



Exchange Rate Outlook *29th July 2011*

- **Dollar struggles against US rate outlook and US debt concerns**
- **Euro finds some support as new Greek deal cheers markets**
- **Outlook for UK economy and rates continues to hold sterling back**
- **Yen remains strong on safe haven flows**

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Summary of Exchange Rate Forecasts

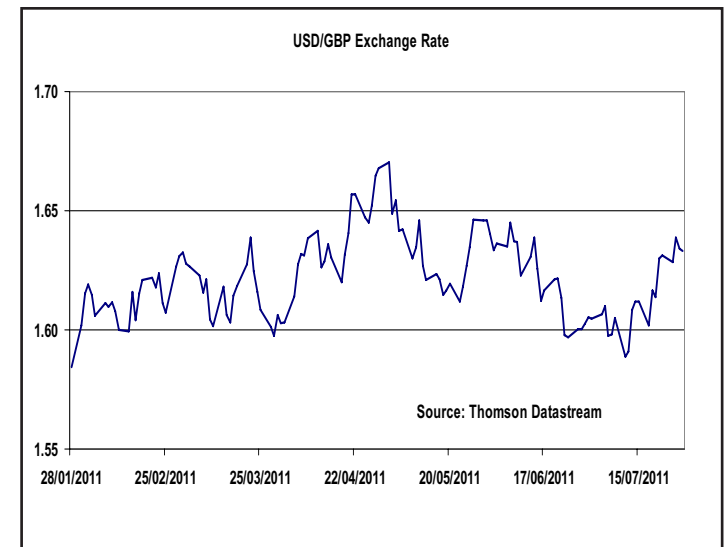
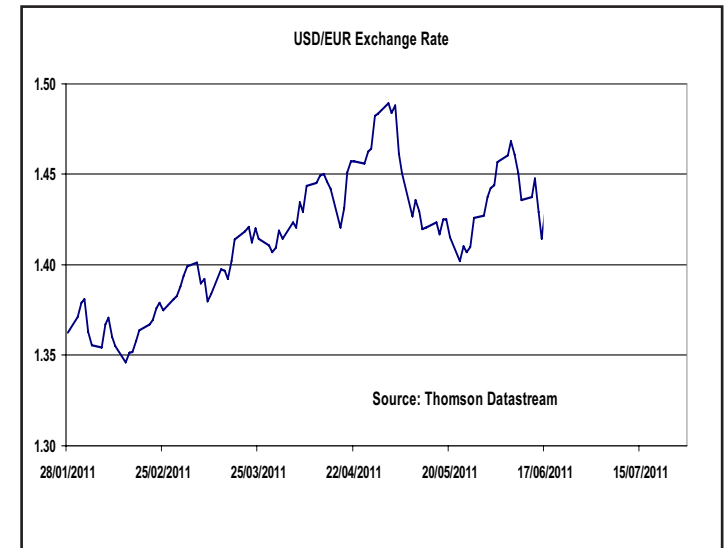
("Spot" Forecasts Represent Mid-Point of Expected Trading Range)

	Current	Q3-2011	Q4-2011	Q1-2012	Q2-2012
Euro Versus					
USD	1.428	1.40-1.50	1.42-1.52	1.43-1.53	1.45-1.50
GBP	0.875	0.87-0.90	0.87-0.90	0.87-0.90	0.86-0.89
JPY	110.50	109-119	115-125	118-128	125-135
PLN	4.01	3.95	3.92	3.90	3.85
HUF	269.83	267	270	270	270
NOK	7.75	7.75	7.75	7.80	7.80
SEK	9.08	9.03	9.00	8.90	8.80
AUD	1.31	1.33	1.39	1.41	1.43
NZD	1.65	1.69	1.73	1.78	1.84
US Dollar Versus					
JPY	77.40	75-80	78-83	80-85	85-90
GBP	1.632	1.60-1.65	1.62-1.67	1.63-1.68	1.65-1.72
CHF	0.80	0.82	0.85	0.87	0.90
CAD	0.96	0.95	0.97	0.99	1.00
AUD	1.09	1.09	1.06	1.05	1.03
NZD	0.86	0.86	0.85	0.83	0.80
CNY	6.44	6.43	6.42	6.40	6.38
Sterling Versus					
JPY	126	127	134	138	148
CAD	1.56	1.56	1.61	1.66	1.69
AUD	1.49	1.50	1.57	1.59	1.64
NZD	1.89	1.91	1.95	2.01	2.11

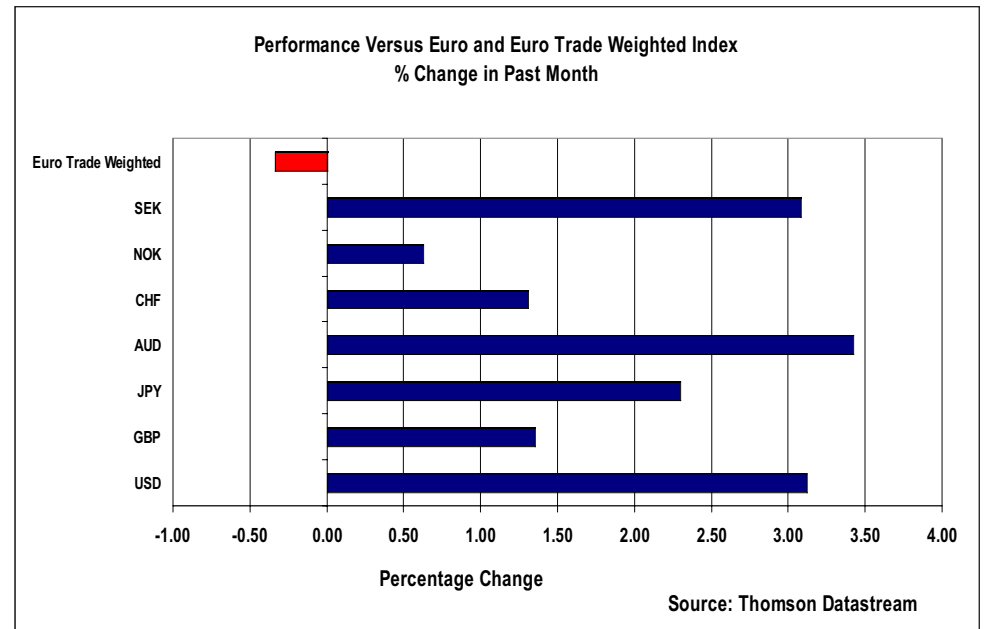
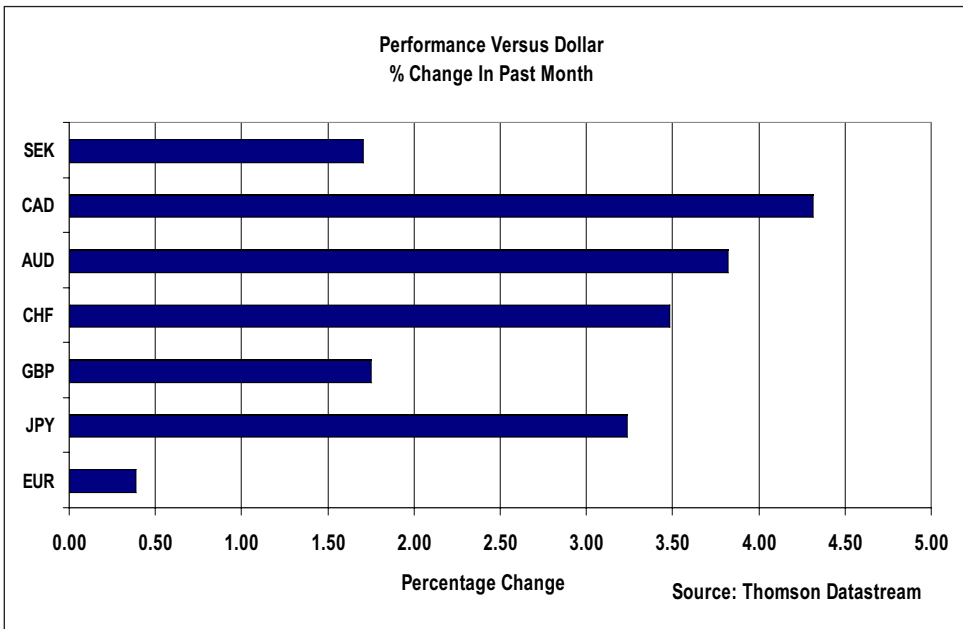
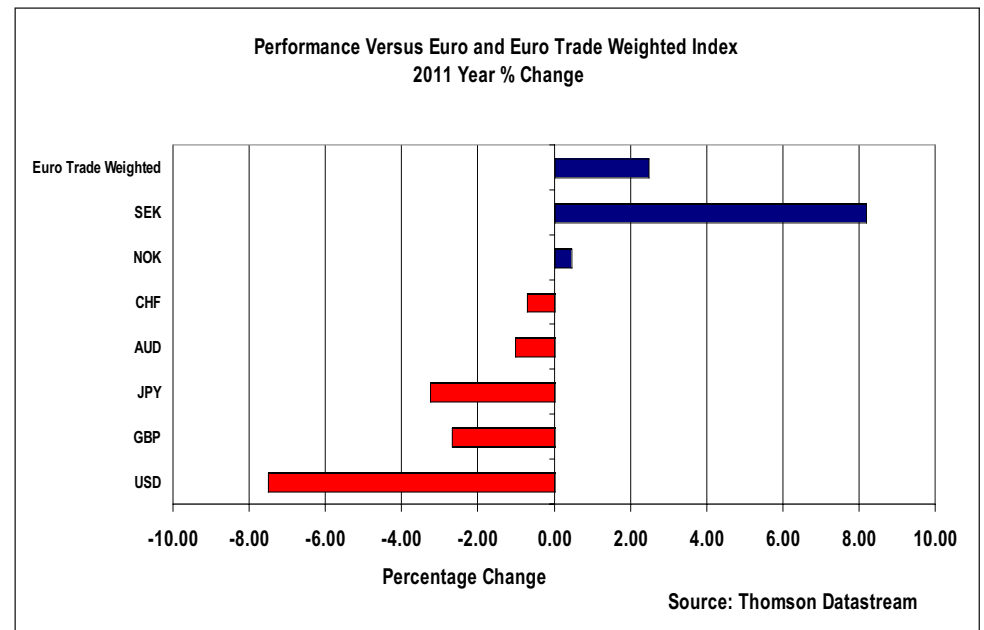
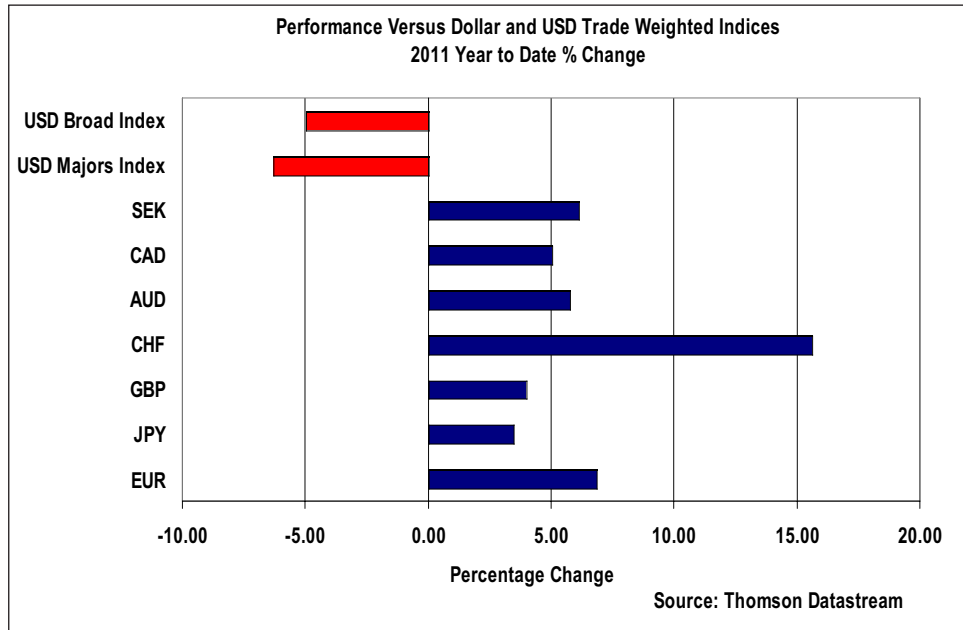
Market Overview

- **Sentiment on foreign exchange markets remains very volatile.** The dollar on the one hand is finding some support in safe haven flows in a risk adverse market, as well as concerns about eurozone sovereign debt issues. This to a large extent, however, is being offset by ongoing evidence of a subdued pace of recovery in the US and the fact that the Fed remains committed to its ultra loose policy stance.
- Markets continue to push out their expectations for a tightening in US monetary policy, with the first rate hike now not anticipated until end 2012. There is even talk of a fresh round of quantitative easing if economic conditions remain sub-trend. Thus, interest rate prospects look set to remain dollar negative.
- **The dollar has also come under selling pressure as the stand-off amongst US policymakers over raising the country's debt ceiling continues.** Even if a deal is hammered out by the August 2nd deadline, it may not be sufficient to satisfy the international rating agencies who are looking for a long term credible debt plan. Despite recent moves, a ratings downgrade has not really been priced in by the market and would be a significant event for the dollar.
- Although still the world's biggest reserve currency by far, **the dollar's safe haven status has been somewhat eroded by recent events**, with the US debt issue becoming increasingly central in terms of the issues that markets are concerned about. The Swiss franc and the yen have benefited from the decline in the dollar's status and are now the two safe haven currencies of choice ahead of the USD. Thus, most factors point to a generally weak dollar for now.
- Meanwhile, after coming under strong selling pressure in early July, **the euro has recovered some ground on hopes that the fresh fiscal support package as agreed for Greece on 21st July** will ease possible contagion risks. However, the issue of eurozone sovereign associated risk has not gone away as reflected in forex movements over recent days, with the euro coming under renewed pressure. Thus, while we may get something of a break from the issue over the August holiday period, we expect plenty of volatility over the coming months as events unfold, though euro downside should be limited.
- **As well as some stabilisation in relation to Greece**, the fact that the ECB is well ahead of the Federal Reserve and the Bank of England in terms of policy tightening means that the euro should remain relatively strong versus the dollar and sterling.
- **Sterling has hardly benefited from recent volatility in the euro and remains highly sensitive to UK interest rate expectations, which are now showing no rate hike until the beginning of next year.** Thus, we see little scope for marked appreciation versus either the USD or EUR, unless eurozone sovereign risks escalate further or US data deteriorate even more.

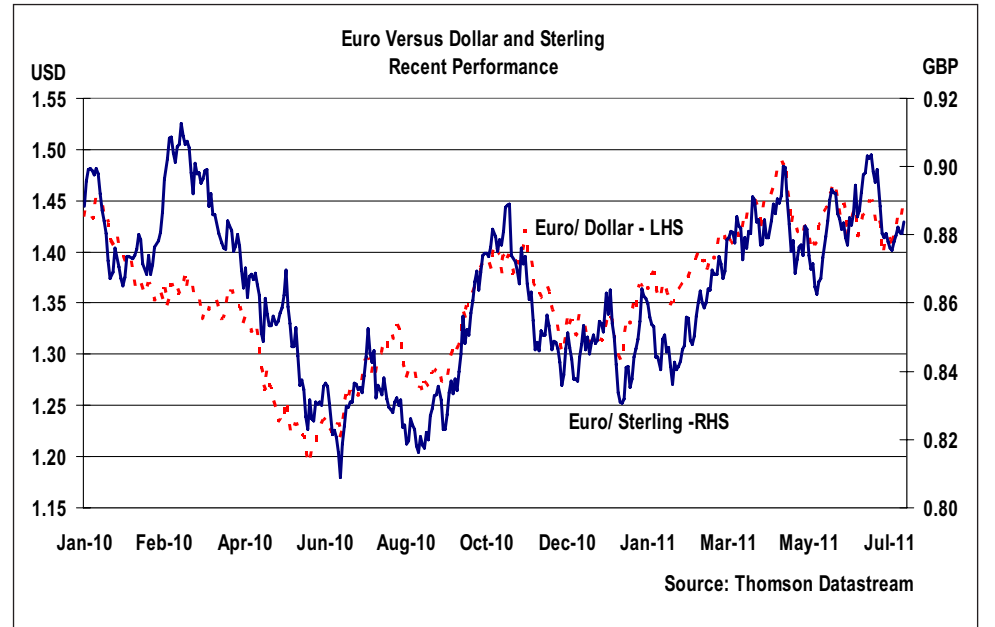
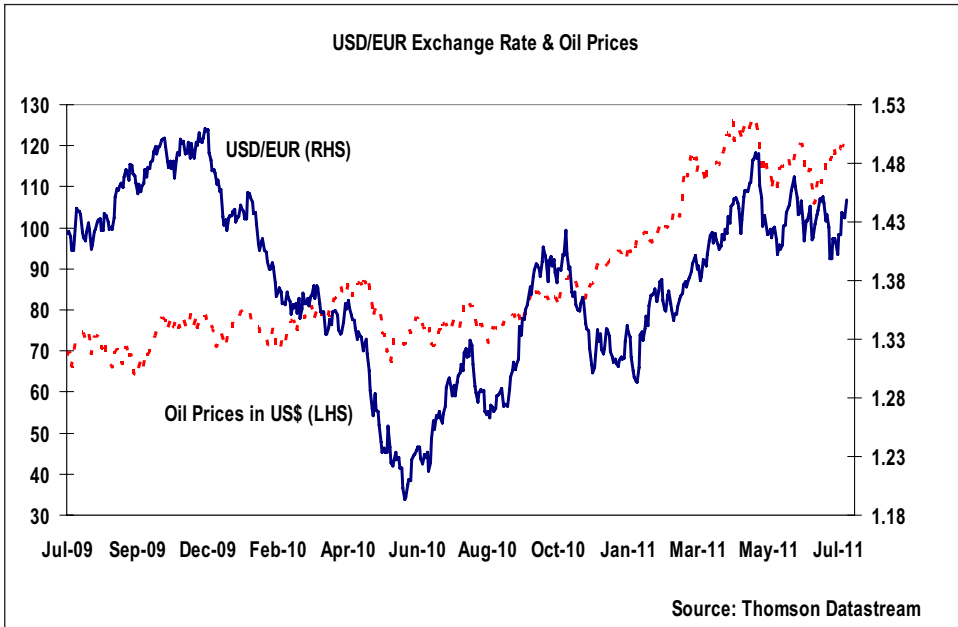
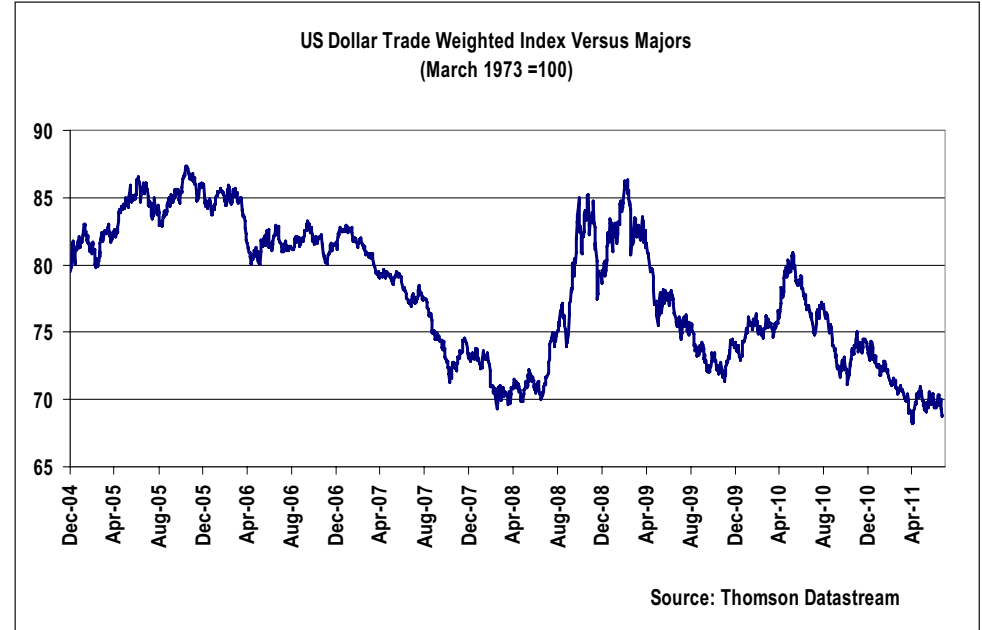
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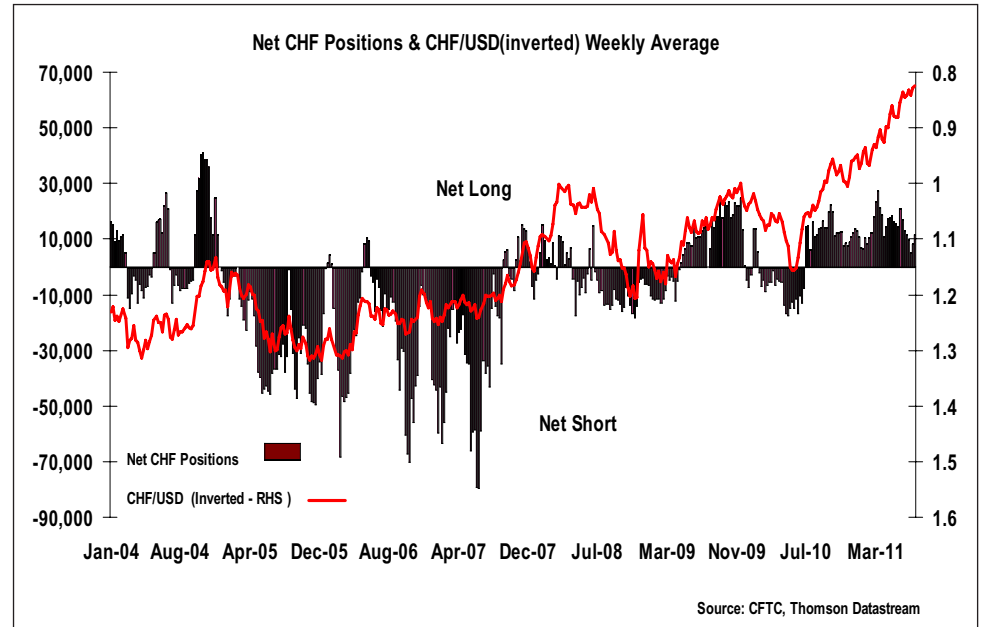
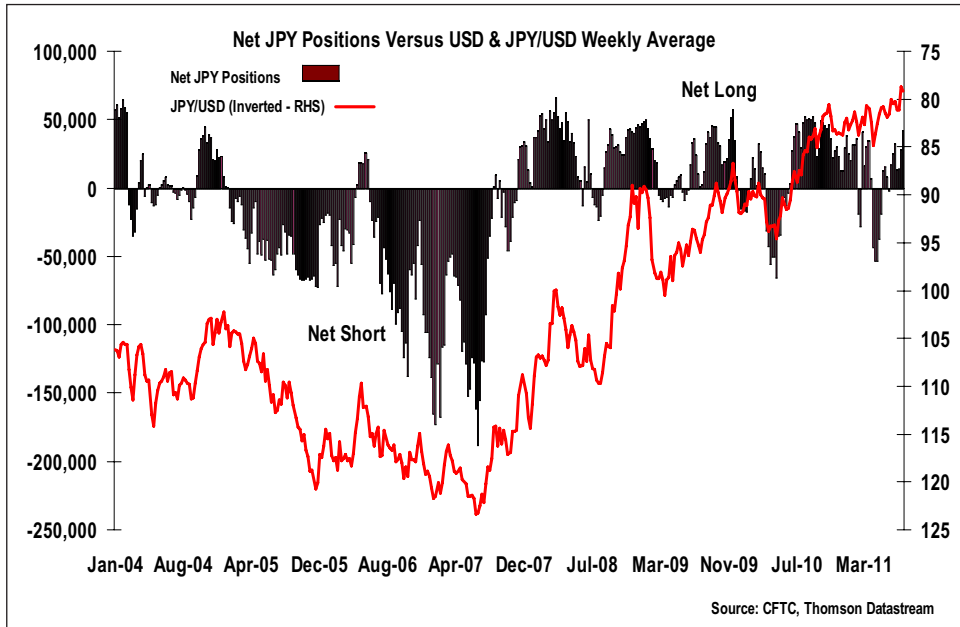
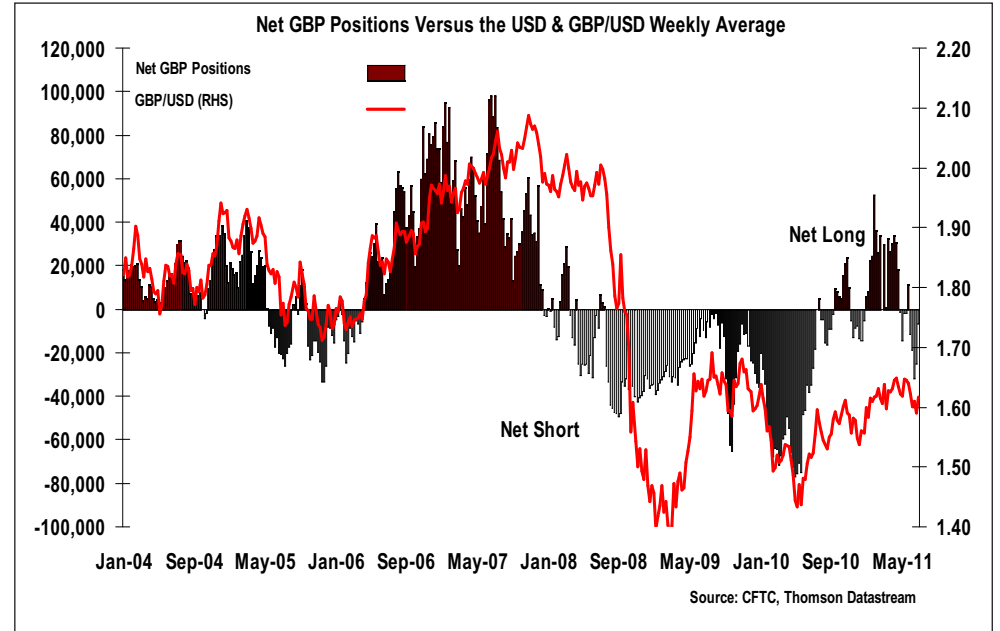
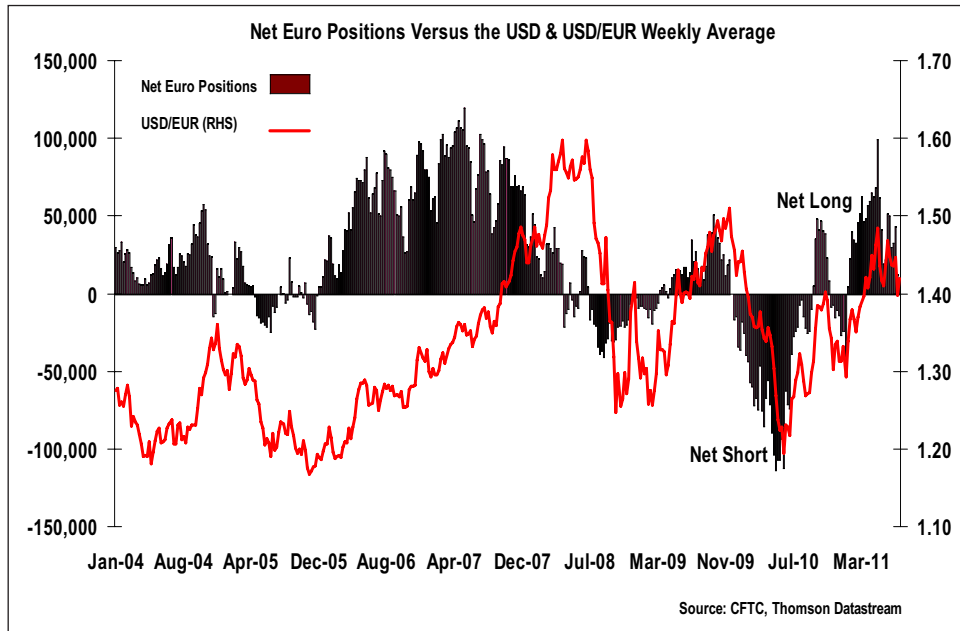
Key Currency Trends



Key Currency Trends



Commitment of Traders Report - Net Positions Versus the US Dollar



Interest Rate Outlook

First Fed Rate Hike Not Expected Until End 2012

The Federal Reserve has kept its key interest rate at the historically low level target range of 0 - 0.25% since December 2008. Rates are likely to remain on hold for some time yet given the subdued pace of economic recovery, the lack of progress on bringing down unemployment and with considerable spare capacity in the economy helping to keep underlying inflationary pressures subdued.

Indeed, there is a possibility of further quantitative easing if recent weakness in the economy proves persistent. Expectations are that it will be the end of 2012 before the Fed begins to increase rates and even then the pace of tightening is expected to be slow. Three month futures contracts suggest that by end 2014/early 2015 official interest rates in the US will have risen to just 2.5%.

ECB Likely to Hike Again in July

The ECB cut interest rates to an historic low of 1.0% in May 2009. The economy emerged from recession in Q3 2009 but the pace of recovery has been subdued. Eurozone inflation, though, moved above the ECB's key 2% target level last December on rising energy costs and has since risen to a high of 2.8%. In response to this the ECB raised official interest rates in July by 0.25% to 1.50%, following a similar 0.25% rate increase in April.

However, the grounds for a sharp tightening in monetary policy are weak. Markets expect at most a further 0.25 - 0.5% increase in rates before end 2012. The next increase may well not occur until into 2012, though a rate rise towards the end of this year cannot be ruled out, depending on factors such as the oil price trend.

Pressure Eases On the BoE to Hike Rates Soon

UK interest rates have been at the historically low level of 0.50% since March 2009. While inflation remains significantly above the BoE's target rate, the central bank persists in the view that this is temporary and has moved further away from any policy tightening. Indeed, there has been some speculation about further quantitative easing (QE), though such a move is unlikely unless inflation falls back substantially from its current levels.

The significant fiscal tightening, which is now under way in the UK, poses a real risk to an already fragile economic recovery and expectations for the first rate hike have been pushed out of late. It could be at least 2012 before there are any rate hikes and even then the pace of tightening is expected to be slow.

US Interest Rate Forecasts (to end quarter)

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	0.26	0.76	0.62	1.69
Sept '11	0.125	0.30	0.80	0.70	1.90
Dec '11	0.125	0.40	0.90	0.85	2.05
Mar '12	0.125	0.50	1.00	0.95	2.15

* Swap Forecasts Beyond 1 Year

Eurozone Interest Rate Forecasts (to end quarter)

	Refi Rate	3 Mth	1 Year	2 Year *	5 Year *
Current	1.50	1.56	2.17	1.91	2.48
Sept '11	1.50	1.60	2.25	2.35	2.95
Dec '11	1.50	1.70	2.40	2.50	3.10
Mar '12	1.75	1.95	2.50	2.60	3.20

* 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	0.83	1.59	1.30	2.12
Sept '11	0.50	0.85	1.60	1.50	2.50
Dec '11	0.50	0.95	1.70	1.60	2.60
Mar '12	0.75	1.00	1.80	1.70	2.70

* Swap Forecasts Beyond 1 Year



US Dollar

There are a number of factors weighing on the US dollar, none of which are expected to change anytime soon. Key is the issue of the pace of US economic recovery, which has clearly lost momentum. After growing by an average 3.0% in 2010, the economy grew at a sub trend annualised rate of 0.4% in Q1 and 1.3% in Q2 of this year. Some of the weakness can be explained by once off factors such as bad weather, lower government spending and the impact of the Japanese earthquake on global manufacturing. The expectation is that the economy will regain momentum in the second half of the year.

Regardless of this, however, the underlying trend is disappointing given the depth of the recession and the scale of policy support. Labour market conditions remain very weak, with the decline in unemployment seen in 2010 and Q1 2011 reversing of late. By June the jobless rate had risen back to 9.2% from a cyclical low of 8.8% in March. This subdued pace of recovery, combined with a weak labour market and low underlying inflation, means that the Fed is expected to keep US interest rates at exceptionally low levels for some time yet.

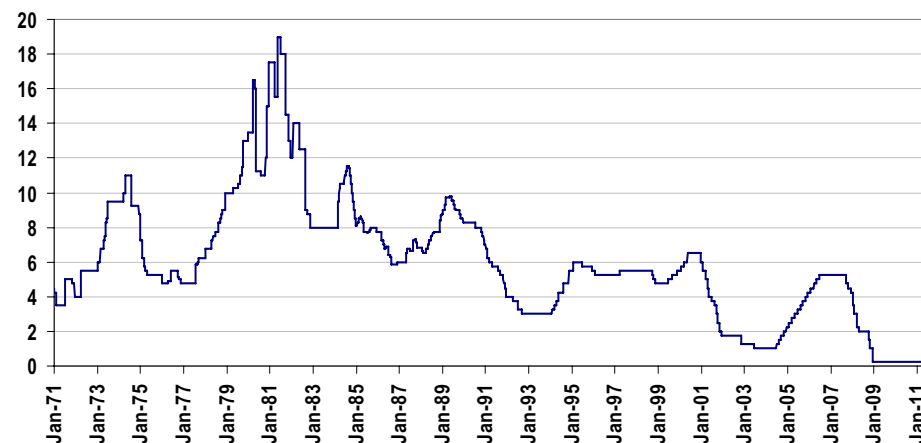
Indeed, markets continue to push out their expectations for the start of policy tightening and now believe that it will be late 2012 at the earliest before the Fed begins to hike rates. This means that the Fed (with the exception of the Bank of Japan) will likely be the last of the major central banks to start reversing the very accommodative policy stance that has been in place since late 2008. Indeed, there is a possibility of further quantitative easing if recent weakness in the economy proves persistent.

As well as interest rate differentials, a high trade deficit and concerns about US fiscal problems are also weighing on the USD, which looks set to remain under pressure versus other majors, including the euro for now, though the EUR could be subject to periodic bouts of selling on eurozone sovereign risk. Global markets are also still unsettled, which could offer some safe haven support to the USD. However, it will likely take a marked shift in expectations for US monetary policy to provide any real boost to the dollar.

Key Forecasts

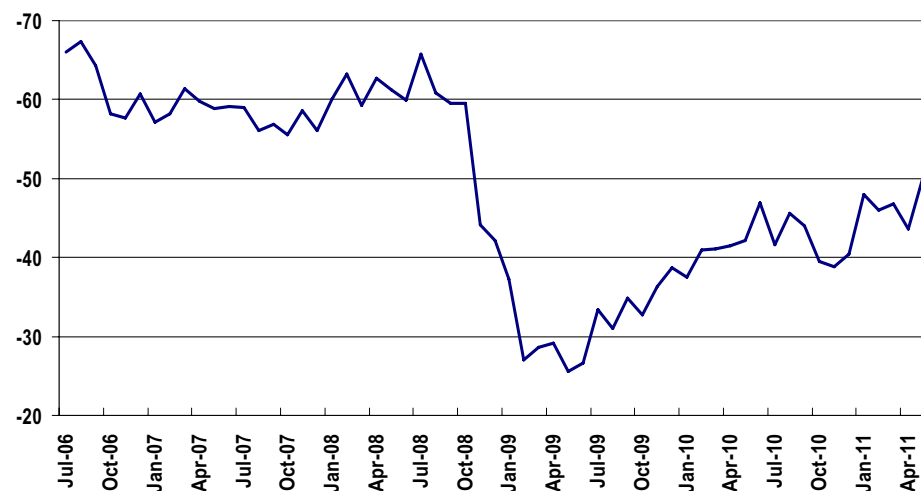
		Q3-2011	Q4-2011	Q1-2012	Q2-2012
US\$/EUR	1.428	1.40-1.50	1.42-1.52	1.43-1.53	1.45-1.50
US\$/GBP	1.632	1.60-1.65	1.62-1.67	1.63-1.68	1.65-1.72
YEN/US\$	77.403	75-80	78-83	80-85	85-90
CHF/US\$	0.796	0.82	0.85	0.87	0.90

US Fed Funds
(US Rates at Historically Low Levels)



Source: Thomson Datastream

US Trade Deficit (USD Billions)



Source: Thomson Datastream

In early May, the euro was at its highest against the dollar since December 2009 at just below \$1.50, bolstered by the fact that the ECB was the first of the major central banks to tighten policy. However, an escalation of fears about a debt default in Greece, and concerns about other periphery bond markets, triggered strong selling pressure, pushing the euro lower versus a host of currencies.

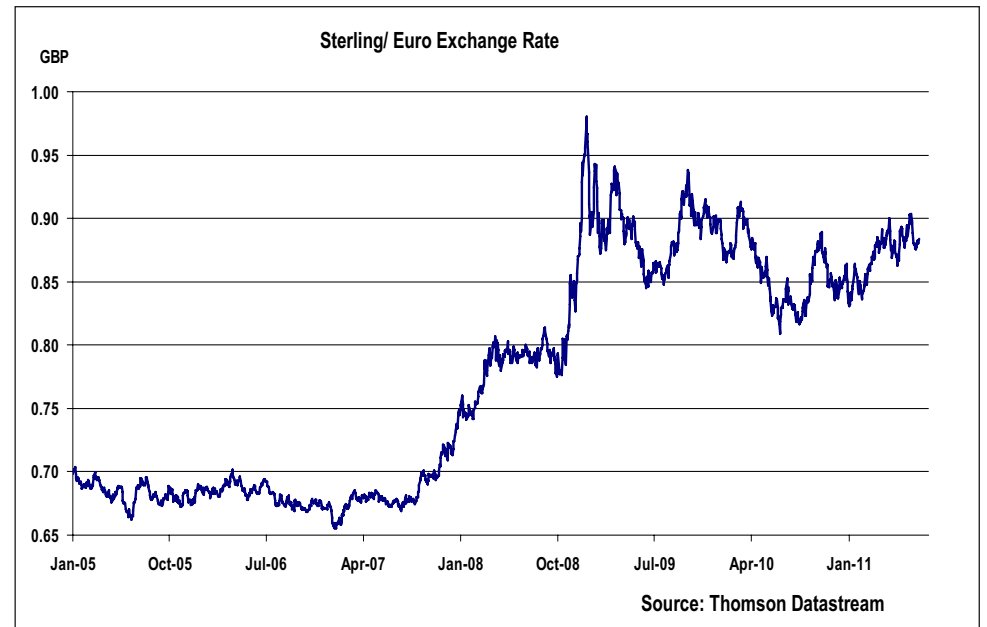
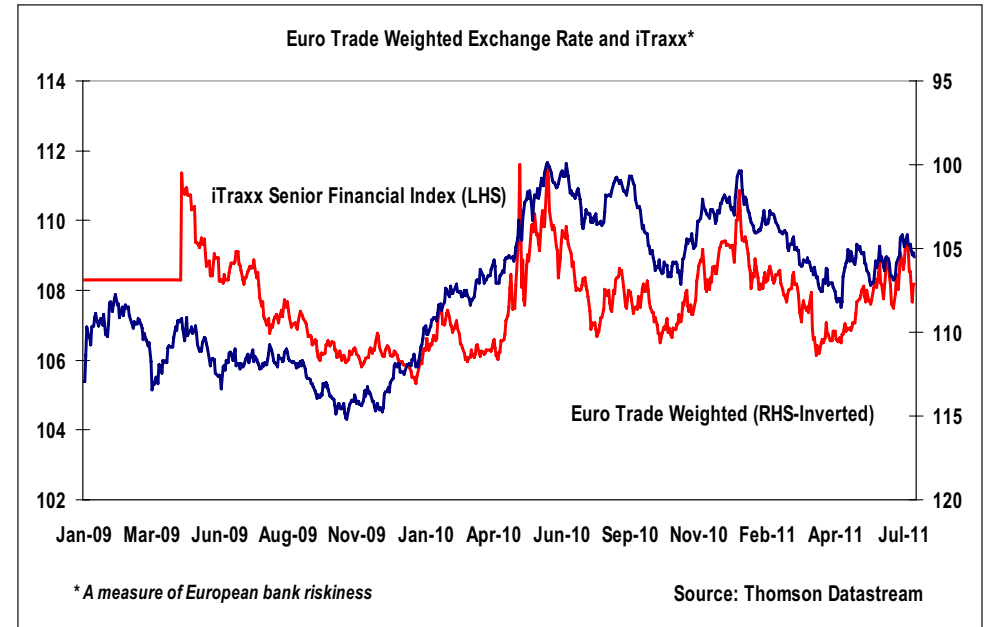
Marked weakness has been seen against other majors such as the Swiss franc and the Japanese yen, the current safe havens of choice. At the same time, activity in euro-dollar has generally been confined to a relatively tight range, with \$1.40 a key support level for the EUR. The euro's downside has been protected by a lack in confidence in the dollar itself given the underlying weakness in the US economy, the extremely accommodative policy stance of the Fed and the fact that the US has its own fiscal problems. Indeed, finding underlying support in recent interest rates hikes from the ECB, the euro remains a relatively strong currency, despite its sovereign debt woes.

The news of a fresh Greek funding package and steps to prevent the crisis spreading to some of the larger eurozone economies, as agreed by eurozone leaders on July 21, has restored some stability to the market, bolstering the euro, though still within its recent range against the dollar. The euro's ability to make further gains, and benefit from the fact that the ECB is the only central bank currently on a tightening path, may well depend on the pace of implementation of the measures agreed to help Greece and other eurozone countries.

Indeed, it is certainly too soon to call the end to the crisis and to periods of debt jitters and euro weakness. At the same time, though, given the headwinds facing the US we see little scope for any substantial sell off in the euro-dollar rate. Versus sterling, meanwhile, the euro has seen some recent bouts of weakness. Euro downside, however, should be contained by the weak outlook for the UK economy and the expectation that the Bank of England will likely leave UK interest rates on hold until next year.

Key Forecasts

		Q3-2011	Q4-2011	Q1-2012	Q2-2012
US\$/EUR	1.428	1.40-1.50	1.42-1.52	1.43-1.53	1.45-1.50
GBP/EUR	0.875	0.87-0.90	0.87-0.90	0.87-0.90	0.86-0.89
YEN/EUR	110.50	109-119	115-125	118-128	125-135
PLN/EUR	4.009	3.95	3.92	3.90	3.85



Sterling

Sterling remains highly sensitive to UK interest rate expectations, as well as general market appetite for risk. UK inflation continues to be substantially above the Bank of England's 2.0% target level, and could move higher again in the coming months. However, the Bank remains of the view that the CPI rate has been boosted by temporary factors while there is no evidence that high inflation has feed through to wages. Meanwhile, the weakness of domestic demand is likely to bear down on inflation.

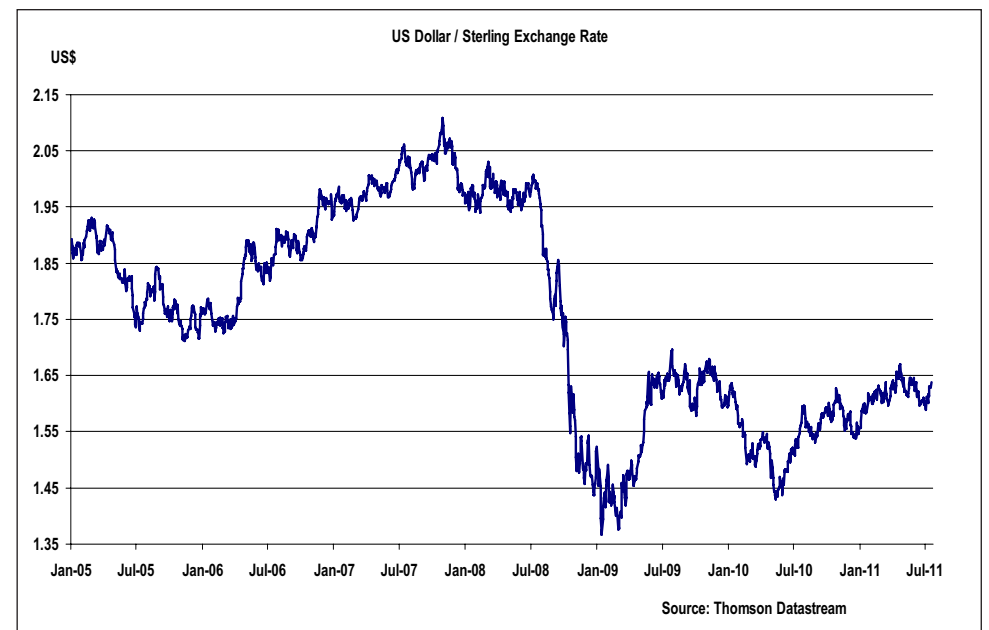
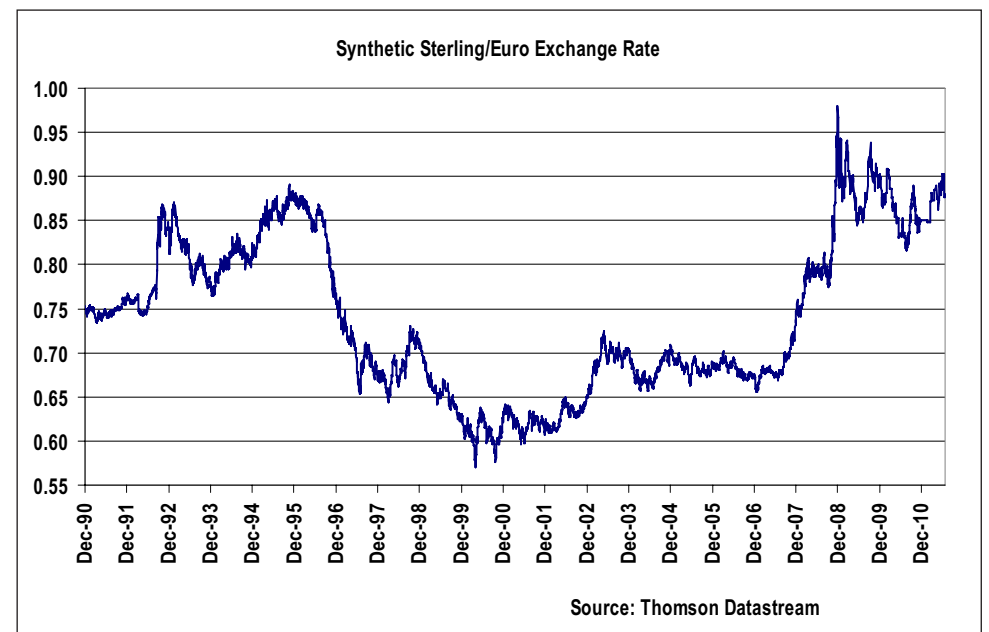
The UK economy grew by 0.5% or 1.8% in year-on-year terms in Q1. However, in Q2 GDP grew by just 0.2%, bringing the year-on-year growth rate down to 0.7%, the slowest rate of expansion since Q1-2010. Similar to the US, some of the weakness was blamed on special factors including the additional holiday for the Royal Wedding. Nonetheless, the subdued Q2 GDP data have helped cement the view that there will be no early rate hike with expectations for the first rate hike having been pushed out. Indeed, the market has rowed back in terms of its expectations for rate increases and, at this stage, it could be at least early 2012 before there is any rate hike.

Thus, despite the problems being experienced by both the euro and the dollar, sterling remains on the back foot and the scale of the challenges facing the UK economy could limit its upside potential over the short to medium term. Versus the euro we anticipated a 0.87-0.90p range over the coming weeks, with the issue of eurozone sovereign risk apparently off the horizon for now as markets react positively to the EMU deal done on 21st July to help Greece and other economies cope with their fiscal problems.

Versus the dollar, sterling has attempted to break out of its \$1.60-1.65 range on a number of occasions but this is mainly as a result of broad based dollar weakness. Given the current market position on the dollar, some further modest gains in sterling could be seen. However, the scale of the challenges facing the UK economy could limit its upside potential. With growth expected to be sub trend this year and next, the UK economy faces many headwinds, including marked fiscal tightening and high unemployment.

Key Forecasts

		Q3-2011	Q4-2011	Q1-2012	Q2-2012
GBP/EUR	0.875	0.87-0.90	0.87-0.90	0.87-0.90	0.86-0.89
US\$/GBP	1.632	1.60-1.65	1.62-1.67	1.63-1.68	1.65-1.72
YEN/GBP	126.31	127	134	138	148
CAD/GBP	1.560	1.56	1.61	1.66	1.69



Japanese Yen

In an environment of global deleveraging and heightened risk aversion, the yen appreciated markedly during the height of the global financial crisis. Despite being overvalued, yen continues to benefit from swings in market sentiment, as a safe haven of choice, behind the Swiss franc.

Indeed, the current period of considerable global uncertainty surrounding the eurozone and US debt problems, along with a slowing of growth in the major economies, has pushed the yen very close to its March highs versus the dollar, at which level the Bank of Japan had then intervened. While the March earthquake did result in a temporary shift into a trade deficit, Japan continues to report current account surpluses, which is supporting JPY strength.

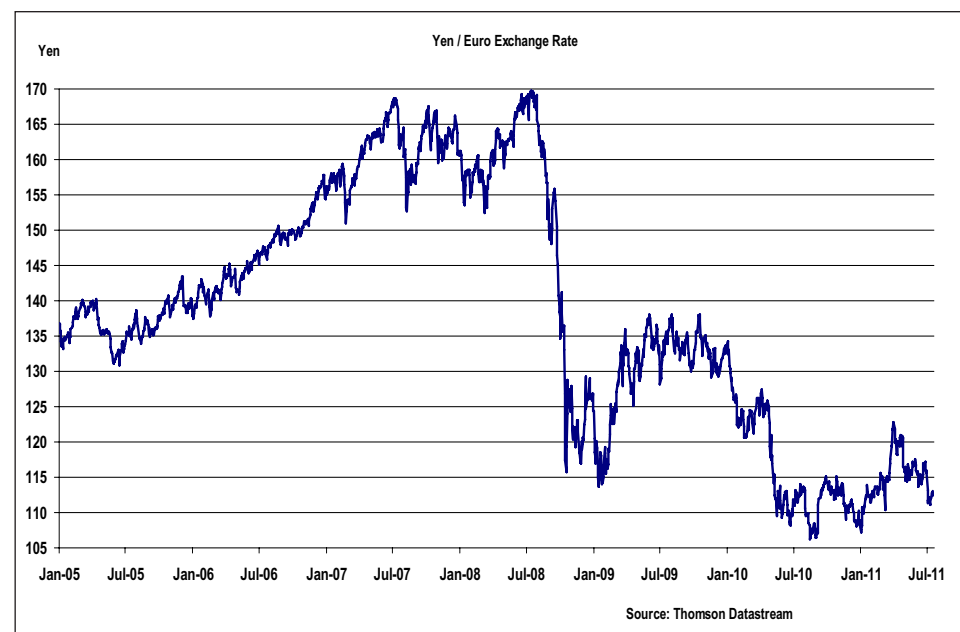
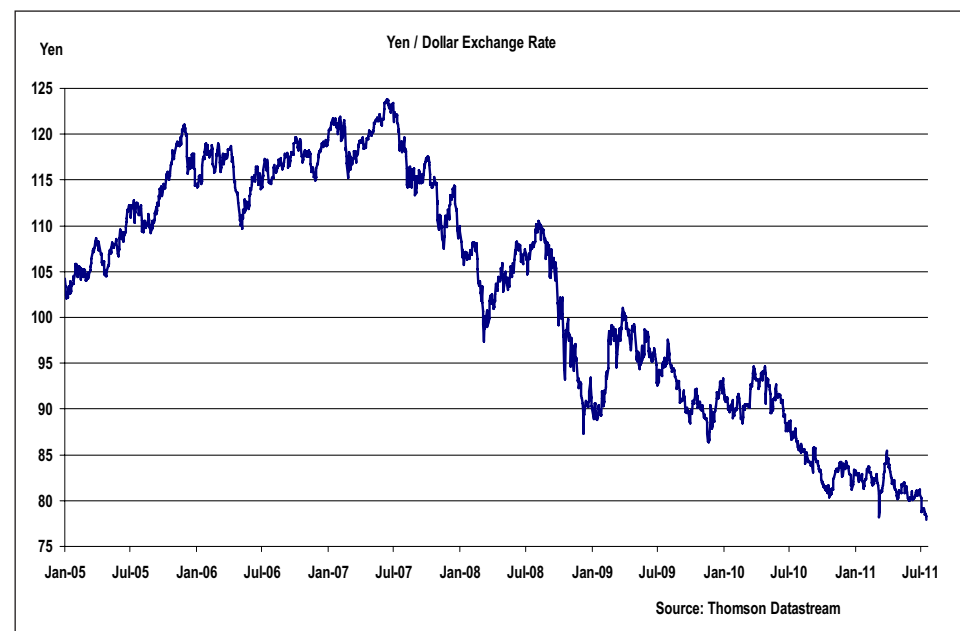
The Bank of Japan has expressed concerns about the yen's appreciation and fears that it could again intervene, along with risk support from the eurozone leader's agreement on measures to ease the debt crisis in the region, could well dampen fresh yen upside moves. At the same time, though, for intervention to have a lasting impact it will have to be done on a co-ordinated basis, along with the other major central banks.

If swings in risk sentiment subside, yield differentials could also work against the yen given the poor outlook for the Japanese economy. GDP growth is forecast to fall back sharply to below 2% this year (from 4.0% in 2010) as the support from exports and fiscal stimulus fades and with activity only slowly recovering from the impact of the devastating earthquake. The strength of the yen is also likely to weigh on the export performance. Meanwhile, Japan is only slowly pulling out of its long period of deflation.

Against this weak economic background, the Bank of Japan has effectively shifted back to a zero interest rate policy. It is not expected to row back on this ultra accommodative monetary policy stance for some time yet, with rates expected to remain on hold throughout next year, at least.

Key Forecasts

		Q3-2011	Q4-2011	Q1-2012	Q2-2012
YEN/US\$	77.40	75-80	78-83	80-85	85-90
YEN/EUR	110.50	109-119	115-125	118-128	125-135
YEN/GBP	126.31	127	134	138	148



Australian Dollar/ New Zealand Dollar

A recovering global economy, increased appetite for risk, rising commodity prices and higher domestic interest rates have all been factors underpinning a sharp rebound in the Australian and New Zealand dollars since their slump versus the US dollar in late 2008 at the height of the global financial crisis. Both central banks cut interest rates aggressively during this period, with the AUD and NZD also suffering from a collapse in the demand for carry trades.

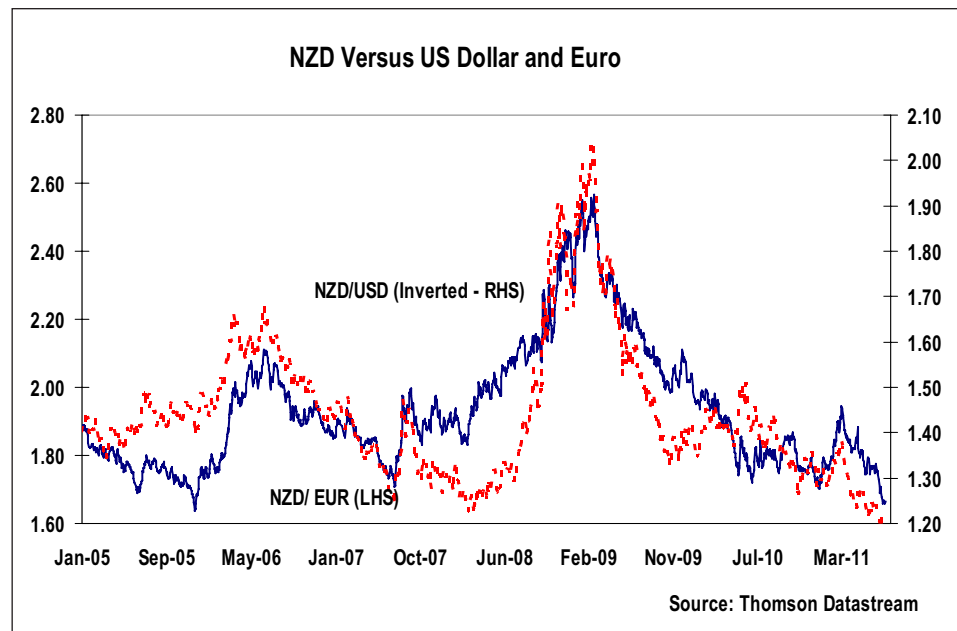
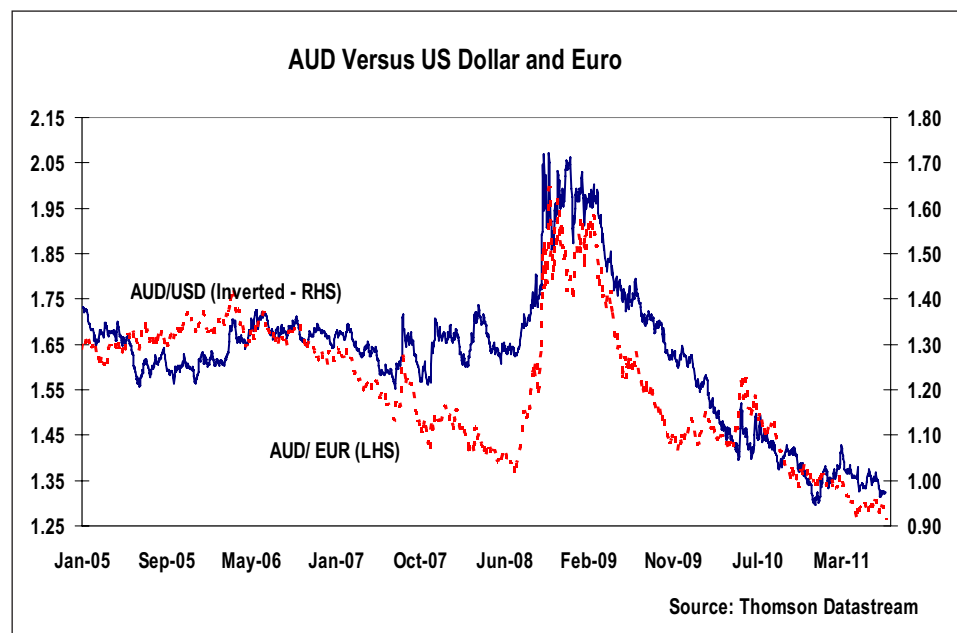
However, with its domestic economy in a healthy state, the Reserve Bank of Australia (RBA) started increasing interest rates from low levels back in late 2009, well ahead of other leading central banks. After several increases, official rates currently stand at 4.75%, with the central bank calling the current mildly restrictive policy stance appropriate at its last policy meeting in July. Official rates in New Zealand, meanwhile, were raised to 3.00%, giving both countries a considerable rate differential versus the majors. Rates in New Zealand were cut again by 0.50% in response to the Christchurch earthquake. However, at 2.50% this still offers value.

Recent economic data from New Zealand have taken on an improving tone, suggesting that the economy is building momentum. Thus, the market is anticipating that rates will be increased again before year end, possibly as early as September. Meanwhile, higher than expected inflation data for Q2 mean that further rate hikes could be on the cards in Australia. As well as interest rate differentials, high commodity prices and structural problems in the US and Europe are also key factors supporting the AUD and NZD.

Thus, although trading is volatile from time to time, as market sentiment in relation to the outlook for interest rates changes, recent weeks have seen fresh buying in both currencies versus the USD, with new lifetime highs seen. We expect both to remain firm in the short to medium term, particularly if markets start pricing in a near term hike in AUD interest rates. Over the longer term, we could expect to see some downward correction in both currencies.

Key Forecasts

		Q3-2011	Q4-2011	Q1-2012	Q2-2012
AUD/USD	1.092	1.09	1.06	1.05	1.05
NZD/USD	0.863	0.86	0.85	0.83	0.83
AUD/EUR	1.31	1.33	1.39	1.41	1.41
NZD/EUR	1.654	1.69	1.73	1.78	1.78





Key Events/Diary

Week 1 (1st August - 5th August)

Aug 1	US/UK/Eurozone	Manufacturing ISM/PMIs (July)
Aug 2	UK	Construction PMI (July)
	US	Personal Income & Consumption (June)
Aug 3	US/UK/Eurozone	Services ISM/PMIs (July)
	US	ADP Employment Report (July)
Aug 4	UK	Bank of England Policy Announcement
	Eurozone	ECB Meeting and Press Conference
Aug 5	US	Non-Farm Payrolls (July)

Week 2 (8th August - 12th August)

Aug 9	UK	Industrial Production (June)
	US	Fed Policy Announcement
Aug 11	US	International Trade (June)
Aug 12	Eurozone	French Q2 GDP - First Estimate
	Eurozone	Industrial Production (June)
	US	Retail Sales (July)
	US	Business Inventories (June)

Week 3 (15th August - 19th August)

Aug 14	Japan	Q2 GDP - First Estimate
Aug 15	US	Net Capital Inflows (June)
Aug 16	UK	Consumer Prices (July)
	Eurozone	German Q2 GDP - First Estimate
	Eurozone	Q2 GDP - First Estimate
	US	Industrial Production (June)
Aug 17	UK	Unemployment Report (July)
	UK	Minutes of August BoE Policy Meeting
	US	Producer Prices (July)
Aug 18	UK	Retail Sales (July)
	US	Consumer Prices (July)

Week 4 (22nd August - 26th August)

Aug 23	Eurozone	Flash PMIs/German ZEW (August)
Aug 24	Eurozone	German Ifo (August)
Aug 26	UK	Q2 GDP - 2nd Estimate
	US	Q2 GDP - 2nd Estimate

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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