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UPDATE

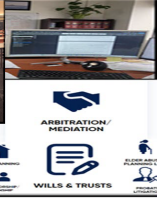


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What to say about term-two Donald Trump? The president is testing his limits...legally, politically and otherwise...with mixed results so far.

WHITE HOUSE This is evident with Trump's signature issues. Take immigration. While the president signed a legally contentious executive order curtailing birthright citizenship during his first week in office, he hasn't dramatically ramped up deportations of undocumented immigrants. Daily arrest numbers have surpassed those under Joe Biden. But Trump has been forced to release some of the detainees because of a lack of detention space, an obstacle that Congress likely must overcome with more funding. As a stopgap, officials are lining up deals with sheriffs around the country. Expanding detention at places like Guantanamo Bay naval base has hit legal snags.

On trade, Trump has found more success, using tariff threats for other objectives. Canada and Mexico staved off the imposition of duties by agreeing to help the U.S. with drug smuggling and immigration enforcement. The White House appears eager to try a similar approach with China.

This isn't the president's final word on either issue. Behind the scenes, he is urging immigration officials to ramp up arrests and deportations. Moreover, tariffs on countries like Canada and Mexico are on hold only temporarily. Don't be surprised if Trump keeps wielding this threat to extract further concessions from the countries being targeted...an effective tactic, but a source of angst for importers and exporters.

The biggest test for Trump's strategy will be efforts to shrink the government, led by Elon Musk. Musk has defied expectations for his Dept. of Government Efficiency by trying to shutter the U.S. Agency for International Development and gaining access to critical government employment and payment databases. At the same time...

Pretty much all of the administration's most ambitious steps face lawsuits. For example, a judge has directed the White House to unfreeze federal grant funding. A judge recently ruled in favor of the president's deferred resignation plan, for which 77,000 employees...over 3% of the federal workforce...have signed up. Also, the upheaval may effectively accomplish some of the president's goals. Government workers whose job status is up in the air may opt to take different jobs.

It's worth noting that Trump continues to enjoy a political honeymoon. He began his second term more popular than his first. His approval rating is currently 49%, on average, three points better than his roughly 46% disapproval. How long it will last remains unclear. Voters strongly like or dislike Trump more than any other modern president, making him vulnerable to sudden swings in popular opinion that could accompany negative economic news, for example.

Economic Forecasts

GDP growth
2.8% in '24,
2.4% in '25

Interest rates
10-year rate staying in mid to upper 4's as progress on inflation stalls

Inflation
3.2% at end '25,
up from 2.9% at end '24

Unemployment
4.0% at end '25, down slightly from 4.1% at end '24

Crude oil
Trading at \$75 to \$80 per barrel into late winter

Federal Reserve policy
Odds of rate cut in '25: 50-50, given stubborn inflation, possible tariffs

THE ECONOMY Jan.'s inflation report will complicate the Federal Reserve's job. Prices rose by 3% from a year earlier...3.3% when excluding volatile food and energy costs. Inflation has been stuck around these levels for months now, after falling significantly in 2023 and early 2024. Prices of used cars and services other than housing accounted for much of Jan.'s overall uptick. While there is still time for price gains to cool off...

If the trend continues this winter, Fed interest rate cuts will be on hold. Jan.'s jobs report also points to continuing inflation pressures. Job growth was a modest 143,000, but was probably artificially reduced by the Calif. wildfires and winter storms across much of the country. More importantly, job gains in Nov. and Dec. of last year were revised markedly higher. And wages grew by 4.1% in Jan. on an annual basis...a level that is likely too high for the Fed's 2% inflation target.

FINANCE The CFPB is suspending all of its consumer protection activities. The new chief of the Consumer Financial Protection Bureau told all staff to cease work until Feb. 14. CFPB examiners have access to banks with \$10 billion or more in assets, but they also oversee debt collectors, payday and online lenders, consumer credit reporting companies, some fintech firms, and payment processors. The 2010 Dodd-Frank Act established the CFPB. The elimination of the agency would require Congress, but the president can downsize and sideline it on his own. The suspension of supervisory activities is a boon for banks. The end of all pending rules eliminates the agency's recent work targeting so-called junk fees, including the credit card late fee and overdraft rules. The open banking rule...which would've made it easier for customers to switch banks...is now on hold, too. Financial tech firms stand to benefit, as the CFPB has primary jurisdiction over nonbank financial services. But courts will ultimately decide the agency's fate.

HOUSING Home prices continue to rise steadily, despite higher mortgage rates. The S&P CoreLogic Case-Shiller National Home Price Index rose 3.8% in Nov. from a year ago, up from 3.6% in Oct. House prices are now 7% higher than at their June 2022 peak. The pickup in the annual pace of growth isn't surprising, given that buyer demand has remained steady, despite elevated mortgage rates and tight inventory. Home prices have risen on a monthly basis now for 22 months. The resilient gains reflect tight inventory in the market. High mortgage rates have dampened demand, but they have had a similar impact on supply. About half of homeowners have a mortgage rate below 4%, making them reluctant to move because of the higher costs they would incur taking out a new loan at current rates. Still, there are signs that price appreciation will soften in coming months. Unsold inventory of existing homes is up 16.2% from a year ago, for instance.

THE WORLD President Trump's penchant for dealmaking is also evident in foreign policy. He has agreed to continue arming Ukraine, for a price...namely \$500 billion worth of critical minerals. Kyiv is hoping to keep the U.S. in its corner, even as Trump pushes for negotiations to end the country's ongoing war with Russian invaders. He played a decisive role in brokering a Gaza cease-fire before taking office... And was willing to scrap that same agreement if Hamas militants refused to free the remaining Israeli hostages. Most do not expect Trump to act on his plan to occupy Gaza and relocate its Palestinian population, nor is it likely that he can. But his threats carry enough weight that they can still compel countries to respond, sometimes with significant concessions, even if Trump also risks burning bridges.



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