

## War Outcome Dominates Thinking: 1Q03 Scenarios Update

Charles Smulders

The outcome of the U.S.-led attack on Iraq dominates IT market outlook thinking, but other fundamental issues remain.

## ANALYSIS

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### Recommendations

Gartner Dataquest makes the following recommendations to users and vendors:

- Develop scenario-based strategies for your business and be able to switch among them as unfolding events dictate.
- Look for an upturn in the U.S. economy in the third quarter of 2003 to precede strengthening IT demand.

### War Worries Dominate Over Other Fundamental Issues

Gartner Dataquest's most likely scenario for the worldwide IT markets has not changed since the last version of this forecast. That scenario is as follows:

- The Iraq war is short-lived; a U.S.-led victory is achieved by the end of the second quarter of 2003.
- The removal of uncertainty leads to a U.S. economic recovery beginning in the third quarter of 2003.
- U.S. economic improvement leads to a rise in U.S. IT spending in the fourth quarter of 2003.
- Economies outside of the United States begin their recoveries a quarter or more after the U.S. upturn.

The outcome of the U.S.-led attack on Iraq dominates market outlook thinking. Business plans and the financial markets will remain paralyzed until clear progress is made. The Iraq war is clearly vital to understanding the prevailing and future economic environment, but it is also essential to recognize other fundamental economic and structural concerns. It is not certain that a short, successfully prosecuted conflict will be enough to override those issues, which include the following:

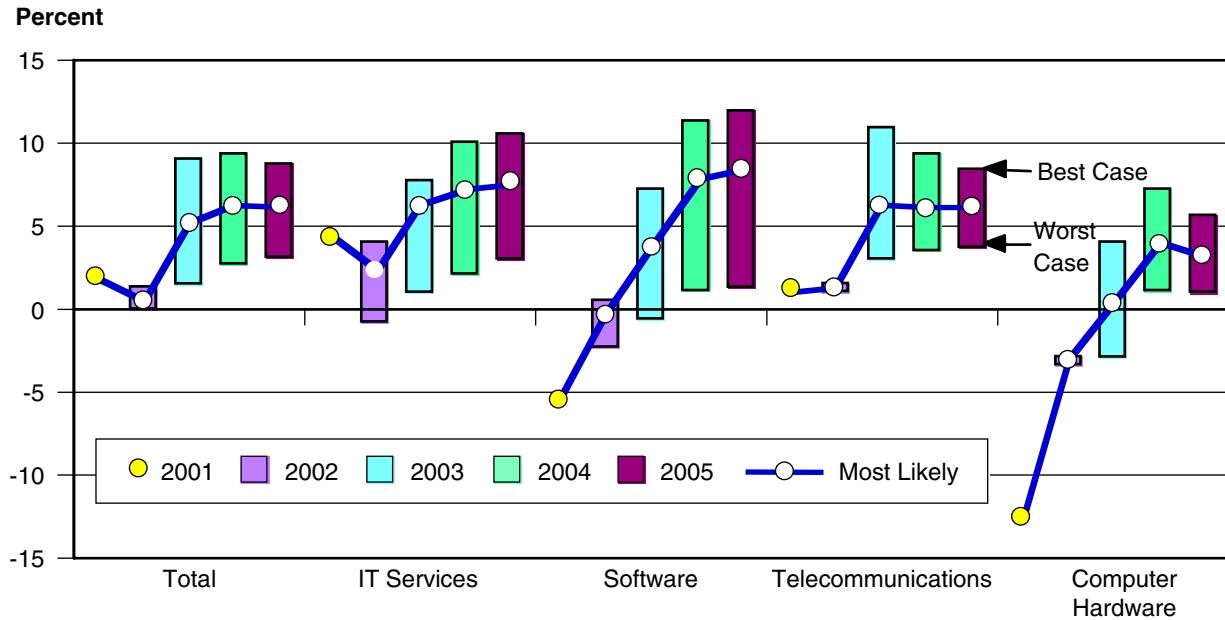
- U.S. budget deficit
- European monetary policy
- Higher oil prices
- The weakening dollar
- Business and consumer confidence
- U.S. house prices
- Deflationary pressures
- The business value of IT

These and other factors led Gartner Dataquest to more carefully consider the worst-case IT spending scenario. In this Spotlight, Gartner Dataquest has written a "what if" piece that more closely examines the factors that would lead to an almost flat-growth scenario for the IT industry until 2005 (see "Worst-Case IT Spending Scenario Gets Worse"). This Perspective represents a

downgrade from Gartner Dataquest's previous worst-case scenario. Gartner Dataquest's best-case scenario calls for an economic upturn in the second quarter of 2003, but this is considered unlikely.

Figure 1 shows the best-, most likely and worst-case growth scenarios by segment for the worldwide IT markets. It compares growth in end-user spending by major market.

**Figure 1. Best-, Most Likely and Worst-Case Annual Growth Scenarios by IT Segment**



Source: Gartner Dataquest (March 2003)

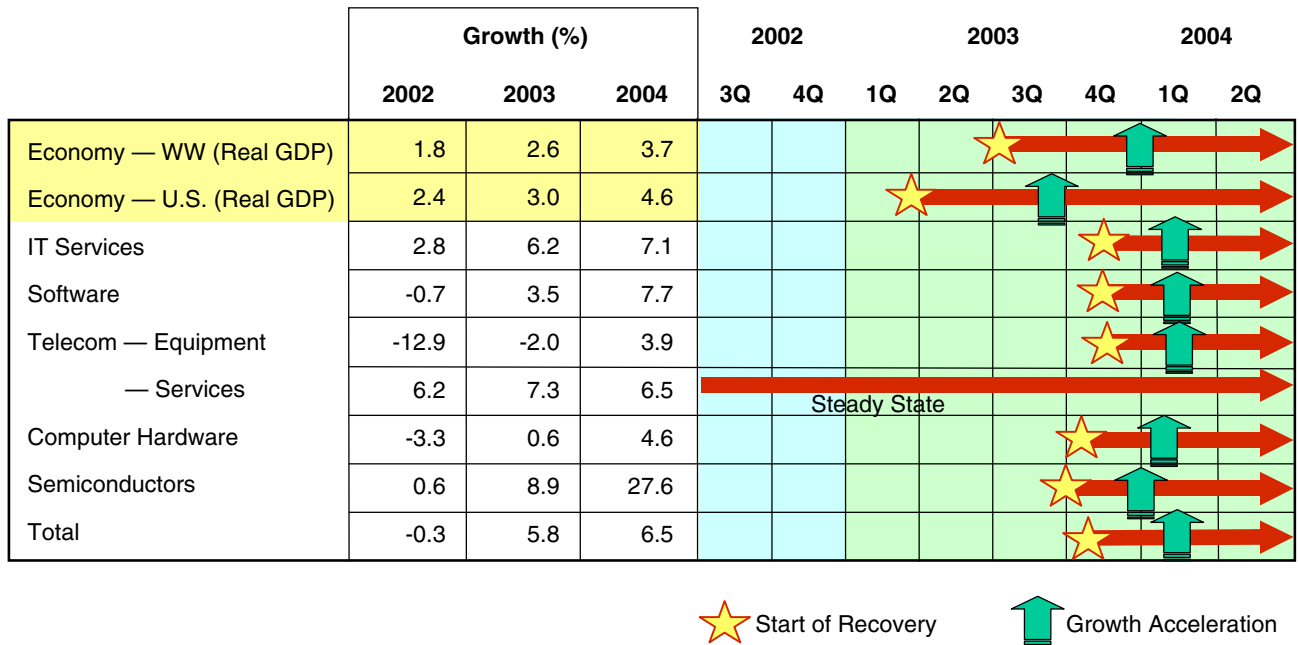
### Worldwide IT Spending — Most Likely Case Reduced Slightly for 2003

Despite the downside potential, Gartner Dataquest's most likely forecast scenario is as follows:

Worldwide IT spending will rise 5.3 percent in 2003, approaching \$2.31 trillion. This is a welcome improvement over 2002, when spending increased only an estimated 0.9 percent to just below \$2.20 trillion. These figures are slightly changed from our December forecast, in which we predicted that global IT spending would rise 5.8 percent in 2003, to more than \$2.34 trillion, after declining 0.2 percent in 2002. For 2002, the change reflects that, based on finalized historical data, worldwide IT spending was marginally better than previously realized. For 2003, the change reflects an acknowledgment, based on growing geopolitical and economic uncertainties surrounding U.S. actions against Iraq and evidence of further corporate IT budget tightening, that spending will be weaker than previously forecast.

Figure 2 shows the expected sustainable recovery inflection and growth acceleration points for each market segment.

**Figure 2. Sustainable Recovery Inflection and Acceleration Points**



Source: Gartner Dataquest (March 2003)

**Semiconductors**

The slowdown in the market in the fourth quarter of 2002 has continued into the first quarter of 2003, leading us to lower our expectation for sequential growth in the first quarter of 2003. This change has reduced our annual revenue growth forecast for 2003 from 12 percent to 9 percent. Visibility into the remainder of 2003 remains poor, but our fundamental assumption that corporate IT spending will return in the second half of 2003 to fuel demand remains unchanged. Nevertheless, we are concerned that our most likely forecast for 2003 is at the upper end of a forecast range, suggesting a significantly greater chance of a downside risk than an upside surprise. We are optimistic about the prospects for strong growth in 2004; a combination of pent-up demand and underinvestment in fab capacity will likely spur semiconductor unit shipment growth and stabilize device pricing.

**Computer Hardware and Systems**

2003 revenue growth expectations for the worldwide computing hardware segment have been reduced from 3.9 percent in the previous forecast to 0.6 percent. Total revenue is forecast to be \$320.7 billion compared with \$327.1 billion in the earlier forecast. Revenue expectations for client platforms, servers and storage subsystems have all been reduced compared with the previous forecast. In the digital document and imaging segment, stronger than anticipated demand for both monochrome and color production devices drove revenue higher than forecast. In addition, the forecast reduction in office copier revenue was offset by increased sales of higher speed and higher priced units compared with our previous forecasts.

**Software**

The significant changes to software growth forecasts in this update are in the AIM, application development and supply chain management (SCM) sectors. We have raised our forecast for the AIM and application development markets and lowered our SCM forecast. The most likely scenario growth rates for global applications and infrastructure software license spending are

starting from a base of negative 0.7 percent in 2002, up 3.5 percent in 2003, up 7.7 percent in 2004 and up 8.2 percent in 2005. Spending on IT infrastructure software has recovered with some small growth in 2003 as buyers give preference to streamlining, optimizing and integrating established applications. Spending on enterprise applications software will recover more slowly from a fall of 8.2 percent in 2001 to regain slow 3.1 percent growth in 2003, as vendors focus on improving their customers' business performance and return on investment.

## **Telecommunications**

With further detailed analysis available across a number of sectors, estimates of the total 2002 market size for communications equipment and services have been reduced slightly. Outside of equipment removed because of a segmentation change, the overall wireline infrastructure market actually grew, while services came down from 6.6 percent to 6.2 percent year over year. The outlook for 2003 has been lowered somewhat — primarily in the wireline data market. Gartner Dataquest is forecasting the overall services market to grow at 7.3 percent during 2003, and our equipment forecast is expected to level off from declines of previous years, with 2 percent growth. As a result, Gartner Dataquest expects the overall market to return to solid growth at 6.2 percent this year. Forecasts for 2004 and beyond are generally reduced from previous estimates. While the services market will grow less than 6 percent per year from 2004 onward, Gartner Dataquest expects equipment to grow moderately in 2004 but to pick up from 2005 onward, in line with previous estimates. Within this overall picture, individual segments are developing at different rates and in response to different factors.

## **Services**

The most likely and best-case scenarios are relatively unchanged pending more detailed analysis of 2002 vendor revenue results, which will be published in the second quarter. Gartner Dataquest has lowered the worst-case scenario for the IT services forecast, allowing for the possibility of a decline in 2002, followed by several years of low growth. Two critical factors impact the IT services market: the degree of business confidence among buyers and the degree to which vendors leverage available technology to develop compelling solutions that address buyer needs.

## **Features**

"1Q03 Update: IT Services Forecast Scenarios, 2002-2005" — Our worst-case scenario grows gloomier. **By Kathryn Hale, Robert De Souza, Tony Adams, Ron Silliman, Eric Goodness, Michele Cantara, Bruce Caldwell and Rebecca Scholl**

"1Q03 Update: IT Telecom Forecast Scenarios, 2002-2005" — The suffering continues in the telecommunications and networking market. **By Wm. L. Hahn**

"1Q03 Update: Hardware and Systems Forecast, 2002-2004" — Growth will return this year to the computer hardware and systems market, even if it's only 0.6 percent. **By Charles Smulders**

"Worst-Case IT Spending Scenario Gets Worse" — Zero growth could be the long-term fate for the IT markets, even after consumers regain their confidence. **By Roger Fulton and Kathryn Hale**

## **Recommended Reading and Related Research**

"Economic Outlook, 1Q03: War Worries and Other Concerns" — War and economic woes cloud the global economic outlook. **By George Shiffler**

"Software Forecast Update: Markets Still Struggling" — Software spending will rise 3.5 percent this year. **By Thomas Topolinski, Joanne Correia and Roger Fulton**

"1Q03 Update: Global Semiconductor Forecast Scenarios" — Semiconductor revenue will grow 9 percent in 2003. **By Richard Gordon**

This research is part of a set of related research pieces. See "IT Databook Forecast Scenarios: 1Q03 Update " for an overview.

## REGIONAL HEADQUARTERS

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Corporate Headquarters  
56 Top Gallant Road  
Stamford, CT 06902-7700  
U.S.A.  
+1 203 964 0096

European Headquarters  
Tamesis  
The Glanty  
Egham  
Surrey, TW20 9AW  
UNITED KINGDOM  
+44 1784 431611

Asia/Pacific Headquarters  
Level 7, 40 Miller Street  
North Sydney  
New South Wales 2060  
AUSTRALIA  
+61 2 9459 4600

Latin America Headquarters  
Av. das Nações Unidas 12.551  
9 andar—WTC  
04578-903 São Paulo SP  
BRAZIL  
+55 11 3443 1509