AIB Global Treasury
Economic Research

Exchange Rate Outlook

16th February 2010

- Dollar gets support from rise in risk aversion
- Euro remains under pressure on sovereign risk concerns
- Sterling beats hasty retreat versus dollar
- Yen continues to see safe haven support

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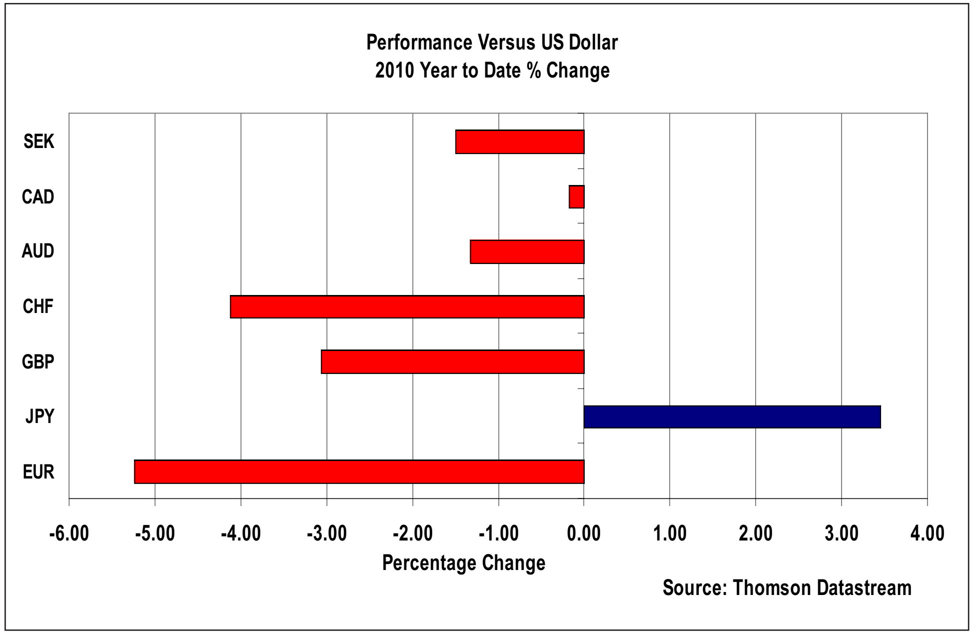
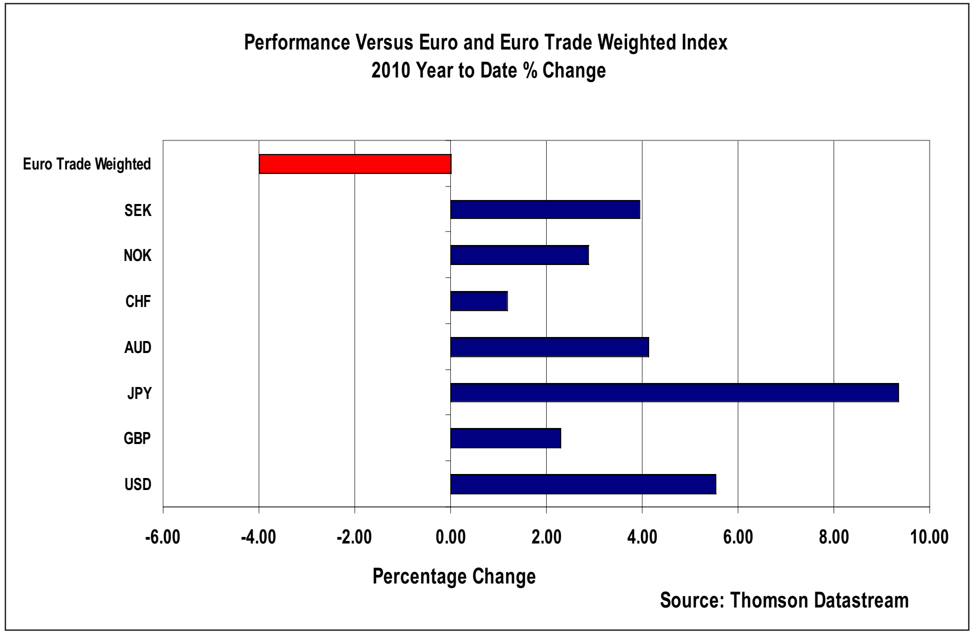
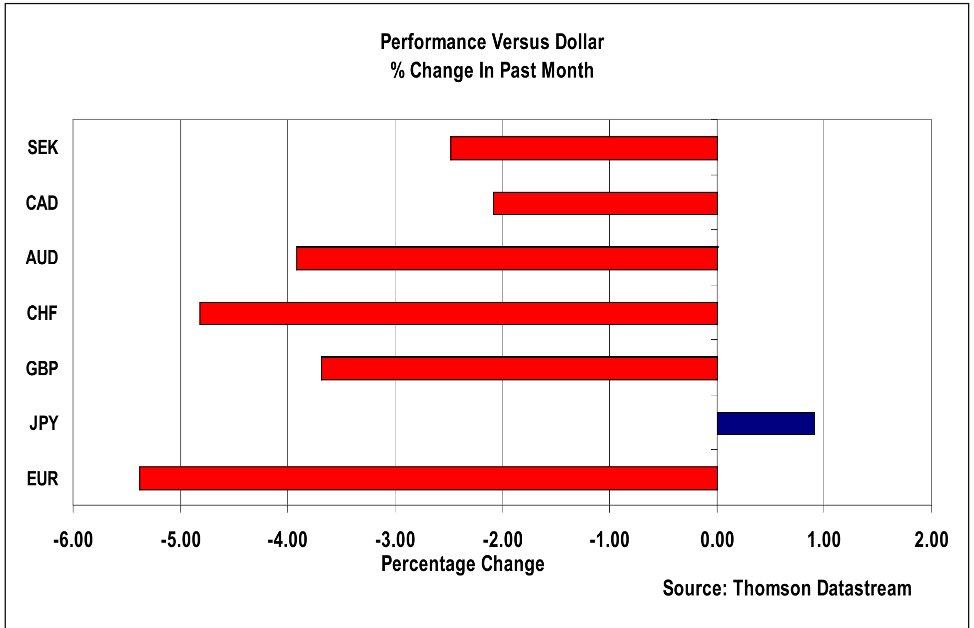
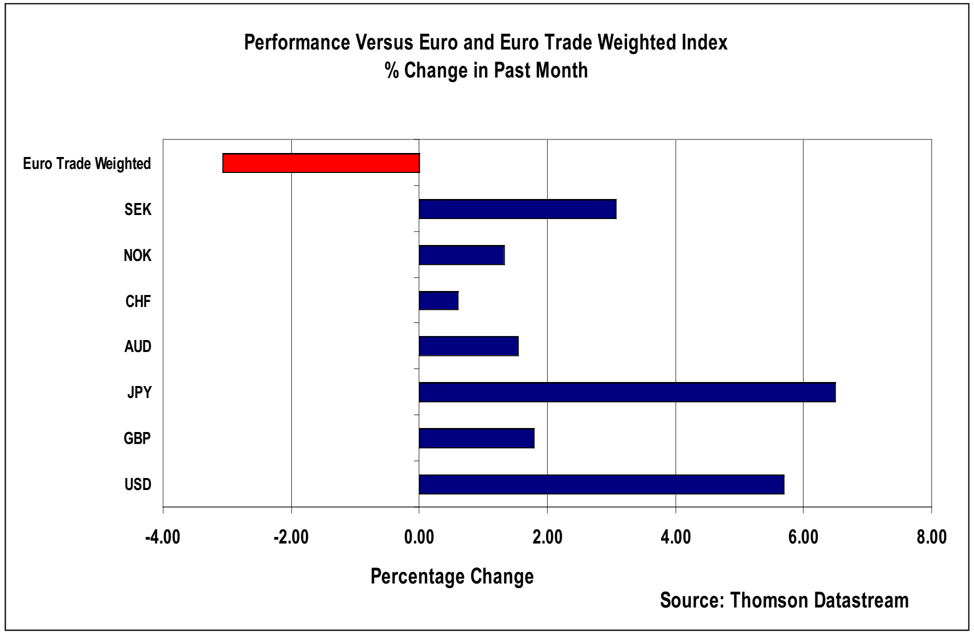
Key Currency Trends









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	1.365	1.32-1.38	1.32-1.38	1.35-1.40	1.35-1.40
GBP	0.870	0.85-0.88	0.85-0.88	0.84-0.87	0.84-0.87
JPY	122.83	120-130	120-130	123-133	125-135
PLN	4.02	4.00	3.93	3.87	3.82
HUF	271.53	270	268	265	265
NOK	8.05	8.15	8.15	8.10	8.10
SEK	9.87	9.90	9.80	9.70	9.60
AUD	1.53	1.52	1.52	1.56	1.56
NZD	1.94	1.96	1.96	2.02	2.02
US Dollar Versus					
JPY	89.99	87-92	90-95	92-97	95-100
GBP	1.570	1.50-1.60	1.50-1.60	1.55-1.65	1.55-1.65
CHF	1.07	1.04	1.06	1.07	1.07
CAD	1.05	1.06	1.06	1.07	1.07
AUD	0.89	0.89	0.89	0.88	0.88
NZD	0.70	0.69	0.69	0.68	0.68
CNY	6.83	6.83	6.82	6.81	6.80
Sterling Versus					
JPY	141	140	144	152	157
CAD	1.64	1.65	1.65	1.72	1.72
AUD	1.76	1.75	1.75	1.83	1.83
NZD	2.23	2.26	2.26	2.36	2.36

Interest Rate Outlook

During the height of the global financial crisis central banks across the world cut official rates to exceptionally low levels to help counter what has proved to be a very deep global recession. Meanwhile, inflation fell close to, or below, zero in many countries. Given the continuing tight credit conditions, high 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 started tightening policy, we do not see the four main central banks hiking until late 2010 or even 2011.

Fed Funds 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 in December 2008, adopting a 0 - 0.25% target range for the Fed funds rate. It also pursued quantitative easing measures last 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. However, there could be an increase in the discount rate in the coming months, though this should not impact on money market rates.

ECB Refi Rate Very Much On Hold At 1%

The ECB cut interest rates by 0.25% to 1.0% at its May 2009 policy meeting, bringing the total reduction in official rates in the eurozone to 3.25% since October 2008. This official rate of 1.0% represents an historical low for the eurozone but it is expected to be the trough in this cycle now that the economy has emerged from recession. At the same time, however, the ECB is not in any hurry to hike rates and 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 at the earliest, with inflation expected to remain very low, unemployment at high levels, and given the considerable doubts about the sustainability of the economic upswing.

UK Rates Set to Remain Low Over 2010

The BoE cut UK interest rates to an historically low level of 0.50% in March 2009, while also employing quantitative easing measures. At its February policy meeting it called a halt to its QE programme but has left the door open to further gilt purchases should they be required down the line. With UK inflation forecast to be below 2% over the medium term, unemployment high, and the economic recovery likely to prove anaemic, policy is set to remain very accommodative well into this year. We do not anticipate any hikes in official rates until late 2010 at the earliest.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	0.25	0.85	1.12	2.66
Mar '10	0.125	0.40	1.10	1.20	2.70
Jun '10	0.125	0.50	1.25	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	0.60	1.20	1.53	2.53
Mar '10	1.00	0.80	1.40	1.85	2.80
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	0.64	1.29	1.62	3.07
Mar '10	0.50	0.75	1.35	1.85	3.20
Jun '10	0.50	0.90	1.50	2.05	3.40
Sep '10	0.50	1.00	1.55	2.15	3.55

** Swap Forecasts Beyond 1 Year*

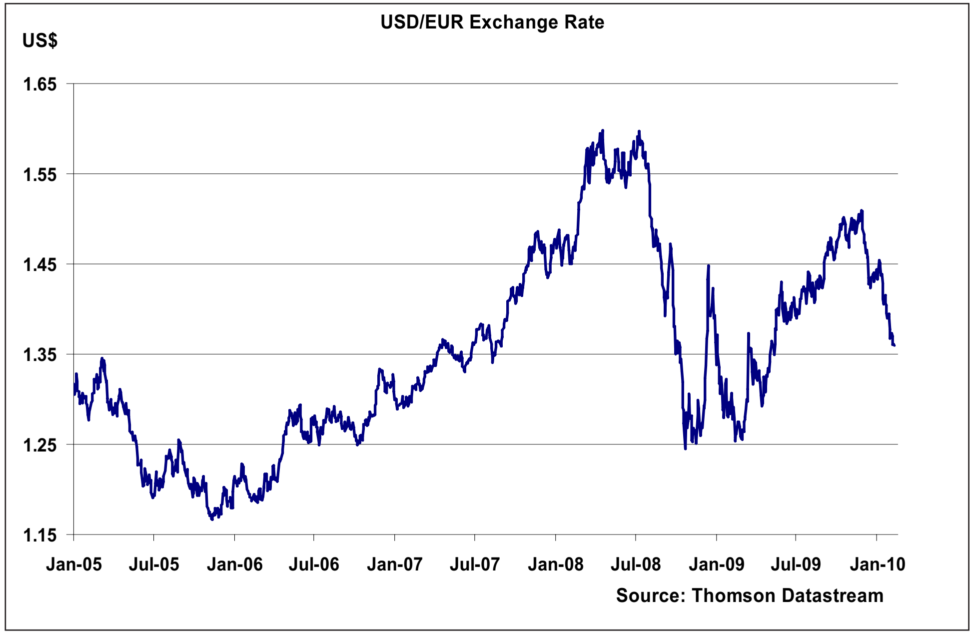
US Dollar

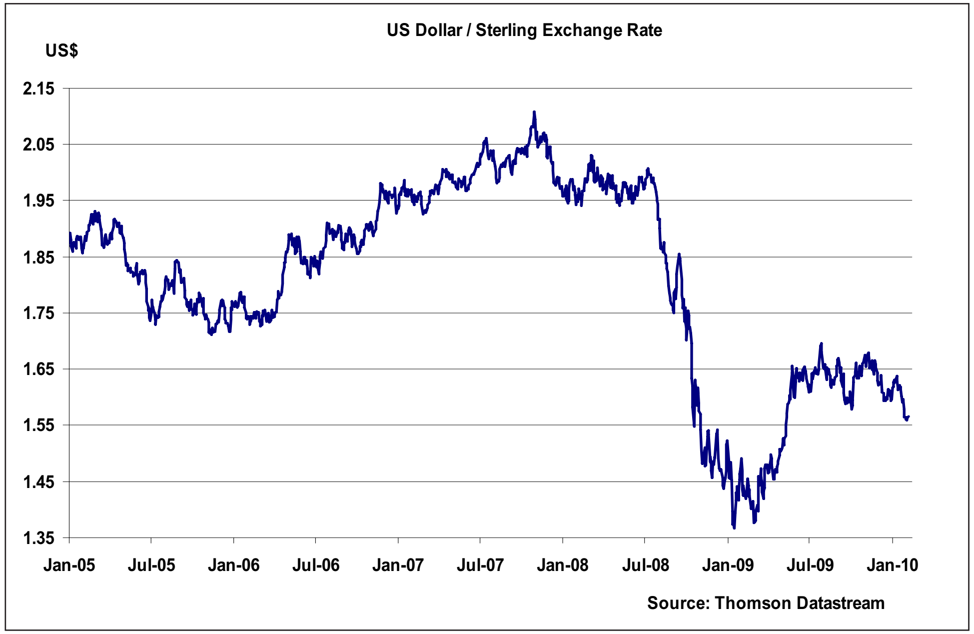
Year to date movements on currency markets have been largely dominated by a broad based rally in the US dollar, with its trade weighed index currently up over 3.5%. Gains have been seen versus the EUR, GBP, AUD, CHF and CAD, with the JPY the only major that has appreciated year to date versus the USD. The rally in the dollar has to some extent been driven by markets focusing on some encouraging US economic data, which have reinforced the view that the Federal Reserve will start tightening monetary policy before the year is out.

However, while the interest rate outlook is turning more supportive, the dollar's rebound has been largely driven by a spike in risk aversion on fresh concerns about the strength of the global upswing, as well as increased sovereign credit concerns, particularly in relation to the eurozone This, amongst other things, has once again raised questions about the long term viability of the single currency, with the euro currently looking towards a break of $1.35 to reach levels not seen for nearly a year. The dollar has also benefited from fears that credit tightening in Asia could derail the global recovery.

While the US public finances are hardly in great shape either, following the huge level of support provided to the economy during the height of the economic crisis, the current focus is on Europe where uncertainty reigns regarding solutions to the problem. This leaves the euro vulnerable to further losses versus the USD and a move through $1.35 can not be ruled out near term if markets remain unconvinced of the resolve of countries like Greece to really tackle their fiscal problems.

Should fears over eurozone sovereign risk eventually dissipate, whether or not the dollar can sustain its recovery over the longer term will very much depend on the prospect for the US economy. Despite talk of US rates hikes by late summer, the economy still faces significant headwinds. We remain of the view that it is likely to be end 2010 or even 2011 before the Fed starts to tightening policy, something that is likely to limit the extent of the dollar's rebound.





Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
US$/EUR	1.365	1.32-1.38	1.32-1.38	1.35-1.40	1.35-1.40
US$/GBP	1.570	1.50-1.60	1.50-1.60	1.55-1.65	1.55-1.65
YEN/US$	89.992	87-92	90-95	92-97	95-100
CHF/US$	1.074	1.04	1.06	1.07	1.07

Euro

Down 4% on a trade weighed basis, the euro has started 2010 with a defensive tone, undermined by concerns about eurozone sovereign ratings, the most notable being the problems in Greece. Despite talk of a Greek support packages, sentiment remains very much against the EUR, which has weakened further versus other majors as uncertainty reigns regarding solutions to the public finances crisis.

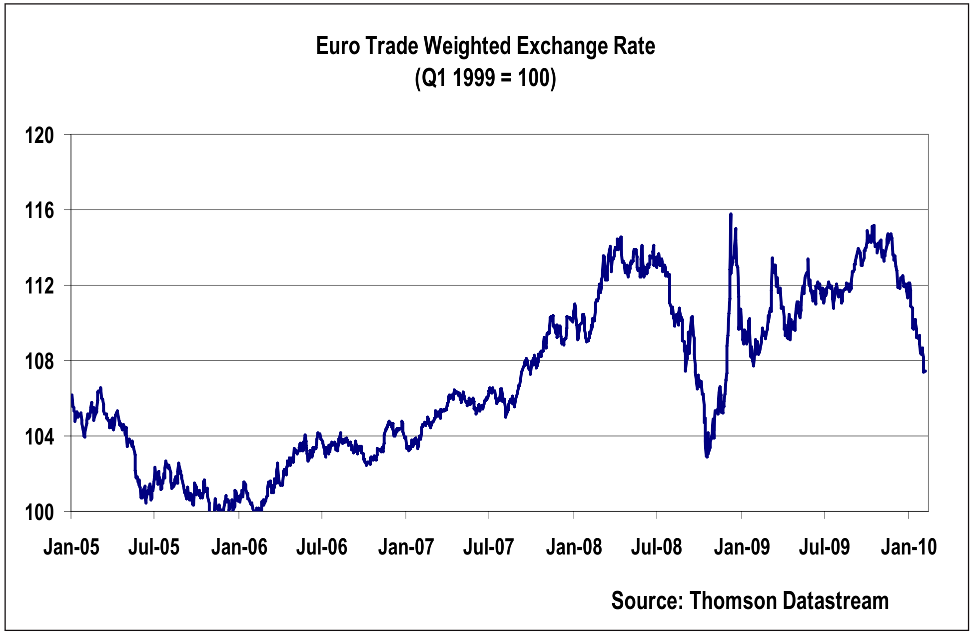
The euro is also being hit by the recent dovish tone of ECB comments. The recession in the eurozone officially ended in Q3, when growth of 0.4% was recorded. However, while the recession proved to be very deep, the ECB expects the recovery in activity to be moderate and uneven, leaving the economy with a large amount of spare capacity for a prolonged period. Meanwhile, unemployment is forecast to remain high, while price pressures should remain very subdued. Thus, the central bank appears to have no plans to start hiking interest rates anytime soon.

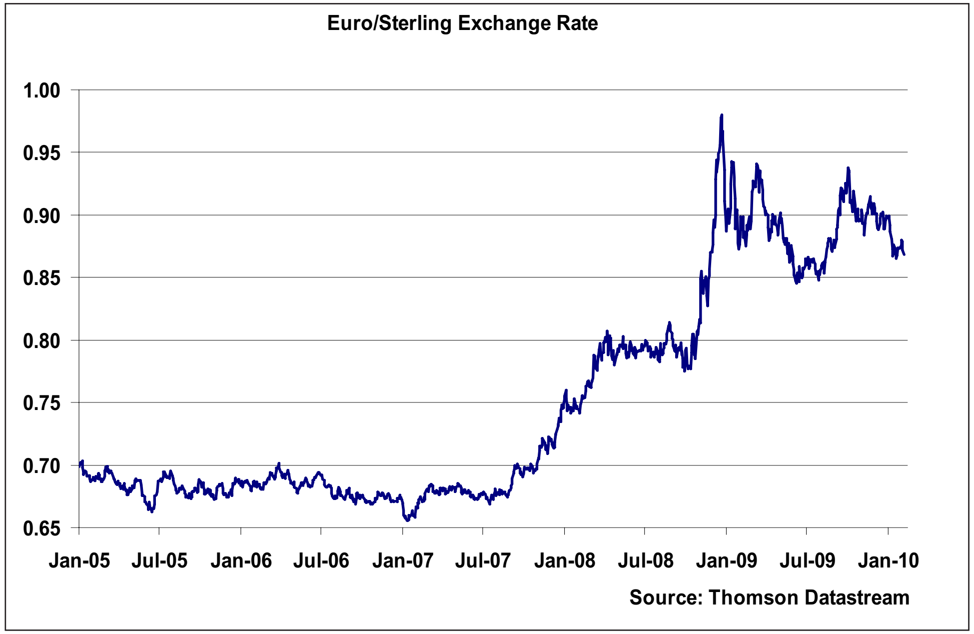
Although still relatively strong, the euro could come under further selling pressure versus the dollar over the year if relative growth prospects and sovereign issues remain against it. The dollar is also likely to benefit from any upside surprises in terms of US data. However, as reflected in our forecasts, any dollar recovery is likely to be limited by the prospect of a sub trend US economic performance and the likelihood that the Fed will also be slow in terms of reversing its accommodative policy stance.

We are also sceptical about any marked recovery in sterling versus the euro. It saw highs of Stg0.859p versus the euro in late January but has failed to hold these levels. Significant upside versus the euro seems unlikely given that the UK faces a number of challenges of its own including poor prospects for economic growth, the possibility of further action from the BoE, a general election and weak public finances. Indeed, despite the current focus on the eurozone, one of the rating agencies recently commented that the UK is amongst the most vulnerable of the top rated sovereigns.

Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
US$/EUR	1.365	1.32-1.38	1.32-1.38	1.35-1.40	1.35-1.40
GBP/EUR	0.870	0.85-0.88	0.85-0.88	0.84-0.87	0.84-0.87
YEN/EUR	122.82	120-130	120-130	123-133	125-135
PLN/EUR	4.017	4.00	3.93	3.87	3.82





Sterling

Sterling performed poorly over the course of 2009. As well as a poor run of economic data, sentiment was undermined by the ultra accommodative stance of the Bank of England, as well as a sharp deterioration in the UK's public finances' position. Although ending the year off its lows, the GBP is still over 20% lower on a broad trade weighted basis than where it was at the beginning of the financial crisis in 2007.

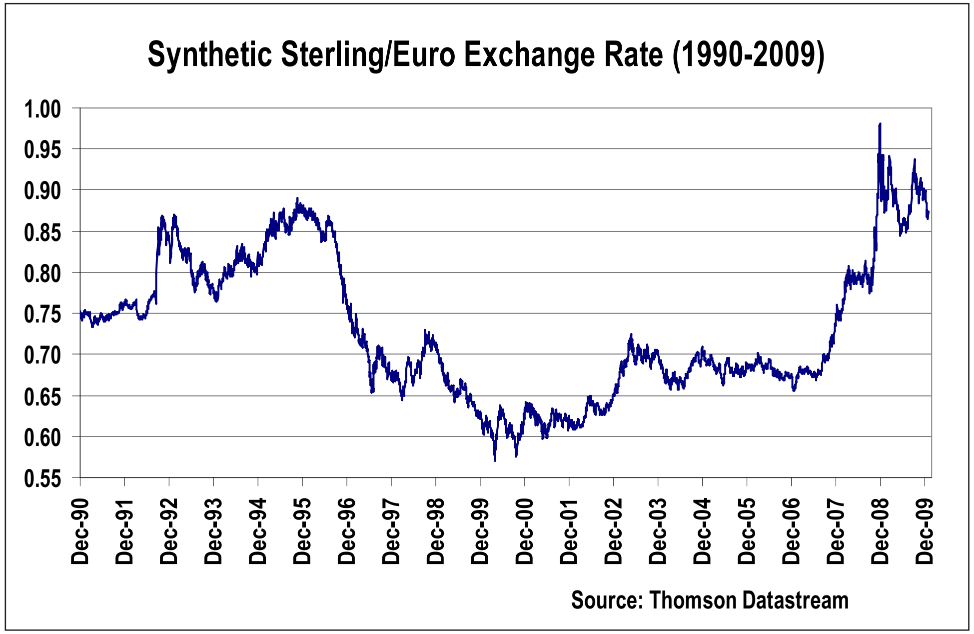
Indeed, after a relatively strong start to 2010, sterling has failed to hold its gains versus the USD and, from a high of $1.6457 in late January, has since fallen back by almost ten cents. Sterling has suffered once again from a broad based rally in the dollar but has also been undermined by the relatively negative outlook for the UK. Indeed, at times it has even underperformed the beleaguered euro, with the GBP/EUR rate retreating from the highs of Stg0.859p seen in late January.

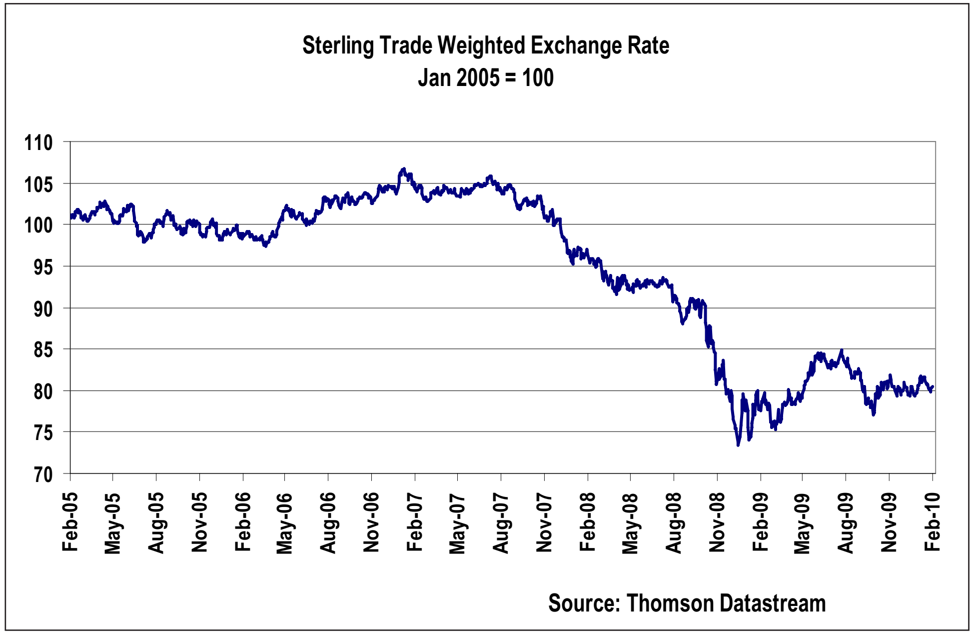
We remain doubtful regarding the prospects for any marked sterling recovery against the dollar or indeed the euro, despite the current wave of negative sentiment towards the EUR. The UK faces an election this year, which will bring with it political uncertainty and upheaval. Data also show that the UK is lagging in terms of the global recovery cycle and the BoE has indicated that it could restart gilt purchases should the economic outlook warrant it. Meanwhile, although the focus is currently on the eurozone, the poor state of the UK's public finances could yet come back to haunt sterling.

From a low of 2.7% in 2007, the UK deficit/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 fresh talk of UK sovereign debt downgrades. Furthermore, the UK authorities are unlikely to favour a sharp rebound in sterling given the implications in terms of hopes for an export led economic recovery.

Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
GBP/EUR	0.870	0.85-0.88	0.85-0.88	0.84-0.87	0.84-0.87
US$/GBP	1.570	1.50-1.60	1.50-1.60	1.55-1.65	1.55-1.65
YEN/GBP	141.24	140	144	152	157
CAD/GBP	1.643	1.65	1.65	1.72	1.72





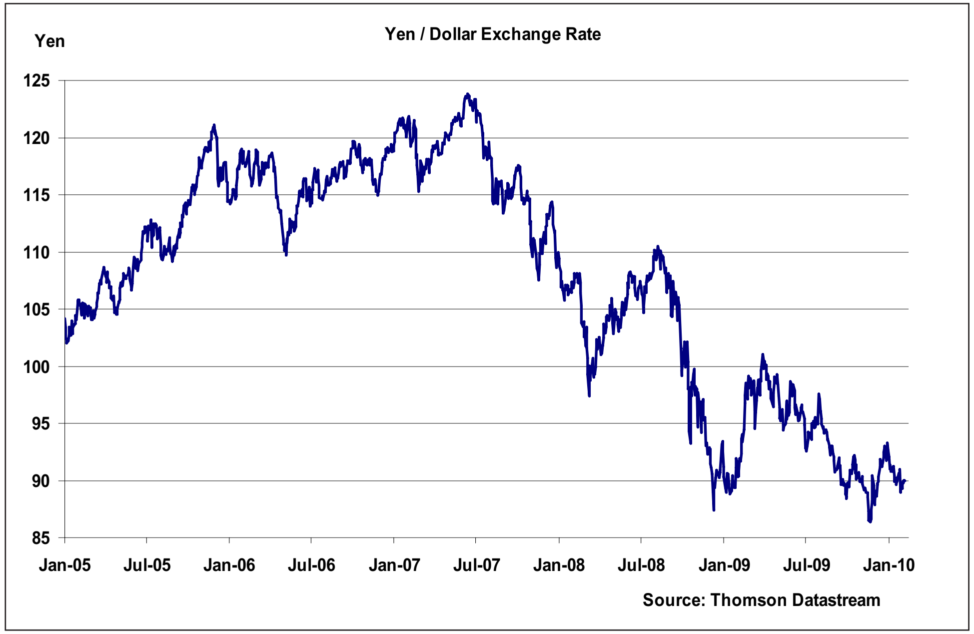
Japanese Yen

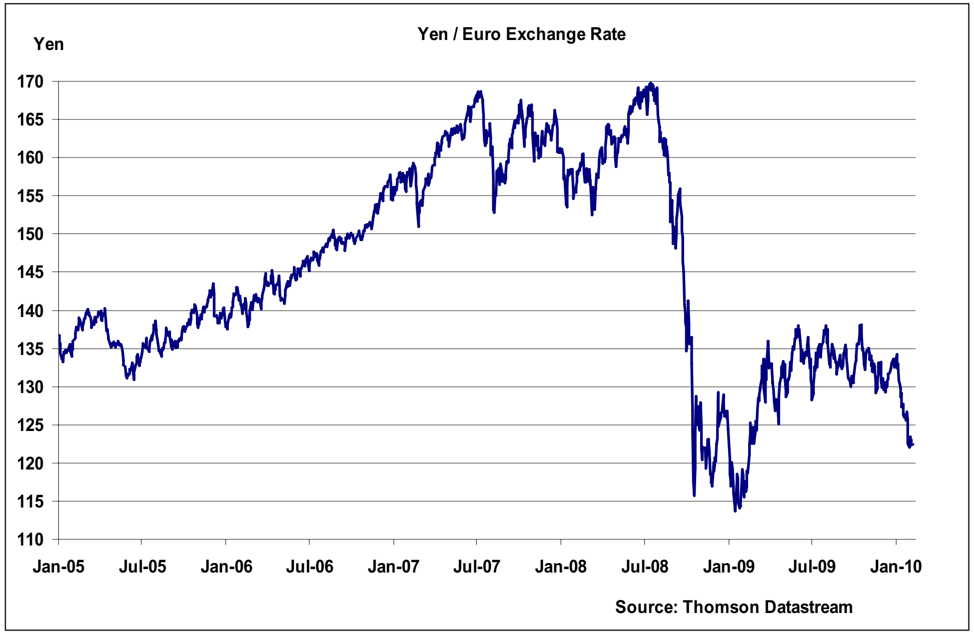
In an environment of global deleveraging and heightened risk aversion, the yen appreciated markedly during the height of the global financial crisis. The JPY is still benefiting from swings in market sentiment (i.e. rallying in line with any spike in risk aversion) but 2010 could well signal an end to the recent period of yen overvaluation. Many in the market place expect it to resume its status as the carry trade currency of choice given relative growth and interest rate predictions.

General dollar weakness saw the dollar/yen rate hit a 14 year low of Y84.8 in late November last year. However, the USD has since recovered some ground on the back of an improving outlook for the US economy and talk of a tightening in US monetary policy. There are also a number of domestic factors that are likely to weigh on the JPY and which could drive it lower versus the USD over the course of the year. The current Japanese regime favours a weaker currency given its impact on the export driven economy, with vague reference made to intervention if necessary.

Meanwhile, the Bank of Japan decided last December to extend its quantitative easing activities, which is in contrast to other major central banks who remain accommodative but look to have ended their policy initiatives. Furthermore, disappointing Japanese economic data indicate a weak economic performance for 2010, with GDP growth expected to be around 1% compared to 2% in the US.

While the dollar is expected to gain ground over the year, the euro could well struggle to make much headway versus the yen, particularly in the near term following its sharp sell off since the New Year. This move downwards mainly reflects the current concerns regarding eurozone sovereign risk. Recent weeks have seen a fall back towards the Y120 level and further selling could be seen near term. We anticipated a Y120-130 trading range for the coming months as markets await a resolution to the eurozone's fiscal problems.





Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
YEN/US$	89.98	87-92	90-95	92-97	95-100
YEN/EUR	122.79	120-130	120-130	123-133	125-135
YEN/GBP	141.22	140	144	152	157

Australian Dollar/ New Zealand Dollar

The AUD and NZD came under strong selling pressure during the height of the global financial crisis. However, the pair bounced back strongly last year in line with a pick up in global risk appetite. Sentiment was also underpinned by rising commodity prices and particularly in the case of the AUD, a resilient economic performance. 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.

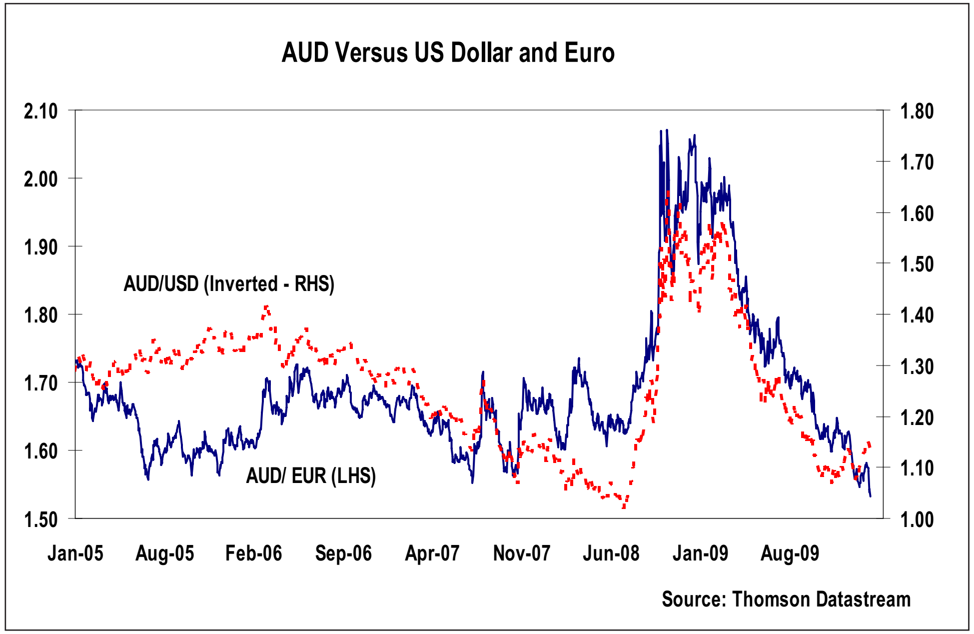
The pair's recovery was further cemented by October's announcement from the Reserve Bank of Australia that, in response to the better than anticipated domestic economic outturn, it was raising interest rates by 0.25% to 3.25%, making it one of the first developed economies to reverse emergency monetary policy action. Rates were increased by a further 0.25% in November and December, opening up a considerable rate differential with other majors.

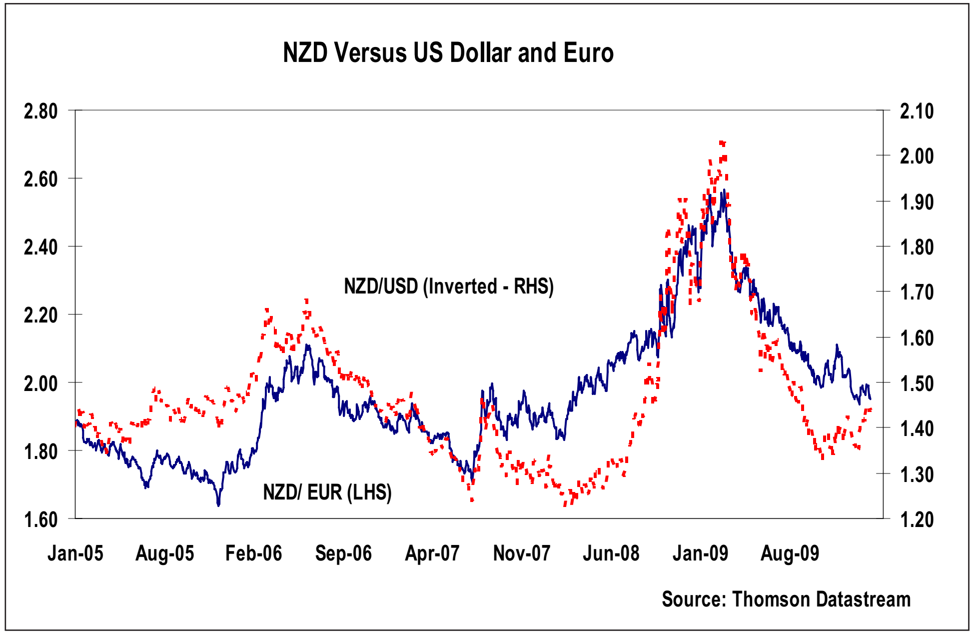
The opening months of this year have seen some fall back from the highs of late 2009, reflecting a fresh spike in risk aversion on concerns that monetary policy tightening in Asia could derail economic recovery in the region. The AUD was also sold following the surprise decision by the Reserve Bank of Australia to leave rates on hold this month. In doing so, it cited the potentially negative impact of higher mortgage rates at home, as well as tighter policy in China and concerns over sovereign debt abroad.

Currently off recent highs, a period of consolidation is expected over the coming months. At the same time, however, fundamentals suggest that the AUD and NZD will remain relatively strong versus other majors, underpinned by the positive correlation between them and the improving global economic cycle. Widening interest rate spreads should also continue to be supportive. The RBA is likely to resume its tightening cycle over the coming months, while the Reserve Bank of New Zealand has indicated that it will start hiking rates around mid year.

Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
AUD/USD	0.894	0.89	0.89	0.88	0.88
NZD/USD	0.703	0.69	0.69	0.68	0.68
AUD/EUR	1.53	1.52	1.52	1.56	1.56
NZD/EUR	1.942	1.96	1.96	2.02	2.02





Key Events/Diary

Week 1 (15th - 19th February)

Feb 15th	**Japan**	**Q4 GDP (First Estimate)**
Feb 16th	UK	Consumer Prices (January)
	Eurozone	German ZEW Index (February)
	US	Net Capital Inflows (December)
Feb 17th	US	Housing Starts and Permits (January)
	US	Industrial Production and Capacity Util (January)
Feb 19th	**Eurozone**	**Flash PMIs (February)**
	US	**Retail Sales (January)**
	US	**Consumer Prices (January)**

Week 2 (22nd-26th February)

Feb 23rd	Germany	Ifo Index (February)
	UK	CBI Distributive Trades Survey
	Eurozone	Europan Commission Economic Forecasts
Feb 25th	Eurozone	EC Sentiment and Activity Surveys (February)
Feb 26th	**UK**	**Q4 GDP (Second Estimate)**
	US	**Q4 GDP (Second Estimate)**

Week 3 (1st - 5th March)

Mar 1st	**UK/US/E-Zone**	**Manufacturing PMIs/ISM (February)**
	US	Personal Income and Consumption (January)
Mar 2nd	Eurozone	HICP Flash Estimate (February)
Mar 3rd	**UK/US/E-Zone**	**Services PMIs/ISM (February)**
	US	ADP Employment Report (February)
Mar 4th	**Eurozone**	**Q4 GDP (Second Estimate)**
	UK	**BoE Policy Announcement**
	Eurozone	**ECB Policy Announcement & Press Conference**
Mar 5th	**US**	**Non-Farm Payrolls (February)**

Week 4 (8th - 12th March)

Mar 9th	UK	Retail Sales (February)
Mar 10th	UK	Industrial Production (January)
Mar 11th	**Japan**	**Q4 GDP (Second Estimate)**
	US	Trade Balance (January)
Mar 12th	US	Retail Sales (February)
	Eurozone	Industrial Production (January)
	US	Michigan Sentiment Survey (March)

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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