Global Headquarters: 5 Speen Street Framingham, MA 01701 USA P.508.872.8200 F.508.935.4015 www.idc.com

EVENT FLASH

The Impact on ICT Spending of the U.S. Financial System Meltdown

John F. Gantz

As we publish this, the U.S. Congress is debating the wisdom and details of the Troubled Asset Relief Act (TARA) of 2008, hereafter referred to as "The Bailout," submitted to it by the Treasury Department.

The Bailout proposal is in response to the widely publicized events in the U.S. financial markets of the last week, hereafter referred to as "The Meltdown." We don't need to recount them here – the Bear Stearns, Merrill Lynch, Lehman Brothers, AIG, Washington Mutual, subprime mortgage saga – but IDC has an excellent analysis of the reshaping of the banking landscape written by the analysts at Financial Insights, entitled: "Fight or Flight: The New Face of Banking and Its Impact on Spending," published on September 25, 2008.

What we DO need to discuss is what this all means for IT (and communications) spending.

To come up with an opinion we have invoked what we call IDC's First Responder System, a process that allows us to take internal and external inputs and develop a set of assumptions in reaction to specific events. We have done this in times past in response to the Asian financial crisis of 1997, the events of September 11, 2001, the Indonesian tsunami of 2004, and hurricanes Rita and Katrina of 2005. Now we have a formal process to establish a global set of assumptions about an event or condition that might have a significant impact on our ICT spending forecasts.

These assumptions are currently being forwarded to IDC analysts around the world to enable them to respond to client requests about our view of the impact The Meltdown will have on individual ICT markets. But the key assumptions are these:

- For the purpose of forecasting ICT markets, we assume that politics notwithstanding, TARA will pass in some form or other in a short enough period of time to establish some calm in global financial markets.
- While the initial funds committed will be in the vicinity of the published $700 billion, we expect more to be required over the long haul (see the Financial Insights document), perhaps as much as $2 trillion.
- Whether the U.S. will recoup these funds over the years – as it did more or less with the $1.2 billion loan guarantee for Chrysler in 1979 and did *not* in the disposal of assets of insolvent savings and loan companies by the U.S.'s Resolution Trust Company of 1989 – is really unknowable. Inasmuch as it matters to forecasting ICT markets, we assume some but not all will be recouped.
- Even the passage of TARA will not erase all damage to the U.S. economy. We assume that U.S. GDP growth for 2008 will drop another 0.2% or so and for 2009 may be as low as 1%, or 0.4% lower than the September poll of economists published by Consensus Economics, Inc. The Economist Intelligence Unit has already lowered its 2009 U.S. GDP forecast to 0.6%.
- The global economy will also feel reverberations. Current estimates by economists polled by Consensus Economics chart global GDP growth of 2009 at 2.5%. IDC assumes that could drop to 2.2%-2.3%.

Thus, our basic assumption is that The Bailout will go through and will provide stability to global stock markets and the financial system, but there will be a longer term hangover that will depress the U.S. and global economies. This represents a change to the current set of macroeconomic inputs we are using in our ICT forecasts.

What does this mean for ICT markets? Or more specifically, for IDC's forecasts? Less than you might think.

For one reason, our forecast assumptions already have the subprime mortgage debacle and inter-bank liquidity issue on the radar screen. For another, we had been assuming higher oil prices, which gave us conservative ICT forecasts to begin. Finally, our advice to analysts for most of 2008 has been to assume GDP growth of one standard deviation lower than the average

Please contact the IDC Hotline at 800.343.4952, ext. 7988 (or +1.508.988.7988) or sales@idc.com for information on applying the price of this document toward the purchase of an IDC service or for information on additional copies or Web rights. Visit us on the Web at www.idc.com. To view a list of IDC offices worldwide, visit www.idc.com/offices.

Copyright 2008 IDC. Reproduction is forbidden unless authorized. All rights reserved.

Filing Information: September 2008, IDC #, Volume: 1

Executive Market Watch: Event Flash

published in the Consensus Economics, Inc. polls (i.e., we had already been forecasting lower economic growth).

Our First Responder poll of key analysts reveals these impacts from The Meltdown:

- While the Financial Services accounts for nearly 20% of IT spending, subsectors are not affected equally by the meltdown, and even bankrupt firms need to "keep the lights on" and run computer systems that run the business. IDC's Financial Insights predicts that about $3 billion of IT spending will be cut by directly-afflicted financial services firms in 2009, not so much in the overall scheme of a global IT spend of $1.5 trillion. A good portion of IT spend is no longer considered discretionary.
- A much bigger impact will be felt from lower economic activity, the increased cost of capital, lower consumer spending (on all goods, not just IT), falling home prices, and lower exports to the U.S.
- Some IT projects will get cut or postponed, not just in the U.S. but in all geographies. The strongest impact may be on project-based IT services. IT budget scrutiny will increase, however.
- Belt tightening will actually drive faster migration to some new technologies, such as virtualization, software as a service, IP based telecommunications, and enterprise Web 2.0 applications.
- Server markets will see slower growth from the financial services sector directly and from a higher cost of capital, but global PC shipments should not suffer all that much, as falling prices and continued desktop replacement continue to occur.
- Overseas, U.S.-based multinationals are likely to curtail spending, but lower inflation driven by lower oil prices may counter that. The regional impact on exports from the falling dollar has been included in previous sets of forecast assumptions.
- Inasmuch as new regulations are put in place, there will be more spending on software and services to enforce compliance.

IDC's current roll-up of U.S. and IT forecasts shows a U.S. 2009 IT growth rate of 4.2% and telecommunications services rate of 3.4%. The worldwide IT forecast is 5.9% for 2009, telecommunications is 3.7%.

As we begin to incorporate the new financial landscape and our new forecast assumptions regarding The Meltdown, these growth rates will likely come down as the ICT recovery slips toward 2010. But we do not believe they will drop to zero or below as they did in 2002 after the dot.com bust and the economic slowdown after September 11, 2001. The worst we would expect for 2009 is a 1% drop in the U.S. and 0.5% worldwide in IT, less in telecommunications.

©2008 IDC