



Episode 1,151: David Stockman on the Real Condition of the Trump Economy

Guest: David Stockman

WOODS: I want to start by talking about an appearance you made on Fox Business about a week or two ago maybe. I ended up making a whole issue of my email newsletter out of it. I included the video and I talked about it, and I just couldn't get over what happened. I don't know how to comment on it. It was not only that you were attacked, but it was that the nature of the attack was just so low-level.

STOCKMAN: Yeah, you know, it was 6:30 in the morning. It was a panel of four. It was a couple of days after Trump unleashed the cruise missiles and bombers on Syria in response to this whole what I call the staged gas attack. And the Foxites on that particular panel apparently drank the Kool-Aid completely and just came after me hammer and tong.

But I thought it was really a good moment because it laid bare the whole issue that, one, how in the world do they know that this actually was a gas attack by Assad? Did the government provide any evidence? Did they even know since it was only a few days after the event? And besides that, whether it happened or not, who appointed Donald Trump spanker-in-chief of the Western world? Because sure, that's horrific, but what's happening in Yemen today where the Saudi Arabian air force has already killed about 10,000 civilians with American weapons and bombs and missiles and we're refueling their planes as they fly over these areas and take the population out.

So you know, it raises the whole issue about the empire, about the imperial foreign policy, about the intervention and meddling everywhere, mainly to keep the military industrial, surveillance, interventionist, deep state complex in business. So it was a good moment because it laid bare all these things, and hopefully maybe some of the viewers got a different angle from me than they normally get from the Fox line.

WOODS: Well, I always like to point out how so-called fiscal conservatives seem to have no interest whatsoever in talking about foreign policy and cutting back there, so I always say these people put the "con" in "fiscal conservatism." They're the worst. They're the worst.

STOCKMAN: Yeah, that's what I say. I say we've got the neocons and we've got the tax cons and we've got the social cons, which are half of the Republican politicians who will give a good, full-throated speech about a 21 trillion national debt, which frankly is heading to 34 trillion — we'll talk about it in the moment — by the likes of CBO. It's not my right-wing or conservative view of the matter. But when it comes to the Pentagon and really the whole apparatus of our imperial foreign policy, including foreign aid and security assistance and military sales and all the rest of it, they forget about fiscal rectitude entirely.

And it goes way back. That was my problem way back in the Reagan administration. Ronald Reagan was a stalwart fiscal conservative on the inside of the Potomac, where all the domestic departments were located. But when you went across the river, the Pentagon was totally off limits. He gave them a blank check. That was the beginning of the ascendancy of the neocon, hawkish, warmongering wing of the Republican Party taken over, and it's basically ruled the roost ever since.

And that's really an important point, because it leads to a bad foreign policy. It leads to a huge waste of fiscal resources that we don't have. Just for national security now, we're spending 720 billion a year, but you've got to actually look at the full bill. The full bill is we've had all these unnecessary wars going all the way back to Vietnam. We now have millions of veterans that we have to take care of who were maimed and wounded and, in many cases, incapacitated for life as a result of being sent there by people in the White House and the DOD and State Department who were not pursuing really an America-first policy to defend our security and freedom here.

But anyway, that's 200 billion a year. And then if you throw on top of that the cost of servicing the debt, which is attributable to all these wars, and the security assistance and the soft side of the imperial policy, which is another 50 billion, you're damn near at 1 trillion a year of cost for what I call imperial Washington's global policy. And that's the heart of the matter, because you never can get enough Republicans to line up to walk the plank for domestic spending cuts and entitlement reforms when they have the excuse: well, we're spending these huge bucket loads on the Pentagon and defense, and so therefore we just can't muster the courage politically. It basically immobilized, paralyzed, and removed the Republican Party as a force for fiscal rectitude and budget constraint. And when you throw that into the mix, the Democrats, who believe in the welfare state and the warfare state, you end up with where we are today, and that leads back to a point I made a moment ago.

The CBO now has a forecast out as a result of the crazy things that have been done. This tax bill was a bad idea because it was borrowed, not earned. In other words, if you'd cut offsetting spending, I would have said: great, fine. Or if you'd closed some serious loopholes or you came up with a more benign tax to replace what was cut, that would all be good. They didn't do any of that. They added 200 billion a year to the deficit. On top of that, they've added 150 billion of spending increases when they busted these budget caps a couple months ago to keep the government open, if you can believe that's what Republicans do these days.

So my point is they inherited a 700 billion deficit for the coming year. They have added upwards of 500 billion on top of that. So we're going to be borrowing 1.2 trillion in the upcoming fiscal year, and that doesn't go away. It keeps building and flowing, and the debt service keeps rising. And then as interest rates normalize, it gets even worse. So we're heading towards 2 trillion a year deficits as far as the eye can see, and even the CBO agrees with that.

And so that's why if you get out their report of a couple weeks ago, you will find buried back a few pages — but not hidden; it's right there in plain sight — a projection that in fiscal 2028, that's the tenth year out, the public debt will be rounded 34 trillion. Not 21 trillion that we started, not the 10 trillion that Obama started with, not the 5 trillion that Bush started with, but \$34 trillion, upwards of 140% of GDP. You end up in kind of a zone that basically is occupied by Greece and Italy today and Japan and very few others. So what I'm saying is this

whole thing is unfolding in a very bad way, and we're stumbling quite quickly towards the fiscal crisis of a lifetime.

WOODS: What do you say to people who come back with, and you probably dealt with this a lot: look, Stockman, we've been dealing with this problem for years and years and no bad seems to come of it? We seem to survive. We grow our way out or, one way or another, we manage to struggle along. So what would make today – why is today different?

STOCKMAN: Well, two things. One, the passage of time. Back when all this started and I started warning about it – you know, I finally left the Reagan administration because the deficits just got more than I could – I couldn't in good conscience go to the press or up to the Hill and support what was happening. But anyway, my point is the national debt was about 25 or 30% of GDP then. Here we are 35 years later; it's 107% and heading towards 140. That's a different ball game. 30% you've got some running room. You have some edge room to borrow a little bit and live high on the hog. But sooner or later, you use up your borrowing capacity. That's one thing.

But the more important second thing is that for 30 years, the Fed and then the other central banks of the world have been making the job a lot easier of digesting all of that debt because they've been monetizing it. That's really what this fancy word of QE and ZIRP and all the rest of it is all about. They buy the debt with money made out of thin air from the dealers on Wall Street, put it on the Fed's balance sheet, and thereby remove it from the supply-and-demand equation and take some of the pressure on interest rates or yields out of the market.

So back in the day when I started on Capitol Hill in the '70s when I was a congressman, boy, we really went hammer and tong after the Democrats because we said: you keep increasing the deficit. And it was like 40 billion then and they were trying to drive it to 80 or something. 80 billion. If we could only have that now. We said: you're going to crowd out private investment, interest rates are going to go up, middle class American families are not going to be able to afford a mortgage – and we were right about that. They went into double digits – businesses will not be able to invest because the cost of capital will be too high. That was the argument, and that's what kept the lid on the whole fiscal equation and the national debt for decades and decades.

But then when Greenspan came in in '87 and they started this whole new era – for a shorthand, I call it bubble finance, money printing, monetary central planning. I have a number of words for it. They began in a systematic and then massive way to monetize the debt, buy in the government bonds, and thereby avoid the day of reckoning, thereby sort of put their big, fat thumb – and by that, I mean the Fed, the Federal Reserve's big, fat thumb on the scale of supply and demand down in the bond pits in the canyons of Wall Street, and for years were able to keep interest rates dramatically lower than they would be if we were honestly financing these massive federal debts and deficits in the market and out of the limited pool of private savings that is available. So that's why for 30 years, the day of reckoning was deferred. It wasn't eliminated; it was simply parked on the balance sheet of the Fed.

Now, the reason this is critically important is we have now – the Fed and other central banks will follow – has finally recognized, even these Keynesians on the Fed, that they've gone over the deep end and back and they have to reverse direction. They have to pivot out of quantitative easing and out of expanding the balance sheet, which by the way, was 200 billion

when Greenspan took over in 1987, August, reached 4.5 trillion a few years ago at the peak. It's a massive increase over that period, 25 times.

But they've recognized that they've reached the limit. They've pivoted to QT, which means they're going to be shrinking in a major way their balance sheet for the first time ever in modern history. And not just by a little bit, 10 or 20 billion for a couple quarters. No, they're going to be draining 600 billion at an annual rate out of the bond market as they dump their balance sheet, as they reduce their holdings. They've got a lot of fancy terms for it: running off the securities, they call it, and stuff like that. But it's really dumping the bonds. So instead of removing supply and easing the pressure on yields and preventing the crowding out, they're going in the opposite direction now. They're going to be adding to the supply by dumping their old bonds.

Now, let's put this in practical numbers for the coming year, for fiscal 2019. Starts in October, not that far away. That's why the market is starting to get very jittery already. The Treasury will be out there trying to sell 1.2 trillion of new bonds while the Fed for the first time in history will be trying to dump into that same market, into those same so-called bond trading pits 600 billion of existing debt. So what I say is, when you add it up, there's 1.8 trillion of homeless federal debt going to have to be absorbed down there on Wall Street, and it's going to change the equation dramatically. Sooner or later, of course, it'll be absorbed. Markets do clear. But not at 2.95% on the ten-year. They're going to shoot through 3%, 3.5, soon 4 and beyond.

And as the yield gets driven up by supply and demand and this 1.8 trillion tsunami of government debt looking for a home, it will ricochet through the entire financial system. In other words, the market is crazily overvalued today at 24 times earnings on the S&P 500, but that presumes that interest rates can stay down in what I call the sub-basement of history at 2.5% or a little higher indefinitely, permanently. And that's just not going to happen. And the market's priced for that. The market is structured for that. For instance, all of this massive borrowing that the corporations have done to buy back their own stock assumed that they wouldn't pay much more next year and five years from now on the bonds they issued than they are today. Well, none of that's true, and so therefore the whole predicate for this massively inflated bubble in the equity market is going to be pulled right out from under it.

So the problem starts in the bond pits. The problem originates out of Washington, and it's going to spread very quickly from there into the equity market and around the world. So we've got some pretty challenging and unprecedented financial pressures — I call it a collision — coming not too far down the road.

WOODS: When this comes, who gets hurt the most?

STOCKMAN: Well, firstly, I guess in the short run the speculators get hurt the most, the leveraged speculators, because there is all kinds of hidden leverage out there where people essentially, instead of buying stock, they put themselves, they've been put by their brokers and advisors into options because you can get a lot more mileage on so-called less capital because essentially you're only putting 10% or 20% down. But all of these people that have now put on massive positions in options, for instance, may find themselves get chopped to pieces. All kinds of people who got into aggressive mutual funds, let's say one that's already in it to the fangs, so-called — Facebook, Amazon, etc. — are going to lose their lunch because Amazon may be the greatest thing since sliced bread, but it isn't remote worth the \$780

billion market cap that's on it today because it doesn't earn anything aside from its cloud services business.

So what I'm saying is there's going to be a lot of hurt among people who've been lured into this highly speculative, bubble-ridden environment. But in the end, it unfortunately at least for a time will spill over into mainstream America too, even among people that decided after the crash of 2000 and 2008 that they wouldn't go back in. But still, the mainstream economy is going to be jeopardized, because the first thing that will happen when the stock market corrects, and heavily — I mean, by 20 or 30%, which can easily happen, is the corporate C suites, as I call them, the boards and top executives, they're going to say: oh my gosh, we've got to appease the angry gods of Wall Street in order to protect our stock price and to keep our options above water, so they start laying off people or restructuring, closing plants, doing write-offs, throwing out the baby with the bath, hoping to put a floor under their stock price. Well, what happens then? Well, factories go dark. Stores are shuttered. People get layoff notices.

These are the kinds of things that unfortunately will happen, and we need to hopefully when the time comes — I think it's unavoidable — make a point of putting blame where it belongs, pinning the tail on the donkey that caused this. And it's the Federal Reserve. If they hadn't created these bubbles that inevitably collapse, that did in 2000 even though they said it never would — it did in 2008 — even though allegedly we had a Goldilocks economy and all the rest that people can remember, they create these bubbles. They inflate and inflate and inflate, seven, eight, nine years. Anybody who questions the underlying predicate for the whole thing is dismissed as some kind of permabear or someone who is perennially negative. And then the thing collapses and there is a lot of collateral damage that hurts tens of millions of innocent people.

And that wouldn't have to happen if the Fed didn't try to manipulate interest rates, if it didn't try to put a floor under the stock market and stock prices and kept out of the way. Then we would have a free market working on Wall Street, and that would be the greatest thing imaginable for restoring growth and prosperity in America. Bring the free market back to Wall Street and get the Fed and the open market committee the hell out of there. That's the first step to wisdom.

Unfortunately, whatever his virtues are, one of them is no understanding monetary policy — and I'm talking about Donald Trump. And as a real estate developer his whole life, he basically became a billionaire, he claims — whether he is or not is beside the point — on borrowed money. So he likes what the Fed does. He refers to himself as a low-interest man. So the one thing that needs to be on above all else, front and center and far more important than the next ten items combined, is clean house of the Fed and into it. He pulled in what I call Janet Yellen in trousers and tie. Jerome Powell is a kind of Keynesian, Washington lifer, and he's not about to really undertake and lead the house-cleaning that's necessary. Unfortunately, that's where we are, and it's going to take another huge financial crisis and dislocation before the debate can then be reopened once again about what's fundamentally wrong. And that time is coming.

WOODS: I know that there isn't really a whole lot we can do to stop this, but I also know people are going to be asking me: given that I can't stop it and we have to just sit and watch a slow-motion train wreck unfold, what can I be doing, either in my professional life or my financial life, to be able to weather the storm the best I can?

STOCKMAN: Well, those are great questions, and I say after nine years of this nonsense in a bubble that has inflated and inflated and inflated to almost unimaginable heights, the first point of wisdom is to get out of the casino. Your odds of making another 5% are reasonably low. Your odds of losing 20 or 30 or 40 or even 50% are enormously high. The risk-reward is totally against spending any more time in the stock market or the bond market or in junk bond funds or other mutual funds. That's the first point.

The second point is: preservation of capital at turning points when there is a big correction and reset of financial prices is the most important thing you can do, because after the correction, after the reset, you have the capital to start investing in things at plausible prices that have some prospect of a reasonable return.

The third thing I would say is the collapse this time is going to be so far-reaching and especially focused in the bond market and not in the banks like last time that I think the Fed is going to be seriously discredited, because remember, they kept saying this was a 100-year flood event — I'm talking about the financial crisis of 2008 — and that we're doing what appears to be all of this radical stuff. We think it's crazy; they call it experimental or emergency policy. Those are just weasel words for it. But anyway, their argument was: we only have to do it once. We'll right the ship. We'll get the economy back on a solid footing, and then we'll go back to normal.

Well, when this whole thing fails, it means everything that they were arguing all the way along was wrong, and I think that's going to create a real crisis of confidence about the Fed and the financial markets and where things are going to go over the next several years. And in that environment, people will look for a safe haven, and here's the key thing: that one safe haven that used to exist on Wall Street that people went to in 2008 or they went to in 2000 or 1987, 1994, other crises, was the bond market. It's going to be in carnage this time, so bonds won't be a safe haven. Even government bonds, treasury bonds won't be a safe haven, and so people are going to either go into cash or gold. And I think if you are looking for upside, there's probably no better time to buy gold or a position in gold one way or another than now.

And the last point is that cash will be king after this entire artificial, bubble-ridden, Fed-inflated system goes into the big correction ahead. So there's nothing wrong with reducing your rate of spending, building up a cash cushion, because cash will be king when the big correction comes.

WOODS: Let's say just a quick word about David Stockman's Contra Corner, which now has an easier URL. ContraCorner.co is where you can get David's commentary. But tell us a little bit about that.

STOCKMAN: Well, that's my daily blog. It comes out five days a week. It covers the whole spectrum of things we've been talking about today: the Fed, monetary policy and Wall Street and the stock market and fiscal policy. And then the whole gamut of the rest of the globe: foreign policy, our interventions in the hot spots everywhere around the world, Russiagate, and the rest of it. I try to focus on what the moving issues and headlines are of the moment but from a totally non-conventional and non-mainstream perspective. In other words, one informed by history, which we don't have today. I mean, if you watch CNN, you'd think the world was born two days ago. That's about the time span and the attention span they have. So I try to put long history into this. I try to build it on my career of 40 years, both half in

Washington and half on Wall Street, so I talk about the two ends of the Acela Corridor on either end of the train between Washington and New York.

And you know, it comes from the point of view of sound money, small government, fiscal rectitude, free markets, individual liberty, and that consolation of values that increasingly have been lost obviously in Washington, but are almost impossible to find in the mainstream media and even Fox. On some of those issues, Fox is okay. On foreign policy, they're the biggest big-government interventionists – or many of them are – around. So that's the angle: the current world through the lens of a non-conformist view of events.

WOODS: Well, if you go ahead and head over there via this link, TomWoods.com/Corner, if you subscribe at the annual level, I will even throw in a bonus. I've got my site LibertyClassroom.com, we've got over 20 courses you can listen to in your car on economics, history, subjects you need to know something about and that chances are you didn't get the full story when you were in school. You can get the full story through Liberty Classroom as a bonus when you sign up for an annual subscription to David Stockman's Contra Corner. So just forward me your receipt over to Bonuses@TomWoods.com and we'll get you set up with that neat little bonus. I'll have also details on all this stuff on the show notes page for today, which – I'm trying to rack my brain what number episode this is – TomWoods.com/1151 is where you'll find information about the Contra Corner and that nice bonus, and it'll probably have a couple of links to a couple of recent articles by David to whet your appetite. So David, I'd like to talk more about that Fox Business thing, but maybe it's best to just let that go as an interesting object lesson in what it's like to take on the entire establishment at 6:30 in the morning.

STOCKMAN: Yeah, okay. Well, listen, very good to cover these issues, and we'll be talking about them more I'm sure in the future.

WOODS: Thanks so much, David. I appreciate it.

STOCKMAN: Very good.