



Exchange Rate Outlook *22nd June 2010*

- **Dollar rally meets resistance as market sentiment stabilises**
- **Euro regains some ground but remains vulnerable**
- **Sterling stabilises as new government takes fiscal action**
- **Market sentiment continues to drive yen**

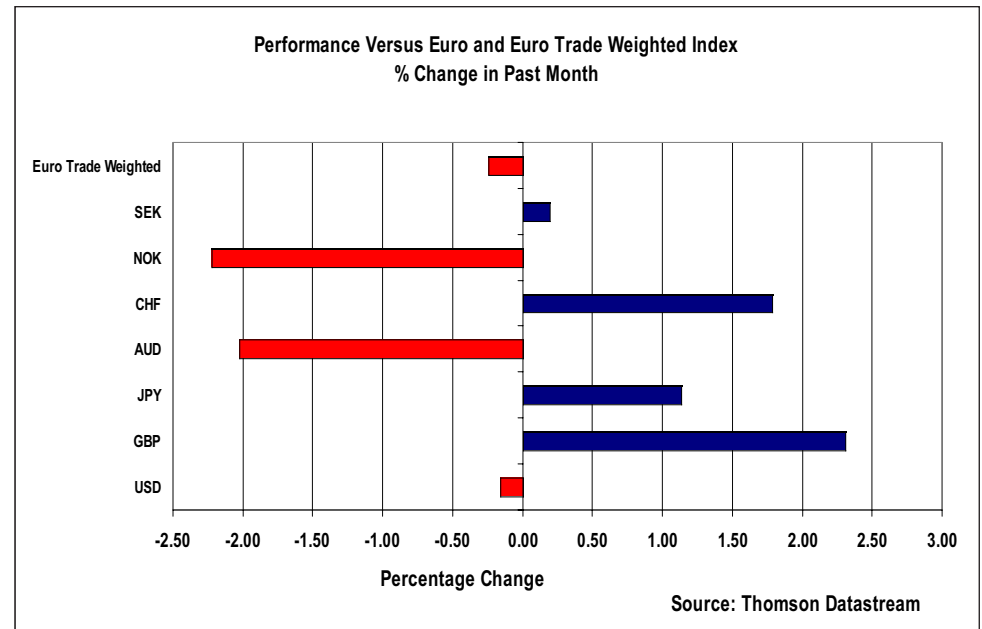
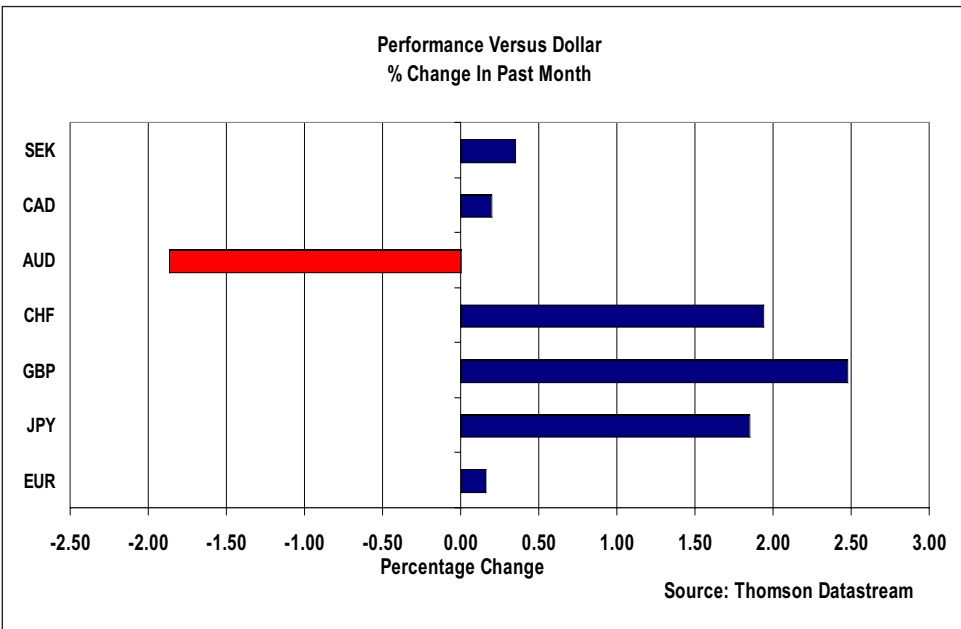
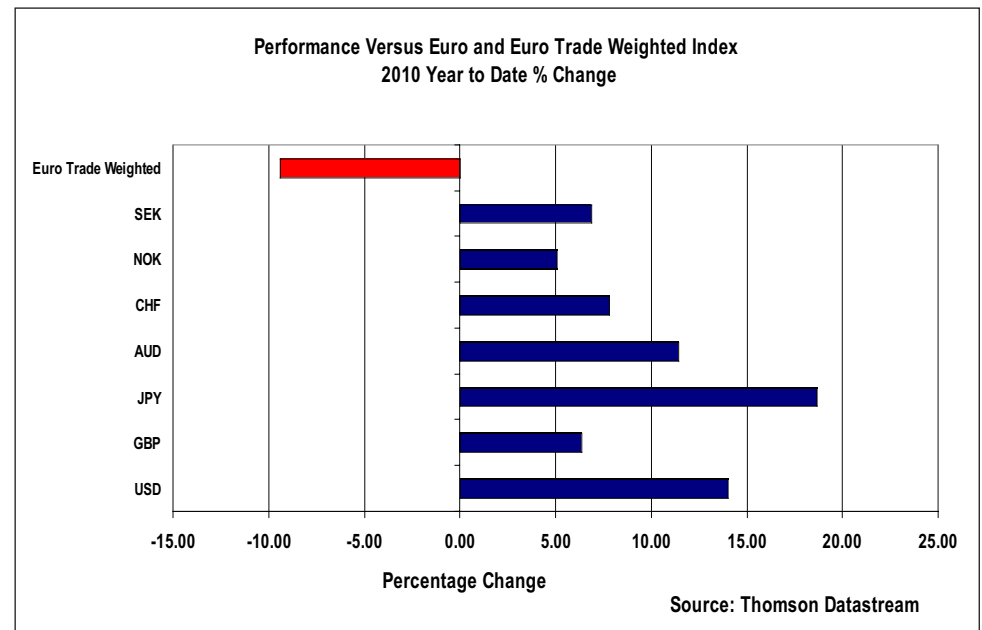
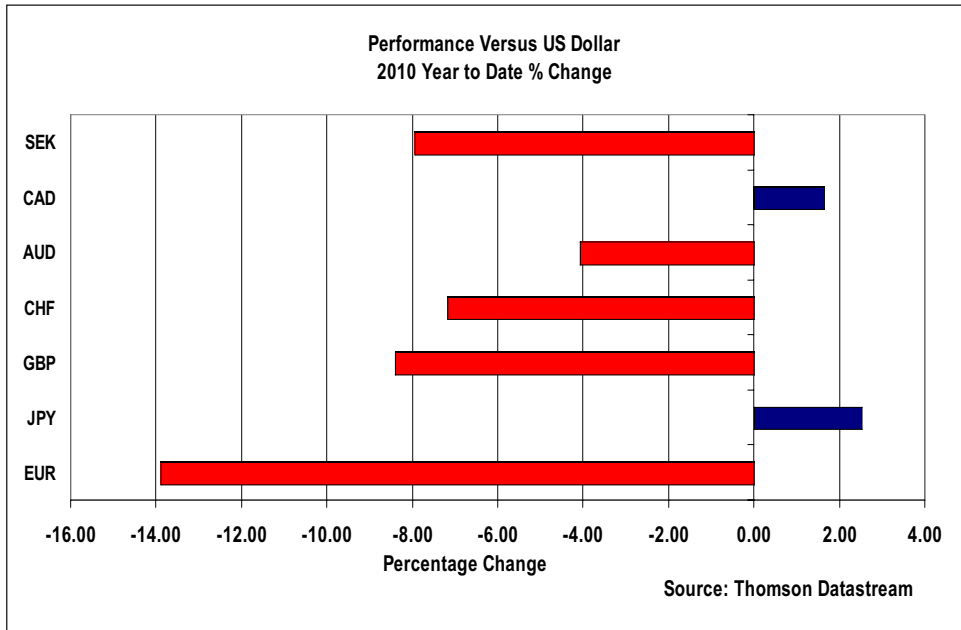
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Key Currency Trends



Summary of Exchange Rate Forecasts

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

	Current	Q3-2010	Q4-2010	Q1-2011	Q2-2011
Euro Versus					
USD	1.238	1.16-1.26	1.18-1.28	1.20-1.30	1.20-1.30
GBP	0.835	0.81-0.85	0.82-0.86	0.83-0.88	0.83-0.88
JPY	112.07	107-117	110-120	115-125	120-130
PLN	4.08	3.95	3.85	3.75	3.70
HUF	280.57	275	270	265	260
NOK	7.86	7.83	7.80	7.75	7.70
SEK	9.55	9.53	9.50	9.45	9.40
AUD	1.43	1.38	1.40	1.40	1.40
NZD	1.76	1.75	1.78	1.79	1.79
US Dollar Versus					
JPY	90.56	88-95	90-97	92-100	95-102
GBP	1.483	1.40-1.50	1.40-1.50	1.42-1.52	1.42-1.52
CHF	1.11	1.10	1.09	1.07	1.10
CAD	1.03	1.03	1.05	1.07	1.07
AUD	0.87	0.88	0.88	0.89	0.89
NZD	0.70	0.69	0.69	0.70	0.70
CNY	6.83	6.81	6.80	6.79	6.79
Sterling Versus					
JPY	134	133	137	140	144
CAD	1.53	1.50	1.54	1.56	1.56
AUD	1.71	1.66	1.66	1.64	1.64
NZD	2.11	2.11	2.12	2.09	2.09

Interest Rate Outlook

Central banks across the world cut official rates to exceptionally low levels in 2008/09 to help counter what proved to be a very deep global recession, which saw inflation fall close to, or below, zero in many countries. The four main central banks have kept interest rates at these historically low levels to date in 2010 as the pace of recovery from the deep recession has proved to be anaemic in developed economies. Furthermore, the deep recession created a lot of spare capacity, with very high unemployment now the case in most countries. This is helping to keep inflation subdued. These conditions are likely to prevail over the balance of the year so we do not expect the four main central banks to start hiking rates until well into 2011.

Fed Funds Rates to Stay Close On 0% Until Mid-2011

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. The US moved out of recession in Q3 2009. However, the unemployment rate remains close to 10% and core CPI inflation has fallen to below 1%. There are also concerns that the recovery in activity may lose some momentum in H2 2010. Hence, the Fed is unlikely to begin raising the funds rate until mid-2011.

ECB Refi Rate Very Much On Hold At 1%

The ECB cut interest rates to a historic low of 1.0% in May 2009. The eurozone economy emerged from recession in Q3 2009 but the pace of recovery has been very slow. Meantime, the unemployment rate has risen to over 10%, while inflationary pressures are very subdued and growth in monetary aggregates is flat. Hence, the ECB has shown no inclination to raise rates and has repeatedly said that the refi rate is at an appropriate level.

The ECB, though, had been gradually withdrawing its non-standard liquidity support measures for the market, in particular fixed-rate, long-term refi operations. However, the difficulties in markets caused by the Greek debt crisis have forced the ECB to reintroduce some of these measures. Given all these negative factors, we do not see the ECB raising rates until mid 2011 at the earliest.

UK Rates Set to Remain Low Well Into 2011

The BoE cut UK interest rates to an historically low level of 0.50% in March 2009, while also employing quantitative easing measures. It has left the door open to do further gilt purchases should they be required down the line. Although UK inflation continues to surprise on the upside, the central bank remains of the view that it will fall below 2% over the medium term. This combined with high unemployment, an anaemic economic recovery and significant fiscal tightening means that we do not anticipate any hikes in official rates until mid 2011 at the earliest.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	0.54	1.18	1.03	2.22
Sept '10	0.125	0.55	1.20	1.10	2.30
Dec '10	0.125	0.70	1.40	1.40	2.60
Mar '11	0.125	0.90	1.55	1.70	2.90

* 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	0.66	1.27	1.36	2.14
Sept '10	1.00	0.70	1.30	1.40	2.20
Dec '10	1.00	0.80	1.50	1.60	2.45
Mar '11	1.00	0.90	1.70	1.85	2.75

* 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	0.73	1.46	1.47	2.57
Sept '10	0.50	0.85	1.50	1.55	2.65
Dec '10	0.50	0.95	1.70	1.80	2.95
Mar '11	0.50	1.10	1.90	2.10	3.30

* Swap Forecasts Beyond 1 Year

US Dollar

Volatility on foreign exchange markets continues to be high and looks set to remain so in the near term as the issue of global sovereign risk dominates. Changing market sentiment with regard to the pace of recovery in the world economy and the delayed timing of any moves by the main central banks to increase official interest rates from their current very low levels is also adding to the uncertain environment.

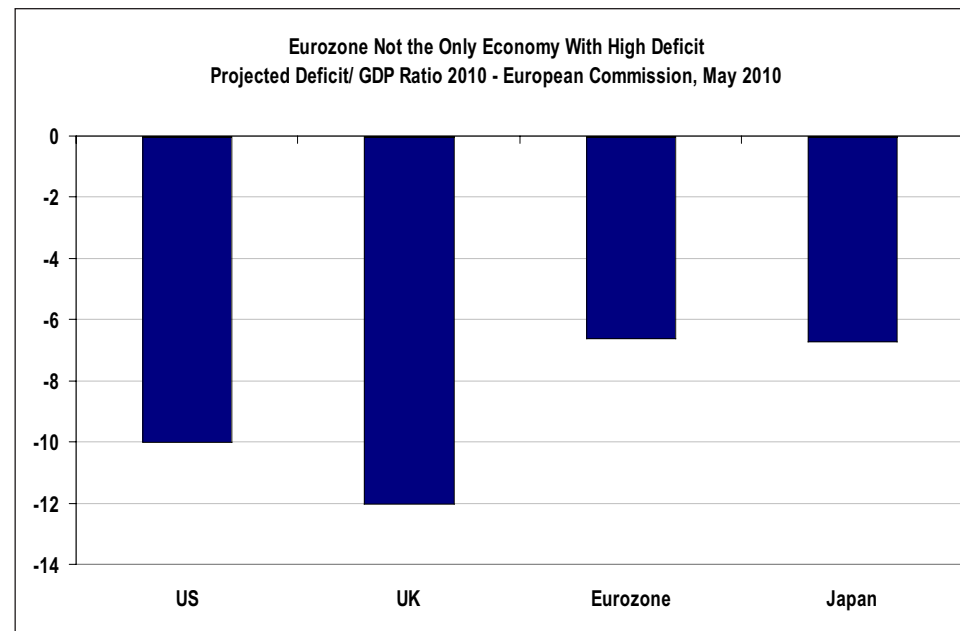
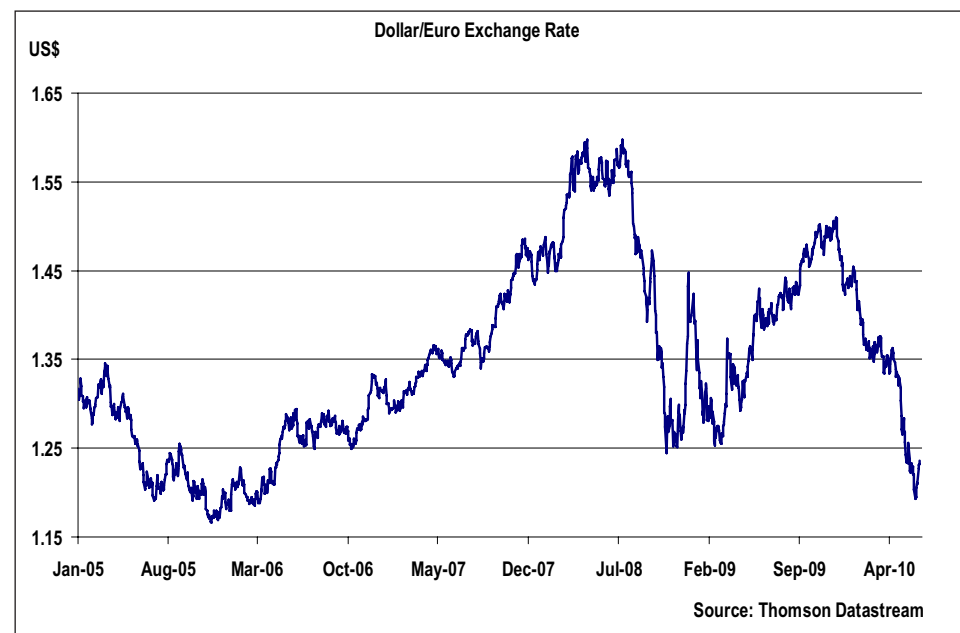
Traditionally a safe haven currency, the dollar has benefited from this volatility, particularly versus European currencies like the euro and sterling, but it has also found support against "high risk" currencies like the AUD. The US public finances are hardly in great shape either but the focus in terms of sovereign risk is on the eurozone and this looks set to remain the case. With sentiment strongly against the single currency, we have already seen a decisive break of the \$1.20 level, with fresh losses possible, despite the recent bounce to \$1.24 on the back of some improvement in market sentiment and a move to cover very short euro positions.

As well as general market volatility, the dollar is also taking some underlying support from the view that the Fed will be the first main central bank to increase rates. However, while the economic outlook in the US has improved, there has been little indication from the Fed that it is about to start moving towards a rate hike anytime soon. Thus, the scope for a further dollar rally on the back of this interest rate story looks limited. Instead, sovereign risk is likely to be the main factor influencing market direction.

This indicates further dollar appreciation near term, though the USD could see some of its gains eroded later in the year, particularly if concerns over eurozone risk and market volatility start to ease. Furthermore, the US economy still faces significant headwinds with the current pace of recovery unlikely to be sustained. 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

		Q3-2010	Q4-2010	Q1-2011	Q2-2011
US\$/EUR	1.237	1.16-1.26	1.18-1.28	1.20-1.30	1.20-1.30
US\$/GBP	1.483	1.40-1.50	1.40-1.50	1.42-1.52	1.42-1.52
YEN/US\$	90.567	88-95	90-97	92-100	95-102
CHF/US\$	1.110	1.10	1.09	1.07	1.10



Euro

Since the beginning of the year the euro has fallen by close to 10% on a trade weighted basis. In terms of other majors, the depreciation has been most pronounced versus the US dollar and Japanese yen, though heavy losses have also been recorded against a host of currencies including sterling and the Aussie dollar. Indeed, with the exception of one of two emerging market currencies, year to date the euro has weakened against the exchange rate of each of its main trading partners.

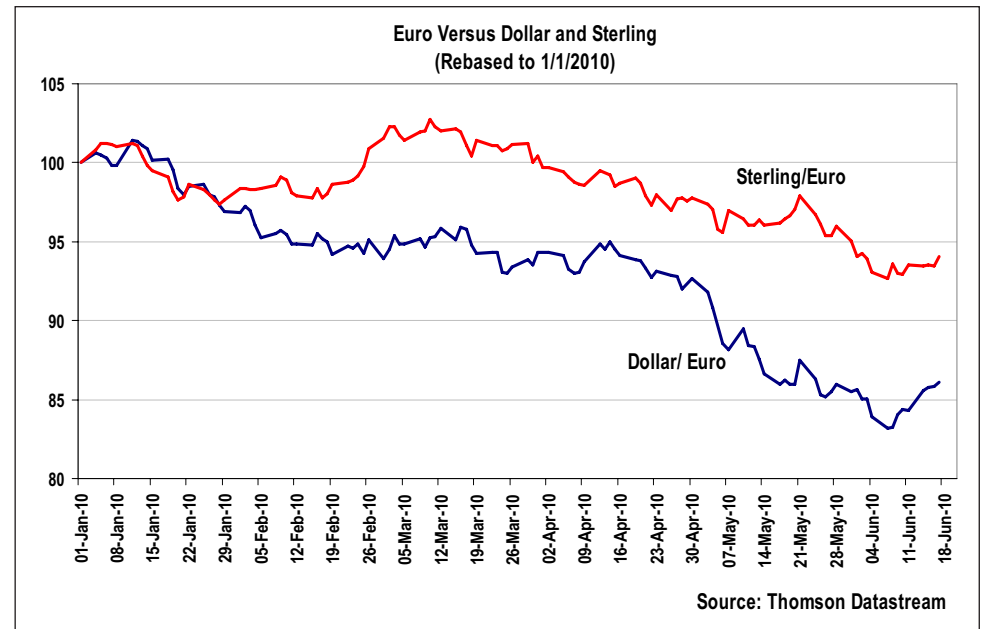
The euro's fall, from an overvalued position in many cases, is primarily due to the sharp rise in the risk premium associated with eurozone sovereign debt (as reflected in rising sovereign and CDS spreads) and the impact that subsequent fiscal policy adjustments will have on growth prospects and interest rate expectations. After falling to a four year low of \$1.1878 versus the dollar and 18 month low of Stg0.8211p versus sterling in early/mid June, a move to cover extended EUR short positions has seen the single currency claw its way back to a respective \$1.23/1.24 and Stg0.83p.

However, significant downside risks remain and we expect that the euro's downward trend will remain in place over the summer months, with its credibility as a leading world currency seriously damaged by recent events. Markets remain deeply concerned about sovereign risk and we could see a break of \$1.20 again. This is despite the fact that the introduction of a €750 billion support package from the European Union and the IMF effectively eliminates the near term prospect of a debt default by any eurozone member.

There has been some talk of possible intervention to stem the currency's sharp decline. However, apart from the odd comment aimed at decelerating the pace of decline, we do not expect to see any official action given that euro weakness can only be positive for export growth in a region struggling to recover from recession. Over the longer term, the boost to growth from a weaker exchange rate should be supportive of the regions growth prospects and thus the EUR, but for now downside risks look set to dominate with a nervous market still expected to sell into any rallies.

Key Forecasts

		Q3-2010	Q4-2010	Q1-2011	Q2-2011
US\$/EUR	1.237	1.16-1.26	1.18-1.28	1.20-1.30	1.20-1.30
GBP/EUR	0.835	0.81-0.85	0.82-0.86	0.83-0.88	0.83-0.88
YEN/EUR	112.04	107-117	110-120	115-125	120-130
PLN/EUR	4.076	3.95	3.85	3.75	3.70



Sterling

Current levels show sterling's trade weighted index virtually unchanged from where it was at the beginning of the year. Over the period, however, marked volatility has left sterling 9% lower versus the US dollar and yen but up nearly 6% versus the euro. Losses against the dollar and yen reflect a general spike in risk aversion (as one of the majors worst hit by the global financial crisis, the GBP is now considered a risk sensitive currency), political uncertainty ahead of May's UK general election, a decidedly dovish policy stance by the Bank of England, as well as UK economic underperformance (the US and Japan economies grew by a respective 0.8% and 1.3% in Q1, while the UK expanded by just 0.3%) and concerns about the state of the UK's public finances.

With the uncertainty with regard to the election now out of the way and the new coalition government wasting no time in terms of tackling the public finances, some of the downside risks attached to sterling have dissipated, with modest gains seen versus the USD. The consistent upside surprise in terms of UK inflation data has also raised questions as to the prospect of a move by the BoE away from its current very accommodative stance sooner than markets had been anticipating.

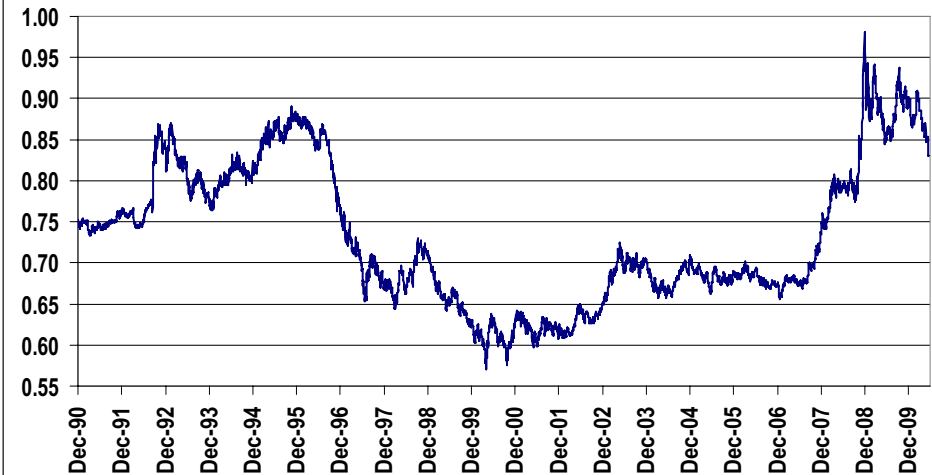
At the same time, however, the UK still faces considerable challenges as it seeks to reduce one of the highest deficit/GDP ratios in the EU, with fiscal tightening likely to weigh on an already fragile UK recovery. This anaemic upturn is likely to see the BoE leave UK rates on hold, despite increasing signs of unease amongst MPC members about inflation trends. Thus, we expect the dollar/sterling rate to stick within its current \$1.40-1.50 range for now, with sterling also likely to remain hostage to market sentiment.

Versus the euro, current trends point to sentiment remaining against the single currency, given that the market views the scale of the sovereign debt problems in the eurozone as more daunting. Having reached 18 months highs of Stg0.8211p versus the EUR in mid June, we expect sterling to trade in a Stg0.81-0.85p range near term, though any further marked appreciation by the GBP could draw negative comments from the UK authorities.

Key Forecasts

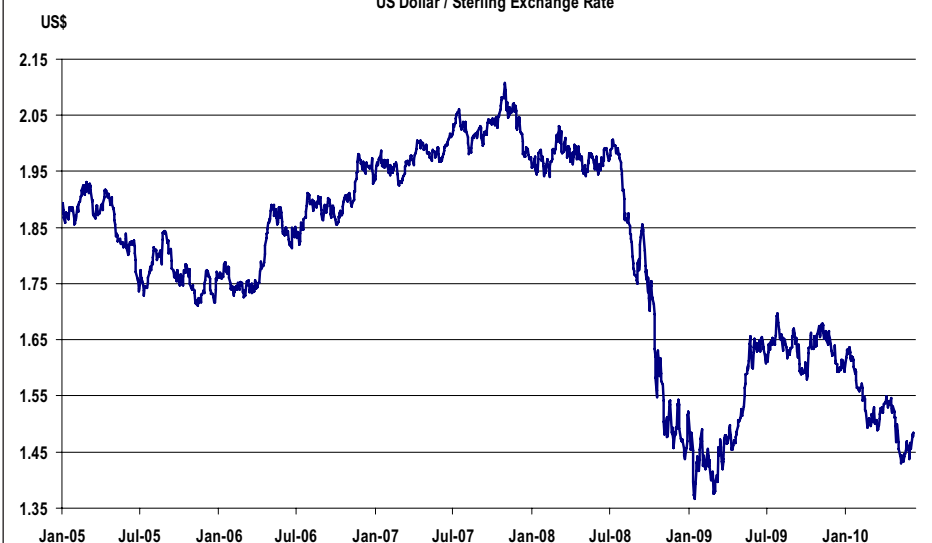
		Q3-2010	Q4-2010	Q1-2011	Q2-2011
GBP/EUR	0.836	0.81-0.85	0.82-0.86	0.83-0.88	0.83-0.88
US\$/GBP	1.473	1.40-1.50	1.40-1.50	1.42-1.52	1.42-1.52
YEN/GBP	133.62	133	137	140	144
CAD/GBP	#VALUE!	1.50	1.54	1.56	1.56

Synthetic Sterling/Euro 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 during the height of the global financial crisis. Indeed, despite being considered overvalued, the JPY continues to benefit from swings in market sentiment, particularly versus the euro as it suffers from sovereign associated risk. Dollar/yen, meanwhile, continues to trade in the Y88-95 range that has prevailed since the dollar recovered from 14 year lows of Y84.8 late last year.

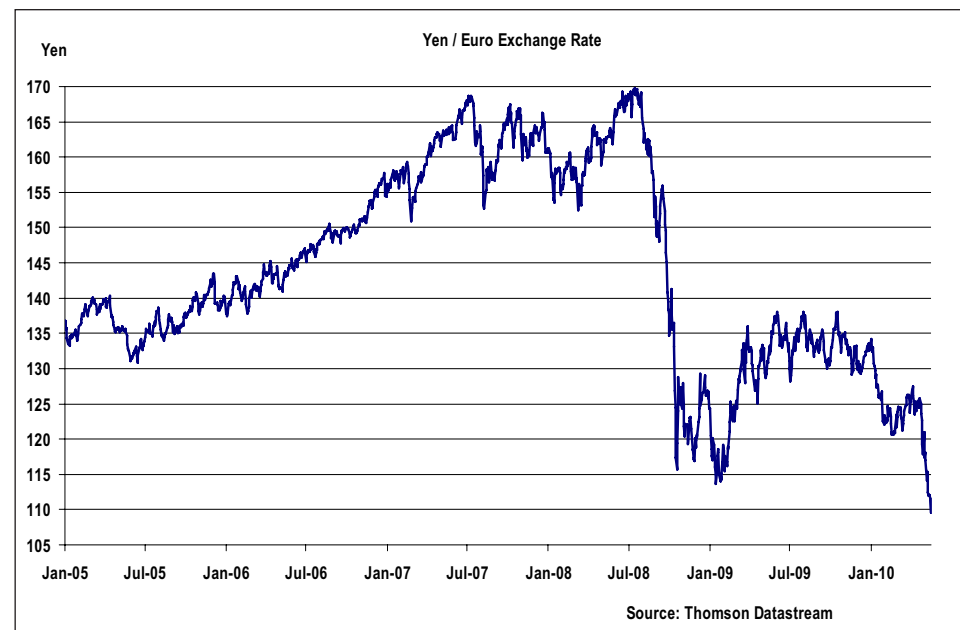
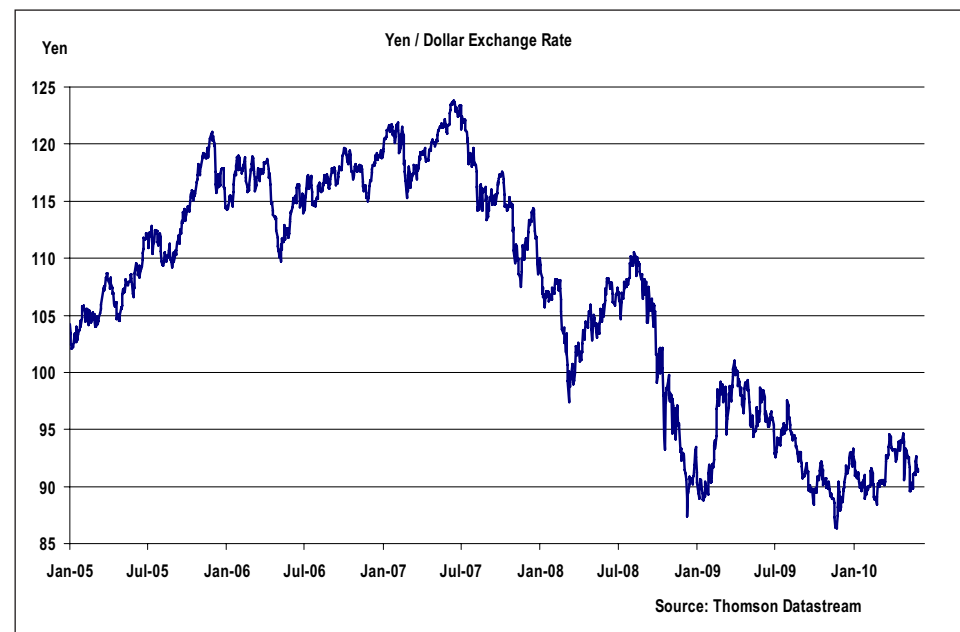
We expect the dollar to continue to hold its own versus the yen, with the improved outlook for the US economy and the current flight to quality providing underlying support. There are also a number of domestic factors that are likely to weigh on the JPY and which could drive it lower versus the USD over the course of the year. The current Japanese regime favours a weaker currency given its impact on the export driven economic recovery, with a number of vague references made to intervention if necessary over recent times.

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 very accommodative in terms of official rates but have begun the process of gradually withdrawing non-conventional monetary support measures for the markets. Although the BoJ recently upgraded its assessment of the domestic economy to reflect some better than forecast economic data, it is not expected to make any changes to its accommodative policy stance anytime soon.

While the dollar could gain ground versus the yen over the year, the euro is likely to struggle to make up much ground versus the Japanese currency, particularly in the short to medium term as markets continue to focus on the depth of the eurozone's sovereign debt issues. Indeed, with the euro currently trade around Y112, further losses could be seen near term as markets await a more comprehensive and long term resolution to the eurozone's fiscal problems.

Key Forecasts

		Q3-2010	Q4-2010	Q1-2011	Q2-2011
YEN/US\$	90.61	88-95	90-97	92-100	95-102
YEN/EUR	112.13	107-117	110-120	115-125	120-130
YEN/GBP	134.37	133	137	140	144



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.

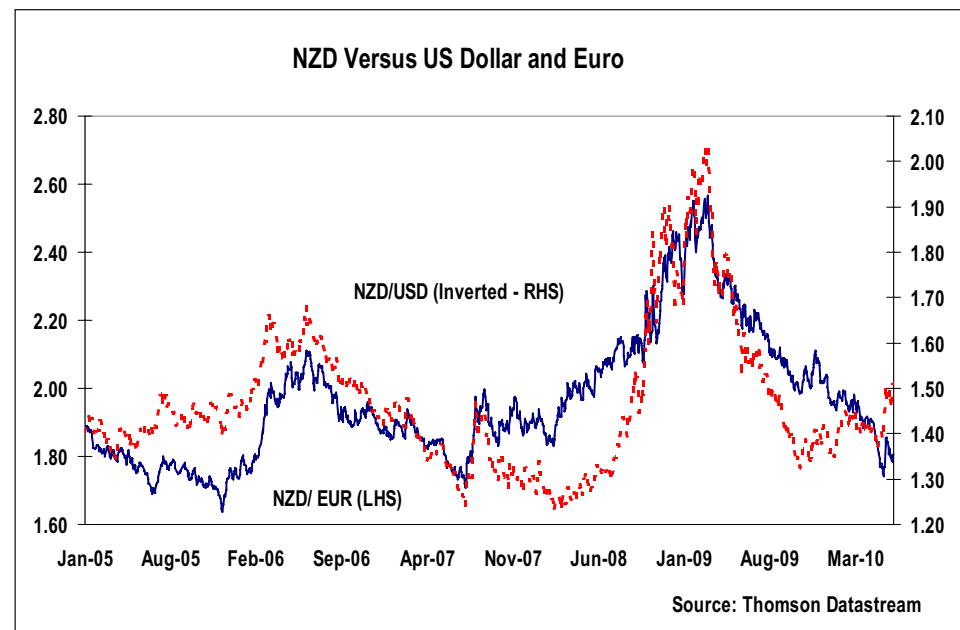
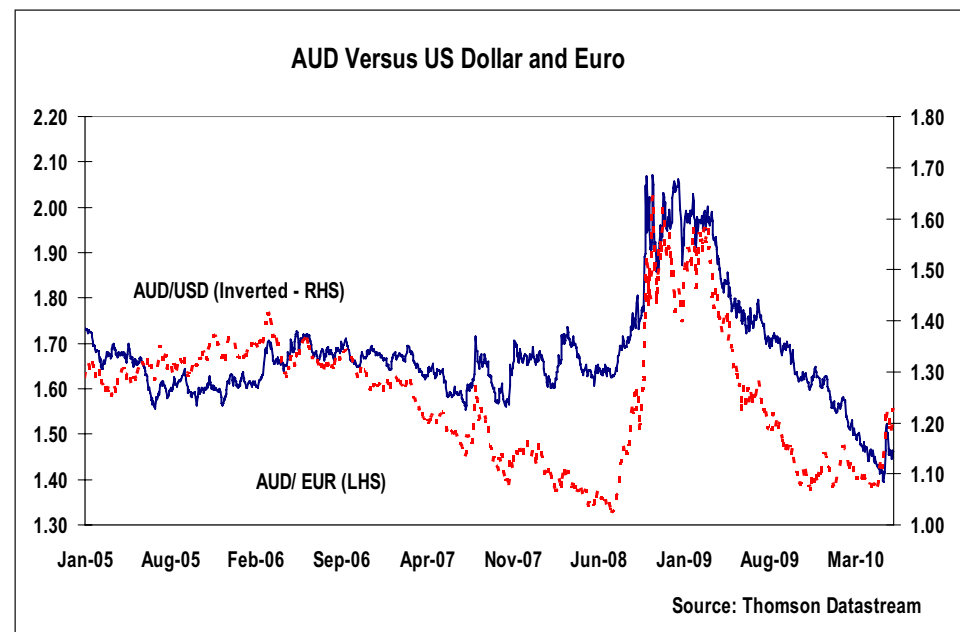
The pair's recovery was further cemented by last October's announcement from the Reserve Bank of Australia (RBA) that, in response to the better than anticipated domestic economic conditions, it was raising interest rates by 0.25% to 3.25%, making it one of the first developed economies to reverse emergency monetary policy action. Rates have since been increased by a further 1.25% to 4.50%, opening up a considerable rate differential with other majors. The Reserve Bank of New Zealand, meanwhile, raised rates earlier this month, at the same time indicating to markets that further tightening is in the pipeline.

Favourable fundamentals (both economies are showing strong domestic demand conditions) and interest rate differentials should support the pair in the months ahead. There is also the threat of intervention from the RBA to smooth out any major fluctuations in the currency. At the same time, however, branded "high-risk " currencies, both remain subject to volatility on the back of changing investor sentiment, as well as potentially unfavourable moves in commodities.

Indeed, the AUD tumbled to a 10-month low versus the USD recently on concerns that Europe's debt crisis would slow global growth. The NZD also weakened, though not by nearly as much. Both, however, remain on an upward trend versus the beleaguered euro. Heightened risk aversion is likely to keep the AUD and NZD off recent highs versus the USD for now, with strong signals from the RBA that it is slowing down its pace of tightening now that official rates are back at "average levels" also dampening demand.

Key Forecasts

		Q3-2010	Q4-2010	Q1-2011	Q2-2011
AUD/USD	0.867	0.88	0.88	0.89	0.89
NZD/USD	0.702	0.69	0.69	0.70	0.70
AUD/EUR	1.43	1.38	1.40	1.40	1.40
NZD/EUR	1.762	1.75	1.78	1.79	1.79



Key Events/Diary

Week 1 (21st-25th June)

June 22nd	Eurozone	German Ifo (June)
	UK	Emergency Budget
June 23rd	US	FOMC Policy Announcement
	Eurozone	Consumer Confidence (June)
	Eurozone	Flash PMIs (June)
	US	New Home Sales (May)
	UK	Minutes of MPC Meeting (9/10th June)
June 24th	US	Durable Goods (May)
June 25th	US	Q1 -GDP (Final Release)

Week 2 (28th June - 2nd July)

June 28th	US	Personal Income & Consumption (May)
June 29th	Eurozone	EC Business & Sentiment Survey (June)
June 30th	Japan	Tankan Survey (Q2)
	UK	Q1-GDP (Final Release)
	US	ADP Employment Report (June)
July 1st	US/UK/Eurozone	Manufacturing ISM/ PMIs (June)
June 3rd	US	Non-Farm Payrolls (June)

Week 3 (5th - 9th July)

July 5th	US	Market Holiday
	UK/Eurozone	Services PMIs (June)
	Eurozone	Retail Sales (May)
July 6th	US	Services ISM (June)
July 7th	Eurozone	Q1-GDP (Final Release)
July 8th	UK	BoE Policy Announcement
	Eurozone	ECB Policy Announcement & Press Conf

Week 4 (12th-16th July)

July 13th	Eurozone	German ZEW Index (July)
July 14th	Eurozone	Industrial Production (May)
	Eurozone	HICP (June)
	US	Retail Sales (June)
	UK	Unemployment (June)
July 15th	Japan	Bank of Japan Policy Announcement
	US	Industrial Prod & Capacity Utilisation (June)
July 16th	US	Consumer Prices (June)

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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