HEALY CONSULTANTS

China's Spending to Ward Off Olympic `Curse' May Help Buoy Asia

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China's leaders are planning tax cuts and a public-works spending spree to make sure their economy's growth isn't doused along with the Olympic flame.

Ten of 11 Summer Olympics host nations analyzed by Morgan Stanley economist Stephen Jen saw growth and investment slump in the year following the games; the only exception in his study, which stretches back to 1956, was the U.S. in 1996. Government officials in China, whose expansion was already slowing before the Beijing games ended last month, are determined to avoid what Jen calls the ``Olympic Curse.''

That would provide a welcome boost for some of China's Asian neighbors, including Korea and Taiwan, as well as for commodity producers from Australia to Brazil whose economies are threatened by faltering demand from the U.S., Japan and Europe.

``The Chinese authorities will do whatever they can to avoid a sharp slowdown,'' says Shane Oliver, Sydney-based head of investment strategy at AMP Capital Investors, which manages about $108 billion. ``China's economy will be a key pillar of strength for Asia.''

China has already eased lending restrictions and halted an appreciation of the yuan that was starting to pinch exports. Now, after four straight quarters of decelerating gross domestic product growth, the government is considering a fiscal stimulus of as much as 400 billion yuan ($58 billion), according to economists and reports in domestic news media.

Tax Cuts and Spending

A plan awaiting approval from the State Council and the National People's Congress includes 220 billion yuan of spending and 150 billion yuan of tax cuts, the Beijing-based Economic Observer newspaper reported last week.

China has tripled railway spending this year to 300 billion yuan. The current five-year plan, which runs through 2010, calls for investing almost 4.8 trillion yuan on power stations, waterways, roads and other infrastructure projects -- more than the combined output of Taiwan, Thailand and Vietnam. Reconstruction after May's Sichuan earthquake could cost another 1 trillion yuan, the government says.

``As the Chinese economy moderates, official priorities are tilting towards maintaining growth and employment,'' says Jing Ulrich, chairwoman of China equities at JPMorgan Chase & Co. in Hong Kong. ``China's infrastructure spending could even accelerate after the games.''

China might go beyond fiscal stimulus. The People's Bank of China said Aug. 15 it would ``fine-tune'' monetary policy to cushion the economy as overseas demand weakens. Frank Gong, head of China research at JPMorgan, expects the central bank to reduce the portion of deposits banks are required to hold as reserves by 2.5 percentage points, to 15 percent, by next year.

`Foot Off the Brake'

China's inflation rate ``is coming down, so they have got potential to take their foot off the brake and ease up on monetary policy,'' AMP's Oliver says. The rate peaked at 8.7 percent in February and was 6.3 percent in July.

China's growth slowed to a 10.1 percent annual rate in the second quarter after a recent high of 12.6 percent in the second quarter of 2007. Some economists say China's expansion -- still the fastest among the world's 20 biggest economies -- remains strong enough to maintain its momentum without new spending or monetary easing. ``But it's an uncertain world situation, so a month or two from now, those plans may look very smart,'' says David Dollar, the World Bank's director for China.

About 20,000 Hong Kong-owned businesses will close or relocate from China's nearby Guangdong province by the end of this year, in part because of slowing export demand, according to the Hong Kong Small and Medium Enterprises Association.

`Quite Nervous' Authorities

In a country where the number of new job-seekers each year exceeds the number of jobs created by 20 million, a decline in economic growth to even 8 percent would be tantamount to a recession, says Tao Dong, chief Asia economist with Credit Suisse AG in Hong Kong. Anything ``below 9 percent would make the authorities quite nervous,'' he says.

That figure is significant for China's neighbors as well. For every 1 percentage point that China increases its growth rate, the rest of Asia will be boosted by half that, says Huang Yiping, chief Asia economist at Citigroup Inc. in Hong Kong.

Among countries with the most at stake are Taiwan, which shipped almost 36 percent of its total exports to China last year; South Korea, which sent 25 percent; and Japan, which shipped 19 percent, according to UBS AG.

Replacing the U.S.

Japan, whose economy shrank at an annual rate of 2.4 percent last quarter, would be even worse off without strong demand from China, which replaced the U.S. as Japan's biggest customer in July. Komatsu Ltd., Japan's largest maker of earthmovers, reported in July that sales in China gained 37 percent in the quarter, while revenue from North and South America declined.

``With Europe and the U.S. starting to struggle, and Asia starting to buckle, you don't want all engines sputtering at the same time,'' says Rob Subbaraman, chief Asia economist at Lehman Brothers Holdings Inc. in Hong Kong. ``It will be more and more helpful if China can keep its economy on an even keel.''

China's spending will also help demand for commodities -- from iron ore mined in Australia to copper produced in Chile. China is the world's biggest consumer of coal, steel, aluminum, iron ore, nickel ore, copper and natural rubber.

``Raw-materials demand in China is going to be very strong for decades to come,'' Marius Kloppers, chief executive officer of BHP Billiton Ltd., said Aug. 18. China's appetite for steel will double by 2015, said Kloppers, whose Melbourne-based firm is the world's biggest mining company.

`Aggressive' Price Gains

Price gains for copper through 2010 will be ``aggressive'' because of limited supplies and Chinese demand, Citigroup said in an Aug. 18 report.

As one of the last remaining engines of growth, China may help keep the global economy from slipping into its first recession since 2001-2002. Economists at the International Monetary Fund deem anything less than a 3 percent world growth rate as a global recession.

``Continued robust, albeit slowing, growth in China and the rest of the emerging markets is a major driver of our view that the world economy will grow by a healthy 3.6 percent next year after 3.9 percent in 2008,'' said Binit Patel, international economist with Goldman Sachs in London, in an Aug. 21 report.

China has ample funds to pay for pro-growth policies, with outstanding debt of only 15.7 percent of GDP, compared with 75 percent in India, a budget surplus and the world's largest currency reserves, at $1.8 trillion.

``This is one country that's been saving during the boom time,'' says the World Bank's Dollar. ``If exports drop off sharply and consumers get cautious, they can come in very quickly with government spending or tax reductions.''

Source: Bloomberg