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The 2022 Olympics: Bread and Circuses, Beijing-Style

The 2008 games were an opiate for China's masses and a stimulant for its economy. The government hopes the 2022 games will provide more of the same.

By
RANDALL W. FORSYTH
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No cold, no snow? No problem!

That in essence was what Chinese officials must have told the International Olympic Committee to persuade it to award the 2022 Winter Games to Beijing. Evidently, the spectacular success of the 2008 Summer Games gave the IOC confidence that China could repeat that feat 14 years later, giving Beijing the distinction of being the only venue ever to be chosen for both international games.

Those Summer Games had the great fortune to begin on Aug. 8, 2008—or 8/8/08, a triple play on the good luck number in Chinese numerology—and merely required a temporary cleanup of the notoriously polluted environment in order to permit outdoor competition and to put on a spectacular show for the world.

The same evidently can't be said for China's fellow BRIC country, Brazil. The Associated Press last week reported that competitors in swimming and boating in next year's Olympics in Rio de Janeiro face almost certain illness from polluted local waters—as if the nation didn't face enough problems already from political scandals, inflation, recession, and a plunging currency.

To be sure, Chinese Olympic officials will have their work cut out for them in 2022. While some of the facilities from the 2008 Summer Games can be repurposed for winter sports, there is the small matter of making snow for skiing events, which will be staged in mountains some 90 miles from the capital city. Even though there is little if any natural snow and little water there, Beijing evidently promised it would make the necessary white stuff. That was apparently sufficient to beat out the only rival bid, from Kazakhstan.

Chinese officials appeared undaunted by that task even while they have their hands a bit full at the moment with the collapse in their stock markets. The Shanghai Composite took another tumble of some 8.5% last Monday, but managed to pull out of that nosedive into a mere downward glide. But despite the billions pumped into the market through monetary easing and direct injections into equities, the Shanghai benchmark still ended the week down 10% and off 14% for July, the biggest drop since August 2009.

So, why would Beijing assume the massive undertaking of the 2022 Winter Olympics? Veteran China watcher Anne Stevenson-Yang of J Capital, whose prophetic warnings about the bursting of the China bubble have been featured in *Barron's* ("Why Beijing's Troubles Could Get a Lot Worse," Dec. 8, 2014), explained the government's approach in a note to clients written prior to the Winter Olympics announcement:

"Deep in the historical memory of the Chinese Communist Party, built into the way it operates, is the structure of a military campaign. The system excels at marshaling resources and deploying them at a single target. The 2008 Olympics were the crowning achievement of this system: a plan that drove monomaniacally beyond any reasonable assessment of need in order to achieve games without blemish.

"No effort was too great in service of the single-minded target of an Olympics that would demonstrate the unprecedented rise of China and the untouchable superiority of the Party," she continued, including the shuttering of factories to clear the fetid air, if only for a few weeks, to show off an artificially clean Beijing to the rest of the world.

"Even then, the Olympic preparations were all the more extravagant for the effort to swamp the economic downturn already looming, and so successful were the games deemed to be in creating a counteractive stimulus that they were followed with the 2009 60th anniversary celebration of the 1949 revolution, the 2010 Shanghai Expo, the Shenzhen Olympiad, and, in fact, a major new event each year. With the Olympics, the Party had rediscovered an opiate for the masses and a stimulant for the economy," she writes. And so, history seems about to repeat.

Beijing appears to believe that "the answer to falling prices and illiquid markets in property is a series of plans so grandiose as to defy any known means of calculation," Stevenson-Yang contends. And while the inflation and bursting of the stock market bubble is all the more visible because the prices can be tracked minute to minute, real estate actually is of greater importance to China's financial structure.

Indeed, the equity market "is only one of many excesses that make up a Chinese bubble economy," according to David A. Levy, who heads the Jerome Levy Forecasting Center. China also suffers from "severely overextended export capacity, real estate markets, bank debt, and shadow banking debt." These balance sheet stresses each constitute a threat to financial stability, and, he contends, "virtually guarantee that, sooner or later, China will undergo a crisis, profound retrenchment, and enduring adjustment problems."

Despite all of the efforts by the Beijing authorities, China’s real (that is, inflation adjusted) interest rates remain among the highest of the world’s economies, according to Reorient Financial Markets Managing Director David P. Goldman, resulting in a 60% upward revaluation of the real effective exchange rate of its currency, the yuan, since 2009. Instead of following this tight monetary policy to maintain the yuan’s peg to the dollar, Beijing would do better to emulate Ben Bernanke’s Federal Reserve and slash real interest rates to combat deflation, which is what’s battering China’s stock market.

The scant attention being paid on this side of the world to the deflationary forces hampering the Asian region comes as a surprise to Christopher Wood, who pens the Greed & Fear letter for CLSA. There has been a continuing parade of interest-rate cuts, especially from commodity-producing countries, including even Russia on Friday. Monetary easing by the likes of China and India, plus Thailand and South Korea, have yet to have the desired effect, however, Wood observes.

As for the world’s second-largest economy, China again seems to be resorting to what Stevenson-Yang dubs “bread and circuses,” in addition to conventional monetary measures and heavy-handed intervention in its stock market. Beijing better hope it is more successful in creating white, as in snow, by 2022 than it has been in producing green on stock-quote screens of late.

CAUSE OR EFFECT? Consumer confidence took a huge tumble in July, while Donald Trump vaulted to the top of the polls for the Republican presidential nomination.
Some might venture that consumers were reacting with horror to the prospect of The Donald taking up residency in the White House. (Peggy Noonan writes in her weekly Wall Street Journal column that his popularity reflects his supporters’ “contempt” for the Washington status quo.)

Sticking to economics, one might infer from the Conference Board’s latest consumer polling that regular folks aren’t seeing the blue skies portrayed by stock market averages hovering near records or a labor market consistent with a jobless rate of just 5.3%. Expectations for the future took the biggest hit in the survey, suggesting gathering clouds over Main Street.

While consumer-confidence numbers can be dismissed as squishy, the data from the Employment Cost Index released on Friday held a similar surprise: Wages and salaries rose only 0.2% in the second quarter, a lot less than the 0.7% jump in the first quarter. That puzzled a lot of economists, who had expected a bigger increase in the June quarter, especially given the steady drumbeat to boost the minimum wage and anecdotes about the difficulty of finding qualified candidates for certain jobs, especially in tech.

One hypothesis is that the mix of jobs is changing. While burger flippers may be mandated to get $15 an hour in New York, the steady decline in the rig count in the oil patch means the loss of a significant number of high-paying jobs for skilled workers. It takes four or five bartenders or baristas to make up for the lost income of a single oilfield worker.

That's what Evercore ISI calls the "first- order effect" of the drop in commodity prices, which it noted on Friday included a 53,000 reduction in jobs at Anglo American (ticker: AAL.UK), layoffs of 1,500 at Chevron (CVX) and 6,500 job cuts at Royal Dutch Shell(RDSA). Later comes the second-order effect of lower costs trickling down to consumers, ISI says, which thus far have been elusive. What makes all of this crucial for the markets is, of course, the impact on the Fed's policy. The Federal Open Market Committee last week said that it would take just "some" improvement in the labor market to clear the way for liftoff in its federal-funds rate target from near zero (adding that four-letter word to its directive). The paucity of pay hikes evident in the ECI made markets think that a September increase is less likely, and Treasury yields retreated on Friday, especially among shorter maturities, the ones most sensitive to Fed moves, while stocks failed to benefit from that.

So, with the Yellen Fed declaring itself "data dependent," markets this week once again will be forced to devote a Friday morning to scrutinizing the monthly employment report (although this being August, the important people are away and leave the rest of us behind to deal with this task).

Morgan Stanley economists are in line with the Wall Street consensus in looking for a 200,000 increase in nonfarm payrolls for July, which is close to the 208,000 average monthly rise for the first half of 2015.

Far more interesting will be Thursday's debate with Trump and the rest of the GOP contenders. Whether that qualifies as "reality" television, given the hyperbole that's likely to be tossed around, remains to be seen. It should be more entertaining than anything being broadcast or streamed. And who knows—the show may even boost consumers' moods. Or not.

E-mail: randall.forsyth@barrons.com