



Policy Friction

Economic Momentum Enters
A More Selective Phase

#33



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Executive Overview

The U.S. economy continues to expand, but moderating services activity, restrictive Federal Reserve policy, cautious consumer credit trends, and a widening trade deficit are creating a more selective environment for growth, investment, and capital allocation.

The latest U.S. macroeconomic releases point to an economy that continues to expand, but with increasingly selective momentum across business activity, monetary policy, consumer behaviour, and global trade.

The ISM Services PMI, released on July 6, 2026, eased to 54.0 from 54.5, confirming continued expansion while slower business activity, new orders, and moderating price pressures signaled a more balanced pace of growth.

The July 8 FOMC Minutes reinforced the Federal Reserve's commitment to maintaining the 3.50%–3.75% policy range, emphasizing persistent inflation risks and a data-dependent approach that keeps financing conditions restrictive.

Household spending patterns also became more disciplined, as revolving consumer credit contracted at an annual rate of 4.7%, while nonrevolving credit increased 1.6%, coinciding with softer second-quarter guidance from several consumer staples companies.

Meanwhile, the May U.S. international trade deficit widened to USD 77.6 billion from USD 54.6 billion in April as imports outpaced exports, increasing the likelihood that net exports will weigh on second-quarter GDP.

Collectively, these developments indicate that economic activity remains resilient but increasingly uneven. For investment banking, private equity, investment research, capital markets, and corporate leaders, disciplined capital allocation, pricing power, financing strategy, and earnings quality will become more important than broad macroeconomic momentum as the second half of 2026 unfolds.

Services Growth Eases

Services activity remained resilient, but slowing demand and easing price pressures point to more balanced economic momentum

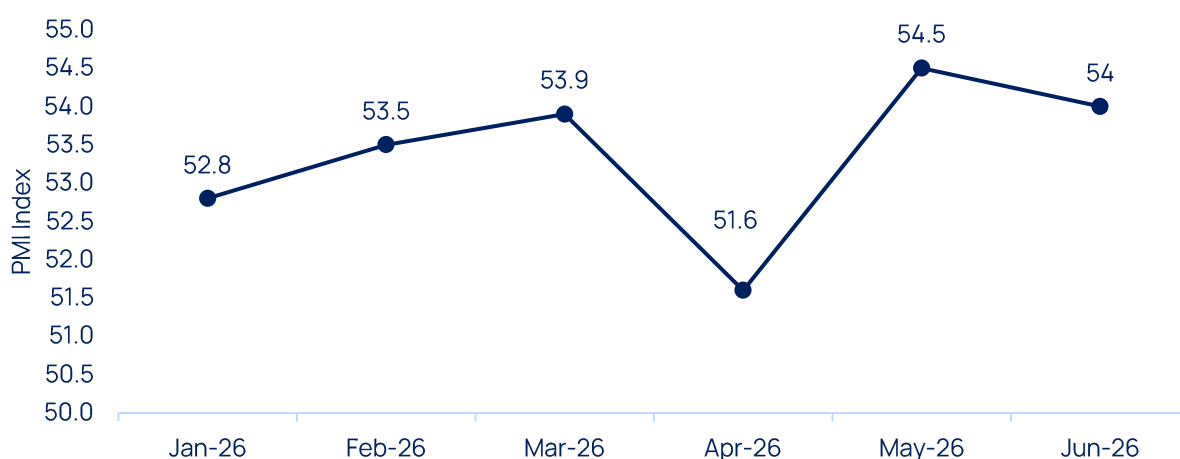
The ISM Services PMI®, released on July 6, 2026, shows U.S. services sector continued to expand in June, although growth moderated from the previous month. The headline index eased to 54.0 from 54.5 in May, marking the 24th consecutive month of expansion and remaining comfortably above the 50-point threshold that separates growth from contraction.

Business activity slowed to 55.4 from 57.7, while the New Orders Index declined to 55.1 from 57.3, indicating that demand remained healthy but lost some momentum after the strong gains recorded in May. A constructive signal emerged from the labor market, with the Employment Index rising to 51.2 from 47.9, returning to expansion for the first time in four months and suggesting that service-sector hiring stabilized despite broader labor-market moderation.

Inflationary pressures also softened, as the Prices Index fell to 67.7 from 71.3, its lowest level since February, reflecting easing fuel costs while wage and tariff-related pressures continued to influence operating expenses. Supplier Deliveries remained elevated at 54.4, highlighting ongoing supply-chain normalization without significant disruption.

For investment banking, private equity, capital markets, the June survey reinforces a soft-landing narrative where service-sector activity continues to support economic growth, but slower order momentum and persistent cost pressures suggest greater emphasis on operating efficiency, pricing discipline, earnings quality, and valuation resilience during the second half of 2026.

Figure 1: ISM Services PMI



Source: Institute for Supply Management

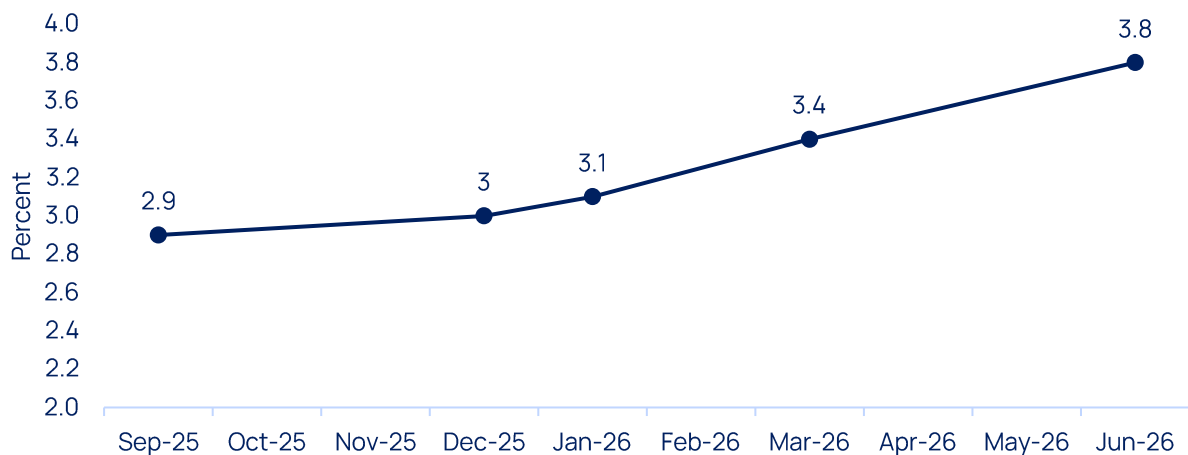
Fed Maintains Policy Discipline

Federal Reserve officials signaled inflation risks still outweigh slowing growth, reinforcing a patient policy approach

The minutes of the June 16–17, 2026 Federal Open Market Committee meeting, released on July 8, 2026, reinforced that the Federal Reserve remains committed to a restrictive monetary policy despite evidence of moderating economic activity. Committee members unanimously voted to maintain the federal funds target range at 3.50%–3.75%, emphasizing that inflation continues to exceed the long-run 2.0% objective and that additional evidence is required before considering policy easing.

Participants acknowledged that labor-market conditions had become more balanced and real GDP growth had moderated, but noted that inflation remained elevated due to persistent services inflation, tariff-related cost pressures, and uncertainty surrounding global trade developments. Several officials highlighted that recent increases in inflation expectations warranting a cautious, data-dependent stance.

Figure 2: Federal Funds Rate Projection



Source: Federal Reserve System

The minutes also indicated that while downside risks to employment had increased modestly, upside risks to inflation remained significant. Financial conditions were viewed as broadly supportive, with credit markets remaining functional despite tighter financing costs. For investment banking, private equity, capital markets, July minutes reinforce a higher-for-longer interest-rate environment where financing costs, valuation multiples, leveraged transactions, refinancing activity, and merger execution will continue to depend on incoming inflation and labor-market data rather than expectations of near-term monetary easing.

Consumer Credit Growth Slows

Households reduced revolving borrowing, signaling more selective spending ahead of the second-quarter earnings season

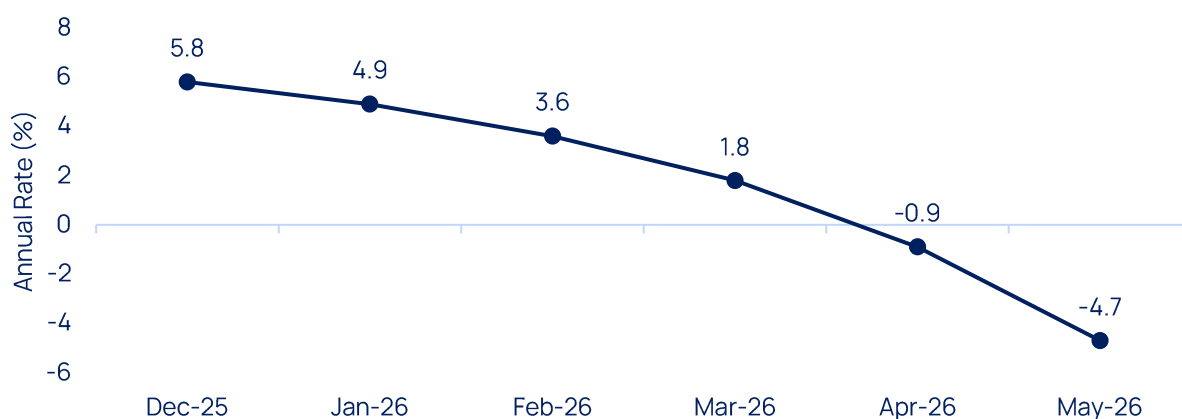
The Consumer Credit report, released on July 8, 2026, indicated that U.S. households became more disciplined in their use of credit during May, reflecting a gradual shift toward more cautious consumer spending. Total consumer credit increased at a 2.0% annual rate, driven entirely by nonrevolving credit, while revolving credit, primarily credit card balances declined at an annual rate of 4.7%, marking the sharpest contraction in several months.

In contrast, nonrevolving credit, which includes auto and student loans, increased at an annual rate of 1.6%, suggesting consumers continued to finance long-term purchases while reducing short-term discretionary borrowing. Revolving credit moderates as high financing costs and tighter budgets follow extended restrictive policy.

The trend is also becoming visible in corporate guidance. Several major U.S. consumer staples companies lowered their outlooks for the second quarter, citing softer consumer demand, increased value-seeking behavior, and persistent pressure on discretionary spending. While essential goods continue to demonstrate relatively stable demand, companies reported greater promotional activity and a more cautious purchasing environment across several product categories.

For investment banking, private equity, capital markets, slowing revolving credit growth signals a more selective consumer backdrop, increasing the importance of pricing power, earnings quality, margin resilience, and demand forecasting as second-quarter earnings season begins.

Figure 3: Revolving Consumer Credit Growth



Source: Board of Governors of the Federal Reserve System

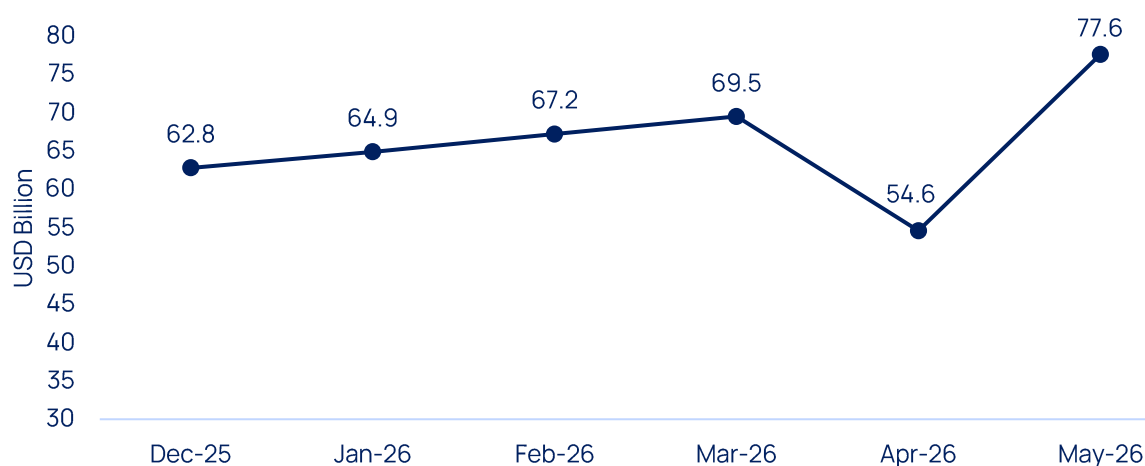
Trade Deficit Widens Sharply

Rising imports outpaced export growth, increasing external-sector pressure on second-quarter U.S. economic growth

The U.S. International Trade report, released on July 7, 2026, showed that the goods and services trade deficit widened sharply to USD 77.6 billion in May, increasing USD 23.0 billion from the revised USD 54.6 billion recorded in April. The deterioration reflected a faster increase in imports than exports, highlighting resilient domestic demand despite tighter monetary conditions. Exports increased USD 11.6 billion to USD 290.5 billion, supported by gains in industrial supplies, capital goods, and civilian aircraft, while imports rose USD 34.6 billion to USD 368.1 billion, driven by higher purchases of consumer goods, pharmaceuticals, automotive products, and capital equipment.

The widening deficit indicates that net exports are likely to become a drag on second-quarter U.S. GDP growth after contributing positively in the previous quarter. However, sustained import growth alongside slower global demand raises questions about the durability of export momentum during the second half of 2026.

Figure 4: U.S. Goods & Services Trade Deficit



Source: Bureau of Economic Analysis

For investment banking, private equity, capital markets, and corporate strategy, the latest trade data reinforces the importance of monitoring global demand, supply-chain resilience, foreign exchange exposure, and cross-border capital allocation. Companies with diversified international revenue streams, efficient sourcing strategies, and flexible operating models are likely to remain better positioned as trade dynamics increasingly influence earnings quality, valuation assumptions, and merger and acquisition activity.

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