



Exchange Rate Outlook *13th March 2009*

- **USD now main safe haven currency of choice**
- **Euro vulnerable as outlook for eurozone economy deteriorates**
- **Sterling under pressure as BoE announces fresh policy initiatives**
- **Yen slips as focus turns to domestic economy**

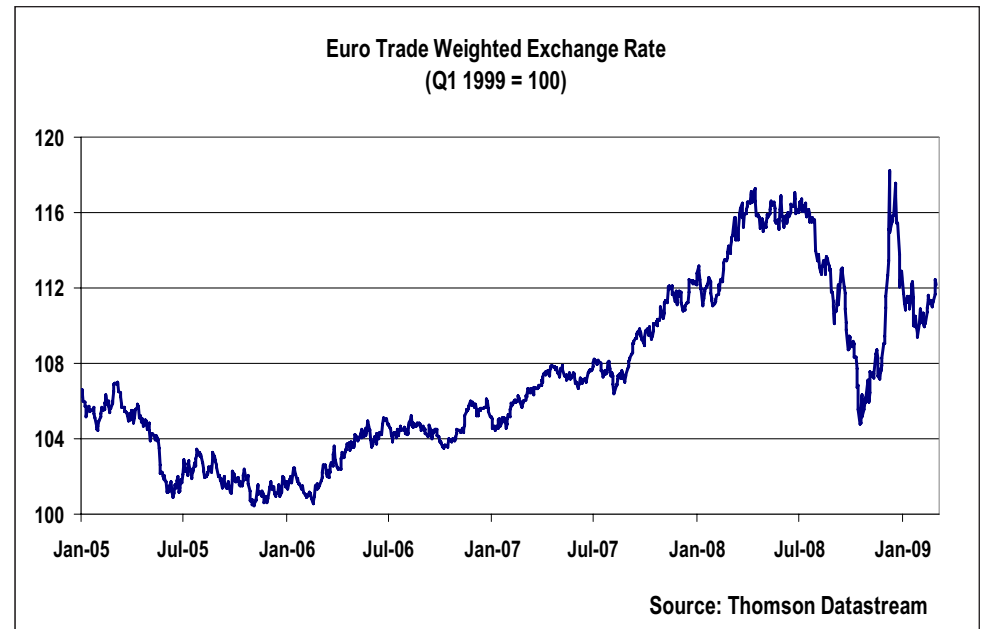
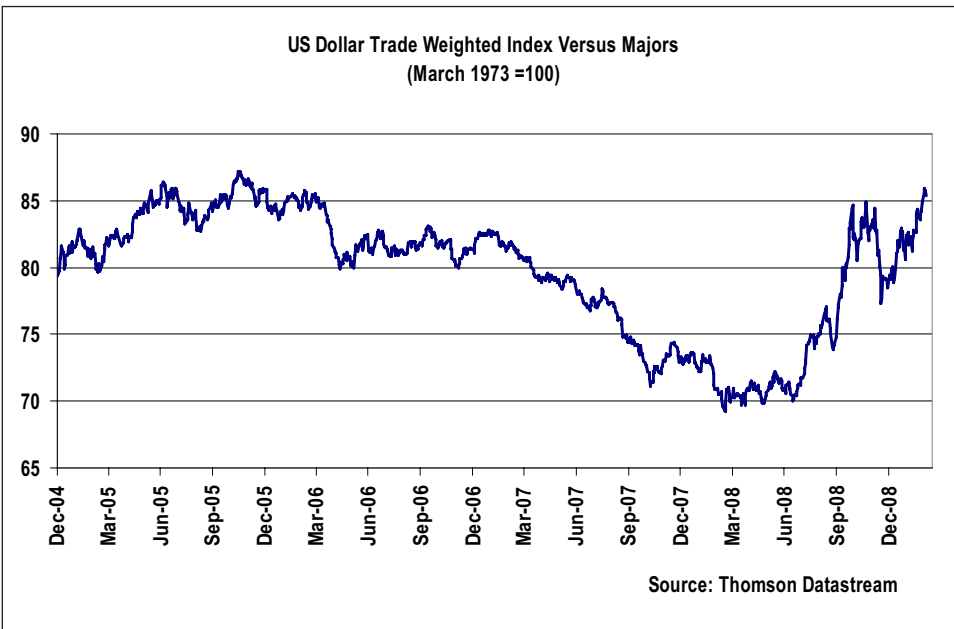
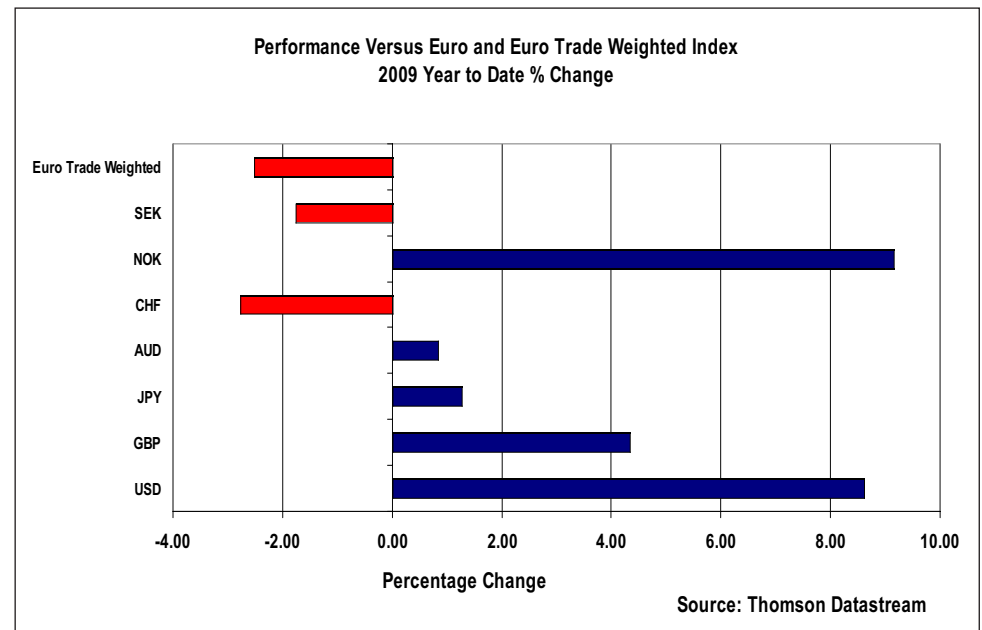
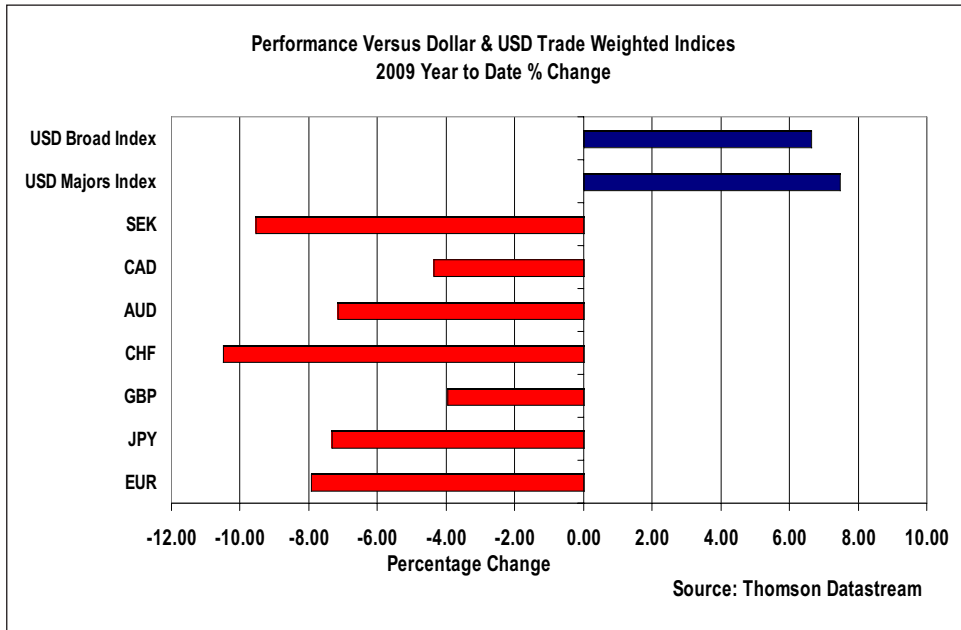
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Key Currency Trends



Summary of Exchange Rate Forecasts

	Current	Q1-2009	Q2-2009	Q3-2009	Q4-2009
Euro Versus					
USD	1.290	1.25-1.30	1.25-1.30	1.28-1.33	1.30-1.35
GBP	0.928	0.88-0.93	0.87-0.92	0.85-0.90	0.82-0.87
JPY	126.46	120-130	120-130	125-135	135-145
PLN	4.47	4.57	4.45	4.15	4.00
HUF	293.90	295	285	280	275
NOK	8.83	8.90	8.70	8.60	8.50
SEK	11.07	11.00	10.80	10.50	10.20
US Dollar Versus					
JPY	98.01	95-100	95-102	98-105	100-107
GBP	1.390	1.35-1.45	1.38-1.48	1.45-1.55	1.50-1.60
CHF	1.19	1.19	1.19	1.17	1.17
CAD	1.28	1.28	1.25	1.22	1.18
AUD	0.65	0.64	0.65	0.67	0.69
NZD	0.52	0.50	0.51	0.53	0.55
CNY	6.84	6.83	6.80	6.77	6.73
Sterling Versus (mid point of expected trading range)					
JPY	136	137	140	151	162
CAD	1.78	1.80	1.78	1.82	1.85
AUD	2.13	2.20	2.19	2.23	2.27
NZD	2.68	2.82	2.79	2.81	2.85

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 1%

The ECB cut interest rates by 0.50% to 1.50% at its March policy meeting, bringing the total reduction in official rates in the eurozone to 2.75% since October. An official rate of 1.50% represents an historical low for the eurozone, with rates troughing at 2% in the previous easing cycle in 2003-2005.

A further reduction of 0.50% seems likely by the summer, taking rates to a new low of 1%. This could represent the trough for the ECB, with some council members indicating that they do not want rates to fall as low as 0%. However, this does not rule out the introduction of other liquidity boosting measures, or money market rates going below 1%

UK Rates Cut To 0.50%

The Bank of England cut its key interest rate by 0.50% to 0.50% at its March meeting, bringing to 4.50% the cumulative reduction in the bank rate since October last year. 0.50% represents the lowest ever level for official rates since the central bank was founded in 1694.

With official rates now at ultra low levels the focus, as in the States, has switched to quantitative easing measures. In this regard, the BoE has begun a programme of asset purchases, which includes private sector assets, but is mainly concentrated in buying gilts.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	1.32	2.23	1.66	2.51
Mar '09	0.125	1.30	2.20	1.65	2.45
June '09	0.125	1.20	1.90	1.50	2.30
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	1.50	1.65	1.94	1.98	2.77
Mar '09	1.50	1.65	1.95	2.00	2.75
June '09	1.00	1.20	1.60	1.85	2.65
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	0.50	1.87	2.24	2.26	2.97
Mar '09	0.50	1.85	2.25	2.20	2.90
June '09	0.50	1.50	1.95	2.10	2.80
Sept '09	0.50	1.20	1.70	2.00	2.70

* Swap Forecasts Beyond 1 Year

US Dollar

Ongoing evidence of prolonged and protracted recessionary conditions in the world's main economies, as well as intensified concerns regarding the troubled financial sector, including ongoing talk of large scale nationalisations, means that the quest for safe haven assets is dominating forex flows. This is benefiting the US dollar, which over the course of the past month, has traded at highs of \$1.2459 versus the euro and \$1.3658 versus sterling. Meanwhile, from lows of Y87.15 seen earlier in the year, it has also made considerable gains versus the yen. Although still overvalued, concerns about the outlook for the Japanese economy are now undermining the yen, which has retreated to a Y95-100 range versus the USD.

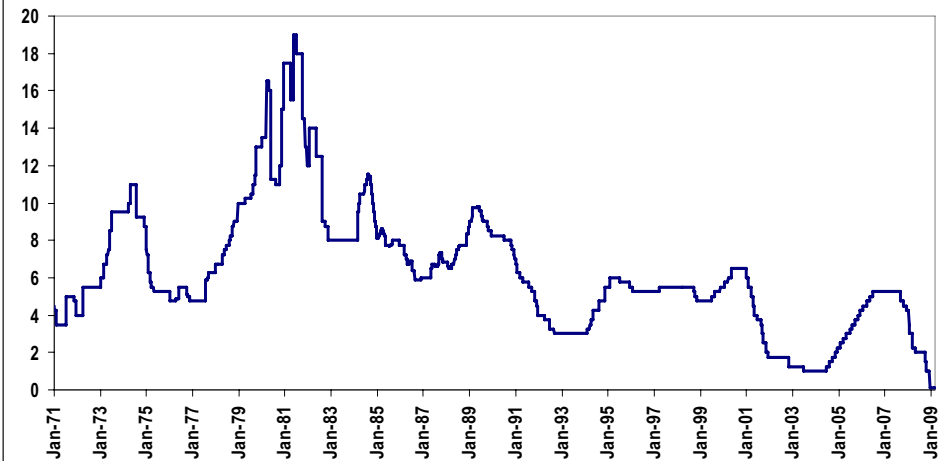
With risk and uncertainty set to remain to the fore for now, our expectation is that the dollar will continue to be the safe haven currency of choice over the coming months, despite the fact that domestic economic conditions continue to deteriorate. After a fall of 6.2% (annualised) in Q4-2008, leading indicators suggest that the US economy will see another sharp contraction in the first three months of the year, with the downturn in activity evidenced by the scale of hemorrhaging from the labour market. However, the dollar has been largely immune to this news as investors focus on the scale of the problems in other economies.

As well as its traditional status as the number one reserve currency, the dollar is also benefiting from expectations that the scale of fiscal and monetary stimulus implemented in the US will stimulate a recovery there ahead of other key economies. At the same time, however, a strong dollar rally is unlikely with some currency pairings, in particular dollar/euro, settling into relatively tight trading ranges as interest rates in the main economies converge at ultra low levels. Indeed, as the year unfolds, the dollar could come under renewed downward 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	1.290	1.25-1.30	1.25-1.30	1.28-1.33	1.30-1.35
US\$/GBP	1.390	1.35-1.45	1.38-1.48	1.45-1.55	1.50-1.60
YEN/US\$	97.962	95-100	95-102	98-105	100-107
CHF/US\$	1.188	1.19	1.19	1.17	1.17

US Fed Funds Rate (%)



Source: Thomson Datastream

Dollar Trade Weighted Exchange Rate
(Jan 1997 = 100)



Source: Thomson Datastream

Euro

After a relatively strong start to the year, sentiment towards the euro has been soured by ongoing evidence of the extent of the economic downturn in the eurozone and the prospect of a move to 1% rates by the ECB. The central bank cut rates to a new low of 1.50% at its March meeting and, on the basis of its medium term outlook for growth and inflation, another 0.50% cut is in prospect by the summer. Overtime, we may also see the introduction of other measures aimed at boosting financial market liquidity.

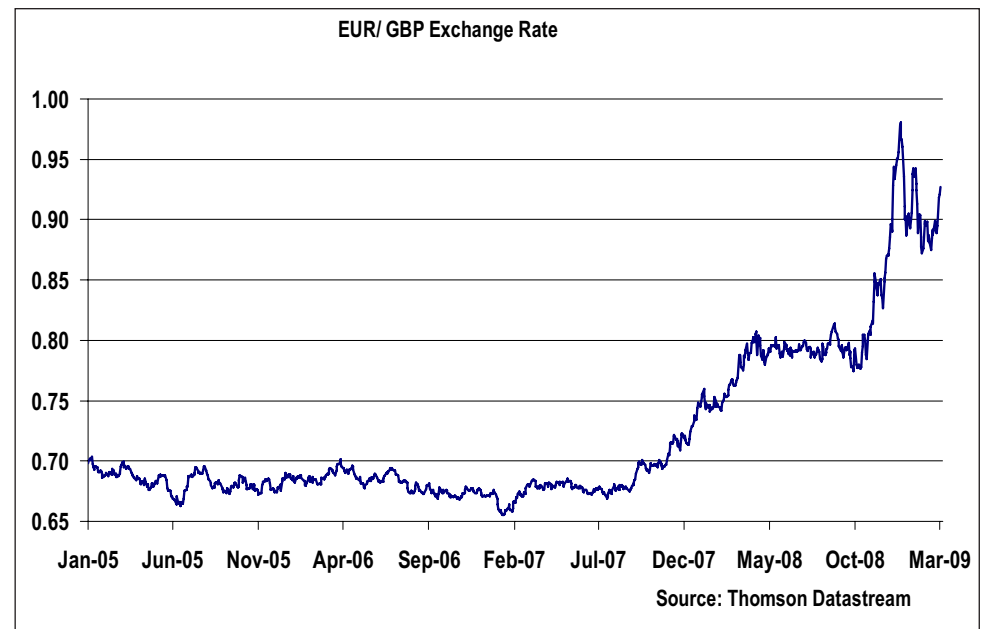
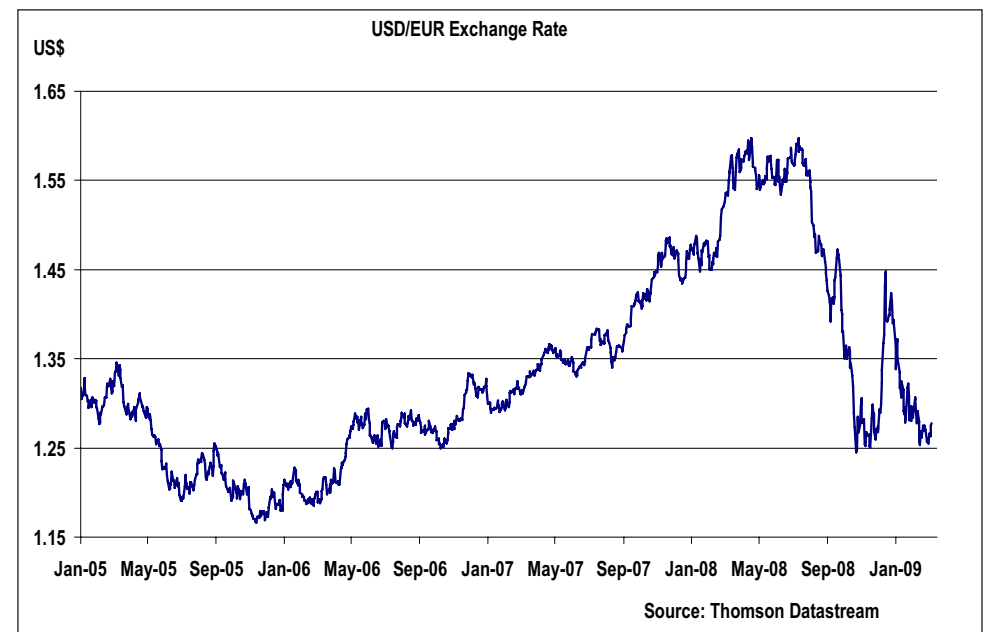
Country risk has also become a negative factor for the euro as international rating agencies downgrade their outlook for member states' sovereign debt on the back of deteriorating economic performances. Burgeoning economic and fiscal problems in Eastern European economies are also weighing on sentiment,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

In terms of dollar/euro, there has been considerable two way activity in a \$1.25-1.29 range over recent weeks. However, the breach of key support at \$1.27 has left the euro vulnerable to further bouts of selling. Downside risks include the prospect of ultra low interest rates in the eurozone and a move to quantitative easing measures like those in the US and the UK, as well as the possibility of further sovereign rating downgrades. Over the longer term, though, we still see scope for a modest euro bounce if 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 Stg0.9803p versus sterling in late 2008. Increasing evidence that the eurozone, like the UK, is facing huge economic challenges has since taken it well off this level, with a low of Stg0.8640 seen in early February. However, sterling recovery has been halted by the BoE's recent decision to engage in quantitative easing with the euro back trading around the Stg0.92p level. We expect a Stg0.88-0.93p range for now, with a modest recovery in sterling seen from Q2 onwards.

Key Forecasts

		Q1-2009	Q2-2009	Q3-2009	Q4-2009
US\$/EUR	1.277	1.25-1.30	1.25-1.30	1.28-1.33	1.30-1.35
GBP/EUR	0.928	0.88-0.93	0.87-0.92	0.85-0.90	0.82-0.87
YEN/EUR	125.26	120-130	120-130	125-135	135-145
PLN/EUR	4.537	4.57	4.45	4.15	4.00



Sterling

Hit by ongoing evidence of an economic downturn that is likely to result in one of the worst UK recessions since World War II, historically low interest rates, a dysfunctional financial and banking system, as well as a sharp unwinding of carry trade positions and a growing current account deficit, sterling continues to be one of the worst performing of the major currencies. Although currently off its lows, it is still down a respective 21%, 31% and 34% versus the euro, dollar and yen compared to where it was trading this time last year.

January's impressive recovery versus the euro ground to a halt in February as the market moved to price in sub 1% official rates in the UK. The recent announcement of quantitative easing measures from the BoE put further pressure on the currency, with fresh selling seen versus the dollar and euro.

In terms of sterling/euro, we anticipate a Stg0.88-0.93p range for the short to medium term. However, given the poor outlook for the eurozone, in our view excessive bad news has been priced into sterling/euro. Thus, 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 Stg0.85p or higher against the euro in H2-2009.

Meanwhile, in terms of the USD/GBP rate, sterling is still trading off the 25 year lows of \$1.3502 seen in late January. However, we could see a fresh test of this level near-term. Considerable downside risks versus the dollar remain in place, given the concerns for the UK economy and investor demands for safe haven assets. We anticipate plenty of volatility in the weeks ahead, though at the same time see activity being largely concentrated in a \$1.35-1.45 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

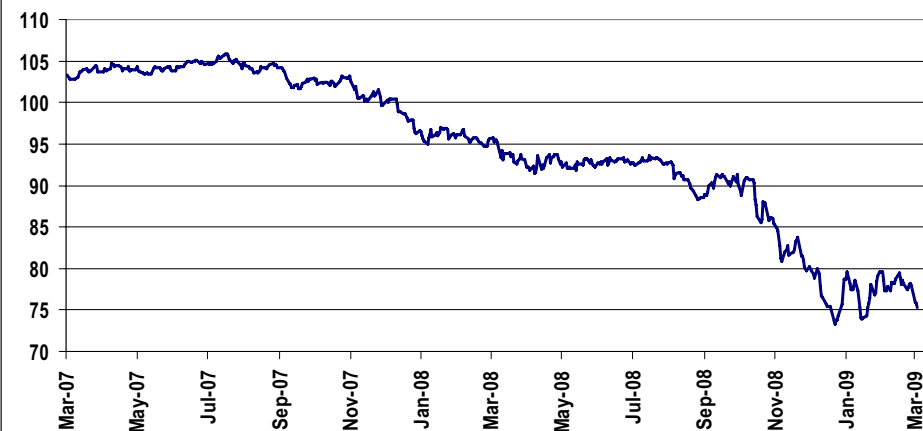
		Q1-2009	Q2-2009	Q3-2009	Q4-2009
GBP/EUR	0.928	0.88-0.93	0.87-0.92	0.85-0.90	0.82-0.87
US\$/GBP	1.376	1.35-1.45	1.38-1.48	1.45-1.55	1.50-1.60
YEN/GBP	135.01	137	140	151	162
CAD/GBP	1.774	1.80	1.78	1.82	1.85

Synthetic Sterling/Euro Exchange Rate (1990-2009)



Source: Thomson Datastream

Sterling Trade Weighted Exchange Rate
Jan 2005 = 100



Source: Thomson Datastream

Japanese Yen

In an environment of global deleveraging and heightened risk aversion, the yen appreciated markedly over the course of 2008 and in early 2009. Indeed, it proved to be one of the best performing currencies of last year as it appreciated rapidly on the back of a reversal of risky carry trade position and a flight to safe haven assets. Its perceived safe haven status was boosted by the fact that Japan has a relatively healthy banking sector. Furthermore, its current account surplus also made the yen an attractive investment choice in the volatile and uncertain environment.

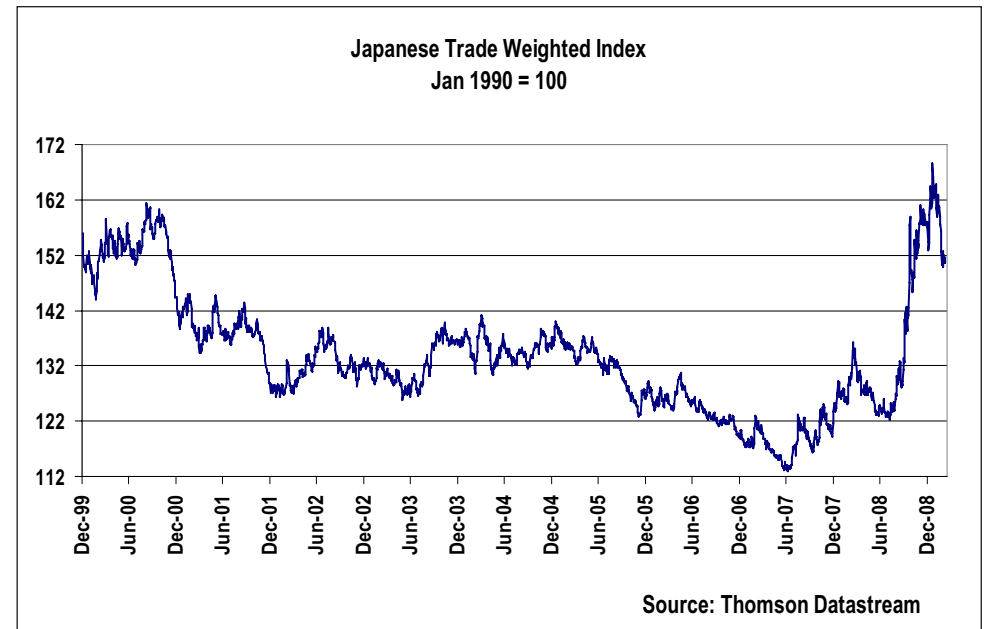
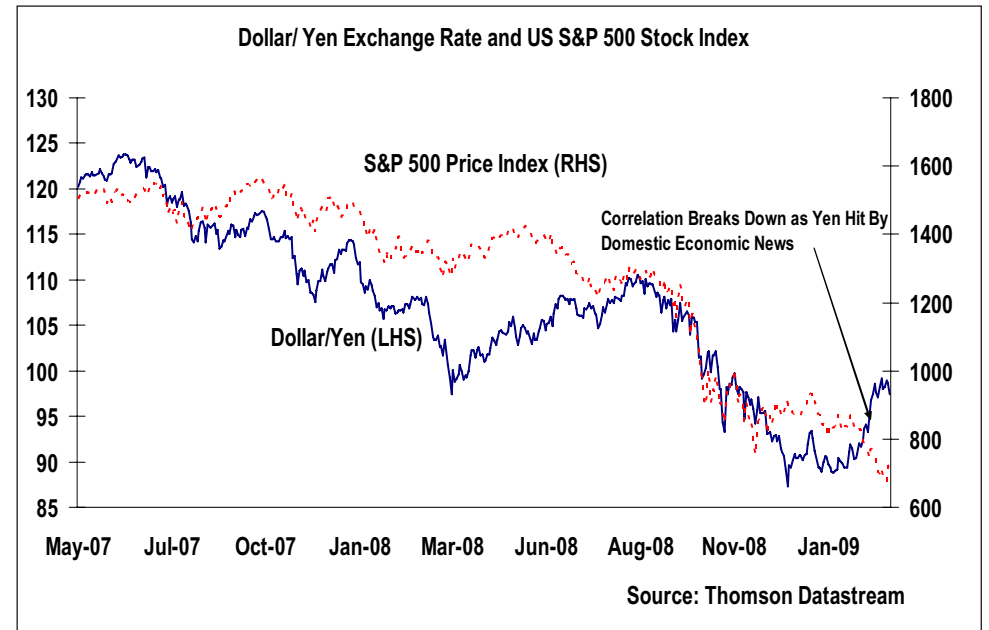
However, sentiment toward the yen has soured of late as markets turn their attention to the fragile state of the Japanese economy. Dragged down by a sizeable negative contribution from net trade, the economy contracted at an annualised rate of 12% in Q4-2008, over twice the rate of contraction seen in the US. The export driven economy has been hard hit by the downturn in global demand, as well as the overvalued position of the yen. Against this background, Japan's healthy current account surplus has vanished with recent current account data showing the first deficit for 13 years.

Thus, from lows of Y87.15 seen in late January, the dollar has recovered back to its current level of Y98. We expect a Y95-100 trading range for dollar/yen over the coming weeks, with the USD now the main safe haven currency. Even if market sentiment improves, any yen rebound could be limited given the poor fundamental outlook for the economy. Meanwhile, the euro has also recovered from its lows. We anticipate a Y120-130 range for now, though the euro's own upside could be limited given the weak outlook for the eurozone economy.

Over the longer term, we expect the yen to weaken further, as reflected in our forecasts. The outlook for Japan is bleak indeed, with official interest rates now back near zero, the economy deep in recession, with business and consumer confidence at low levels and the marked appreciation in the yen continuing to hit export demand.

Key Forecasts

		Q1-2009	Q2-2009	Q3-2009	Q4-2009
YEN/US\$	98.01	95-100	95-102	98-105	100-107
YEN/EUR	125.13	120-130	120-130	125-135	135-145
YEN/GBP	134.90	137	140	151	162



Key Events/Diary

Week 1 (16th - 20th March)

March 16th	US	Industrial Prod & Capacity Utilisation (February)
March 17th	IRL	Public Holiday
	US	Producer Prices (February)
March 18th	UK	Minutes of MPC Meeting (4/5th March)
	UK	Unemployment Report (February)
	US	Consumer Prices (February)
	US	FOMC Policy Announcement

Week 2 (23rd - 27th March)

March 23rd	US	Existing Home Sales (February)
March 24th	Eurozone	Flash Markit Manf and Services PMIs (March)
	UK	CPI (February)
March 25th	US	New Home Sales (February)
March 26th	UK	Retail Sales (February)
	US	Q4 GDP (Revised)
March 27th	UK	Q4 GDP (Final Estimate)
	US	Personal Income and Consumption (February)

Week 3 (30th March - 3rd April)

March 30th	Eurozone	EU Business & Consumer Confidence (March)
March 31st	Eurozone	HICP Flash Estimate (March)
	US	Consumer Confidence (March)
April 1st	US/UK/Eurozone	Manufacturing ISM/Markit PMIs (March)
	US	ADP Employment Report (March)
April 2nd	Eurozone	ECB Policy Announcement & Press Conference
April 3rd	US/UK/Eurozone	Services ISM/Markit PMIs (March)
	US	Non-Farm Payrolls (March)

Week 4 (6th April - 10th April)

April 7th	UK	Industrial Production & Manf Output (February)
	IRL	Mini Budget 2009
	Eurozone	Q4 GDP - Final Estimate
April 9th	UK	Producer Prices (March)
	UK	BoE Policy Announcement
	US	Trade Report (February)
April 10th	Europe/US	Market Holiday

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.
The information in the Key Events/Diary is from publicly available sources.

Charts based on daily closing rates as provided by Thomson Datastream.

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