



# Exchange Rate Outlook

*19th March 2010*

- **Cautious Fed curtails dollar rally**
- **Euro stabilises but still on back foot on sovereign risk**
- **Sterling pressured by pre election uncertainty**
- **Yen loses some of its appeal on further BoJ easing**

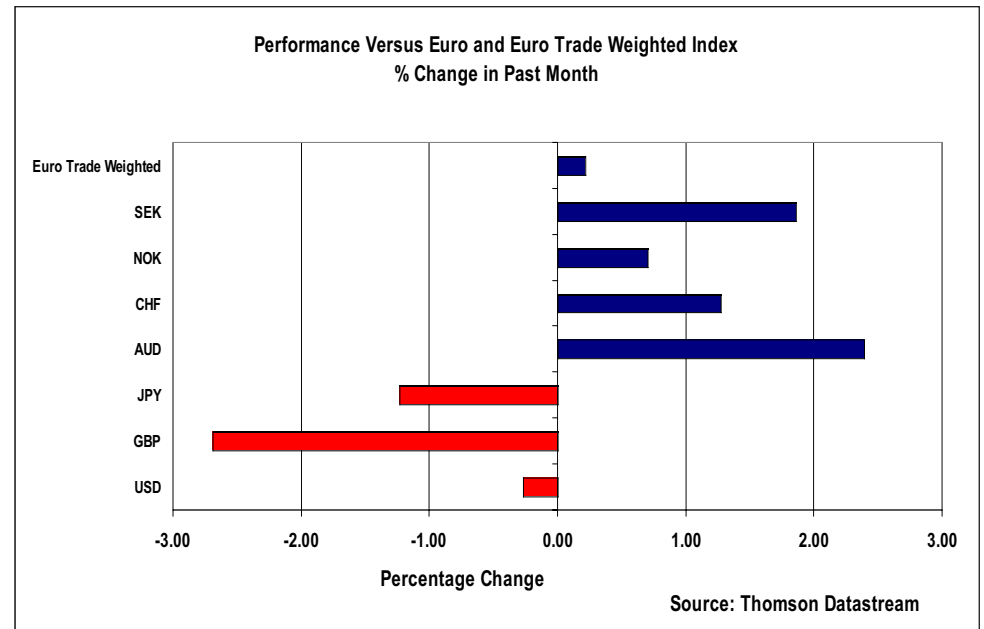
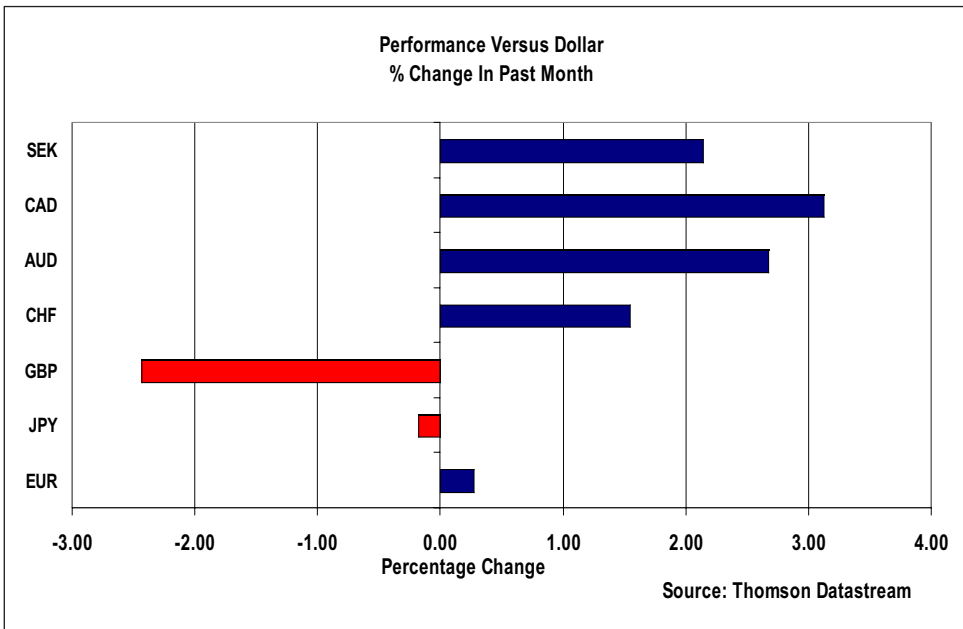
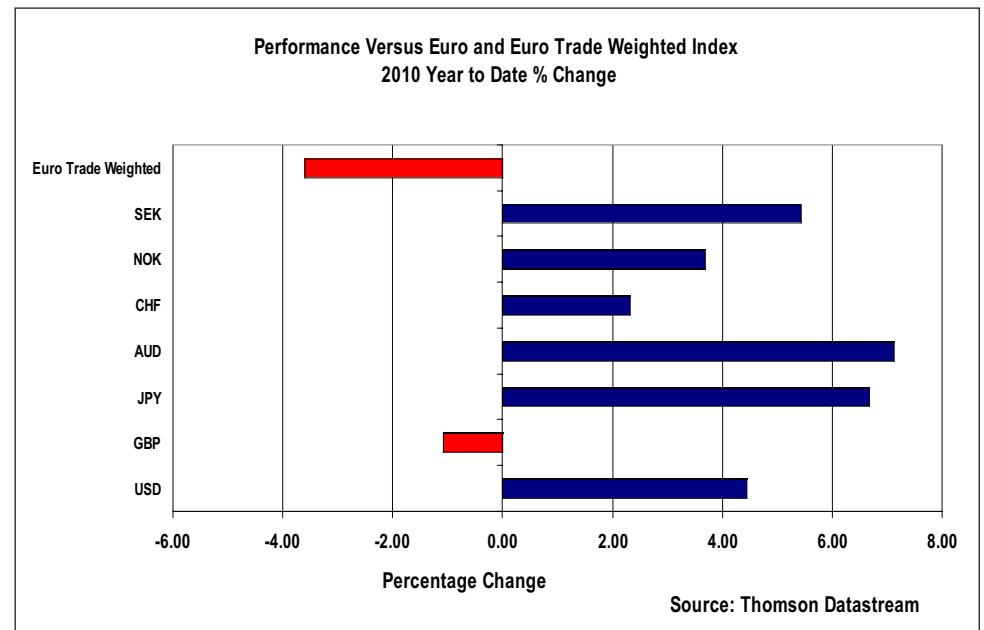
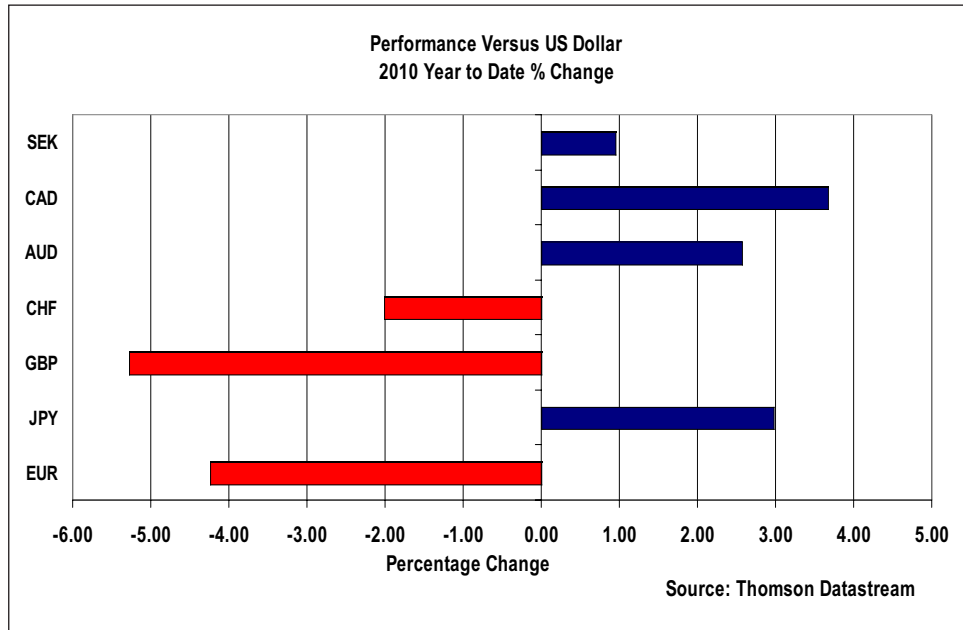
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# Key Currency Trends



# Summary of Exchange Rate Forecasts

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

	<b>Current</b>	<b>Q2-2010</b>	<b>Q3-2010</b>	<b>Q4-2010</b>	<b>Q1-2011</b>
<b>Euro Versus</b>					
<b>USD</b>	1.356	1.34-1.39	1.35-1.40	1.35-1.40	1.37-1.42
<b>GBP</b>	0.895	0.87-0.92	0.85-0.90	0.85-0.90	0.83-0.88
<b>JPY</b>	122.66	120-130	123-133	130-140	135-145
<b>PLN</b>	3.89	3.85	3.78	3.73	3.70
<b>HUF</b>	262.85	262	262	260	260
<b>NOK</b>	7.96	8.00	7.90	7.80	7.70
<b>SEK</b>	9.68	9.60	9.50	9.45	9.40
<b>AUD</b>	1.47	1.50	1.53	1.54	1.59
<b>NZD</b>	1.90	1.95	2.02	2.02	2.08
<b>US Dollar Versus</b>					
<b>JPY</b>	90.46	90-95	92-97	95-100	98-103
<b>GBP</b>	1.516	1.50-1.60	1.55-1.65	1.55-1.65	1.58-1.68
<b>CHF</b>	1.06	1.06	1.07	1.07	1.09
<b>CAD</b>	1.01	1.03	1.05	1.07	1.07
<b>AUD</b>	0.92	0.91	0.90	0.89	0.88
<b>NZD</b>	0.71	0.70	0.68	0.68	0.67
<b>CNY</b>	6.83	6.82	6.81	6.80	6.79
<b>Sterling Versus</b>					
<b>JPY</b>	137	141	149	153	164
<b>CAD</b>	1.53	1.57	1.65	1.68	1.75
<b>AUD</b>	1.65	1.68	1.75	1.77	1.85
<b>NZD</b>	2.13	2.18	2.31	2.31	2.44

# 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 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 rates until early 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, conducting substantial purchases of Treasuries and mortgage securities, to help stimulate the economy and aid financial markets. The US is now out of recession. However, with the unemployment rate having reached 10% and the current pace of US economic growth unlikely to be sustained, as well as very subdued inflation, we expect that the exceptionally low level of the Fed funds rate will remain in place until early 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. This official rate of 1.0% represents an historical low for the eurozone but is seen as 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 early 2011 at the earliest, with inflation expected to remain very low, unemployment at high levels, and given the marked weakness 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 anemic, policy is set to remain very accommodative well into next year. We do not anticipate any hikes in official rates until Q1 2011 at the earliest.

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

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
<b>Current</b>	0.125	0.27	0.86	1.08	2.58
<b>Jun '10</b>	0.125	0.35	1.00	1.25	2.70
<b>Sept '10</b>	0.125	0.50	1.20	1.40	2.80
<b>Dec '10</b>	0.125	0.70	1.40	1.60	3.00

\* 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	0.59	1.20	1.50	2.43
<b>Jun '10</b>	1.00	0.70	1.30	1.60	2.50
<b>Sept '10</b>	1.00	0.80	1.40	1.70	2.65
<b>Dec '10</b>	1.00	1.00	1.60	1.90	2.80

\* 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	0.65	1.32	1.59	2.90
<b>Jun '10</b>	0.50	0.75	1.45	1.75	3.05
<b>Sept '10</b>	0.50	0.90	1.60	1.90	3.20
<b>Dec '10</b>	0.50	1.10	1.80	2.10	3.40

\* Swap Forecasts Beyond 1 Year

# US Dollar

The rally seen in the dollar in the opening months of the year seems to have run out of steam, with the USD/EUR rate currently off its early March lows. Other majors such as the AUD, GBP and CAD have also gained ground as USD supportive factors have waned. The dollar's rebound had 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.

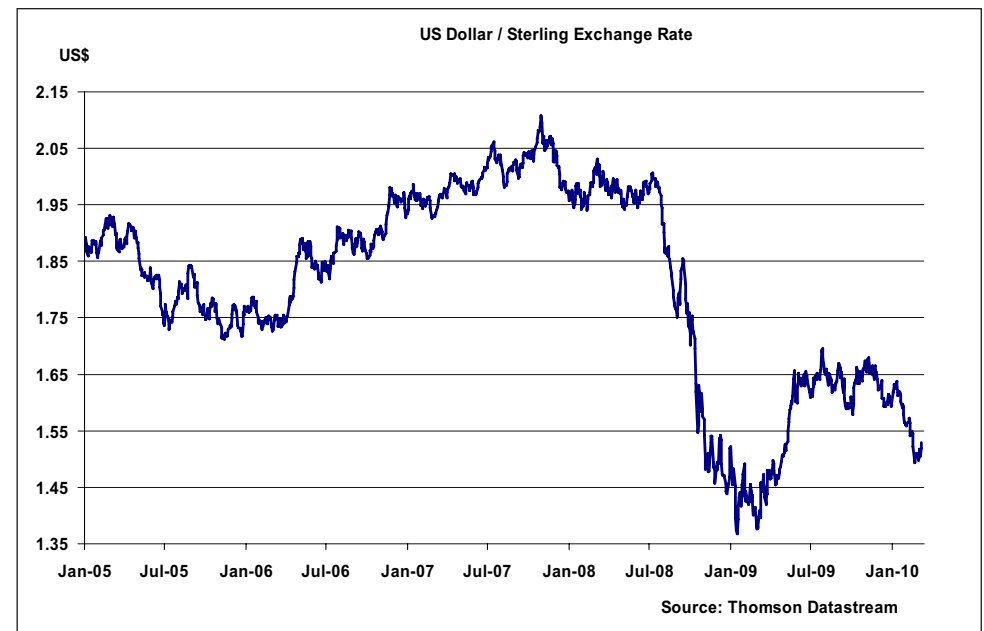
Although the threat of sovereign downgrades continues to overshadow the euro, the situation in relation to Greece has at least stabilised amid talk of severe fiscal rectitude and the availability of support from other eurozone members if needed. Meanwhile, market sentiment has also been underpinned by the fact that the four leading central banks continue to indicate that monetary conditions will remain very supportive. This reassurance has helped to partially offset investor concerns that monetary policy tightening in Asia would derail the global economic recovery.

The rally in the dollar was also driven by markets focusing on some encouraging US data, which heightened speculation that the Federal Reserve would start tightening monetary policy before the year is out. However, while the economic outlook in the US has certainly improved, there has been little indication from the Fed that it is about to start moving towards a hike in the Fed funds rate anytime soon. Thus, the scope for any further dollar rally on the back of the interest rate story looks limited for now.

Indeed, the USD could see gains further eroded over the medium term. Although now out of recession, the US economy still faces significant headwinds with the current pace of recovery unlikely to be sustained over the second half of the year. We are of the view that it is likely to be early 2011 before the Fed starts to tightening policy, something that is likely to weigh on the dollar. At the same time, though, the scope for any marked euro recovery should also be restricted by the ongoing evidence of a weak eurozone economic performance, a dovish ECB and sovereign associated risk.

## Key Forecasts

		Q2-2010	Q3-2010	Q4-2010	Q1-2011
US\$/EUR	1.356	1.34-1.39	1.35-1.40	1.35-1.40	1.37-1.42
US\$/GBP	1.516	1.50-1.60	1.55-1.65	1.55-1.65	1.58-1.68
YEN/US\$	90.473	90-95	92-97	95-100	98-103
CHF/US\$	1.058	1.06	1.07	1.07	1.09



# Euro

The euro fell sharply in the opening weeks of 2010, undermined by concerns about eurozone sovereign ratings, and in particular the deficit problems being faced by Greece. Recent developments, including talk of support packages from Europe, have helped the euro recover from its lows, though it remains on the defensive as uncertainty remains regarding solutions to the public finances crisis.

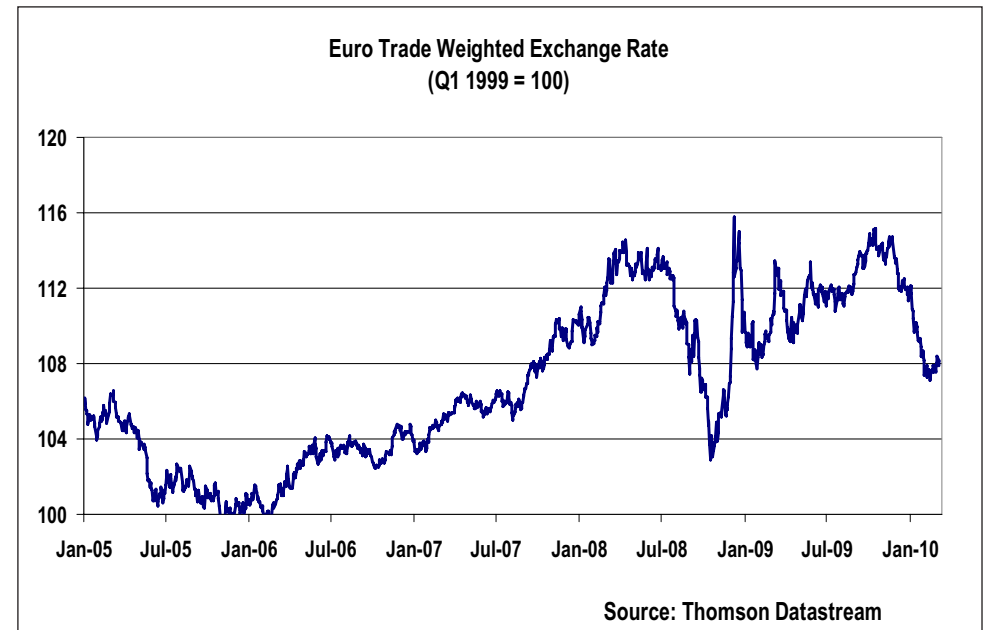
The increasing focus on growth differentials is also weighing on the euro, with the US economy set to outperform the eurozone, at least in the first half of the year. The recession in the eurozone officially ended in Q3, when growth of 0.4% was recorded. However, recovery is expected to be moderate and uneven, leaving the economy with a large amount of spare capacity for a prolonged period. Thus, the central bank does not appear to have any plans to start hiking eurozone interest rates anytime soon.

Although still relatively strong, the euro looks set to remain on the backfoot versus the dollar over the coming months 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 or talk of Fed tightening. However, as reflected in our forecasts, any fresh dollar strength is likely to be limited by the prospect of a sub trend US economic performance in the second half of the year and the likelihood that the Fed will also be slow in terms of reversing its accommodative policy stance.

Sterling saw highs of Stg0.859p versus the euro in late January but it failed to hold these levels as market attention turned to pre-election uncertainty in the UK, the equally poor prospects for the UK economy as indicated by recent data and the dire state of the public finances. There seems little prospect of any marked rebound in sterling versus the euro over the coming months, at least until the general election is out of the way. Indications from the Bank of England that it remains open to the prospect of providing further monetary support to the economy is also likely to weigh on the GBP.

## Key Forecasts

		Q2-2010	Q3-2010	Q4-2010	Q1-2011
US\$/EUR	1.356	1.34-1.39	1.35-1.40	1.35-1.40	1.37-1.42
GBP/EUR	0.895	0.87-0.92	0.85-0.90	0.85-0.90	0.83-0.88
YEN/EUR	122.66	120-130	123-133	130-140	135-145
PLN/EUR	3.888	3.85	3.78	3.73	3.70



# Sterling

Of the major currencies, sterling has been the one most severely impacted by the global financial crisis, with its trade weighted index currently trading about 25% below where it was before the crisis began in 2007. A very weak economic performance and ultra accommodative policy stance by the Bank of England have weighed heavily, as has the UK's perceived exposure to the financial sector.

2010 started on a strong note but the pound has since come under renewed pressure against the dollar, euro and yen. From highs of \$1.6457 in late January, the sterling/dollar rate is currently trading around \$1.52/53, having seen lows of sub \$1.48 in early March. Sterling/euro, meanwhile, has also fallen well back from early year highs of Stg0.859p, despite the fact that the euro itself has been under pressure. We expect downside pressures to remain at least in the near term.

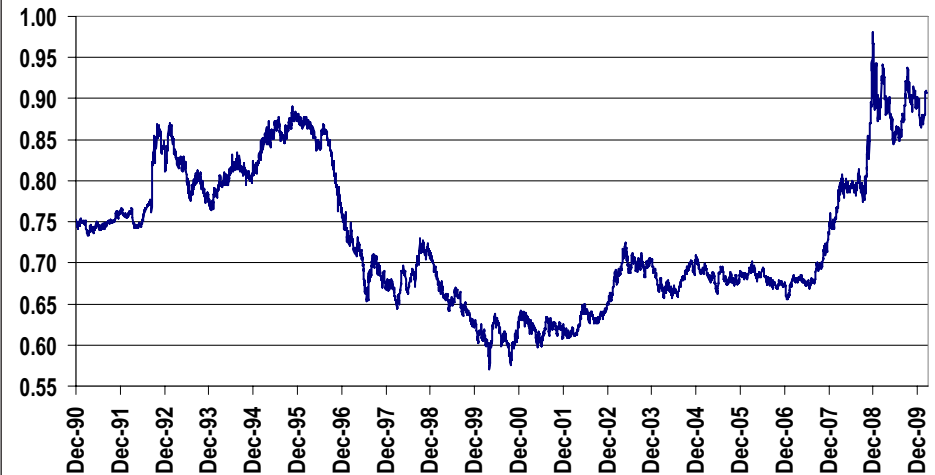
The recent wave of weakness has been largely related to uncertainty ahead of this year's general election. Given the current focus on fiscal policy and the associated sovereign risks, markets are concerned about the potential impact of a hung parliament on the ability/willingness of the political parties to move forward with the measures necessary to rein in the fiscal deficit. The UK deficit/GDP ratio is forecast at 12.9% for this year, one of the highest in Europe. Although the 2010 pre Budget report outlined some corrective measures, there was little evidence of a medium term plan to get the public finances back on track. The election must take place before June 3, with early May seen as a likely date. Between now and then, sterling looks set to remain hostage to opinion polls and any commentary from the main parties on fiscal policy.

Sterling is also being undermined by the fact that real UK economic data continue to point to an anemic recovery, thus leaving open the prospect of further support from the BoE. The central bank did call a halt to its quantitative easing activities in February but has indicated that it stands ready to act again should the need arise.

## Key Forecasts

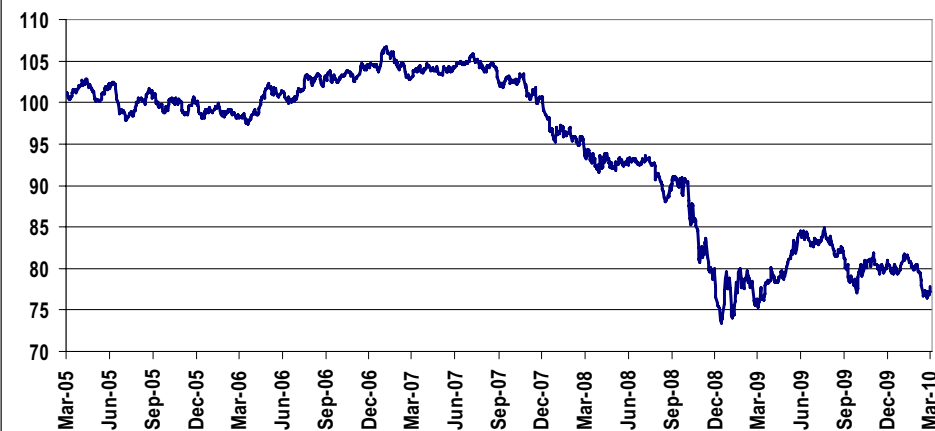
		Q2-2010	Q3-2010	Q4-2010	Q1-2011
<b>GBP/EUR</b>	0.895	0.87-0.92	0.85-0.90	0.85-0.90	0.83-0.88
<b>US\$/GBP</b>	1.515	1.50-1.60	1.55-1.65	1.55-1.65	1.58-1.68
<b>YEN/GBP</b>	137.08	141	149	153	164
<b>CAD/GBP</b>	1.532	1.57	1.65	1.68	1.75

### Synthetic Sterling/Euro Exchange Rate (1990-2009)



Source: Thomson Datastream

### Sterling Trade Weighted Exchange Rate Jan 2005 = 100



Source: Thomson Datastream

# 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.

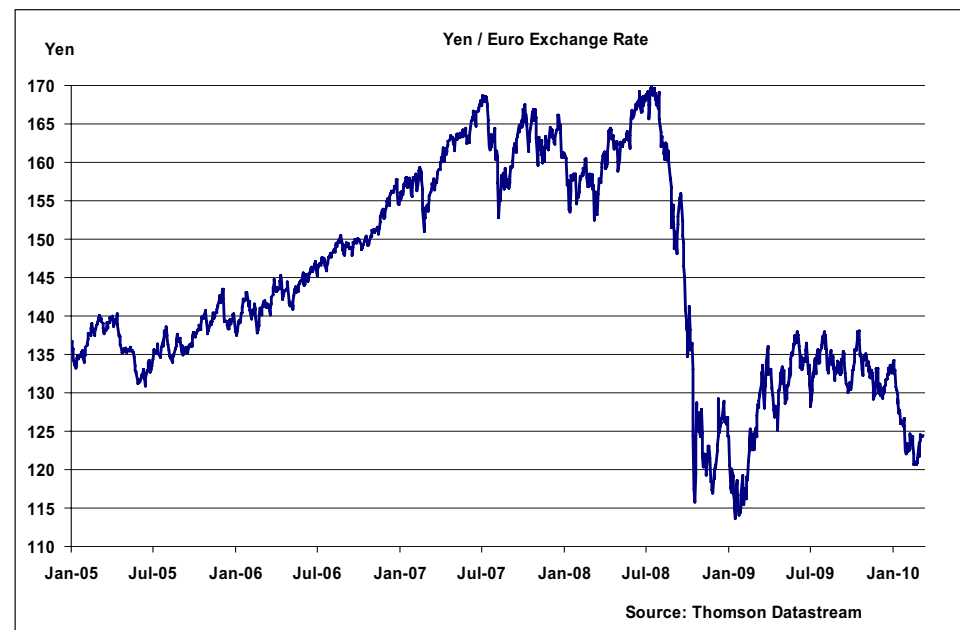
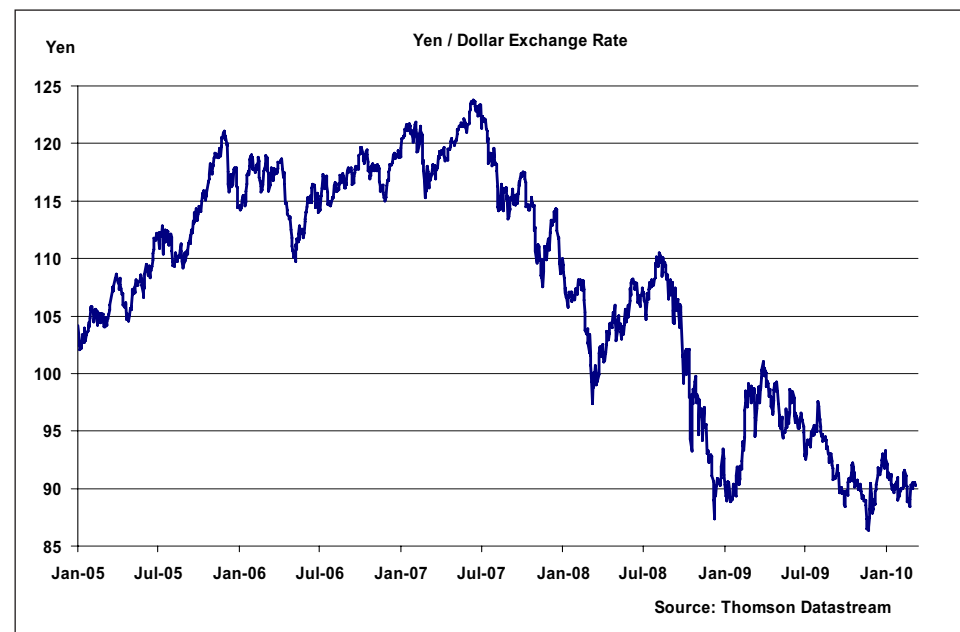
General dollar weakness saw the dollar/yen rate hit a 14 year low of Y84.8 in late November last year. However, the USD has since recovered some ground on the back of an improving outlook for the US economy and talk of a tightening in US monetary policy. There are also a number of domestic factors that 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.

Furthermore, the Bank of Japan have extended quantitative easing activities on two occasions since December, which is in contrast to other major central banks who remain accommodative but have ended their policy initiatives. Meanwhile, 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 short to medium term as markets continue to focus on the depth of the eurozone's fiscal problems. Recent lows of sub Y120 remain within the euro's sights and renewed selling pressures could be seen near term, particularly as fiscal year end (March 31st) in Japan draws near. We anticipate a Y120-130 trading range for the coming months as markets await a full resolution to the eurozone's fiscal problems.

## Key Forecasts

		Q2-2010	Q3-2010	Q4-2010	Q1-2011
<b>YEN/US\$</b>	90.46	90-95	92-97	95-100	98-103
<b>YEN/EUR</b>	122.66	120-130	123-133	130-140	135-145
<b>YEN/GBP</b>	137.07	141	149	153	164



# 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.

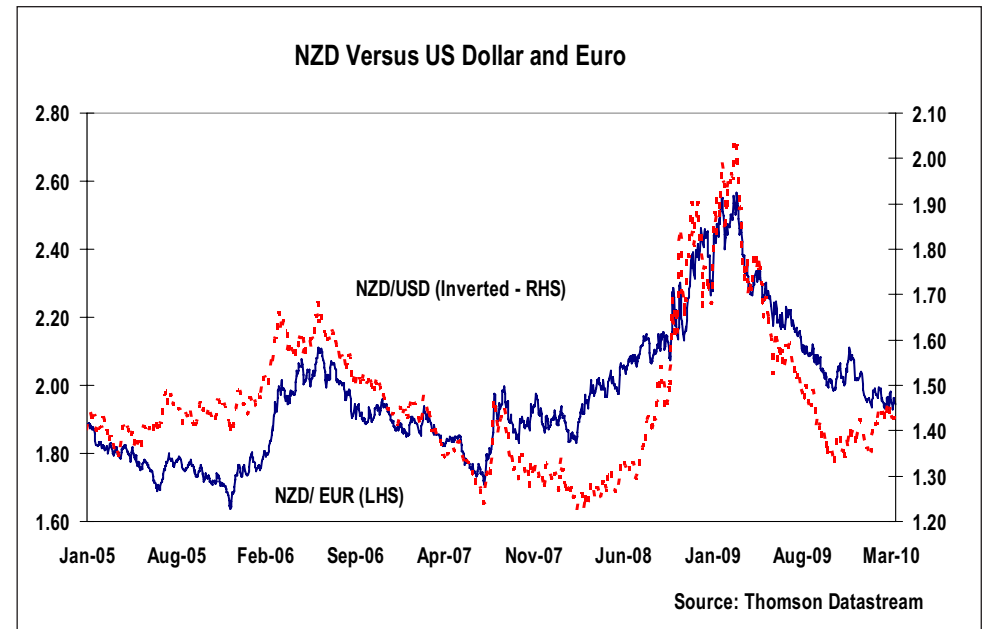
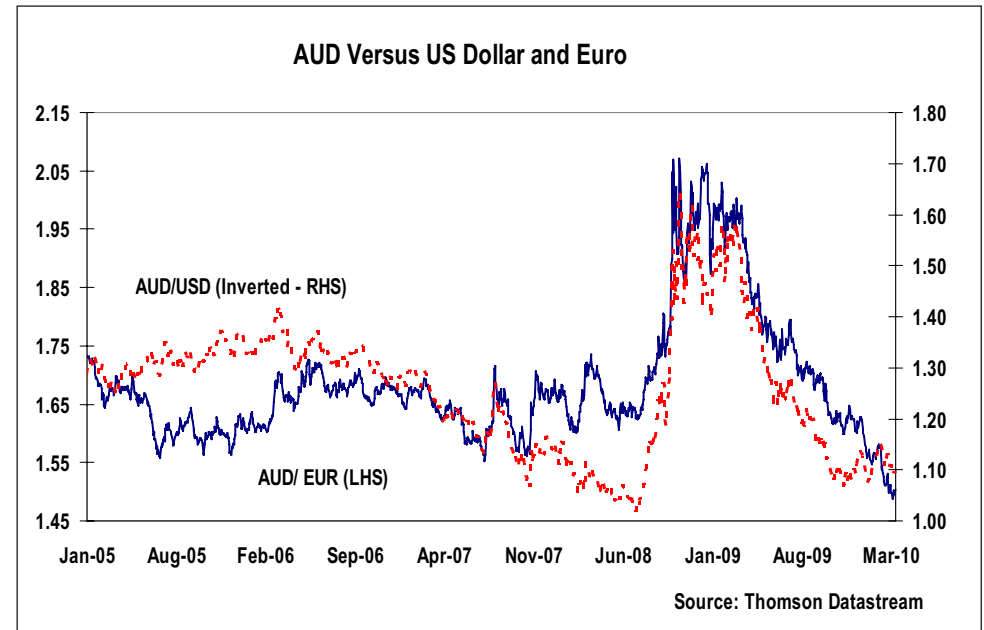
The pair's recovery was further cemented by October's announcement from the Reserve Bank of Australia that, in response to the better than anticipated domestic economic outturn, it was raising interest rates by 0.25% to 3.25%, making it one of the first developed economies to reverse emergency monetary 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 saw 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 in January. 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.

The pair have since regained ground and fundamentals suggest that the AUD and NZD will remain relatively strong versus other majors over the coming months, underpinned by the positive correlation between them and the improving global economic cycle. Widening interest rate spreads should also continue to be supportive. After its New Year pause, the RBA resumed its tightening cycle in February, with rates now at 4.00%, while the Reserve Bank of New Zealand has indicated that it will start hiking official rates around mid year.

## Key Forecasts

		Q2-2010	Q3-2010	Q4-2010	Q1-2011
<b>AUD/USD</b>	0.920	0.91	0.90	0.89	0.88
<b>NZD/USD</b>	0.712	0.70	0.68	0.68	0.67
<b>AUD/EUR</b>	1.47	1.50	1.53	1.54	1.59
<b>NZD/EUR</b>	1.905	1.95	2.02	2.02	2.08



# Key Events/Diary

## Week 1 (22nd - 26th March)

Mar 22nd	UK	Consumer Prices (February)
Mar 23rd	US	New Home Sales (February)
<b>Mar 24th</b>	<b>Eurozone</b>	<b>Flash PMIs (March)</b>
	Eurozone	German ZEW Index (March)
	US	Durable Goods (February)
	UK	Distributive Trades Survey (March)
	UK	Budget 2010
<b>Mar 25th</b>	<b>UK</b>	<b>Retail Sales (February)</b>
Mar 26th	US	Q4 GDP - Final Release

## Week 2 (29th March - 2nd April)

Mar 29th	Eurozone	EC Sentiment and Activity Surveys (March)
	UK	Consumer Credit (February)
	US	Personal Income and Consumption (February)
Mar 30th	UK	Q4 GDP - Final Release
<b>Mar 31st</b>	<b>Eurozone</b>	<b>Flash HICP (March)</b>
<b>Apr 1st</b>	<b>UK/US/E-Zone</b>	<b>Manufacturing PMIs/ISM (March)</b>
Apr 2nd	UK/US/E-Zone	Market Holiday

## Week 3 (5th - 9th April)

Apr 5th	UK/E-Zone	Market Holiday
	<b>US</b>	<b>Services ISM (March)</b>
<b>Apr 7th</b>	<b>UK/E-Zone</b>	<b>Services PMIs (March)</b>
	Eurozone	Q4 GDP - Final Release
	US	ADP Employment Report (March)
Apr 8th	UK	Industrial Production (February)
	<b>UK</b>	<b>BoE Policy Announcement</b>
	<b>Eurozone</b>	<b>ECB Policy Announcement &amp; Press Conference</b>
<b>Apr 9th</b>	<b>US</b>	<b>Non-Farm Payrolls (March)</b>

## Week 4 (12th - 16th April)

Apr 13th	UK	External Trade Report (February)
	US	External Trade Report (February)
Apr 14th	US	Consumer Prices (March)
	<b>US</b>	<b>Retail Sales (March)</b>
Apr 15th	US	TICs (Net Capital Inflows) Report (February)
	US	Industrial Production & Capacity Utilisation (March)
Apr 16th	US	Michigan Sentiment Survey (April)

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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