



Exchange Rate Outlook *11th September 2009*

- **USD pressured as safe haven status undermined**
- **Euro breaks out of summer trading ranges to hit new yearly highs**
- **Sterling on backfoot on underlying concerns about UK recovery**
- **Yen benefits from weakened dollar position**

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Chief Economist

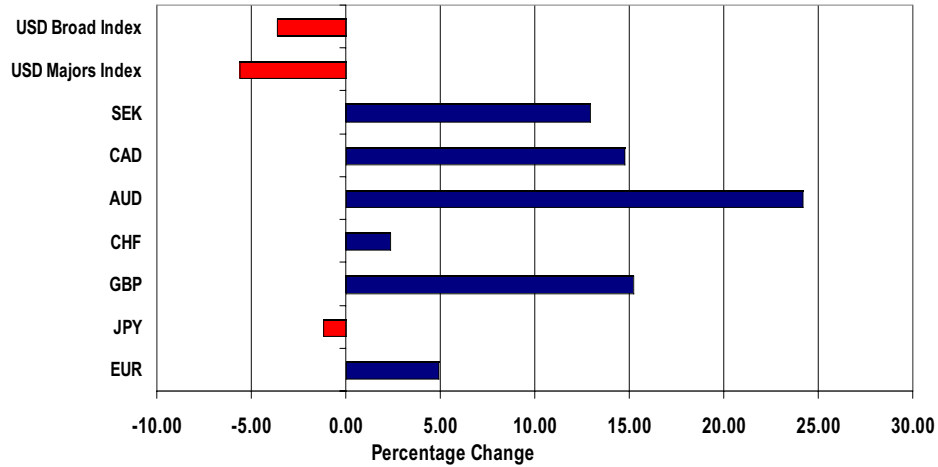
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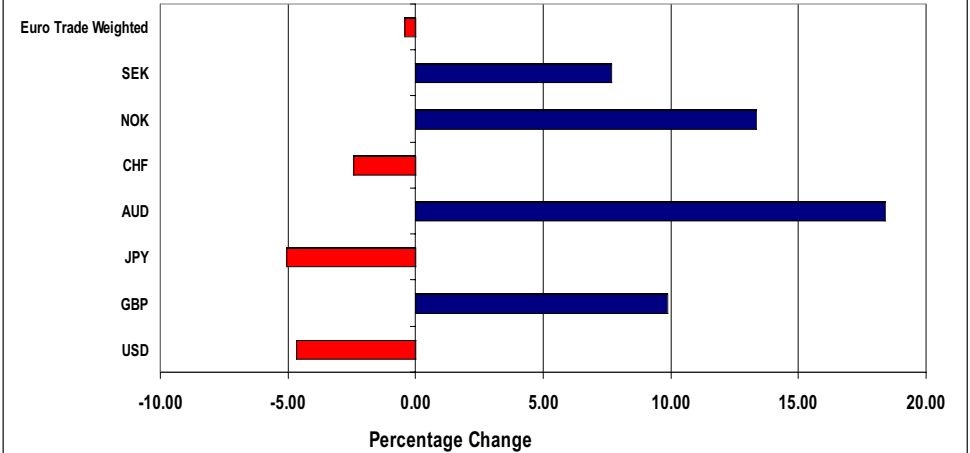
Key Currency Trends

Performance Versus Dollar & USD Trade Weighted Indices
2009 Year to Date % Change



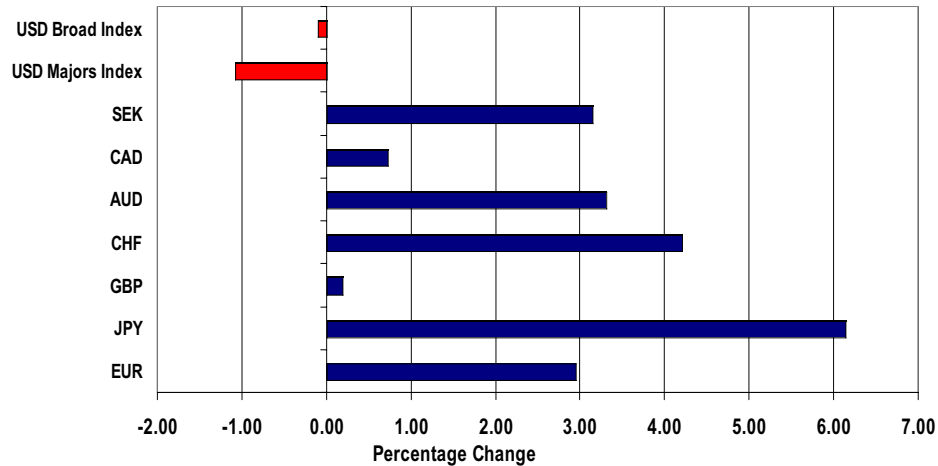
Source: Thomson Datastream

Performance Versus Euro and Euro Trade Weighted Index
2009 Year to Date % Change



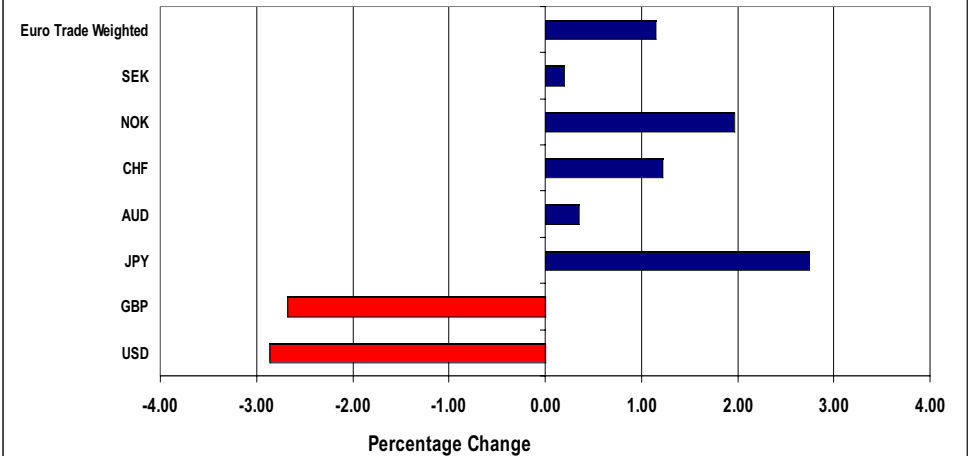
Source: Thomson Datastream

Performance Versus Dollar & USD Trade Weighted Indices
% Change In Past Month



Source: Thomson Datastream

Performance Versus Euro and Euro Trade Weighted Index
% Change in Past Month



Source: Thomson Datastream

Summary of Exchange Rate Forecasts

	Current	Q3-2009	Q4-2009	Q1-2010	Q2-2010
Euro Versus					
USD	1.458	1.43-1.48	1.43-1.49	1.40-1.45	1.38-1.43
GBP	0.874	0.87-0.89	0.86-0.89	0.85-0.88	0.83-0.86
JPY	132.67	127-137	130-140	132-142	132-142
PLN	4.19	4.15	4.05	4.00	3.95
HUF	272.92	272	275	275	275
NOK	8.66	8.62	8.60	8.60	8.50
SEK	10.21	10.22	10.00	9.90	9.80
US Dollar Versus					
JPY	90.98	88-95	90-95	93-98	95-100
GBP	1.669	1.63-1.68	1.60-1.70	1.60-1.70	1.60-1.70
CHF	1.04	1.05	1.05	1.07	1.09
CAD	1.08	1.08	1.08	1.07	1.05
AUD	0.86	0.85	0.85	0.87	0.87
NZD	0.70	0.69	0.69	0.71	0.71
CNY	6.83	6.82	6.82	6.80	6.80
Sterling Versus (mid point of expected trading range)					
JPY	152	152	154	157	162
CAD	1.80	1.79	1.80	1.76	1.75
AUD	1.94	1.95	1.96	1.89	1.91
NZD	2.37	2.40	2.42	2.32	2.34

Interest Rate Outlook

Central banks across the world cut official rates aggressively to help ease the crisis that gripped the world's financial system and counter what has proved a very deep global recession. Meanwhile, inflation has fallen close to, or below, zero in many countries. Given the continuing tight credit conditions, high and rising unemployment, uncertainty about the strength and durability of the current pick up in activity as well as subdued inflation, we believe that current very low official interest rates environment will last for a considerable time. While some smaller economies may raise rates, we do not see the four main central banks hiking rates until H2 2010 or even 2011.

Fed Rates To Stay Close On 0% For A Long Time

With inflation falling sharply and the economy in deep recession, the Fed cut US interest rates effectively to zero per cent last December, adopting a 0 - 0.25% target range for the Fed funds rate. The Fed pursued quantitative easing measures this year, in particular substantial purchases of Treasuries and mortgage securities, to help stimulate the economy and aid financial markets.

With the unemployment rate set to soon breach 10% and the US economic recovery expected to prove fragile, as well as very subdued inflation, the current exceptionally low level of the Fed funds rate can be expected to remain in place until H2 2010 and possibly even into 2011.

ECB Refi Rate Very Much On Hold At 1%

The ECB cut interest rates by 0.25% to 1.0% at its May policy meeting, bringing the total reduction in official rates in the eurozone to 3.25% since last October. An official rate of 1.0% represents an historical low for the eurozone. A further cut in interest rates seems most unlikely at this point, with leading economic indicators picking up in the eurozone and elsewhere. Indeed, the eurozone economy is expected to return to growth in this quarter.

At the same time, however, we do not expect that the ECB will consider raising the refi rate until H2 2010, with inflation expected to remain very low, unemployment at high levels and rising, and given the considerable doubts about the sustainability of the economic upswing.

UK Extends Quantitative Easing

The Bank of England cut its key interest rate to 0.50% at its March meeting. As official rates are now at ultra low levels, the focus has switched to quantitative easing measures. In this regard, the BoE announced after its August meeting that it was increasing the size of its asset purchases by a further £50 billion to £175 billion. With inflation forecast to remain below 2%, unemployment high and rising, and the economic recovery likely to prove anaemic, policy is set to remain very accommodative well into next year. We do not see any rate hikes before H2 2010.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	0.30	1.26	1.20	2.65
Dec '09	0.125	0.35	1.30	1.20	2.65
Mar '10	0.125	0.40	1.35	1.25	2.75
Jun '10	0.125	0.50	1.50	1.50	3.00

* Swap Forecasts Beyond 1 Year

Eurozone Interest Rate Forecasts (to end quarter)

	Refi Rate	3 Mth	1 Year	2 Year *	5 Year *
Current	1.00	0.74	1.26	1.63	2.71
Dec '09	1.00	0.75	1.30	1.65	2.70
Mar '10	1.00	0.80	1.35	1.70	2.80
Jun '10	1.00	1.00	1.55	1.90	3.00

* 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	0.63	1.17	1.87	3.29
Dec '09	0.50	0.65	1.20	1.90	3.30
Mar '10	0.50	0.75	1.25	2.00	3.40
Jun '10	0.50	0.90	1.45	2.20	3.60

* Swap Forecasts Beyond 1 Year

US Dollar

Despite increasing evidence of a recovery in the US economy, the dollar continues to struggle versus other majors. Investors are showing a preference for riskier assets over the traditional safe haven currency as it becomes increasingly apparent that the global financial crisis is over. After a summer of range trading, selling pressure has intensified once again, with the USD falling to fresh yearly low versus the euro in early September on the back of a bounce in risk appetite. Losses have also been seen versus the JPY and GBP as talk of reserve currency diversification, in addition to higher oil prices and commodities generally, also weighing on the USD.

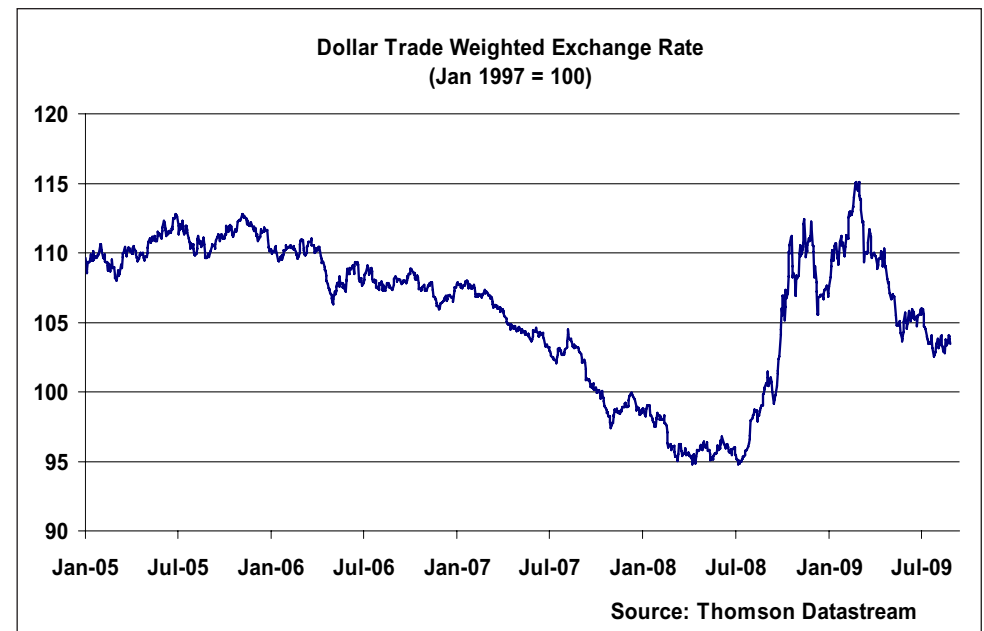
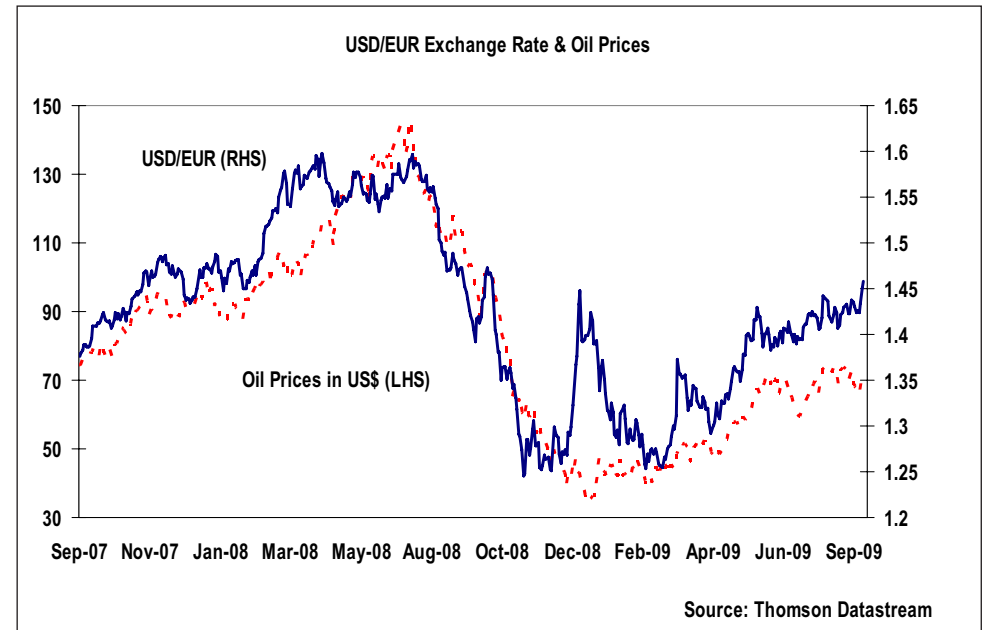
The dollar is also being undermined by the ultra accommodative stance of US monetary policy. While the Fed has noted that the economy is picking up, there is still a great deal of uncertainty and the central bank has indicated that policy is to remain very accommodative for a prolonged period. With data in all developed economies pointing to improved conditions, the timing of global monetary policy tightening is likely to become an increasingly important factor for forex markets going forward. Expectations for the Fed relative to other central banks are currently dollar negative.

The improved sentiment environment could well see the dollar come under further pressure over the coming months, particularly versus risk sensitive currencies like the euro and sterling, as well as commodity driven currencies like the AUD. Even if sentiment were to be temporarily hit by any renewed pick up in risk aversion, the increasing search for yield in a more confident global marketplace is likely to continue to weigh on the dollar.

Longer term, however, we see some modest recovery in the dollar. The US economy is well advanced in terms of the recessionary cycle and the dollar should eventually benefit from any build up of speculation of a tightening in US monetary policy. Meanwhile, the rebalancing in terms of global demand suggests that the US balance of payments position is also likely to be less dollar negative going forward.

Key Forecasts

		Q3-2009	Q4-2009	Q1-2010	Q2-2010
US\$/EUR	1.458	1.43-1.48	1.43-1.49	1.40-1.45	1.38-1.43
US\$/GBP	1.669	1.63-1.68	1.60-1.70	1.60-1.70	1.60-1.70
YEN/US\$	91.023	88-95	90-95	93-98	95-100
CHF/US\$	1.038	1.05	1.05	1.07	1.09



Euro

The euro continues its upward trend versus the dollar, finishing the summer on a high note as sentiment is underpinned by the increasing prospects of an improvement in global economic conditions and further evidence of stability in financial markets. This improvement in sentiment is diverting resources away from the safe haven dollar towards more risk sensitive currencies like the EUR. As well as that, some upside surprises in terms of eurozone economic data, including better than expected Q2 GDP numbers, have also lent support to the euro.

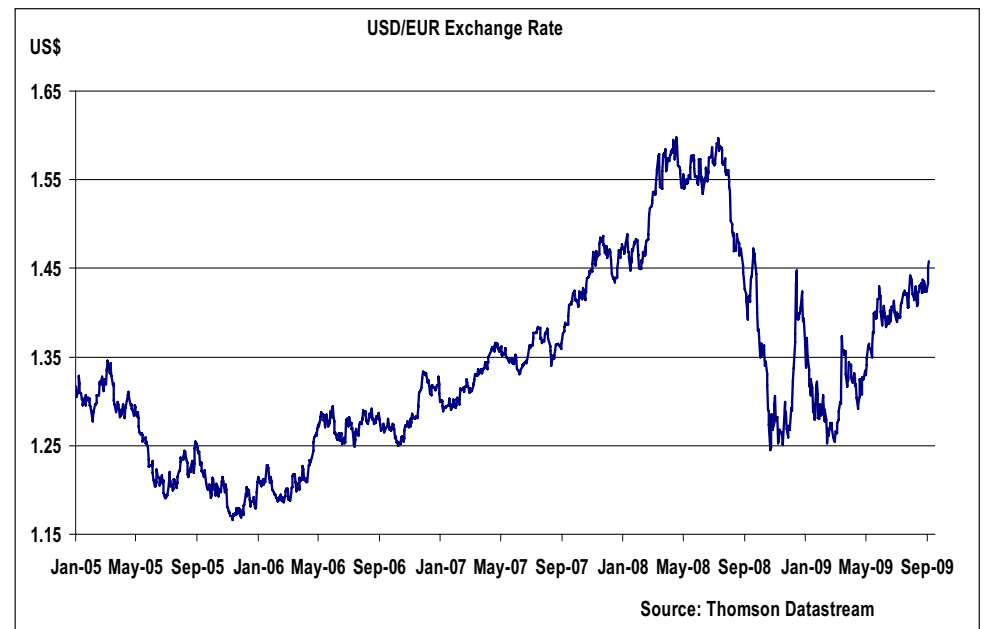
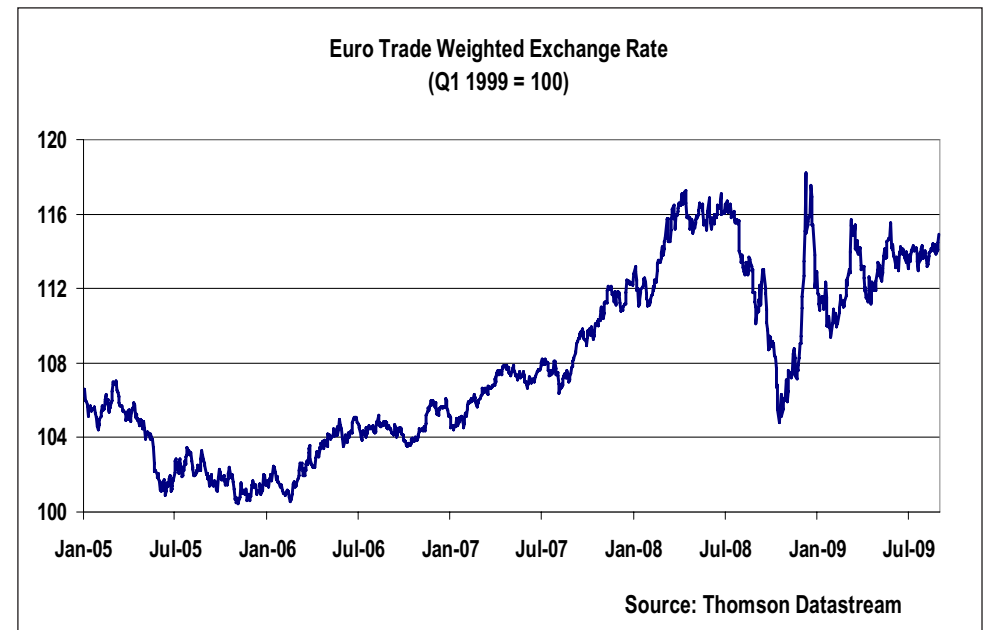
The dollar's position versus the euro also continues to be undermined by the extensive quantitative easing activities of the US central bank relative to those of the ECB, as well as ongoing talk of reserve diversification and the need for reserve currency alternatives to the USD. Recently breaking through the \$1.45 level to see yearly highs, we expect positive risk sentiment to keep the euro firm versus the dollar over the near term. We anticipate a \$1.43-1.48 trading range over the coming weeks, with a move towards the \$1.50 level possible near term.

Over the longer term, we continue to see scope for some modest recovery in the dollar as the improvement in the US economy and expectations of any moves by the Fed towards normalising interest rates provide some support. However, upside potential for the US currency looks to be limited and a relatively weak dollar could well continue to be the trend for forex markets going into 2010.

The euro hit lifetime highs of Stg0.9803p versus sterling in late 2008 before slipping all the way back to a low of Stg0.8463 by in mid June. Since then the euro has moved back to trade around Stg0.87/0.88p following a sterling sell off on the back of some disappointing UK data and the BoE's decision to extend its quantitative easing activities. With strong support at Stg0.875p giving way, sterling looks set to continue trading with a negative bias versus the euro near term before recovering some ground into 2010.

Key Forecasts

		Q3-2009	Q4-2009	Q1-2010	Q2-2010
US\$/EUR	1.458	1.43-1.48	1.43-1.49	1.40-1.45	1.38-1.43
GBP/EUR	0.874	0.87-0.89	0.86-0.89	0.85-0.88	0.83-0.86
YEN/EUR	132.73	127-137	130-140	132-142	132-142
PLN/EUR	4.185	4.15	4.05	4.00	3.95



Sterling

As one of the currencies worst hit by the global financial crisis, sterling suffered a marked depreciation last year, falling to lifetime lows versus the euro and multi year lows versus the USD and yen. Since then the pound has recovered considerable ground versus other majors, with a series of yearly highs seen versus the USD over June, as well as a marked recovery against the euro and yen.

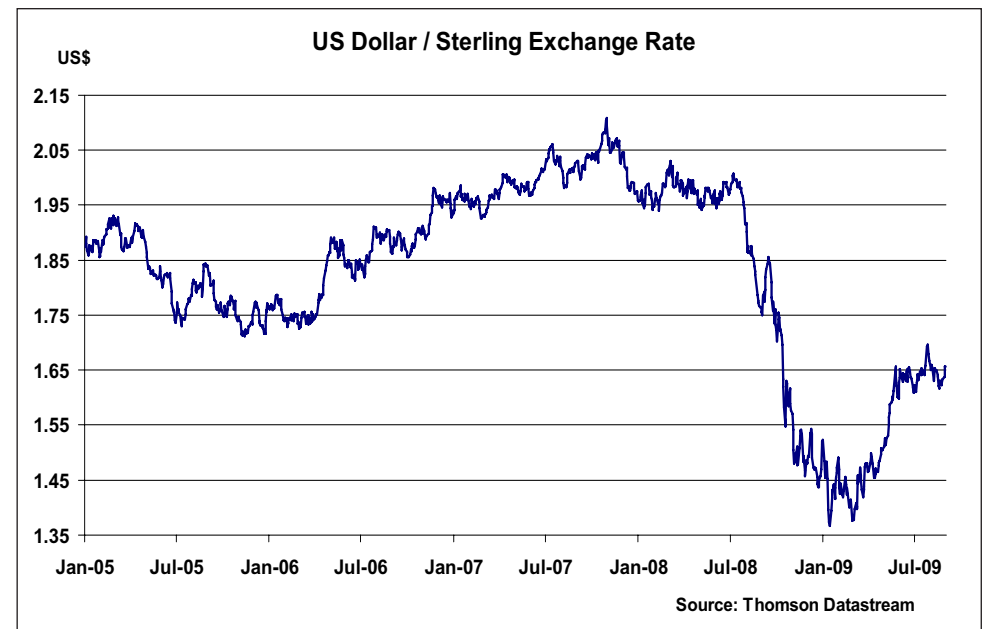
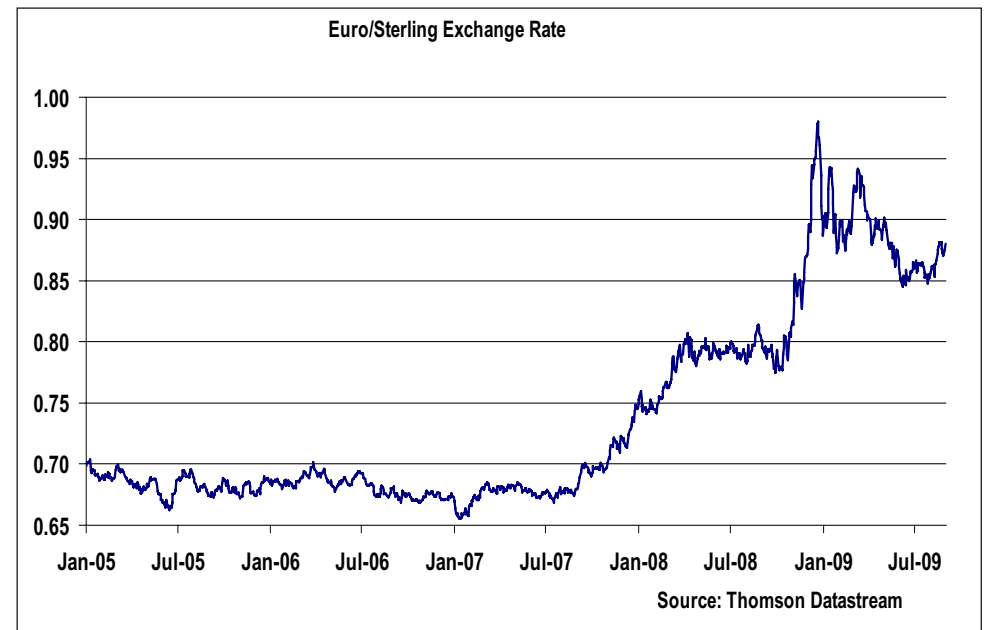
However, sterling's upside momentum faded over the summer months as traders booked profits on sharp gains and took a more cautious view with regard to the underlying prospects for the UK economy, particularly relative to the eurozone. While in general, UK data are pointing to a recovery in H2, some key data releases have disappointed, with comparable data from mainland Europe surprising on the upside.

Investors also sold the UK currency when the BoE announced in August that it was increasing its quantitative easing activities by a further Stg50bln to Stg175bln (a reflection of how cautious the MPC is on recovery prospects), with some in the market believing that this could be extended even further. Concerns about the UK public finances are also building, with the focus on this only set to increase as the 2010 general election gets closer. Thus, against this negative backdrop, the sterling/ euro rate is back trading around the Stg0.87/88p level. The UK currency is expected to underperform versus the euro for the time being, before seeing some modest recovery out over the medium term.

Currently a risk sensitive currency, sterling has benefited versus the dollar from the recent rise in investor appetite but at the same time has failed to reach highs seen earlier in the year, again a reflection of the underlying concerns about the UK economy. Any further broad base dollar weakness could see cable push back to the \$1.70 level but strong resistance at \$1.67 has to be breached before this can happen. As well as risk appetite, the projected timing of any exit strategies by the BoE will also be important.

Key Forecasts

		Q3-2009	Q4-2009	Q1-2010	Q2-2010
GBP/EUR	0.874	0.87-0.89	0.86-0.89	0.85-0.88	0.83-0.86
US\$/GBP	1.668	1.63-1.68	1.60-1.70	1.60-1.70	1.60-1.70
YEN/GBP	151.81	152	154	157	162
CAD/GBP	1.797	1.79	1.80	1.76	1.75



Japanese Yen

In an environment of global deleveraging and heightened risk aversion, the yen appreciated markedly over 2008 and early 2009. It appreciated rapidly on the back of a reversal of carry trade positions and a flight to safe haven assets. Its perceived safe haven status was boosted by Japan's relatively healthy banking sector. Furthermore, Japan's current account surplus also made the yen an attractive investment choice in the then volatile and uncertain environment.

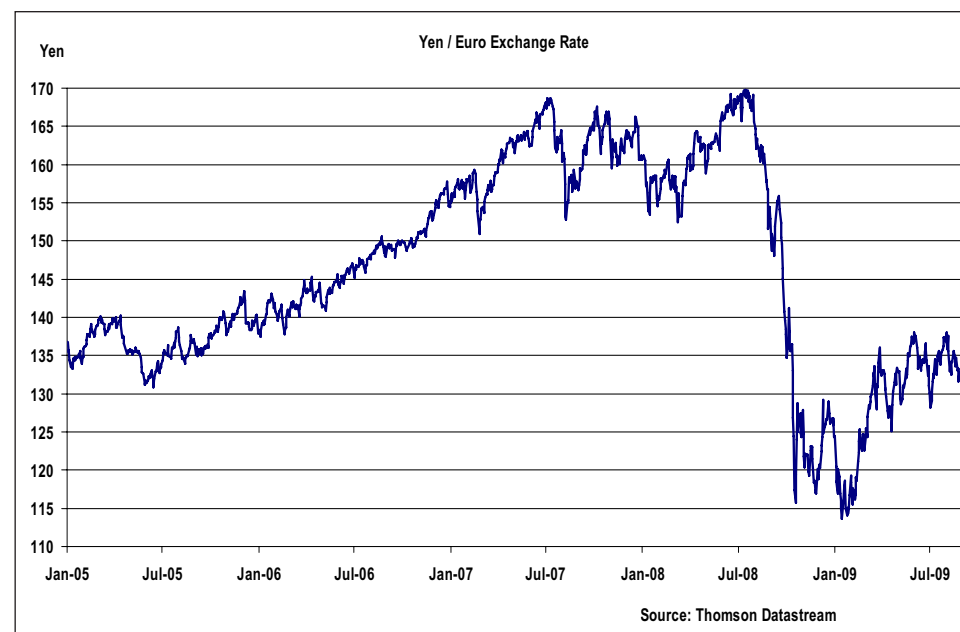
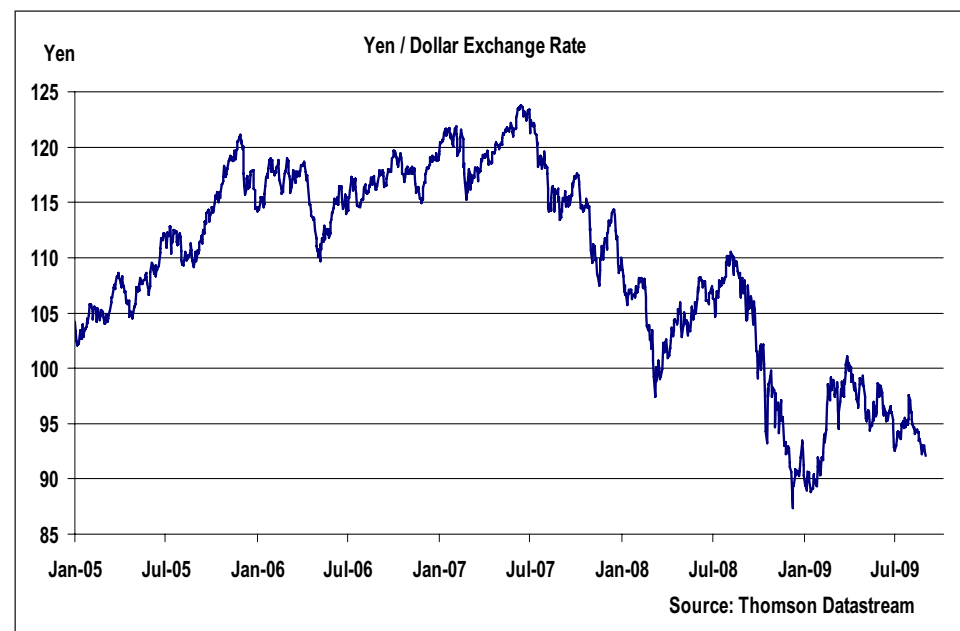
The yen then reversed direction, with sentiment undermined by the fact that Japan was more severely hit by the global downturn than any other industrialised nation. As a result of a sharp fall off in world trade, its healthy current account surplus vanished and external imbalances were no longer a supporting factor for the currency. At the year progressed, the yen was also hit by a pick up in investor appetite as the outlook for the global economy started to stabilise.

While year to date, the euro is still well up versus the yen and is currently trading off its lows, upside momentum has been hampered some what by the news that Japan was the only major economy to record an expansion in GDP in the second quarter of the year. Nevertheless, we continue to expect that the euro will take support from the general improvement in market sentiment.

Meanwhile, versus the dollar, from highs of Y87.15 seen in late January, the yen moved lower to hold a tight range centred on Y95 over much of the summer months. It has since broken into higher ground as the US currency has come under renewed pressure versus all majors. The expectation is that the USD will slip further near term, though marked yen appreciation is unlikely given the poor fundamental outlook for the Japanese economy. The currency is already view as overvalued versus the USD, a cause for concern as the Japanese economy is heavily reliant on the traded sector to lift it further out of recession.

Key Forecasts

		Q3-2009	Q4-2009	Q1-2010	Q2-2010
YEN/US\$	91.02	88-95	90-95	93-98	95-100
YEN/EUR	132.75	127-137	130-140	132-142	132-142
YEN/GBP	151.87	152	154	157	162



Key Events/Diary

Week 1 (14th-18th September)

Sept 14	Eurozone	Industrial Production (July)
Sept 15th	UK	Consumer Prices (August)
	Germany	ZEW Business Sentiment Index (September)
	US	Retail Sales & Producer Prices (August)
	US	Business Inventories (July)
	US	Existing Home Sales (August)
Sept 16th	UK	Unemployment (August)
	US	Industrial Production & Capacity Utilisation (August)
	US	Consumer Prices (August)
Sept 17th	UK	Retail Sales (August)

Week 2 (21st - 25th September)

Sept 23rd	Eurozone	Flash Markit Manufacturing PMIs/ISM (September)
	UK	Minutes of MPC Meeting (9/10 September)
	US	FOMC Policy Announcement
Sept 24th	US	Existing Home Sales (August)
Sept 25th	US	New Home Sales & Durable Goods (August)

Week 3 (28th September - 2nd October)

Sept 29th	UK	Q2 GDP (Final Estimate)
	UK	Mortgage Applications (August)
	Eurozone	EC Sentiment & Activity Surveys (September)
Sept 30th	Eurozone	Flash HICP (September)
	US	Q2 GDP (Final Estimate)
Oct 1st	US/UK/E-zone	Markit Manufacturing PMIs/ISM (August)
	US	Personal Income & Spending (August)
Oct 2nd	US	Non-Farm Payrolls (September)

Week 4 (5th - 9th October)

Oct 5th	US/UK/E-zone	Markit Services PMIs/ISM (August)
	Eurozone	Retail Sales (August)
Oct 6th	UK	Industrial Production (August)
Oct 8th	UK	BoE Policy Announcement
	Eurozone	ECB Policy Announcement and Press Conference
Oct 9th	UK	Producer Prices (September)
	US	Trade Balance (August)

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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