarks have put a rate increase later this year squarely on the table. The ECB chief appears increasingly uncomfortable with the ECB's very accommodative policy stance 18 months after the recession ended. Inflation last month spiked to 2.2%, putting it above the ECB's sub-2% target for the first time in more than two years.

"We are never pre-committed" on interest rates, Mr. Trichet said. "We have proved that in the past....it is important to keep that in mind." Mr. Trichet said that while he still expects inflation to drift back below 2% toward the end of 2011, risks "could move to the upside."

"The pain threshold is being crossed," says Royal Bank of Scotland economist Nick Matthews. "The ECB is probably looking at an inflation forecast that's above 2%" for 2011.

On three separate occasions during his hourlong conference, Mr. Trichet cited the ECB's last rate increase, which occurred in July 2008, just weeks before the Lehman Brothers failure sparked a global financial crisis. Though that decision has been criticized in some economic circles for exacerbating the crisis, Mr. Trichet sees it as proof of his anti-inflation credibility even in the face of market turbulence.

Mr. Trichet also emphasized that the ECB could raise interest rates even while maintaining its crisis lending programs, which provide unlimited loans to commercial banks at maturities up to three months. ECB watchers have long assumed that the ECB would unwind those programs first as a precondition to raising interest rates. "These two concepts are disconnected," Mr. Trichet said.

"It's a bolt from the blue," says Ken Wattret, economist at BNP Paribas in London. "Most people have been associating [monetary policy] with the sovereign debt crisis, and suddenly the ECB has put a rise in inflation on the agenda," he says. He is sticking to his forecast that the ECB won't raise interest rates until next year, but the "unambiguous" risk is that "rate hikes might come sooner."

Meanwhile, in London on Thursday, U.K. Prime Minister David Cameron said that Britain wouldn't be drawn into fresh mechanisms to solve the euro zone's problems. Following a meeting with French Prime Minister François Fillon, Mr. Cameron said that while the U.K. supported a strong and successful currency bloc, he indicated that Britain wouldn't be taking part in new strategies to bolster it.

Mr. Cameron added that there was "absolutely no chance" of the U.K. joining the currency bloc while he was prime minister.

For now, economists see Mr. Trichet's tough talk as largely a verbal effort to keep expectations for future inflation firmly in check, which he called "of the essence." Fragile economies in Greece, Ireland, Portugal and Spain will

Please turn to page 4

Ratings firms warn U.S. on debt

By Mark Brown And Nathalie Boschat

LONDON—Two leading ratings firms have cautioned the U.S. on its credit ranking, expressing concern over a deteriorating fiscal situation that they say needs correction.

The warnings issued Thursday echoed prior statements by the firms, however, and financial markets largely ignored them. Treasury yields, which move in the opposite direction as prices, were lower in late-morning trade and the cost of insuring U.S. debt against the risk of default, already below that of Germany, the euro-zone benchmark, barely budged.

"My traders are shrugging it off as stuff we've heard before," said Tom Di Galoma, head of interest-rate trading at Guggenheim Partners in New York.

Moody's Investors Service said in a report that the U.S. will need to reverse an upward trajectory in the debt ratios to support its triple-A rating.

"We have become increasingly clear about the fact that if there are not offsetting

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The Quirk

Home buyers call in witches and warlocks to beat bad repossession vibes. Page 29

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PAGE TWO

Colonial children have flown the nest, but Britons cling to their nanny state

[Agenda]

By David Cottle

The latest index of economic freedom from the Heritage Foundation and The Wall Street Journal knocks the U.K. down and then, rather unsportingly, kicks it hard as well.

For the country has fallen precipitously since last year. It's now in a lowly 16th place rather than the number 11 spot it managed in 2010.

But not only that; it must also suffer the indignity of seeing places it used to rule running rampant in the rarified heights far above.

Hong Kong, Singapore, Australia and New Zealand hog the top spots. Canada, Ireland, the U.S. and even Bahrain all beat the Old Country.

The reason for the U.K.'s underperformance is plain enough. Economically, the place has a split personality.

It doesn't score badly at all against benchmarks of investment freedom, lack of corruption, labor-market flexibility and all that good stuff. Indeed, it's still one of the better places in Europe to do business, judged by these criteria.

But when it comes to state involvement in the economy, fiscal freedom and government spending, well...that's when the U.K. starts to look positively Third World.

As the Heritage Foundation says, "a dramatic expansion of government intervention has taken place in the U.K. in response to the global financial and economic crisis. The government has nationalized or seized ownership positions in some of the major banks. Public finance has deteriorated markedly. Welfare benefits have become a daunting burden. The government deficit has widened sharply, and gross public debt has climbed to over 70% of GDP."


Bloomberg News

The Bank of England is battling with above-target inflation.

Well, there you go.

But the real question is, would the British have it any other way?

If economic freedom is to be equated with a lack of state involvement, the people seem not to want it. Indeed, they usually vote against it.

The reason for the U.K.'s underperformance is plain enough. Economically, the place has a split personality.

Look at the last election. Despite the patchy performance of both the vast National Health Service and Britain's state-provided education system, neither of which bears comparison with the world's best, all the major political parties felt they had to promise to support both, come what may. To do otherwise was judged electoral suicide. Probably rightly.

Think about that for a moment. Even in the face of an austerity program unprecedented in peacetime, these two massive, costly edifices had to be guaranteed, undamaged, to the people even by parties such as the Conservatives, which are supposed to have free-market leanings and an affinity for the private sector.

No, there comes a point when all British free-marketers are eventually forced to realize they are doomed to be in a minority, albeit sometimes a large one. Probably forever.

A long postwar history of state involvement, if not dominance, in just about everything that matters to individual voters has left its mark. And it's a mark so deep on the British public that other ways forward in health or education, especially, are seldom seriously discussed.

Public money is not only the default position in answer to almost any problem in national discourse, but it is also usually the only position.

And look at the dominance of the concept of "fairness" in any national debate. Argue as you will that fate doesn't create humans equal. It won't do you any good. The British want a state that redresses the balance, come what may.

Of course there is that sizable minority that looks back to the swashbuckling Thatcher years as a lost golden age. But theirs remains perhaps the last love that cannot speak its name. Mrs Thatcher's way seemed just too brutal for the majority, and the Grand Old Lady of the free market remains popularly reviled.

It's not all bad news, of course. Compared with its big European rivals and partners, the U.K. comes out of the index rankings rather well. Only the Netherlands is above it, and it still leaves Germany and, especially, France in the dust. The Old Enemy only manages to scrape in at 64, sandwiched between Cape Verde and Romania. Try telling Paris it's on a par with either of those two in anything.

But here again we see the U.K.'s split personality. Its apologists may look once more to that oft-touted talent for compromise to explain away this halfway house between market and state.

Others may see it more as endless, incoherent dithering, saddling the country with the worst of both worlds, unable to reap the full benefits of either.

The U.K. isn't alone on the slippery slope, of course. For similar, postcrisis reasons, the U.S. comes in at a lowly ninth place; the lowest score it has notched up in a decade.

But that will be scant comfort in London. If the U.K. is ever to rival its old colonies in terms of economic freedom, the free marketers may just need better, gentler salespeople than they have had so far.

In all likelihood, though, economic freedom for the British will forever stop at the hospital door or the school gate; much as it always has.

What's News

■ **An Italian court** struck down a key pillar of a law that postpones criminal trials facing Berlusconi and other top government officials. The ruling could revive the prime minister's trials and heighten tensions within his already-weakened ruling coalition. 5

■ **Slovakia's finance** minister said efforts to defend the euro by bailing out indebted nations are failing and financial stresses could increase over the next two years. 5

■ **SAP released** preliminary fourth-quarter revenue well above expectations, but said a $1.3 billion verdict awarded to Oracle will hurt profit. 17

■ **UBS's joint chiefs** for Asia warned that the battle for financial-services talent in the region is causing costs to spiral and will lead to a shake-out in the industry. 17

■ **Economists are** increasingly optimistic about the pace of the U.S. recovery, a WSJ survey found. 8

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'I can't say that the market is perfect, but the market is reality, the market is business itself.'

Hungarian PM **Viktor Orban** in an interview with The Wall Street Journal.

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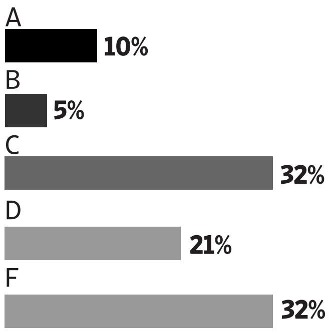

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NEWS

‘Spider-Man’ show spins troubled web

By Ellen Gamerman
And Erica Orden

Scheduled to open in less than a month, “Spider-Man: Turn Off the Dark” still hasn’t figured out its final scene and its lead producer has bought repeat tickets for audience members to get feedback on the show’s many changes.

The most expensive production in Broadway history was vaulted once again into the national spotlight Dec. 20 when Christopher Tierney, the primary Spider-Man stunt double, fell 25 feet during a performance. He ended up hospitalized with broken ribs, a hairline skull fracture and other injuries.

Producers canceled two shows as they worked out new stunt protocols that satisfied state and federal safety inspectors. The show has been running ever since to packed audiences during its extended preview. Last week, it narrowly surpassed “Wicked” as the top box office performer on Broadway.

Four actors in the show have sustained injuries as the production has prepared for its Feb. 7 opening at the Foxwoods Theatre. Emails obtained by The Wall Street Journal through the Freedom of Information Law from the New York State Department of Labor show inspectors raised serious concerns about the safety of the musical’s complex aerial maneuvers. The day after Mr. Tierney’s accident, state safety inspector Lansing Lord wrote in an email to six other labor officials: “May be time to do something here before someone is killed.”

Lead Producer Michael Cohl said the musical—directed by Julie Taymor with a score by U2’s Bono and the Edge—and state inspectors have worked cooperatively from the start to ensure the production is safe. “All that happened there was safety, safety, safety,” he said.

Mr. Cohl hedged his bets when asked if the opening date, which has been postponed three times, remains Feb. 7. “It’s life—I don’t expect it to [change], but it’s life,” he said during an interview with fellow producer Jeremiah J. Harris in Mr. Harris’s corner office overlooking an edge of the theater district. A spokesman for the show, Rick Miramontez, said Wednesday that “all systems are absolutely go” for the planned opening.

One key element the show is still hammering out: the ending. Producers intend to replace the $65 million show’s temporary finale—a scrim unfurling to reveal an image of Spider-Man—with a more elaborate scene, Mr. Cohl said. “The actual ending that we have planned is still not in the show,” he said. “Nobody’s seen it—including us, by the way.”

The artistic challenges come amid investigations by the state labor department and the U.S. Occupational Safety and Health Administration into the technically complex production. Emails show that some labor department officials anticipated safety problems months ago.

“I hate to say I told you so…,” wrote the department’s safety and health inspection supervisor, Kevin Dillon, on Oct. 31, informing other labor officials of an accident earlier that month that catapulted an actor, Kevin Aubin, across the stage, leaving him with two broken wrists. “I again express to you my reservations and concerns regarding the speed of the flights and the effect upon the performer if an emergency stop must be made during the flight.”

“Those concerns were very much heard, and they focused everything we did,” the labor department’s deputy commissioner for worker protection, Pico Ben-Amotz, said in an interview.

Labor officials were originally inclined to reject the show’s request for permits needed for risky aerial maneuvers based on their conclusion that the computer system controlling the stunts “has demonstrated the ability to harm performers,” a Nov. 1 email from the department’s senior safety and health engineer, Edward A. Smith, said.

Inspectors eventually cleared the show as safe for performance on Nov. 24, four days before the first preview.

In response to the concerns raised in the labor department emails, Mr. Miramontez said Wednesday: “The production worked closely with the Department of Labor throughout the process and never heard of any grave concerns. Any and all concerns and issues have always been addressed in a timely and appropriate manner.”

“Spider-Man” last week beat “Wicked” by $58 in box-office receipts, grossing $1.59 million. “Wicked” had been No. 1 almost continuously since 2004.

To pay back investors, “Spider-Man” must match that exceptional result for at least another two years, according to longtime Broadway producers. Mr. Miramontez doesn’t dispute that assessment. Some of the show’s backers, like Kathryn Sherman, aren’t certain they will see a return on their money. “It wasn’t our intent to be as heavily invested as we are, but that’s the way things have rolled,” Ms. Sherman said.

Meanwhile, the show’s creative team is working to make the storyline clearer. While the first act is made up of moments familiar to fans of the “Spider-Man” films, the second act is an original story written as a dream sequence by Ms. Taymor and book co-author Glen Berger.

“Some people are confused, yeah,” said Mr. Cohl, the lead producer. “It’s hard to tell that it’s all an illusion, it’s all a dream.”

He says he’s spoken with audience members to get their feedback and has bought tickets for a handful of them to get their opinion on revisions.

Safety changes also have altered at least one key moment in the show. Whereas Mr. Tierney was supposed to run almost to the edge of the elevated platform during the stunt that injured him when he went too far, the performer doing the move now has been instructed to halt four feet shy of the precipice.

Mr. Tierney, who’s recovering and hopes one day to return to the musical, has said that not running up to the edge can blunt the stunt’s potency: “If you don’t go for it, it just doesn’t play,” he said during a recent appearance on “Good Morning America.” “It just doesn’t look good.”

Mr. Miramontez said the safety changes haven’t affected the look of the show or its ability to excite audiences. He noted that no flying moments have been altered as a result of the new safety protocols.

The production’s weekly running costs have held firm at $1 million. The show is selling tickets through April, and the producers say they plan in the next few weeks to offer a new block of tickets for sale into the fall.

Messrs. Harris and Cohl said they are fully dedicated to Ms. Taymor’s artistic vision and attribute fascination with the musical’s troubles partly to professional jealousy targeted at the director. “Why are they picking on Julie? It’s probably personal,” Mr. Cohl said.

Mr. Cohl said he doesn’t believe any audience members are there to see accidents, but he readily acknowledged that a sense of fear draws crowds. “Is it thrilling to see something dangerous?” he said. “Well, the circus has been around a lot longer than Broadway, and so the answer has to be a resounding yes.”

Hanging on

The most expensive production in Broadway history, ‘Spider-Man: Turn Off the Dark,’ continues to tinker with artistic changes and remains under investigation by state and federal agencies amid injuries to four of its actors. Its planned opening is less than a month away.

Rescheduled Previews

~~FEB. 25, 2010~~
~~NOV. 14, 2010~~
NOV. 28, 2010

Rescheduled Openings

~~MARCH 2010~~
~~DEC. 21, 2010~~
~~JAN. 11, 2011~~
FEB. 7, 2011

Dollar signs

Weekly box-office grosses, In thousands; Weekly attendance

Weekly box-office grosses (in thousands)	Week	Weekly attendance
$201	Nov. 28, 2010	1,923
$919	Dec. 5	9,468
$912	Dec. 12	9,595
$1,036	Dec. 19	11,455
$944	Dec. 26	7,720
$1,881	Jan. 2, 2011	15,443
$1,589	Jan. 9	15,443

Injuries

BRANDON RUBENDALL
The Lizard
Broken toe

KEVIN AUBIN
Spider-Man stunt double
Two broken wrists

NATALIE MENDOZA
Arachne
Concussion

CHRISTOPHER TIERNEY
Primary Spider-Man stunt double
Hairline skull fracture, four broken ribs, bruised lung, three fractured vertebrae, among others

Dropouts

EVAN RACHEL WOOD
March 2010

ALAN CUMMING
April 2010

NATALIE MENDOZA
January 2011

Sources: WSJ research; Broadway League Photos: Associated Press; Getty Images

S&P, Moody’s again warn U.S. on its ratings

Continued from first page

measures to reverse the deterioration in negative fundamentals in the U.S., the likelihood of a negative outlook over the next two years will increase,” said Sarah Carlson, senior analyst at Moody’s.

Standard & Poor’s Corp. also didn’t rule out changing the outlook for its U.S. sovereign-debt rating because of the recent deterioration of the country’s fiscal situation. The U.S. has a triple-A rating with a stable outlook at both raters.

“The view of markets is that the U.S. will continue to benefit from the exorbitant privilege linked to the U.S. dollar” to fund its deficits, said Carol Sirou, head of S&P France, at a conference in Paris on Thursday. “But that may change. We can’t rule out changing the outlook” on the U.S. sovereign-debt rating in the future, Ms. Sirou warned. She said the jobless nature of the U.S. recovery was one of the biggest threats to the economy. “No triple-A rating is forever,” she said.

Moody’s said the U.S., Germany, France and the U.K. still have debt metrics, including debt affordability, compatible with their triple-A ratings. But all four countries must bring the future costs arising from pension and health-care subsidies under control if they “are to maintain long-term stability in their debt burden credit metrics,” Moody’s said in its regular triple-A Sovereign Monitor report.

Moody’s noted that measures were recommended by the U.S. National Commission on Fiscal Responsibility and Reform, appointed by President Obama, to achieve a balanced primary budget, which excludes the cost of interest payments, by 2015, but that there was insufficient support to trigger consideration of those recommendations by the full Congress.

The wide variety of recommended measures included Social Security reform, cutbacks in the growth of Medicare outlays, elimination or modification of the mortgage-interest tax deduction, a gasoline tax and other measures, Moody’s said.

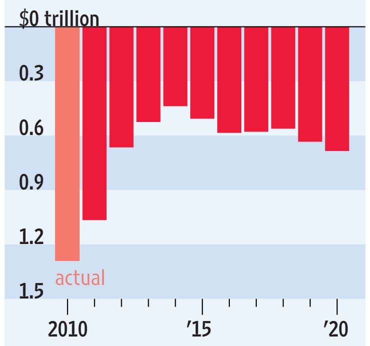
“In Moody’s view, a plan that would result in a reversal of the upward trajectory in the debt ratios would indeed be supportive of the country’s Aaa rating,” the ratings agency said in its report. “However, it is unlikely that the Commission’s recommendations will be adopted.”

The most recent official figures show the ratio of federal debt to revenue averaging 397% of gross domestic product in the period to 2020, while the ratio of interest to revenue will rise to 17.6% by 2020, from 8.6% in the last fiscal year.

—Mark Gongloff in New York contributed to this article.

A sea of red ink

Projected U.S. budget deficit



Source: U.S. Congressional Budget Office

EUROPE NEWS

Ideas on putting bailout fund to work

[Brussels Beat]

By Stephen Fidler

Brussels this week has been abuzz with ideas about how to make the euro zone's main bailout fund more effective. As the crisis that started in Greece and enveloped Ireland now threatens to overtake Portugal, it's evident that the European Financial Stability Facility has not provided a firebreak between countries that its architects hoped for when it was created in May.

"The EFSF funding capacity must be reinforced," European Commission President José Manuel Barroso said Wednesday, adding that "the scope of activities should be widened."

The discussions have taken place mostly behind closed doors, but enough detail has emerged to suggest that many ideas dismissed in the past—some because of German opposition—are now back on the agenda. European officials appear to be moving toward a package that would at once reshape the EFSF and also specify the rules of engagement for the permanent bailout fund that will replace it after mid-2013.

The Doomsday nature of the bailout fund has been noted here before: It's only when the victim is at the point of drowning that a rescue takes place, by which time the next country in line is up to its neck in water. The stipulation that bailouts can only occur as a last resort has rendered them virtually useless in preventing contagion.

One idea now under discussion is to use the fund to preempt a crisis. It is backed in a number of capitals, including Paris, but critically Berlin has resisted.

The idea would be to use the fund, perhaps in tandem with the precautionary funds available from the International Monetary Fund, as a credit line to stave off a self-fulfilling downward spiral.

This week the IMF agreed to expand to $72 billion ($96 billion) a line of credit for Mexico, the sort of financing available to countries whose policies are seen as strong. The technique may, some officials say, be appropriate for Spain. Ideally, it would never be used.

Such precautionary credit lines can be effective in providing firepower to deter speculative attacks. Yet, some analysts say that Spain and other peripheral euro-zone countries may be facing a permanent retreat of investors, most of which are elsewhere in the euro zone. If so, a preemptive credit may be less effective.

Linked with this is another proposal: Let the bailout fund buy bonds. This idea is, officials say, eagerly supported by the European Central Bank, the reluctant buyer of last resort in the euro zone's sovereign bond markets. Intervening early could prevent the upward spiral of bond yields which sends the signal to the markets that a country's debt position is unsustainable, and closes off future market finance. However, buying existing debt—as Stephen Lewis of Monument Securities in London points out—would reduce the money available for future financings.

One other possibility is to lower the interest rates payable on the bailout funds, as discussed in this column last week. High interest rates are meant to make sure a bailout isn't an easy way out for impecunious governments. But high interest rates raise questions about whether countries can really bear the costs of servicing their debts.

Cutting interest rates for the bailout funds would be relatively easy. It would just require EU leaders to make a political decision. Most of the other proposals, including the next one, would require the leaders to return to their national parliaments to seek agreement and would therefore be tougher politically.

The other major debate is over enlarging the size of the fund. Using government guarantees totaling €440 billion, it raises money by issuing top-rated bonds. That lowers its funding capacity to just €255 billion, which is supplemented by €60 billion from another EU bailout fund, and a contribution from the IMF of up to half of what the Europeans pitch in.

That's more than enough to finance Portugal, should it need help. But it may not be able to cover Spain's requirements over the next three years, particularly if the government needs to boost the capital of its banks.

Expanding the fund can be done in several ways. The guarantees of the EFSF could be amended to apply "jointly and severally," a term that would imply every country was in effect guaranteeing all the bonds. This is unpopular in the richer countries starting with Germany, and officials say it's unlikely to get very far.

Alternatively, the fund could issue its bonds with a lower rating, bringing into play guarantees from non-triple-A-rated countries. But the EFSF has been marketing itself as a top-rated credit and that would sit ill with some European officials.

More likely is an agreement to expand the size of the guarantees. To increase the lending capacity to the current headline size of the fund, €440 billion, would require more than €700 billion in guarantees.

One drawback: It could start to create problems for some guarantors. In a research note this week, Stephen Jen of BlueGold Capital Management LLP, a hedge fund manager, wrote: "If the EFSF is enlarged to €700 billion or above, one or more of the currently AAA-rated government debts may be downgraded." A downgrade of any of the five triple-A countries in the euro zone—France, Germany, the Netherlands, Austria or Finland—would in turn compromise the credit ratings of EFSF bonds themselves.

It's a prospect that European officials dismiss as a fantasy. But it does suggest a practical limit to the expansion of the bailout fund.

Agence France-Presse/Getty Images

European Commission President José Manuel Barroso urged European leaders to increase the size of the crisis fund.

Germany debates rescue fund

By Marcus Walker

BERLIN—German leaders are divided over whether to boost the bailout fund for euro-zone countries, amid growing calls from other European leaders to greatly expand the currency bloc's safety net.

German Finance Minister Wolfgang Schäuble voiced support for changes that would significantly raise the bailout fund's true lending capacity, which is currently much lower than its headline €750 billion ($985 billion) size thanks to quirks in its fine print.

"We must discuss whether it wouldn't be right that €750 billion are actually available" as rescue loans, Mr. Schäuble told foreign correspondents in Berlin on Thursday.

Doing so wouldn't amount to increasing the fund, as it would merely fulfill a pledge Europe made last May, Mr. Schäuble argued. But it would require beefing up the main part of the safety net with extra credit guarantees or capital from euro-zone governments, he said.

While Mr. Schäuble, Germany's most powerful supporter of deeper European integration, signaled flexibility on new measures to combat the debt crisis in the euro zone, other German officials dismissed proposals to boost the rescue fund as unhelpful.

German Economy Minister Rainer Brüderle said on Thursday that the safety net is "sufficient" as it stands, adding: "I don't think it's good to make new proposals every day."

The European Union has for days been debating an overhaul of its aid mechanisms for euro-zone countries struggling with their debts, with the aim of presenting what Mr. Schäuble called a "comprehensive package" by March that would restore confidence in markets about the EU's ability to master the crisis.

But Europe's ability to take bold action is being held hostage by domestic politics in Germany, the EU's biggest economy and financial powerhouse.

In a replay of last year's divisions over how to handle a budget crisis in Greece—the first euro member to lose investors' trust because of its debts—Chancellor Angela Merkel is wary of electoral fallout at home, and is putting the brakes on ambitious new proposals by other European leaders.

A chorus of top EU officials is calling for a bigger bailout fund, to reassure markets that Europe has enough firepower to support any country that might need aid, including a large euro-zone nation such as Spain.

Mr. Schäuble said doomsday scenarios that would exhaust the aid funds currently available are unlikely. But he acknowledged that there is widespread uncertainty in financial markets about whether Europe has set aside enough money to cover all eventualities.

"This is an argument for us to make it clear that what we agreed in May is truly available," he said.

Mr. Schäuble's comments show that Germany's finance ministry is searching for a compromise between pressure from around Europe to expand the safety net, and political fears in Germany of a voter backlash if Berlin is seen as sending more taxpayer money to euro-zone countries that have failed to balance their books.

—Bernd Radowitz contributed to this article.

ECB warning lifts the euro

Continued from first page

keep the ECB from raising interest rates for at least the next few months, many analysts say. The ECB on Thursday kept its crisis-era lending programs in place—a lifeline to banks in Ireland, Greece and Portugal that have trouble accessing funds from the interbank markets—and Mr. Trichet said the ECB's government-bond purchase programs remain in place.

The ECB so far has purchased €74 billion ($97 billion) in Irish, Greek and Portuguese government bonds since the program started in May. Though ECB officials appear reluctant to embark on large-scale purchases, they have been willing to intervene in a targeted way, as they did Monday and Tuesday ahead of Portugal's key bond sale, according to bond traders.

The euro was also bolstered Thursday by encouraging debt auctions by Spain and Italy. While investors demanded higher yields from both countries, which are viewed as two of the more vulnerable euro-zone economies, the auction temporarily alleviated worries that the euro zone's debt crisis would spread.

Mr. Trichet declined to comment on whether the ECB bought bonds this week, and rejected speculation that it was trying to smooth Lisbon's debt sale. The ECB's aim is to make its interest-rate policies transmit smoothly through financial markets, Mr. Trichet said, adding there is "no other goal than that."

Mr. Trichet renewed his call for European leaders to increase the size and scope of Europe's €440 billion rescue fund. "The message is to improve the effectiveness of this instrument, both in quantity and quality," Mr. Trichet said, adding he wants "maximum" flexibility.

Separately, French President Nicolas Sarkozy reiterated that the euro's exchange rate against the dollar is still too strong and is hurting the competitiveness of companies in the euro zone.

Visiting an assembly plant of European commercial aircraft builder Airbus, Mr. Sarkozy said he will "fight" during France's presidency of the Group of 20 industrialized and developing nations to ensure that euro-zone companies have a competitive exchange rate and aren't a victim of "monetary dumping."

EUROPE NEWS

Court dents Berlusconi’s legal shield

By Stacy Meichtry

ROME—An Italian high court struck down a key pillar of a law that postpones criminal trials facing Italian Prime Minister Silvio Berlusconi and other top government officials.

The long-awaited ruling on Thursday could revive the billionaire leader’s trials and heighten tensions within his already-weakened conservative ruling coalition.

The law, which Parliament passed in March, had forced judges to automatically postpone trials of cabinet ministers up to 18 months if the premier’s office deemed the legal proceedings a “legitimate impediment” to their governing duties.

Italy’s Constitutional Court upheld the part of the law that says the trials of cabinet members can in principle be put on hold. However, the court ruled that only the judges presiding over the trials in question—and not the government—can decide whether such trials interfere with government affairs.

Mr. Berlusconi “did not comment and has no intention of commenting,” his office said in a statement.

A joint statement by two of Mr. Berlusconi’s lawyers, Nicolo Ghedini and Piero Longo, praised the ruling for leaving the “framework” of the law intact. However, they criticized the ruling for assuming judges are not biased against Mr. Berlusconi’s government.

Mr. Berlusconi has long argued that he is the victim of persecution by left-wing magistrates.

Mr. Longo said the judges presiding over each of the premier’s three trials could take more than a month to decide whether to postpone the trials further or let them resume.

The ruling marks the latest chapter in Mr. Berlusconi’s longtime battle with Italy’s courts. He faces three criminal trials on charges of tax fraud, corruption and embezzlement—charges he has long denied.

Over the years, in the face of criminal charges, Mr. Berlusconi has repeatedly introduced new laws that shield top officials from prosecution only to see the measures stripped away by the Constitutional Court. The tug of war, which has been the subject of long debate in Parliament, has often distracted lawmakers from dealing with other key issues facing the country, from economic measures to an overhaul of Italy’s education system.

Last year, Mr. Berlusconi used his strong parliamentary majority to pass the current law after the Constitutional Court struck down a 2008 law that had given Mr. Berlusconi and other top officials immunity from criminal prosecution.

Today, however, Mr. Berlusconi lacks a strong majority in Parliament. The premier narrowly survived a vote of confidence in the Chamber of Deputies, the lower house of Parliament, by a mere three votes in December.

Since then, Mr. Berlusconi has struggled to lure enough lawmakers, particularly those in a pro-Vatican opposition party, to comfortably offset the defection of dozens of lawmakers allied with Gianfranco Fini, his former ally and the speaker of the Chamber.

Mr. Fini has recently warned that he wouldn’t support any overhaul of Italy’s judiciary that “retroactively” shields Mr. Berlusconi.


Agence France-Presse/Getty Images

Mr. Berlusconi, shown in Rome in December, faces the possibility of three trials.

Bailouts failing, says key Slovak

By Sean Carney
And Gordon Fairclough

BRATISLAVA, Slovakia—Efforts to defend Europe’s common currency by bailing out indebted countries are failing and financial stresses could increase over the next two years, Slovakia’s top finance official said Thursday.

Slovak Finance Minister Ivan Miklos said new rules that could require private investors to share the costs of any rescue efforts after 2013 risk “increasing pressure for markets to shift the whole burden onto taxpayers before then.”

In an interview with The Wall Street Journal, Mr. Miklos also said that uniting the finances of euro-zone governments isn’t the solution to the euro zone’s continuing woes.

“The main responsibility, the main effort needs to be at the national level,” Mr. Miklos said. Governments need to “respect fiscal rules and convince people there is no free lunch. We have to pay the bills and work hard if we want a better life.”

‘Loans to Greece were the first mistake; formal debt restructuring would be much, much better,’ he said.

Slovakia’s new, right-leaning government, which took office last year, has refused to participate in the $140 billion bailout of Greece and criticized the establishment of the so-called European Financial Stability Facility as a mistake. Slovakia adopted the euro in 2009.

The country, the euro area’s poorest member until the tiny Baltic nation of Estonia joined Jan. 1, has said it is unfair for its citizens to foot the bill for wealthier neighbors that overspent.


Associated Press

Slovak Finance Minister Ivan Miklos

Since the Greek bailout and a similar rescue of Ireland, fears have mounted that other troubled euro-zone countries, such as Portugal and Spain, could end up needing assistance. And the European Union has scrambled to maintain financial stability.

“This is very dangerous, it is not effective,” Mr. Miklos said of the bailout efforts. “It is destroying confidence in the market economy. What kind of capitalism is it, when profits are private, but losses are nationalized?”

He said there is no reason that national bankruptcies or debt restructurings should cause the euro to collapse. “Loans to Greece were the first mistake; formal debt restructuring would be much, much better,” he said.

The Slovak finance minister said that stricter budget-deficit rules for EU members would be useful, but that a complete fiscal union would go too far, threatening the competitiveness of countries such as Slovakia that want to keep taxes and spending low.

EUROPE NEWS

Russia redirects arms talks

By Richard Boudreaux


Getty Images

Russian Foreign Minister Sergei Lavrov discussed arms treaties during a news conference in Moscow on Thursday.

MOSCOW—Russia said further cuts in nuclear weapons sought by the U.S. can be achieved only as part of a multinational accord limiting other types of armaments, a position that dims the Obama administration's chances for swift progress toward one of its biggest foreign policy goals.

Under the conditions spelled out Thursday by Foreign Minister Sergei Lavrov, a new round of talks aimed at slashing Russia's large arsenal of short-range tactical nuclear weapons must involve other nuclear powers and focus as well on conventional warheads and weapons in space.

The statement comes in the wake of the two countries' landmark treaty to limit long-range strategic warheads. U.S. officials have said they expect talks with Russia on tactical nuclear weapons to begin as soon the New Strategic Arms Reduction Treaty, or New Start, goes into force.

The treaty, a centerpiece of the administration's efforts to "reset" relations with Russia, won U.S. Senate ratification on Dec. 23. Russian lawmakers say they will follow suit this month.

"Before talking about any further steps in the sphere of nuclear disarmament," Mr. Lavrov cautioned at a news conference, "it's necessary to fulfill the New Start agreement." That process could take years, as the former Cold War enemies shrink their long-range nuclear warheads to a limit of 1,550 each, down from the current ceiling of 2,200.

"Then it will become clear what further steps must be taken to strengthen global security and strategic stability," Mr. Lavrov said.

When those steps are considered, he added, other nuclear-armed nations must take part and the agenda must include weapons in space, strategic missiles equipped with conventional explosives and other nonnuclear conventional weapons. Russia opposes U.S. plans for space-based weapons.

"Let's imagine that everyone abandons nuclear weapons, but that in parallel nonnuclear strategic weapons are developed...that may be even more effective in military terms," Mr. Lavrov said. "What then?"

Defense analysts in Moscow said the remarks reflect Russia's reluctance to give up its strength—a large stockpile of tactical nuclear weapons—in the face of superior conventional forces in the West and in China and its own lag in developing new weapons technologies.

Unlike the strategic warheads covered by New Start, which are meant to be used against cities, tactical warheads are meant to be used at short range against military units on the battlefield.

Russia has a decided advantage in tactical nuclear weapons, with about 2,050, compared with 500 in the active U.S. arsenal.

Russia needs this edge, Mr. Lavrov said Thursday, because "the balance of forces in Europe has been seriously tilted" with the North Atlantic Treaty Organization's eastward expansion.

Mr. Lavrov coupled his reservations about new arms talks with praise for the Obama administration's reset. He said the warming ties had brought a "noticeable improvement in the international situation" over the past year. "The most important task in our contacts" with Washington, he added, "is to maintain positive dynamics in our relations."

Fyodor Lukyanov, editor of Russia in Global Affairs, an influential journal, said Mr. Lavrov's insistence on delaying a new round of arms-reduction talks for years "should not be taken literally." But he said Russia is determined to broaden and reshape the agenda for those negotiations.

"The issue of tactical nukes isn't just about the West," he said. "Russia also needs to compensate for its weakness in conventional forces vis a vis China, in the event of a conflict along that border."

Czechs give asylum to Ukrainian ex-minister

By James Marson

KIEV, Ukraine—A former Ukrainian economy minister was granted political asylum by the Czech Republic, a sign of increasing international disquiet over the Ukrainian government's investigations of leading opposition figures.

Bohdan Danylyshyn, an ally of former Prime Minister Yulia Tymoshenko, had been detained in Prague, the Czech capital, in October on an international warrant issued by Ukraine. He was accused of abuse of office in connection with a tender in which the state allegedly lost $1.8 million, a charge he denies.

Instead of turning him over to Ukrainian authorities, the Czech government decided to let him remain in the country, a spokesman for the Czech Interior Ministry said Thursday. He didn't elaborate.

The Ukrainian general prosecutor's office declined to comment, saying it had received no official word of the decision.

U.S. and EU officials have raised concerns that the authorities, by investigating several allies of the former prime minister, appeared to be targeting the opposition.

Supporters of Ms. Tymoshenko, now an opposition leader, called the Czech action a rebuke of Ukrainian President Viktor Yanukovych's administration. "This decision sends a powerful signal to the president to stop the campaign against the opposition," said Hryhoriy Nemyria, an adviser to Ms. Tymoshenko.

U.S. and European Union officials have recently raised concerns that by investigating and detaining several allies of Ms. Tymoshenko, the authorities appeared to be selectively targeting the opposition.

Ms. Tymoshenko was herself ordered to the general prosecutor's office on Thursday to study details of charges, filed in late December, that she misspent $425 million of government funds allotted for environmental spending. Yuriy Lutsenko, her former interior minister, is in detention on charges of abuse of office. Both deny the charges.

Ms. Tymoshenko says the detentions and investigations are aimed at jailing and discrediting Mr. Yanukovych's leading opponents.

The president's administration says it is clamping down on corruption in the previous government.

Since narrowly defeating Ms. Tymoshenko in a presidential runoff in February 2010, Mr. Yanukovych has moved quickly to cement his authority and sideline his rival, ousting her from government and appointing close allies to the posts of prime minister, security-service chief and head of the central bank.

Critics have accused Mr. Yanukovych and his allies of intimidating nongovernmental organizations, rigging local elections and overseeing a decline in press freedom, accusations his administration denies.

Turkish bank warns of lending rise

By Joe Parkinson

ISTANBUL—Turkey's central bank warned that lending is growing too fast but denied the country's economy was overheating, as it responded to worries over the bank's low interest-rate policies.

Speaking to business delegates in Istanbul, Durmus Yilmaz, governor of the Central Bank of the Republic of Turkey, said consumer-loan growth needed to slow and indicated the bank could further raise banks' reserve requirements to cool the boom.

"The Turkish economy is not overheating...but loan volume has been increasing strongly due to the robustness of the financial sector. Thus, our problem is slowing down the pace of lending," said the governor, whose term ends April 18.

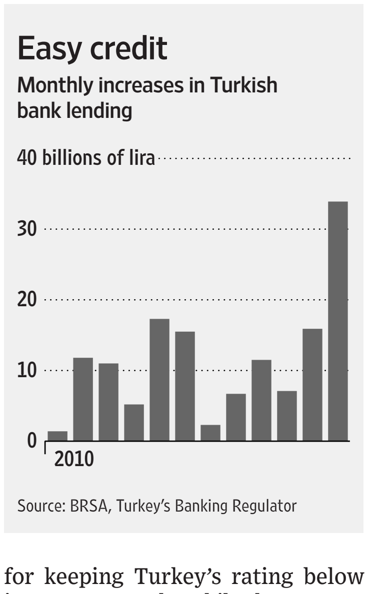
The central bank in December simultaneously raised reserve ratios and cut the benchmark interest rate. It said its goal was to stem lending and the rising tide of speculative investment that is flowing into the economy because of low interest rates in the U.S., the U.K. and the euro zone.

So far, however, it isn't clear whether the two-pronged policy is working. Firm data on hot money flows since the bank acted aren't yet available. Data released this week by Turkey's bank regulator BRSA showed bank loans surged 34% in 2010.

Mr. Yilmaz and Economics Minister Ali Babacan in December called 49 banking chiefs to Ankara to urge them to cap credit growth in 2011 at 25%. Market players are increasingly nervous that the surge in lending is magnifying the economy's key structural weakness: a mushrooming current-account deficit financed by hot money that leaves the economy vulnerable to external shocks.

"The bank is clearly worried about how credit growth is affecting the current account and they're right to be. The pace of the widening is crazy and the market is fixated on this weakness," said Murat Ucer, an Istanbul-based economist at Global Source Partners, a research consultancy.

The latest data from the Turkish statistics agency show the current-account deficit more than tripled in November from a year ago to a hit a record of $5.93 billion, or about 6% of forecast gross domestic product, as imports grew more than 10 times as fast as exports. Ratings agencies regularly cite the current-account imbalance as the principal reason for keeping Turkey's rating below investment grade, while the International Monetary Fund warned in November that the deficit leaves Turkey vulnerable if market sentiment turns negative.



Mr. Yilmaz's decision to lower rates in December was seen as bold, but highly risky. Turkey's economy expanded 8.9% in the nine months to October, one of the fastest growth rates of any of the Group of 20 nations. Expansion has been underpinned by record low interest rates, after the central bank lowered its key rate 14 times from an October 2008 high of 16.75%.

So far, inflation has remained under control. But lending, propelled by tightly regulated banks, has outpaced the expectations of even the most bullish analysts. The recent numbers have heightened concern among some analysts, despite Turkey's relatively low debt burden. Turkish household debt, at around 16% of GDP, is much lower than the 30% figure in Eastern Europe, over 60% in the euro zone, and 80% in the U.S.

Government ministers here warn with increasing regularity that the economy's exposure to hot money could undermine recent gains.

Mr. Yilmaz on Thursday appeared to warn the ruling AK Party not to undermine fiscal stability ahead of the national elections due this summer. "There will be no problem in the Turkish economy as long as fiscal discipline is maintained....All authorities with capacity to regulate, oversee and balance should coordinate their actions," he said. Government ministers have said they believe a current-account deficit of 5% to 6% of GDP is "manageable."

THE ARIZONA SHOOTINGS

Obama calls for civility after shooting

TUCSON, Ariz.—President Barack Obama called on Americans to resist the temptation to assign blame for a shooting rampage here that may never fully be explained and to emerge from the tragedy a more thoughtful, civil nation.

By Laura Meckler , Jonathan Weisman and Andrew Morse

Concluding a memorial service for Saturday's victims, Mr. Obama urged: "Rather than pointing fingers or assigning blame, let us use this occasion to expand our moral imaginations, to listen to each other more carefully, to sharpen our instincts for empathy."

The president spoke at the McKale Memorial Center at the University of Arizona four days after a gunman left six dead and 14 wounded, including Rep. Gabrielle Giffords (D., Ariz.), who authorities said was the target of the attack. The suspected shooter, 22-year-old Jared Lee Loughner, is being held in federal custody without bail.

Agence France-Presse/Getty Images

President Barack Obama embraced Mark Kelly, husband of shooting victim Rep. Gabrielle Giffords, at Wednesday's memorial service in Tucson. Daniel Hernandez, at left, is an intern who helped Ms. Giffords after the shooting.

The president chose to dwell on the heroes, and the victims of the violence—especially 9-year-old Christina Taylor Green—as he urged the nation to rise above ugly political debates and to "guard against simple explanations'' for the shootings.

"I want us to live up to her expectations,'' he said of Christina. "I want our democracy to be as good as she imagined it.

"If this tragedy prompts reflection and debate, as it should, let's make sure it's worthy of those we have lost," he said. "Let's make sure it's not on the usual plane of politics and point scoring and pettiness that drifts away with the next news cycle."

Before the address, the president and first lady Michelle Obama visited surviving victims of the shootings in a local hospital, including Ms. Giffords.

In a highlight of the speech, Mr. Obama described seeing Ms. Giffords in her intensive care unit room, and reported to boisterous applause: "She opened her eyes for the first time."

Astronaut Mark Kelly, Ms. Gifford's husband, attended the speech.

The president's emotionally charged address capped days of debate about whether the U.S.'s heated political rhetoric played a role in inciting the violence. Mr. Obama addressed the point, saying incivility didn't cause the tragedy of Tucson. But, he added that "only a more civil and honest public discourse can help us face up to our challenges as a nation."

"At a time when we are far too eager to lay the blame for all that ails the world at the feet of those who think differently than we do,'' the president said, "it's important for us to pause for a moment and make sure that we are talking with each other in a way that heals, not a way that wounds."

The nationally televised speech, delivered to more than 14,000 in the university arena and almost as many in an overflow area, was an opportunity for the president to connect with a hurting nation.

"For President Obama, the public has been trying to evaluate if he relates to the average person,'' said Democratic pollster Peter D. Hart. "There are a limited number of times when the public opens a window and is willing to listen. Times of tragedy are one of those times."

He pointed to President Bill Clinton's address after the Oklahoma City bombing in 1995, which helped restore his standing with the public a few months after a brutal election, and to President Ronald Reagan's remarks in 1986 after the space shuttle Challenger exploded.

As Mr. Obama identified people in the audience who had helped stop the gunman, the crowd gave each an extended cheer. They also gave a long ovation to Daniel Hernandez, an intern in Ms. Giffords's office who is credited with tending to the congresswoman's wounds and keeping her alive.

Mr. Hernandez, in his own remarks to the audience before Mr. Obama's speech, said the incident had united Arizona and the nation. He also said the spotlight belonged to others who played a role in responding to the shooting.

"Although I appreciate the sentiment, I must humbly reject the use of the word 'hero,' because I am not one,'' Mr. Hernandez said. The "real heroes,'' he said, included Ms. Giffords, the officials who responded to the emergency call and the doctors providing care to the wounded—"people who have dedicated their life to public service."

Also on Wednesday, Ms. Giffords's colleagues in the U.S. House of Representatives held an extensive session of floor remarks honoring her and other shooting victims, including a member of Ms Giffords's staff who was killed.

Students and community members gathered for Wednesday night's memorial service appeared hungry for Mr. Obama's words. Roy Layne, 30, a Republican, said he was "proud" of the president for coming. "I think it's the right thing to do," said Mr. Layne, a waiter at Red Lobster. "The city is hurting."

It was a 9-year-old child that formed the emotional heart of the president's appeal. Christina Green, born on Sept. 11, 2001, had been featured in a book on babies born that day. In that book, "Faces of Hope," she said, "I hope you jump in rain puddles."

"If there are rain puddles in heaven, Christina is jumping in them today," Mr. Obama concluded. "And here on Earth, we place our hands over our hearts, and commit ourselves as Americans to forging a country that is forever worthy of her gentle, happy spirit."

—Michael Rothfeld contributed to this report.

Ex-girlfriend recalls Loughner as 'normal'

TUCSON, Ariz.—He was the shy, sweet boy who once bought her a box of Belgian chocolates, loved the Beatles and practiced clarinet with her in his parents' living room. And when 15-year-old Kelsey Hawkes asked him to be her boyfriend, Jared Loughner's face lit up with happiness and surprise. "I was going to ask you!" he exclaimed.

That was six years ago, before Mr. Loughner allegedly shot and killed six people Saturday and wounded 14 more, including U.S. Rep. Gabrielle Giffords. A funeral was planned Thursday in Tucson for the youngest victim, 9-year-old Christina Green.

Also Thursday, doctors said Ms. Giffords was making steady improvement, able to move her arms and legs and respond to simple commands. In remarks at a speech in Tucson Wednesday night, President Barack Obama said Ms. Giffords had opened her eyes in the hospital. Five other gunshot victims are recovering at the University of Arizona Medical Center.

Ms. Hawkes, now a 21-year-old student at the University of Arizona in Tucson, spoke about her memories of her first boyfriend.

College classmates and instructors feared the young man and have described behavior that worried them. And some neighbors of the Loughners have described a reclusive family, with occasional outbursts from Mr. Loughner's father.

"That's not the person I knew, and there were no signs he would become this person," said Ms. Hawkes, a petite young woman with large bluish-green eyes and straight blond hair. She said she couldn't believe it when her sister called to tell her that the boy she dated for 10 months in high school was the suspected shooter in Saturday's attack.

"I was in shock. He was completely normal," she said. "I wouldn't have dated him if there was anything wrong."

Ms. Hawkes's account sheds new light on the earlier life of Mr. Loughner and his parents—an apparently peaceful and happy time in the family before Mr. Loughner allegedly experimented with drugs and alcohol and exhibited the darker forces of his own mind.

The teens met at a fall football game at Mountain View High School, a sprawling campus of nearly 2,000 students on the northern edge of Tucson. Ms. Hawkes and Mr. Loughner weren't really there for the game. They were there to see friends.

A mutual friend introduced the pair, and they hit it off that night.

Both liked classic rock, both played the saxophone and both lived in the same neighborhood and even waited at the same school-bus stop.

CBS News

Kelsey Hawkes dated Jared Lee Loughner six years ago.

The tall, skinny sophomore with scruffy blond hair was shy, like her.

"I liked his personality," Ms. Hawkes said. "He was nice, attentive. He was never rude. He had no interest in drugs or alcohol. He was respectful. He would give me compliments and never ignore me."

A few weeks after they met, Ms. Hawkes, a freshman, asked him to be her boyfriend. He immediately said yes. "We always joked about how I'd asked him first," she said. He was her first "real" boyfriend, and she was his first girlfriend.

Soon, the two spent hours a day together, lounging in the school's outdoor plaza for lunch and spending time at each other's houses doing homework or playing instruments. When Mr. Loughner started playing the clarinet, Ms. Hawkes said, "Hey, I want to learn too." Mr. Loughner taught her.

Ms. Hawkes's parents met Mr. Loughner's parents, and the adults all liked each other.

Mr. Loughner's father was quiet, Ms. Hawkes said, but not distant. He spent most of his time restoring old cars, she said. "His dad was always there," she said. "He'd get these old cars and fix them up really nice."

Mr. Loughner's mother worked and would offer the pair snacks and check in on them when she got home, Ms. Hawkes said. "She didn't hover. I guess she did the normal amount of checking," Ms. Hawkes said.

If Mr. Loughner had complaints about his parents, she never heard them. "He admired his mom," she said. "She was really sweet and thoughtful."

The Loughner house was neat and comfortable, with framed family pictures all around, she recalled.

Mr. Loughner became more open and extroverted around Ms. Hawkes. They went to the movies at the Foot Hills Mall and played Super Mario Brothers at his house. Mr. Loughner was into videogames, she said, "but not the kind of person who would sit there and play all day."

If anything, he liked his music more. Instruments cluttered his room, and the two planned to take band class together the following year.

But Ms. Hawkes was beginning to feel restless over the summer. There was no big fight, no change in Mr. Loughner's personality. The relationship began to fade, at least for Ms. Hawkes.

"I just wanted to be single," she said. Just before school started, she worked up the courage to tell Mr. Loughner she wanted to break up.

"He was surprised and sad," she said. He asked her why.

After that, Mr. Loughner and Ms. Hawkes broke off communication. They met silently at the bus stop in the morning and sat on opposite sides of the room in band class.

"I knew he was really sad, but he mostly kept it to himself," she said.

After that, Ms. Hawkes mostly lost track of Mr. Loughner. "I haven't seen or spoken to him in over five years," she said. "I just had no way of knowing he would ever do anything like this."

The last thing she heard about him was through mutual friends. "I'd heard he was drinking and that he wasn't doing so well," she said.

U.S. NEWS

Associated Press

U.S. economic data showed a still-weak employment market. Above, job-seekers at a center in Tualatin, Ore., this month.

U.S. trade gap narrows, but jobless woes persist

By Sara Murray

The U.S. trade deficit narrowed slightly in November as exports grew faster than imports, although the balance with China—a hot-button political issue—worsened.

America's trade gap declined 0.3% to $38.3 billion, compared with October, the Commerce Department said Thursday, fueled in part by increases in U.S. sales of planes and food overseas.

The narrower deficit is likely to prompt economists, who have already become more upbeat about U.S. growth, to again boost estimates for the fourth quarter. A narrowing deficit means the U.S. is producing more, both to fill export orders as well as meet domestic demand.

U.S. exports to China hit an all-time high of $9.5 billion in November, an increase of 1.9% from the month before. But the growth in exports doesn't begin to match U.S. imports from China, which rose 0.9% to $35.12 billion. This pushed the overall U.S. deficit with China up 0.5% to $25.63 billion.

Trade tensions between the two countries have grown in recent months and will likely be a major topic at next week's meeting of U.S. and Chinese leaders in Washington.

U.S. exports and imports both gained modestly in November, with exports increasing 0.8% to $159.6 billion. Imports rose 0.6% to $198 billion in the same time frame.

A separate report Thursday reflected the job market's fitful recovery: New claims for jobless benefits jumped last week, the Labor Department said, rising by 35,000 to 445,000. The four-week average for jobless claims, designed to smooth out volatility in the data, also increased, by 5,500 to 416,500.

The Labor Department said that the recent holidays could have led to some distortion in the data, and analysts predicted the labor market would continue to improve this year as the private sector creates more jobs.

"There's a lot of noise in these numbers," said Michelle Girard, an **RBS Securities** Inc. analyst. "The labor market does appear to be strengthening."

Continuing claims for jobless benefits—those drawn by workers for more than a week—dropped by 248,000 to 3.9 million in the week ended Jan. 1. That is partly an effect of jobless Americans exhausting their unemployment benefits.

Slow economic growth and high unemployment have kept a lid on inflation during the downturn and lackluster recovery. But price pressures have begun to build in the production pipeline.

The producer price index increased a seasonally adjusted 1.1% in December, the Labor Department said Thursday. It is the sixth consecutive month that producer prices have risen. In the past year, prices increased 4%.

Food and gas prices continued to climb. The December increase in producer prices was largely driven by a 3.7% jump in costs for energy goods.

Food prices also rose 0.8% in December. Over the past 12 months, food and energy prices increased 3.5% and 11.9%, respectively.

Price pressures were modest in other goods, though. Excluding food and energy, prices rose just 0.2% last month and were up a slight 1.3% for the year.

At Obama's halfway point, economy key to 2012 push

[Analysis]

By Peter Brown

After the pasting the Democrats took in the November midterm election, the conventional wisdom was that President Barack Obama could be next: The Republican congressional landslide was an indication of how much trouble he might have getting re-elected.

Maybe yes, maybe no.

In fact, a look at where Mr. Obama and his recent predecessors stood with the American people at the halfway marks of their first terms makes crystal clear the lack of a correlation between their polling numbers then and whether they won a second term.

What happens in the last two years of a presidency matters much more than the first two.

For instance, Mr. Obama's 48% approval rating during the first week of January in the third year of his presidency is much better than Ronald Reagan's 37% approval rating during the first week of January in 1983.

In 22 months, however, Mr. Reagan went from the political basement in the eyes of America to the largest landslide victory in presidential history; he carried all but one state, Minnesota, the home of his opponent Walter Mondale, in the 1984 election.

Mr. Obama's 48% approval rating puts him at about the same level in voters' eyes as Bill Clinton was in 1995 after he also suffered a severe midterm rebuke from the voters. In 1994, the Democrats lost control of the U.S. House and Senate—yet Mr. Clinton also comfortably won re-election two years later.

On the other hand, Mr. Obama is not in nearly as strong with the American people at this point as were George H.W. Bush (58%) or George W. Bush (63%). The former lost his bid for a second term. The latter won a narrow re-election.

And then there is Jimmy Carter. His 50% job approval rating in early 1979 is slightly better than Mr. Obama's is today.

All these polling numbers about the standing of past presidents come from the Gallup Poll's library while the numbers on Mr. Obama's standing comes from a Quinnipiac Poll released Thursday. While it is often tricky to compare different polls because of variations in the question or methodology, the numbers tell an interesting story.

Taken together the job-approval numbers from past presidents illustrate just how much the events of the second half of a president's term are what really matter.

Both Mr. Clinton and Mr. Reagan were easily re-elected, in large part, because of substantial improvements in the economy during the last two years of their first terms. Given the state of the economy during Mr. Obama's first term, it's a good bet he, too, will see an uptick, although most economists don't see the kind of robust recoveries that helped Mr. Clinton and Mr. Reagan.

George H. W. Bush and Mr. Carter probably lost because the economy turned south during the last two years of each man's tenure—although it would be wrong not to acknowledge that the Iranian hostage crisis was also partly responsible for Mr. Carter's defeat. It is certainly possible the course of the war in Afghanistan will play a role in whether Mr. Obama is a two-termer.

At Mr. Obama's halfway mark, the new national Quinnipiac poll out Thursday tells us just how evenly split the American people are about the president and his first two years in office. They like him personally, but not necessarily his policies.

The Quinnipiac University survey found that 43% of voters said they liked Mr. Obama as a person and his policies and 2% didn't like him personally, but liked his policies.

Conversely, 29% liked him, but not his policies, and 17% don't like him or his policies.

But perhaps most importantly, the American people are split down the middle—47%-45%—on whether they think the first half of Mr. Obama's term has been a success or a failure.

—Peter A. Brown, assistant director of the Quinnipiac University Polling Institute, is a former White House correspondent.

Economists more upbeat about the pace of recovery

By Phil Izzo

Economists surveyed by The Wall Street Journal are increasingly optimistic about the pace of the recovery, predicting the U.S. will grow at better than a 3.2% annual rate in each quarter this year.

"The U.S. economy appears to have successfully navigated the adjustment from a recovery driven primarily from economic stimulus and inventory rebuilding to one driven by private domestic demand and rising exports," said economists at Wells Fargo & Co. "Three percent growth looks pretty good, particularly with housing stuck in low gear."

Economists have steadily grown more upbeat about growth in recent months and boosted their estimates for the fourth quarter of 2010 in this survey. On average, respondents now estimate the U.S. grew 3.3% at a seasonally adjusted annual rate in the fourth quarter—up from an estimate last month of 2.6% growth. The economy grew 2.6% in the third quarter.

These upbeat forecasts come despite a persistently bleak outlook for housing. On average the economists now expect that home prices will post a decline in 2011, after more than 12 months of forecasting modest gains for the current year.

Meanwhile, 30 of the 56 surveyed economists, not all of whom answer every question, say home prices won't outpace inflation for at least the next three years. The excess supply of homes also is seen keeping construction at moribund levels. On average, the economists expect 700,000 housing starts in 2011, above 2010 and 2009 levels, but well below the 1.5 million averaged from 1959 to 2007.

"The labor market weakness is suppressing a housing recovery," said Sean M. Snaith of the University of Central Florida.

Amid the stronger growth forecasts, economists now expect the U.S. to generate nearly 180,000 jobs a month on average this year, significantly more than last year's average of 94,000. But with continued population growth, that isn't nearly enough to quickly bring down the unemployment rate, now at 9.4%. By the end of 2011, the economists, on average, expect the jobless rate to be 8.8%.

Persistent weakness in the job market also is expected to keep inflation in check over the course of 2011. On average, the economists expect consumer prices will rise 1.9% this year, within the Federal Reserve's comfort zone of 1.5% to 2%.

The central bank has a dual mandate to promote full employment and maintain price stability. With little pressure on the inflation front and a slow recovery in the job market, most of the economists don't expect the Fed to start raising interest rates until early 2012 at the earliest.

As the recovery moves forward, they expect the central bank to keep mostly to the sidelines. Fifty of 55 respondents predict policy makers will complete a previously announced $600 billion of bond purchases, and stop there. But the policy remains contentious, with just 27 economists supporting the full amount of the program.

The economists also were generally encouraged by President Barack Obama's selection of Bill Daley as White House chief of staff and Gene Sperling to take over the National Economic Council .

WSJ.com

ONLINE TODAY: See charts and data from The Wall Street Journal's survey of economists at **WSJ.com/Economists.**

WORLD NEWS

European Pressphoto Agency

Residents paddled through a Brisbane suburb Thursday, as the floodwaters receded and cleanup challenges loomed.

Australia faces cleanup of 'postwar' proportion

Brisbane residents face a massive, costly rebuilding task after floods swamped thousands of homes in Australia's third-largest city, adding to the mounting cost of the deluge across Queensland.

*By **Enda Curran** in Brisbane and **Geoffrey Rogow** in Sydney*

Cost estimates for the cleanup throughout the region hit by floods exceeded 15 billion Australian dollars (US$14.9 billion).

Workers began Thursday the slow process of pumping water out of underground car parks across the city's business district. Others attempted to retrieve abandoned cars in streets caked with a thick layer of brown mud discharged by the overflowing Brisbane River.

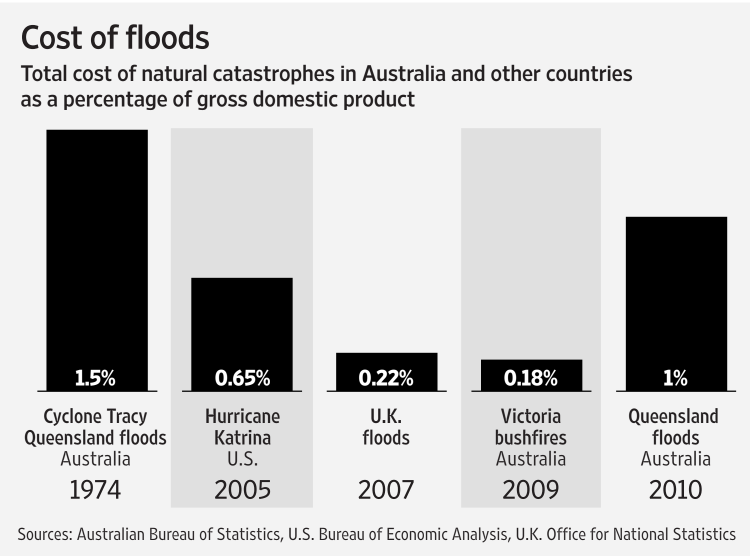
In an evacuation center at Brisbane's Royal National Association, one of five refuge sites across the city, around 700 people were sleeping on air mattresses or huddled around a television. Red Cross, military and other aid workers dealt with inquiries while local charities handed out food.

State Premier Anna Bligh said that reconstruction of the region was of a "postwar" proportion, with 20,000 homes flooded in the city and 5,000 businesses inundated with water. The floods have killed at least 25 people in the state and left thousands displaced.

"No one knows what's going on," said Rocky O'Gilvie, 43 years old, pondering his future after his home in the Rocklea district of the city was destroyed, forcing him to the evacuation center.

Queensland police have formed an antilooting squad for the flood struck Brisbane and the nearby town of Ipswich. Authorities said that while there have been only a handful of reports of looting, the 200-strong force was deployed as a pre-emptive measure.

Disease is a further risk for Queenslanders as stagnant water gathers and rivers fill with dead livestock and debris.



"There is the distinct possibility of very serious infection," said Andrew Laming, a federal opposition health spokesman. "We are seeing a combination of infected waters, mosquito-borne illnesses and others yet to be determined."

The government had gauged the cost of rebuilding at A$5 billion, but this figure doesn't include the increased devastation that has now destroyed homes and hundreds of private businesses in the state's capital.

In the past two days, much of Brisbane's central business district has seen its bridges and waterways devastated by the flooding and, in several cases, washed away.

When including the cost of rebuilding ports throughout Queensland, northern New South Wales and parts of Brisbane, the eventual cost to the economy could hit A$13 billion, according to estimates from J.P. Morgan Chase & Co.

Add in unforeseen losses to revenue and the rebuilding hit to be felt by the state's booming mining industry, and the total cost could reach more than A$15 billion.

"The cost of the current disruption to lives and economic activity will be vastly exceeded by the rebuilding of homes, business premises and infrastructure," said Paul Brennan, senior economist with Citigroup in Sydney.

To be sure, after the initial hit, Mr. Brennan notes the rebuilding effort over time will add to the country's economic growth, though inflation is likely to also surge.

The devastation well exceeds the record Brisbane flooding of 1974, which had an inflation-adjusted cost of about A$4 billion.

High estimates put the flooding damage at a cost of about 1% of Australia's total gross domestic product. Hurricane Katrina hit about 0.65% of U.S. GDP in 2005.

The federal government is expected to foot about 75% of the disaster recovery bill, with the state government's funding body, Queensland Treasury Corp., picking up the rest.

Adding to the problems of cleaning up, rescue services may face an unseen threat after worried residents reported sightings of bull sharks swimming in the murky floodwaters.

Landslides in Rio kill at least 355

By Jeff Fick

RIO DE JANEIRO—Brazilian President Dilma Rousseff flew over the rain-drenched mountains northwest of the beachfront city of Rio de Janeiro on Thursday, surveying the damage from floods and landslides that have claimed at least 355 lives.

Ms. Rousseff briefly stopped in Nova Friburgo, one of the region's hardest-hit towns, to speak with residents struggling without electricity and water. The president was accompanied by Rio de Janeiro Governor Sergio Cabral. The two leaders were expected to hold a news conference later Thursday in Rio de Janeiro.

The disaster is the first major test of Ms. Rousseff's presidency. The new chief executive has been in office for just 13 days, spending most of her time ensconced in Brasilia. The disaster is also a test for officials who have turned a blind eye toward illegal construction and lax building codes that compounded the damage.

"This is a national tragedy," said Carlos Minc, Rio de Janeiro's environment secretary, in a telephone interview broadcast on the O Globo network. "It shows how difficult it is for local mayors to impose unpopular measures on the population."

Building codes are rarely enforced in poor areas, which are riddled with quickly constructed shantytowns and other buildings—many of them perched on steep hillsides above wealthier areas.

Government officials will set up a program to prevent unsafe construction in the future, Mr. Minc said, calling such construction "a criminal occupation of hillsides."

President Rousseff has released $465 million in federal funds for relief efforts in Rio de Janeiro and neighboring São Paulo, which has also been hit by heavy rains this week.

Brazil sent in 250 troops to aid firefighters, police officers and residents digging out from the disaster in the treacherous area, where centuries-old cities from Brazil's days in the Portuguese empire sit perched along steep mountain valleys.

Access to the valleys was hampered as landslides washed out many of the region's roads and bridges.

Most of the damage is centered on the cities of Nova Friburgo, Petropolis and Teresopolis, Rio de Janeiro state officials said. Isolated residents signaled an O Globo television network helicopter flying overhead that they were without food and water.

Ampla Energia said the company was working to restore power to Teresopolis and Petropolis, while sewer and water company Cedae said trucks were on the way to the region to supply fresh drinking water.

A spokesman for BR Distribuidora, the logistics arm of state-run energy giant Petroleo Brasileiro, or Petrobras, was working on alternative routes to get fuel into the area.

In Teresopolis, residents ferried the injured down mountain paths using makeshift stretchers cobbled together out of logs and blankets, television images broadcast by the O Globo network showed.

Swaths of Teresopolis, a vacation retreat, were covered in mud, trees and boulders.

An elderly woman huddled with her dog amid the ruins of her house, which crumbled as rushing floodwaters battered the walls, O Globo showed. She was thrown a rope and pulled to safety by neighbors in a two-story building, but the tiny dog was ripped from her arms by the raging torrent and disappeared into the churning water. "It looked like the world was ending," a small boy told O Globo.

Meteorologists at the Climatempo weather service said light rain was falling over the region early Thursday, and more rain—including the possibility of heavy downpours—was likely through Sunday.

"The rain in the mountain region is going to persist," said Climatempo's Fabiana Weykamp. The region has been hit with nearly twice as much rain as normal over the past two months.

So far in January, Novo Friburgo has had 378 millimeters (15 inches) of rain, including about 280 millimeters from midnight Tuesday to 8 a.m. Wednesday. The 30-year average for the city in January is 208 millimeters.

"The volume of rain in Nova Friburgo was absurd," Ms. Weykamp said.

The rainfall followed a wetter-than-usual December, which is typically the rainiest month for the region, Climatempo data showed. Rainfall in December was 422 millimeters, nearly double the monthly average of 238 millimeters.

"The soil is extremely saturated," Ms. Weykamp said. "The rain could provoke more landslides. There could be even greater tragedies if they don't get people out of at-risk areas."

—Rogerio Jelmayer in São Paulo and Diana Kinch in Rio de Janeiro contributed to this article.

European Pressphoto Agency

Refugees from heavy rains sheltered in a sports hall in Teresopolis on Thursday.

WORLD NEWS

In Gujarat state, an Indian test case

Pro-business leader has helped cut red tape to attract investment and spur growth; questions over 2002 bloodshed

By Geeta Anand
And Amol Sharma

AHMEDABAD, India—Western India's Gujarat state has transformed itself into one of the country's economic and export engines by presenting an alternative to the red tape and widespread corruption that have stymied big projects elsewhere in the country, turning it into a springboard for the apparent national political ambitions of its controversial leader.

Under the direction of Chief Minister Narendra Modi, Gujarat has tackled several problems that usually frustrate both foreign and domestic businesses here. Investors characterize Gujarat's civil service as a disciplined force that approves land purchases and environmental permits quickly. The state invests heavily in modern road and power infrastructure. It has set up a Web portal that lets foreign investors track their government requests and complain about delays.

"Our progress was not delayed by even a single day by the government," says Asutosh Shah, managing director of Duravit India Pvt. Ltd., a unit of **Duravit** AG of Germany, which began making ceramic toilets and sinks here in September. "It was a 100% corruption-free process. You have to experience it to believe it."

Gujarat boasts India's two largest oil refineries as well as manufacturing plants set up by global names such as **General Motors** Co. and **Mitsubishi Heavy Industries** Ltd. It has averaged more than 11% economic growth in recent years, well outpacing the national rate. It accounts for 22% of India's exports despite having just 5% of the 1.2 billion population.

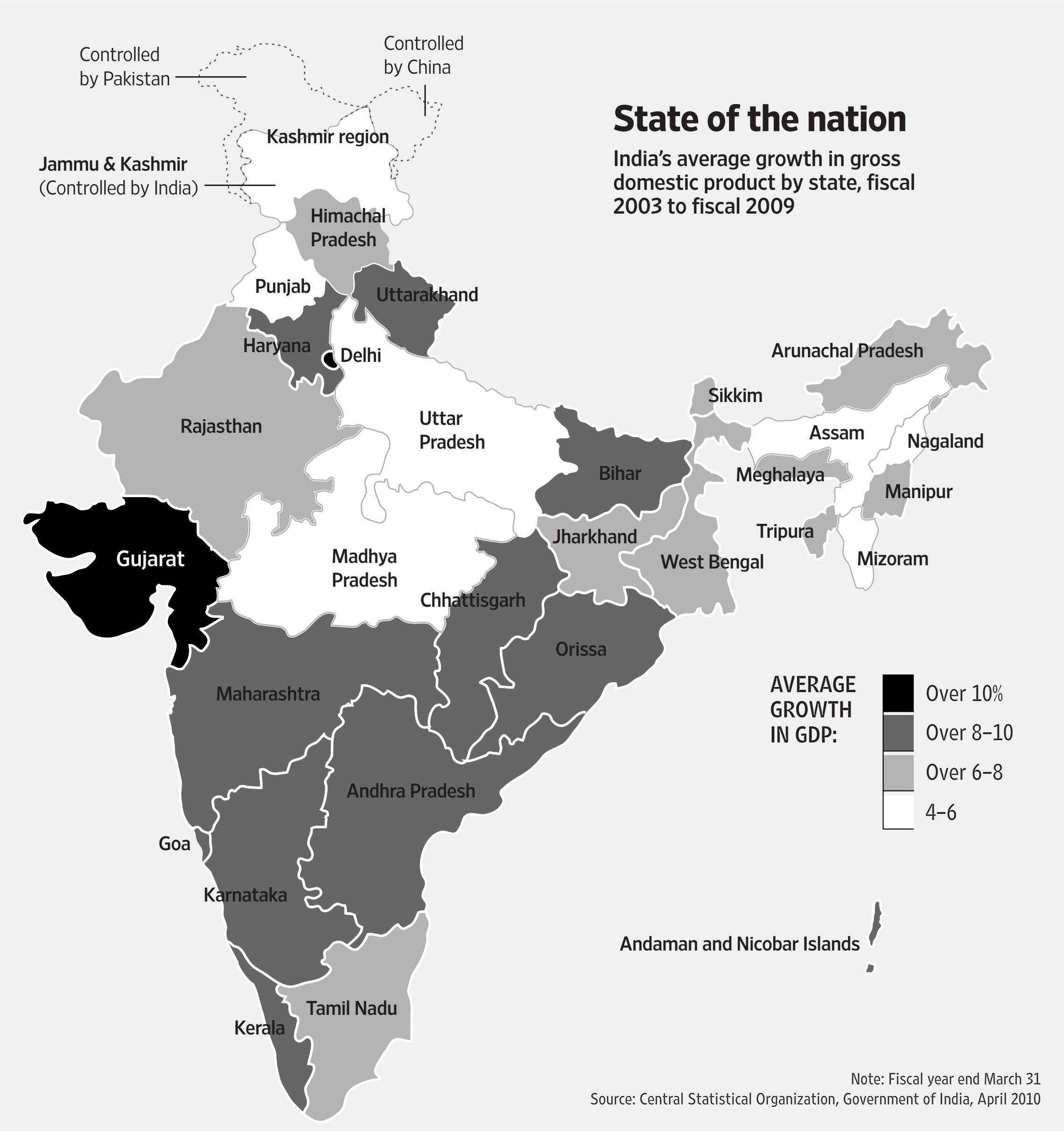
Gujarat's approach—mirrored in a handful of other business-friendly states such as Tamil Nadu—offers a model for how India can fulfill its economic potential in the next decade and pave the way for hundreds of millions of poor Indians to move from subsistence living to an industrialized economy that will make India a more potent rival to China.

"To me, good governance means minimum government and maximum governance," Mr. Modi said at Gujarat's biennial investment summit this week. Invitations to the event went to people from all of India's 28 states, and the event's 10,000 attendees, included Indian industrialists Ratan Tata and Mukesh Ambani, delegates from Indian states and government officials from more than 70 countries.

Mr. Modi, 60 years old, became chief minister, the state's top executive office, in 2001. The previous year, Gujarat's economic output shrank almost 5%.

His turnaround of the state's economic fortunes has come amid controversy. In February 2002, 58 Hindu pilgrims died in a mysterious fire aboard the train carrying them home from a holy site. Hindus believed Muslims were behind the fire. The incident sparked a backlash by Hindu mobs against Muslims. A spiral of sectarian killing left more than 1,000 people dead.

Mr. Modi's fiercest critics believe he encouraged or at least countenanced the anti-Muslim violence through instructions to police to stand down and allow Hindu fundamentalists to carry out attacks. These allegations are still under investigation by a special committee appointed by India's Supreme Court. Mr. Modi, who declined repeated requests for an interview, has vigorously insisted he had no role in fomenting the riots.



Others say his intense focus on attracting big business hasn't benefited ordinary Gujaratis enough for the state to be considered a positive example. "He's consolidated his power by delivering a dream wish list to business. But there's a point at which governments have a responsibility to constituents other than business," said Mira Kamdar, a senior fellow at the New York-based World Policy Institute who is based in Paris.

Gujarat has made progress in some human-development areas under Mr. Modi, but like the rest of India is still struggling to overcome many poverty-linked problems. According to India's national family health survey in 2006, 41.1% of children under three years of age in Gujarat were underweight, virtually unchanged from the 1999 survey and slightly higher than the national average of 40.4%. More recent figures weren't available.

Still, Mr. Modi's performance in delivering economic growth and attracting development has put the national government on the defensive. Mr. Modi's BJP, a Hindu nationalist party, is the main opposition to the Congress party that leads the coalition government in New Delhi.

When Rahul Gandhi, heir to the Gandhi-Nehru dynasty and a leading candidate to be the next Congress prime minister, visited Gujarat in late November to speak to college students, he responded to praise of Gujarat's economic record by comparing Mr. Modi to China's Mao Zedong. "Many evil leaders have done great development work," local news reports cited him as saying. Students believed it was an apparent reference to the 2002 violence.

Reuters

Investors credit Gujarat Chief Minister Narendra Modi, seen Wednesday at a business summit, with building a pro-business state government. But critics say questions over Hindu-Muslim violence may cloud his national politics potential.

Questions about that time will temper Mr. Modi's prospects of winning a high-profile national office based on Gujarat's economic record, some observers say. "Modi cannot be a statesman who would command respect from all sections of society," said political analyst Chintamani Mahapatra at New Delhi's Jawaharlal Nehru University.

Others say Mr. Modi's repeated re-election to office proves the electorate has moved beyond the issues of his past and is giving him credit for Gujarat's development.

Gujarat's 1,600-kilometer coastline—the longest in India—has given it an advantage over other states, making it the leading entry port for crude oil and heavy-industry imports. Mr. Modi's regime has further encouraged investment. In 2009, Gujarat set up "special investment regions" where the government reserves swaths of land for industries like petrochemicals or textiles and then pays for the infrastructure to be built there.

Among the biggest such projects is in Dholera, a port south of the capital of Ahmedabad, where the state hopes to attract $20 billion in investments to develop a center for biotechnology, software development and light manufacturing in coming years. The state has plans to open an international airport nearby and add high-speed rail service.

Canada's **Bombardier** Inc., which won a €500 million ($650 million) contract to manufacture coaches for New Delhi's new metro train network, located its production facility in an industrial park in Gujarat after scouting several options.

"We were looking at a very rapid rollout and wanted a government system that would allow for no roadblocks," said Rajeev Jyoti, managing director of Bombardier's India transportation subsidiary. After contacting Gujarat in August 2007, Bombardier got a 20-hectare plot of land within weeks and set up its entire plant within 15 months, one of the fastest rollouts in the company's history, Mr. Jyoti said.

In some sectors, Gujarat is more welcoming of foreign firms than the central government. The state is attracting international solar-power companies partly because its subsidy regime allows power generators to purchase their solar panels from foreign manufacturers; India's multibillion-dollar national solar-power subsidy program deters foreign participation.

Gujarat's investment in an extensive natural-gas pipeline is what initially persuaded Duravit, the German ceramics maker, to set up manufacturing for its Indian subsidiary here, says Mr. Shah, the unit's managing director. Natural gas is required in the production of ceramics.

In 2009, Mr. Shah settled on Gujarat and began identifying possible sites. He homed in on 16.4 hectares of land zoned for agricultural uses about 72 kilometers from Ahmedabad, Gujarat's largest city. The land was owned by 21 families, requiring signatures of 130 people to complete the sale. The process of signing the documents and registering the sale took just three weeks, largely because of the land-registration department's professionalism, he says.

■ Starbucks to expand in India—and sell more Indian coffee globally..... 17