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Stimulus Assessment Update: Cement Impacts

Overview

Significant attention is being focused on the size and details of the forthcoming stimulus package. It must be remembered that the economic stimulus program will be overlaid upon the underlying economic fundamentals. Lacking a clear assessment on this critical point could lead to substantial errors in cement consumption projections for 2009-2011. This flash report serves as an update regarding PCA's assessment of the underlying economic fundamentals, the potential stimulatory impact on cement consumption, and finally an estimate on annual cement consumption volumes. ***This Flash Report contains rough estimates. Once passage of the stimulus bill materializes, PCA will perform a more comprehensive forecast assessment.***

The volume estimates contained in this report are subject to four key risks including: forecast errors in assessing the underlying economic fundamentals, the size and details of the final stimulus package, the stimulatory impact on the economy, construction activity and cement consumption, and the timing of these stimulatory impacts. These risks are considerable and should be noted when used to support senior management decisions.

Economic Updates

Underlying economic fundamentals will serve as the base upon which stimulus programs will be applied. PCA projections have long been among the most pessimistic among construction forecast groups. Our recent flash report on the stimulus plan painted a bleak picture regarding the underlying economic conditions. Recent data suggests a continued and alarmingly rapid deterioration of economic fundamentals – beyond those previously forecast. In addition to prevailing issues regarding sub-prime mortgages, the deterioration in economic conditions is being accelerated in the loss of consumer, business, and bank confidence which in-turn is fueled by massive job losses. ***PCA believes the recession may have entered into a new phase, one characterized by a severe loss in confidence which, in-turn, feeds upon itself - a "viscous circle".***

Labor Market Weakness: The U.S. economy shed nearly 2.9 million jobs during 2008 with 2.0 million jobs lost since September 1st. Unfortunately, the monthly job loss trend is accelerating with nearly 600,000 jobs lost in January. The job losses are broad based across industries and regions. With the private sector of the economy contracting, and given the time lags that are likely to materialize before fiscal stimulus gains traction, nothing lies in the near term horizon to prevent a continued acceleration in monthly job losses. PCA's stimulus assessment report assumed 500,000 jobs lost monthly through the first quarter and 350,000 jobs lost monthly during the second quarter. While our first half job loss projections are considered extremely pessimistic by the forecasting community, PCA now believes that our projections may be optimistic. Even larger first half 2009 job losses are anticipated compared to PCA's last flash report. ***PCA now expects as many as 3 million jobs will be lost during the first half of 2009.*** Job losses will lead to further erosion in consumer spending, economic growth and consumer/business sentiment. In addition, job losses will worsen state fiscal conditions.

Loss of Confidence: In addition to structural and other cyclical problems facing the economy, a broad based deterioration in consumer, business and banking confidence marks a new phase for the recession. This phase is defined by risk aversion in even currently healthy economic consumers and could lead to accelerated economic weakness. While a myriad of issues are responsible, massive job losses have heightened a loss of confidence. Consumer sentiment has decline 57% from year-ago levels and now stands at the lowest level in the survey's history. Business confidence has recorded similar erosion.

The dramatic loss of confidence across sectors is the latest wrinkle among economic troubles, and could be among the hardest to correct. If PCA's labor market assessment for the near future is correct, consumer sentiment will remain depressed throughout 2009. Depressed sentiment, coupled with job market losses imply that consumers' will retrench further. Consumer spending accounts for two thirds of overall U.S. economic activity. Business sentiment declines are expected to feed upon the declines in business activity.

Credit Conditions: Bank confidence, measured by the estimated risk premiums associated with commercial lending, reached an all time high in December (527 basis points). While an easing materialized in January, risk premiums remain extremely high. Furthermore, according to Federal Reserve surveys, the number of banks engaged in a tightening of lending standards for mortgage, consumer and commercial lines of credit reached its apex in the fourth quarter of 2008. While some easing by banks has materialized in January, it remains restrictive.

Prior to the \$700 billion financial bailout, bank write-downs totaled \$500 billion. Keep in mind, the sub-prime crisis is not over. Increased sub-prime resets and softer labor markets will result in acceleration in mortgage defaults. Accelerated foreclosures imply further bank write-downs – offsetting the treasury's cash infusions into the banking sector. This may slow an easing in lenders' aversion toward risk. Our fall forecast suggested that these dynamics may result in requests for additional funds to supplement the existing program. Supplements to the existing TARP are being considered. Without an easing in lending standards, it will be difficult for the economy to recover.

Cement Consumption: Cement consumption has been declining at an accelerated rate. November's consumption recorded a 79.7 million metric ton SAAR – the lowest level in more than 13 years and reflected a 29.5% decline compared to weak 2007 levels. **Unfortunately, sub-80 million metric ton SAARs are expected to remain in place through much of the first half of 2009.** Relief from such low cement consumption selling rates is solely dependent upon the potential success of the forthcoming stimulus package. Lacking its success, neither private residential or nonresidential construction are expected to begin recovery until the second half of 2010, at the earliest.

Conclusion: The stimulus bill will be overlaid atop weaker than previously expected underlying economic fundamentals.

Policy Updates

A stimulus bill is expected to be passed by congress soon. PCA performed a very rough and preliminary assessment of both the House and Senate versions of the proposed stimulus packages. Due to the time required to run stimulus scenarios, PCA used Senators Nelson/Collins preliminary compromise estimates of the senate bill. The final Senate bill contains some changes compared to the preliminary estimates used in PCA's analysis. The changes could increase the net cement consumption estimates associated with the senate bill.

On a line item basis, PCA applied cement intensities to each spending initiative identified in both bills to estimate potential cement consumption increases. Details of each spending initiative are somewhat lacking. Furthermore, crude cement intensity estimates were applied. Significant risks/errors, therefore, could be contained in our estimates. PCA assumes that all spending initiatives are exhausted by 2012. Our timeline further assumes House spending initiatives of 15% during 2009, 65% during 2010, and 20% during 2011. The Senate seems to have scrubbed questionable stimulatory spending items and focused spending on more meaningful infrastructure investment. This may imply a slower start-up for transportation initiatives. As a result, our timeline assumes Senate spending initiatives of 12% during 2009, 63% during 2010, and 25% during 2011.

According to our analysis, both proposals stimulate the economy and cement consumption. PCA estimates that the \$260-\$270 billion proposed spending initiatives will directly increase cement consumption roughly 16 million metric tons over program lives (see table). For both the House and Senate bills, roughly 80% of cement consumption gains are attributed to transportation and infrastructure spending initiatives.

Preliminary Stimulus Bill Spending Impacts on Cement Consumption				
	House Spending \$	Senate* Spending \$	House Cement Consumption (000 Metric Tons)	Senate Cement Consumption (000 Metric Tons)
Agriculture	\$6,926,500	\$5,109,430	166	176
Commerce, Justice	\$14,191,000	\$21,513,000	29	146
Defense	\$4,865,000	\$3,746,000	19	13
Energy and Water Development	\$48,915,000	\$53,843,000	350	511
Financial Services, General Government	\$12,094,000	\$10,762,000	88	125
Homeland Security	\$1,102,000	\$5,076,700	23	206
Interior				
- Land Management	\$3,340,000	\$2,248,600	769	430
- Environmental Protection Agency	\$9,420,000	\$7,400,000	898	686
- Interior Related Agencies	\$2,250,000	\$1,995,000	51	64
Labor, HHS, Education	\$90,409,000	\$90,184,000	777	514
Legislative Branch	\$25,000	\$20,000	0	0
Military Construction and Veterans Affairs	\$7,001,000	\$7,428,295	103	193
State, Foreign Operations	\$500,000	\$1,031,000	6	6
Transportation, Housing Urban Development	\$59,435,000	\$60,580,500	12,770	13,456
Total Direct Spending/Cement Consumption	\$260,473,500	\$270,937,525	16,047	16,525
* Senate based on preliminary Nelson-Collins estimates, actual bill may differ slightly				

Tax relief, aid-to-states, and increases in entitlement spending account for the remaining portions of the \$800 billion stimulus package. Tax and entitlement spending aspects of the stimulus bill are expected to yield relatively rapid impacts on the economy. To a large extent these measures are viewed as job-saving, rather than job-creating actions designed at preventing further accelerated erosion of the economy. The tax impact is assumed to be fully dissipated in the second half of 2010. The less adverse economic environment generated by tax cuts will translate into a slower deterioration in construction markets and lend some marginal support to cement consumption levels during 2009 and 2010. PCA believes these impacts will be relatively small. The Senate bill contains a higher amount of tax relief compared to the House bill. As a result, the tax impacts on cement consumption are somewhat larger under the Senate bill. In both bills, the tax component accounts for less than one million tons in 2009 and 2010.

Aid-to-states could make a more significant improvement in the cement consumption outlook. Roughly 50% of cement consumption is consumed by the public sector. Of that, more than 90% is related to state and local construction. According to the no stimulus plan, the state fiscal crisis is the largest contributor to near term weakness. The House bill is more generous to the states than the Senate bill and as a result contains higher cement impacts. By providing aid-to-states, PCA estimates the cement impact at 2.9 million tons in 2009, 7.2 million tons in 2010, and 3.2 million tons in 2011 under the House bill. PCA estimates the cement impact at 2.2 million tons in 2009, 5.5 million tons in 2010, and 2.5 million tons in 2011 under the Senate bill. Keep in mind, state-aid cement impacts include induced economic benefits associated with the job creation aspects of the entire stimulus package. This is particularly noteworthy when assessing PCA's 2011 cement impact estimates.

House Stimulus: Cement Scenario
- Thousand Metric Tons

	2009	2010	2011
Fall Forecast	85,485	83,327	91,507
- Percent Change	-11.6%	-2.5%	9.8%
No Stimulus	76,950	70,025	76,327
- Percent Change	-19.0%	-9.0%	9.0%
House Bill			
House Spending	2,407	10,431	3,209
House Tax	465	698	0
House State Aid	2,939	7,214	3,246
House Indirect Benefits	581	3,668	12,911
Total House Stimulus	6,392	22,011	19,367
-House Direct Stimulus	5,811	18,343	6,456
-House Indirect Stimulus	581	3,668	12,911
House Scenario Total	83,342	92,035	95,694
- Percent Change	-12.3%	10.4%	4.0%
Note: Some state aid impacts include indirect benefits			

Senate Stimulus: Cement Scenario*
- Thousand Metric Tons

	2009	2010	2011
Fall Forecast	85,485	83,327	91,507
- Percent Change	-11.6%	-2.5%	9.8%
No Stimulus	76,950	70,025	76,327
- Percent Change	-19.0%	-9.0%	9.0%
Senate Spending	1,983	10,411	4,131
Senate Tax	750	985	0
Senate State Aid	2,271	5,576	2,509
Senate Indirect Benefit	500	3,394	13,281
Total Senate Stimulus	5,504	20,366	19,922
-Senate Direct Stimulus	5,004	16,972	6,641
-Senate Indirect Stimulus	500	3,394	13,281
Senate Scenario Total	82,454	90,391	96,248
- Percent Change	-13.2%	9.6%	6.5%
Note: Some state aid impacts include indirect benefits.			
*Senate assessment based on Nelson/Collins preliminary estimates.			

In assessing the potential impacts of the stimulus bill on cement consumption, direct and indirect impacts must be addressed. Direct impacts on cement consumption arise from spending and tax initiatives. Indirect benefits (induced benefits) arise by generating economic momentum, brightening the jobs and construction markets to the benefit of cement consumption. PCA believes that the stimulus package may be slow in reviving the economy. Indirect benefits to cement consumption in 2009 are expected to be modest. As jobs are created and economic momentum increases, benefits will be accrued to the construction industry – increasing cement consumption. By 2011, indirect benefits to cement consumption resulting from the stimulus could be the largest contributor to cement consumption.