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PCA Perspectives:

Cement Outlook:

Short-Term Challenges Give Way To Long-Term Gains

This is the second in an ongoing series on the impact of the Economic Stimulus Plan

By Al Perlman

The U.S. construction industry will be boosted significantly by the historic $787 billion economic stimulus plan signed by President Obama earlier this year. The stimulus plan will be a catalyst for the building of new highways, roads and bridges, and it will create and save several million jobs at a time when the economy desperately needs this kind of shot in the arm.

That's the good news. The less-than-good news is that the impact of the stimulus plan will take time to be felt, both in actual infrastructure spending and in job creation. Beyond that, there is the question of whether the $787 billion infusion will be large enough to solve the nation's financial woes and whether a second stimulus plan will be required.

These are among the findings addressed in the most recent economic forecast issued by the Portland Cement Association and their widely respected chief economist, Ed Sullivan. The findings from PCA are particularly relevant to the overall U.S. construction industry because concrete is the foundation material upon which much of the nation's infrastructure is built.

Because of the way in which the stimulus plan is being rolled out, the advantages to the construction industry will take some time to be realized. Sullivan points out that the first phase of the stimulus program—tax relief, entitlement spending and state aid—will have little impact on cement consumption. In addition, much of the early spending will focus on shovel-ready projects such as road resurfacings, rather than on the building of new roads. Eventually, the spending patterns will shift, but the bulk of initial spending will not be on projects that are extensive in their use of cement.

However, while the cement industry may be dealing with short-term challenges as it waits for the impact of the economic stimulus plan to kick in, it is also finding that its long-term position is particularly encouraging, due to two key factors:

1. The long-term boost in infrastructure spending created by the stimulus plan
2. A significant shift in the cost differential between concrete and asphalt—a shift that is swinging dramatically in favor of concrete.

As a result of these key factors, PCA is looking forward to a period of large and sustained growth once the economic recovery is in place, beginning next year and extending for many years into the foreseeable future.

A Cost Breakthrough

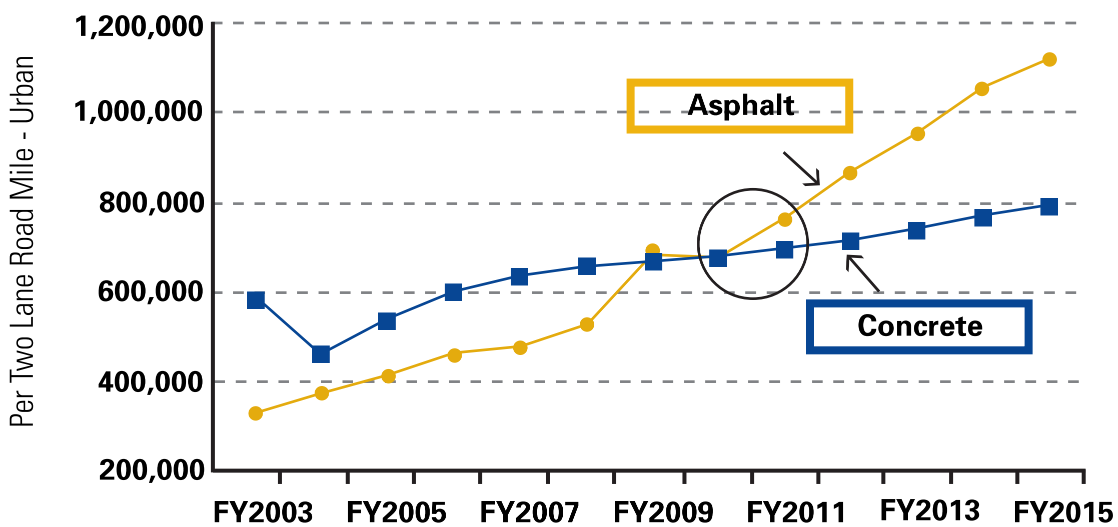
The long-term potential for the cement industry is greatly enhanced because, in addition to the rolling out of the economic stimulus plan, this is turning out to be a breakthrough year in the competitive cost battle between concrete and asphalt in the building of roads.

Concrete has always enjoyed a long-term cost advantage over asphalt because it is more durable, energy efficient and requires less ongoing maintenance. However, in most comparisons of short-term costs—generally referred to as the initial bid or initial construction costs—asphalt has typically enjoyed an advantage. This typical advantage will disappear completely during the current fiscal year, and concrete will achieve both short-term cost parity and long-term cost advantage.

Moreover, beyond this year, looking out into 2010, 2011 and beyond, the advantage for concrete as a cost-effective building solution versus asphalt will continue to grow. Asphalt prices will continue to rise and supplies will continue to diminish. Beyond volatility linked to oil prices, changes in oil refining (cokers) are limiting asphalt supplies, resulting in real and projected shortages, according to liquid asphalt producers.

Beginning next year, concrete will assume a leadership position versus asphalt in short-term as well as long-term costs. This cost advantage is

Projected: Initial Bid Concrete Vs Asphalt Paving Costs



Parity Achieved in Fiscal 2009

expected to expand significantly in the years beyond 2010 and 2011. This shift in the cost advantage of concrete versus asphalt will occur at a time when the most significant benefits of the economic recovery are expected to be taking place, which is why PCA sees the potential for many years of large gains and sustained growth.

Getting There From Here

To reach those potential glory years of sustained growth, however, the cement industry will have to undergo some growing pains, which will largely be concentrated in the first half of this year. Overall cement consumption will decline by 17% this year to 77 million metric tons, PCA estimates, with the bulk of the drop occurring during the beginning of the year. This makes sense: The impact of the stimulus package on public infrastructure spending is not yet being felt, and spending in the private sector is still weak due to the soft economy.

PCA envisions “traditional” infrastructure spending—the building and expansion of highways and bridges—to materialize by the second half of 2010, after the initial focus on shovel-ready projects such as the repaving of roads or the painting of bridges. In addition, by 2011 the indirect benefits to cement consumption from the stimulus could really provide a boon to the market in areas outside of road and bridge construction. This would reflect recoveries in the housing and non-residential construction sectors, fueled by the economic stimulus plan.

Spending on road and bridge construction may also be bolstered in 2011 by a new highway bill, which PCA assumes would be funded at a level of $400 billion, a 42 percent increase over the $280 million funded by the current program. PCA also expects that this new highway bill will have an increased emphasis on concrete-intensive projects such as the building of new routes and capacity expansion, as opposed to system preservation, which was the predominant spending area of the current highway bill.

Is A Bigger Stimulus Needed?

In building PCA’s forecasts and reports, Sullivan analyzes a wide range of economic trends and projections, including the GDP growth rate; lending conditions; unemployment rates; residential family housing; non-residential construction; and others. It is noteworthy that he believes the $787 billion economic stimulus plan may not be enough to solve the nation’s economic woes, particularly in the hot-button area of job creation.

PCA estimates that 8.5 million jobs may be needed to be created and/or saved, versus the Obama plan’s goal of creating or saving 3.7 million jobs. Sullivan’s conclusion: Don’t be surprised if a second stimulus plan materializes.

Conservatively, Sullivan believes the amount needed for the stimulus plan could be at least $1.5 trillion. He also believes the proposed new highway bill—if it does get passed at a $400 billion level—could go a long way toward achieving the growth in jobs that will be required, according to PCA’s projections.

An Optimistic Outlook

Even though the short term may be difficult and the stimulus play may fall short of accomplishing everything that is needed for the economic recovery, the long-term outlook is quite bright for the construction industry in general and the cement industry in particular. This is in large part due to the economic stimulus plan and its emphasis on infrastructure spending—without it, the outlook would be decidedly bleak.

As the stimulus plan rolls out and infrastructure spending increases, PCA sees clear positive results for the years ahead. For 2011-2012, credit standards are expected to ease and job creation is expected to be in full force, generating real GDP growth in excess of 3.5 percent. In addition, housing starts are expected to record double-digit gains and non-residential construction is expected to stabilize and recover by the second half of 2011. Stronger gains could materialize in 2012, PCA predicts.

The PCA report concludes: "In the context of strong economic growth and strength in each of the key construction sectors—residential, nonresidential and public—portland cement consumption is expected to grow extremely strong—reaching a level of 97 million metric tons."

That would represent an increase of more than 25 percent versus 2009 in consumption of portland cement. It is still not quite at the peak levels of 2005, but it is strong growth and reflective of the positive impact of the stimulus plan.

Beyond that, as concrete continues to gain advantage over asphalt as the material of choice, that level of growth could just be the beginning of the road, so to speak.

About the Author:

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About the Sponsor

The Portland Cement Association, based in Skokie, Ill., represents cement companies in the United States and Canada. It conducts market development, engineering, research, education and public affairs programs. More information on PCA programs is available at www.cement.org.