



Exchange Rate Outlook

14th October 2009

- **USD remains on backfoot versus other majors**
- **Euro sees fresh yearly highs versus dollar as \$1.50 beckons**
- **Sterling increasingly vulnerable on UK concerns**
- **Yen continues to benefit from weakened dollar position**

John Beggs
Chief Economist

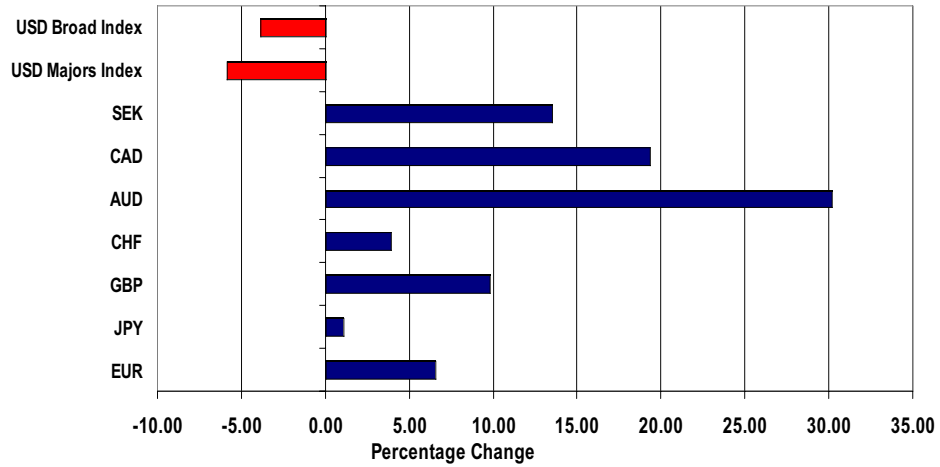
Geraldine Concagh
Senior Economist

Oliver Mangan
Chief Bond Economist

Jenny Pollock
Senior Economist

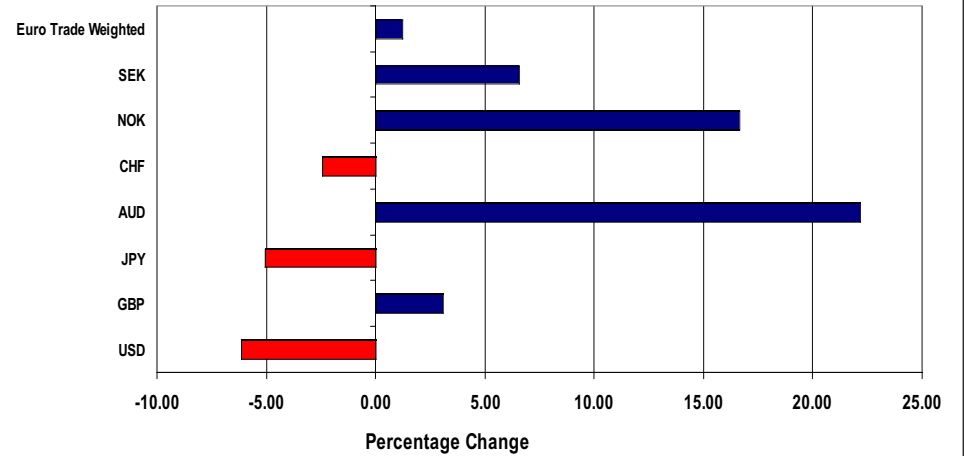
Key Currency Trends

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



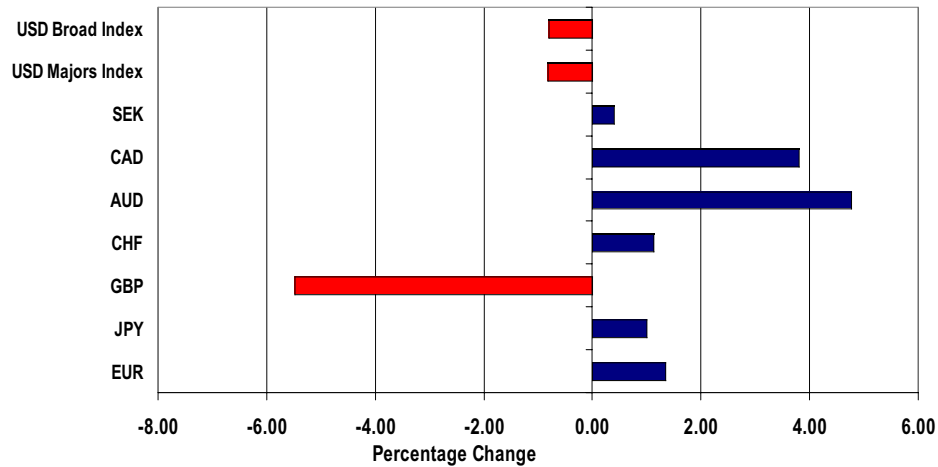
Source: Thomson Datastream

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



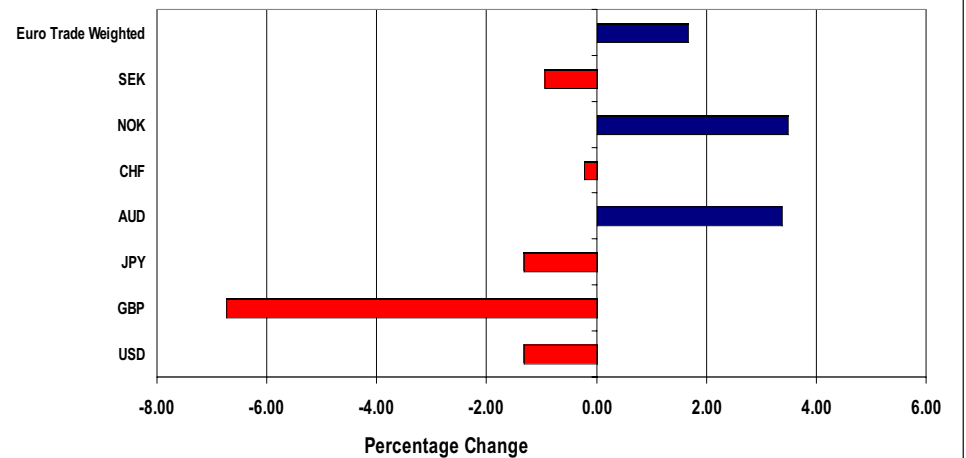
Source: Thomson Datastream

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

("Spot" Forecasts Represent Mid-Point of Expected Trading Range)

	Current	Q4-2009	Q1-2010	Q2-2010	Q3-2010
Euro Versus					
USD	1.489	1.46-1.52	1.45-1.50	1.43-1.48	1.40-1.45
GBP	0.930	0.92-0.97	0.90-0.95	0.87-0.92	0.85-0.90
JPY	132.71	127-137	132-142	132-142	135-145
PLN	4.20	4.20	4.10	3.95	3.90
HUF	267.45	270	273	275	275
NOK	8.29	8.35	8.30	8.10	8.10
SEK	10.29	10.30	10.00	9.90	9.80
AUD	1.63	1.64	1.62	1.62	1.60
NZD	2.00	2.01	1.99	1.99	1.98
US Dollar Versus					
JPY	89.11	86-92	92-97	95-100	95-100
GBP	1.601	1.54-1.62	1.55-1.65	1.57-1.67	1.60-1.70
CHF	1.02	1.03	1.05	1.06	1.07
CAD	1.03	1.06	1.07	1.07	1.07
AUD	0.91	0.91	0.91	0.90	0.89
NZD	0.74	0.74	0.74	0.73	0.72
CNY	6.83	6.82	6.80	6.80	6.80
Sterling Versus					
JPY	143	140	148	154	159
CAD	1.64	1.67	1.71	1.74	1.74
AUD	1.75	1.73	1.75	1.81	1.83
NZD	2.16	2.13	2.15	2.23	2.26

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 the 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 likely to have returned to growth in Q3.

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	0.28	1.22	1.32	2.70
Dec '09	0.125	0.35	1.30	1.35	2.70
Mar '10	0.125	0.40	1.35	1.40	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	0.70	1.23	1.78	2.72
Dec '09	1.00	0.75	1.30	1.70	2.75
Mar '10	1.00	0.80	1.35	1.85	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	0.56	1.11	1.78	3.08
Dec '09	0.50	0.60	1.20	1.80	3.15
Mar '10	0.50	0.75	1.25	1.90	3.30
Jun '10	0.50	0.90	1.45	2.20	3.50

* Swap Forecasts Beyond 1 Year

US Dollar

The dollar continues to struggle versus other majors as investors show a preference for riskier assets over the traditional safe haven currency. Indeed, the USD saw fresh yearly lows versus the euro once again this month on the back of the ongoing improvement in risk appetite. Losses have also been seen versus the JPY as talk of reserve currency diversification, in addition to higher oil prices and commodities generally, also weigh on the USD. Sterling is the notable exception to the generally weaker dollar trend as the UK currency underperforms on concerns about the UK economy.

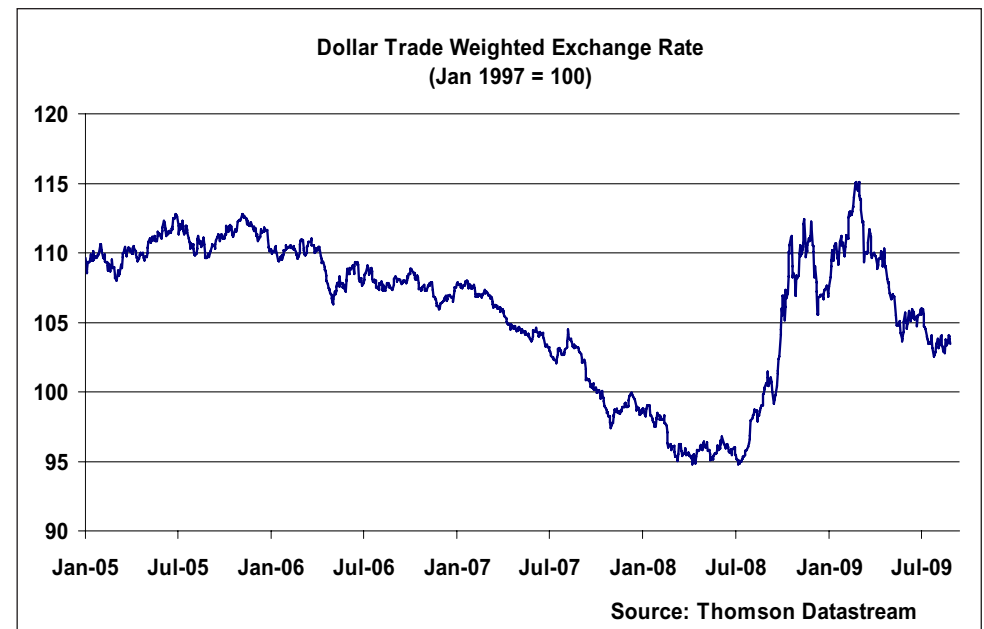
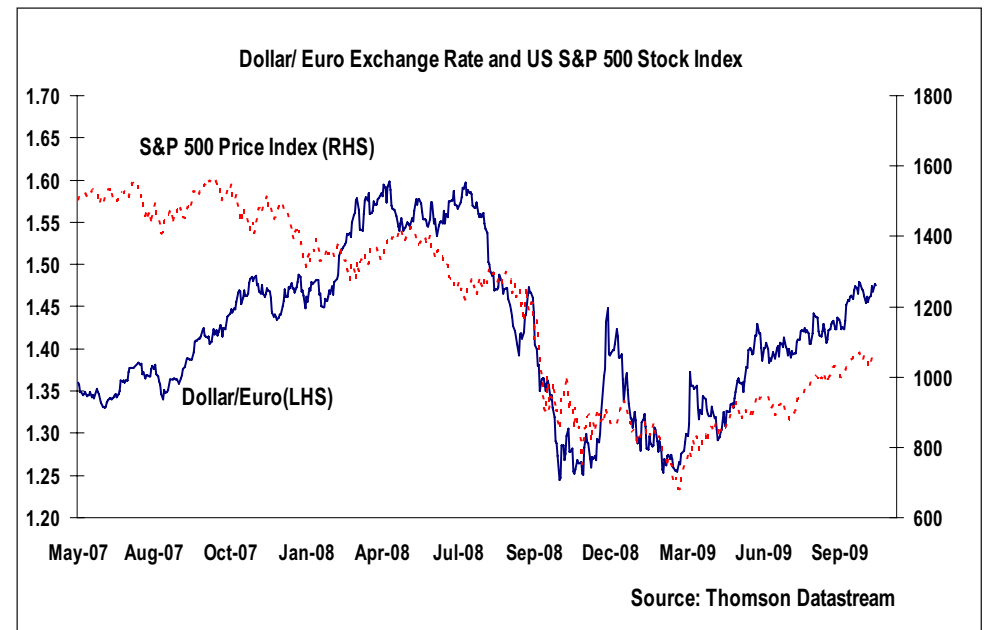
The dollar is also being undermined by the ultra accommodative stance of US monetary policy. While the Fed continues to note that the economy is picking up, it is guarded in its optimism. Thus, the central bank has indicated that policy is to remain very accommodative for a prolonged period. With data 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 improvement in market sentiment, as well as the increasing focus on interest rate differentials, could keep the dollar under pressure over the coming months, not only versus other majors like the euro and yen, but also against currencies like the AUD. Even if current forex trends were undermined by a renewed pick up in risk aversion (on a potential correction in stocks or a run of disappointing data) or dollar supportive rhetoric from global central bankers, 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

		Q4-2009	Q1-2010	Q2-2010	Q3-2010
US\$/EUR	1.489	1.46-1.52	1.45-1.50	1.43-1.48	1.40-1.45
US\$/GBP	1.600	1.54-1.62	1.55-1.65	1.57-1.67	1.60-1.70
YEN/US\$	89.134	86-92	92-97	95-100	95-100
CHF/US\$	1.018	1.03	1.05	1.06	1.07



Euro

The euro remains in an uptrend versus the dollar, as sentiment continues to be underpinned by the general improvement in risk appetite. This improvement in sentiment is diverting resources away from the safe haven dollar towards more risk sensitive and higher yielding 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.

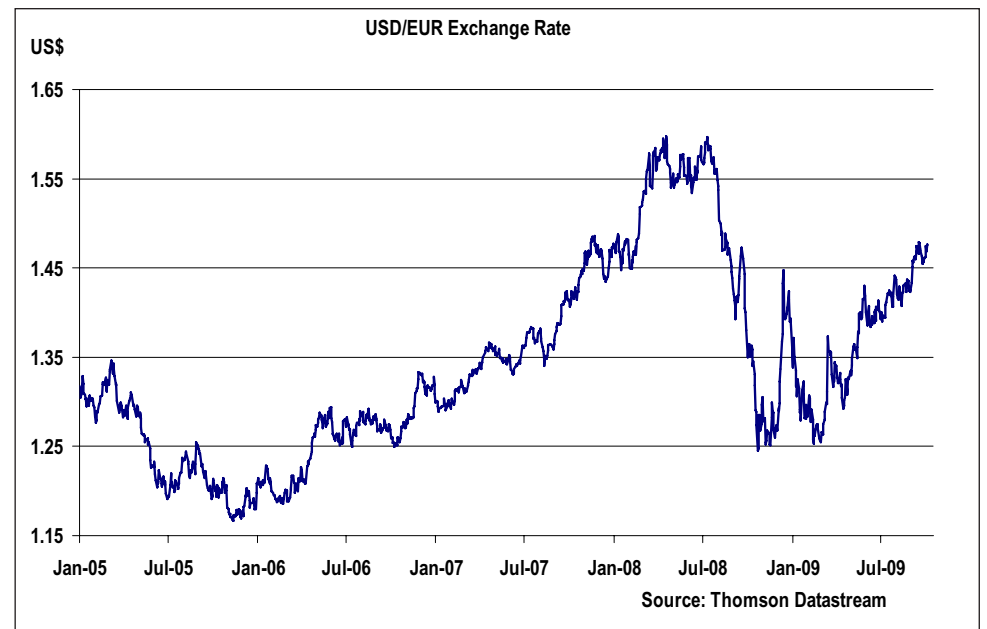
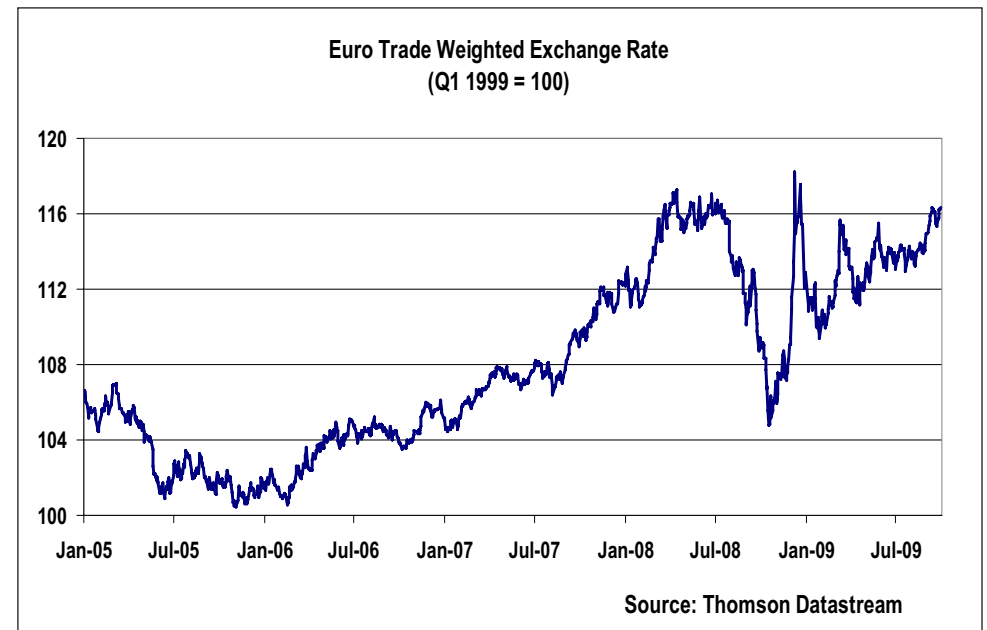
The dollar's position versus the euro is also being undermined by expectations that the Federal Reserve will be behind the ECB in increasing interest rates from emergency levels, as well as ongoing talk of the need for reserve currency diversification. Recently breaking through the \$1.48 level to see fresh yearly highs, positive risk sentiment, as well as interest rate differentials, should keep the euro firm versus the dollar near term and we anticipate a \$1.47-1.52 trading range. Upside momentum much beyond the \$1.50 level could prove difficult, though, following recent remarks from the ECB suggesting that the central bank is keen to prevent a marked rise in the euro.

Over the longer term, we continue to see scope for a 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, even in this environment, 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.

Sterling/euro hit lifetime highs of Stg0.9803p 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 Stg0.93/94p following sterling's sell off on the back of disappointing UK data, the BoE's decision to extend its quantitative easing activities and undermining comments from the BoE's King. Sterling looks set to continue trading with a negative bias versus the euro near term before recovering some modest ground into 2010.

Key Forecasts

		Q4-2009	Q1-2010	Q2-2010	Q3-2010
US\$/EUR	1.489	1.46-1.52	1.45-1.50	1.43-1.48	1.40-1.45
GBP/EUR	0.931	0.92-0.97	0.90-0.95	0.87-0.92	0.85-0.90
YEN/EUR	132.71	127-137	132-142	132-142	135-145
PLN/EUR	4.201	4.20	4.10	3.95	3.90



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. It recovered considerable ground versus other majors to mid 2009, 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 quickly faded as traders 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 appearing to suggest a superior economic performance.

Investors also sold the GBP when the BoE announced in August that it was increasing its quantitative easing activities to Stg175bln, with some in the market believing that this could be extended even further. Concerns about the UK public finances are also building as the 2010 general election gets closer. The renewed downside pressure on sterling, however, really intensified following comments from the BoE's King in late September that he was comfortable with sterling's current weak level. Back trading around Stg0.93/0.94p, the UK currency is expected to underperform versus the euro for the time being. A move through Stg0.95p seems increasingly likely as downside risks dominate and indeed parity cannot be ruled out. In terms of the outlook for sterling much will depend on the outcome of the BoE's November policy meeting (4/5 November) and the tone of its forthcoming Quarterly Inflation Report (11 November).

Now a highly risk sensitive currency, sterling has benefited to some extent from improved investor appetite but is currently underperforming versus the USD, again a reflection of the underlying concerns about the UK. Broad based dollar weakness could see cable hold the \$1.54/\$1.55 level in Q4 but upside momentum will be limited, unless there is a turn in market sentiment. As well as risk appetite, the projected timing of any exit strategies by the BoE versus the Fed will also be key in terms of setting the tone.

Key Forecasts

		Q4-2009	Q1-2010	Q2-2010	Q3-2010
GBP/EUR	0.930	0.92-0.97	0.90-0.95	0.87-0.92	0.85-0.90
US\$/GBP	1.601	1.54-1.62	1.55-1.65	1.57-1.67	1.60-1.70
YEN/GBP	142.65	140	148	154	159
CAD/GBP	1.644	1.67	1.71	1.74	1.74

Euro/Sterling Exchange Rate



Source: Thomson Datastream

US Dollar / Sterling Exchange Rate



Source: Thomson Datastream

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.

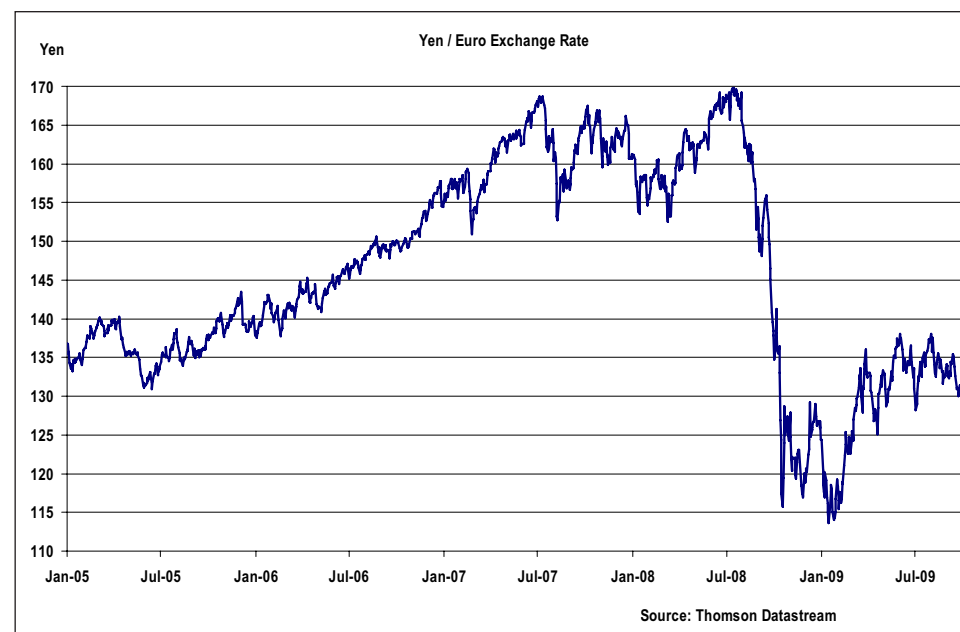
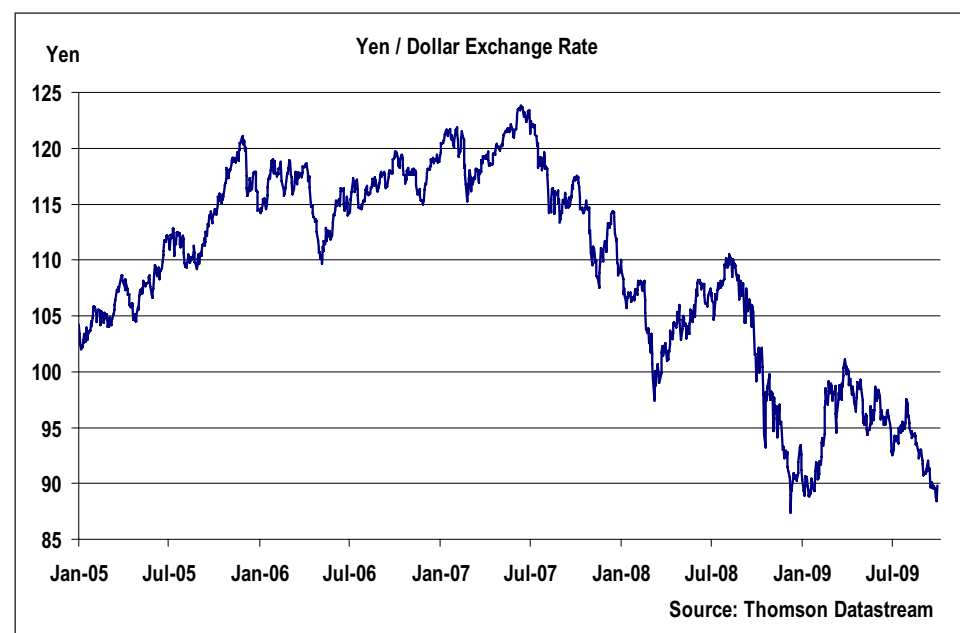
The yen then reversed direction, with sentiment undermined by the fact that Japan was more severely hit by the global downturn than any other industrialised nation. As a result of a sharp fall off in world trade, its healthy current account surplus vanished and external imbalances were no longer a supporting 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 remains off its lows, upside momentum has been hampered somewhat by the news that Japan was the only major economy to record an expansion in GDP in the second quarter of the year as well as renewed gains by the yen versus the USD. 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 fresh downward pressure. With Y88 under renewed pressure, the expectation is that the USD will slip further near term, though marked yen appreciation is unlikely given talk of intervention from the Bank of Japan. 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

		Q4-2009	Q1-2010	Q2-2010	Q3-2010
YEN/US\$	89.11	86-92	92-97	95-100	95-100
YEN/EUR	132.71	127-137	132-142	132-142	135-145
YEN/GBP	142.67	140	148	154	159



Australian Dollar/ New Zealand Dollar

The AUD and NZD came under strong selling pressure during the height of the global financial crisis, with projections for a weak global economy hitting the commodity driven currencies. A sharp reversal of carry trade plays on the back of a move to safe haven assets also impacted negatively. Both the AUD and NZD carried significant interest rate premiums going into the crisis, with official interest rates at a respective 7.25% and 8.25% at mid 2008. However, rates were subsequently slashed to historically low levels of 3.0% and 2.5%.

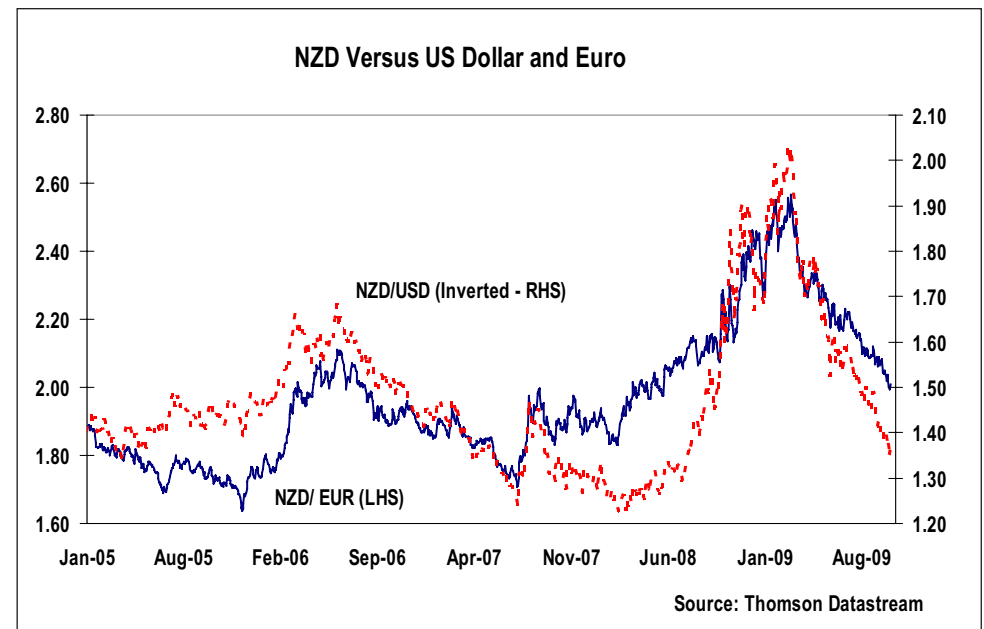
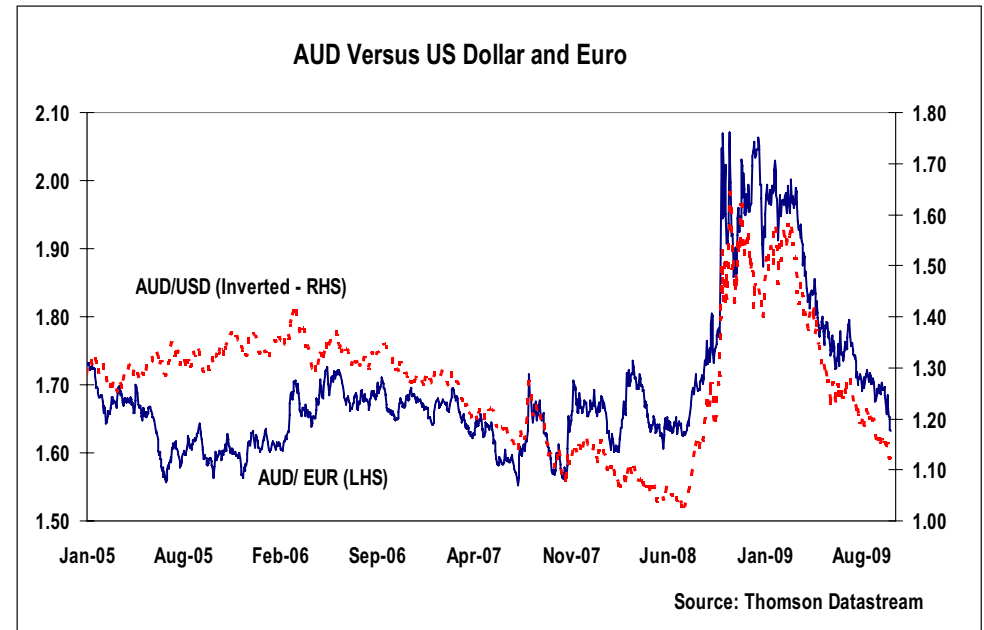
As the worst of the global economic news proves to be behind us, commodity prices have trended upwards, as has investor appetite for riskier currencies like the AUD and NZD. Furthermore, Australia proved to be one of a handful of economies that avoided recession, in large part due to the successful implementation of a fiscal stimulus measures. New Zealand did fall into recession but indicators show that the economy is moving back into a growth phase.

The pair's recovery was further cemented by the announcement from the Reserve Bank of Australia on 6th October that, in response to a better than anticipated domestic economic outturn, it was raising interest rates by 0.25% to 3.25%, making it one of the first developed economies to reverse the emergency monetary policy action delivered during the financial crisis.

Near-term, the AUD and NZD look set to continue trending upwards, particularly versus the USD. Sentiment will be underpinned by a number of factors, not least of which is the positive correlation between the currencies and the improving global economic cycle. Widening interest rate spreads should also be supportive, with markets pricing in further tightening from the RBA before end year. Although New Zealand is behind in terms of its economic performance, the earlier than anticipated rate hike from the RBA has affirmed market expectations for a rate hike by the RBNZ by the middle of next year.

Key Forecasts

		Q4-2009	Q1-2010	Q2-2010	Q3-2010
AUD/USD	0.915	0.91	0.91	0.90	0.89
NZD/USD	0.742	0.74	0.74	0.73	0.72
AUD/EUR	1.63	1.64	1.62	1.62	1.60
NZD/EUR	2.007	2.01	1.99	1.99	1.98



Key Events/Diary

Week 1 (19th-23rd October)

Oct 20th	US	Producer Prices (September)
Oct 21st	UK	Minutes of MPC Meeting (7/8 October)
	US	Fed Beige Book
Oct 22nd	UK	Retail Sales (September)
Oct 23rd	Eurozone	Flash Markit PMIs (October)
	Eurozone	German Ifo Survey (October)
	UK	Q3 GDP - 1st Estimate
	US	Existing Home Sales (September)

Week 2 (26th - 30th October)

Oct 27th	US	Consumer Confidence (October)
Oct 28th	US	New Home Sales (September)
	US	Durable Goods Orders (September)
Oct 29th	US	Q3 GDP - 1st Estimate
	Eurozone	EC Sentiment & Activity Surveys (October)
Oct 30th	Eurozone	Flash HICP (September)
	US	Personal Income and Spending (September)

Week 3 (2nd - 6th November)

Nov 2nd	US/UK/E-zone	Markit Manufacturing PMIs/ISM (October)
Nov 4th	US/UK/E-zone	Markit Services PMIs/ISM (October)
	US	ADP Employment Report (October)
	US	Fed Rate Announcement
Nov 5th	Eurozone	ECB Rate Announcement & Press Conference
	UK	BoE Rate Announcement
	UK	Industrial Production (September)
Nov 6th	US	Non-Farm Payrolls (October)

Week 4 (9th - 13th November)

Nov 10th	Eurozone	German ZEW Survey (November)
Nov 11th	UK	BoE Quarterly Inflation Report (November)
	UK	Unemployment and Earnings (September/October)
Nov 13th	Eurozone	Flash Q3 GDP
	German	Flash Q3 GDP
	US	International Trade (September)
	US	Michigan Sentiment Survey (November)

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.

The publication is for information purposes and is not an invitation to deal. The information is believed to be reliable but is not guaranteed. Any expression of opinions are subject to change without notice. This publication is not to be reproduced in whole or in part without prior permission. Allied Irish Banks p.l.c. is regulated by the Irish Financial Regulator.