March 15, 2019

# Economics Group


**Tim Quinlan, Senior Economist**
tim.quinlan@wellsfargo.com • (704) 410-3283
**Sarah House, Senior Economist**
sarah.house@wellsfargo.com • (704) 410-3282
**Shannon Seery, Economic Analyst**
shannon.seery@wellsfargo.com • (704) 410-1681


# What 737-MAX Groundings Mean for Durable Goods

***The widespread grounding of the 737-MAX aircraft means that durable goods orders will likely be under added pressure the next few months. The pause on deliveries also represents a near-term risk to equipment spending.***

## The Fast-Growing 737 MAX Now Poised for Potential Decline

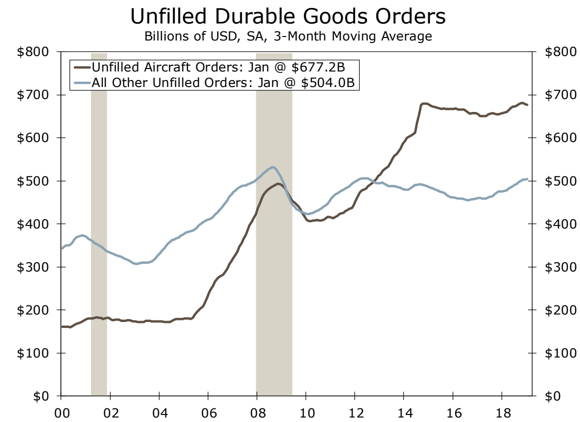
Whether from the Defense Department or from private airlines, aircraft orders are usually a big swing factor in overall durable goods orders. With news this week that the U.S. Federal Aviation Agency (FAA) joined its counterparts around the world grounding the 737-MAX and Boeing halting deliveries, we consider the potential implications for durable goods orders and equipment spending.

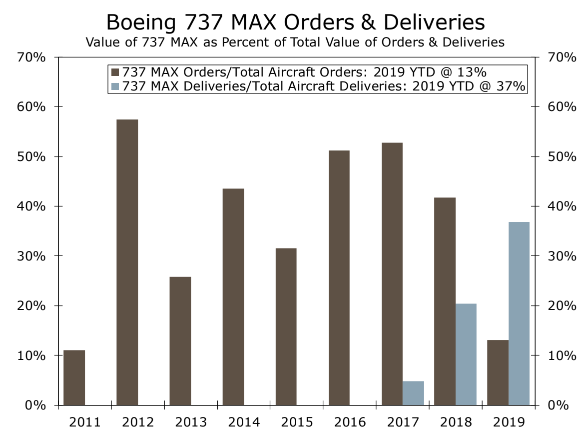
The groundings apply only to the 737-MAX, the most recent generation of the world's best-selling aircraft. Since the first shipment in May 2017, Boeing has delivered just 376 of the aircraft in question, though the total number of orders booked is just over 5,000, the earliest of which were recorded as far back as 2011. If some of those orders were to be canceled, the Commerce Department would subtract them from the headline figure in the month in which they occur for the durable goods report, according to notes in the report release and our discussions with Commerce Department staff.

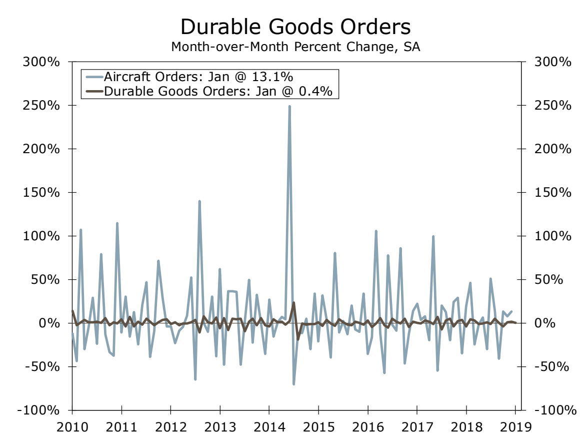
We have had some success forecasting headline durable goods in recent years partly due to a time series we constructed based on actual orders data from Boeing and an informed guess of an average discount to the list aircraft pricing published on its website. While this is not intended to be spot-on accurate, it functions reasonably well and offers a decent starting point for understanding the potential impact on durables from recent groundings.

Aircraft orders can be highly volatile from month to month, but they made a little under a tenth of total durable goods orders over the past year. From 2011 to 2015, orders for all types of the 737-MAX aircraft comprised roughly a third of Boeing orders, though it has become more important since 2016, comprising just under half of all bookings (47.1% by our estimate). Considering the 737-MAX aircraft comprises almost half of Boeing's orders in the past few years the total negative impact to durables could be substantial if airlines hold off on new 737-MAX orders the next few months.

We doubt we'll see significant cancellations, however. Cancellations tend to incur hefty penalties, and Boeing is working on a fix for the issue at hand. In addition, multi-year backlogs at Airbus leave airlines looking to expand or upgrade aging fleets few alternatives. A similar situation occurred after a battery problem linked to fires aboard the 787 Dreamliner caused a grounding of that aircraft from January to April of 2013. Orders still came in during the grounding period and the Dreamliner has subsequently seen steady sales volume. Also reminiscent of that period, Boeing said they will continue to build the 737-MAX while it resolves the issue, which will likely prevent any major disruption to supply chains. Suspended deliveries, on the other hand, could weigh on capex spending as early as the current quarter. The 737-MAX aircraft averaged roughly 40% of aircraft deliveries in the past three months. With fewer aircraft being shipped until the issue is resolved, we see some risk to our near-term outlook for equipment spending.




Source: Boeing, U.S. Department of Commerce and Wells Fargo Securities

## Wells Fargo Securities Economics Group


| | | | |
|---|---|---|---|
| Jay H. Bryson, Ph.D. | Global Economist | (704) 410-3274 | jay.bryson@wellsfargo.com |
| Mark Vitner | Senior Economist | (704) 410-3277 | mark.vitner@wellsfargo.com |
| Sam Bullard | Senior Economist | (704) 410-3280 | sam.bullard@wellsfargo.com |
| Nick Bennenbroek | Macro Strategist | (212) 214-5636 | nicholas.bennenbroek@wellsfargo.com |
| Tim Quinlan | Senior Economist | (704) 410-3283 | tim.quinlan@wellsfargo.com |
| Azhar Iqbal | Econometrician | (212) 214-2029 | azhar.iqbal@wellsfargo.com |
| Sarah House | Senior Economist | (704) 410-3282 | sarah.house@wellsfargo.com |
| Charlie Dougherty | Economist | (704) 410-6542 | charles.dougherty@wellsfargo.com |
| Erik Nelson | Macro Strategist | (212) 214-5652 | erik.f.nelson@wellsfargo.com |
| Michael Pugliese | Economist | (212) 214-5058 | michael.d.pugliese@wellsfargo.com |
| Brendan McKenna | Macro Strategist | (212) 214-5637 | brendan.mckenna@wellsfargo.com |
| Shannon Seery | Economic Analyst | (704) 410-1681 | shannon.seery@wellsfargo.com |
| Matthew Honnold | Economic Analyst | (704) 410-3059 | matthew.honnold@wellsfargo.com |
| Dawne Howes | Administrative Assistant | (704) 410-3272 | dawne.howes@wellsfargo.com |