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Ireland's Greens head for the exits

Associated Press

John Gormley, front, head of Ireland's Green Party, walks out of Dublin's government buildings on Sunday. The party withdrew from Ireland's government, turning up the pressure for Prime Minister Brian Cowen to resign and for Ireland to hold an election sooner than March 11. **Article on page 5**

Trichet warns price pressure is increasing

By Brian Blackstone And Marcus Walker

FRANKFURT—European Central Bank President Jean-Claude Trichet defended his hard-line stance on fiscal policy and inflation, saying budget austerity and vigilance in the face of rising energy and commodity prices are the best path to economic recovery.

In an interview with The Wall Street Journal ahead of this week's annual meeting of the World Economic Forum in Davos, Switzerland, Mr. Trichet warned that inflation pressures in the euro zone must be watched closely, and urged central bankers everywhere to ensure that higher energy and food prices don't gain a foothold in the global economy. He signaled that he won't let the economic weakness in Greece, Ireland and other countries on Europe's troubled fringe delay ECB interest-rate increases if he sees threats to price stability.

Mr. Trichet's warning comes at a time when inflation concerns are mounting among investors around the globe.

"All central banks, in periods like this where you have inflationary threats that are coming from commodities, have to...be very careful that there are no second-round effects" on domestic prices, Mr. Trichet said.

The 68-year-old Frenchman, whose eight-year term as head of the central bank ends in October, argued that budget discipline would help growth in Europe more than renewed stimulus, and called on the euro zone's 17 member countries to strengthen "surveillance" of each other's fiscal policies.

Mr. Trichet has attended the Davos gathering of policy makers, business executives and academics since the 1980s, when he headed the Paris Club, an international debt-restructuring body. His four-decade public career includes top posts at France's Treasury, the governorship of the Bank of France and, since 2003, the ECB presidency.

In addition to his tough line on inflation, his stance on a top economic issue of 2011—whether countries should engage in more stimulus to safeguard recoveries, or shift to deficit reduction—is controversial.

The U.S. is taking the former approach, extending fiscal stimulus this year as Federal Reserve Chairman Ben Bernanke tries to boost

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Jerry Lewis is funny to the French, but comic books are serious business. Page 29

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Tony Blair, still in the dock over Iraq after all these years. Page 11

More firms plan to hire in U.S. as the gloom lifts

By Luca Di Leo

WASHINGTON—U.S. companies optimistic about the economy plan to hire more workers in coming months, a quarterly survey being released Monday found, another signal that the jobs market is turning up.

The fourth-quarter poll of 84 companies by the National Association for Business Economics found 42% expect to increase jobs in the next six months. That is up from 29% in the first quarter of 2010. Only 7% of companies in the latest survey predict they will shed jobs in the coming six months, down from 23% at the start of last year.

"It looks like the opening melody of a true recovery in the labor market," said Shawn DuBravac, economist at the Consumer Electronics Association, a trade group, and chairman of the NABE committee that conducts the survey.

The U.S. economy has been growing for a year and a half but companies have been slow to ramp up hiring. That may change soon as the economy is widely expected to pick up steam. To meet higher demand, many businesses have relied mainly on existing workers to increase output. But there is a limit to how much they can boost productivity.

NABE surveyed companies in various industries including manufacturing and finance. The poll, conducted from Dec. 17 to Jan. 5, found the gap between companies planning to hire workers over the next six months and those that expect to shed jobs widened to the highest level since 1998.

To be sure, the 2007-2009 recession was so deep that a lot more jobs need to be created to make a dent in the high unemployment rate, currently at 9.4%. The U.S. government's jobs report for December shows hiring remains

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Spain can still avoid financial doom

[Agenda]

By Irwin Stelzer

And so we wait. We wait for the spate of new data on the health of the euroland economies, we wait for the policymakers to come up with some device that satisfies the markets that the eurocracy has come up with a structure that controls national budgets to the satisfaction of German Chancellor Angela Merkel, euroland's paymaster-in-chief.

The waiting for data will end this week, at least for a while; the waiting for a policy decision might not arrive before Godot. Meanwhile, it is all about Spain, Europe's fifth largest economy. Greece is gone, Ireland is gone and Portugal is going—all will have to restructure one way or another. If Spain, larger than all three combined, can survive the tender attentions of the bond market, policymakers will have time for their usual leisurely decision-making pace.

There are some reasons to believe that Spain will escape the fate in store for its smaller colleagues-in-debt. Goldman Sachs Global Economics, in a new report fetchingly titled, "Spain: Sustainable!", reckons that Spanish public debt "is unlikely to exceed 90% of GDP at the peak: hardly a case of insolvency." There is, concede the Goldman Sachs economists, the possibility of a liquidity crisis that might force Spain to seek "external assistance," aka a bailout, but that can be handled by euro-zone policymakers, who should by now have some competence in this sort of situation.

Start with Spain's financial situation compared with those of the troubled trio. The Economist reports that Spain's gross government debt stands at 64% of GDP, well below the levels of Portugal (83%), Ireland (97%), and Greece (140%). The yield on 10-year government bonds is about half that of Greece, as is the Economist's forecast of gross government debt levels in 2015—85% of GDP compared with 165%. (Ireland and Portugal clock in at 125% and 100%, respectively.) "Spain is probably solvent," concludes the Economist, with a "prospective debt burden...similar to those of 'safe' France and Germany today."

Spain's fate will depend on Prime Minister José Luis Zapatero's reforms.

The key word is "probably," not quite as ringing an endorsement as Goldman Sachs' "Sustainable!"

There are reasons to believe that Spain will escape the fate in store for its smaller colleagues-in-debt.

All will depend on four things. The first is the general macroeconomic atmosphere in the euro zone as a whole. Right now the future is finely balanced between a continuation of German-led growth, and a slowdown caused by a European Central Bank decision to tighten monetary policy to nip inflationary pressures, now running at levels the ECB is unprepared to accept if they persist. In the near term the level of the euro should keep Germany's export machine humming, and the new interest of German consumers in spending should give the entire euro zone a bit of a fillip. Also in the near term, Jean-Claude Trichet, head of the ECB, should hold fire on any interest rate increase and any retreat from the bond market until the policymakers agree on a permanent solution to the crisis created by the weakness of periphery countries. All of which is probably a plus for Spain.

A second factor that will determine Spain's ability to avoid a crisis will be the behavior of its highly indebted consumers. Households have significantly reduced their debts (increased their savings), and so have reduced the burden of interest payments, and are actually now net recipients of interest payments. This augurs well for at least a stabilizing of consumer spending, unless—and this is a very big "unless"—household incomes continue to fall. Economists at Jefferies Fixed Income report that real household disposable incomes fell by almost 6% in the year ending with the third quarter of last year. If a decline at anything like that rate continues, all bets are off, and Spain will not only have to get help from its euro-zone partners (read, Germany), but abandon its position that the banks' creditors are to emerge from the process their curly locks unshorn.

A third addition to the positive side of the ledger is the growth in exports which, combined with a decline in imports, has reduced the current account deficit from 15% in 2008 to 4.3%. Which is one reason economic activity no longer is declining, and seems to be on a modest upswing.

Finally, there is the question of Spain's banks, best described as a mess. The savings banks, or cajas, have lent about €189 billion ($257 billion) to property developers who reportedly are unlikely to be able to repay those loans. The government is forcing the cajas to merge—the 45 have become 17—and to raise capital, and has already injected an estimated €11-€15 billion into its Fund For Orderly Bank Restructuring. It says it will inject close to €100 billion into the fund if it has to, if the banks are unable to raise capital from the private sector, which Spanish Prime Minister José Luis Rodríguez Zapatero keeps insisting they can.

Which is what has investors demanding premia for lending money to Spain. After all, it wasn't until Ireland decided to bail out its banks that investors realized the country was bust. Spain has to raise some €93 billion this year, and has already fled to the relative safety of a syndicate of banks, who charge a commission and then break up the bonds into smaller packages for resale, rather than risk peddling some 10- and 15-year bonds on the market.

In the longer term, of course, all will depend on whether Mr. Zapatero can make his labor market and other reforms stick, increasing his economy's competitiveness and growth rate. Polls suggest he will not survive the next election, and so will be watching from the sidelines.

—Irwin Stelzer is a director of economic-policy studies at the Hudson Institute.

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On Angry Birds

europe.wsj.com/technology

'With a well-aimed throw it was now easy for even weak individuals to punish those who abused their position.'

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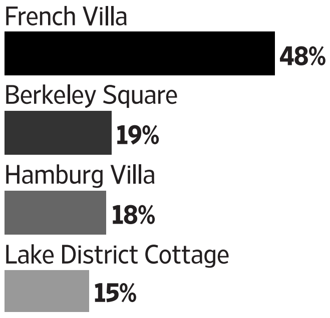

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(Left) Associated Press, (center) Reuters, (right) Xinhua/ZUMAPRESS.com

Deng Xiaoping, left, donned a Stetson on his 1979 U.S. visit. Jiang Zemin, center, aimed to boost China's image in 1997. China sees President Hu Jintao's welcome by President Barack Obama as a new era.

China calls Hu's visit a big success

By Jeremy Page

BEIJING—For Chinese citizens following President Hu Jintao's visit to the U.S., the message from Communist Party is loud and clear: The world's dominant power is finally treating China as an equal, and Mr. Hu, who steps down as Communist Party chief next year, is the man to thank.

State-controlled media have gone into overdrive to portray the visit as a resounding success and the start of a new era of bilateral relations, based on "mutual respect and mutual benefit," while Internet censors have scrubbed clean chat rooms and blogs of almost all comments that might suggest otherwise.

One forum set up on 163.com—one of China's leading news portals—to discuss Mr. Hu's visit showed 248,555 participants as of Sunday evening, but only 19,936 comments were visible, suggesting tens of thousands had been deleted. The comments that remained were overwhelmingly positive.

The only online commentary allowed to stray from the official party line was widespread praise from nationalist bloggers for Lang Lang, the China-born pianist who played a tune from a famous anti-U.S. Chinese film about the Korean War during the White House state banquet.

"This is so not giving face to the U.S....hoho, this is so cool!" wrote Jing Niu on sina.com's microblogging service, one of thousands of netizens who hailed Mr. Lang's choice as a snub to President Barack Obama. The pianist himself, writing about the White House evening on his blogsite, gives no hint that he understood the political implications.

The tightly controlled media blitz illustrates how sensitive party leaders are to public opinion about China-U.S. relations, which were rocked by a series of disputes last year over issues such as China's territorial claims, U.S. arms sales to Taiwan and the value of the Chinese currency.

China's civilian foreign-policy establishment is now anxious to stabilize one of the world's most important bilateral relationship, but party leaders also must appease an increasingly diverse and demanding array of interest groups, including hawkish People's Liberation Army generals and nationalist bloggers.

Another important factor in the publicity campaign is Mr. Hu's desire to secure his own political legacy as the architect of China's "peaceful rise" to a major world power ahead of his anticipated retirement as party chief in 2012, and as president a year later.

China's leaders long have been judged by their colleagues and successors in part on their ability to manage relations with the U.S., and Mr. Hu's influence after his retirement will depend to a significant extent on his record on this front.

Mao Zedong, who led Communist forces to victory in 1949, oversaw the rapprochement between China and the U.S. that stemmed from the Sino-Soviet split, and famously shook hands with President Richard Nixon when he visited Beijing in 1972.

Deng Xiaoping, who rose to power after Mao's death in 1976, established full diplomatic relations with Washington in 1979, and visited the U.S. a month later. He donned a Stetson and rode a stagecoach at a Texas rodeo, creating an image that defined U.S.-China relations—and his economic reform program—for the next two decades.

When Jiang Zemin paid a state visit to the U.S. in 1997, his mission was to attract foreign investment and to repair the damage done to China's image in the West by the military crackdown on protesters at Tiananmen Square eight years earlier. Mr. Jiang sparred openly with his hosts over human rights, but also charmed them, for example, by trying on a colonial tricorn hat in Williamsburg, Va., and reciting part of the Gettysburg Address on a tour of the White House.

Mr. Hu wishes to secure his political legacy as architect of China's 'peaceful rise' to a major world power.

By contrast, Mr. Hu's visit in 2006—three years after he took over as president—was a disappointment.

He wanted it to be a full state visit, but President George W. Bush downgraded it to an "official visit," and offered him only a "working lunch" instead of a full state banquet. That visit was further marred by a series of perceived slights, including a supporter of the Falun Gong movement, which is banned in China, heckling Mr. Hu during a welcoming ceremony, and a White House aide introducing China's national anthem as that of Taiwan.

State media didn't report either incident, but accounts of them spread by word of mouth in political circles in Beijing and over the Internet.

Mr. Hu tried to emulate his predecessors in presenting a friendly image in 2006, at one point putting on baseball hat at a Boeing plant near Seattle, but his efforts seemed to fall flat in the U.S. and in China.

Since then, the 2008 financial crisis has accelerated China's emergence as an economic and military power, and encouraged some party insiders, especially in the military, to argue that Beijing needs to reshape the U.S.-dominated world order. Others, especially in the civilian foreign-policy establishment, say China needs to focus first on its domestic problems—especially on inflation and corruption—and are pushing the U.S. to shore up its defense ties with allies in Asia.

State media attempted to appease both sides of the debate in the past few days by stressing that Mr. Hu was given the respect due to a major world power, and by showing him reassuring the U.S. that it shouldn't feel threatened by China's rise.

"During his visit, President Hu spared no efforts to make friends, to proclaim China's philosophy of peaceful development and to express the Chinese people's willingness to join hands with the world to greet a spring of harmonious development," the official Xinhua news agency said in a commentary.

"In Washington, President Hu and his U.S. counterpart, Barack Obama, agreed to build a China-U.S. cooperative partnership based on mutual respect and mutual benefit, and marked out priorities of the development of China-U.S. relations for the future."

The People's Daily quoted Yang Jiechi, China's foreign minister, as saying Mr. Hu had attended nearly 20 events in Washington and Chicago in 68 hours, and "interacted widely with Americans from various circles."

State media also made no mention of Mr. Hu's words on human rights, which despite suggestions to the contrary from some U.S. officials, didn't represent a departure from previous statements by Chinese leaders.

The success of the trip was especially important for Mr. Hu as he is directly responsible for the U.S. relationship as head of the party's leading group on foreign affairs. Further friction with Washington, especially on the military front, could affect the leadership change in 2012, when Mr. Hu and six other members of the nine-man Politburo Standing Committee are due to retire.

Mr. Hu is almost certain to be replaced by Xi Jinping, currently vice president, following Mr. Xi's promotion to vice chairman of the Central Military Commission in October last year. But the other positions on the Standing Committee have yet to be decided, and Mr. Xi has offered few indications of how he views the U.S.

U.S. officials are hoping for further insight when Mr. Xi hosts U.S. Vice President Joe Biden on an official trip to China later this year, and then makes a reciprocal visit to the U.S., the date for which has yet to be announced.

—Juliet Ye in Shanghai contributed to this article.

Reuters

Randall Kroszner: 'Turning point.'

More U.S. firms are planning to hire

Continued from first page

weak. But the recent drop in weekly jobless claims points to a stronger labor market, and the tax-cut package approved at the end of 2010 is seen as likely to help the economy in 2011.

More than half the companies surveyed—especially those in manufacturing, mining and agriculture–expect to see a favorable impact on sales from the tax-cut deal. Companies generally have raised their expectations for growth this year.

"The economy is potentially at a turning point in job creation," said Randall Kroszner, a professor at the University of Chicago Booth School of Business and a former Fed governor.

All of the survey's four major industry sectors—goods-producing; services; finance, insurance and real estate; and transportation, utilities, information and communications—registered stronger demand in the final three months of 2010.

Economists in the private sector and government are increasingly optimistic about the pace of the recovery.

Strong U.S. consumer spending during the holiday season has raised expectations for growth, despite a persistently poor outlook for housing.

The economy expanded by a 2.6% annual rate in the third quarter and is expected to have grown by more than 3.0% in the final three months of 2010, as well as in each quarter this year, according to a Wall Street Journal survey of economists published this month. When Federal Reserve officials meet this week, they are expected to raise their growth forecasts for 2011 slightly.

Reuters; European Pressphoto Agency

Prime Minister José Sócrates takes a ballot in Lisbon on Sunday, left; Aníbal Cavaco Silva, shown casting his vote, won the election as voters sought stability.

Portuguese voters return president for a second term

By Alex MacDonald
And Jeffrey T. Lewis

LISBON—Portuguese voters re-elected Aníbal Cavaco Silva to a second presidential term Sunday, in a message that they want political stability as the country tries to extricate itself from the European sovereign debt crisis.

The seasoned Social Democratic president—who is head of state, but doesn't run the government—is facing tough months ahead.

Amid concerns that Portugal won't be able to repay its debt, Lisbon has been under pressure from its European partners to take a bailout, a measure the government has denied it needs.

Domestic political trouble lies ahead as well.

After months of political unity between the ruling Socialist government and the center-right opposition Social Democratic Party, rifts are starting to emerge.

In particular, the Social Democratic Party and its leader, Pedro Passos Coelho, are hoping Mr. Silva will call new elections in the spring.

According to an exit poll from TV news station SIC Notícias, Mr. Silva won between 52% and 56% of the vote, while Manuel Alegre of the Socialist Party is in second place with between 17% and 21%. The remaining votes were divided among four other candidates.

Turnout was low, with an abstention rate of 47% to 51%, according to SIC Notícias.

Mr. Silva, 71 years old, will start his second five-year presidential term under great pressure to maintain the political stability that has allowed Portugal to approve a harsh austerity plan and so far to avoid having to ask for outside help.

The minority government of Socialist Prime Minister José Sócrates managed to pass the 2011 budget, which included public-sector wage cuts, reductions in welfare benefits and tax increases, with the help of the Social Democrats, who abstained from voting after forcing the government to accept deeper spending cuts than originally planned.

Mr. Silva's re-election sent a message that voters are seeking political stability as Portugal tries to extricate itself from the European sovereign debt crisis.

The budget aims to reduce the government's fiscal deficit to 4.6% of gross domestic product in 2011 from an estimated 7.3% of GDP in 2010.

Concern about the country's ability to repay its debt, following the crises that forced the Greek and Irish governments to accept help from the EU and the International Monetary Fund, has pushed the price Portugal has to pay to finance its deficit higher in recent months.

If international financial markets continue to demand higher interest rates from Portugal, the country might also be forced to turn to the EU and the International Monetary Fund for help, despite Mr. Sócrates's insistence that won't be necessary.

The cease-fire between Mr. Sócrates and the biggest opposition party seems to be unraveling following comments from Mr. Coelho that the prime minister and his government will be ousted if the country requires help from the IMF.

"If the IMF enters Portugal, the current government will have to step down," Mr. Coelho, 46, recently said on local radio station TSF.

As president, Mr. Silva's role is largely ceremonial, because executive power lies with the prime minister. But the president has the right to dissolve parliament, and he can also use his office as a platform to criticize the government. Mr. Silva has hinted he could do either, or both.

During his campaign Mr. Silva broke away from his traditionally conciliatory tone to underscore the fact that Portugal still faces the possibility of a "grave crisis" in both economic and political terms.

He noted that he would be more demanding of the current government and would be prepared to act as an instrument of last resort in a crisis situation.

Mr. Silva later distanced himself from the comments, saying he had "little appetite" to use the "atomic bomb" of dissolving parliament and would seek stability for the country.

But political analysts say the threat is still real. The president would only be able to break up parliament from March 9, when he is sworn in for his second term; by law, he isn't allowed to exercise that power before then.

The process of dismantling and electing a new government could also take several months, meaning any change in government wouldn't happen until sometime in the summer at the earliest.

The government will face two trigger points that could spark a general election, according to political analysts and economists: the first-quarter budget results, due sometime around April, and the debate on next year's budget, set to occur sometime this summer.

If the government fails to meet its budget-deficit reduction target for the first quarter, it would lose credibility "and the probability that the government would need to step down would rise," political analyst André Freire at Lisbon University Institute said.

Failure to agree on a budget for next year could force a vote of no confidence, which would cause the current government to topple, said João Cantiga Esteves, economist at Technical University of Lisbon.

The president wouldn't dissolve parliament in that case, but rather would have to build a consensus among the parties for a vote of no confidence. Mr. Esteves said such consensus-building was unlikely to happen.

—David Gauthier-Villars in Paris contributed to this article.

Economics background aided Silva in election

By Alex MacDonald

LISBON—In re-electing Aníbal Cavaco Silva as president, Portuguese voters left the nation's reins in the hands of an economics scholar who has pledged to use his second five-year term to help steer his country out of sovereign debt crisis.

Although Portugal's constitution gives Mr. Silva few executive powers, the 71-year-old center-right Social Democrat has vowed to preserve unity and stability at a time when the country is increasingly divided on how to reduce its budget deficit and avoid an international bailout.

Mr. Silva, 71 years old, was born in Boliqueime, in Portugal's sun-kissed southern region of Algarve. He showed an interest in finance and economics from an early age and earned a doctorate in economics from York University in the U.K.

He served as a military officer for three years in Mozambique, a Portuguese colony at that time, and then returned to Europe to complete his studies, teach and work at the Bank of Portugal.

Mr. Silva became active in politics only after the Carnation Revolution of 1974, a bloodless military coup that toppled the 42-year dictatorship of António de Oliveira Salazar and ushered in a new era of democracy.

Though the role is largely ceremonial, the president plays a key role in mediating between parties.

Mr. Silva served as Portugal's finance minister at the beginning of the 1980s and was president of the National Advisory Plan from 1981 to 1984. He assumed the leadership of the Social Democrat Party in 1985 and in the same year became prime minister, serving two consecutive terms until 1995.

As prime minister, he presided over the county's first years as a member of the European Union and gained popularity for guiding Portugal through a period of strong, uninterrupted growth.

In 1995, however, his government lost popularity due to an economic crisis and internal politics. He decided not to run for another term as prime minister, instead seeking the presidential office in 1996, a race he lost by a narrow margin.

Mr. Silva returned to teaching and became a well-respected economist, writing nearly a dozen books ranging from topics such as the public debt to political budgets, the euro and economic stabilization.

He returned to politics in 2006 with a successful campaign for president of Portugal. The role of president is largely ceremonial, as the state's executive powers lie with the prime minister. But as head of state, the president plays a key role in mediating, striving for unity between the country's fractious party system. The president also has the power to dissolve parliament if the government is rendered ineffective.

Thousands march at Belgian unity rally

Associated Press

Protesters took to the streets of Brussels on Sunday to demand that rival political groups form a coalition after seven months without a government. The rally also promoted solidarity among the country's Flemish and Walloon communities.

Ireland's Greens quit government, speeding up vote

By Guy Chazan
And Quentin Fottrell

DUBLIN—Ireland's Green Party pulled out of the government Sunday, a move that will hasten elections scheduled for March 11 and bring down the curtain on one of the most crisis-racked administrations in Ireland's history.

The Greens, junior partner in the governing coalition, said they still would support legislation underpinning the €67.5 billion ($91.8 billion) international bailout arranged for Ireland in November.

But the early election could affect the fate of the rescue package. The main opposition parties voted against it, and have vowed to renegotiate parts of it—particularly the average 5.8% interest rate on the funds—if they form the next government.

The Greens' move delivered the coup de grace to a government that over the past week has spectacularly imploded in full view of a weary and apprehensive electorate.

In the past few days, six ministers resigned, a wide-ranging cabinet shuffle backfired, Prime Minister Brian Cowen stood down as leader of his party, Fianna Fail, and his junior partners quit. Mr. Cowen now has seven ministers in his cabinet to run 15 ministries.

"It is a circus, and it's embarrassing," said Elaine Byrne, lecturer in politics at Trinity College, Dublin. "The Irish people now just want to get this over with as soon as possible and have a new government."

Fianna Fail, which dominated Irish politics for nearly 80 years, now is bracing itself for a defeat of historic proportions in elections that could be held as early as next month. A Sunday Independent/Quantum Research poll showed support for the party has fallen to a record low of 8%. That is a dire rating for a party that has loomed large in Irish politics since 1932 and has been in government for all but three of the past 20 years.

Tensions between Fianna Fail and the Greens have simmered since last fall, when the government was forced to ask for a bailout from the European Union and the International Monetary Fund to save the Irish banking system from collapse. Relations turned icy after Mr. Cowen's aborted cabinet shuffle last week, which critics saw as a ploy to enhance the prospects of younger Fianna Fail members in the coming election.

"Our patience has reached an end," Green leader John Gormley told a news conference Sunday. He said Fianna Fail's leadership problem was too much of a distraction for the government, and an immediate election was needed.

Similar calls had been made over the weekend by opposition parties, who were outraged by Mr. Cowen's decision to step down as Fianna Fail leader but stay on as prime minister. The center-right Fine Gael said it would pursue a vote of no confidence in Mr. Cowen's leadership.

Yet the opposition says it will support the finance bill—which implements many of the tax and other changes set out in the 2011 austerity budget—but wants it passed by Friday so an election can be called. Mr. Cowen has said it is impossible to adopt such complex legislation in the space of a week. Ireland's access to the EU-IMF bailout money is contingent on the bill being passed.

As things stand, center-right Fine Gael is expected to emerge as the largest party in the coming election, and will likely form a coalition government with Labour.

—Ainsley Thomson contributed to this article.

Trichet defends austerity as a path to economic recovery

Continued from first page

growth through a government bond-buying program known as quantitative easing. In contrast, countries throughout the euro bloc will enact austerity measures this year, as Mr. Trichet has repeatedly urged. "It's not for me to give a lecture to other advanced economies," he said.

In Europe, budget discipline benefits growth and job creation by "improving confidence of households, enterprises, investors and savers," Mr. Trichet said.

His remarks come as the ECB, which must balance a widening debt crisis in Southern Europe and Ireland with a robust recovery in its largest member, Germany, and rising inflation throughout the euro bloc.

Last month, inflation unexpectedly jumped to 2.2% in the euro zone from 1.9%, the first time in more than two years it has exceeded the ECB's target of just below 2%. Some economists think it will rise above 2.5% in the next two months.

Mr. Trichet first ratcheted up his anti-inflation rhetoric at his monthly news conference earlier this month, spurring many economists to move forward their forecasts for rate increases.

In the interview, he reinforced that tough stance, dismissing some economists' argument that the ECB should hold off on raising rates because euro-zone "core" inflation, which excludes food and energy prices, was still weak at 1.1% in December.

"In the U.S., the Fed considers that core inflation is a good predictor for future headline inflation," he said. But in the euro zone, "core inflation is not necessarily a good predictor."

That implies the ECB could raise rates this year if it senses that companies and workers expect headline inflation to stay above 2% for some time—even if the main source of inflation is world commodity markets.

Changes in food and energy prices are largely determined on world markets, and thus aren't directly influenced by interest rates in any one economy. For that reason, central banks in many major economies, including the U.S., put greater weight on core inflation than on headline measures. For now, Fed officials don't see much evidence that commodity price pressures are feeding broader inflation in the U.S.

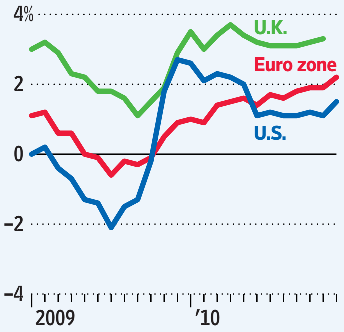
The Fed isn't expected to raise its key interest rate for some time, in order to help the U.S. economy recover, despite signs of rising headline inflation. The Bank of England has yet to raise rates, though U.K. inflation is approaching 4%. The potentially divergent U.S. stance is a reminder of what happened in the summer of 2008, when the ECB raised short-term interest rates in the face of rising oil prices while the Fed held rates steady amid concerns about economic growth.

Still, Mr. Trichet's remarks suggest that, for now, his tough talk is aimed at keeping inflation expectations in check rather than signaling an imminent rise in rates. If consumers see energy- or food-driven price increases as temporary, they are less likely to alter their behavior or push for higher wages. But if workers expect permanently higher inflation, they are likely to press for faster pay rises. "At this stage, we do not see" those longer-term forces, Mr. Trichet said, "and everybody knows we would not let [such] second-round effects materialize."

Why the worry?

ECB warning on inflation even though it is still relatively low in the euro zone

Consumer-price indexes, change from a year earlier



Sources: Eurostat (U.K. and euro zone); U.S. Bureau of Labor Statistics

Struggling countries on the euro zone's fringe, including Greece, Ireland and Portugal, face an extended period of economic pain: They must raise taxes and cut spending to reduce soaring government debt, while holding wages down to make their products more price-competitive. At the other extreme, Germany's mix of rapid, export-driven growth and tumbling unemployment usually puts central bankers on edge because it often leads to rising wages and prices.

Mr. Trichet dismisses these divergences as normal, and similar to those among states and regions in the U.S.

He brushed off skeptics of Europe's focus on budget austerity, including the International Monetary Fund and the United Nations, which warned last week that "the impact of fiscal austerity planned or under way risks a renewed economic downturn" in Europe.

"I do not buy the very simple reasoning that would suggest that pursuing sounder fiscal policy would hamper growth," Mr. Trichet said.

U.S. NEWS

Point man on sanctions set to leave

By Jay Solomon

ISTANBUL—The point man for the Obama administration's financial wars on Iran, North Korea and al Qaeda, Stuart Levey, has decided to leave his senior U.S. Treasury Department post at what is turning out to be a particularly critical time.

Mr. Levey's departure will leave President Barack Obama without the principal architect of Washington's economic-sanctions campaign against Tehran, just as that campaign is likely to be ramped up following the breakdown of talks among Iran, the U.S. and a bloc of global powers on Saturday.

The negotiations, held in Turkey, were aimed at curtailing Iran's nuclear program. With no date set for a resumption of the dialogue, American and European diplomats acknowledged here that they would likely need to put in place more of the economic penalties against Iran that Mr. Levey's office has been central to implementing over the past year. Lawmakers on Capitol Hill, meanwhile, are vowing to increase pressure for more punishing sanctions.

Senior Obama administration officials disclosed Mr. Levey's departure, after nearly a decade in government service, but stressed that it doesn't signal a shift in U.S. policy or a slackening of Washington's financial campaigns against Tehran, Pyongyang and international terrorist groups.

They said the White House is set to nominate David Cohen, Mr. Levey's deputy at Treasury and longtime confidant, to succeed him as the undersecretary for terrorism and financial intelligence. Mr. Levey, a Republican, was one of the few senior members of President George W. Bush's national security team to stay on under Mr. Obama.

"When Stuart came [into the Obama administration], he agreed to stay for six months, and it's been two years. There's no perfect time for these things. But this is as good a time as any" to make the change, Treasury Secretary Timothy Geithner said. "It will have no effect on policy, or on our ability to execute the president's policy."

Messrs. Levey and Cohen, in a joint interview at the Treasury last week, said they believed U.S. strategy wouldn't be slowed because the two men had closely coordinated in implementing sanctions policy over the past two years.

A Harvard-trained attorney, Mr. Levey, 47 years old, said he is taking time off before deciding on his next job. He said his letter of resignation would arrive at the White House Monday and that he would stay on at Treasury for about one more month.

Mr. Cohen, 48, is a Democrat who was a partner with Mr. Levey at a Washington law firm. He returned to private practice after a stint in the Clinton administration's Treasury Department in the 1990s, and rejoined Treasury in 2009.

Washington's sanctions campaign against Iran is likely to intensify in the coming months, as Tehran has so far shown little interest in negotiating a diplomatic settlement over its nuclear program.

During the two days of talks with Iran, U.S. and European officials had hoped to reach an agreement on new measures to address international fears that Tehran is seeking to develop atomic weapons, a charge Iran denies. Instead, Iran's chief nuclear negotiator, Saeed Jalili, said the Obama administration and its allies need to start lifting economic sanctions against Tehran before it engages in substantive talks on its nuclear work. He also said the international community must publicly recognize Iran's right to develop the technologies required to produce nuclear fuel.

The countries negotiating with Iran—which included the U.S., the U.K., France, China, Russia and Germany—ended talks Saturday saying they had found no common ground to continue the diplomacy. U.S. and European officials could only say they hoped Tehran would reassess the proposals presented to it and agree to return to the table.

Messrs. Levey and Cohen acknowledged that America's adversaries are continuing to adapt to U.S. financial measures and that the ultimate impact of long-term sanction campaigns remains unclear.

Mr. Cohen said the Treasury has "rewritten the rules of economic warfare" in recent years. But he added: "We'd like to add some new plays."


European Pressphoto Agency

Stuart Levey said his departure won't prompt a shift in U.S. sanctions strategy.

New push at Fed to set an official inflation goal

[The Outlook]

By Jon Hilsenrath

Federal Reserve officials last year, prodded by Chairman Ben Bernanke, seriously considered adopting an explicit target for inflation of 2%, but Mr. Bernanke failed to forge a consensus and backed away. The issue could resurface in 2011.

The Fed informally has said its goal is inflation of around 2%. But after years of internal debate on the subject, it hasn't adopted an official target.

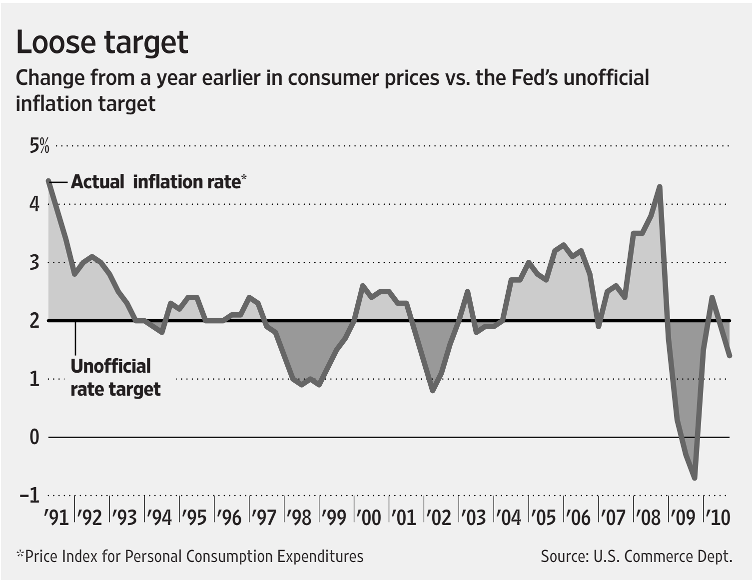
Proponents say adopting a formal objective would blunt criticism of the Fed that current easy-money policies could lead to an upward spiral in consumer prices and could reinforce the Fed's commitment to avoiding deflation, or falling prices. Skeptics, however, wonder if an inflation target is needed and worry it could distract the Fed from its congressionally set mandate of maximum employment.

"An explicit inflation target would help us immensely," says Charles Plosser, president of the Federal Reserve Bank of Philadelphia and a longtime proponent. Mr. Plosser says he feels like Sisyphus, the mythical Greek condemned to pushing a boulder up a hill only to watch it roll down in his efforts to advance a target. "It helps promote the credibility of the central bank by being explicit about its objectives and it helps anchor [inflation] expectations," he says.

Proponents say inflation targets help to cement public expectations about price changes, making investment and spending decisions simpler. They also say targets help to give the public a roadmap for how the central bank is likely to behave—when inflation is running below target they would expect easy monetary policy and when above they would expect tight policy. It also provides more accountability than vague pledges of "price stability."

The European, British and Canadian central banks each set inflation targets—typically around 2%—and commit to move interest rates as needed to keep inflation near that goal.

Mr. Bernanke, a strong advocate of inflation targeting before he joined the Fed, has moved a reluctant Fed toward the approach.



In January 2009, the Fed began publishing long-run inflation forecasts of its policy makers, essentially their long-term inflation goal. Forecasts cluster between 1.75% and 2%.

Inside the Fed, the idea resurfaced in the fall as the Fed debated the merits of initiating a $600 billion bond-buying program known as quantitative easing. In an Oct. 15 speech in Boston, Mr. Bernanke took another step, saying that Fed officials "generally judge the mandate-consistent inflation rate to be about 2% or a bit below." With inflation running at around 1%, he said there was a case for more Fed easing. An inflation target might be an easier sell when inflation is low; if it were adopted when rates were high, it would be seen as a reason for higher interest rates, which are never popular.

After the speech, Mr. Bernanke flew to Washington for a video conference call with other policy makers in which talk about targets quickly got bogged down on familiar issues, according to people who participated. One big hurdle was the Fed's legal mandate. The Federal Reserve Act requires the Fed to aim for "stable prices" and "maximum employment." Some officials worry that adopting an inflation objective could be viewed as putting more weight on inflation-fighting and less on unemployment-fighting.

Some argue an inflation objective might not be needed because the Fed's informal goal is well understood. "I think it's pretty clear that we have a relatively narrow range of inflation rates that we think about as mandate consistent," Narayana Kocherlakota, president of the Minneapolis Fed, said in a recent interview. Others at the October discussion worried that adopting an inflation goal while launching the new quantitative-easing program might confuse the public.

New challenges this year could put the inflation target back on the agenda. Several Republican lawmakers have proposed narrowing the Fed's mandate to price stability, eliminating the employment part.

Adopting an inflation target would ease the concerns of legislators and the public about inflation, says Columbia University's Frederic Mishkin, a former Fed governor. "The Fed needs to make it clear that it will do whatever it takes to keep inflation from getting out of control," he says.

The controversial decision to embark on a new round of quantitative easing gave the Fed added reason to adopt a target, Mr. Mishkin says. "In order to make quantitative easing understandable you need to move in this direction of being much clearer about what your long-run inflation objective is and how quantitative easing fits into it," he says.

Those arguments don't fall on deaf ears at the Fed. Mr. Bernanke has been slowly building the case since he first joined the Fed in 2002. He's gone a way toward implementing one and seems unlikely to give up the cause now.

U.S. NEWS

Reuters

President Barack Obama will give the annual State of the Union address Tuesday.

Obama to focus on jobs, deficit in key address

By Jonathan Weisman

WASHINGTON—President Barack Obama will appeal to the U.S. for political unity in his State of the Union address Tuesday night as he turns his attention to the tasks of job creation and deficit reduction.

In a videotaped message emailed to Democratic organizers, Mr. Obama laid out the main themes of his address, which will be delivered to a Republican-controlled House and a Democratic Senate struggling for comity. He said he would focus mainly on national competitiveness, economic growth and job creation.

Mr. Obama will also talk up what he will call "responsible" deficit reduction, according to a transcript of the video address to volunteers for Organizing for America, his grass-roots political organization. Republicans have said deep and immediate deficit reduction is needed to shore up the nation's finances and foster economic growth.

The president will also call for new spending on infrastructure, education and research, despite Republican demands for deep budget cuts, people familiar with the speech said.

With a fight brewing over the federal budget, and Republicans pushing to repeal the Democratic-sponsored health-care overhaul, the president will appeal for civility and unity.

"These are big challenges that are in front of us, but we're up to it, as long as we come together as a people—Republicans, Democrats, independents," Mr. Obama told organizers, "as long as we focus on what binds us together as a people, as long as we're willing to find common ground even as we're having some very vigorous debates."

Some lawmakers have pledged a new tone in the aftermath of the shooting rampage in Arizona that killed six and severely injured a House member, Rep. Gabrielle Giffords (D., Ariz.). Lawmakers of different parties have pledged to sit together during Mr. Obama's speech Tuesday night, suggesting that the event won't feature the traditional sight of lawmakers from one party cheering the president from their side of the House chamber while those on the other side look on in silence.

Among those pledging to set together are Sens. Charles E. Schumer (D., N.Y.) and Tom Coburn (R., Okla.); Mark Kirk (R., Ill.) and Richard Durbin (D, Ill.); and Olympia Snowe (R., Maine) and Mary Landrieu (D., La.).

But the vast majority of lawmakers will be in their usual seating arrangement. Rep. Paul Broun, a conservative Republican from Georgia, on Friday called the effort to get members to mix it up "a trap."

"I already believe very firmly that it is a trap and a ruse that Democrats are proposing," Mr. Broun said on a conservative radio show. "They don't want civility. They want silence from the Republicans."

Mr. Obama will acknowledge that the composition of the Congress has changed dramatically since his last address, due to Republican gains in the November elections. The president will appeal to Republicans by talking up his compromise with Republicans that extended Bush-era tax cuts for wealthy families, his promises to trim spending and his recent pledge to toss out onerous, outdated business regulations.

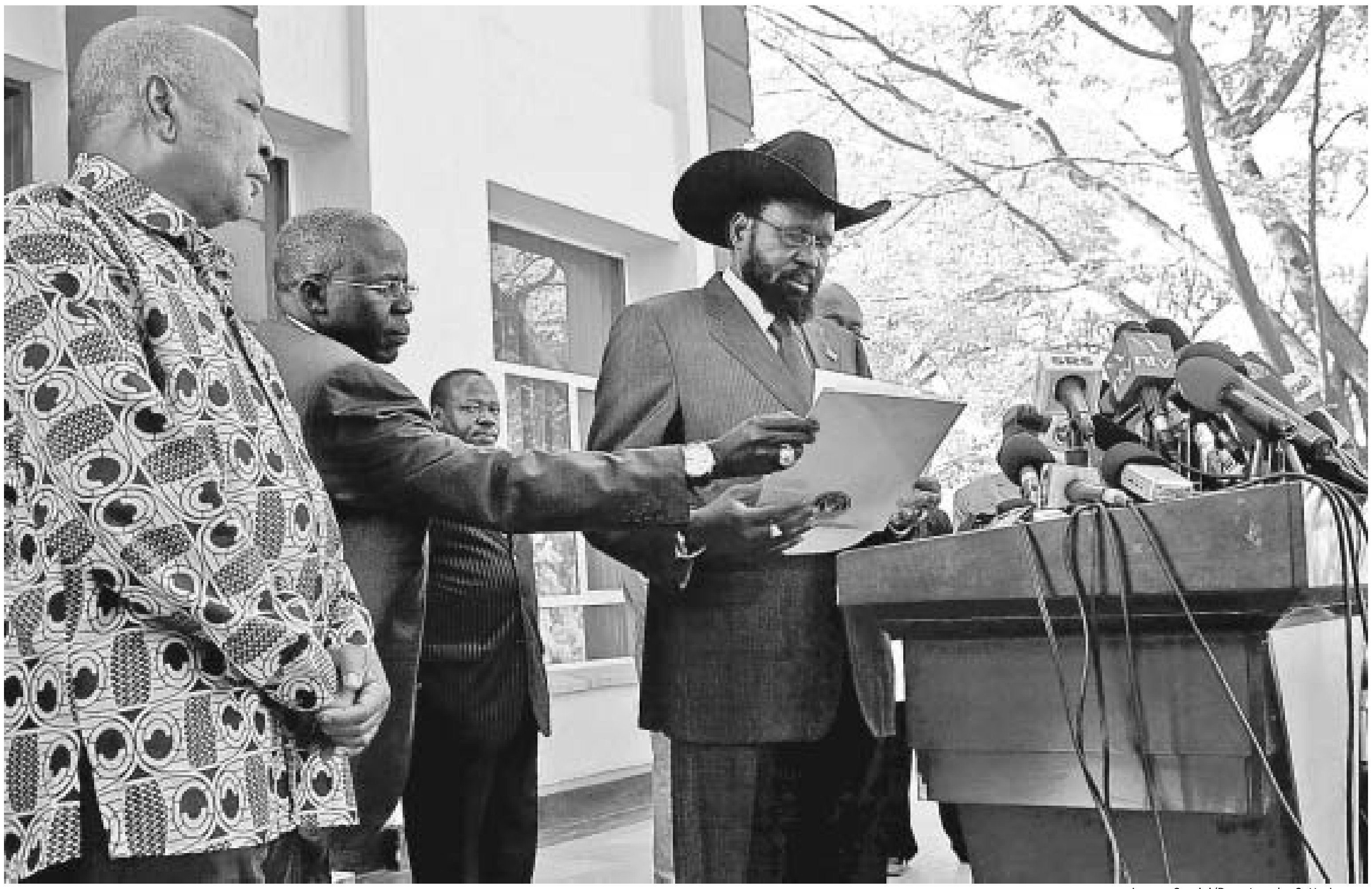
The president will also call for new spending on infrastructure, education and research, despite Republican demands for deep budget cuts, people familiar with the speech said.

Mr. Obama will argue that the U.S., even while trying to reduce its budget deficit, must make targeted investments to foster job growth and boost U.S. competitiveness in the world economy. The new spending could include initiatives aimed at building the renewable-energy sector—which received billions of dollars in stimulus funding—and rebuilding roads to improve transportation, people familiar with the matter said.

Mr. Obama will lay out significant budget cuts elsewhere, people familiar with the plans said, though they will likely fall short of what Republican lawmakers have requested.

In the House, Republicans are pushing to cut $100 billion from the annual budget as soon as this year.

WORLD NEWS



Jerome Sessini/Reportage by Getty Images

President Salva Kiir in early January. 'The referendum is not the end of a journey, but rather the beginning of a new one,' he said ahead of the vote.

South Sudan's vote for split sets president on rocky path

BY SARAH CHILDRESS

The first official tally from southern Sudan's referendum on independence showed that voters were nearly unanimous in their desire to separate from the North, setting the head of the southern government on a difficult path toward founding Africa's newest nation.

Salva Kiir, the southern Sudan government's president, saw his region through this month's referendum. His likely reward will be running a destitute country, under lofty expectations.

Mr. Kiir is credited with bringing about the peaceful vote following five years of negotiations with Sudan's northern government. The two sides—which have fought two wars in two decades believed to have left more than 2 million dead—agreed to set aside differences so that 3.9 million voters could cast ballots on whether to become a separate state.

So far, 98.6% of voters have chosen secession, according to results published Friday on the website of the Southern Sudan Referendum Commission in Khartoum. All votes cast outside of Sudan and those from eligible southerners living in the north have been tallied, as well as 83% of the votes from the south, according to the referendum commission's site. The final result isn't expected until February.

Last week, the commission's branch in the southern city of Juba reported 95% of voters there sought succession.

The nearly unanimous results are in line with expectations. The right to vote was determined along ethnic and residential lines, basically ensuring those who had been the subjects of decades of slave raids, massacres and neglect from the northern government would be those casting ballots. The Carter Center, the main international observer group, called the vote credible.

Through it all, said one Western diplomat, Mr. Kiir's biggest concern has been that the referendum wouldn't happen. His next biggest concern, this person said, was that it would—leaving him to rebuild a devastated economy and battered infrastructure, as "president of a country in name only."

A lot is riding on Salva Kiir, the southern Sudan government's president—a 59-year-old former rebel often seen wearing a black cowboy hat.

About 90% of the south's population lives on less than $1 a day. Though the region is rich in oil, southern Sudan has little running water, few paved roads and bare-bones health care.

But expectations among southern Sudanese for their new country have soared. Independence is seen among many as a panacea for poverty and repression by Sudan's government in the northern city of Khartoum.

"The propaganda that we cannot govern ourselves is baseless," said John Alphones, a 30-year-old accountant. "We will achieve democracy and economic progress and respect the rights of everybody."

There is a lot riding on Mr. Kiir, a 59-year-old former rebel often seen wearing a black cowboy hat. Any leader who can build democratic institutions and develops the country is likely to lure investment dollars from regional powers including Kenya and Uganda, and bolster its relationship with China, which already is invested in Sudanese oil. But Africa has also had a history of liberation presidents who have become mired in allegations of corruption as they have sought to cling to power.

The U.S. and European countries want to ensure southern Sudan succeeds, and Mr. Kiir is seen as a key to the new nation's future, say analysts. "He has done an effective job at keeping the ship afloat and keeping everyone moving in the right direction," said Zach Vertin, a Sudan analyst at the International Crisis Group in Nairobi.

When he took office in 2005 as the head of the newly autonomous southern Sudan region, Mr. Kiir said the area was "starting from zero."

It hasn't advance much since then. Oil reserves aren't expected to last more than a couple decades, so the government plans to invest in agriculture and train subsistence farmers. Low education levels have hobbled efforts to cultivate government officials to administer the new state."The referendum is not the end of a journey, but rather the beginning of a new one," Mr. Kiir said in remarks at his presidential palace on the eve of the vote.

As a young man, Mr. Kiir joined the south's first rebel movement, the Anyanya. Composed of southerners who are mostly black and Christian or animist, it fought those in the largely Arab, Muslim north.

When a peace deal was signed with the north in 1972, calm briefly returned to Sudan. Mr. Kiir joined Sudan's national army. But he left in 1983 to re-join the rebellion. The southern army, known as the Sudan People's Liberation Army, formed the armed wing of what would become the south's ruling party.

In early 2005, the movement's leader, John Garang, signed a peace deal with the north that ended the war and paved the way for the independence vote. Mr. Garang died later that year in a helicopter accident, and Mr. Kiir was pushed to the forefront of the independence movement.

In elections in April, Mr. Kiir, who had until then governed by appointment, was elected president of the south with 93% of the regional votes. The vote was marred by allegations of rigging and violence against opposition-party members, according to international observers.

Mr. Kiir has presided over a government whose officials are driven around Juba in shiny SUVs, in stark contrast with residents who walk or herd cattle through the streets.

Mr. Kiir maintains the vote was fair. He has advocated "zero tolerance" for corruption and promoted press freedom.

His political opponents are already angling for his office, with some eager for fresh presidential elections once the country becomes independent. No date has been set for such a vote.

Mr. Kiir's government should establish an appropriate transition period that would lead to new elections, says Hon. Onyoti Adifo Nyikwech, head of the south's main opposition party. "If they cling to power, nobody will accept that," he said.

Ivory Coast incumbent squeezed by new acts

BY WILL CONNORS AND JOHN JAMES

ABIDJAN, Ivory Coast—The government of presidential aspirant Alassane Ouattara over the weekend moved to squeeze off funding to his rival, Laurent Gbagbo, ousting a key banker and calling for a month-long suspension of cocoa and coffee exports.

On Saturday, the Central Bank of West African States forced an ally of presidential incumbent Mr. Gbagbo to resign, effectively handing the country's purse strings to Mr. Ouattara, who is recognized by most foreign countries as winning a recent presidential run-off.

The move ratchets up pressure on the embattled Mr. Gbagbo to step down. But it also increases the risk that deteriorating economic conditions in the Ivory Coast could fuel violence. The regional central bank, or BCEAO, gives financial instructions to commercial banks, which could become a target of popular anger if salaries aren't paid.

At least 260 people have been killed in violence since the disputed Nov. 28 presidential vote resulted in a stalemate.

The resignation of Philippe Henri Dacoury-Tabley as central bank governor came at the request of regional heads of state during a meeting in Mali. The heads of state accused Mr. Dacoury-Tabley of allowing Mr. Gbagbo access to state funds, despite a ruling in December that the incumbent president's signature at the bank was no longer recognized.

Mr. Ouattara, a former BCEAO governor, is expected to name a replacement within the next few days. He will have the option of using state funds to pay expenses, helping to bolster his international status as leading the legitimate government of Ivory Coast.

A spokesman for Mr. Gbagbo called the central bank's decision "illegal and without effect." The spokesman appealed for calm and added that "the measures have been taken to ensure the banking system continues to function as normal," according to a statement read on state television.

Mr. Gbagbo, who has led the Ivory Coast for 10 years, has tapped the bank's coffers to pay army and civil-servant salaries. Since December, Mr. Gbagbo's administration is estimated to have withdrawn around $160 million from the central bank, according to Mr. Ouattara's government. Mr. Gbagbo's spokesman couldn't immediately be reached to comment on the figure, but his administration has acknowledged accessing bank funds.

Retaining the support of army officers and bureaucrats has helped Mr. Gbagbo resist mounting regional and international pressure to step down.

In another step to choke off funding for Mr. Gbagbo's administration, Mr. Ouattara's government issued a communique calling for the suspension of all cocoa and coffee exports for a month, beginning Jan. 24.

The communique prompted handwringing among traders.

WORLD NEWS

Associated Press

Former legislator Najibullah Mujahed speaks Sunday in Kabul during a protest against last year's parliamentary poll.

Talks to seat legislators continue in Afghanistan

By Yaroslav Trofimov And Maria Abi-Habib

KABUL—Afghan lawmakers and President Hamid Karzai moved closer to resolving the constitutional crisis over his order to delay the legislature's opening, though a tentative compromise worked out over the weekend could still unravel.

Averting a potentially violent showdown, lawmakers aborted their plans to inaugurate the parliament unilaterally on Sunday, a move that would have defied Mr. Karzai's orders for a monthlong delay.

Mr. Karzai, who cut short a trip to Russia to deal with the crisis, has told lawmakers that he would inaugurate the parliament on Wednesday instead, if his concerns about investigating fraud allegations during the Sept. 18 election are properly addressed. Negotiations are continuing over the exact wording of this compromise, Afghan officials and Western diplomats say.

"The two sides have come closer to each other, and they both seem to be interested in finding a solution," a Western diplomat said. "It's far too early to say who will emerge as a winner, and who will be the loser here."

Mr. Karzai, who has criticized the new legislature's makeup as unrepresentative because it doesn't give enough seats to the country's largest ethnic group, the Pashtuns, last month established a special court to investigate complaints of fraud made by the losing candidates. The court has said it has the power to order recounts and even annul the entire election.

Afghan election authorities, Western governments and the incoming lawmakers have rejected the special court as unconstitutional. The United Nations, backed by the U.S. and European countries, on Friday expressed "deep concern" with Mr. Karzai's decision to delay the inauguration to give the special court more time for its inquiries, and called for seating the new parliament as soon as possible.

The U.N. envoy, Staffan de Mistura, who took an active role in mediating between Mr. Karzai and the lawmakers this weekend, said that the tentative deal worked out over the weekend was "a major step forward," and that he was "very hopeful" about the inauguration occurring on Wednesday.

"We have to close this situation," Mr. de Mistura said after meeting leading lawmakers Sunday in Kabul's Intercontinental Hotel. "We need to make sure that the parliament convenes, but it needs to be done with the agreement of everyone, and within the laws and constitution."

In a show of hands at the hotel's meeting room late on Sunday, the incoming parliamentarians approved a letter to Mr. Karzai, which they said was drafted with Mr. de Mistura's help. Without mentioning the special court, the letter says that lawmakers will accept the pursuit of criminal inquiries about fraud in the Sept. 18 election, in accordance with the constitution and other laws, and "with respect of parliament members' immunities and privileges."

Lawmakers aborted their plans to inaugurate the parliament unilaterally on Sunday, a move that would have defied Mr. Karzai's orders for a monthlong delay.

The letter dropped an earlier demand for Mr. Karzai to dissolve the special court altogether. That issue caused heated debates among lawmakers, many of them suspicious that the president could use the special court, packed with his loyalists, to blackmail and possibly remove from office dozens of hostile parliamentarians. There are 249 members in the parliament's directly elected lower house.

Parliamentarians removed their demand from the letter only after the former parliament's speaker, Younus Qanooni, who has emerged as an influential leader of the new crop of lawmakers, made an impassioned call for compromise. "If we keep on insisting, then the inauguration will be delayed from Wednesday to Thursday, and then to Friday, and everything will remain unresolved," he said.

It remains to be seen, however, whether the letter's wording, approved by parliamentarians on Sunday, will be acceptable to Mr. Karzai. Western diplomats said the ball was now in the president's court.

"What they're trying to determine is the exact legal mechanism through which these criminal investigations of fraud could proceed," one diplomat said.

Though Mr. Karzai's minister for parliamentary affairs, Humayun Azizi, Sunday publicly discussed a possible parliament inauguration on Wednesday, the presidential palace so far has made no official statements about reversing last week's order for a monthlong delay.

"The issue is under discussion by the government, and we have not reached any agreement in this regard so far," an Afghan official said Sunday night.

Several of Mr. Karzai's key supporters in the previous legislature failed to win re-election and are hoping that continuing fraud investigations will allow them to gain seats if rivals are disqualified by the special court.

Losing candidates are scheduled to meet Mr. Karzai on Monday to voice their objections to the parliament's seating, said Daud Sultanzoy, who failed to win re-election in the eastern Ghazni province.

Many losing candidates have already called for street protests on Wednesday. "If this inauguration takes place, it will be seen by ordinary Afghans that the international community is giving its blessing to thugs and thieves," Mr. Sultanzoy said.

The confrontation with Mr. Karzai has solidified opposition to the Afghan president within the new legislature, and signaled that he could expect tough new scrutiny from the lawmakers in coming months.

"The president may have a little fear now," said parliamentarian Khaled Pashtun from the southern province of Kandahar. "The parliament this time may be more aggressive, more harsh, more decisive."

—Habib Khan Totakhil and Arif Afzalzada contributed to this article.

Turkey rejects panel on Israeli ship raid

By Charles Levinson

JERUSALEM—An Israeli raid against a Gaza-bound Turkish aid ship in May that killed nine passengers was legal under international law, an Israeli commission of inquiry said in a report released Sunday.

The commission, headed by retired Supreme Court judge Yaakov Turkel, ruled that Israel's continuing land, sea and air blockade of the Gaza Strip also complies with international law because Israel is effectively in a state of war with the territory's rulers, who are from the Palestinian Hamas movement.

Turkey's Prime Minister Recep Tayyip Erdogan denounced the findings. "In my judgment there is no value or credibility to this report," he told reporters in Ankara, according to Anadolu Ajansi, Turkey's state news agency. Israeli human-rights groups also rejected the report's findings that the continuing blockade of Gaza is legal because of military necessity.

The actions by Israeli soldiers' were "lawful and in conformity with international law," the commission said in the report summary. "When examining the operation as a whole it seems that the soldiers did not overreact."

The commission will publish the second part of its findings in coming months, focusing on Israel's methods for investigating itself and government decision making in the run-up to the botched raid.

Turkey's own commission investigating the incident issued a response Sunday to the Israeli findings. The Turkish board said in the statement it was "surprised, appalled and dismayed that the national inquiry process in Israel has resulted in the exoneration of the Israeli armed forces despite all the facts that have also been confirmed by the International Fact-Finding Mission" set up by the United Nations Human Rights Council and reported by that panel last fall.

The Turkish commission said its preliminary findings found that both the Israeli blockade of Gaza and its boarding of a ship in international waters were illegal. The Turkish panel sent its interim report to the United Nations Secretary-General in September.

The killings on board the Mavi Marmara vessel caused popular outrage and rare unity in Turkey, which has demanded Israel apologize for the deaths before damaged relations between the two countries can be restored. Israel has declined, although in recent months the two sides have taken steps to smooth over differences.

The investigations follow the May 31 raid by Israeli commandoes on a six-ship aid flotilla carrying 700 passengers headed for Gaza with food, medicine and other humanitarian aid. After seizing control of the first five ships without fatalities, soldiers rappelled from helicopters onto the largest of the ships, the 590-passenger Mavi Marmara, where passengers affiliated with a Turkish Islamic aid organization known as the IHH attacked them with chains, pipes, knives, and other light weapons, according to eyewitness accounts and supported by videos of the raid taken by israeli soldiers.

In the ensuing fight, eight Turkish citizens and one Turkish-American were killed, and 55 wounded. Nine Israeli soldiers also were wounded. The incident plunged Israel into one of its worst diplomatic crises in decades. Washington demanded Israel ease the blockade of Gaza, which Israel has taken some steps to comply with, while Turkey withdrew its ambassador from Tel Aviv and canceled three joint military exercises.

The findings by the Turkel commission largely support the findings of an Israeli military inquiry last July. The military report criticized the poor planning and faulty intelligence that preceded the raid, but praised the "heroic" commandoes who carried it out.

—Marc Champion in Istanbul and Joe Lauria in New York contributed to this article.

Egypt says Gaza group was behind church bomb

By Matt Bradley

CAIRO—Egypt's interior minister accused an al Qaeda-linked Palestinian militant group in the Gaza Strip of killing at least 21 Christian Egyptians when it bombed a church in the northern port city of Alexandria on New Year's Day.

Habib al Adly said he had "conclusive evidence" that the Army of Islam planned the attacks and may have recruited Egyptians to execute the bombing, which also injured about 100 Christians. The Army of Islam denied responsibility for the bombing on its website.

In a statement emailed to reporters Sunday night, the ministry of the interior said Ahmed Lotfi Ibrahim Mohammed, who it said was born in 1984 in Alexandria, had confessed to helping organize the attack. According to the ministry's statement, Mr. Mohammed first visited the Gaza Strip in 2008 to seek out radical groups affiliated with al Qaeda. Last October, it said, he proposed two churches and a synagogue as possible targets, one of which, the Church of Two Saints, was ultimately attacked on New Year's Day.

If the accusations are true, they could validate concerns that the unresolved conflict between residents of the Palestinian coastal enclave and Israel is spilling over into neighboring countries.

Still, some analysts said that by blaming Gaza-based militants, the Egyptian government may hope to vindicate its cooperation with Israel, whose efforts to isolate Hamas, an Islamist group that has governed the Gaza Strip for nearly four years, have been widely criticized in Egypt.

Egyptian authorities have long viewed the Gaza Strip with suspicion. Hamas has historical connections to the Muslim Brotherhood, Egypt's largest opposition political movement.

INTERVIEW

Mr. Rodés Vilà says agencies must build 'social capital' and learn how to help brands establish a dialogue with their clients.

Havas

Adventures in cyberspace

The chief executive of Havas is determined the advertising agency won't be a casualty of the Internet revolution

[Fernando Rodés Vilà]

By Ruth Bender

It was easier for Marie Antoinette to adapt to the French Revolution than for advertising agencies to understand the profound impact the Internet would have on their businesses. So says Fernando Rodés Vilà, chief executive of French agency **Havas** SA, in a frank admission of the challenges facing the industry.

Ad agencies failed to react quickly enough when the Internet emerged, and just stood by, watching entrepreneurs behind technology companies such as **Google** Inc. or **Facebook** transform the industry, says the 50-year-old Catalan who has been at the helm of the world's fifth-biggest advertising agency by revenue since 2006.

"We were so successful in the '60s, '70s and '80s that when the Internet came, we didn't react. We were very slow in embracing that new technology. We allowed all other elements in the chain to embrace it for us," Mr. Rodés Vilà says, taking a sip of tea in the bar of Paris's chic hotel Le Bristol. "We were like athletes who have already won all the medals and then sit in front of the TV not moving any more."

Mr. Rodés Vilà recalls watching "The Social Network," the movie about the creation of Facebook, and thinking: "I'm watching the creation of probably the most important initiative in communication ever and there is not one single professional from the communication sector in there. No advertiser, no marketer."

He regrets that it wasn't advertisers that invented Facebook. Even more, though, he regrets that ad agencies today are only capturing a tiny portion of the value that the Internet has created for the advertising industry over the past few years.

That needs to change and Mr. Rodés Vilà is confident agencies are now on course to find the magic formula that will allow them to capture more of that value in the future.

The past four or five years have been a learning process for Havas, like other agencies, and it's not quite over yet. "The solutions we have to build brands today are not as perfect as they were 20 or 30 years ago," Mr. Rodés Vilà says.

"Clients are demanding things that we are not yet able to do, things others are doing," he says, referring to big names such as Facebook or Google but also the numerous start-ups that are creating innovative ways to track consumer behavior on the web or analyze data collected on social-networking sites. "They don't call themselves ad agencies but they build brands."

Mr. Rodés Vilà likens the change that the Internet brought to the advertising industry to the switch from tyranny to full democracy. Brands today have to accept that the power structure has flipped, he says. "Brands now can aspire to share some control with the consumer but if you think you can control the consumer, you're out of business."

The key for agencies right now is to build what he calls "social capital." They must, he says, learn how they can help brands establish a dialogue with their clients that gets consumers thinking about a brand and, eventually, establishes trust in that brand or product. And to succeed in this, Mr. Rodés Vilà is working on three things: finding the right technology; recruiting tech-savvy staff; and making sure digital experts are integrated at all levels of his organization, not just in special digital units.

So far, Havas's development in the digital area has been mostly organic. Unlike its larger rivals WPP PLC or Publicis Groupe SA, Havas opted not to buy any big digital advertising companies but rather to develop digital expertise in-house or through partnerships or very small acquisitions.

But as the company moves closer to understanding how to operate in the new environment, it could soon change strategy and embark on a larger deal, Mr. Rodés Vilà says.

"Four years ago, I would clearly not have recommended a huge association with another big organization. Today, we are ready. I don't know if I would recommend it or not, that would depend on the partner, but we are ready," he says. "Today, Havas has the structure to start another journey."

If Havas feels ready to embark on new adventures, it's not only because it is coming to terms with the industry's new power paradigm, but also because it has spent the past five years sorting out its finances under the close eye of its chairman and biggest shareholder, Vincent Bolloré.

Mr. Bolloré, the French businessman who owns just under 33% of Havas, as well as nearly 30% of U.K.-based rival **Aegis Group** PLC, has kept a tight rein on the French company since he was named chairman in 2005, tidying up the legacy of its past acquisition spree.

Between 2000 and 2001 alone, Havas spent more than €3 billion ($4.1 billion) on buying about 200 companies, including about $2 billion for U.S. agency Snyder Communications Inc. But the buying spree left the group with a fragile balance sheet, costly restructuring plans and a capital hike, and Mr. Bolloré and his new management team pulled the plug on any further large acquisitions.

Mr. Rodés Vilà, who himself owns close to 3% of Havas's capital, works hand-in-hand with Mr. Bolloré. The chairman attends all of Havas's executive committee meetings at its headquarters in the Parisian suburb of Suresnes, as well as most of its financial committees and lately also presents the group's results to analysts and the media.

"He's very involved and very present," Mr. Rodés Vilà says of his chairman. Besides financial support and managerial experience, Mr. Rodés Vilà values Mr. Bolloré's long-term commitment to the group. "Having a key shareholder with a long-term vision, you cannot imagine what a difference that makes," he says.

Mr. Bolloré's link to both Havas and Aegis has inevitably led to speculation that he could merge the companies, a move Mr. Rodés Vilà says would make sense. Asked whether the fact that Havas is now ready for new ventures means it could tie up with Aegis, Mr. Rodés Vilà says: "We could, or with another player. We are ready. But it's not Havas's call; it's Mr. Bolloré and the other shareholders of Aegis who have to decide." But to his knowledge, he says, there currently aren't any talks about a tie-up.

The main advantage of combining Havas's and Aegis's portfolios, Mr. Rodés Vilà says, would be that the resulting company would be involved in more digital and media-buying and planning activities than traditional advertising. The two portfolios are also complementary in terms of geography and clients, he says. Owning Aegis' market-research unit Synovate might not be necessary, even though it is an interesting asset, he adds.

At the end of 2010, Havas hit its target of deriving 20% of its revenue from digital advertising, the CEO says—up from less than 9% in 2006. Mr. Rodés Vilà says he expects this to continue rising, saying clients that operate in industries with registered customers—for example, banks and insurance companies—should clearly be spending more than 50% of their budgets on digital media.

As of the end of June, larger rivals such as WPP and Publicis made around 28% of their revenue from digital advertising. "Naturally, as we didn't do any acquisitions, we grow more slowly," says Mr. Rodés Vilà. But, he says, this isn't a disadvantage. Increasing the share of revenue from digital isn't so much a target now as a consequence of the company's other priorities, he says.

Besides the digital transformation, Havas's main aim this year is to keep profits at least at the same level as last year and to deliver sustainable growth. "We don't want to have great results one year and then bad ones the next...We want to be regular at a time when everything changes," Mr. Rodés Vilà says. And if by achieving these targets, the share of revenue from digital rises, he won't be displeased.

Stability will be key to survival in an industry that, Mr. Rodés Vilà says, is likely to be made up of even fewer players in the future. He is ready to bet that in the agencies' race to master the digital revolution, at least one of the current six largest ad holding companies is doomed to fail: "Not everybody will make the bridge, but those who manage to cross it will be very strong."