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Inflation puts new pressure on ECB stance

BY BRIAN BLACKSTONE

FRANKFURT—Euro-zone inflation jumped past the European Central Bank's target for the first time in more than two years, threatening the ECB's coveted anti-inflation credibility as it continues to take aggressive measures to stem the region's fiscal crisis.

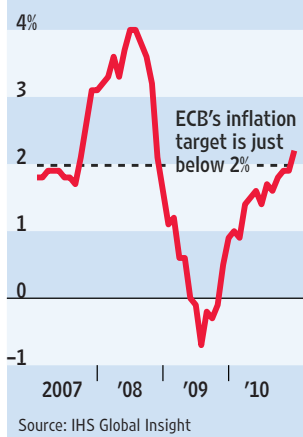
Annual inflation across the currency bloc was 2.2% in December, according to the European Union's statistics office, Eurostat, up from 1.9% in November and the highest since October 2008. Tuesday's report didn't provide a country or product breakdown, though economists said the rise was likely due to higher food and energy prices.

The ECB's mandate is to keep inflation just below 2% over the medium term. Inflation had dipped into negative territory in late 2009 as the global recession drove prices down and kept wages in check, and was under 1% as recently as last February.

But the euro-zone economy's subsequent turnaround, led by Germany, reversed that trend. Gross domestic product grew robustly in the middle of last year and carried that mo-

Sticker shock

Under wraps since the recession, euro-zone inflation is back above the ECB's target



mentum into the end of the year. Still the ECB, under President Jean-Claude Trichet, has kept crisis-era programs in place, including record-low interest rates, abundant loans to banks and, for the past eight months, purchases of government bonds to help vulnerable countries such as Greece, Ireland and Portugal that face high debt levels and meager

growth prospects.

"If inflation is rising, this will make it harder for Trichet to justify his actions," says Charles Wyplos, professor of economics at The Graduate Institute in Geneva.

And it won't get easier anytime soon. Barclays Capital expects inflation to rise to 2.3% this month and 2.5% in February. "The monetary stance does look on the easy side" against those figures, says Barclays economist Julian Callow.

President Trichet repeatedly cites his anti-inflation bona fides as a defense from critics, particularly in Germany, who say ECB policies will lead to higher prices. Mr. Trichet recently recalled a meeting with European parliamentarians where he noted that the ECB has delivered 1.97% average inflation over its first 12 years, a figure he frequently cites. "We even had applause. I was quite moved," Mr. Trichet said.

Inflation rates slightly above 2% aren't yet a threat to Mr. Trichet's track record, economists say, noting that when food and energy prices are stripped out, core inflation is still below 2%.

Please turn to page 6

Tensions grow in Ivory Coast



Associated Press

United Nations troops from Niger prepare to patrol the streets of Abidjan, Ivory Coast, Tuesday. The failure to dislodge Ivory Coast leader Laurent Gbagbo from power has exposed differences in West Africa, with some arguing for the use of force and others ruling out the option. **Article on page 10**

The Quirk



Pouring cold water on Turkmenistan's grandiose resort ambitions. **Page 29**

Editorial Opinion

The ECB's Yves Mersch says governments must cut deficits—now. **Page 13**

Shell faces setback in Alaska drilling

BY GUY CHAZAN

Royal Dutch Shell suffered a new setback to its plans to drill offshore in the arctic, after environmentalists successfully challenged a decision to grant the company air-quality permits.

Shell has invested \$3.5 billion in an exploration program in Alaska's Beaufort and Chukchi seas, but has yet to drill. The company's plans have been dogged by legal challenges and regulatory obstacles.

Shell had finally overcome all hurdles last spring, until

BP PLC's Gulf of Mexico oil well exploded, triggering the worst offshore oil spill in U.S. history. The Obama administration responded by suspending most new offshore drilling, including in the arctic, throwing Shell's exploration program into disarray.

Yet the Anglo-Dutch oil company remains committed to the region, which it believes contains up to 25 billion barrels of oil reserves—most of it in the Chukchi Sea. In 2008, Shell spent \$2.1 billion to obtain leases in the Chukchi.

After the moratorium was

lifted, Shell scaled back its plans, resubmitting its application to drill in the Beaufort but postponing a plan to enter the more remote Chukchi Sea pending the outcome of various legal challenges.

The company was planning to drill an exploratory well in the Beaufort this year. But without clean-air permits, it will struggle to meet that deadline.

Shell was issued the air-quality permits by the U.S. Environmental Protection Agency last year, allowing the company to operate the Frontier Discoverer drilling ship

and support vessels, such as icebreakers and a supply ship, in the Chukchi and Beaufort seas. But two conservation groups and a group representing Native American communities in Alaska requested a review, arguing that in granting the permits, the EPA had applied outdated nitrogen-dioxide standards.

In a decision filed Dec. 30, the EPA's Environmental Appeals Board agreed with the petitioners, saying the analysis of the impact of the nitrogen-dioxide emissions on people living on Alaska's North Slope had been "limited in

scope." It remanded the Beaufort and Chukchi permits, effectively sending them back to the EPA and Shell to be rewritten.

Shell said the decision was "very disappointing," given the efforts it had made to minimize the impact of air emissions on arctic air quality and North Slope residents. The company said it has consistently met or exceeded requirements for operating in the arctic and retrofitted the Frontier Discoverer with the best available technology for controlling emissions, at a cost of \$25 million.

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PAGE TWO

Tough-talking Merkel makes it clear: Germany needs Europe—and the euro

[Agenda]

BY GEOFFREY T. SMITH

Will 2011 be the year that Angela Merkel finds her euro-mojo?

The German chancellor has certainly started the year in a manner that suggests that she has had enough of people calling her weak and “konzeptlos” when it comes to leading Europe out of its debt crisis.

Her televised address to the nation at New Year may have lacked the passion of her speech to the Bundestag in December ahead of an EU summit, but it gave no comfort either to nostalgic enthusiasts of the Deutsche mark, or to the unreconstructed Euroskeptics of London. It's worth repeating the key parts in full: “We have to strengthen the euro, and it is not only a question of money. The euro is more than just a currency. It is our good fortune that we Europeans are united. A united Europe is the guarantor for our peace and our freedom. The euro is the basis of our economic well-being. Germany needs Europe and our common currency, for our own good, and for coping with global challenges.”

The echoes of Helmut Kohl are unmistakable and deliberate: the euro is a symbolic and political project; economics and politics are inseparable; and, most of all, Germany cannot contemplate a future based on anything other than partnership within Europe, and God be praised for that.

It is the rhetoric that characterized the postwar generation, and still does characterize what remains of it. It is conspicuous that the only senior figure in the coalition to talk convincingly in Europe in those terms is 68-year-old Finance Minister Wolfgang Schäuble, a Kohl protégé. His counterparts at



German Chancellor Angela Merkel at the recording of her New Year speech.

last year's Ecofin meetings may have bridled at how rigidly he defended the German line, but they can be thankful that they had to deal with a man who remembers how much Germany needs Europe. They should breathe no sighs of relief if he is forced to retire this year because of ill health.

The echoes of Helmut Kohl are deliberate: the euro is a symbolic and political project.

The crisis that is now in its fourth year is, in fact, the first of many since the World War II when Europe has had to deal in earnest with a generation of German politicians with no memories of the helplessness and devastation of the postwar period. Ms. Merkel's own formative years were spent in the heady days of national reunification, and some of her ministers barely remember Nena's “99 Red Balloons,” let alone the Marshall Plan or Willy

Brandt's gesture of penance at the Warsaw Ghetto memorial.

Among younger Germans, and particularly among younger German journalists, it seems it has become fashionable to think that the economic relations between Germany and the rest of Europe, and Germany and the rest of the world, have changed so much that the original rationale for monetary union no longer adds up.

Demand for German products from emerging markets such as China and India, so the argument goes, is so well entrenched that the country can, effectively, do without the deadweight that is Greece and the rest of the euro zone's periphery. We have put our house in order, and if Greece and Spain can't do the same, then tough luck.

There is no lack of figures to back the argument up: over the first three quarters of last year, exports to China were up 45.7% from a year earlier, while those to the euro zone were up only 13.5%. Exports to France, long considered the most important German export market of all, were up a paltry 11.3%, while those to

Turkey were up 35.5%. Even Russia, the only one of the big emerging-market economies to have a serious recession and problems returning to growth, took 26% more German goods in the first nine months of last year than in the 2009 period.

But it's a commonly German preoccupation to focus on visible trade flows. A look at the financial interconnectedness between Germany and the rest of Europe makes clear that any notion of being able to act independently of Europe is illusory.

German banks had \$548 billion—or €446 billion at prevailing exchange rates—at risk in the five problem countries of the euro zone as of June, according to the Bank for International Settlements. They had €392 billion of capital and reserves, according to the Bundesbank. Thus, it doesn't matter whether Germany tries to withdraw from monetary union, or have fiscal sinners expelled from it: the credit losses and write-downs caused by the ensuing currency moves would effectively bankrupt the German banking system, even before manufacturers start shifting jobs to cheaper locations as capital that had been stored in the euro gets reallocated to the new Deutsche mark. The economy as Germany knows it today would not survive, but it would still fare better than the country's political reputation, which would be shattered by the dismantling of the EU's most ambitious project.

For a country that prizes stability above all else in economic matters, further debate should be superfluous.

The trouble for Ms. Merkel is this: If you know all this to be true, how do you stop your counterparts from gaming you? Just as importantly, how do you do that while persuading panicky financial markets to keep their heads?

What's News

■ **Severe flooding** in Australia has interrupted coal production, pushing up prices and threatening to constrain world-wide steel output and drive up steel prices in some parts of the world. 17

■ **U.K. manufacturing** grew at its fastest rate in 16 years last month, adding weight to indications the nation's economic recovery is picking up pace. But other figures provided a more cautious view. 6

■ **The Fed believes** a stronger U.S. economy is one reason for the rise in government bond yields, which may undermine its efforts to keep the recovery going. 8

■ **Spanish builder ACS** said it now owns a 30.34% stake in Hochtief, topping a key shareholding threshold in its battle to acquire the German construction firm. 17

■ **GM said** its U.S. auto sales rose 8% in December, while Ford's increased 3.5% and Chrysler's climbed 16%. 19

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Fiscally stronger

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NEWS

New Chinese stealth jet is revealed

BY JEREMY PAGE

BEIJING—The first clear pictures of what appears to be a Chinese stealth fighter prototype have been published online, highlighting China's military buildup just days before U.S. Defense Secretary Robert Gates heads to Beijing to try to repair defense ties.

The photographs, published on several unofficial defense-related websites, appear to show a J-20 prototype making a high-speed taxi test—usually one of the last steps before an aircraft makes its first flight—according to experts on aviation and China's military.

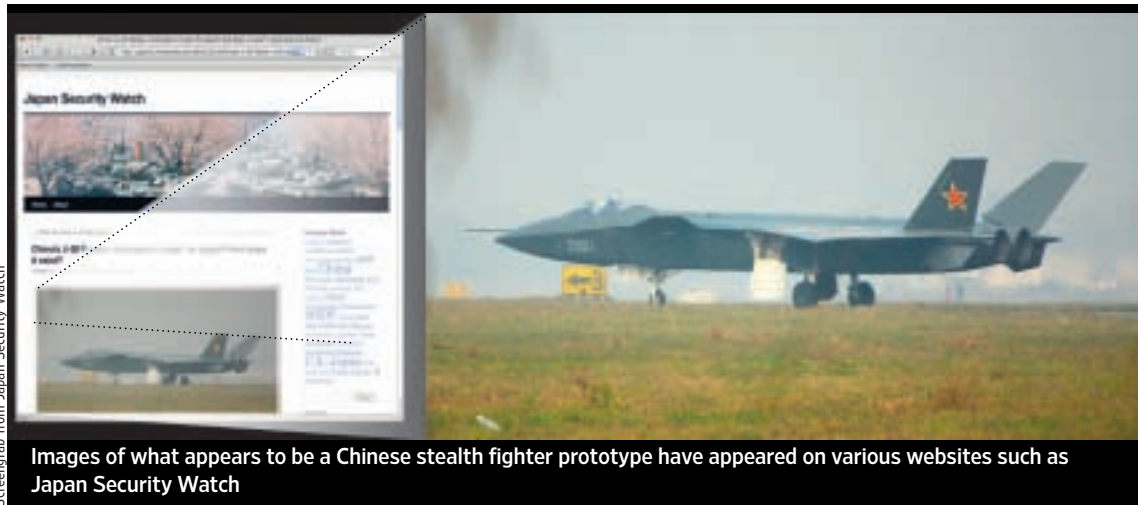
The exact origin of the photographs is unclear, although they appear to have been taken on or around the Chengdu Aircraft Design Institute, where the J-20 is in development, in western China. A few experts have suggested that the pictured aircraft is a mock-up, rather than a functioning prototype of a stealth fighter—so-called because it is designed to evade detection by radar and infrared sensors.

But a majority of experts consulted say they believe the pictures and the aircraft are authentic, giving the strongest indication yet that Beijing is making faster-than-expected progress in developing a rival to the U.S. F-22—the world's only fully operational stealth fighter.

China's defense ministry and air force couldn't be reached to comment about the latest photos.

Even without official confirmation, however, the photographs are likely to add to concerns among U.S. officials and politicians about China's military modernization, which also includes the imminent deployment of its first aircraft carrier and "carrier-killer" antiship ballistic missiles.

Such weapons systems would significantly enhance China's capability to hinder U.S. intervention in a conflict over Taiwan, and would challenge the naval supremacy the



Images of what appears to be a Chinese stealth fighter prototype have appeared on various websites such as Japan Security Watch

Heightened tensions

Military disputes between Beijing and Washington in 2010

- **January** China suspends military ties over U.S. arms sales to Taiwan
- **March** China refuses to blame North Korea for sinking of South Korean ship
- **July** China protests after Hillary Clinton says U.S. has national interest in South China Sea
- **September** China angered by perceived U.S. support for Japan in row over disputed islands. U.S. House of Representatives passes

bill authorizing action against China's currency manipulation

- **October** U.S. congratulates Liu Xiaobo, jailed Chinese dissident, for winning the Nobel Peace Prize
- **November** China refuses to condemn North Korea for artillery raid on South Korea. U.S. sends aircraft carrier to joint military exercises with South Korea in Yellow Sea
- **December** U.S. again expresses support for Liu Xiaobo ahead of Nobel ceremony. U.S. moves two more aircraft carriers to the region

U.S. has enjoyed in the Asia-Pacific region since 1945.

Gen. He Weirong, deputy head of China's Air Force, announced in 2009 that China's first stealth fighters were about to undergo test flights and would be deployed in "eight or 10 years." But there was no clear physical evidence of their existence until the latest photographs emerged.

Chinese authorities who closely monitor Internet traffic in the country appear not to have tried to block the J-20 pictures, even though they appear to have been taken from on or around a highly sensitive defense industry facility.

"The photos I've seen look genuine," said Gareth Jennings, aviation desk editor at Jane's Defence Weekly.

"It's pretty far down the line," he said. "The fact that its nose wheel is off the ground in one picture suggests this was a high-speed taxi test—that usually means a test flight very soon afterwards."

Other experts who said they thought the photographs were authentic included Andrei Chang of the Canadian-based Kanwa Asian Defence Monthly, and Richard Fisher, an expert on the Chinese military at the International Strategy and Assessment Center in Washington.

Several experts said the prototype's body appeared to borrow from the F-22 and other U.S. stealth aircraft, but they couldn't tell from the photographs how advanced it was in terms of avionics, composite materials or other key aspects of stealth technology.

They said China was probably several years behind Russia, whose first stealth fighter, the Sukhoi T-50, made its first flight in January 2010, but Beijing was catching up faster than expected.

The U.S. cut funding for the F-22 in 2009 in favor of the F-35, a smaller, cheaper stealth fighter that made its first test flight in 2006 and is expected to be fully deployed by

around 2014.

The F-22 has mainly been used for exercises and operations around U.S. airspace, but some have been deployed to Guam and Okinawa to help maintain the U.S. security umbrella in the Asia-Pacific region.

The Chinese prototype looks like it has "the potential to be a competitor with the F-22 and to be decisively superior to the F-35," said Mr. Fisher. The J-20 has two engines, like the F-22, and is about the same size, while the F-35 is smaller and has only one engine.

The apparent progress in China's stealth-fighter program has implications also for Japan, which is considering buying F-35s, and for India, which last month firmed up a deal with Russia to jointly develop and manufacture a stealth fighter.

The photographs throw a fresh spotlight on the sensitive issue of China's military modernization just as Washington and Beijing try to set relations on a more positive course.

The two countries clashed last year over issues including the value of the Chinese currency, China's territorial claims, U.S. arms sales to Taiwan and vocal U.S. support for a jailed Chinese dissident who won the Nobel Peace Prize.

The U.S. was also frustrated by China's refusal to condemn two North Korean attacks on South Korea, while Beijing was angered by a U.S. decision to respond to the second attack by sending an aircraft carrier to take part in joint naval exercises with Seoul in the Yellow Sea.

Mr. Gates is due to begin a long-delayed visit to Beijing on Sunday—almost exactly a year after China suspended military ties in protest over U.S. arms sales to Taiwan. China's President Hu Jintao is then due to begin a state visit to the U.S. on Jan. 19.

Mr. Hu needs to avoid appearing weak or provoking further diplomatic crises in the run-up to a leadership change that is due to start in 2012, diplomats and analysts say.

India and Iran try new conduit for oil sales

BY RAKESH SHARMA AND JAY SOLOMON

NEW DELHI—Days after India's government clamped down on the main conduit Indian companies use to pay for Iranian oil, New Delhi and Tehran have opened a temporary channel for transactions, a senior Indian official said Tuesday—one that involves routing payments through an Iranian bank that is already under U.S. sanctions.

India's move essentially exchanges one poison for another and could place Indian firms at loggerheads with the U.S. legal system. Under new U.S. legislation enacted in July, any foreign firm dealing with Iranian entities sanctioned by Washington could also find themselves banned from conducting business inside the U.S.

The U.S. Treasury blacklisted Hamburg-based European-Iranian Trade Bank AG Bank in September, saying it provided a financial lifeline to Iranian companies that it alleges support weapons proliferation.

"India is finding how difficult it's becoming to do business with Iran globally," said Avi Jorisch, a former Treasury official who has tracked the Iranian bank. "The number of leg-

itimate channels are constricting."

The clock has been ticking for India to find ways to pay for critical supplies of crude oil from Iran. Last week, India's central bank, the Reserve Bank of India, said all trade-related payments with Iran had to be processed outside the Asian Clearing Union, a trade-finance clearinghouse through which Iran does most of its business with India.

The Obama administration has raised its concerns with India about the Clearing Union, due to fears Iran has used it to shield its companies from U.S. sanctions.

The senior Indian official told reporters Tuesday that Iran's state-owned National Iranian Oil Co. sent a letter to Indian oil companies saying payments to Iran could be routed through a euro account the European-Iranian Trade Bank, known as EIH Bank.

EIH isn't subject to sanctions by the United Nations or the European Union. But in September, the U.S. Treasury blacklisted the bank, barring it from conducting any business inside the U.S. and freezing any assets it holds in the American financial system. Indian firms dealing with the bank could face the same penalties under new U.S. legislation

passed into law by President Barack Obama in July.

The senior Indian official said Tuesday that Indian oil companies wouldn't themselves open accounts at EIH. Rather, he said, the government has advised oil companies to open individual accounts with government-owned State Bank of India—India's largest lender—which has a branch in Frankfurt. State Bank of India, in turn, would open an account with EIH through which oil firms could make payments to Iran, the official said.

That arrangement would appear to place State Bank of India in a vulnerable position. The huge lender has branches in New York, Chicago, Los Angeles and Washington, which could all be affected by the U.S. legislation. American banks holding corresponding banking relationship with the State Bank of India could also potentially be affected.

State Bank of India couldn't be reached to respond to questions about the arrangement and how it was reached.

The National Iranian Oil Co. and the Iranian central bank couldn't be reached to comment.

A spokesman for EIH in Germany said the Iranian bank "continues to



Bullock carts haul oil in Mumbai, India said Tuesday Iran oil would keep flowing.

handle banking transactions." He declined to discuss details of the Iran-India transactions or the U.S. sanctions against the bank. In the past, EIH has denied any violations of German law or sanctions.

In an email to The Wall Street Journal, a spokesman for the German Ministry of Economics said EIH operates "under special strict controls of its oversight agencies."

EU investigators are currently sifting through years of EIH banking

transactions to check for possible violations, a person familiar with the matter said.

Describing the payment mechanism announced Tuesday as a stop-gap matter, the senior Indian official said a delegation of Indian officials will be visiting Tehran in mid-January to discuss a longer-term oil-payment mechanism.

—Subhadip Sircar in New Delhi and David Crawford in Berlin contributed to this article.

EUROPE NEWS

Swedish exporters brace for krona rise

By CHARLES DUXBURY
AND SVEN GRUNDBERG

STOCKHOLM—With Sweden's central bank set to keep pushing interest rates higher, the country's exporters are growing nervous that their already highflying currency will rise too high for their comfort.

The Riksbank is expected to continue tightening monetary policy in 2011, indirectly widening the difference between Swedish interest rates and the European Central Bank rate. As the gap between those two rates increases, demand for the krona should continue to grow relative to the euro, making Swedish products more expensive in a market where it sends 75% of its exports.

"I think the Riksbank is about to carry out a dangerous experiment," said Mauro Gozzo, chief economist at the Swedish Trade Council, which helps Swedish companies do business overseas. "It seems we are about to get [a bigger] interest rate differential, and we don't know where that will lead."

The krona reached its strongest level against the euro since 2006 at the end of 2010, as the Riksbank raised rates four times in the second half owing to its strong economic recovery from the financial crisis. In the opening trading days of 2011, the euro is trading just below 9.0 kronor.

Nordea, Sweden's biggest bank, predicts the Riksbank will continue to increase the repo rate in 2011, with 0.25-percentage-point increases in February and again in April, bringing the rate to 1.75%. That would put the rate significantly above the European Central Bank's benchmark rate of 1%, and analysts are scrambling to raise their targets for the krona as a result. **Skandinaviska Enskilda Banken** now predicts that the euro will sink to 8.85 kronor by the middle of



Agence France-Presse

this year, and 8.75 kronor by the end of the year.

A 12% strengthening of the krona last year already has some of Sweden's industrial companies thinking about how their earnings might be hit. In its annual report last year, ball-bearing maker **SKF AB** said a 5% strengthening of the krona against major currencies such as the euro would knock around 250 million kronor off its earnings.

The company, which last year posted a third-quarter operating profit of 2.3 billion kronor (\$342 million), has forecast that negative currency effects will hit its fourth-quarter operating profit by approximately 50 million kronor. "For 2011, we have said that there could be a negative effect from currency [im-

pacts] on the operating result of between 600 million and 700 million kronor," said Marita Bjork, SKF's head of investor relations.

Truck maker **Scania AB** said it also sees the stronger krona hurting its results. "We have a lot of production in Sweden and a lot of costs in krona, so long term, a stronger krona against the euro is bad for us," said Per Hillstrom, the company's head of investor relations. "We are competing with companies like **Daimler AG** whose costs are more denominated in euros."

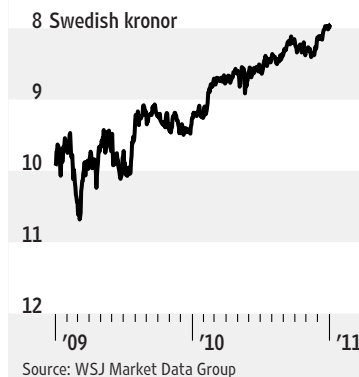
Still, in the third quarter Scania's currency loss was only 20 million kronor, largely thanks to the strength of the Brazilian currency, since Brazil was Scania's largest market by sales in the third quarter.

Another potential victim of a stronger krona is the tourism industry, as tourists begin shying away from an increasingly expensive Sweden. Dan Bjork, director of sales and marketing at the **Ice Hotel** in Jukkasjarvi, said he is talking to his biggest clients about how the changing exchange rate will affect them. "In the end it can probably make us think twice before raising prices, so it is going to affect us," Mr. Bjork said.

The krona's ascent isn't all bad news, say some observers. Hans Tson Soderstrom, professor at the Stockholm School of Economics, argues that a stronger krona is a "welcome development" that will help to hold back inflation by, among other things, suppressing exporters' profit

The climbing krona

How many Swedish kronor one euro buys, scale inverted



A just married couple leave the chapel of the ice hotel in Jukkasjarvi. About 150 couples are married each winter before the ice structure melts away.

growth.

To help soften the blow from a strong currency, many Swedish companies have already engaged in hefty outsourcing of production to low-cost countries in recent years, a move that serves as a natural hedge when the krona appreciates. As an example, home-appliance maker **Electrolux AB**, which has 55% of its production in low-cost countries such as Hungary and Mexico, said it isn't particularly concerned about movements of the Swedish currency.

Local production and distribution in foreign markets also acts as a natural hedge for Swedish engineering firm **Atlas Copco AB**, Chief Executive Ronnie Leten said during the company's capital markets day in December.

Spanish judge summons Iraqi

A Spanish judge summoned an Iraqi military commander, who is accused of having directed a 2009 assault on a camp in Iraq holding Iranian opponents of the Tehran government for questioning, over charges of breaching the Geneva Convention.

By David Roman in Madrid
and Ali A. Nabhan
in Baghdad

A representative for Spain's National Court said Tuesday that a writ signed by Judge Fernando Andreu summoned Abdul-Hussein Shemmari, now a major general, to appear before the court March 8 to answer questions about his alleged role in the attack on the Ashraf refugee camp.

The attack, which followed sustained pressure from Iran on the Baghdad government to close the camp, left 11 people dead and 450 wounded.

The summons is the latest in a series of controversial summons by Spanish judges applying the "universal justice" principle to take on international cases.

Spanish law enshrines the doctrine of universal justice, under which crimes against humanity alleged to have taken place anywhere can be tried in its courts. In prac-

tice, government prosecutors have sometimes tried to rein in the country's judges, who have unsettled Spanish diplomats by taking up controversial cases involving events from China to Israel.

Gen. Shemmari, 57 years old, has been police chief of Diyala, the province northeast of Baghdad in which Ashraf is located, since September 2008.

Reached by telephone in Baquba, the capital of Diyala, Gen. Shemmari said he had nothing to do with the assault. "I was not present at the scene of the clashes and I challenge anyone who says so," he said.

Gen. Shemmari said he knew nothing of the summons. Asked whether he would go to Spain, he said: "I did nothing wrong. Why should I go?" He said he wouldn't appear before the court unless ordered to by the Iraqi authorities.

A statement from the chief lawyer in the case, Juan Garcés, said Gen. Shemmari worked during the operation under the supervision of a committee responsible to Prime Minister Nouri al-Maliki.

Mr. Maliki himself, who has the support of the Tehran government, isn't accused or cited in the court summons.

Iraqi government spokesman Ali al-Dabbagh couldn't be reached to comment.

The Ashraf assault targeted members of the Mujahedin-e-Khalq, a group classified as terrorist organization by the U.S. that has opposed the Iranian regime for decades.

According to the Spanish investigation, the assault—conducted by 2,000 soldiers against unarmed civilians—was in breach of the Geneva Convention provisions for the protection of civilians during wartime.

The summons is the latest in a series by Spanish judges applying the 'universal justice' principle.

Mr. Garcés, a combative attorney who was a force behind the 1998 indictment of late Chilean strongman Augusto Pinochet by Spanish Judge Baltasar Garzón, said this was the first time that an Iraqi official had been summoned before a court for serious violations of international law.

The MEK said in a statement that the summons made the resumption of U.S. military protection of the camp "unavoidable" and indicated a United Nations monitoring mission was needed.

Italy presses Brazil over fugitive case

Associated Press

ROME—Italy stepped up pressure on Brazil on Tuesday to reverse a decision not to extradite Cesare Battisti, with new EU diplomatic efforts, protests outside Brazil's embassy, and a meeting between the Italian premier and the son of one of the fugitive rebel's alleged victims.

Prime Minister Silvio Berlusconi stressed diplomatic relations with Brazil remain unchanged. But after meeting with Alberto Torregiani, whose father was killed in 1979, Mr. Berlusconi said Italy considers the Battisti case a matter of justice that it will pursue at all levels.

Brazil, however, reaffirmed its decision and warned the EU not to get involved.

Mr. Battisti, a former leftist rebel, was convicted in absentia of four murders carried out in the late 1970s. He lived as a fugitive in Mexico and France before fleeing in 2004 to Brazil, where he was arrested in 2007 on an Interpol warrant. Mr. Battisti has admitted to participating in a rebel group but has denied he ever shot anyone.

On his last day in office Dec. 31,

Brazilian President Luiz Inacio Lula da Silva refused to extradite Mr. Battisti, who has repeatedly said he fears persecution if sent back to Italy.

Italy has denounced Mr. da Silva's decision and said it would pursue all judicial means in Brazil to reverse it; the Brazilian Supreme Court is to rule on the legality of Mr. da Silva's decision.

On Tuesday, Italy's government indicated it was taking the matter to the European Union. Foreign Minister Franco Frattini met with Italy's recalled ambassador to Brazil and Italy's EU representative to study legal options at the European level to pressure Brazil to turn Mr. Battisti over, the Foreign Ministry said.

But it wasn't clear what the EU could do.

"It is basically a bilateral issue," said European Commission spokesman Michael Mann, adding that rules on extradition also made it difficult for the EU to get involved.

The Foreign Ministry disputed that, saying: "The case is far more complex and one cannot exclude, including in the coming hours, a European initiative proposed by Italy on the question."



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EUROPE NEWS

U.K. manufacturing surges, but warning signs abound

LONDON—U.K. manufacturing expanded at its fastest rate in 16 years in December, adding weight to indications that the country's economic recovery is picking up pace.

By Ainsley Thomson,
Natasha Brereton
and Nicholas Winning

But other figures also released Tuesday provided a more cautious view. The Bank of England said money-supply growth accelerated only slightly in November and net consumer lending was weaker than expected despite a rise in the number of loans approved for house purchases.

Overall, the data support the view that the next BOE move is more likely to be an interest-rate increase than an extension of stimulus. Still, the central bank is expected to keep policy on hold for some months, until a clearer need emerges for action.

The purchasing-managers index for the manufacturing sector rose to 58.3 in December from 57.5 in November, said Markit Economics and the Chartered Institute of Purchasing and Supply. December's figure is the highest since September 1994. A reading above 50 indicates the sector is expanding, while a reading below 50 indicates it is contracting.

The unexpectedly strong manufacturing PMI figure saw sterling rise to \$1.5591 against the dollar from \$1.5473 late in New York on Monday, while the euro lost ground against the pound, falling to 85.38 pence from its opening level Tuesday of 86.28 pence.

But the BOE figures showing that the housing market remains subdued tempered the robust manufacturing data. Banks and other financial institutions approved 48,019 mortgages for home purchases in November, up from an eight-month low of 47,315 in October and the highest total since July. Still, the number of approvals remains lower than the 59,019 seen in November 2009 and the previous six-month average of 48,145.

Net lending to individuals slipped to £668 million (\$1.04 billion) in November from £1.5 billion in October, and lagged behind economists' predictions of £1.1 billion. The struggling housing market, coupled with the low level of mortgage approvals, is a sign that residential property prices could fall further, economists



A Sainsbury's employee loaded pallets at the retail chain's depot in Waltham Abbey, England, last month.

said.

Other data released by the BOE on Tuesday were also less encouraging. The BOE's preferred measure of broad money supply picked up only modestly in November, with the pace of growth remaining weak, underscoring the likelihood that the central bank will keep policy on hold for some time.

The figures showed that broad money supply, excluding those financial institutions whose activities distort underlying trends, rose 3.5% in November in three-month annualized terms, stronger than 2.7% in October.

"Although the pace [of money-supply expansion] is probably just under half the pace we would hope to see in 'normal' conditions, we suspect the Bank of England will take comfort from the fact that the growth rate is moving in the right direction—at least on the headline measure," said Alan Clarke, U.K. economist at BNP Paribas.

The BOE suspended its £200 billion policy of quantitative easing—buying U.K. government bonds with freshly created central bank money—in February 2010, but it has left open the possibility of restarting it if conditions deteriorate. Monetary Policy Committee member Adam Posen has voted for further stimulus at recent meetings, while

Picking up steam

Purchasing-managers index for the U.K.'s manufacturing sector



Source: Markit

Andrew Sentance has called for modest policy tightening.

In a rather ominous sign, the PMI survey also recorded an increase in average input costs, with manufacturers in sectors such as clothing, food products and chemicals hit hard by demand exceeding supply for certain input products, as well as rising energy costs.

"The hawks on the Bank of England's Monetary Policy Committee will be further unnerved by these rising price pressures," said Rob Dobson, senior economist at Markit.

Meanwhile, a survey by Citi and pollsters YouGov published Tuesday showed the inflation expectations of the U.K. public rising to two-year highs in December as price growth remained strong.

Average annual inflation expectations for the year ahead were 3.5% in December, up from 3.3% in November and the fastest rate of growth since September 2008. Five- to 10-year expectations also posted their highest rate since May 2008, increasing to 3.8% in December from 3.5% in November.

Andrew Goodwin, senior economic adviser to the Ernst & Young ITEM Club, said the PMI figure provided confidence for a firm reading for fourth-quarter gross domestic product. Manufacturing output accounts for 12.8% of U.K. GDP.

"The pace of growth may slow a little, given that we cannot rely on construction to keep contributing in the way it has done recently, but the recovery appears to have some good momentum behind it," he said.

While December's figures show the manufacturing activity is growing steadily, the sector faces a number of challenges in 2011 as the government implements the bulk of its spending cuts and tax increases.

—Laurence Norman and Paul Hannon in London contributed to this article.

The EU's shrinking rotating presidency

[Brussels Beat]

By JOHN W. MILLER

Is the golden age of the European Union's six-month rotating presidency over? Thirteen months into the Lisbon Treaty, which was supposed to downgrade the role of the rotating presidency, that seems to be happening.

Witness Belgium, whose turn at the top ended last week. Eurowatchers say the Belgian presidency was a success, as seemed likely at its halfway point. Among other things, it successfully oversaw negotiations on a 2.9% increase in the EU budget, hedge funds, financial supervision, a continental patent system and the signing of a free-trade deal with South Korea.

And yet, few noticed. On the dominant issue over the past half-year, the European debt crisis, Belgium was seldom heard.

"In a way, the Germans had the presidency," says Katinka Barysch of the Centre for European Reform in London.

Expectations are low for the presidency of Hungary, which took over Jan. 1. Its program is based on a number of small, focused items such as improving the lives of Roma.

The expansion of the EU to 27 members and the expanded Lisbon Treaty powers of the European Parliament have marginalized the rotating presidency. "The euro crisis accentuated the existing trend" of weaker and weaker presidencies, says Ms. Barysch.

Expectations are even lower for Hungary, which took over on Jan. 1. It's a non-euro nation that has come under the threat of sanctions for a controversial new law that allows the government to fine media outlets for coverage that violates moral order. It can also force reporters to reveal their sources. The EU is also investigating the legality of special "crisis" taxes on certain industrial sectors, against which some big European companies have complained.

Hungary's presidency program is based on a number of small, focused items such as improving the lives of Europe's Roma population and building a single energy market. Expect another subdued presidency, say analysts.

After Hungary come two more non-euro countries, Poland and Denmark, then four small EU members—Cyprus, Ireland, Lithuania and Greece, two of which are euro-zone bailout "beneficiaries."

It isn't until July 2014 that one of Europe's Group of 20 members, Italy, takes the helm.

Inflation puts new pressure on ECB

Continued from first page
tion is closer to 1%. But risks of a prolonged rise in prices are mounting. Cold weather has pushed up energy and food prices, and a revival in global growth could keep commodity prices elevated for some time. Consumption taxes in parts of Europe may lead to higher wage demands, while in Germany a robust economy is giving workers their strongest bargaining position in years. Despite a small rise in unemployment last month—the first since June 2009—German unemployment remains near 7%, among the lowest

in Europe.

As a result German unions, who at the height of the crisis traded wage gains for job security, are demanding steeper wage increases to offset the rise in prices. German inflation rose last month to a 26-month high rate of 1.9%, according to regional data released last week.

It isn't just countries on sound economic footing that face rising wages and prices. On Monday, Spain reported that inflation closed the year at 2.9% despite that country having an unemployment rate above 20%, reflecting higher tobacco and

household-power prices and a value-added tax-rate increase that became effective in July.

The usual response by central banks to such risks would be to tap the brakes by raising interest rates or withdrawing other stimulus. Germany, France and other big economies could handle higher rates, but they would cripple vulnerable countries in Southern Europe and Ireland by driving up already high debt costs, economists warn.

That will keep the ECB under pressure to deliver more stimulus, not less, despite higher inflation.

The ECB has already bought €73.5 billion (\$97.93 billion) in government bonds of Greece, Portugal and Ireland since May. Many economists say that with Portugal and Spain likely to come under pressure in coming weeks as they issue billions of euros in new government bonds, the ECB will have to step up those purchases even more. "The ECB needs to ensure that the euro area hangs together to start with; there are bigger issues at hand" than inflation, says Mr. Callow.

—David Roman contributed to this article.

U.S. NEWS

House Republicans set to take over

As parties brace for new health-care brawl, incoming GOP leader cites tax overhaul as possible area of cooperation

BY NAFTALI BENDAVID
AND COREY BOLES

WASHINGTON—A House Republican leader said Tuesday that an overhaul of the U.S. tax code was a policy goal his party could work with Democrats to achieve.

Rep. Eric Cantor (R., Va.), who will become majority leader when Republicans assume control of the House Wednesday, said changes to the tax code could be “a significant boost” to U.S. competitiveness.

Mr. Cantor said Republicans would be looking at President Barack Obama’s State of the Union Address and subsequent budget request to see what ideas he has about changes to the tax code.

House Republicans have already announced that they plan to vote Jan. 12 on a repeal of the health-care law, which they have called an example of federal overreach.

As Mr. Cantor outlined areas of possible cooperation, the two parties were preparing to do battle once again over health care.

House Republicans have already announced that they plan to vote Jan. 12 on a repeal of the Democrats’ new health-care law, which the GOP has called an example of federal overreach. But their chances of success seemed remote as Democrats retained a majority in the Senate and hold the White House.

Departing House Speaker Nancy Pelosi and other Democratic leaders said Tuesday they would be willing to work with Republicans on areas of agreement, but would fight attempts to undo the health-care overhaul and other legislation enacted by Democrats over the past

two years.

The Democrats also criticized Republicans for using what they portrayed as budget gimmickry to circumvent promises to reduce the deficit.

Rep. John Boehner (R., Ohio), who is expected to be elected speaker on Wednesday, has announced the GOP’s intention to cut discretionary spending to 2008 levels, which would save \$100 billion a year. But GOP leaders have so far detailed only a limited set of spending cuts.

Rep. Greg Walden (R., Ore.), who heads Mr. Boehner’s transition team, announced Tuesday that by cutting the budget of House offices by 5%, lawmakers would save \$35 million in the first year.

That is a small fraction of government spending, but Mr. Walden argued it was a case of leading by example.

“While only a first step, these cuts provide real savings,” Mr. Walden said, calling it a “first installment” of the savings the GOP will produce.

Democrats on Tuesday noted that the health-care law Republicans want to repeal was estimated to save about \$138 billion over the next 10 years.

Democrats also listed what they saw as the most popular elements of the health law, such as the prohibition on insurance companies denying coverage to children due to pre-existing conditions.

As lawmakers prepared to be sworn in Wednesday for the new Congress, Republicans used symbolism to underscore their message about limiting the federal government’s reach.

Chief Justice John Roberts swore in Mr. Boehner’s staff in a private ceremony Tuesday on Capitol Hill.

By inviting Mr. Roberts, Mr. Boehner was signaling his intent to adhere to the Constitution when he becomes speaker.



Ohio Rep. John Boehner, right, who will become House Speaker Wednesday, with Rep. Greg Walden in November.

The notion that government has strayed from the Constitution has been a big argument of tea-party activists and Republicans were making an effort to show they agreed.

On Thursday, lawmakers will read the Constitution on the House floor, and Republicans are adopting a rule that every law must state the constitutional authority on which it rests.

The ceremonial rituals of a new Congress will unfold Wednesday, though Mr. Boehner’s office has said

he intends to restrain the pomp, given the country’s economic struggles.

After new members are sworn in and Mr. Boehner is elected as speaker, he will be escorted to the chamber, where Ms. Pelosi will hand him the gavel.

Rep. Darrell Issa (R., Calif.), the incoming chairman of the House Committee on Oversight and Government Reform, said Tuesday that he had sent a letter to more than 150 companies, trade associations

and think tanks, asking what regulations had hurt their ability to create jobs.

Democrats criticized the move as an early sign Republicans were catering to big business at the expense of middle-class Americans.

“House Democrats will continue to protect the gains we have made in terms of health and economic security of the American people,” Ms. Pelosi said.

—Janet Hook
contributed to this article.

Obama can’t count on support in Senate

BY JANET HOOK

The Senate is the Democratic bastion of power in the new Congress, but it will be a sometimes-shaky platform for President Barack Obama’s agenda as lawmakers in his own party prepare for re-election bids next year.

An unusually large group of 23 Democrats must defend Senate seats in 2012, many in conservative and swing states such as Nebraska, Missouri and West Virginia. Republicans, by contrast, will defend only 10 Senate seats.

Many of the Democrats were first elected in a far different climate four years ago, when then-President George W. Bush was losing favor and an anti-GOP windstorm swept Democrats into office. Now facing different political currents, some Democratic senators are taking steps to chart a course independent of Mr. Obama, to appeal to political independents and fiscal conservatives.

The president, for example, is pushing legislation to allow some children of illegal immigrants to become citizens. That appeals to La-

tino voters. But when the bill came up in December, senators blocking it included Democrats Jon Tester of Montana, Ben Nelson of Nebraska and Joe Manchin of West Virginia. Mr. Obama has pledged to try again.

The White House will try to craft a tight federal budget, but swing-state Democrats might demand even deeper spending reductions. Sen. Claire McCaskill (D., Mo.) last year led efforts to cut \$30 billion from Mr. Obama’s 2011 budget request.

Democrats facing re-election in economically struggling states such as Ohio and Michigan have said they would fight the White House’s trade-liberalization pact with South Korea, potentially undercutting the president over a major economic issue.

In the November elections, Democrats lost their majority in the House and six Senate seats, bringing their ranks well below the 60 votes it usually takes to pass major legislation in the Senate. The new Senate will have 47 Republicans and 53 Democrats and allied senators.

Democrats from conservative and swing states aren’t likely to coalesce and vote as a bloc, but their

fate as a group in the 2012 election will make or break the party’s ability to retain or expand their narrow Senate majority.

They include Jim Webb of Virginia, whose home state ousted three Democratic congressmen in 2010, and Bob Casey of Pennsylvania, where the governor’s office and a Senate seat switched to the GOP. In Ohio, where Sen. Sherrod Brown faces re-election, Democrats last year lost control of the governor’s office and five House seats.

Ms. McCaskill of Missouri barely won election to the Senate in 2006 with the political winds blowing at her back. A close ally of Mr. Obama, she is facing re-election at a time when more than half the voters in her state disapprove of the president, according to recent polls.

In a television interview after the November election, Ms. McCaskill was asked how her support for the pillars of the Obama agenda—health care, economic stimulus and Wall Street regulation—squared with her efforts to portray herself as a political independent. Ms. McCaskill briskly countered with a list of issues on which she and the president

differ: immigration, environmental measures and “cash for clunkers.”

There will be broad swaths of policy on which Mr. Obama and fellow Democrats share political interests heading into the 2012 election, especially in seeing the economy rebound. But Republicans are hoping that swing-state Democrats will be less inclined to hold to the party line on other issues, such as GOP efforts to repeal parts of the new health-care law or to make spending cuts.

“They are going to look over their shoulders at their own re-election prospects,” said Sen. John Cornyn (R., Texas), chairman of the National Senatorial Campaign Committee.

Senate Republican Leader Mitch McConnell said just after the mid-term elections that he expected to see more Democrats “peel off” from their party. “Every one of the 23 Democrats up [for re-election] in the next cycle has a clear understanding of what happened Tuesday,” he said.

Mr. Casey said Pennsylvania voters would judge him independently of Mr. Obama, and he shrugged off suggestions that he would be any more inclined to vote with Republi-

cans now. “I don’t think I buy that theory,” he said. “I don’t think a candidate can vote a certain way for four years of a term and then for the last two terms start teaming with Mitch McConnell and expect voters not to notice.”

Sen. Charles Schumer (D., N.Y.), a senior party leader, is planning to intensify leadership efforts to frame floor debates with an eye to the needs of Democrats up for re-election.

One example of how that might work—and how it might conflict with White House goals—came during last month’s tax-cut debate. Mr. Obama initially held fast to his proposal to extend tax breaks only for families with income up to \$250,000. Mr. Schumer pushed an alternative that would have allowed tax breaks for family income up to \$1 million.

Among other reasons, Mr. Schumer believed the higher limit was more palatable to small businessmen, who are especially important to vulnerable Democrats. In a deal with Republicans that resolved the issue, tax cuts were extended for people at all income levels.

U.S. NEWS

New York packs in tourists

By MICHAEL HOWARD SAUL

NEW YORK—New York City drew a record 48.7 million visitors last year, marking a 6.8% increase from 2009 and giving a strong signal that the tourism industry is rebounding from the downturn caused by the global recession, Mayor Michael Bloomberg said Tuesday.

Preliminary records show the tourism growth is fueled, in part, by a record number of international visitors flocking to the five boroughs. In 2010, 9.7 million international visitors spent time in the city, an increase of almost 13% from the previous year.

"We are glad to extend our hospitality to every visitor," Mr. Bloomberg said at a news conference at the Brooklyn Botanic Garden. "But we certainly love international visitors because they spend, on average, 3½ times what domestic visitors do."

New York City is the destination for roughly one-third of overseas visitors to the U.S., making the city by far the most popular overseas destination in the country, Mr. Bloomberg said. Miami and Los Angeles, by comparison, were tied as the second most popular destination for international visitors, each attracting about 11% of the market share.

The preliminary numbers represent a turnaround for the tourism industry in New York City, which has suffered recently because of the dramatic downturn in the economy.

In 2009, the number of tourists declined 2.9%, to 45.6 million, and visitor spending plunged 12%, to \$28.2 billion, compared with 2008.

In 2010, tourists spent an estimated \$31 billion in the city, a nearly 10% jump from 2009. A major part of that increase, officials said, is fueled by the city's arts and culture scene.

So far this season, Broadway attendance is above 7.55 million, up 3.8% from this point last season.

Attendance at museums and cultural institutions, which generates \$18 billion in annual tourism spending, increased 5% last year. The world-famous Metropolitan Museum of Art and Museum of Modern Art both set attendance records last year.

"The strength of our tourism industry is one of the reasons New York City was less impacted by the national recession than other cities, and it continues to be one of the reasons we're growing faster than



New York's Times Square. The city's tourism growth is fueled in part by a record number of international visitors.

other cities," Mr. Bloomberg said.

Officials said the city remains on pace to meet its goal of attracting 50 million visitors a year by 2012.

To better attract international visitors, the city has created a network of 18 international offices that allow officials to promote New York as a tourism destination. In recent years, the city spent money on outdoor ads in countries such as Italy, Spain and Brazil.

"When the national recession hit, many worried if New York City could attract visitors in the numbers it had become used to," said Robert Steel, deputy mayor for economic development. "We've put in place a series of global marketing programs to showcase New York City and attract visitors, and it's clear that those efforts continue to pay off."

For Mr. Bloomberg, the record-breaking tourism numbers come at an opportune time. New Yorkers have spent the past week heaping criticism on the mayor for the city's sluggish response to a major snowstorm that left many of the city's streets impassable for days.

Mr. Bloomberg dismissed the notion that the media coverage surrounding the city's inadequate response to the snowstorm will have any impact on tourism. "Most of

Big Apple, big draw

New York City attracted a record 48.7 million visitors in 2010, up 6.8% from 2009. European visitors by country or region

	Number of visitors	Change from previous year
U.K.	1,095,000	0.6%
Germany	588,000	3.5
France	548,000	5.5
Italy	458,000	6.3
Scandinavia	436,000	9.1
Spain	376,000	5.2
Benelux	308,000	0.6
Ireland	167,000	-13.8

Source: NYC & Company

these people, remember, from around the world, around the country, come from cities—they have problems, so they're understanding."

When most visitors think about New York City, they picture Manhattan's skyline, or Broadway or the shops on Fifth Avenue. But Brooklyn Borough President Marty Markowitz boasted that his borough is a popular destination in its own right. En-

gaging in some friendly borough rivalry, he heralded Coney Island, the new Brooklyn Bridge Park and the borough's diverse neighborhoods as key attractions.

"I know it's easy to get caught up in all that Brooklyn has to offer," he said with a smile, "but spare a thought for our brethren across the river: Remember Manhattan is still perfect for a day trip."

Path opens for drilling to resume in the Gulf

By BEN CASSELMAN
AND DANIEL GILBERT

Deep-water drilling in the Gulf of Mexico could resume within weeks under a policy by the Obama administration, which has come under increasing criticism from the oil industry and politicians in the region over the impact of the drilling halt.

Oil and gas exploration in the Gulf's deep waters has been stopped since May, when President Barack Obama announced a six-month drilling moratorium in the wake of the April explosion of the Deepwater Horizon drilling rig, which killed 11 workers and set off the worst offshore oil spill in U.S. history.

The administration lifted the ban in October—a month ahead of schedule—but hasn't issued any permits for new deep water oil wells.

On Monday, The Wall Street Journal reported that the delay has hurt both the oil industry, which has seen billions of dollars in projects put on hold, and the Gulf Coast's economy, which has been hit hard by the slowdown.

The administration said Monday that it would clear the path for 13 companies, including **Chevron Corp.** and **Royal Dutch Shell PLC**, to resume work on a handful of wells that were already approved and under way when the moratorium took effect. The 16 projects must still comply with strict new safety rules announced after the Deepwater Horizon disaster, but in most cases won't be subjected to new environmental reviews.

The announcement means that some drilling could resume in a matter of weeks, although the exact timing remains unclear. But the policy doesn't affect the more than a dozen permit requests that were pending when the moratorium took effect or have been filed since. Those must still undergo enhanced environmental reviews.

Michael Bromwich, director of the Bureau of Ocean Energy Management, Regulation and Enforcement, the newly formed federal agency in charge of offshore drilling, said projects that were interrupted by the moratorium deserved special consideration.

"For those companies that were in the midst of operations at the time of the deep-water suspensions, today's notification is a significant step toward resuming their permitted activity," Mr. Bromwich said in a statement.

Oil companies in recent weeks had become increasingly pessimistic about a quick resumption of drilling in 2011, with some predicting that the wait would last into the second half of the year. On Monday, the industry praised the decision but said more details were needed.

"It appears to be a step in the right direction," Randall Luthi, president of the National Ocean Industries Association, a trade group, said in an interview.

However, he said, "there are still major questions and some confusion among the companies about what is being required."

—Siobhan Hughes
and Tennille Tracy
contributed to this article.

Fed weighs causes of rising yields

By LUCA DI LEO
AND JEFFREY SPARSHOTT

The Federal Reserve believes a stronger U.S. economy is among the reasons behind the rise in government-bond yields, which may undermine its efforts to keep the recovery going via low interest rates.

In minutes of the central bank's Dec. 14 meeting, released with the customary lag on Tuesday, Fed officials offered several explanations for why U.S. Treasury yields have been increasing despite their \$600 billion bond-purchase program.

Investors' lowered expectations for the ultimate size of the program, the improved economic outlook and the impact of the recent tax-cut deal

on the budget deficit were all factors behind the rise in yields, Fed officials said.

Some noted the rise in rates may have even been amplified by year-end positioning.

But despite the improvement in the economy, Fed officials "generally felt that the change in the outlook wasn't sufficient to warrant any adjustments to the asset-purchase program, and some noted that more time was needed to accumulate information on the economy," the minutes showed.

The bond-purchase program was supposed to help the economy by, among other things, keeping borrowing rates low.

But interest rates charged on consumers and companies that bor-

row to spend and invest have actually been rising since the Fed on Nov. 3 announced its plan to buy \$600 billion in government bonds through June 2011.

The yield on the 10-year Treasury note, used as a benchmark for several interest rates, currently stands at about 3.35%, up from 2.48% on Nov. 4.

The U.S. economy's recovery from the severe recession was already gathering pace when the Fed last met three weeks ago. Since then, signs have grown that the job market is improving and President Barack Obama signed a bipartisan tax package into law that is expected to boost the economy further in 2011—at the cost of increasing the budget deficit.

The improved outlook, together with concerns the economy may eventually overheat and bring high inflation, led investors to sell government bonds, bringing lower prices and higher yields.

Critics of the central bank point to the interest-rate increase to say the Fed's strategy isn't working. Fed officials counter in the minutes that bond yields would be even higher without them.

Supporters of the Federal Reserve's policy also note that the bond purchases help the economy in other ways: by driving investors into riskier securities, thus contributing to the rise in stocks, and by keeping the U.S. dollar value against other currencies low, thereby boosting exports.

WORLD NEWS

Pakistani governor is assassinated

By TOM WRIGHT

A leading politician from Pakistan's ruling party was gunned down in a wealthy neighborhood of Islamabad Tuesday by a member of his security detail after speaking out against the country's controversial blasphemy laws, an assassination that highlights the nation's struggle to contain extremism even among those close to the center of power.

Salmaan Taseer, governor of Punjab, Pakistan's most-populous province, and a member of the ruling Pakistan People's Party, died after a member of his security team fired multiple shots into his car at a shopping complex, police said.

His attacker, Malik Mumtaz Qadri, who surrendered to police, admitted he was angered by Mr. Taseer's opposition to the blasphemy laws, Interior Minister Rehman Malik told local television.

Mr. Taseer had become a leading opponent in recent weeks of a court decision in November to sentence a 45-year-old Christian farm laborer, Asia Bibi, to death for blasphemy against the Prophet Muhammad.

The case attracted international attention, with Pope Benedict XVI and human-rights groups calling for her release. Mr. Taseer had attacked the court's decision and recently had been urging supporters on Twitter to take to the streets in protest against the blasphemy laws. His opposition had been condemned by Islamist political parties.

In a Dec. 31 post on his Twitter account, a day before Islamists took to the streets across the country to demand the laws stand, Mr. Taseer wrote: "I was under huge pressure...2 cow down b4...pressure on blasphemy. Refused. Even if I'm the last man standing."

The assassination—the first of a prominent politician since former President Benazir Bhutto was killed by a bomb in 2007—illustrates the difficulties the U.S. faces in attempting to bolster secular elements in Pakistan, a key U.S. ally in fighting Islamist extremists that operate from the border region between Pakistan and Afghanistan and fight both the Pakistani military and U.S. troops across the border. The Pakistan Taliban, an affiliated extremist group to



Agence France-Presse/Getty Images (2)



Malik Mumtaz Qadri sits in a police van in Islamabad Tuesday after admitting he shot Salmaan Taseer, Punjab province's governor, above.

the Taliban in Afghanistan, have regularly attacked Pakistani cities and towns in the past two years.

The U.S. has poured billions of dollars in aid into the effort to dim the appeal of radical Islam among Pakistan's mostly poor population of 180 million people. But Mr. Taseer's assassination by a member of an elite police unit shows how religious extremism pervades even segments of society that are close to the centers of power, a result of decades of official Islamization.

Islamist political groups had called for Mr. Taseer's ouster as governor over his opposition to the blasphemy laws and saw in his stance a Western conspiracy to roll back Pakistan's religious edicts and turn the country into a secular democracy. One party issued an edict condemning Mr. Taseer for blasphemy.

"We tend to draw these neat lines between Islamists and secularists but those lines in daily life in Pakistan are constantly blurred," said Sadanand Dhume, resident fellow at the American Enterprise Institute in Washington.

Pakistan's religious laws were tightened under the rule of Gen. Zia-ul-Haq, a military dictator who oversaw an Islamization of the nation's

institutions such as the army and judiciary in the 1980s.

Since then, Pakistani authorities have charged scores of minority groups under the laws, including at least 50 members of the heterodox Ahmadi Muslim community in 2009, many of whom remain in prison, according to Human Rights Watch. In no cases have the death sentences been carried out, with courts commuting sentences on appeal.

Pakistan's secular politicians have largely failed to unite to combat religious extremism out of fear of sparking a backlash, and in some cases have even courted extremist groups, analysts say.

Officials from the U.S., India and other countries say some elements of Pakistan's military continue to have close ties with Islamist groups, especially those that don't operate inside Pakistan but instead hit targets in Afghanistan and India.

The secular elite, meanwhile, are widely viewed as corrupt by ordinary Pakistanis, in some cases increasing the appeal of Islam among Pakistan's poor.

The assassination also comes at a time of great political and economic instability in Pakistan and is likely to further paralyze the government of

President Asif Ali Zardari. Last weekend, the coalition led by Mr. Zardari's Pakistan People's Party, of which Mr. Taseer was a leading member, lost its majority in the National Assembly after a key ally joined the opposition.

On Tuesday, the Pakistan Muslim League (N), the largest opposition party, headed by former Prime Minister Nawaz Sharif, said it wouldn't launch a no-confidence motion in the government, providing the coalition with a measure of stability.

But Mr. Sharif told a news conference it would do so unless the government agrees to a series of measures, including cutting government expenditure, taking action against corruption and rolling back fuel-price increases.

The political fighting comes as the U.S. and other foreign donors are increasingly worried about Pakistan's growing budget deficit, which the government is funding by borrowing from the central bank, essentially printing money and stoking inflation. Rising prices for food, fuel and other necessities could further destabilize a country that is still recovering from the summer's floods, which killed almost 2,000 people and affected 20 million others.

The U.S. wants the government to raise taxes on the rich to pay for programs to help lift Pakistanis out of poverty and combat the draw of Islamist groups, who often run their own charity arms.

Some observers, however, say the case of Ms. Bibi shows how hard it is to dislodge Islamist ideologies.

Ms. Bibi was accused in June 2009 by local village women in Sheikhpura, a district of Punjab province, of blasphemy against the Prophet Muhammad, which under Pakistani law can carry the death penalty. Ms. Bibi, who is in jail, says the women hated her because she was a Christian, a minority in Pakistan, and had gotten in a fight over their refusal to drink water she had touched. She is appealing the court's November decision to impose a death sentence.

One radical cleric offered \$6,000 to anyone who would kill Ms. Bibi.

Mr. Taseer became vocal in defending her, saying Mr. Zardari, the president, would overturn the decision if necessary. Mr. Taseer's supporters later Tuesday placed wreaths on the spot where he died.

—Zahid Hussain and Rehmat Mehsud contributed to this article.

Wave of killings puts Baghdad on high alert

By SAM DAGHER

BAGHDAD—Iraq issued an unusual high state of alert here Tuesday in response to a wave of assassinations targeting Iraqi security-force members and government employees.

Ten officials have been killed and four injured since Jan. 1 by assailants with silencer-equipped handguns, in what security officials described as a stepped-up campaign by "terror and organized crime" groups.

Baghdad provincial Gov. Salah Abdul-Razzaq convened an emergency meeting Tuesday of the city's top police commanders and members of a special security task force responsible for the capital, known as the Baghdad Operations Command.

On Monday, Prime Minister Nouri al-Maliki ordered an ad hoc security committee, made up of senior commanders, to investigate the

assassinations and to take unspecified preventive measures.

In the latest attack, the spokesman for the Ministry of Interior, Brig. Gen. Alaa al-Taiee, was wounded Monday evening when gunmen opened fire on his vehicle after it passed a security checkpoint in the center of the capital, according to a senior officer at the ministry. Gen. Taiee was in stable condition, according to the official.

"We are in a state of high alert and security preparedness in Baghdad to prevent more assassinations," said Mr. Abdul-Razzaq, the Baghdad province governor, after his emergency meeting.

Mr. Abdul-Razzaq said additional security forces and checkpoints were being mobilized throughout Baghdad, a city of more than five million. He said a number of suspects, including some members of the security forces, have been arrested in connection with the killings.



Prime Minister Nouri al-Maliki ordered an investigation into the killings.

Among those killed since Saturday in shootings throughout Baghdad were eight Iraqi army and police officers, a municipal engineer

and a government lawyer, according to security officials.

The assassination of security officials using pistols has been steadily rising since last year, but authorities appeared to have been taken aback by the intensity and timing of the latest campaign at the start of the new year.

The government has blamed similar assassinations on a mix of insurgent groups, criminal gangs and political opponents. U.S. military commanders have previously said the targeted assassination of security and government officials were signs of a resilient insurgency determined to erode public confidence in the security forces.

U.S. military officials believe Shiite groups backed by Iran, Sunni groups tied to Saddam Hussein's ousted regime and al Qaeda, as well as some political groups are all competing with each other for dominance ahead of the scheduled withdrawal of all remaining U.S. soldiers

from Iraq by the end of this year.

The flurry of assassinations comes amid fresh U.S. casualties in Iraq. The U.S. military said this week that two of its soldiers were killed by insurgents on Sunday. Iraq Body Count, a nonprofit organization, said 4,017 Iraqi civilians and 408 members of the country's security forces were killed in 2010—the lowest annual death toll since the U.S.-led invasion in 2003.

But the group, which uses media reports as one of its sources, said 2010 saw the smallest year-on-year reduction in casualty figures, suggesting "a persistent low-level conflict in Iraq that will continue to kill civilians at a similar rate for years to come." Officials at the ministries of defense, health and interior all declined to provide the government's own tally of the death toll in 2010.

—Munaf Ammar, Ali A. Nabhan and Jabbar Yaseen contributed to this article.

WORLD NEWS



Agence France-Presse/Getty Images

Sudanese President Bashir, right, is welcomed by southern leader Salva Kiir, left, in Juba on Tuesday. Mr. Bashir said he would respect the results of Sunday's vote.

Sudan girds for critical vote

BY SARAH CHILDRESS

JUBA, Sudan—Sudan's President Omar al-Bashir pledged to respect the outcome of the impending referendum on whether the south should become an independent nation, raising hopes that Africa's biggest country can avoid more bloodshed even if it breaks apart.

"If secession is the end result, we will come and congratulate and celebrate with you," Mr. Bashir said Tuesday beside the south's president, Salva Kiir. Mr. Bashir also promised technical and logistical aid to help the south make the transition to independence.

Soldiers and police blocked most of Juba's few paved roads for Mr. Bashir's arrival Tuesday morning. While the official welcome was cordial, the south also made clear its determination to secede. People lin-

ing a major road to greet the leader waved small white flags stamped with a thumbprint and the word "separation," as well as the flag of southern Sudan.

The referendum vote, scheduled for Sunday Jan. 9, is the culmination of a peace agreement between the north and south that was forged in 2005. That agreement followed a civil war that left at least two million dead and millions more displaced.

Under the peace pact, both sides agreed on a transitional government for five years, after which the south would vote on whether to secede. Mr. Bashir, who is wanted by the International Criminal Court for war crimes related to massacres in the Darfur region, has suggested as recently as December that his government might not recognize a vote for secession if the southern govern-

ment didn't campaign for unity as well as separation.

Now that the south's independence appears to be a fait accompli, however, Mr. Bashir has shifted course and sought to allay tensions that could lead to more unrest and disrupt oil supplies. "Imposing unity by force failed," said Mr. Bashir in his remarks. "The end result was more hatred, more division, more enmity....We all are in dire need of peace."

Sudan is rich in oil, which comes mainly from the south through a pipeline to the north, where it is refined and sold. The two sides currently share revenue from the oil—now pumping at about 500,000 barrels a day—as part of the peace agreement. Both rely heavily on oil to fund their respective governments.

The U.S., Norway and Brit-

ain—the three Western countries that pledged to help make the peace accord work—have encouraged Mr. Bashir to support the referendum. The U.S., for example, offered to remove Sudan from its list of state sponsors of terrorism, if Mr. Bashir helped to ensure a peaceful vote. But a top official from Mr. Bashir's party rejected that offer, saying that the U.S. doesn't have any power to negotiate with its government.

Southerners have long been wary of the north, which in the past has failed to keep promises. But on Tuesday, officials were more receptive to the remarks of President Bashir. "He said he would be the first to recognize an independent southern Sudan," said Barnaba Marial Benjamin, the southern government spokesman. "That has made the people of southern Sudan very happy."

Ivory Coast dialogue appears to collapse

The apparent failure of West African leaders to dislodge Ivory Coast leader Laurent Gbagbo from power has exposed deep differences in the region and dimmed hopes that the nation's disputed election will be resolved through dialogue.

By Will Connors in Lagos, Nigeria and John James in Abidjan, Ivory Coast

Representatives of the Economic Community of West African States, or ECOWAS, arrived Monday to tell Mr. Gbagbo he must step down, ostensibly under threat of military intervention.

A statement by ECOWAS Tuesday suggested a breakthrough was imminent, but a Western diplomat who was briefed on the talks said no progress had been made.

The statement said both sides in the dispute "agreed to negotiate a peaceful end to the crisis without any preconditions," and that Mr. Gbagbo had pledged to immediately lift his military's blockade around the Golf Hotel, where rival Alassane Ouattara has been staying, protected by 800 United Nations peacekeepers.

But the blockade remained in place Tuesday evening. "It was a complete failure," the Western diplomat said. "When you come in with an ultimatum and the best thing [Mr. Gbagbo] does is agree to lift a hotel blockade, and he doesn't do that, that ain't progress."

The diplomat said the delegation—presidents Pedro Pires of Cape Verde, Boni Yayi of Benin, Ernest Bai Koroma of Sierra Leone and Raila Odinga, the Prime Minister of Kenya—was divided over the use of force, which was meant to be the delegation's key bargaining tool.

The African Union and the U.N. declared Mr. Ouattara the winner of a Nov. 28 presidential run-off vote. But Mr. Gbagbo, the incumbent, says he is the rightful winner, and has been unmoved by economic and travel sanctions handed down on him and his allies by the European Union and the U.S.

The apparent failure of the talks is another setback for African and Western governments hoping to avoid a violent outcome to the political impasse.

Members of Mr. Ouattara's camp, barricaded inside the hotel, were dismissive of the ECOWAS talks. "For President Alassane Ouattara the negotiations have ended," said a spokeswoman for Mr. Ouattara. "He accepted the second round of negotiations because he's full of respect for his fellow heads of state. Mr. Gbagbo shows clearly that he's not willing to leave."

Foreign mediators have sought to avoid placing the two rivals in a power-sharing agreement similar to those brokered in Kenya and Zimbabwe after violent elections.

Mr. Gbagbo's camp, which has been able to retain control of state television and most of the country's military, was more optimistic about the prospects of a positive outcome.

"I think during these recent negotiations we've been able to move forward," said Gnamien Yao, Mr. Gbagbo's diplomatic adviser.

Israeli leader asks U.S. to free spy

BY JOSHUA MITNICK

TEL AVIV—Israeli Prime Minister Benjamin Netanyahu asked U.S. President Barack Obama to release Jonathan Pollard, an unusually public request by the Israeli leader on behalf of the former naval intelligence officer, who was sentenced to life in jail for spying for the Jewish state.

The Israeli government has quietly inquired about clemency for Mr. Pollard in the past, and previous requests have been met coolly by Washington. Tuesday's appeal comes as the Obama administration and Israel's government have sparred publicly for months over how to proceed with peace talks with the Palestinians.

The U.S. has generally supported a Palestinian call for a freeze in Israeli settlement building in the West

Bank and East Jerusalem. Palestinian officials have refused to restart talks until a total freeze is agreed upon, something Mr. Netanyahu has been unwilling to do.

In recent months, the subject of Mr. Pollard's possible release from a U.S. prison has become entwined in the public dialogue over how Israel and Palestinian authorities might renege in peace talks. Gaining Mr. Pollard's release would win Mr. Netanyahu political points with Israeli hard-liners, for whom the Israeli spy has long been a cause célèbre.

Those hard-liners are also a key pillar in Mr. Netanyahu's governing coalition, and they have vehemently opposed any concessions to the Palestinians. Mr. Pollard's release could make it easier for Mr. Netanyahu to make concessions, including agreeing to a settlement freeze.

A spokesman for the U.S. Em-

bassy in Tel Aviv said the letter had been received and is being reviewed.

After his arrest in 1985, Mr. Pollard agreed to a plea bargain, pleading guilty to one count of espionage, in the hopes of a lenient punishment. Despite the deal, he was sentenced in 1987 to life in jail. Israel belatedly acknowledged that Mr. Pollard passed information to its intelligence services. In his letter Tuesday, Mr. Netanyahu acknowledged Israeli regret for the episode, which frayed U.S.-Israeli ties at the time.

"Even though Israel was in no way directing its intelligence efforts against the United States, its actions were wrong and wholly unacceptable," Mr. Netanyahu wrote in the letter. "Since Jonathan Pollard has now spent 25 years in prison, I believe that a new request for clemency is highly appropriate."



Associated Press

Jonathan Pollard, in a 1998 file photo, has been in a U.S. prison since 1987.