AIB Global Treasury
Economic Research

Exchange Rate Outlook

13th February 2009

- **USD continues to benefit from market volatility and uncertainty**
- **Euro struggles as outlook for eurozone economy deteriorates**
- **Sterling stabilises but remains vulnerable versus other majors**
- **Yen remains strong despite Japan's economic difficulties**

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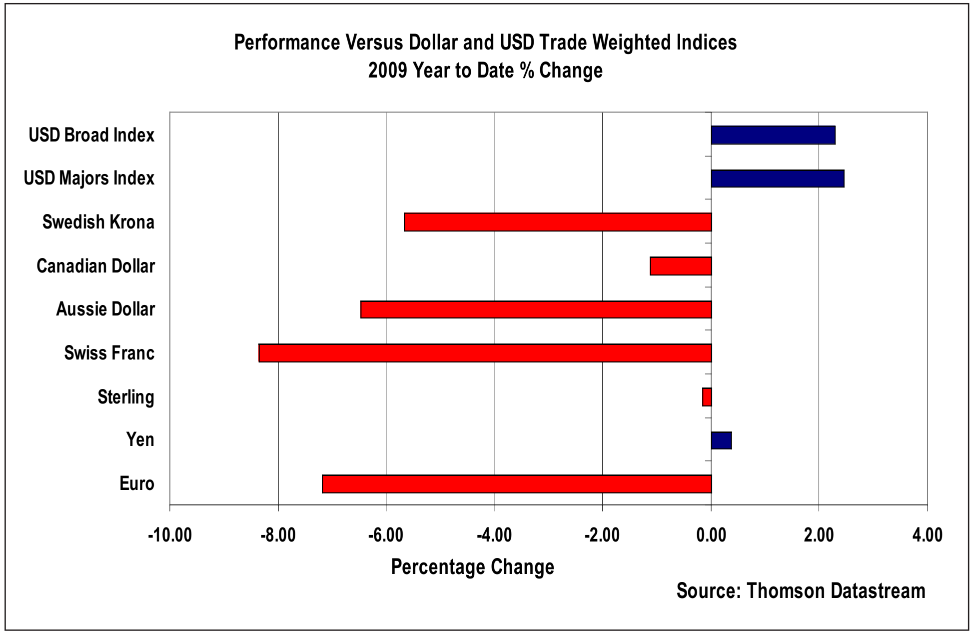
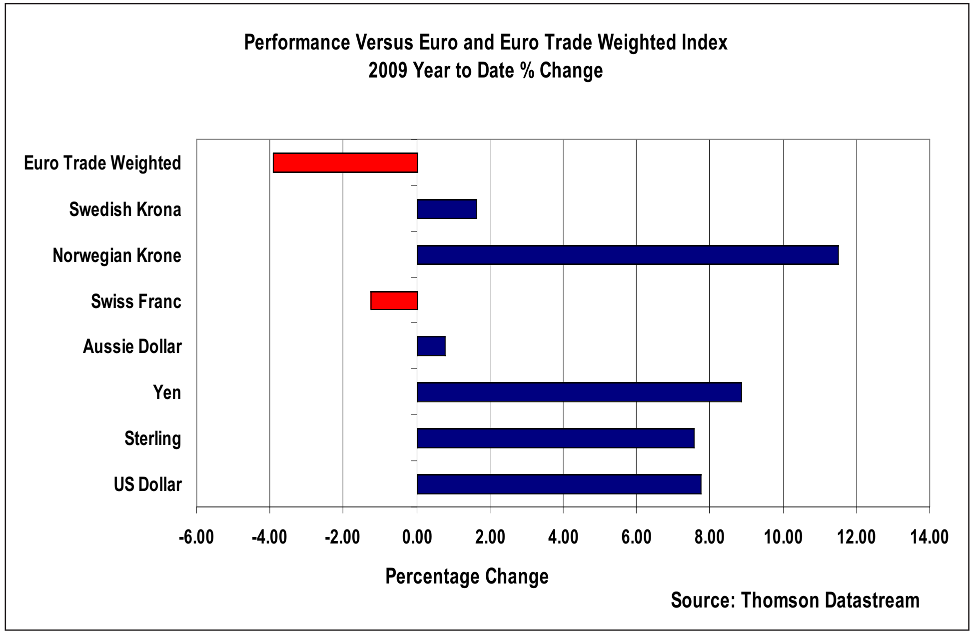
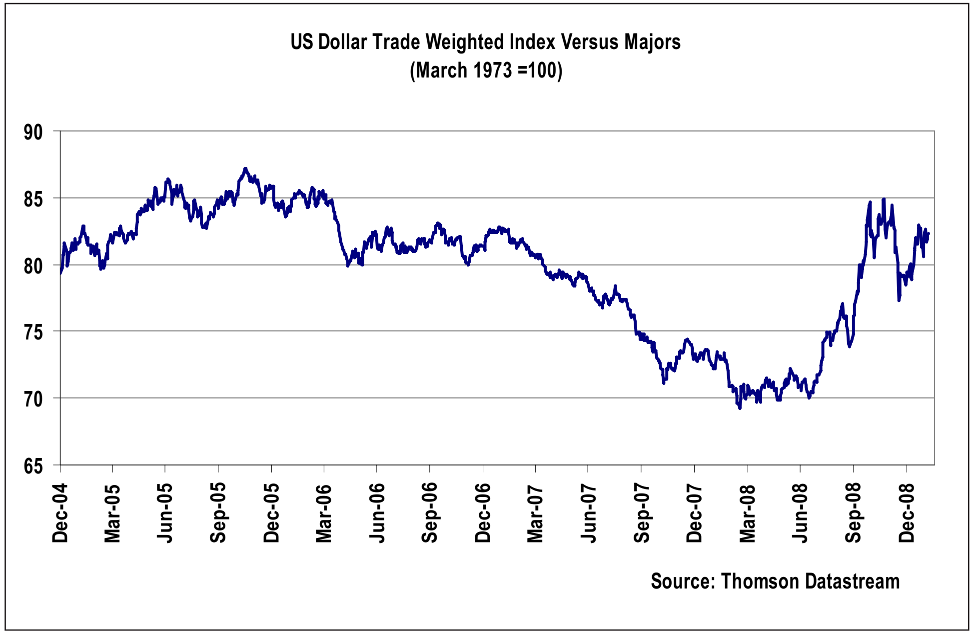
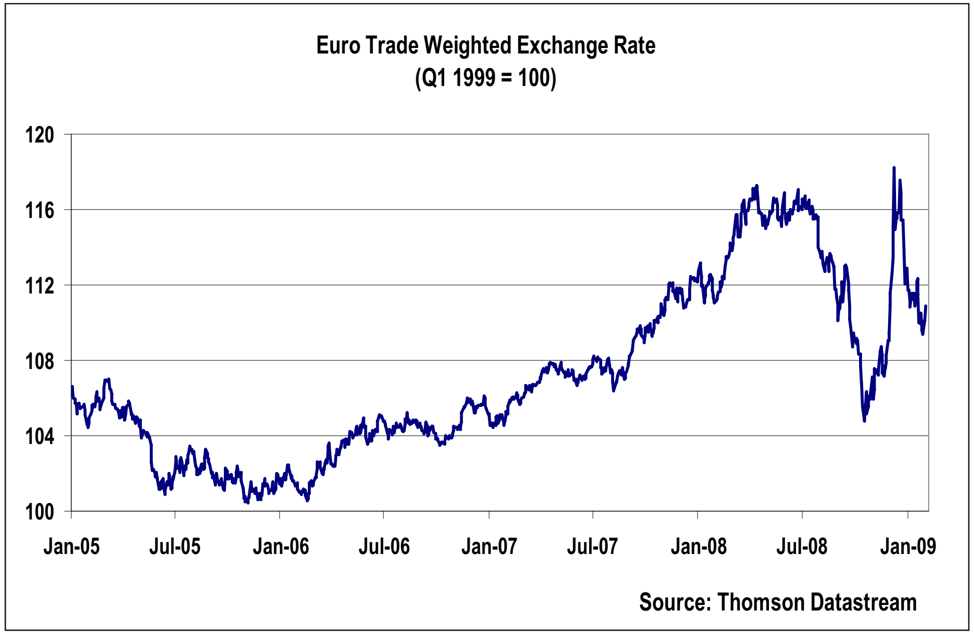
Key Currency Trends









Summary of Exchange Rate Forecasts

Euro Versus	Current	Q1-2009	Q2-2009	Q3-2009	Q4-2009
USD	1.288	1.26-1.32	1.25-1.30	1.28-1.33	1.35-1.40
GBP	0.887	0.86-0.92	0.85-0.90	0.83-0.88	0.80-0.85
JPY	117.87	113-123	115-125	125-135	135-145
PLN	4.63	4.55	4.30	4.00	3.90
HUF	298.06	295	280	275	270
NOK	8.76	8.75	8.70	8.60	8.50
SEK	10.75	10.70	10.50	10.00	9.80
US Dollar Versus					
JPY	91.49	87-97	90-100	95-105	100-105
GBP	1.453	1.38-1.48	1.40-1.50	1.45-1.55	1.60-1.70
CHF	1.16	1.17	1.16	1.16	1.15
CAD	1.24	1.24	1.22	1.20	1.18
AUD	0.66	0.65	0.68	0.70	0.72
NZD	0.53	0.52	0.55	0.57	0.59
CNY	6.84	6.83	6.80	6.75	6.70
Sterling Versus (mid point of expected trading range)					
JPY	133	133	138	153	171
CAD	1.79	1.80	1.78	1.83	1.97
AUD	2.20	2.23	2.14	2.18	2.31
NZD	2.76	2.79	2.65	2.68	2.82

Interest Rate Outlook

Central banks across the world have been cutting rates aggressively to help ease the crisis that has gripped the world's financial system and counter what is becoming a very deep global recession. Meanwhile, deflation risks are rising with inflation heading towards zero in many countries. With money and credit markets still malfunctioning and a very weak global economy, we are heading for a prolonged period of very low official interest rates.

Fed Rates Cut To Close On 0%

With inflation falling sharply and a deepening recession, the Fed cut US interest rates effectively to zero per cent in December, adopting a 0 - 0.25% target range for the Fed funds rate. With the Fed becoming increasingly concerned about the prospect of deflationary forces becoming entrenched and given the very weak economic conditions, the current exceptionally low level of the Fed funds rate is likely to remain in place for a considerable time.

With official rates now close to zero, the Fed's focus has shifted to open market operations and other measures, including the purchase of mortgage securities, to help stimulate the economy and the functioning of financial markets.

ECB To Reduce Rates To Well Below 2%

The ECB cut interest rates by 0.50% to 2.0% at its January policy meeting, bringing the total reduction in official rates in the eurozone to 2.25% since October. The refi rate now stands at 2%, matching its low in the previous easing cycle in 2003-05. Unlike the Fed and BoE, the ECB has managed to bring money market rates down to the level of official rates and, indeed, very short term interbank rates have moved well below official interest rates.

Policy was left on hold in February but we see rates being reduced by a further 0.5% at the March meeting. Indeed, with the economy now in deep recession, inflation falling sharply and credit markets still malfunctioning, rates could be cut to as low as 1.25% or 1% by the summer.

UK Rates To Be Cut To Under 1%

The BoE cut interest rates from 5% in October to 2% by end year. In its first two meetings of 2009, rates were cut by a further cumulative 1.0% to an historically low level of 1.0%.

The UK economy is now in a deep recession and inflation is falling sharply. There is a real risk of the MPC undershooting its 2% inflation target in the next two years. Thus, we anticipate further monetary easing. We expect the MPC to reduce rates by another 0.5% at its March meeting and to also implement quantitative liquidity boosting measures to boost lending activity.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	1.23	2.02	1.54	2.46
Mar '09	0.125	1.20	1.90	1.45	2.30
June '09	0.125	1.10	1.80	1.35	2.20
Sept '09	0.125	1.10	1.70	1.35	2.20

** Swap Forecasts Beyond 1 Year*

Eurozone Interest Rate Forecasts (to end quarter)

	Refi Rate	3 Mth	1 Year	2 Year *	5 Year *
Current	2.00	1.96	2.15	2.10	2.86
Mar '09	1.50	1.60	1.80	1.90	2.70
June '09	1.00	1.10	1.50	1.75	2.60
Sept '09	1.00	1.10	1.50	1.75	2.60

** Swap Forecasts Beyond 1 Year*

UK Interest Rate Forecasts (to end quarter)

	Repo Rate	3 Mth	1 Year	2 Year *	5 Year *
Current	1.00	2.07	2.39	2.60	2.87
Mar '09	0.50	1.60	2.10	2.40	2.65
June '09	0.50	1.10	1.75	2.20	2.50
Sept '09	0.50	1.10	1.75	2.20	2.50

** Swap Forecasts Beyond 1 Year*

US Dollar

The US dollar came under strong selling pressure in the first half of 2008 as the effects of the sub prime crisis unfolded and the Fed embarked on an aggressive easing cycle. Markets also speculated about the prospects of a US recession at that time, with these fears since being realised. Record high oil prices further contributed to the downward pressure, with the USD falling to lifetime lows of $1.6035 versus the euro in mid July.

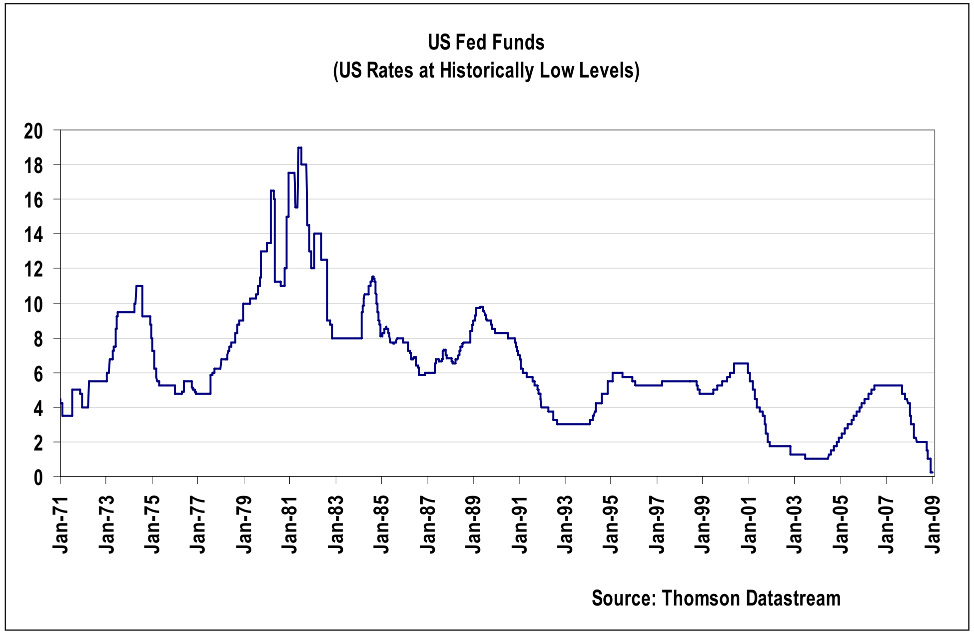
This trend, however, was reversed in the second half of the year as it became increasingly obvious that the fallout from the financial crisis would not be confined to the US. A rush to safe haven assets like US Treasuries, as well as very illiquid market conditions, resulted in a scramble for dollar funds, with the sharp fall in oil prices also favouring the USD. It came under renewed selling pressure before year end as the newsflow from the US, in particular the labour market, became increasingly negative and the Fed effectively cut interest rates to zero.

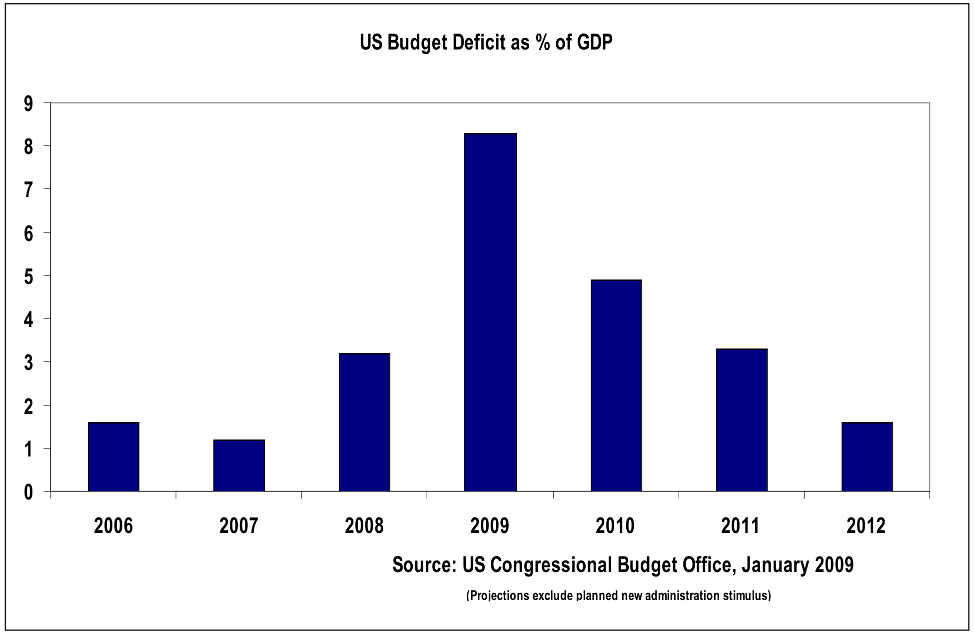
Nonetheless, as 2009 got underway, the quest for safe haven assets triumphed once again, with a batch of appalling eurozone data also helping the dollar recover from its year end level of $1.45 to around $1.30. Given the ongoing volatility in financial markets and the fact that the economic news is not good on either side of the Atlantic, it is particularly difficult at this juncture to predict where the dollar is headed. The scale of fiscal stimulus in the US, as well as the aggressive actions of the Fed, suggest that the dollar will remain relatively strong versus other majors (with the exception of the yen) on the anticipation that the US will recover ahead of other key economies. Ongoing heightened risk aversion could also favour the USD near term.

At the same time, however, a strong rally is unlikely. Indeed, as the year unfolds, the dollar could come under renewed pressure if risk aversion starts to ease and markets begin to focus on the longer term implications of the sharp rise in the US budget deficit and the potential impact of the Fed's quantitative easing policy.

Key Forecasts

		Q1-2009	Q2-2009	Q3-2009	Q4-2009
US$/EUR	1.288	1.26-1.32	1.25-1.30	1.28-1.33	1.35-1.40
US$/GBP	1.452	1.38-1.48	1.40-1.50	1.45-1.55	1.60-1.70
YEN/US$	91.508	87-97	90-100	95-105	100-105
CHF/US$	1.161	1.17	1.16	1.16	1.15





Euro

After staging an impressive rally that extended all the way to $1.47 versus the dollar and 0.98p versus sterling going into year end, confidence in the euro has since faltered. Sentiment towards the single currency has been soured by increasing evidence of the extent of the economic downturn in the eurozone and the prospect of a move to sub 2% rates by the ECB. The central bank left official rates on hold at 2% in February but we expect a cut of up to 0.50% in March. Indeed, we would not rule out a move to 1.0% in the refi rate by the summer, given the bleak outlook for the economy.

Country risk has also become an increasingly negative factor for the euro as international rating agencies move to downgrade member states' sovereign debt on the back of deteriorating economic performances. Burgeoning economic and fiscal problems in Eastern European economies are also weighing on sentiment, given the eurozone's exposure to the region.

In terms of dollar/euro, a base at $1.27 does appear to have formed for now, as markets also fret about the outlook for the US. However, the euro could see this level come under threat if the ECB is forced to cut interest rates to ultra low level such as we have seen in the US and the UK or if further sovereign rating downgrades are announced. Over the longer term, we still see scope for a modest euro bounce as conditions in global economies and financial markets stabilise, with the scale of fiscal stimulus in the US also becoming a potential negative for the dollar.

The euro hit lifetime highs of Sty0.9803p versus sterling on 30th December. It has since weakened notably versus the pound as it becomes increasingly evident that the eurozone, like the UK, is also facing huge economic challenges. With support at Sty0.88p giving way, we expect a Sty0.86-0.92p range for now, with a modest recovery in sterling towards 0.80p anticipated from Q2 onwards. Meanwhile, versus the yen, we continue to expect the euro to continue to trade with a negative bias for now.

Key Forecasts

		Q1-2009	Q2-2009	Q3-2009	Q4-2009
US$/EUR	1.288	1.26-1.32	1.25-1.30	1.28-1.33	1.35-1.40
GBP/EUR	0.887	0.86-0.92	0.85-0.90	0.83-0.88	0.80-0.85
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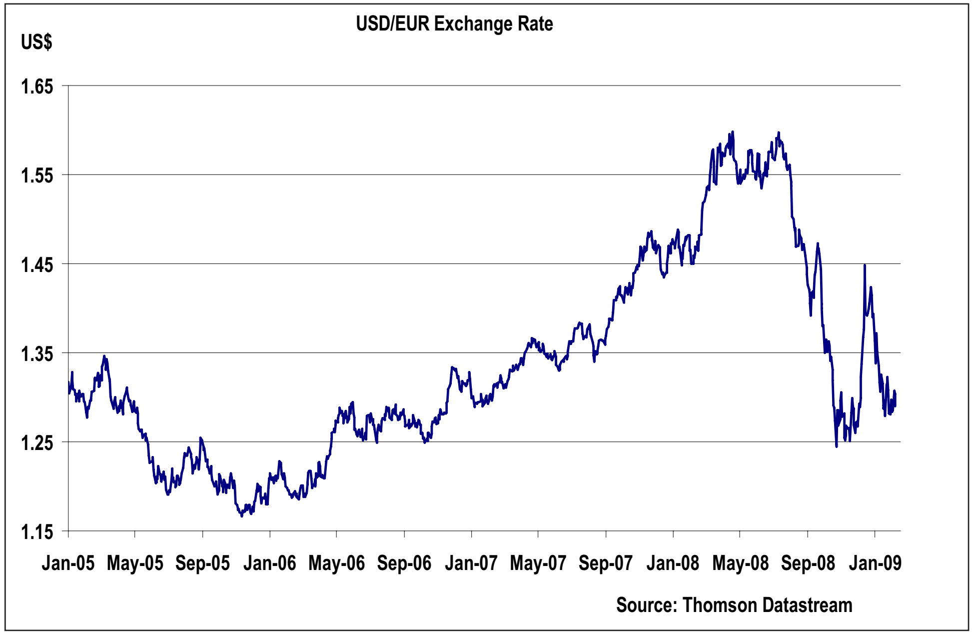
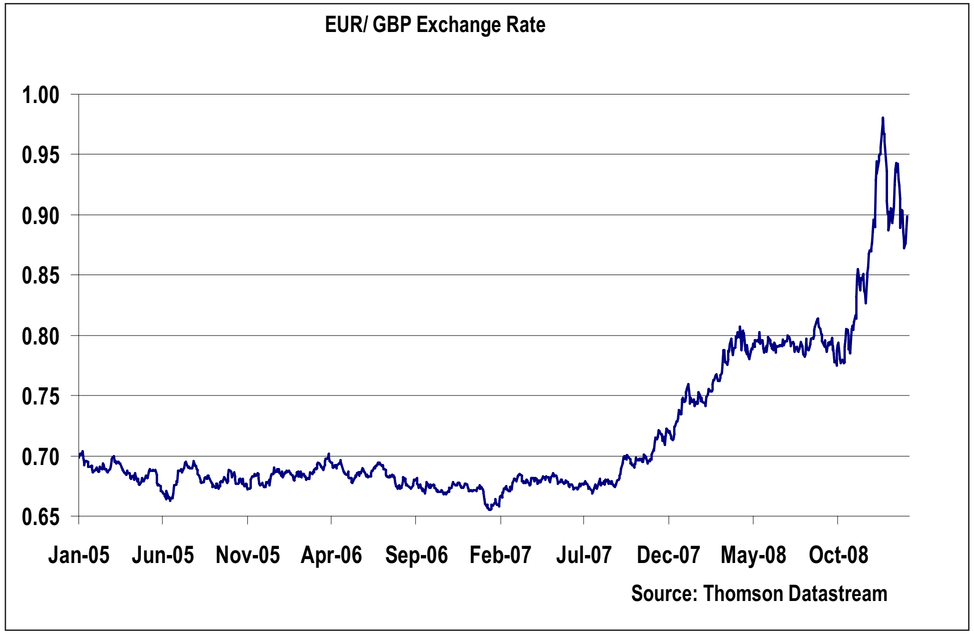




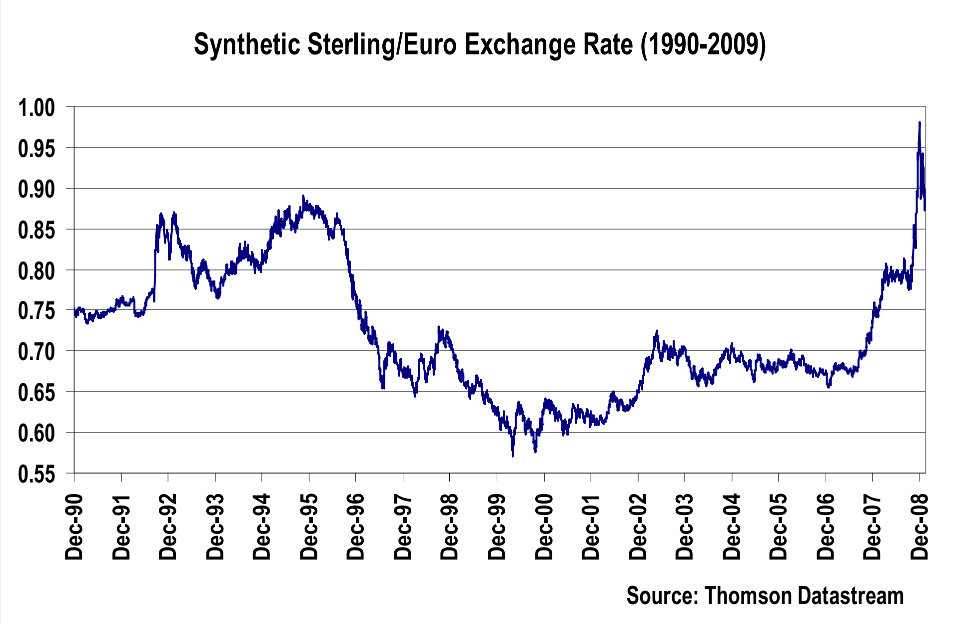
Sterling

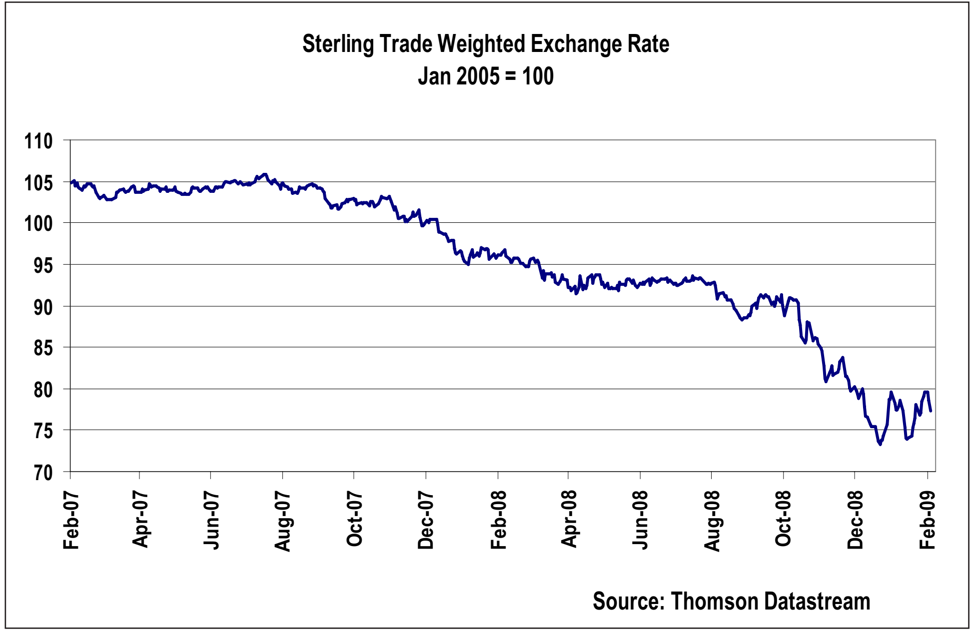
Growing concerns about the scale of economic downturn in the UK and expectations of aggressive easing from the Bank of England saw sterling came under intensive selling pressure versus other majors last year. Indeed, it was the worst performing currency in terms of the majors in 2008, falling a respective 20%, 26% and 38% versus the euro, dollar and yen.

Intensive selling was seen versus the euro over the year end period, with the sterling/euro rate trading through the Sty0.98p level to see lifetime highs in late December. However, since then the pound has staged a notable recovery versus the single currency as markets increasingly focus on the negative outlook for the eurozone economy and consider the fall in sterling to have been excessive.

With growth in the UK expected to contract for at least the next three quarters and further easing anticipated from the Bank of England, sterling is not likely to stage further major gains versus the euro over the near term. Nevertheless, we look to be over the worst in terms of the downside risks, with the recent breach of the euro's base at Sty0.88p a significant move. We anticipate a Sty0.86-0.92p range for the short to medium term outlook. Over the longer term we see a move to more "fair value" levels as the impact of comprehensive UK policy action starts to feed through, allowing sterling to move back to around Sty0.85p or higher against the euro in H2-2009.

Meanwhile, in terms of the USD/GBP rate, sterling has recovered considerable ground from the 25 year lows of $1.3502 seen versus the US currency in late January, again as markets react to its oversold position. Nonetheless, with heightened risk aversion continuing to benefit the dollar, we anticipate plenty of volatility in the weeks ahead with activity concentrated in a $1.38-1.48 trading range. Providing the UK economy stabilises, sterling should recover ground over the course of the year, moving back into a $1.60-1.70 trading range by end 2009.





Key Forecasts

		Q1-2009	Q2-2009	Q3-2009	Q4-2009
GBP/EUR	0.887	0.86-0.92	0.85-0.90	0.83-0.88	0.80-0.85
US$/GBP	1.452	1.38-1.48	1.40-1.50	1.45-1.55	1.60-1.70
YEN/GBP	132.87	133	138	153	171
CAD/GBP	1.793	1.80	1.78	1.83	1.97

Japanese Yen

In an environment of global deleveraging and heightened risk aversion, the yen appreciated markedly over the course of 2008. By year end it was up 23% versus the dollar (hitting 13 year highs of Y88.10 in late October), 30% versus the euro and 38% versus sterling, with the bulk of these gains seen since the summer. It has also made substantial gains versus previously high yielding and commodity driven currencies like the AUD and NZD. Year to date it has maintained its overvalued position.

Despite ultra low interest rates, money continues to flow into Japan as concerns about the outlook for the global economy see investors rush to reverse risky trade positions. With conditions on financial markets remaining fraught, we expect the yen to remain in a favourable position in the near term. Its perceived safe haven status is being boosted by the fact that Japan has a relatively healthy banking sector. Furthermore, its current account surplus is also making the yen an attractive investment choice in the current volatile and uncertain environment.

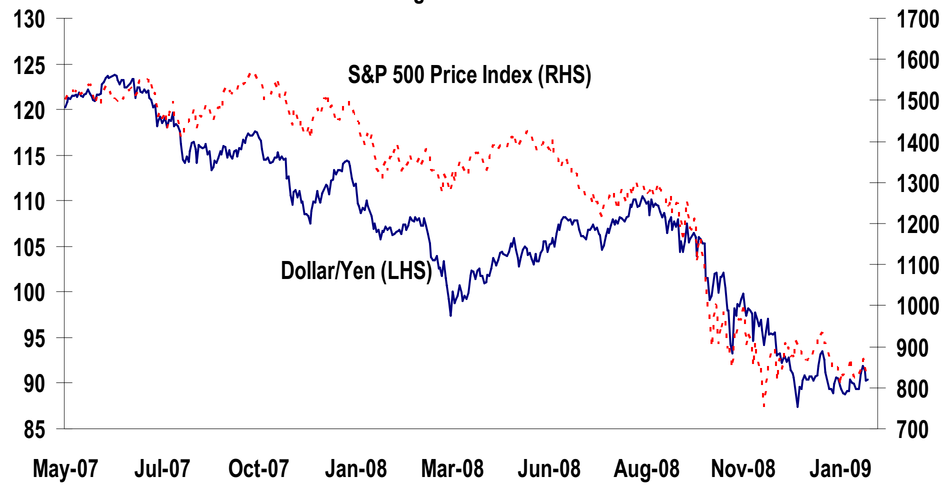
We continue to expect a Y87-97 trading range for dollar/yen over the coming weeks, with the USD seeing considerable upside resistance at the top end of this range. Even if financial market conditions improve on the back of a comprehensive range of rescue and bailout packages, yen downside should still be limited as investor sentiment remains fragile. Meanwhile, versus the euro, we anticipate a Y113-123 range for now, with the EUR also under pressure as the outlook for the eurozone economy deteriorates.

Over the longer term, however, we continue to expect the yen to weaken out again, particularly if we see a return to normalised trading conditions and there is a marked easing in global risk aversion. While the focus is elsewhere at the moment, the outlook for Japan is bleak, with official interest rates now back near zero. The economy is back in recession, with business and consumer confidence at low levels as the marked appreciation in the yen hits export demand.

Key Forecasts

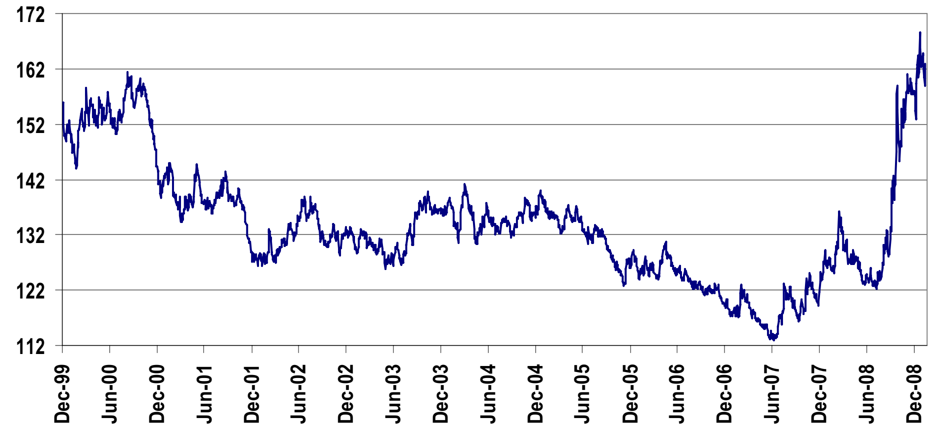
		Q1-2009	Q2-2009	Q3-2009	Q4-2009
YEN/US$	91.51	87-97	90-100	95-105	100-105
YEN/EUR	117.79	113-123	115-125	125-135	135-145
YEN/GBP	132.86	133	138	153	171

Dollar/ Yen Exchange Rate and US S&P 500 Stock Index



Source: Thomson Datastream

Japanese Trade Weighted Index
Jan 1990 = 100



Source: Thomson Datastream

Key Events/Diary

Week 1 (16th - 20th February)

February 16th	Japan	Q4 GDP (1st Estimate)
February 17th	UK	Consumer Prices (January)
February 18th	UK	Minutes of MPC Meeting (4/5th February)
	US	Industrial Production & Capacity Utilisation (January)
February 19th	US	Producer Prices (January)
February 20th	Eurozone	Flash Manf and Services PMIs (February)
	US	Consumer Prices (January)
	UK	Retail Sales (January)

Week 2 (23rd - 27th February)

February 24th	Germany	Ifo Business Survey (February)
	US	Consumer Confidence (February)
February 25th	UK	Q4 GDP (2nd Estimate)
	US	Existing Home Sales (January)
February 26th	US	Durable Goods (January)
	US	New Home Sales (January)
February 27th	US	Q4 GDP (2nd Estimate)

Week 3 (2nd - 6th March)

March 2nd	US	Personal Income & Expenditure (January)
	US	Core PCE (January)
	US/UK/Eurozone	Manufacturing ISM/PMIs (February)
March 4th	US/UK/Eurozone	Services ISM/PMIs (February)
	US	ADP Employment Report (February)
March 5th	UK	BoE Rate Announcement
	Eurozone	ECB Rate Announcement & Press Conference
March 6th	US	Non-Farm Payrolls (February)

Week 4 (9th - 13th March)

March 11th	Japan	Q4 GDP (2nd Estimate)
March 12th	US	Retail Sales (February)
	Eurozone	Industrial Production (January)
March 13th	US	Trade Report (January)
	US	Michigan Sentiment Survey (March)

All forecasts prepared by AIB's ERU. Current (at time of writing) interest rates and exchange rates quoted in this document are sourced from Reuters. Charts based on daily closing rates as provided by Thomson Datastream. The information in the Key Events/Diary is from publicly available sources.

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