Episode 1,072: David Stockman on Bannon, Trump, and What's Coming for the Economy

Guest: David Stockman

WOODS: Before we get started today, I'm curious to know if you're sticking to your prediction that Trump will not last through the end of 2018. Has anything changed?

STOCKMAN: I don't think so. They seem to think that this tax bill victory changed the game and put him back in the saddle, but I think there's less there than meets the eye. This bill was passed in desperation by the congressional Republicans because they want to have something they can campaign on to say, *This is the Republican agenda. We did it. Trump didn't do it. If you don't like him, vote for us anyway*. So I think it's only a matter of time before the deep state and the establishment and business as usual in Washington closes in on him. Of course he's his own worst enemy. It's just getting worse and worse by the day. I don't object to him using Twitter to communicate, but at some point the sheer egomaniacal bluster and exaggeration begins to, I think, undermine any confidence that they have down in Washington.

And I was there during the early 1970s when Nixon was taken down, and things can change very rapidly. In January 1973, Nixon was riding high. He won a landslide victory that was almost unprecedented: 508 electoral votes, 42 million to 28 million in the popular vote every single state, I think, except Minnesota, if I remember right. And yet, 18 months later they showed him away to the helicopter and he was gone and out of there as one event and one cut after the next finally eroded his standing.

Now, Nixon went into that — I don't want to dwell on it too long, but I think it's well worth it. Nixon went into that 18-month period I'm talking about here not only riding an electoral victory that dwarfs the squeaker that Trump actually was elected on, but also on top of 25, 30 years of relentless politicking, where essentially he had campaigned from coast to coast in practically every congressional district in the country on behalf of Republicans. Well, Trump, he's an outsider. No one even knew he was a Republican a couple years ago. He doesn't have that massive of inventory of IOUs and history of obligations that politicians call in when the going gets rough.

So while Trump's polls may have stabilized a bit in the last few weeks since the tax bill, I think that's highly misleading. If the market breaks — and you know, it's at a crazy, crazy, insane level at the moment, going up 150 points a day for no reason whatsoever in the face of some pretty serious headwinds that we can get into. If the market breaks, and it will spill into the economy, the perception of Trump in the country, in our Capitol Hill will change quickly and quite dramatically.

So this is a long way of saying that don't assume anything. This is an exceedingly unstable, unprecedented situation. Trump came to Washington with now friends, and I think he has even fewer now. So we'll see how it goes, but I think there's a risk of a pretty serious political upheaval that could take us by surprise in the right turn of events.

WOODS: David, in this week's episode of our podcast *Contra Krugman*, we look at January 1st, 2018 column by Krugman in which he is suddenly reminded that presidents after all don't really have that much influence over economic health. And he points out that, right at the time of the election when it looked like foreign markets were reacting badly to the election of Trump and he was basically being asked when will markets recovered from this and he responded never — I mean, never? Come on — he says, all right, look, I admit I let my politics get in the way of my sober forecasting, but what he's saying is it's the Fed chairman who really has the most influence over the economy, not the president, and so when Trump is taking all this credit for the strong economy, he probably doesn't deserve the credit. Now, that's actually a legitimate point. That's what we've been saying for a long time. The Fed chairman really is the one who deserves the praise or the blame.

But what I'm interested in at this particular moment is, given that everybody has been saying the first year of Trump has actually been pretty good for the economy, are you actually saying something different? Not that Trump doesn't deserve the credit, but rather that it's not actually as good as people think it is?

STOCKMAN: Yeah, I'm saying that, and I'm also saying I can't remember any occasion for years and years that I've agreed with Krugman, but in this case when he said never, I think he was right in the sense that there is no reason why the S&P ought to be up 30% from where it was on Election Day in November 2016, because there is nothing good that's going to come out of all of this that's sustainable.

The problem is that you have a Federal Reserve that's created this bubble and is running on kind of a residual momentum, so the idea that Trump ought to be claiming credit for this is really a huge mistake and misnomer. This is simply the market speculators looking for the top and waiting for something — a black swan, an orange swan, a red swan, something — to appear and stop the sheer momentum of it.

So Trump shouldn't be claiming credit at all. In fact, he was right in the campaign. *This is a giant bubble. It was created by the Obama fiscal stimulus, the Fed's massive monetary expansion. It's not sustainable, it's not healthy, and it's going to collapse*. That was his position in the campaign. He should have actually stuck with it and he should have asked for Yellen's resignation immediately, put a hard-money man or woman in the Fed. That would have collapsed the bubble and it would have allowed him to blame the breakdown and the consequent negative impact on the economy on his predecessors and on the regime that he was elected to change. But instead, he's embracing the whole thing. I mean, this is like putting your head on the chopping block and asking for the axe to be lowered.

This is really one of the reasons, going back to our starting question, why I think his tenure is still very much in doubt, because the minute this whole thing begins to crack and unwind — and it surely will. I mean, if you realize that today the Russell 2000 is trading at about 130 times reported income, or even the S&P 500 today rose to upwards of 26 times. These are crazy multiples this late in the cycle. No one has really abolished the business cycle. We're in month 103 of this so-called expansion. We're nearing the all-time record of 119 months that happened in the 1990s under far more propitious conditions. And so, therefore, why in the world are you valuing the market at the tippy top of the historic range in terms of multiples when the game is nearly over, when the jig is nearly up?

So that's kind of why, in some backwards way, I come to the same conclusion as Krugman, but not for the same reason. He's just trying to make a partisan point about Trump inherited this bubble and it's expanded for another year on his watch. My point is we have a rotten monetary policy. We have a dangerous institution that dominates all in the Federal Reserve, and it's heading for a real collision, because finally the Keynesians that are running that joint — and Trump has appointed some more. The new Fed chairman is about as much of a Keynesian as Yellen or Bernanke or Greenspan were. But even they have now kind of spooked themselves, because they do recognize we're in month 103 of this expansion. There will be a recession someday and maybe not that far down the road. And they have now drive power left.

So what they are doing now, pivoting to QT, quantitative tightening, and normalization is the biggest thing happening, and it's being totally ignored both by the stock market and by most of Washington, but especially the Donald in the Oval Office. They have said we are going to shrink this balance sheet that became elephantine at 4.4 trillion by roughly 2 trillion over the next several years, and we're on an automatic pilot schedule that began at 10 billion a month of shrinkage, or it just ended going to 20 billion a month in the current quarter, and ramping up rapidly to what will amount to a 600 billion annual rate of balance sheet shrinkage by October of this year.

Now, I want to juxtapose that with the massive fiscal explosion that is happening as a result of the king of debt being in the Oval Office and the Republicans on Capitol Hill throwing any remnant of fiscal rectitude to the winds. They inherited for the year ahead, fiscal 2019 — and that's the same time that the Fed is going to be dumping 600 billion a year worth of bonds into the market. They inherited a 700 billion deficit, built-in, structural, a huge, monstrous problem, but they've already added 280 billion of more revenue loss in the tax cut, which is front-loaded and has its biggest revenue loss the first year. And on top of that, they want to add another 120 billion for defense and non-defense appropriations, 100 billion on top of that for all of these crazy disasters we've had. They've promised money to various Republican senators to bail out the Obamacare subsidies in return for their vote in the tax bill. They have just gone nuts spending money like drunken sailors.

So to bring it all to a head, I think we're heading for a 1.2 trillion deficit in fiscal '19. Nine months from now that starts. 1.2 trillion deficit, ten years into a recovery. Remember, you're supposed to have a big deficit in a recession, and then the first and second year you're supposed to get back to normal and maybe even run a surplus if you're prudent ten years out. But here we are facing a 1.2 trillion deficit, and the Fed, for the first time in 30 years, is not buying bonds and thereby holding down the yields in a sense and effectively monetizing the government's debt, but the Fed is going to actually be piling on and selling — that's essentially what balance sheet shrinkage means — selling down its balance sheet at the same time that the Treasury is selling 1.2 trillion of new paper. Now, that's 1.8 trillion if you add it up.

And the question is: who's going to buy it and who's going to buy it at anything like a 2.3% yield on the ten-year that prevailed until just a few days ago? Today it soared. Some gurus like Bill Gross, the great bond king from PIMCO of past times, has said we went over the trip wire; the bond bear market has started. I'm not sure whether you can call it with that fine a point, but it now is heading towards 3%. And the whole financial system is basically geared to and predicated on ultra-low interest rates being sustained indefinitely. That's changing right now, and we're heading into a bond market collision this fall like we've never seen before.

And I think that's just going to throw everything into a cocked hat. The Republicans are going to panic as they face the possibility of losing the House. The White House is going to panic as they face the possibility of a Democratic Congress, because you know what that would mean for the I word. This is just — what a giant mess. And it's unfolding by the day. As you look at what's happening in Washington, they can't even pass a continuing resolution that lasts more than a couple weeks at a time. I mean, that's how fractured and paralyzed and confused the situation is. So we're kind of at a — they use the word "peak debt" or "peak oil." I think we're at peak financial absurdity at the moment, and this is going to come unstuck, unwound pretty quickly here. It will only take something not expected to start the run on this whole house of cards.

WOODS: David, I'd like to ask you about Steve Bannon, and I'll do that after we thank our sponsor.

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Just yesterday, David, we learned that Steve Bannon was stepping down, obviously forced out, over at Breitbart, and I want to ask you a couple of things here, first of all, about Steve Bannon himself. Has he maybe overestimated his own influence? What's going to happen to him now? He had that feud with Trump. But more importantly about Bannonism and your opinion of that, because I'm interested in somebody who is critical of Bannon from a non-leftist perspective.

STOCKMAN: Yeah, you know, I'm happy that Bannon is gone, but I think Bannonism is still very much on the table at the White House, because Bannon simply was a self-described intellectual who tried to make sense in some ideological framework that he called nationalism of the dog's breakfast of Trumpian policies, which, when push comes to shove, boil down to protectionism, nativism, xenophobia, and strongman bluster. There isn't any policy there that makes any sense whatsoever.

The problems that we have in flyover America today and an economy that's grinding to a crawl in terms of its growth isn't due to imports, per se. It isn't because a lot of people are coming across the border in Texas and taking away American jobs. It isn't because there is a whole bunch of crime coming from immigrants, other than the drug trade, which is a function of our stupid war on drugs, not anything that can be remedied other than getting rid of that. So I think the whole package that he put together of — I call it walls, walls on the economy, walls on the border — it was really upside down.

The problem we have in America today is not what's flowing in by way of imports or immigrants, but what's flowing out by way of the imperialism that we're imposing all around the world and bankrupting ourselves fiscally and the monetary imperialism of the Fed. I mean, the Fed, when it took its balance sheet from 500 billion in the year 2000 at the turn of the century to 4.5 trillion, that's a nine-fold increase in 17 years. Well, nobody wanted that many dollars, and so they flowed into the world economy. That's the economic consequence in the form of our massive foreign account deficit. Had the rest of the world played by the old rules, their exchange rates would have soared. The dollar would have collapsed. But they weren't willing to do that because they're all mercantilists and Keynesians and statists of one type or another, so they intervened heavily in the foreign exchange markets, bought up dollars in order to prevent the RND and all the other currencies from rising. And that essentially meant that we were exporting to the rest of the world the monetary insanity that was being conducted from the Eccles Building.

So the problem is that we're living way beyond our means. These falsified cheap interest rates have allowed households and corporations to borrow like there's no tomorrow. That has in the short run added to GDP, because that's the way they calculate it, even though it doesn't really amount to sustainable growth and real wealth. But these are the reasons why we're having the economic maladies that we have today in flyover America in all of those precincts that voted out of desperation for Trump.

The Fed is destroying the purchasing power of wages. The 2% inflation target is ridiculous. The Fed is destroying the value of savings as a result of interest rates that have been held close to the zero bound for nine years. The Fed is encouraging the C suites, the executive leadership of corporate America to cycle their cash flow and their balance sheet capacity into financial engineering, buying back their stock, paying bloated dividends, engaging in massive, unproductive M&A deals. All of this really flushes the corporate resources back into Wall Street, levitates stock prices, fuels the speculative cycle in spirit that's underway. But it doesn't result in real, tangible production investments on Main Street that create productivity, rising profits and wealth, and real sustainable economic growth.

So that's the heart of the problem, and what did Bannonism or Trumpism have to say about the Fed? Well, Trump said, "I'm a low-interest man." And as far as I can tell, and I follow Bannon pretty carefully, he never said anything about the core problem that was creating the economic decline that he proposed to solve with walls on the border when the problem is the corrupt people in the Eccles Building and the need for a complete housecleaning, which obviously hasn't even remotely happened. I mean, in addition to Jerome Powell, who's not only a Keynesian from a philosophical point of view but a crony capitalist from the Carlyle Group, for crying out loud.

He's appointed a couple of other people or nominated a couple of other people to the Fed who actually believe in negative interest rates. Now, let's just get right down to the lick log here. Negative interest rates are confiscation of the wealth of people who are unwilling to buy junk bonds or overpriced stock because the Fed tells them to. And negative interest rates are a way of forcing people to do what the monetary central planners demand. But really, it's theft. It's like a fundamental wrong, an evil that shouldn't even be on the table of respectable thought. But we actually have a nominee, Professor Goodtime, by a Republican White House who's not only advocated negative interest rates the next time there's a downturn in the economy, but that we ought to get rid of cash so that people have no alternative except to have their savings confiscated if they're unwilling to buy junk bonds.

I mean, this is really crazy stuff, and I think it's indicative of why Trumpism has nothing to do with healing the economy, that Bannonism is a huge distraction and misdirection. And meanwhile, the two problems that we really have — an out-of-control national debt and a central bank that is dominated by monetary central planning — neither of those are being addressed in the slightest. In fact, if you can fathom it, they're actually being made worse. I can't think of anybody worse than to put someone on the Fed who actually wants to abolish cash and impose negative interest rates, if in its wisdom the Fed decides to do that, or someone who, ten years effectively into this business cycle, thinks it's a swell thing to pump up the deficit to 1.2 trillion in the face of what will be a recession one of these years and even bigger deficits that will result from the breakdown of revenue.

The big picture is, before this asinine tax bill that they passed and all this spending for defense and disasters and Obamacare, bailouts, and all the rest of it, we already had built in roughly 12 trillion of new debt over the next ten years in the baseline federal budget, which would take the national debt from 32 trillion. And now they're adding on top of that trillions and trillions more. And this is a very dangerous and scary picture, and it's not something — this is the important point that I'll conclude on. This is not something that's going to happen in the by and by, a danger for 2024 or 2027. This is happening in the here and now. The furniture is going to start breaking in fiscal 2019, which is just ahead, and I don't see how they extract themselves from that kind of fiscal calamity.

WOODS: And David, let's of course remember that in November 2016, Bannon was quoted as saying, "I'm the guy calling for a trillion-dollar infrastructure plan." So it's maybe right-wing Keynesianism or it's — there's no overarching philosophy here. It's a lot of ad-hoc ideas. There's no — you can't trace a philosophy through it. And it's coupled with a dismissal of libertarianism and market economics, the presumption being that we should use the state to guide the economy in ways that benefit the base, the constituency, primarily the working class and maybe the white working class that, if trade deals are hurting them or we perceive them to be hurting them, then we need to do this and that. It's a lot of ad-hocery. *We're going to have an infrastructure program.* And the thinking is that if we have this or that kind of intervention, then the sum total of these policies will benefit the people who support us. But the thing of it is you put all of these policies together and they win up hurting the people who support them. So it's just — it's what I've heard described as ad-hocery in place of a philosophy.

STOCKMAN: Yeah, I agree, that's why I called it a dog's breakfast [laughing].

WOODS: Yeah, that's a better term.

STOCKMAN: Yeah, there's no coherence, there's no logic, and there's no sound economic principle to it. The one — taking the principle of fiscal responsibility or rectitude. You can have a nice argument about how much deficit you should tolerate at the bottom of a serious recession like we had in 2008, but that isn't now. It's 2018. Supposedly, the unemployment rate is 4%. By the likes of all these Keynesians running the central bank or advising Wall Street, we're at damn near full employment. And in any common-sense version of the world, you don't run a trillion-dollar deficit in that environment. It's just totally mistaken and wrong.

So the priority for a new administration should have been: how do we get our arms around this deficit monster? And that goes to two areas: entitlements and defense. Well, look at defense. Trump has no clue what he's talking about, what's doing. We were already spending 600 billion for defense, as much as the next ten countries combined when he got there. He's now got it up to 700 billion. And the thing is nonsense. It's another discussion for another day, but we don't really have any industrial-sized state enemies in the world that can threaten us. We don't need 600 billion. If we did away with 300 billion, we would still be plenty safe.

This whole Russiagate thing and all of this hysteria about the Russian threat is ridiculous. I sometimes say I considered my apartment in New York City, which is on the 19th floor on the East River, I can see pretty far in all directions. And the point I make is I can see Russia from there, because the GDP of New York metropolitan area of 1.6 trillion is bigger than the entire GDP of Russia. So if you take a pipsqueak economy that's basically a giant hydrocarbon province, some huge wheat fields, and decrepit factories and compare that to the industrial might and base of the United States and a military budget that is ten times bigger than theirs, the question is what's the hysteria all about and why are we being panicked into this massive expansion of what I call the deep end of the swamp over on the Pentagon side of the Potomac River. Well, this is where Trump is taking us, and it just makes no sense and is pretty scary when you really think about it.

WOODS: It really is the worst aspect of Trumpism, in my opinion, because it just feeds into the standard narrative of American foreign policy. He's somewhat different on foreign policy but not nearly as different as he should be. And often, he's different in unhelpful ways. But certainly, to call for a massive increase in military spending, that's just out to lunch.

I want to recommend to everybody, by the way, DavidStockmansContraCorner.com. You are going to get there just unbelievable insight constantly coming from David Stockman. You'll be able to read this stuff and then just demolish anybody who comes up against you. He's absolutely top notch. There's never been anybody, I think, from a former presidential administration who's come out and been as hardcore and incredible as David Stockman, and you're missing out if you're not checking out DavidStockmansContraCorner.com. You'll definitely want to read his article on Steve Bannon over there, but then also subscribe to get all his content at DavidStockmansContraCorner.com/subscribe. Now, that's a lot of letters to type in, but there's no way David Stockman is going to let you down after you type all those letters in. You've got to know as you're typing them something amazing is awaiting me. So check it out at DavidStockmansContraCorner.com/subscribe. How do you like that, David?

STOCKMAN: [laughing] Okay, I appreciate that very much, Tom. I guess the real story is that after four years in the Reagan White House, I got one out-of-towner on a rail, so it wasn't a matter of — instead of hanging around the basket and making rationalizations and justifications of becoming a lifer in the Beltway. That's the problem. Prosperity doesn't come out of the Beltway. The Beltway is the enemy of prosperity. I guess I was able to maintain some clarity of thought because I left Washington in 1985 and have had no reason to go back and become confused and conflicted, as a lot of people do.

WOODS: Well, I was doing a little Twitter push to get you nominated to be Secretary of the Treasury, and I think I had the hashtag, #StockmanforTreasury or something like that. But it was not successful. The Tom Woods bump was not substantial enough to get you over the top.

STOCKMAN: Didn't quite do it.

WOODS: And the funny thing is I think if you had been approached, you would have turned it down.

STOCKMAN: Well, given what Trump's fiscal policy was, it would have been impossible. I would have said, "Yes, let's have a tax cut, but let's cut payroll taxes." There's 160 million people paying it on first dollar. If you're struggling at the minimum wage or you've been thrown out of your factory job and you have to make ends meet on two or three part-time jobs, you're really getting hit by $2,000, $3,000, $4,000 a year in payroll tax. That's what should be cut. But secondly, it needs to be refunded to something else, ideally spending cuts, but if not that, then a consumption tax. But the worst thing we can be doing is taxing labor in the highest-cost labor market in the world at 15.7%, which is the combined employer/employee OASDHI tax. That's what we should have done. And I'll tell you what, they didn't want to hear about that. They just wanted to whack the income tax and the corporate rate again and expect good things to happen when it's not a tax cut at all; it's just they've deferred the tax increase that taxpayers, born and unborn, are going to be paying in spades down the road.

WOODS: Well, again, David, thanks so much. Always a pleasure to talk to you. I cannot recommend DavidStockmansContraCorner.com highly enough. You are just going to love it. David's analysis helps you interpret the news and understand what's really going on beneath the surface almost like no other resource out there. So I'll link to it of course at TomWoods.com/1072, and thank you, David.

STOCKMAN: Okay, great to be with you, Tom.