FIRST LIGHT

24 February 2023

RESEARCH

[SECTOR REPORT] IT SERVICES

Runaway cloud growth hits a bump; tier-I players a safe haven

BOB ECONOMICS RESEARCH | GDP OUTLOOK

GDP to grow by 4.6% in Q3FY23

BOB ECONOMICS RESEARCH | FY24 CURRENCY OUTLOOK

INR to trade in the range of 82-84/$ in FY24

Daily macro indicators

Ticker	21-Feb	22-Feb	Chg (%)
US 10Y yield (%)	3.95	3.92	(4bps)
India 10Y yield (%)	7.36	7.40	4bps
USD/INR	82.80	82.86	(0.1)
Brent Crude (US$/bbl)	83.1	80.6	(3.0)
Dow	33,130	33,045	(0.3)
Hang Seng	20,529	20,424	(0.5)
Sensex	60,673	59,745	(1.5)
India FII (US$ mn)	**20-Feb**	**21-Feb**	**Chg ($ mn)**
FII-D	(18.9)	(86.9)	(68.0)
FII-E	56.9	124.3	67.5

Source: Bank of Baroda Economics Research

SUMMARY

[SECTOR REPORT] IT SERVICES

- Macro uncertainty inducing cautious IT budget spends and a sharper focus on cost optimisation
- Capex moderation by tech giants (Google, Microsoft) a clear indicator of near-term weakness in cloud migration
- Despite the challenging backdrop, deal wins and pipeline commentary remain strong for Indian IT players; prefer large-caps over mid-caps

Click here **for the full report.**

INDIA ECONOMICS: GDP OUTLOOK

Global economy remains unsettled as it battles the wind of uncertainty posed by geo-political tension and concerns emerging over global growth. Investors have been fretting over the future of monetary stiffness by global central banks in their ongoing fight to combat inflation. Fed in its upcoming minutes is expected to provide guidance on rate trajectory. Markets have already priced in the peaking of the terminal rates to 5.3% by Jul'23. Indian economy has been relatively insulated from these global risks. For Q3FY23, the economy is projected to grow at a slower pace by 4.6% against a growth of 6.3% in Q2FY23 with major respite offered by services sector (festive surge and hospitality sector has lifted growth). With this, Indian economy is poised to grow by 6.8% in FY23 compared with a growth of 8.7% in FY22.

Click here **for the full report.**

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INDIA ECONOMICS: FY24 CURRENCY OUTLOOK

The trajectory of USD/INR in the next year will be determined by both global as well as domestic macro fundamentals. Just like 2022, perhaps the most important driver of USD/INR rate this year will be the trajectory of the dollar. Amongst domestic factors, India's current account deficit will be the key factor impacting USD/INR. Apart from this, FPI flows and oil prices will also be important for the exchange rate going forward.

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IT SERVICES

23 February 2023

Runaway cloud growth hits a bump; tier-I players a safe haven

- Macro uncertainty inducing cautious IT budget spends and a sharper focus on cost optimisation
- Capex moderation by tech giants (Google, Microsoft) a clear indicator of near-term weakness in cloud migration
- Despite the challenging backdrop, deal wins and pipeline commentary remain strong for Indian IT players; prefer large-caps over mid-caps

Saptarshi Mukherjee
research@bobcaps.in

Cloud capex moderating: Cloud capex, a key growth indicator for the cloud migration business, has softened against the backdrop of a weak global macro and moderating capex by tech giants such as Microsoft and Google. In contrast, Amazon is showing positive traction with US$ 16.4bn in capital outlay during Q3CY22, beating consensus estimates by 8%. We note that semiconductor chip suppliers have a cautious outlook on the purchasing pattern of cloud service providers. Enterprise clients remain conservative on capex which could, in turn, impact cloud vendors.

SaaS players recalibrating strategies amid slowdown: Global SaaS companies have downgraded their growth guidance due to the recessionary headwinds. Earnings commentary indicates elongated decision-making cycles for digital/cloud business and a shift in client priorities towards cost-takeout projects. Managements of Hubspot and ServiceNow confirmed that clients are increasingly favouring shorter-tenure projects which deliver quicker ROI than multi-year engagements. Amid macro challenges, Google and Microsoft have renewed their focus on high-growth areas and on increased productivity of the existing workforce.

Cloudy near-term outlook for hyperscalers: Hyperscalers (software/SaaS vendors) such as Microsoft and Amazon witnessed high sequential growth till Q3CY22 but are likely to come under pressure in Q4CY22/Q1CY23. Players anticipate a slowdown in cloud spends over the near term, though the long-term growth story of an organisational shift to the cloud remains intact. Despite the weak quarter, Indian IT companies witnessed above-average deal wins and their market share in cloud deal wins, in particular, remains intact.

Prefer large-caps over mid-caps: We have already factored in the postponement of product development and large digital transformation projects, as well as slowing demand for hyperscalers that will impact the revenue growth of IT services players. We prefer Indian stocks that are less vulnerable to the slowdown and that will continue to gain market share even in a weak economic environment. Accordingly, we retain our preference for large-caps – **INFO** (BUY, TP: Rs 1,760) and **HCLT** (BUY, TP: Rs 1,240) in that order, over mid-caps.

Recommendation snapshot

Ticker	Price	Target	Rating
HCLT IN	1,093	1,240	BUY
INFO IN	1,562	1,760	BUY

Price & Target in Rupees | Price as of 22 Feb 2023

GDP OUTLOOK

22 February 2023

GDP to grow by 4.6% in Q3FY23

Jahnavi Prabhakar
Economist

Global economy remains unsettled as it battles the wind of uncertainty posed by geo-political tension and concerns emerging over global growth. Investors have been fretting over the future of monetary stiffness by global central banks in their ongoing fight to combat inflation. Fed in its upcoming minutes is expected to provide guidance on rate trajectory. Markets have already priced in the peaking of the terminal rates to 5.3% by Jul'23. Indian economy has been relatively insulated from these global risks. For Q3FY23, the economy is projected to grow at a slower pace by 4.6% against a growth of 6.3% in Q2FY23 with major respite offered by services sector (festive surge and hospitality sector has lifted growth). With this, Indian economy is poised to grow by 6.8% in FY23 compared with a growth of 8.7% in FY22.

Q3FY23 GDP

India's GDP is expected to moderate by 4.6% in Q3FY23 against an increase of 6.3% in Q2FY23. Growth in Q3 is although better than Q2, however it has largely been uneven across sectors with few of them registering better growth than others.

- Agriculture growth expected to improve by 3.5% in Q3FY23. This comes against the backdrop of robust rabi acreage (higher by 3.3% compared with previous year).
- Even as commodity prices have now cooled off from its all-time high, seen back in Q1 FY23 due to ongoing geo-political tensions between Russia and Ukraine. However, input cost pressure continues to impinge on profits of the firms. The impact was visible on corporate results of the industries such as textiles, refineries, chemicals, metal and even plastic. Thereby, manufacturing sector continues to remain in the weak zone with growth of 3.1% in Q3FY23.
- Electricity is expected to clock a growth of 6.5% in Q3FY23 compared with 5.6% in Q2FY23, earning have reported a similar trend of improvement since the last quarter.
- On the other hand, construction sector is expected to grow at a solid pace on the back of the improvement in steel and cement output. This is further supported by steady demand push led by housing. Moreover, buoyancy by infra/construction and capital goods output bodes well for this sector.
- For services, festive surge has brought upon a broad based improvement in Q3. This in turn is expected to boost the hospitality sector. Even as firms passed on higher cost to consumers, robust demand has boosted both profit and sales of this sector. The same has been reflected by the earnings report.

FY24 CURRENCY OUTLOOK

22 February 2023

INR to trade in the range of 82-84/$ in FY24

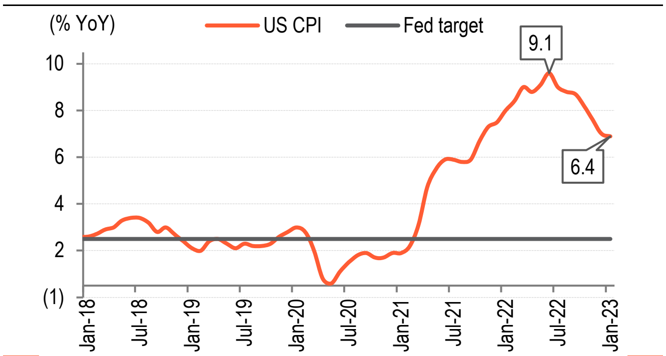
The trajectory of USD/INR in the next year will be determined by both global as well as domestic macro fundamentals. Just like 2022, perhaps the most important driver of USD/INR rate this year will be the trajectory of the dollar. Amongst domestic factors, India's current account deficit will be the key factor impacting USD/INR. Apart from this, FPI flows and oil prices will also be important for the exchange rate going forward.

Aditi Gupta
Economist

What will happen to the dollar?

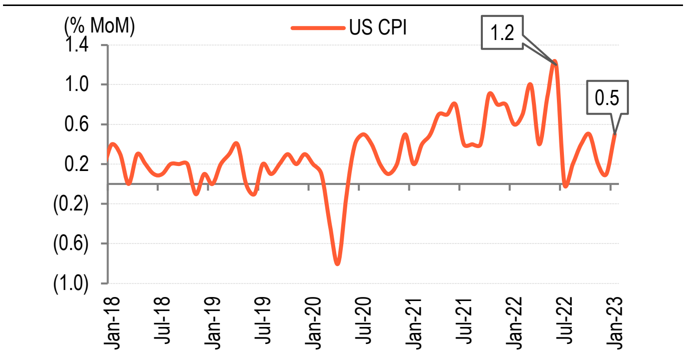
The trajectory of the dollar (DXY) will be quite significantly be contingent on the Fed action, which in turn will be determined by the inflation and growth dynamics. Recent data points from the US suggest that while inflation has shown signs of moderation, it still remains uncomfortably high. Furthermore, several sub-components, such as services, continue to show significant inflationary pressures. In Jan'23, both CPI and PPI inflation in the US inched up on a MoM basis. This reinforces comments from several Fed officials who have continued to maintain that the war against inflation is far from over.

Figure 1: CPI inflation continues to remain elevated



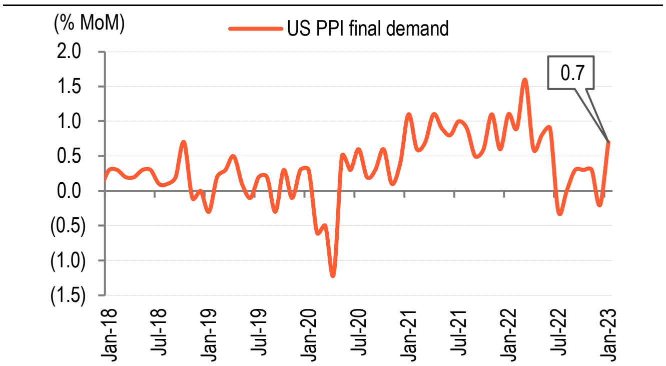
Source: Bloomberg, Bank of Baroda Research

Figure 2: Acceleration on a MoM basis



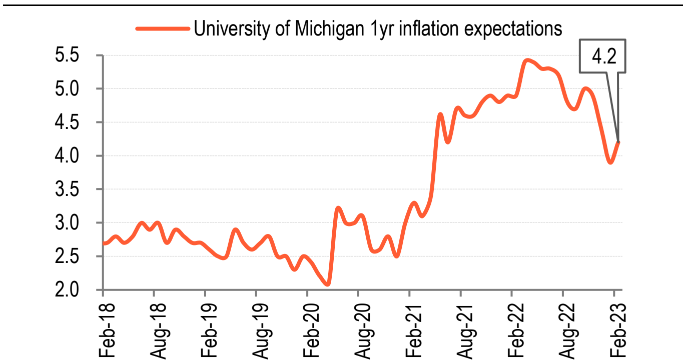
Source: Bloomberg, Bank of Baroda Research

Figure 3: PPI inflation also higher



Source: Bloomberg, Bank of Baroda Research

Figure 4: 1 year inflation expectations inched up



Source: Bloomberg, Bank of Baroda Research

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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