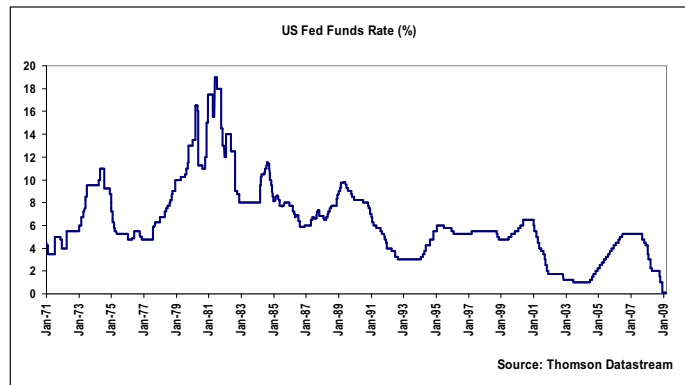


FED STEPS UP QUANTITATIVE EASING

The US Federal Reserve kept its key interest rate, the Fed funds rate, in a target range of 0 to 0.25 per cent at the conclusion of its two day FOMC policy meeting yesterday. Once again the Fed statement noted that US economic conditions remain weak, with job losses, declining equity and housing wealth as well as tight credit conditions weighing on consumer sentiment and spending. Meanwhile, the prospect of weaker sales and difficulties in obtaining credit have led firms to cut back on inventories and fixed investment, while export demand has slumped as major trading partners have fallen into recession. **These difficult conditions are likely to warrant exceptionally low levels of the Fed funds rate for some time, which probably means well into 2010 at a minimum.**

Fed Stuns With Plan to Buy Treasuries

All of this was in line with expectations. **The Fed, however, stunned markets when it also announced that it plans to buy up to €300 billion of longer-term Treasuries over the next six months.** This is the first time that the central bank has bought Treasuries since the 1960's and represents a major expansion of its quantitative easing tools.



It also said that, in an attempt to bring down mortgage rates and support the housing market, it will purchase an additional \$750 billion of agency mortgage backed securities (Fannie Mae and Freddie Mac), bringing its total purchase of such assets up to \$1.25 trillion this year. It also plans to increase its purchases of agency debt this year by up to \$100 billion, to a total of up to \$200 billion. All combined, this means that the Fed will be buying \$1.75 trillion of debt.

While the extension of the MBS buying programme was a surprise, **it was the move to commence buying government bonds that really caught markets off guard.** Fed Chairman Bernanke had recently indicated that a Treasuries purchase scheme was under discussion but markets did not believe that such a move was imminent, suggesting that the economic outlook for the US may be even worse than what the Fed had believed.

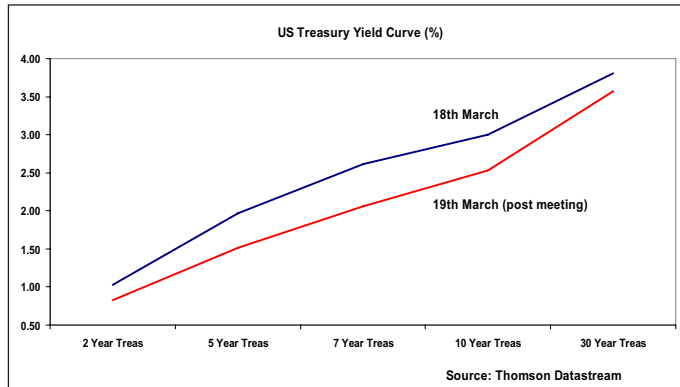


The Fed plans to concentrate its buying activities in the two-year to 10-year sector, through competitive auctions, which will likely be held two or three times a week.

Fed's Announcement Drives Treasury Yields Lower

The Fed's announcement triggered the biggest one day slide in benchmark 10 year Treasury yields since 1987, a slide in 30 year mortgage rates towards record lows, as well

as facilitating another positive close on Wall Street. The curve also flattened, with 2 year yields falling from 0.98% to a low of 0.80% while 10 year yields dropped from 2.95% to a low of 2.50%.



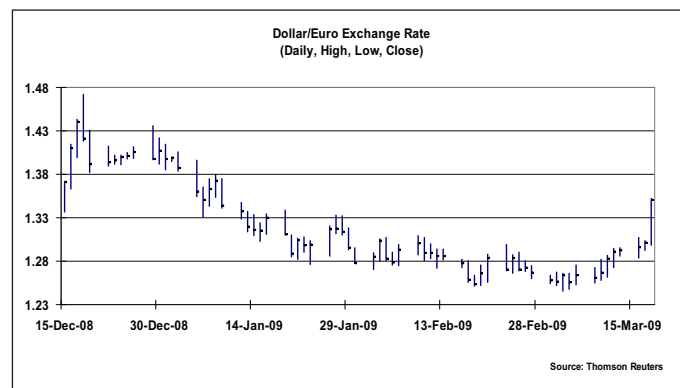
The Treasury debt purchase programme should help keep yields lower over the coming months, while also improving liquidity and hopefully underpinning a revival in the housing market through lower mortgage rates. It is, however, at the same time likely to raise concerns about the long term impact of such an expansion of the Fed's balance sheet plus the potential long term inflation threat.

And Sends Dollar Reeling

Igniting concerns about a sharp rise in the level of dollars in the system, the USD plunged versus other majors on the news, with the euro breaking through resistance at \$1.36 and sterling trading above the \$1.45 level. It also lost ground against the yen, despite a gloomy assessment of the Japanese economy from the Bank of Japan overnight.

Given the current mood, the US currency remains vulnerable to further selling. However, while the euro may see further gains over the coming trading sessions, **we**

would not rule out a bounce back in the dollar, given that conditions in the eurozone may yet prompt similar policy moves from the ECB.



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