ECONOMIC UPDATE
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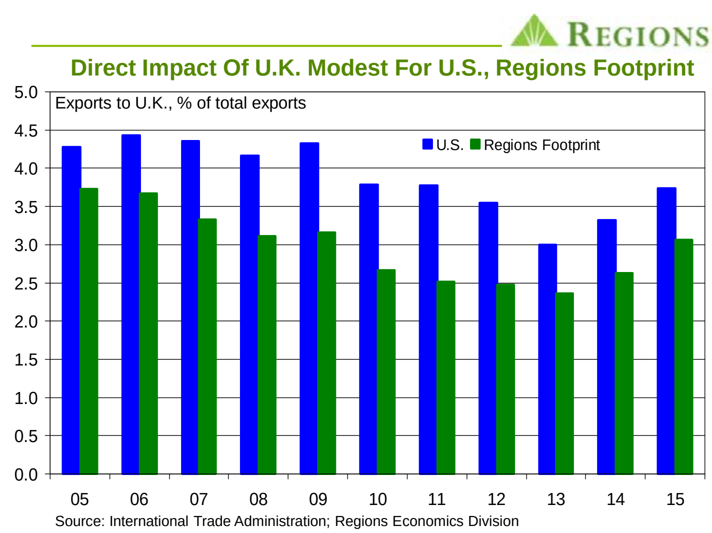
Regions Footprint Faces Limited Direct Impact From Brexit

Voters in the U.K. threw global financial markets and policy makers for a loop by voting to exit the European Union. It will, literally, take years for the economic and financial impact of the Brexit vote to play out, but however long this process takes, it will likely be marked by considerable volatility and uncertainty. In the near-term, though, it seems highly likely the outcome of the Brexit vote will push the British economy into recession. A natural question is the extent to which the U.S. economy would be impacted should the British economy slip into recession, and a natural follow up for us is the extent to which this would be felt in the economy of the Regions footprint. In both cases, the direct effects would be rather limited, as exports to the U.K. account for a relatively minor share of overall exports, which is true of the Regions footprint and the U.S. as a whole. Unfortunately, however, it could very likely be the case that the indirect effects stemming from a prolonged period of economic and political uncertainty and heightened volatility in the financial markets, could exact a sterner toll on the U.S. economy and, in turn, the Regions footprint. In what follows we will focus on the direct effects stemming from export exposure to the U.K.

In the aftermath of the Brexit vote, the British pound has depreciated against other major currencies, including the U.S. dollar. This in turn alters the relative price of British and U.S. goods – goods produced in the U.S. and priced in terms of U.S. dollars are now more expensive in the U.K. while, conversely, goods produced in the U.K. and priced in terms of pounds are cheaper for U.S. firms and consumers. This "price effect" compounds the "income effect" that would be in play should the British economy fall into recession, i.e., in the event of recession, there will simply be less British demand for goods and services regardless of where they are produced, and some of this decline in demand will be felt by U.S. producers who sell their goods in the U.K. Naturally, in order to fully assess the impact on U.S. producers one would have to make some assumptions as to the severity and duration of any such recession in Britain. What we do know, however, is that the U.K. is simply not a very large export market for U.S. firms, including most of the Regions footprint. (For a brief note on the state level export data, please see the bottom of Page 3.)

As seen in the chart to the side, exports to the U.K. account for a minor share of total U.S. exports and an even smaller share of exports from the Regions footprint. In 2015, exports to the U.K. accounted for 3.7 percent of total U.S. exports and for 3.1 percent of exports from the 15-state Regions footprint. The U.K. was, in 2015, the fifth largest export market for the U.S. and the seventh largest export market for the footprint as a whole. That the U.K. accounts for such a small share of exports despite a fairly high rank amongst export markets simply illustrates how highly concentrated exports are amongst the top export markets. In other words, the top three export markets for both the footprint and the U.S. as a whole are Canada, Mexico, and China, which combined to account for 42.1 percent of all U.S. exports in 2015 and for 44.0 percent of all exports from the Regions footprint.



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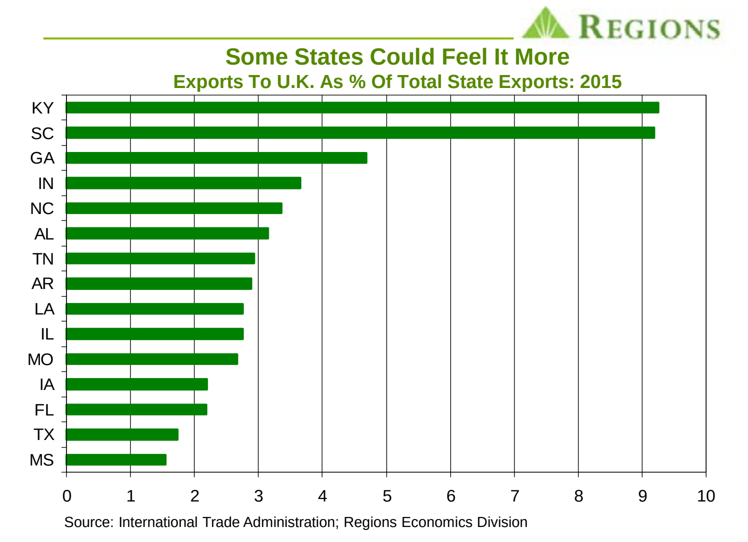
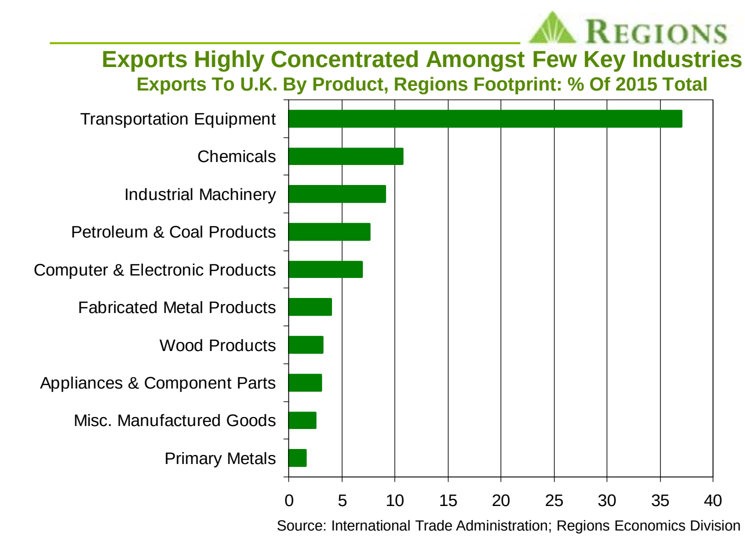


Of course, when discussing the footprint one must be mindful of what can be significant differences on a state-by-state basis that can be lost in the discussion of the footprint as a whole, and this is just as true of the data on exports as with any other data series. For instance, the chart to the side shows exports to the U.K. as a share of total 2015 exports for each of the fifteen states in the footprint. In both Kentucky and South Carolina, the U.K. accounted for over 9 percent of total exports in 2015 – the U.K. ranked as the second largest export market for Kentucky and the fourth largest for South Carolina. As such, these states could be more vulnerable to a pronounced and sustained downturn in the U.K. economy than other states in the footprint. At the other end of the spectrum, the U.K. accounted for less than three percent of total exports in nine of our states in 2015, meaning these states would likely feel little, if any, ill effects of a downturn in the U.K. economy, at least in terms of the direct impact.

To the extent there are adverse effects on exports stemming from the Brexit fallout, these effects would be would be concentrated in a relatively small number of industry groups. The chart to the side shows the top-ten export products flowing from the Regions footprint to the U.K. and, as seen in the chart, there is a very high concentration amongst a very small number of products. Transportation equipment accounted for 37.1 percent of all exports from the footprint to the U.K. in 2015, and this is a long-running characteristic of exports from the footprint to the U.K. Chemicals accounted for 10.7 percent of 2015 exports from the footprint to the U.K. and industrial machinery another 9.1 percent. In other words, the top three products accounted for 56.9 of total 2015 exports from the footprint to the U.K. in 2015. For the U.S. as a whole, the concentration is less pronounced but transportation equipment and chemicals are also the top two export products to the U.K., accounting for 23.3 percent and 14.3 percent, respectively, of all exports to the U.K.



That transportation equipment is the main export from the Regions footprint – overall and to the U.K. – shouldn't come as a major surprise given the prominence of automobile manufacturing across the footprint. But, it isn't just motor vehicles and motor vehicle parts being produced and shipped abroad, as aircraft engines and parts comprise a significant share of Kentucky's exports of transportation equipment, and in other states shipbuilding also factors into the mix in the broad transportation equipment category. It is interesting to note that the Regions footprint accounted for 58.2 percent of exports of transportation equipment from the U.S. to the U.K. in 2015 and for 27.5 percent of exports of chemicals.

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The above discussion illustrates the point that the direct effects of any Brexit-related downturn in the U.K. economy would be fairly limited, both for the Regions footprint and the U.S. economy as a whole. Clearly, specific states and specific industry groups would be more at risk but, still, in terms of the impact on the economy as a whole, these direct effects would be modest. That does not, however, mean there is no reason for concern. For instance, a downturn in the U.K. economy would have an adverse impact on the Euro Zone economy which, in turn, would likely exact a further toll on exports, including from the Regions footprint. But, as we have discussed in prior reports, the Euro Zone as a whole accounts for a relatively small share of total exports from the U.S. and from the Regions footprint.

There are a number of other channels through which Brexit-related weakness in the U.K. and Europe could have an adverse impact on the U.S. economy. For instance, though to this point U.S. dollar appreciation has been fairly limited – mainly against the British pound and, to a lesser extent, the euro – should there be a new wave of concerns over the outlook for the global economy or signs that other nations may follow the U.K.'s lead and exit the E.U., or possibly the Euro Zone, we would surely see a more intense flight to the safety of U.S. dollar denominated assets. This would result in a broader and more pronounced appreciation of the U.S. dollar, making U.S. produced goods more expensive relative to goods produced in a much larger group of foreign countries which, in turn, would lead to more significant declines in U.S. exports.

There would be other effects of a pronounced and sustained appreciation of the U.S. dollar, such as downward pressure on commodity and energy prices which would throw another hurdle in the path of U.S. energy producers just regaining some footing after a challenging period. Additionally, a stronger U.S. dollar would also make it more costly for foreigners to vacation in the U.S. and to buy properties, residential and commercial. As such, even an economy such as Florida, in which exports of goods play a fairly minor role, would still feel a downdraft from a stronger U.S. dollar.

There is a counterpoint to keep in mind as well when considering potential fallout from the Brexit vote. To the extent the British pound is depreciating against the U.S. dollar and other major currencies, British goods are cheaper in global markets. Thus, there could actually be stronger U.K. demand for raw materials or intermediate goods used in the production of finished products subsequently exported by Britain. As such, producers of products such as primary metals or jet engines/parts, might actually experience a softer ride than producers of finished products for sale to British firms and consumers.

There is obviously a considerable degree of uncertainty with regards to the political and economic fallout from the Brexit vote. While it is true the direct economic effects on the U.S. and the Regions footprint would be fairly modest in the event the British economy slips into recession, we'd also caution that any such downturn is highly unlikely to be so well-contained that the direct effects are the only effects we need consider. Indeed, we'd argue that the indirect effects, though much harder to quantify ex ante, have the potential to do far more damage. This is especially the case with the experiences of 2007-09 still so strongly etched in the minds of many financial market participants and in an environment in which monetary policy has become less and less effective and there is no faith in either the will or the ability of fiscal policy makers.

NOTE ON STATE LEVEL EXPORT DATA: The state level export data are compiled on an "origin of movement" basis. In other words, the data credit export merchandise to the state where the goods began their final journey to the point of exit from the U.S., which can either be the location where the goods were produced or, in some cases, the location of a distributor, warehouse, or cargo processing facility. In some cases, as with agricultural goods, the origin of movement is different from the transportation origin. For example, it is often the case that inland states have their agricultural products shipped down the Mississippi River for export from the Port of New Orleans and, in these cases, Louisiana is credited for all such agricultural exports while the states in which the goods originate see their exports undercounted. This is far less of an issue with manufactured goods and simply reflects an unavoidable limitation of the data we have to work with.

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