



# **Exchange Rate Outlook**

*21st January 2010*

- **Dollar consolidates New Year gains**
- **Euro slips on eurozone debt concerns and dovish ECB**
- **Sterling benefits from euro sell-off**
- **Yen falls back versus USD but still sees safe haven support**

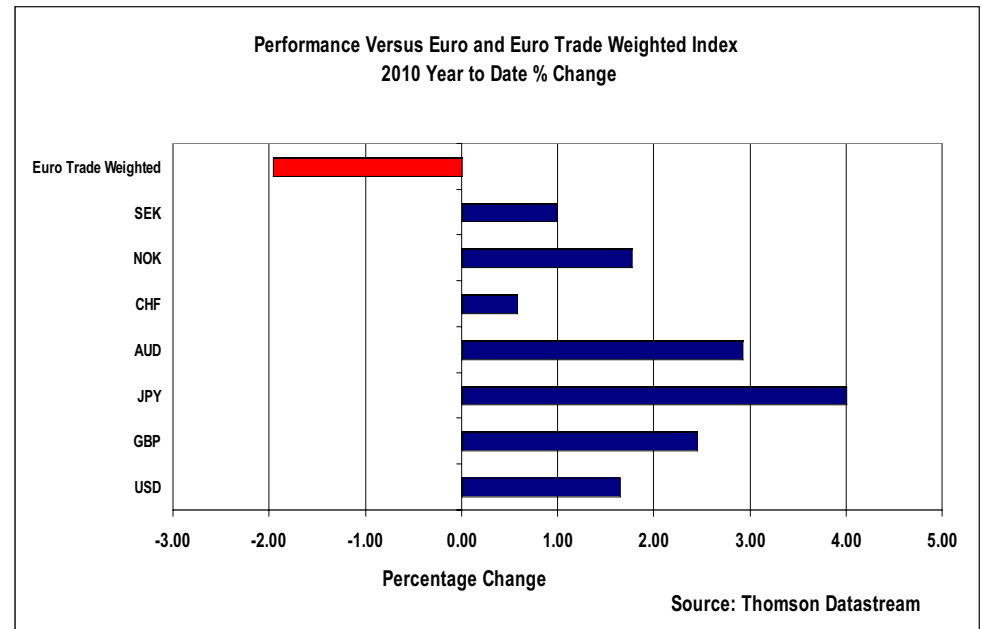
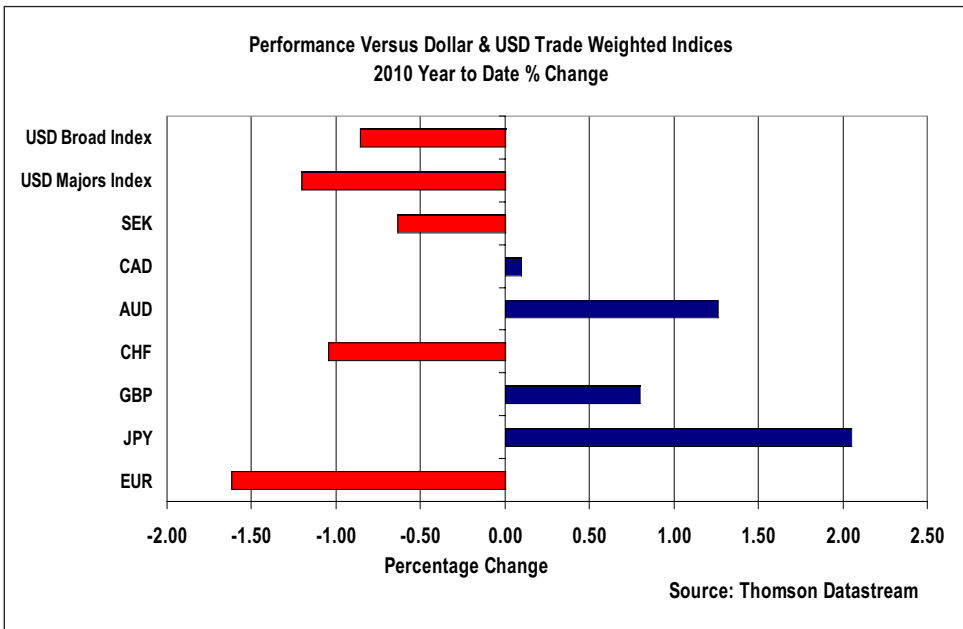
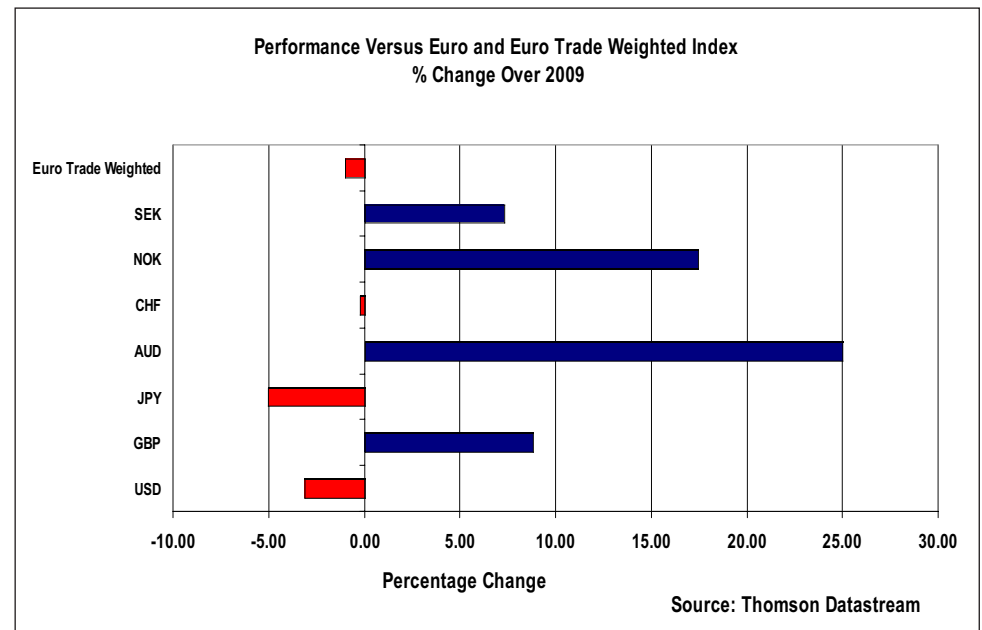
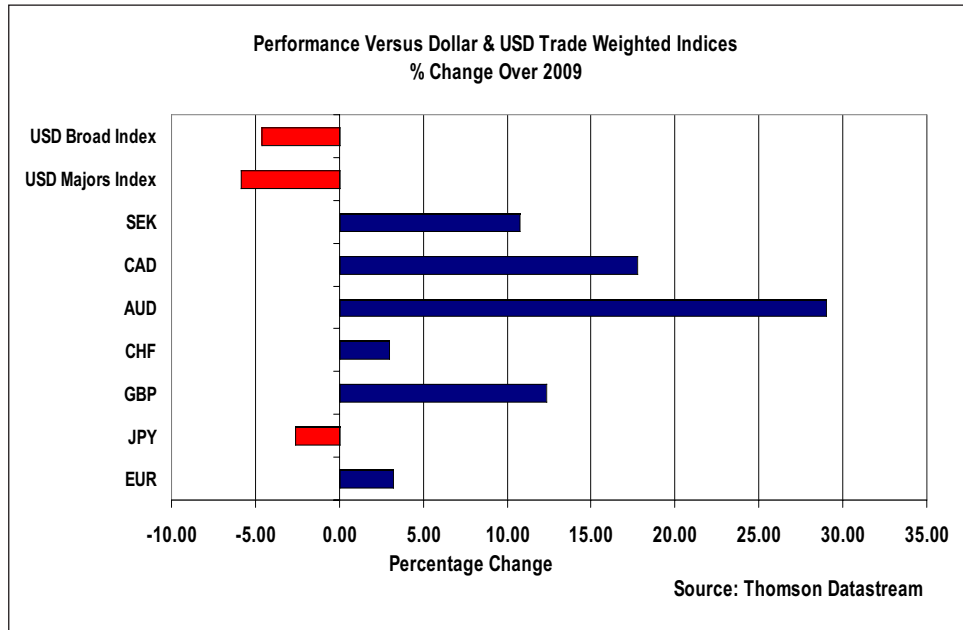
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# Key Currency Trends



# Summary of Exchange Rate Forecasts

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

	<b>Current</b>	<b>Q1-2010</b>	<b>Q2-2010</b>	<b>Q3-2010</b>	<b>Q4-2010</b>
<b>Euro Versus</b>					
<b>USD</b>	1.409	1.39-1.45	1.38-1.44	1.37-1.43	1.36-1.42
<b>GBP</b>	0.871	0.86-0.89	0.85-0.89	0.84-0.89	0.84-0.88
<b>JPY</b>	129.23	123-133	125-135	128-138	130-140
<b>PLN</b>	4.05	4.00	3.93	3.87	3.82
<b>HUF</b>	270.00	270	268	265	265
<b>NOK</b>	8.14	8.20	8.15	8.10	8.10
<b>SEK</b>	10.13	10.00	9.90	9.80	9.70
<b>AUD</b>	1.54	1.56	1.57	1.59	1.58
<b>NZD</b>	1.96	1.97	1.99	2.03	2.01
<b>US Dollar Versus</b>					
<b>JPY</b>	91.74	87-95	90-95	92-97	95-100
<b>GBP</b>	1.618	1.59-1.65	1.59-1.65	1.58-1.64	1.58-1.64
<b>CHF</b>	1.04	1.04	1.06	1.07	1.07
<b>CAD</b>	1.05	1.06	1.06	1.07	1.07
<b>AUD</b>	0.91	0.91	0.90	0.88	0.88
<b>NZD</b>	0.72	0.72	0.71	0.69	0.69
<b>CNY</b>	6.83	6.82	6.81	6.80	6.80
<b>Sterling Versus</b>					
<b>JPY</b>	148	148	150	153	158
<b>CAD</b>	1.69	1.72	1.72	1.73	1.73
<b>AUD</b>	1.78	1.78	1.80	1.84	1.84
<b>NZD</b>	2.25	2.25	2.28	2.35	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 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 in December 2008, adopting a 0 - 0.25% target range for the Fed funds rate. The Fed 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.

## **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. 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 2009. With official rates at ultra low levels, the focus switched to quantitative easing measures. In this regard, the BoE has to date conducted an asset purchases of £200 billion. With UK inflation forecast to be below 2% over the medium term, unemployment high, and the economic recovery likely to prove anemic, policy is set to remain very accommodative well into this year. We do not anticipate any hikes in official rates before late 2010.

### US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
<b>Current</b>	0.125	0.25	0.88	1.16	2.71
<b>Mar '10</b>	0.125	0.40	1.10	1.25	2.75
<b>Jun '10</b>	0.125	0.50	1.25	1.40	2.80
<b>Sep '10</b>	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 *
<b>Current</b>	1.00	0.62	1.20	1.67	2.64
<b>Mar '10</b>	1.00	0.80	1.40	1.90	2.90
<b>Jun '10</b>	1.00	1.00	1.60	2.10	3.10
<b>Sep '10</b>	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 *
<b>Current</b>	0.50	0.62	1.27	1.85	3.24
<b>Mar '10</b>	0.50	0.75	1.35	2.00	3.35
<b>Jun '10</b>	0.50	0.90	1.50	2.10	3.50
<b>Sep '10</b>	0.50	1.00	1.55	2.15	3.55

\* Swap Forecasts Beyond 1 Year

# US Dollar

After a year that was predominantly characterised by broad based dollar weakness, with a pick up in investor appetite prompting traders to move out of the safe haven currency, the USD finished 2009 on a relatively strong note. This rebound was driven by a re-rating of US growth and interest rate expectations, with some better than anticipated US data prompting markets to pull forward their timing for a US rate hike. The dollar also rallied on the back of a wave of safe haven buying and technical short covering before the year end, as markets questioned the robustness of a general global economic recovery and looked to sovereign risk in Europe.

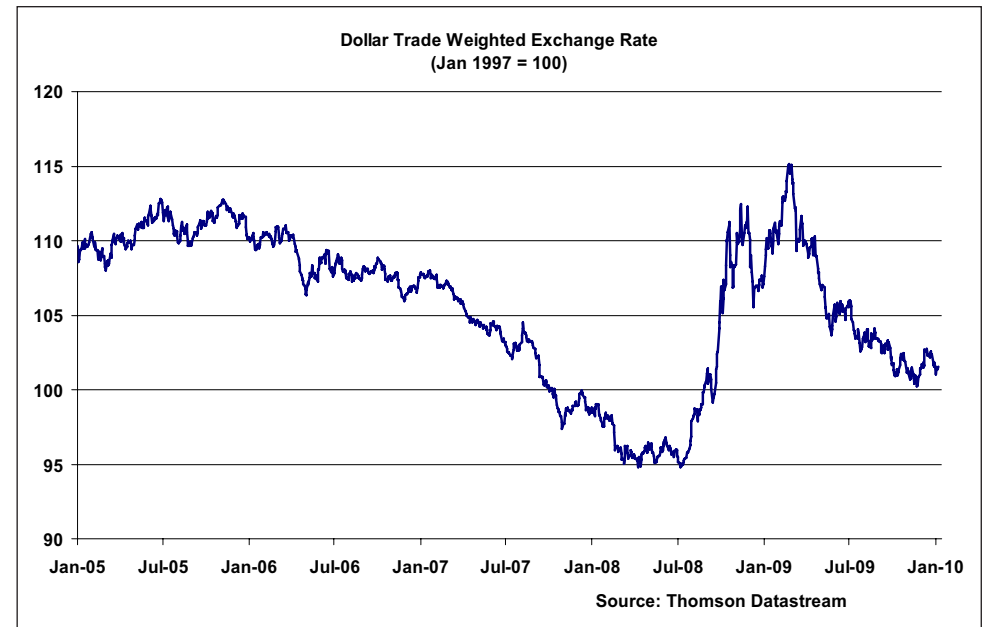
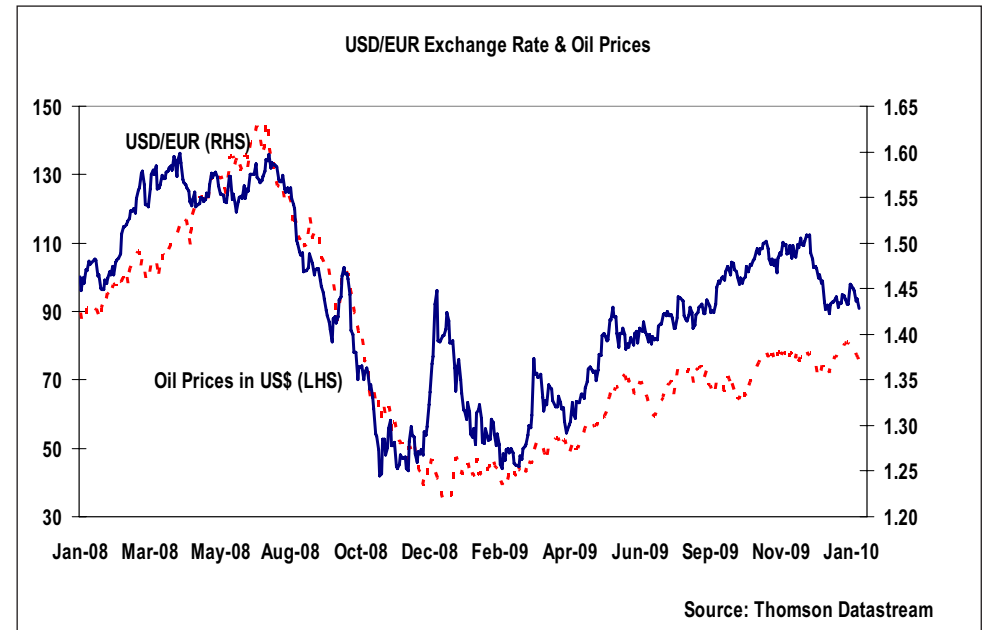
December's disappointing US non-farm payrolls reports dented optimism regarding US economic prospects, hitting expectations for an interest rate hike anytime soon and triggering some dollar selling, though the sell-off lacked real momentum and was not broad based. Communication from Fed members has also seemed to see markets pull back in terms of the outlook for the timing of a rate hike, with the central bank remaining very cautious in its economic assessment.

Despite the pull back in terms of interest rate expectations, the dollar is showing underlying resilience, particularly versus the euro, which has fallen to six month lows as a break of \$1.40 threatens. Fiscal policy is also likely to be a key driver for markets over 2010 and, while the US public finances are hardly in great shape following the level of support provided to the economy during the height of the economic crisis, the current focus in terms of sovereign risk is currently on Europe and in particular Greece, which is weighing heavily on the euro versus the USD.

Growth differentials are also likely to be key in terms of setting direction for forex markets this year, as markets try and anticipate a turn in the interest rate cycle. Thus, any fresh signs of a pick-up in US economic activity should be dollar supportive, with the currency expected to gradually trend upwards as markets start to fully price in a tightening in policy from the Fed.

## Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
US\$/EUR	1.409	1.39-1.45	1.38-1.44	1.37-1.43	1.36-1.42
US\$/GBP	1.618	1.59-1.65	1.59-1.65	1.58-1.64	1.58-1.64
YEN/US\$	91.736	87-95	90-95	92-97	95-100
CHF/US\$	1.044	1.04	1.06	1.07	1.07



# Euro

As reflected in the drop in its trade weighted index, the euro has started 2010 with a defensive tone, undermined by concerns about eurozone sovereign ratings, the most notable being the problems in Greece. The Greek government's plans to get the finances back on track have met with little EU or investor approval, given the lack of detail and perceived unachievable targets outlined. Negative comments on the situation have also come from other European authorities including the ECB. The EU is expected to report on the Greek stability plan in mid-February, which leaves the euro vulnerable near-term.

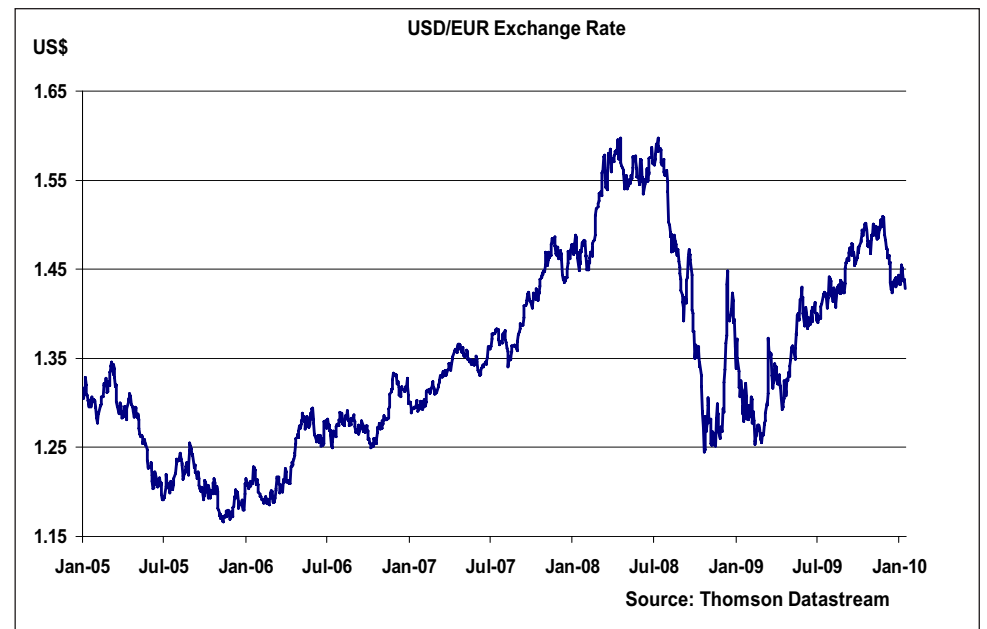
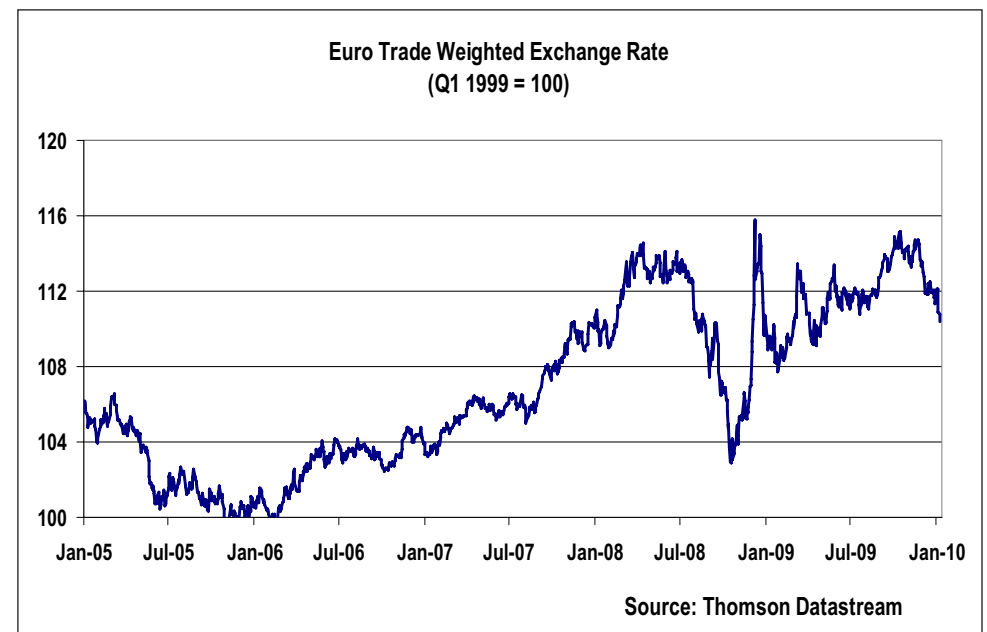
The euro is also being hit by the recent dovish tone of ECB comments. The recession in the eurozone officially ended in Q3, when growth of 0.4% was recorded. However, while the recession proved to be very deep, the ECB expects the recovery in activity to be moderate and uneven, leaving the economy with 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.

As one of the currencies of choice versus the USD in 2009, the euro could come under further selling pressure versus the dollar over the course of this year if relative growth prospects and sovereign issues continue to move against it. Furthermore, 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 believe the same to be true in the case of sterling, which is currently trading around four month highs versus the EUR. Significant upside versus the euro is unlikely with the UK facing a number of challenges of its own this year including poor prospects for economic growth, a general election and weak public finances.

## Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
US\$/EUR	1.409	1.39-1.45	1.38-1.44	1.37-1.43	1.36-1.42
GBP/EUR	0.871	0.86-0.89	0.85-0.89	0.84-0.89	0.84-0.88
YEN/EUR	129.21	123-133	125-135	128-138	130-140
PLN/EUR	4.049	4.00	3.93	3.87	3.82



# Sterling

As one of the currencies worst hit by the global financial crisis, 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 some 23% lower on a broad trade weighted basis than where it was at the beginning of the financial crisis in 2007.

Having said this, sterling has had a relatively strong start to 2010, rallying against both the USD and EUR. Gains have been seen on the back of stronger than anticipated UK data, including a sharp spike upwards in the CPI in December, broad based EUR weakness on concerns over the Greek deficit situation as well as supportive M&A activity. Further attempts to the upside could come near term, particularly versus the euro. As well as eurozone sovereign risk, the prospect of a decision by the BoE at its February policy meeting not to extend its QE programme could provide a boost for the GBP.

However, despite current moves we are sceptical regarding the medium term prospects for a marked sterling recovery. The UK faces into 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. Meanwhile, although the focus is currently on Greece, concerns about 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

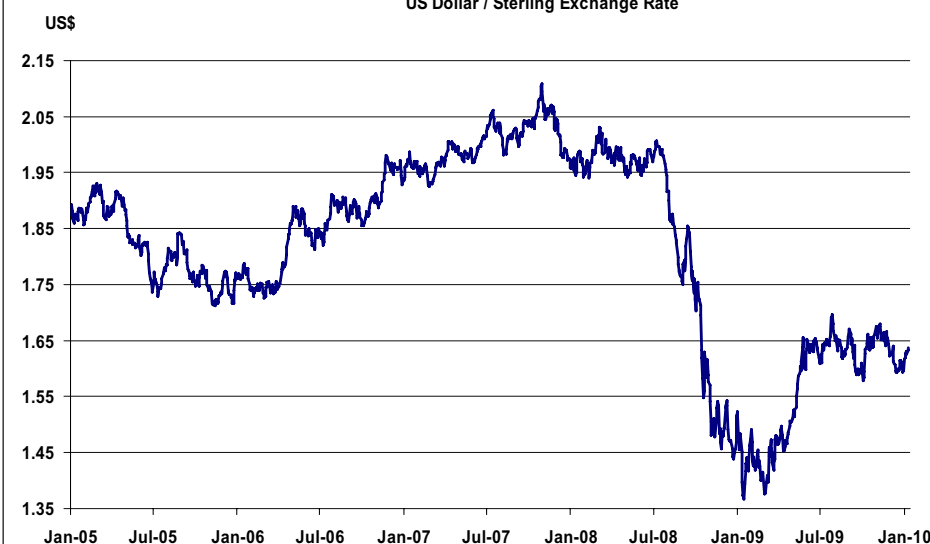
		Q1-2010	Q2-2010	Q3-2010	Q4-2010
<b>GBP/EUR</b>	0.871	0.86-0.89	0.85-0.89	0.84-0.89	0.84-0.88
<b>US\$/GBP</b>	1.618	1.59-1.65	1.59-1.65	1.58-1.64	1.58-1.64
<b>YEN/GBP</b>	148.44	148	150	153	158
<b>CAD/GBP</b>	1.693	1.72	1.72	1.73	1.73

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 on the back of a reversal of carry trade positions and a flight to safe haven assets. As the year progressed, the yen was hit by a pick up in investor risk appetite as the outlook for the global economy stabilised but it remains in a relatively strong position versus other majors nonetheless.

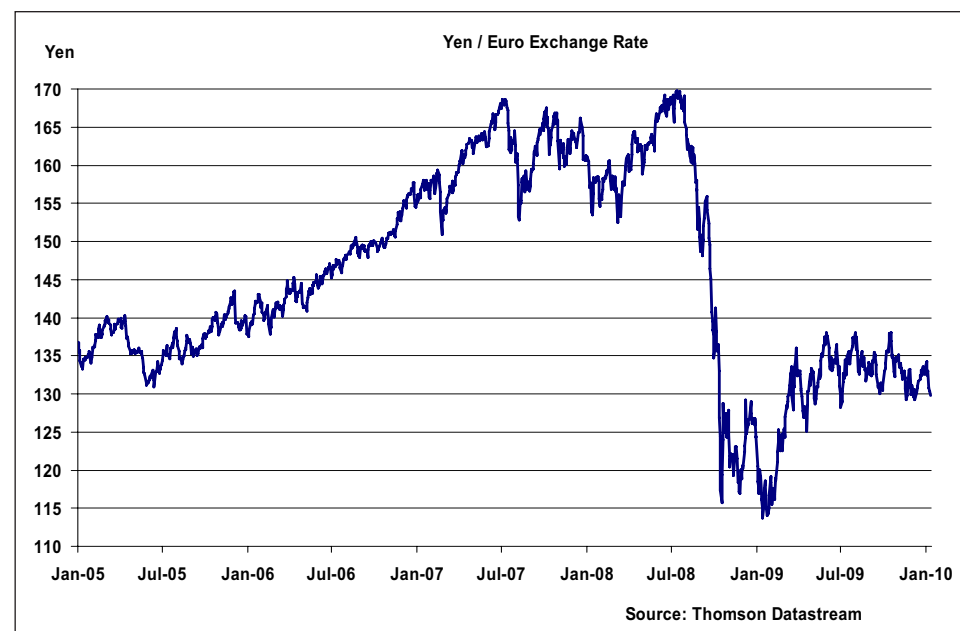
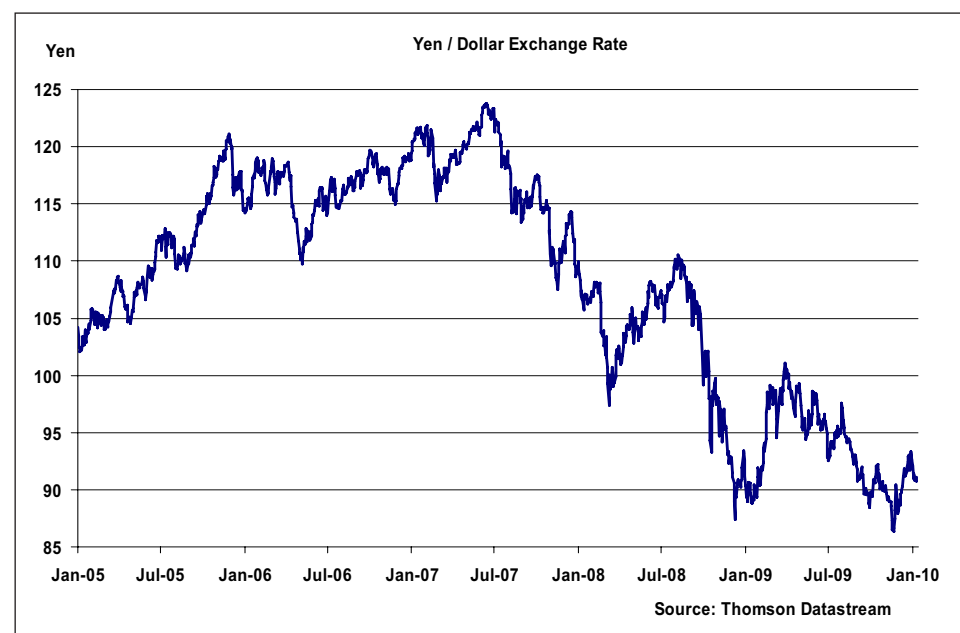
However, while the JPY is still benefiting from swings in market sentiment, 2010 could well signal an end to the recent period of yen overvaluation. Many in the market place expect it to resume its status as the carry trade currency of choice given relative growth and interest rate predictions. General 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, though it is currently off early year highs.

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. Japan's newly appointed Finance Minister has stated that he wants to see 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 in 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 struggle to make much headway versus the yen, particularly in the near term following a New Year sell off. This mainly reflects the current concerns regarding eurozone sovereign risk and strong resistance remains in place at the Y137 level.

## Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
<b>YEN/US\$</b>	91.72	87-95	90-95	92-97	95-100
<b>YEN/EUR</b>	129.22	123-133	125-135	128-138	130-140
<b>YEN/GBP</b>	148.43	148	150	153	158



# 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%.

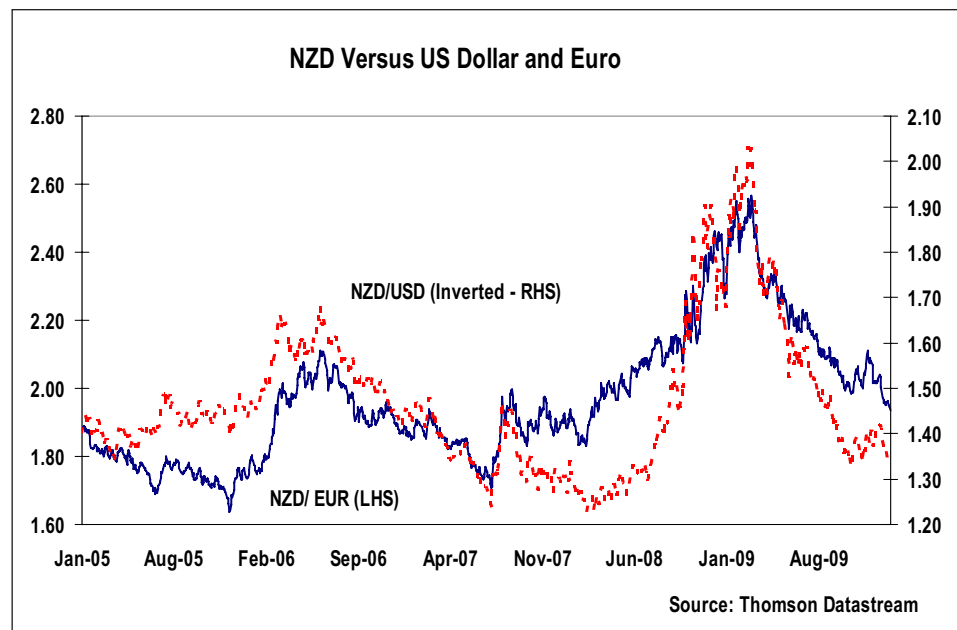
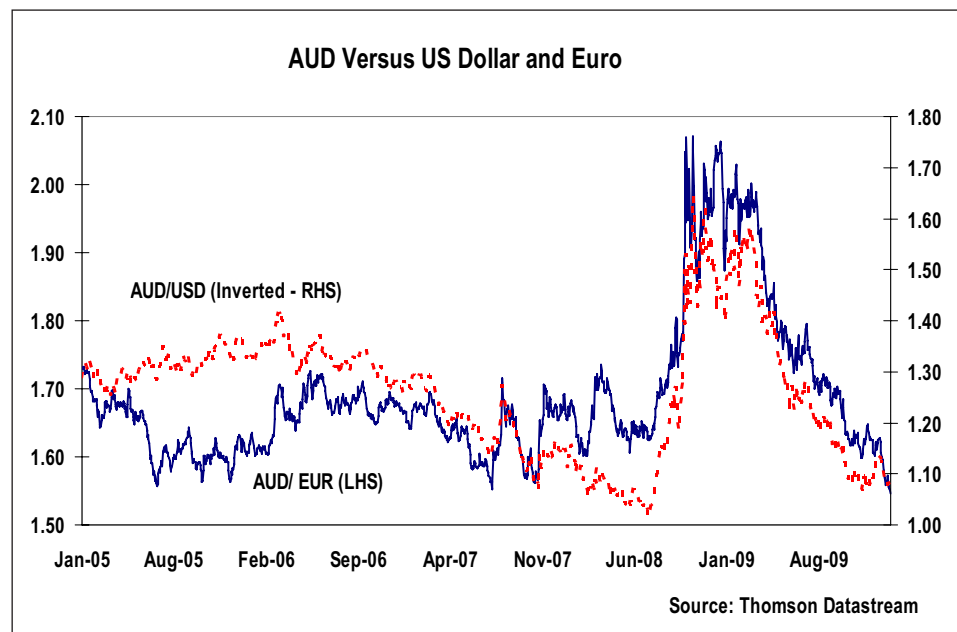
With the worst of the global economic news now behind us, investor appetite for riskier and commodity driven currencies like the AUD and NZD has picked up again. Furthermore, Australia proved to be one of a handful of economies that avoided recession, in large part due to the successful implementation of fiscal stimulus measures. Meanwhile, Q3 GDP data signalled a modest 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, certainly in the opening months of the year, with markets anticipating further tightening from the RBA, 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 correction in global commodity prices, as well as any moves by markets to price in policy tightening elsewhere.

## Key Forecasts

		Q1-2010	Q2-2010	Q3-2010	Q4-2010
<b>AUD/USD</b>	0.912	0.91	0.90	0.88	0.88
<b>NZD/USD</b>	0.720	0.72	0.71	0.69	0.69
<b>AUD/EUR</b>	1.55	1.56	1.57	1.59	1.59
<b>NZD/EUR</b>	1.957	1.97	1.99	2.03	2.03



# Key Events/Diary

## Week 1 (25th - 29th January)

Jan 26th	Eurozone	German Ifo Index (January)
	<b>UK</b>	<b>Q4 GDP (First Estimate)</b>
Jan 27th	US	<b>Fed Policy Announcement</b>
		New Home Sales (December)
Jan 28th	Eurozone	EC Sentiment Surveys (January)
Jan 29th	Eurozone	Flash HICP (January)
	<b>US</b>	<b>Q4 GDP (First Estimate)</b>

## Week 2 (1st - 5th February)

<b>Feb 1st</b>	<b>US/UK/E-zone</b>	<b>Manufacturing ISM/Markit PMI (January)</b>
	US	Personal Income and Spending (December)
<b>Feb 3rd</b>	<b>US/UK/E-zone</b>	<b>Services ISM/Markit PMI (January)</b>
	US	ADP Employment Report (January)
<b>Feb 4th</b>	<b>UK</b>	<b>BoE Policy Announcement</b>
	<b>Eurozone</b>	<b>ECB Policy Announcement &amp; Press Conference</b>
	US	Durable Goods (December)
<b>Feb 5th</b>	<b>US</b>	<b>Non-Farm Payrolls (January)</b>

## Week 3 (8th - 12th February)

<b>Feb 10th</b>	<b>UK</b>	<b>Industrial Production (December)</b>
	US	International Trade (December)
Feb 11th	US	Retail Sales (January)
<b>Feb 12th</b>	<b>Eurozone</b>	<b>Q4 GDP (First Estimate)</b>
	German	Q4 GDP (First Estimate)
	<b>US</b>	<b>Michigan Sentiment Survey (February)</b>

## Week 4 (15th - 9th February)

<b>Feb 15th</b>	<b>Japan</b>	<b>Q4 GDP (First Estimate)</b>
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)
<b>Feb 19th</b>	<b>Eurozone</b>	<b>Flash PMIs (February)</b>
	<b>US</b>	<b>Retail Sales (January)</b>
	<b>US</b>	<b>Consumer Prices (January)</b>

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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