AIB Global Treasury
Economic Research

Exchange Rate Outlook

18th December 2009

- Dollar claws back ground as year end approaches
- $1.51 a step too far for the euro as eurozone debt concerns build
- Sterling remains volatile on UK concerns
- Yen continues to reflect market appetite for risk

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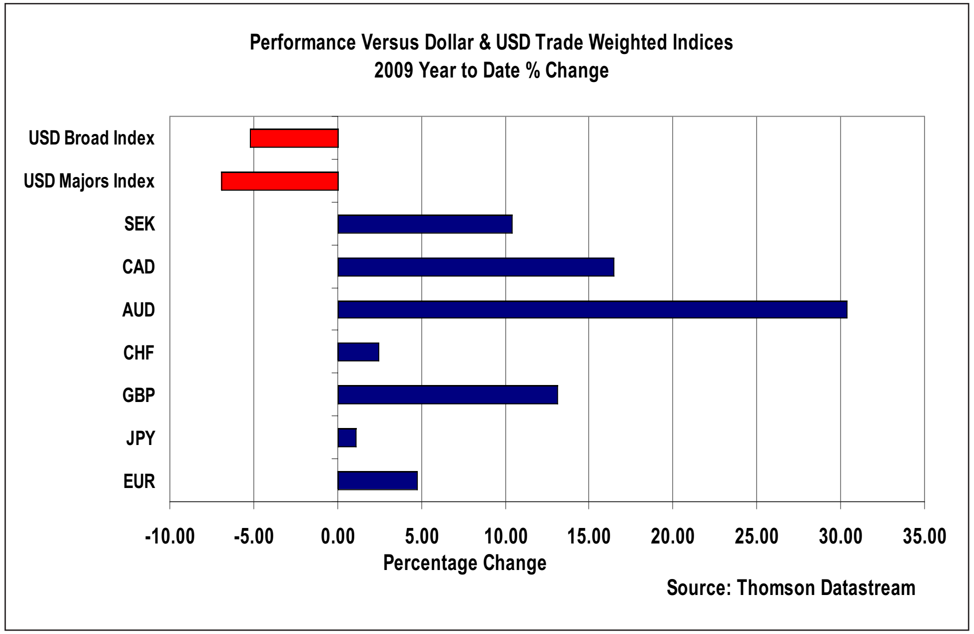
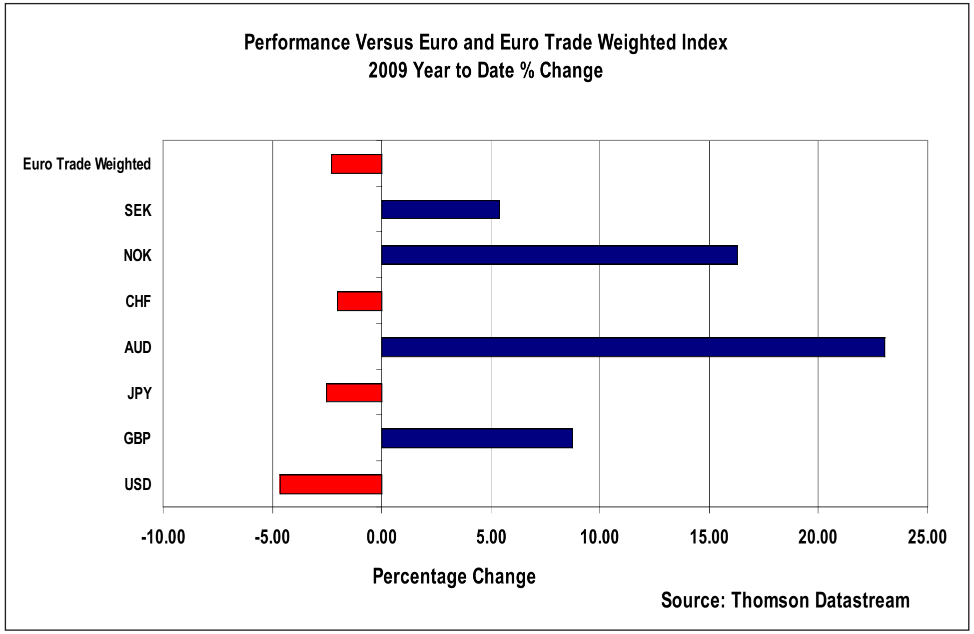
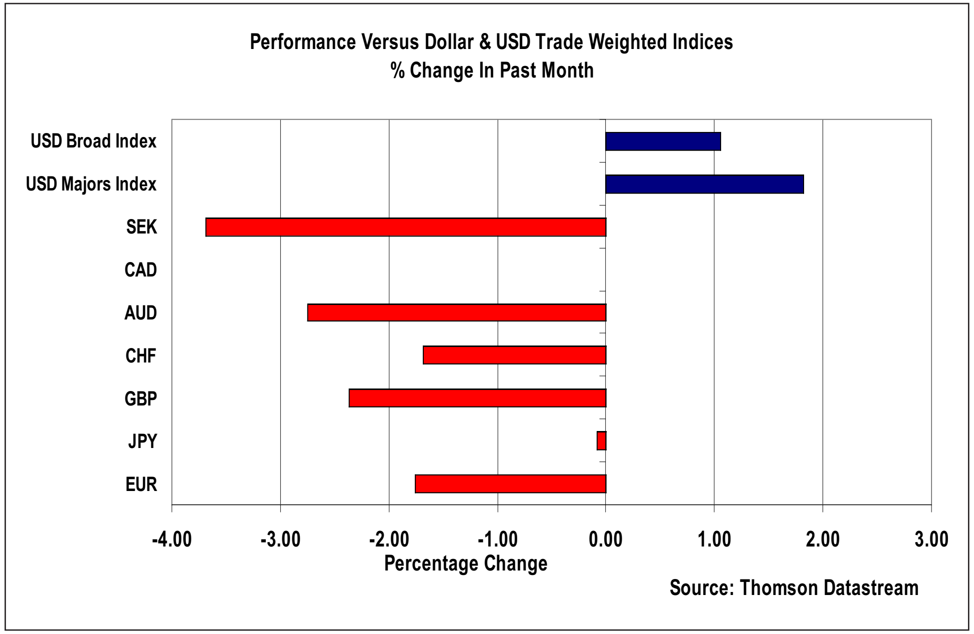
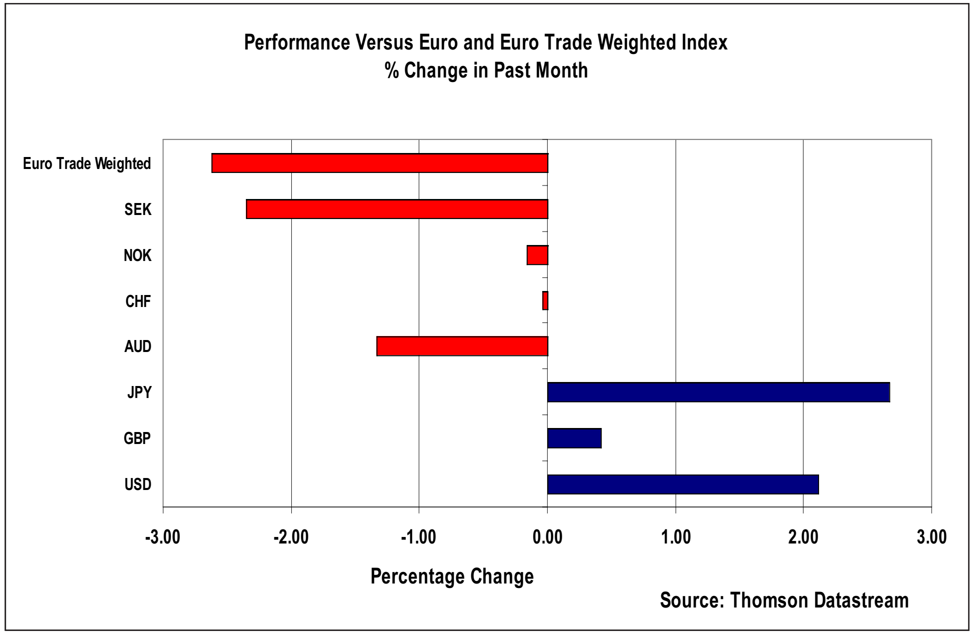
Key Currency Trends









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Summary of Exchange Rate Forecasts

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

Euro Versus	Current	Q1-2010	Q2-2010	Q3-2010	Q4-2010
USD	1.439	1.43-1.48	1.42-1.47	1.40-1.45	1.40-1.45
GBP	0.887	0.88-0.92	0.87-0.91	0.85-0.89	0.84-0.88
JPY	129.95	125-135	128-138	130-140	133-143
PLN	4.19	3.98	3.93	3.87	3.82
HUF	275.63	270	273	275	275
NOK	8.40	8.38	8.35	8.25	8.15
SEK	10.45	10.00	9.90	9.80	9.70
AUD	1.62	1.63	1.62	1.62	1.62
NZD	2.02	2.08	2.06	2.07	2.07
US Dollar Versus					
JPY	90.32	86-92	90-95	92-97	95-100
GBP	1.622	1.58-1.65	1.58-1.65	1.60-1.68	1.60-1.68
CHF	1.04	1.04	1.06	1.07	1.07
CAD	1.07	1.06	1.06	1.07	1.07
AUD	0.89	0.89	0.89	0.88	0.88
NZD	0.71	0.70	0.70	0.69	0.69
CNY	6.83	6.80	6.80	6.80	6.80
Sterling Versus					
JPY	147	144	150	155	162
CAD	1.73	1.71	1.72	1.75	1.77
AUD	1.83	1.82	1.82	1.86	1.88
NZD	2.28	2.31	2.32	2.37	2.40

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 proved a very deep global recession. Meanwhile, inflation fell 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 rate environment will last for a considerable time. While some smaller economies have raised rates, we do not see the four main central banks hiking until late 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 having reached 10% and the current US economic recovery likely to prove below par, as well as very subdued inflation, the current exceptionally low level of the Fed funds rate can be expected to remain in place until late 2010 or 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 the previous October. An official rate of 1.0% represents an historical low for the eurozone but it is expected to be the trough in this cycle.

The ECB is not in any hurry to hike rates even though the economy is now out of recession. It has repeatedly said that the refi rate is at an appropriate level. We do not expect that the ECB will consider raising the refi rate until late in 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 lending rate to 0.50% in March. 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 November meeting that it was increasing the size of its asset purchases by a further £25 billion to £200 billion. With inflation forecast to remain below 2%, high unemployment, and the economic recovery likely to prove anemic, policy is set to remain very accommodative well into next year. We do not see any rate hikes before late 2010.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	0.25	0.99	1.12	2.60
Mar '10	0.125	0.40	1.20	1.25	2.70
Jun '10	0.125	0.50	1.30	1.40	2.80
Sep '10	0.125	0.60	1.40	1.45	2.85

** 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	0.67	1.22	1.69	2.61
Mar '10	1.00	0.80	1.40	1.90	2.90
Jun '10	1.00	1.00	1.60	2.10	3.10
Sep '10	1.00	1.10	1.70	2.15	3.15

** 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	0.60	1.24	1.77	3.12
Mar '10	0.50	0.75	1.35	1.90	3.30
Jun '10	0.50	0.90	1.50	2.10	3.50
Sep '10	0.50	1.00	1.55	2.15	3.55

** Swap Forecasts Beyond 1 Year*

US Dollar

In historical terms, the dollar remains relatively weak versus other majors. At the same time, however, recent weeks have seen a distinct shift in market sentiment with regard to the main currency pairings. From yearly highs of $1.5144 seen in late November, the euro is trading around the $1.44 level, with key support at $1.45 giving way. The yen is well off its 14 year high of Y84.8, while sterling has also slipped back versus the USD.

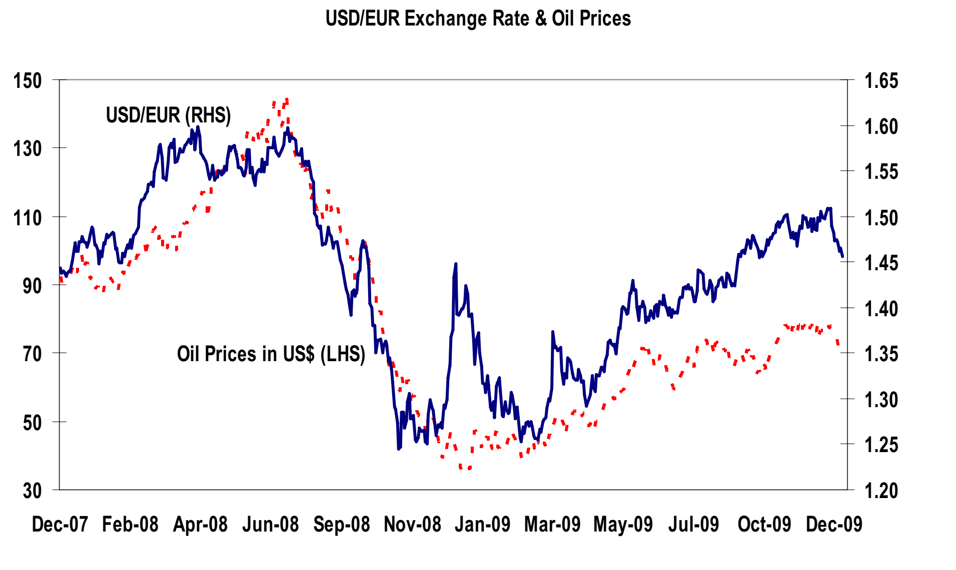
The USD has rallied on a wave of short covering before year end, triggered by a round of better than expected US data. The data have raised speculation in forex markets that the Fed may start exiting from its extremely accommodative policy stance earlier than anticipated. As well as that, the dollar is also benefiting versus the euro from deepening concerns about excessively high budget deficits in the eurozone, in particular that of Greece. Meanwhile, there are also underlying concerns about the sustainability and robustness of the global economic recovery, which has lead to a spike in risk aversion. This is reflected in the recent fall back in oil prices and other commodities, which is also providing a general lift to the dollar.

Despite currently trading off its lows, the dollar could well weaken out again if market sentiment improves. Furthermore, expectations of very easy US monetary policy are also likely to continue to weigh on the USD near term. Although the Fed did strike a more positive note in its view of the economy in December, the FOMC reiterated a low level of Fed funds for an "extended period". The economy continues to face "formidable headwinds" with low rates of utilisation, subdued inflation and high unemployment.

Thus, notwithstanding heightened volatility and exaggerated price moves around year end we anticipate a near term $1.43-1.48 trading range for dollar/euro. Longer term, there continues to be scope for further dollar recovery. The US is well advanced in terms of the business cycle, which will eventually lead to tightening action from the Fed. 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

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
US$/EUR	1.438	1.43-1.48	1.42-1.47	1.40-1.45	1.40-1.45
US$/GBP	1.622	1.58-1.65	1.58-1.65	1.60-1.68	1.60-1.68
YEN/US$	90.309	86-92	90-95	92-97	95-100
CHF/US$	1.042	1.04	1.06	1.07	1.07



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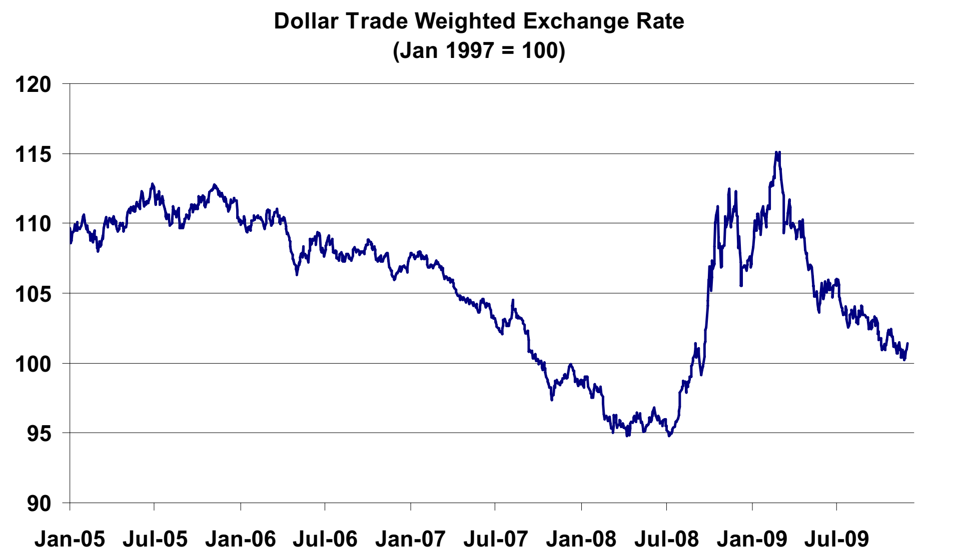


Source: Thomson Datastream

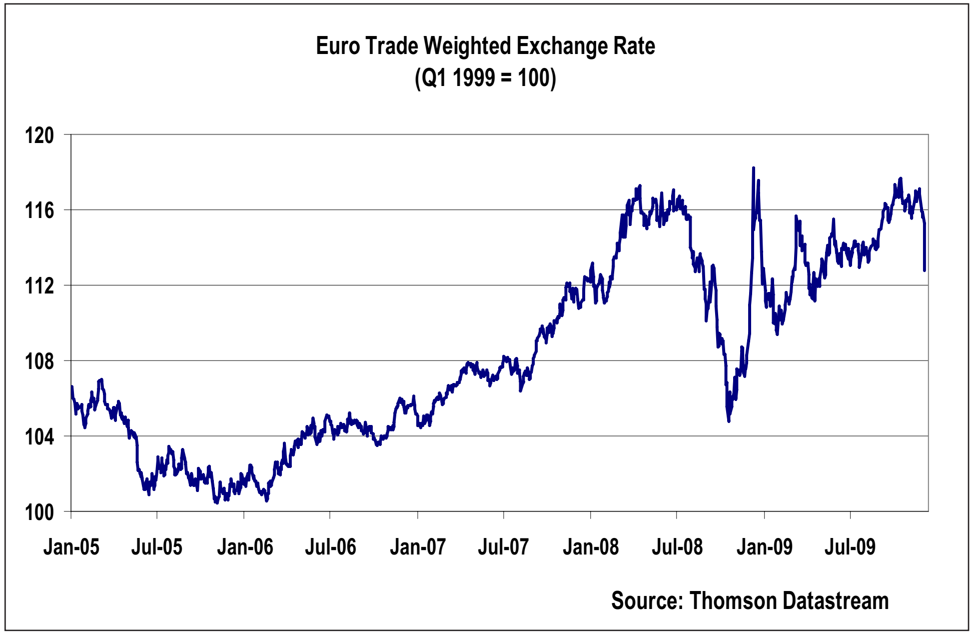
Euro

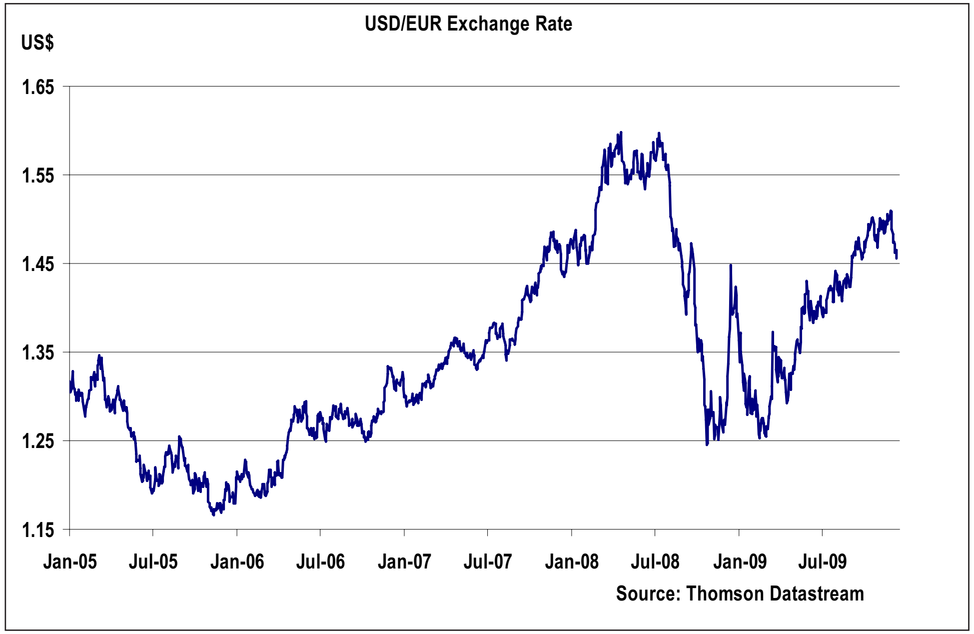
While the euro remains relatively firm versus the dollar, it has been on the defensive over recent weeks, weighed down by the Dubai situation, concerns about eurozone sovereign ratings (in particular Greece), as well as some deterioration in market sentiment on fears that the global recovery is losing momentum. From yearly highs of $1.5144 in late November, the USD/EUR rate is currently trading around $1.44. However, the euro could quickly recover ground versus the USD if sentiment regarding Greece improves and global risk appetite picks up.

Any dollar recovery is also likely to be limited by expectations that the Fed will be behind the ECB in terms of increasing interest rates from emergency levels. A number of recent US data releases have surprised on the upside but the Federal Reserve is still indicating a very accommodative policy stance. However, fresh upside momentum beyond the $1.50 level seems unlikely given the recent shift in market sentiment and the euro's failure to make a sustained break into a $1.50-1.55 range.

Over the longer term, we continue to see scope for a further recovery in the dollar as the improvement in the US economy and expectations of an eventual move by the Fed towards normalising interest rates provide some underlying support. However, even in this environment, upside potential for the US currency could be limited and a relatively weak dollar could well continue to be the trend for forex markets over 2010.

Having recovered from lows of Stg0.93/0.94p in mid October, sterling has been in a relatively tight range versus the euro over the past month, with activity centred on the Stg0.89/90p. Despite its rebound, sterling remains vulnerable on underlying concerns about the outlook for the UK, in particular the need for corrective action with regard to the public finances, as well as the fact that the BoE has left the door open to further quantitative easing. We expect the GBP/EUR rate to trade in a Stg0.88-0.92p for now, with some modest recovery in sterling predicted over the course of next year.





Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
US$/EUR	1.439	1.43-1.48	1.42-1.47	1.40-1.45	1.40-1.45
GBP/EUR	0.887	0.88-0.92	0.87-0.91	0.85-0.89	0.84-0.88
YEN/EUR	129.87	125-135	128-138	130-140	133-143
PLN/EUR	4.186	3.98	3.93	3.87	3.82

Sterling

Sterling is currently trading well off the lows seen versus the dollar, euro and yen earlier in the year. However, as one of the currencies worst affected by the global financial crisis, markets remain negative on the pound. Sentiment continues to be undermined by unease over the underlying prospects for the UK economy, which is clearly lagging the US and the eurozone in terms of the business cycle. Both the US and the eurozone returned to growth in Q3, while the UK remained in recession.

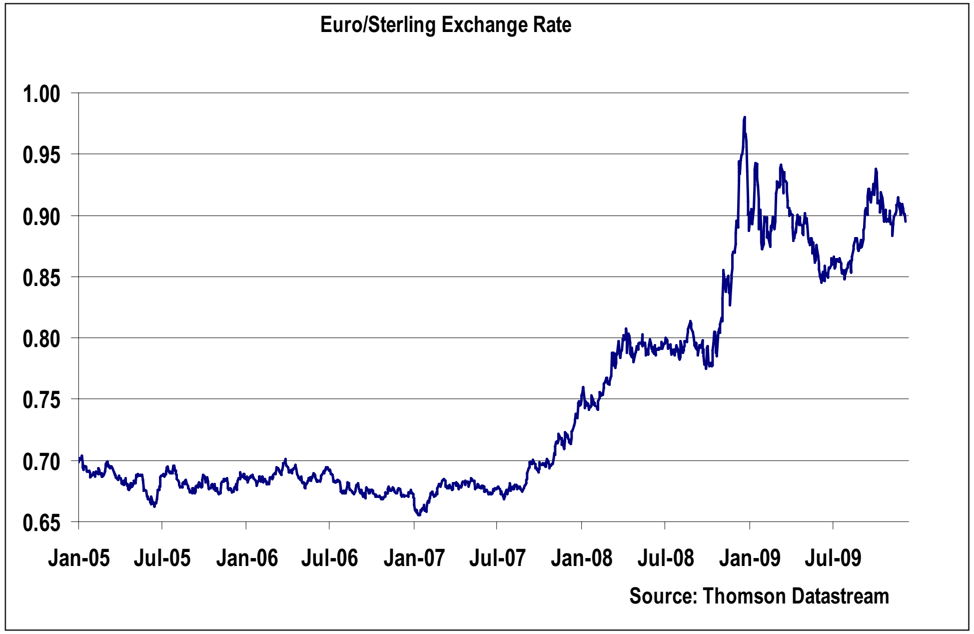
Furthermore, there are serious concerns in the market about the level of deterioration in the UK's public finances. From a low of 2.7% in 2007, the debt/GDP ratio is predicted at 12.9% in 2010 (EU Commission Forecast, October 2009), once of the highest in the eurozone. Although the recent pre Budget report for 2010 outlined some corrective measures, there was little evidence of a medium term plan to get the public finances back on track. Thus, the GBP remains vulnerable to talk of sovereign debt downgrades.

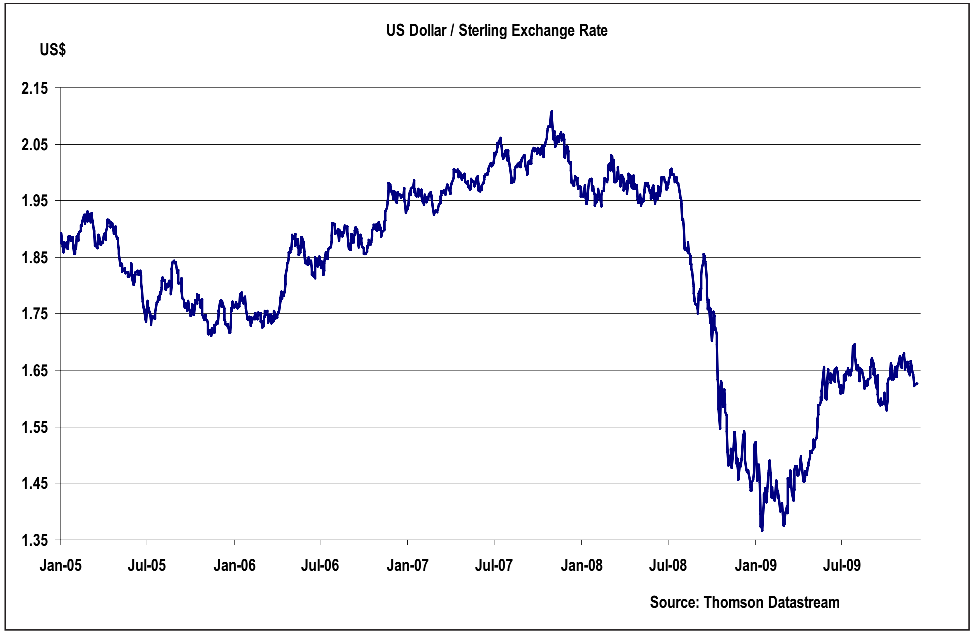
Sentiment towards sterling also continues to be undermined by the ultra accommodative stance of the BoE. Voting to extend its QE programme in November, the MPC also indicated that it remains open to the prospect of further monetary support should the economy require it. The MPC, however, indicated it would not consider extending policy again until February of next year, when the central bank does its next set of economic forecasts. This leaves sterling vulnerable to ongoing volatility ahead of this.

The BoE has also indicated on numerous occasions that it is comfortable with the 20% depreciation seen in sterling's trade weighted index over the past two years, viewing the improvement in competitiveness as an important part of the policy mix required for economic recovery. We expect sterling/euro to be choppy in a Stg0.88-0.92p range over the coming months, with volatility levels likely to remain high in the run up to next year's general election. Moves in the sterling/dollar rate are likely to be largely dictated by general market sentiment, with a $1.58-1.65 range anticipated near term.

Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
GBP/EUR	0.887	0.88-0.92	0.87-0.91	0.85-0.89	0.84-0.88
US$/GBP	1.622	1.58-1.65	1.58-1.65	1.60-1.68	1.60-1.68
YEN/GBP	146.48	144	150	155	162
CAD/GBP	1.731	1.71	1.72	1.75	1.77





Japanese Yen

In an environment of global deleveraging and heightened risk aversion, the yen appreciated markedly over 2008 and early 2009 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.

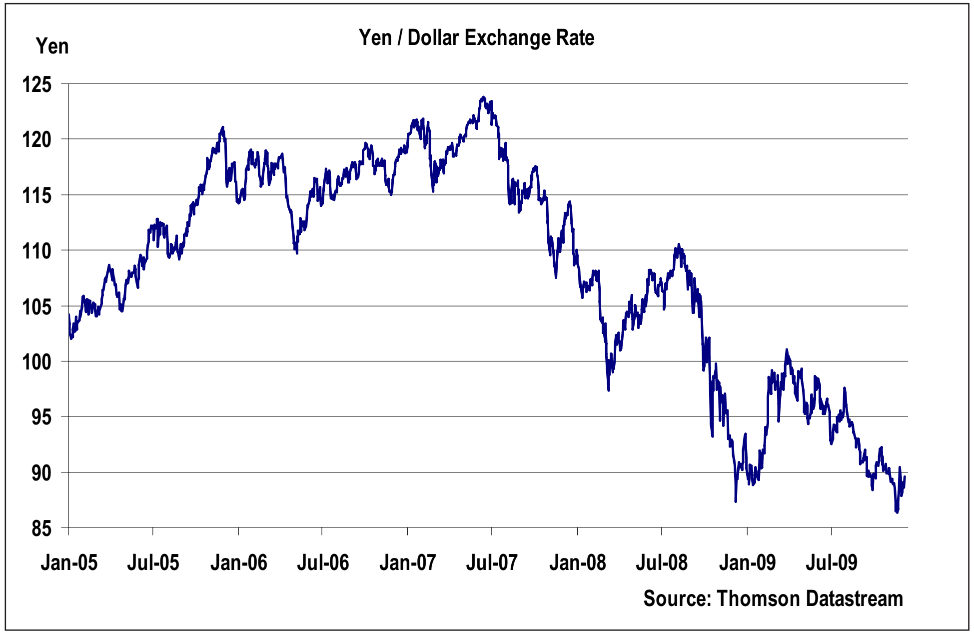
The yen then reversed direction, with sentiment undermined by the fact that Japan was more severely hit by the global downturn than any other industrialised nation. As a result of a sharp fall off in world trade, its healthy current account surplus vanished and external imbalances were no longer a supporting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

While year to date, the euro is well up on its earlier lows versus the yen, trading has been confined to very tight ranges over the past quarter. Strong resistance is seen at the Y137 level, as the yen itself is supported by the general sell-off in the dollar, as well as confirmation of a return to growth in the Japanese economy. Thus, we anticipate a Y125-135 trading range over the coming weeks.

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. General dollar weakness then saw it hit a 14 year high of Y84.8 in late November. However, this rally proved unsustainable given repeated talk of intervention from the Bank of Japan, as well as a bounce back in the dollar on the release of some better than expected US data. The yen is already viewed as overvalued versus the USD, a cause for concern as, with domestic demand still weak, the Japanese economy is heavily reliant on the traded sector to lift it further out of recession.

Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
YEN/US$	90.28	86-92	90-95	92-97	95-100
YEN/EUR	129.90	125-135	128-138	130-140	133-143
YEN/GBP	146.45	144	150	155	162



Australian Dollar/ New Zealand Dollar

The AUD and NZD came under strong selling pressure during the global financial crisis, with projections for a weak global economy hitting the commodity driven pair. 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%.

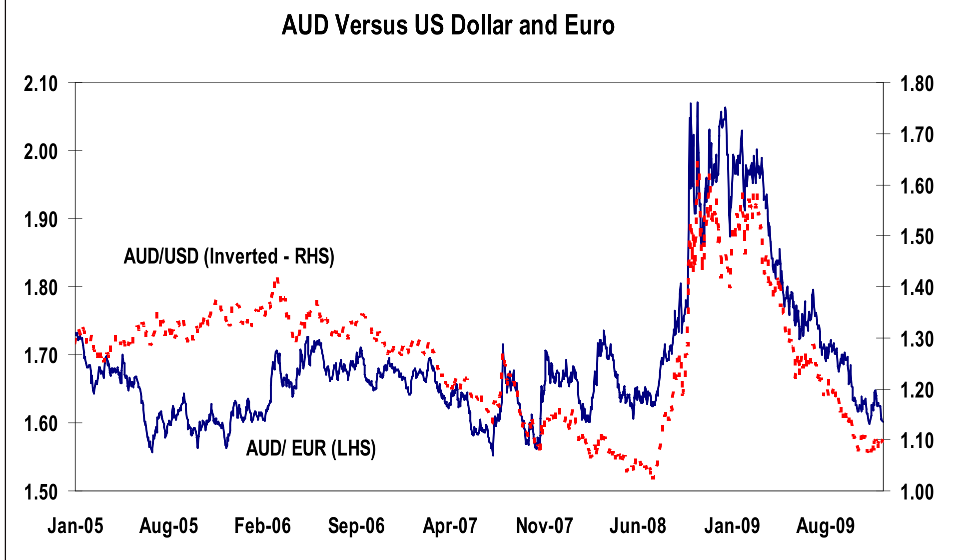
With the worst of the global economic news now behind us, investor appetite for riskier and commodity driven currencies like the AUD and NZD has picked up again. Furthermore, Australia proved to be one of a handful of economies that avoided recession, in large part due to the successful implementation of fiscal stimulus measures. Meanwhile, Q3 GDP data are expected to signal a return to growth in New Zealand.

The pair's recovery was further cemented by October's announcement from the Reserve Bank of Australia 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 emergency monetary policy action. Rates were increased by a further 0.25% in November and December.

The AUD and NZD look set to remain firm versus other majors, underpinned by the positive correlation between them and the improving global economic cycle. Widening interest rate spreads should also be supportive, with markets anticipating further tightening from the RBA over the course of next year, as well as a move to a tightening bias by the Reserve Bank of New Zealand by the middle of 2010. However, fresh attempts at the upside could be curtailed by the recent fall back in global commodity prices, as well as a view that, after three successive rate hikes, the RBA may pause its tightening cycle in early 2010.

Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
AUD/USD	0.889	0.89	0.89	0.88	0.88
NZD/USD	0.711	0.70	0.70	0.69	0.69
AUD/EUR	1.62	1.63	1.62	1.62	1.62
NZD/EUR	2.024	2.08	2.06	2.07	2.07



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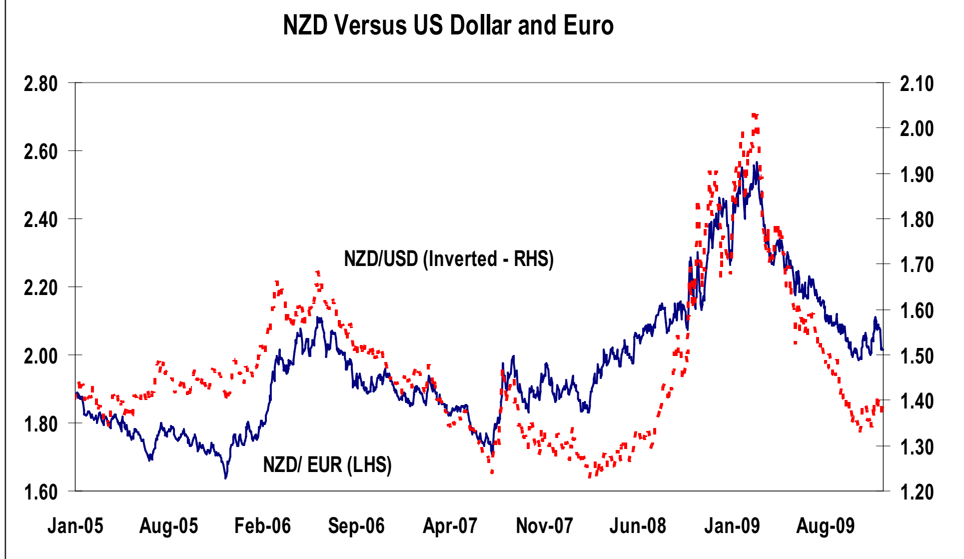

Source: Thomson Datastream

Key Events/Diary

Week 1 (21st - 25th December)

Dec 22nd	UK/US	Q3 GDP (Final Estimate)
	US	Existing Home Sales (November)
Dec 23rd	**UK**	**Minutes of December MPC Meeting**
	US	New Home Sales (November)
	US	Personal Income & Consumption (November)
Dec 24th	US	Durable Goods (November)
Dec 25th	US/UK/E-zone	Market Holiday

Week 2 (28th December - 1st January)

Dec 29th	**US**	**Consumer Confidence (December)**
	US	Case Shiller House Prices (October)
Dec 30th	Eurozone	M3 Money Supply (November)
	US	Chicago PMI (December)
Dec 31st	UK	Mortgage Applications/ Bank Lending (November)
Jan 1st	US/UK/E-zone	Market Holiday

Week 3 (4th - 8th January)

Jan 4th	**US/UK/E-zone**	**Manufacturing ISM/Markit PMI (December)**
Jan 5th	Eurozone	Flash HICP (December)
Jan 6th	US	ADP Employment Report (December)
	US/UK/E-zone	**Services ISM/ Markit PMI (December)**
	US	**Minutes of December FOMC meeting**
Jan 7th	**UK**	**BoE Policy Announcement**
	Eurozone	EC Sentiment & Activity Surveys (December)
Jan 8th	**US**	**Non-Farm Payrolls (December)**

Week 4 (11th - 15th January)

Jan 12th	US	International Trade (November)
Jan 13th	Eurozone	Industrial Production (November)
Jan 14th	**Eurozone**	**ECB Policy Announcement & Press Conference**
	US	Retail Sales (December)
Jan 15th	US	Consumer Prices (December)
	US	Industrial Production (December)

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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