



Exchange Rate Outlook

18th November 2011

- **Euro remains resilient to eurozone crisis but risks are intensifying**
- **Core eurozone bonds now under pressure with no end to crisis**
- **Sterling holds up despite weak UK economic outlook**
- **BoJ intervenes to hold back safe haven yen**

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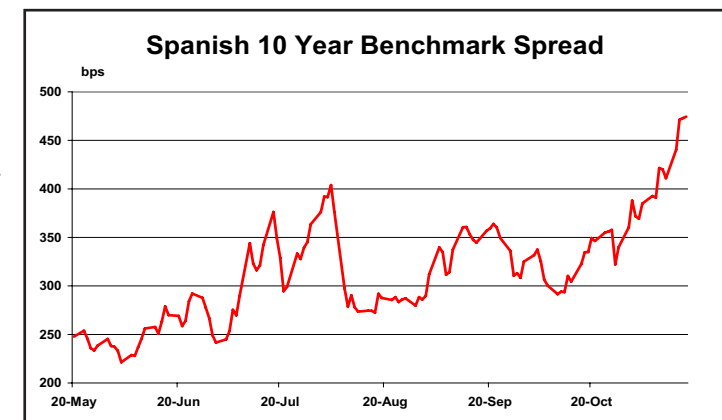
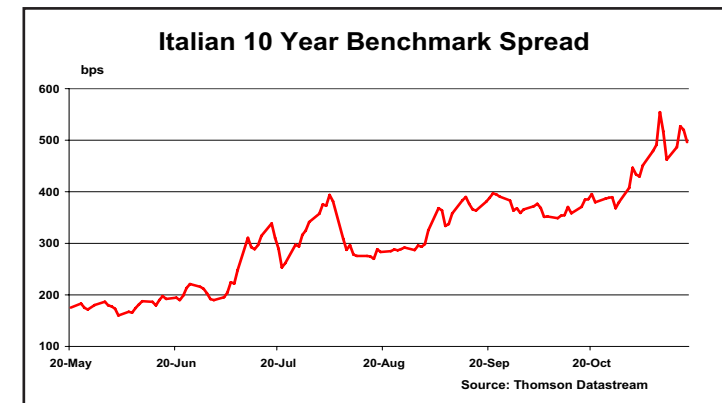
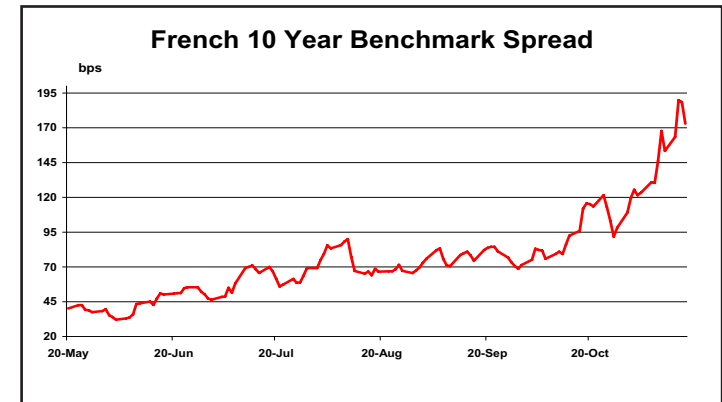
Summary of Exchange Rate Forecasts

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

	Current	Q4-2011	Q1-2012	Q2-2012	Q3-2012
Euro Versus					
USD	1.352	1.30-1.40	1.30-1.40	1.30-1.40	1.32-1.42
GBP	0.858	0.84-0.88	0.85-0.89	0.85-0.89	0.86-0.90
JPY	103.92	97-110	97-110	100-120	115-125
PLN	4.42	4.40	4.30	4.20	4.10
HUF	305.00	310	295	290	285
NOK	7.82	7.50	7.40	7.40	7.40
SEK	9.17	9.05	9.00	8.90	8.80
AUD	1.35	1.35	1.34	1.34	1.33
NZD	1.78	1.71	1.69	1.65	1.65
US Dollar Versus					
JPY	76.85	74-79	74-80	75-85	77-87
GBP	1.577	1.52-1.62	1.52-1.62	1.55-1.65	1.55-1.65
CHF	0.92	0.90	0.90	0.91	0.91
CAD	1.03	1.02	1.03	1.05	1.05
AUD	1.00	1.00	1.01	1.01	1.01
NZD	0.76	0.79	0.80	0.82	0.82
CNY	6.36	6.35	6.33	6.30	6.30
Sterling Versus					
JPY	121	120	119	124	137
CAD	1.62	1.60	1.60	1.63	1.63
AUD	1.57	1.57	1.54	1.54	1.51
NZD	2.08	1.99	1.94	1.89	1.88

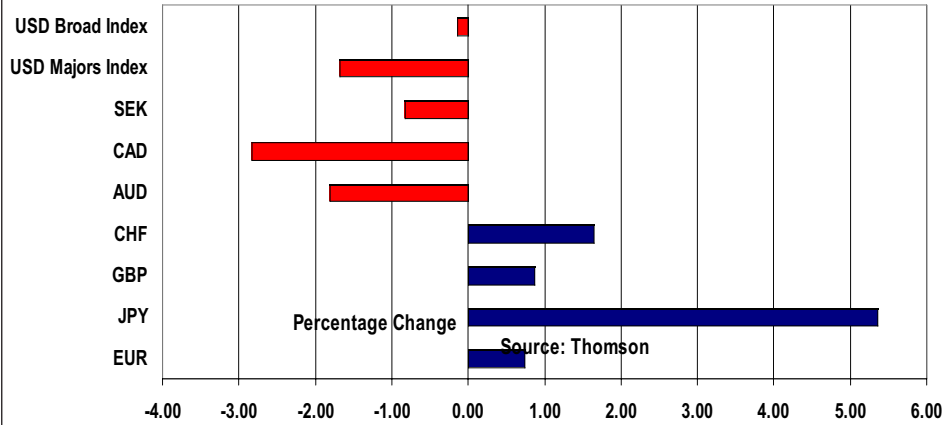
Market Overview

- Plans outlined by the EU on 26th October aimed at tackling its debt crisis brought some stability to forex markets but this proved to be little more than short term relief. Since then, sovereign associated risk has taken a turn for the worst with Italian, French and Austrian bond yields coming under severe pressure. Indeed, the temporary move in Italian ten year yields above the 7% level that is seen as unsustainable, as well as the recent pressures on core markets, have taken the eurozone sovereign debt crisis to a whole new level.
- Europe's current financial support mechanism, the European Financial Stability Fund (EFSF), is no where near big enough to provide a bail-out for Italy, whose debt stands at €1.9 trillion. The agreement on 26th October proposed increasing the firepower of the fund to around one trillion. However, no real progress has been made on beefing up the fund so far, with European authorities distracted by political turmoil in Greece and Italy, fears of a debt downgrade for France and talk of a euro break up. Stories emerging from Germany and France that leaders in the two countries are seriously exploring the idea of a core eurozone group have been shot down but concerns about the future of the single currency project remain.
- This recent escalation in eurozone debt risk has had a negative impact on the euro. Versus the dollar it has fallen back from highs of \$1.41 (seen after a jump in market sentiment post the 26th October Summit) to its current level of \$1.35. Losses have also been seen versus other majors though when you consider the scale of the problems being faced by Europe, the moves have been pretty limited. The euro remains a fundamentally strong currency and reasonably stable on a trade weighted basis, though some of this may be due to technical factors such as repatriation flows. However, there are significant downside risks given the way that the debt crisis is developing.
- For now though it's something of a waiting game. Expectations are that the EU will eventually come to the rescue of Italy but the pace of contagion has clearly picked up over recent days. The track record of European politicians so far, leaves markets with little confidence in how and when a comprehensive solution will be found. Indeed, markets appear to have entered a phase of expecting little and getting less and a permanent solution to the crisis seems some way off. Meanwhile, question marks remain over what level of support the ECB will provide to countries such as Italian and Spanish to provide them with enough breathing space to try and address their fiscal problems.
- Aside from all of this, markets are coping with a downgrade of global growth prospects, including fears of a move back into recession in the eurozone. Thus, central banks are back cutting interest rates or introducing new support mechanisms such as additional quantitative easing. This is also impacting on risk sentiment, with sterling, the AUD and many emerging market currencies looking vulnerable versus safe haven alternatives like the US dollar, Japanese yen and Swiss franc. However, as the Swiss and Japanese central banks become more aggressive in terms of intervention, the search is on for other safe havens. Thus, forex markets, which remain exceptionally correlated to market risk sentiment, face many challenges in the run up to the year end and we expect plenty of volatility.

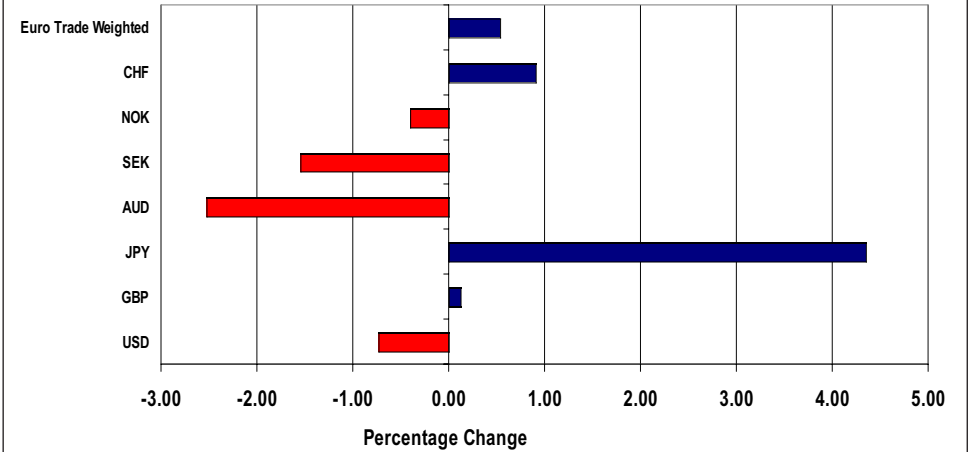


Key Currency Trends

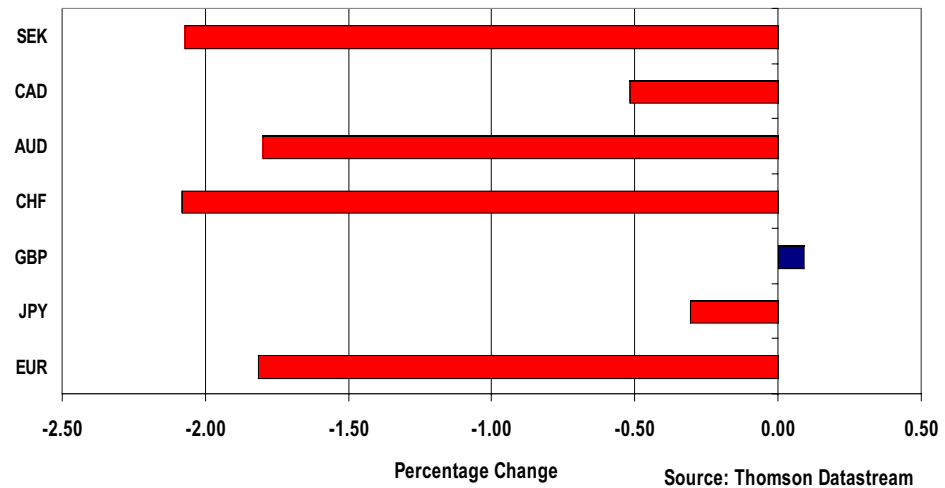
Performance Versus Dollar and USD Trade Weighted Indices
2011 Year to Date % Change



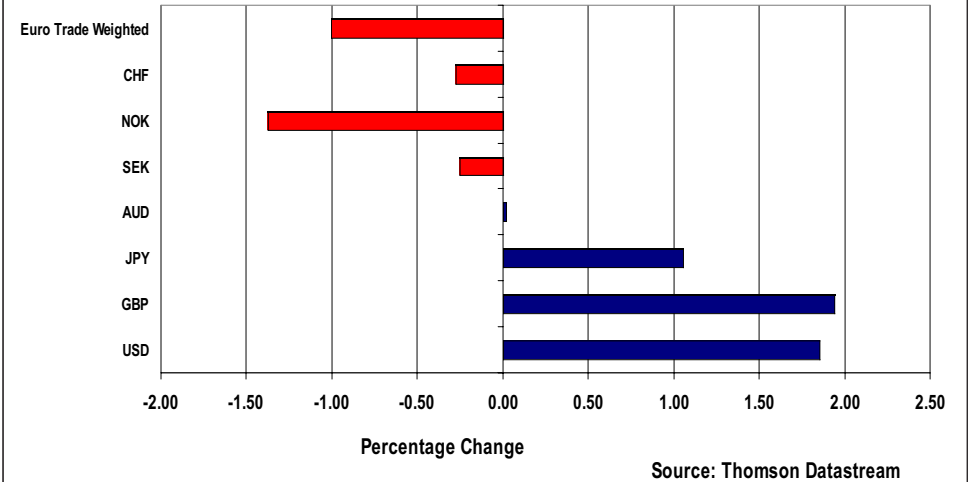
Performance Versus Euro and Euro Trade Weighted Index
2011 Year % Change



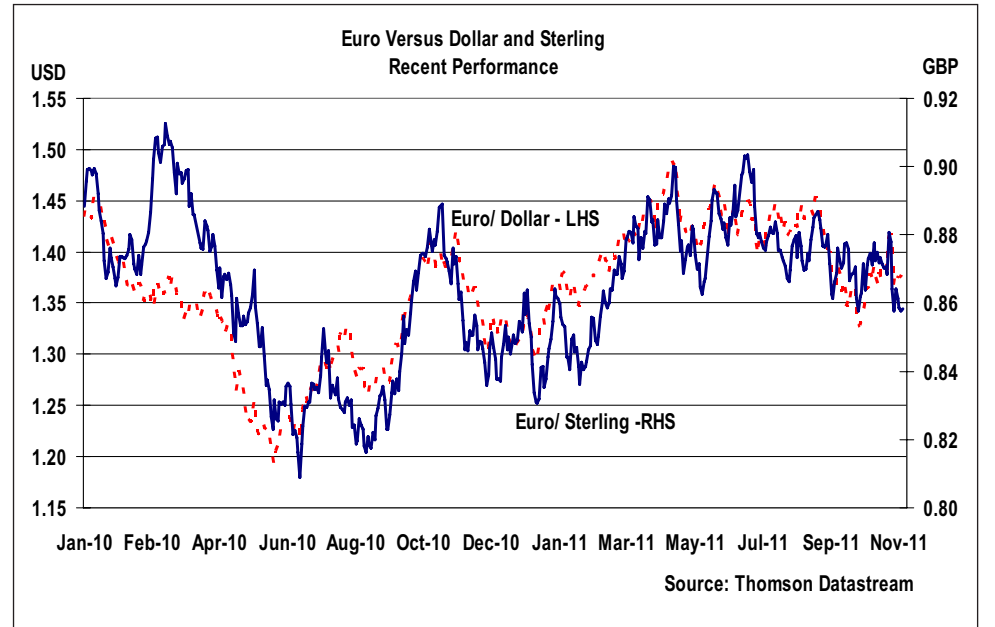
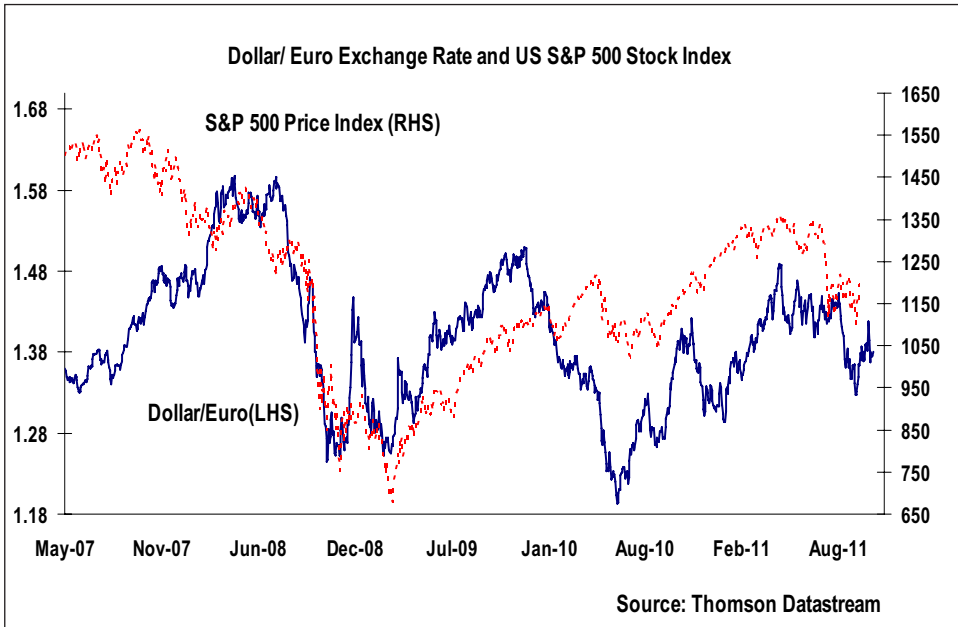
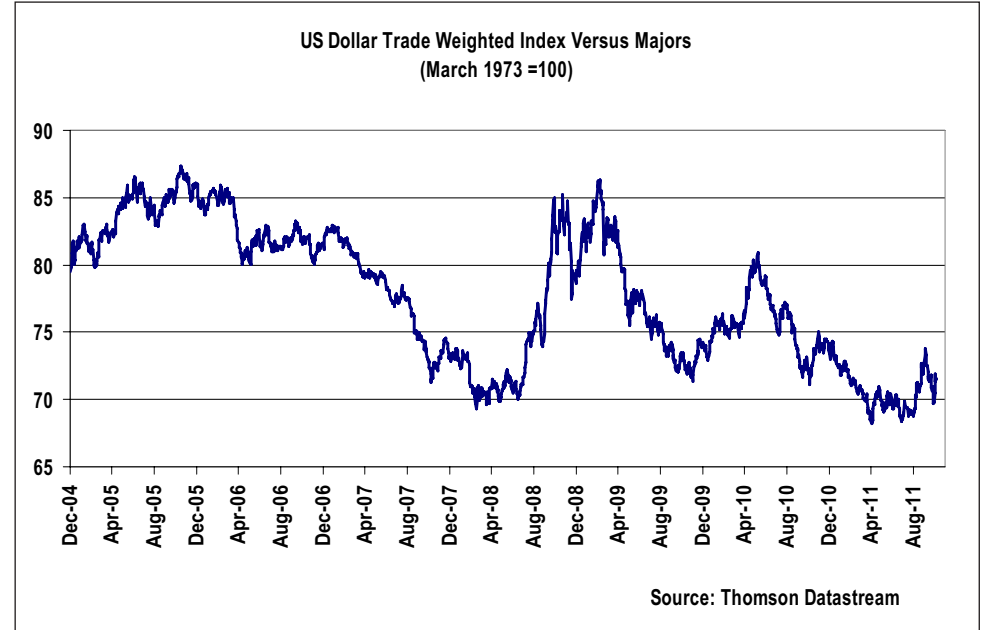
Performance Versus Dollar
% Change In Past Month



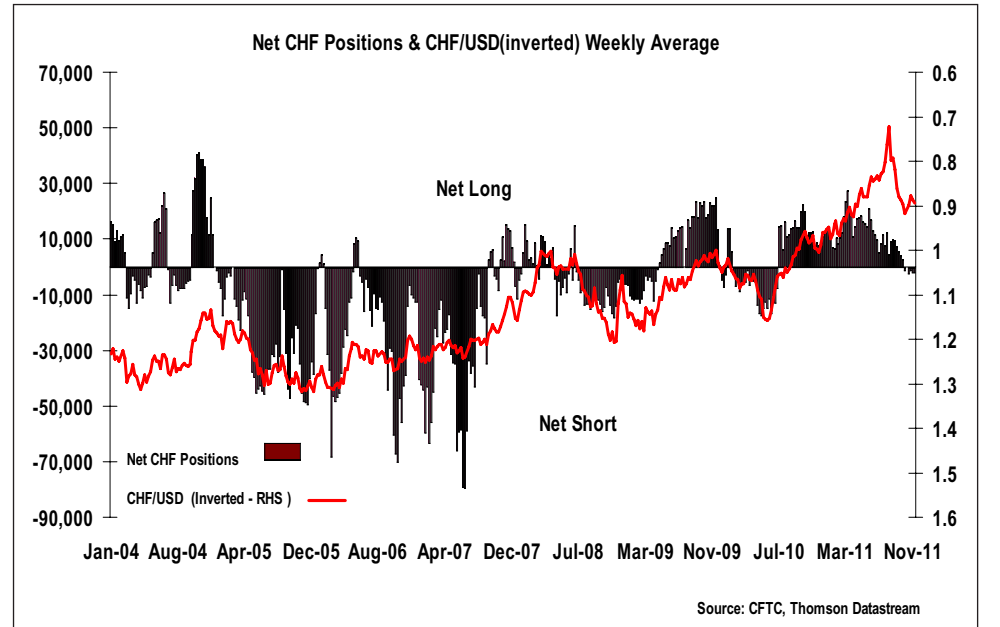
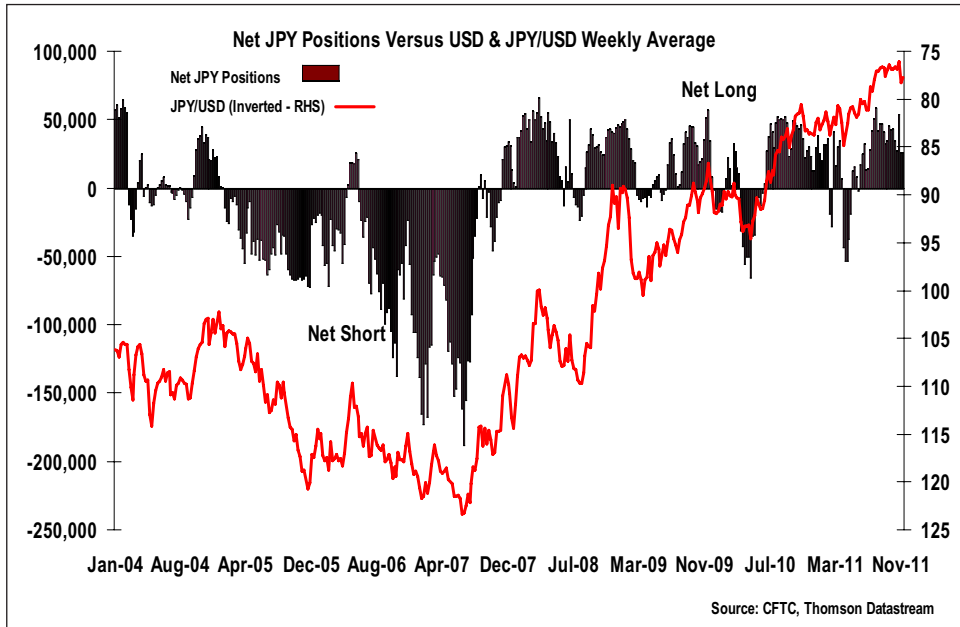
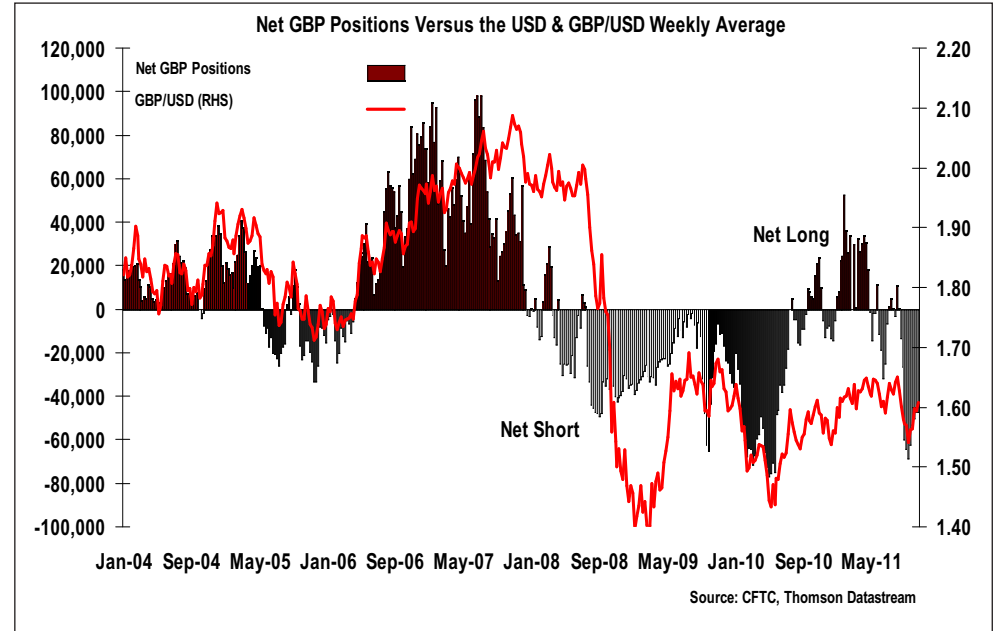
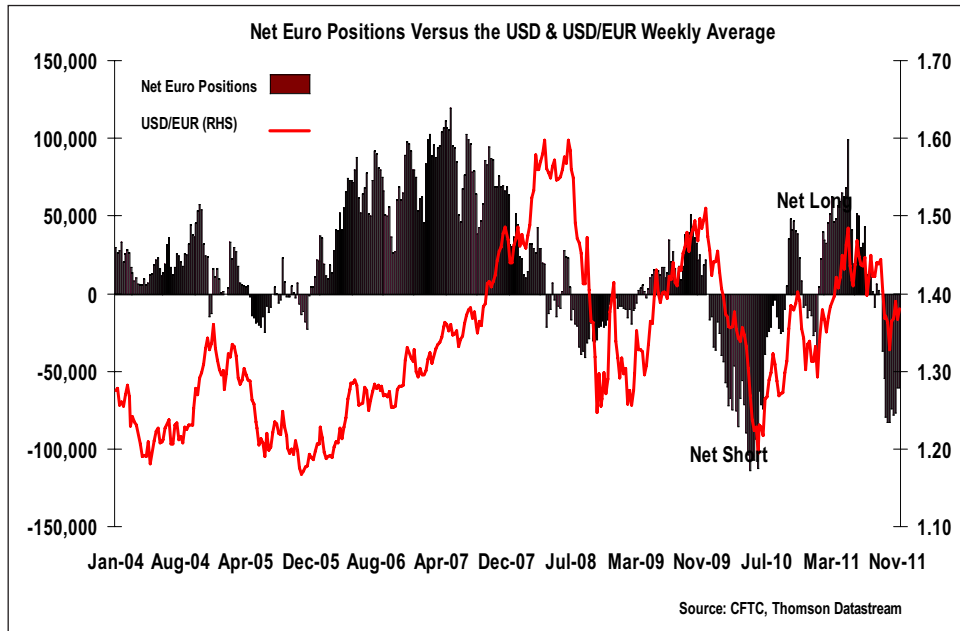
Performance Versus Euro and Euro Trade Weighted Index
% Change in Past Month



Key Currency Trends



Commitment of Traders Report - Net Positions Versus the US Dollar



Interest Rate Outlook

First Fed Rate Hike Not Expected Until Late 2013

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.

Expectations are that it will be late 2013 at the earliest before the Fed begins to increase rates and even then the pace of tightening is expected to be slow. Meanwhile, against a backdrop of weak economic data, the Fed introduced some further monetary support measure (Operation Twist) at its September policy meeting. There is a possibility of further quantitative easing if recent weakness in the economy proves persistent.

ECB Cuts Rates, Further Moves Expected

The ECB cut interest rates to an historic low of 1.0% in May 2009. The economy emerged from recession in Q3 2009 but while the pace of recovery has been subdued, inflation moved above the ECB's key 2% target level. In response to this, the ECB raised official interest rates in April and again in July bringing them to 1.50%.

However, given the marked weakening in economic conditions over recent months and the deepening of the regions debt crisis, the ECB was forced to cut interest rates by 0.25% to 1.25% at its November policy meeting. Given the poor outlook for the eurozone economy and with inflation concerns easing, it seems like that the ECB will fully unwind the rate hikes implemented earlier in the year. Thus, another 0.25% rate cut seems likely, either next month or in January.

BoE Takes on More Dovish Tone

UK interest rates have been at the historically low level of 0.50% since March 2009. The MPC has also engaged in quantitative easing or asset purchase activities. While inflation remains significantly above the BoE's target rate, the central bank persists in the view that this is temporary and it will fall back. Indeed, against a background of weak economic data, the MPC announced further QE measures at its October policy meeting.

Meanwhile, the significant fiscal tightening in the UK is yet another factor weighing on the fragile economic recovery. Thus, following a dovish November inflation report there are expectations that the BoE will announce further QE measures. Rate hikes are off the agenda until 2013 at the earliest.

	Fed Funds	3 Mth	1 Year	2 Year *	5 Year *
Current	0.125	0.49	1.02	0.79	1.32
Dec '11	0.125	0.50	1.00	0.80	1.35
Mar '11	0.125	0.50	1.00	0.80	1.35
June '12	0.125	0.50	1.00	0.80	1.35
<i>* Swap Forecasts Beyond 1 Year</i>					

Eurozone Interest Rate Forecasts (to end quarter)					
	Refi Rate	3 Mth	1 Year	2 Year *	5 Year *
Current	1.25	1.42	2.00	1.59	2.07
Dec '11	1.25	1.40	2.00	1.60	2.05
Mar '11	1.00	1.25	1.90	1.50	2.00
June '12	1.00	1.25	1.80	1.50	2.00
<i>* Swap Forecasts Beyond 1 Year</i>					

UK Interest Rate Forecasts (to end quarter)					
	Repo Rate	3 Mth	1 Year	2 Year *	5 Year *
Current	0.50	1.02	1.80	1.54	1.87
Dec '11	0.50	1.00	1.80	1.50	1.80
Mar '11	0.50	1.00	1.80	1.50	1.80
June '12	0.50	1.00	1.80	1.50	1.80
<i>* Swap Forecasts Beyond 1 Year</i>					

US Dollar

US fundamentals suggest a poor outlook for the dollar. The US continues to experience a very slow rate of recovery from the 2008/2009 recession, expanding by an average 1.4% (annualised) in the first three quarters of the year. Despite a recent run of reasonable data, the outlook remains one of a prolonged period of subtrend growth. There are tentative signs of improvement in the jobs market but the unemployment rate remains historically high at 9.0%, with business and consumer confidence still subdued.

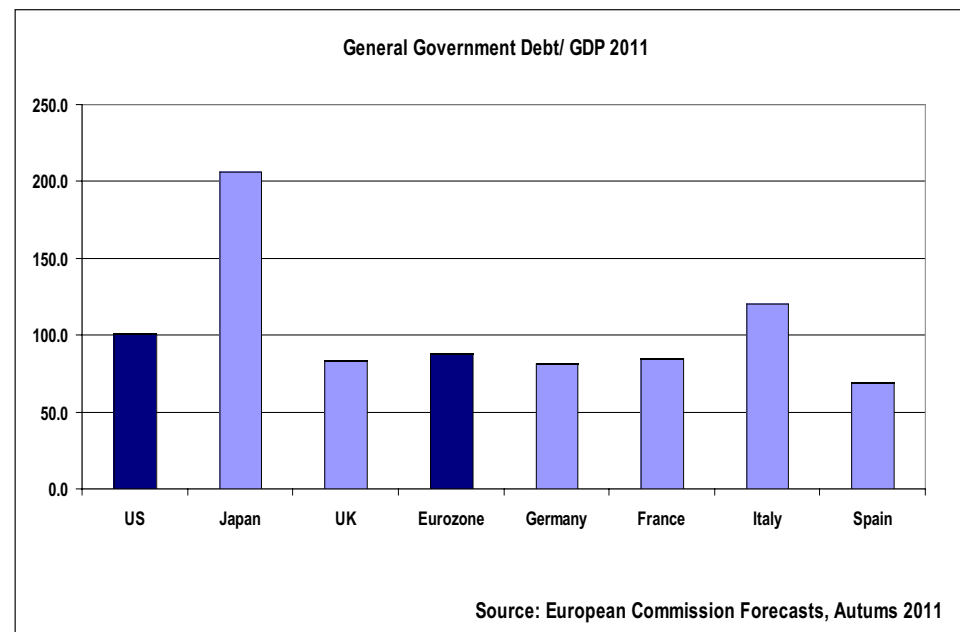
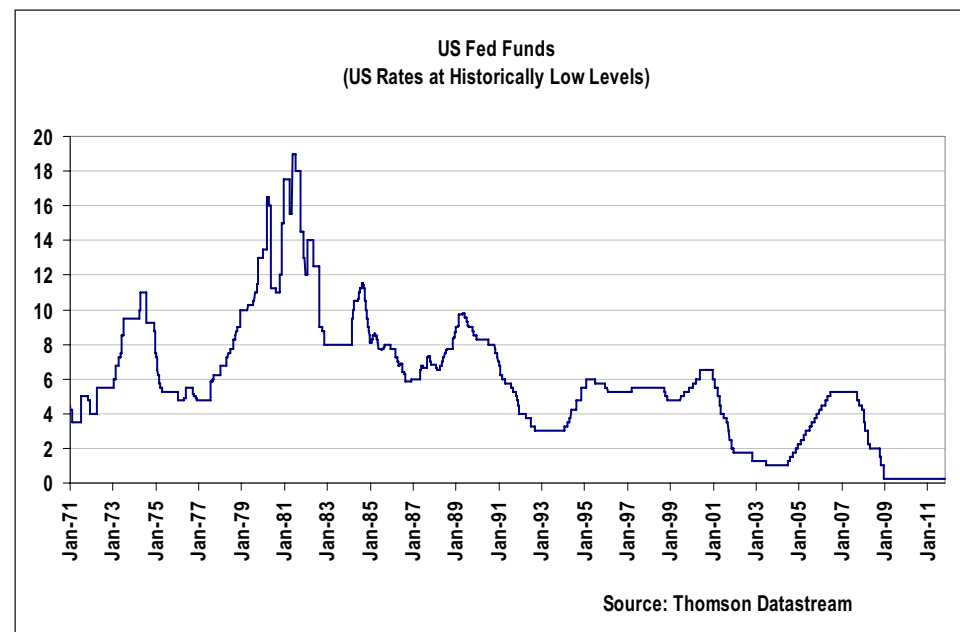
Fiscal policy is now less supportive and the current account deficit is trending upwards. As well as that, interest rates are at extremely low levels across all maturities, with the Federal Reserve announcing further monetary support initiatives ("Operation Twist") at its September policy meeting. There is a possibility of further quantitative easing if recent weakness in the economy proves persistent. Furthermore, although most of the focus is on the eurozone right now, the fiscal situation in the US is also very unstable.

Recent European Commission forecasts show a US debt/GDP level of 101.0% for 2011, compared to a level of 88.0% in the eurozone. A US congressional super committee has until end November to come up with plans for \$1.2 trillion in budgetary savings over the next ten years but even this is not expected to significantly alter the medium term debt trajectory. Despite all of this though, the dollar remains a key safe haven in a very uncertain and nervous market environment. The yen is a bigger safe haven, though, and the dollar has struggled to hold up against the JPY despite significant intervention from the Bank of Japan.

Given the current level of volatility and uncertainty it is extremely difficult to call the direction of forex markets right now and the trend will be very much determined by how markets react to ongoing events in Europe, as well as the tone of Q4 economic data. At the same time though, sentiment appears to favour the dollar. Its longer term upside potential, however, could be limited by a sub trend US growth performance and a very dovish Fed, as well as high fiscal and current account deficits.

Key Forecasts

		Q4-2011	Q1-2012	Q2-2012	Q3-2012
US\$/EUR	1.352	1.30-1.40	1.30-1.40	1.30-1.40	1.32-1.42
US\$/GBP	1.577	1.52-1.62	1.52-1.62	1.55-1.65	1.55-1.65
YEN/US\$	76.847	74-79	74-80	75-85	77-87
CHF/US\$	0.916	0.90	0.90	0.91	0.91



The eurozone debt crisis remains the central focus for markets. The agreement at the EU Summit on 26th October outlining plans to recapitalize European banks, discount Greek debt and increase the firepower of the ESFS fund brought some stability, with the euro rallying to \$1.41 versus the dollar immediately after the event. However, no real progress has been made on any of these issues since then and market sentiment has deteriorated once again. Indeed, if anything the stakes in Europe are now even higher.

Italian bond yields are under severe pressure, with spreads in core countries such as France and Austria (both AAA rated) also widening sharply. The euro has come under renewed selling pressure and is back trading around the \$1.35 level versus the USD. Downside risks are likely to remain in place and recent lows of \$1.314 could come under threat. Markets will be looking to new governments in Italy and Greece to step up the pace of fiscal and economic reform, while progress on expanding the ESFS is also required. None of this is going to happen quickly.

Against this background, it is difficult to see a near term end to the regions' debt crisis and to periods of euro selling versus safe havens like the dollar and yen. As well as the escalation in the debt crisis, the outlook for the euro has been further complicated by an increasingly weak economic outlook for the eurozone. A string of poor data means that the ECB has had to row back on interest rate increases implemented earlier in the year. Rates were cut by 0.25% in November meeting to 1.25% with another further easing expected over the coming months.

Thus, rates could also weigh on the euro, despite the fact that policy in the US, the UK and Japan is even accommodative. At the same time though, the euro remains relatively strong, with its trade weighted index unchanged year to date, though some of this may be due to technical factors such as repatriation flows. Indeed, despite much speculation in the marketplace about a euro break up this has not really been priced into the currency, suggesting plenty of downside potential should risks intensify further.

Key Forecasts

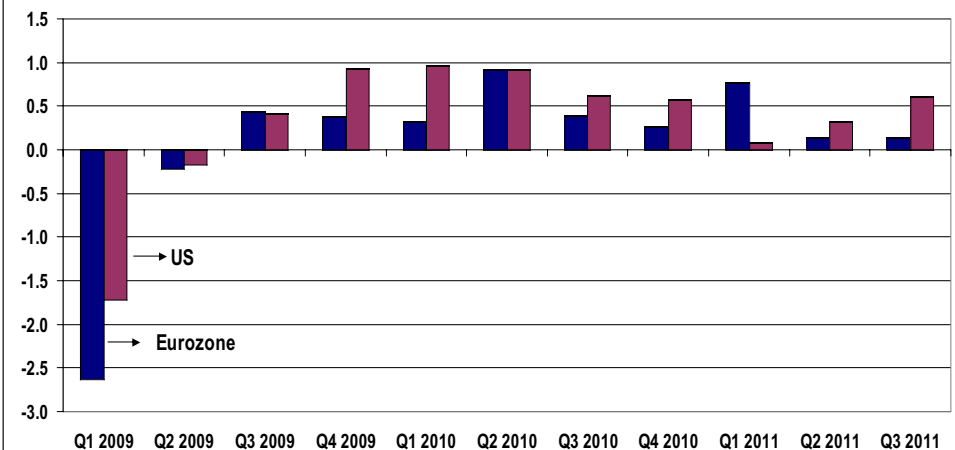
		Q4-2011	Q1-2012	Q2-2012	Q3-2012
US\$/EUR	1.352	1.30-1.40	1.30-1.40	1.30-1.40	1.32-1.42
GBP/EUR	0.858	0.84-0.88	0.85-0.89	0.85-0.89	0.86-0.90
YEN/EUR	103.92	97-110	97-110	100-120	115-125
PLN/EUR	4.421	4.40	4.30	4.20	4.10

USD/EUR Exchange Rate



Source: Thomson Datastream

Eurozone and US GDP Growth (Q-on-Q % Change)



Source: Thomson Datastream

Sterling

Sterling remains highly sensitive to UK interest rate expectations, as well as general market appetite for risk. Despite the fact that it looks to have peaked, UK inflation continues to be substantially above the Bank of England's 2.0% target level. 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 fed through to wages. Meanwhile, the pace of economic recovery remains anaemic at best.

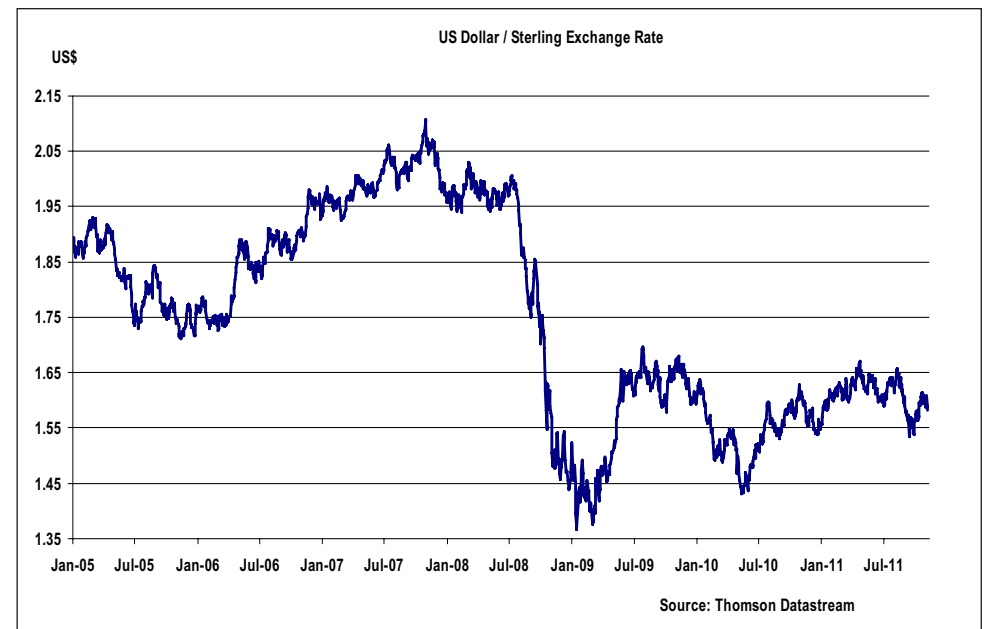
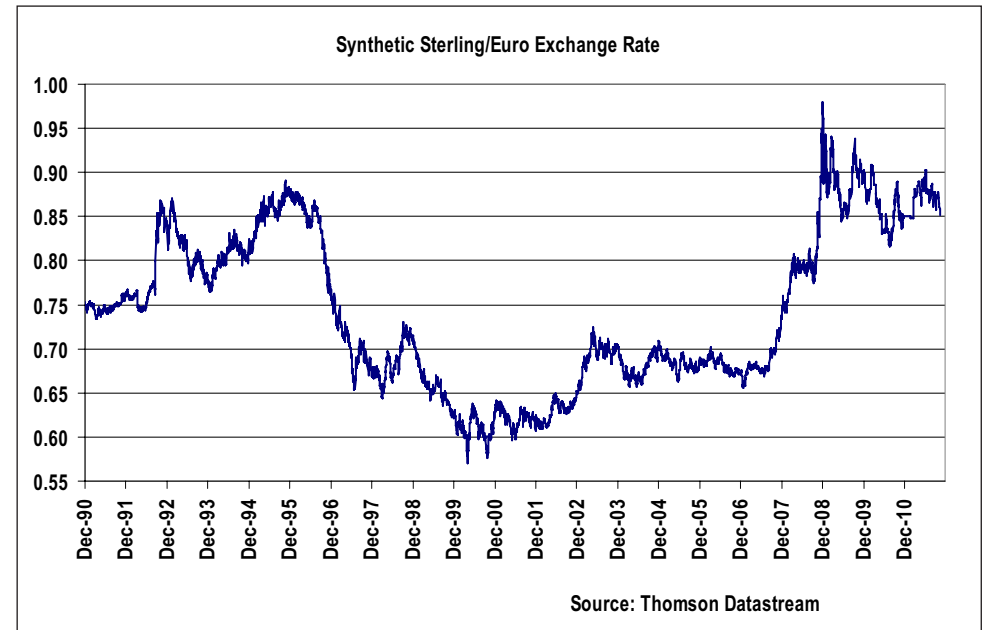
For the first nine months of 2011, UK GDP growth averaged just 0.9% in year-on-year terms. Leading indicators available so far for Q4 suggest another poor growth number for the final three months of the year. Downside risks on the growth side, as well as heightened financial market risk, saw the BoE announce in October that it was embarking on a fresh round of quantitative easing to the tune of Stg75bln. Further asset purchases could follow if necessary, while in terms of official rates it could be late 2013 before there is any increase. This dovish policy outlook is likely to weigh on sterling, which has only benefited to a limited extent from the deepening eurozone debt crisis.

Sterling hit eight and a half month highs of Stg0.8485 versus the EUR in mid November. It is currently off this level but further attempts at the upside could be seen near term. At the same time though the euro remains fundamentally strong versus the GBP, most likely a reflection of the markets view of the scale of the economic challenges facing the UK itself. Versus the euro, we anticipate a Stg0.84-0.88p range over the coming weeks, though trading could be very choppy and depend on events in Europe's.

Given current sentiment, we see little prospect of any real gains in sterling versus the USD either, despite its recent attempts to trade above the the \$1.60 level. With GDP growth expected to be sub trend this year and next, the UK economy faces many headwinds, including marked fiscal tightening and high unemployment, as well as the prospect of very low interest rates for some time to come. Thus, there is little to favour sterling versus the dollar near term.

Key Forecasts

		Q4-2011	Q1-2012	Q2-2012	Q3-2012
GBP/EUR	0.858	0.84-0.88	0.85-0.89	0.85-0.89	0.86-0.90
US\$/GBP	1.577	1.52-1.62	1.52-1.62	1.55-1.65	1.55-1.65
YEN/GBP	121.19	120	119	124	137
CAD/GBP	1.619	1.60	1.60	1.63	1.63



Japanese Yen

Despite being overvalued, the Japanese yen continues to benefit from swings in market sentiment given its status as a safe haven of choice. Indeed, the current period of considerable uncertainty surrounding the outlook for the global economy, as well as the ongoing concerns about Europe's debt problems, are keeping the yen closely to yearly highs of ¥75.9 (mid August) and ¥100.7 (early Oct) seen versus the dollar and euro. We expect little change in this trend near term as markets awaits updates on the pace of the global recovery, as well as the latest on the EU's debt plans.

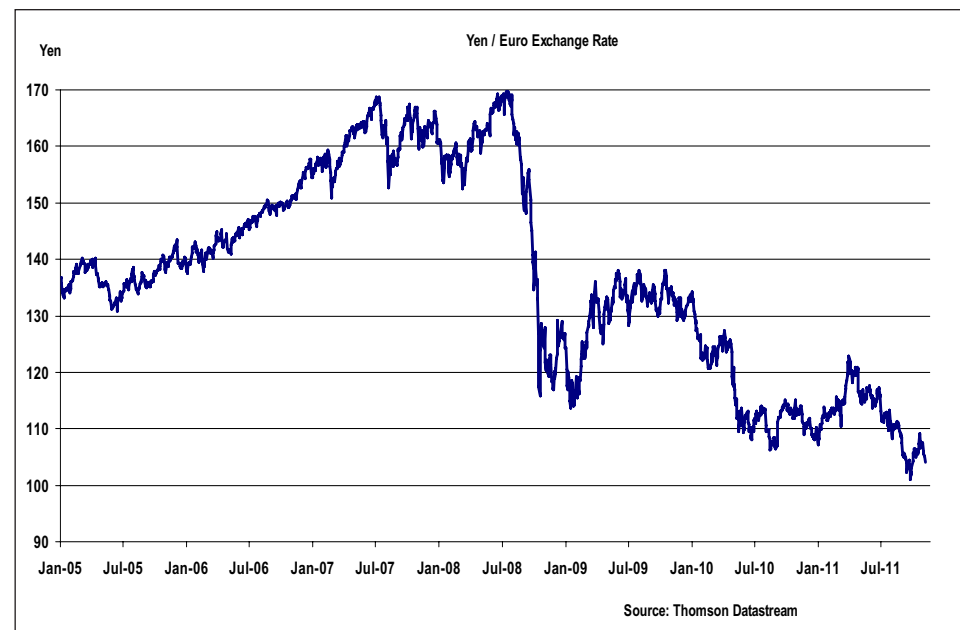
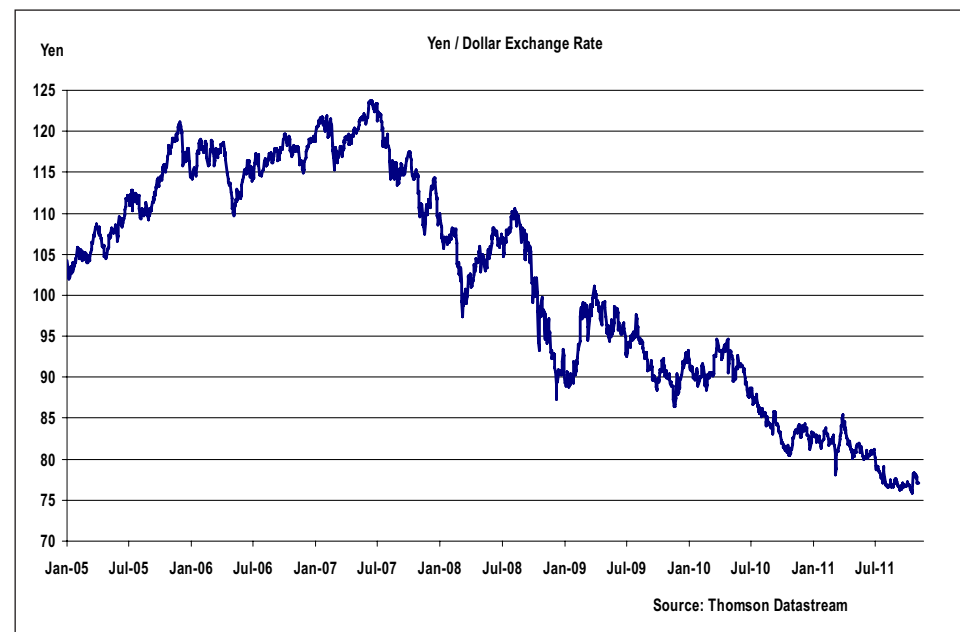
The Bank of Japan continues to express concern about the yen's appreciation and indeed after taking action in March and August, intervened again in late October/early November. Reports suggest that the size of the recent action was more aggressive than that seen earlier in the year but this has done little more than bring some near term stability to the yen. Any fresh sharp movements in the yen are likely to be met with further intervention. However, we do not expect this to have any real impact in terms of weakening the Japanese currency.

The JPY should continue to be supported by risk aversion, a strong external balance and reserve diversification. Recent economic data have also been supportive. After growing by 4.0% last year, GDP growth in the Japanese economy fell sharply in the first half of the year following the March earthquake. However, its recovery has been better than expected, with recent data showing annualised growth of 6.0% in the three months to September. The ongoing reconstruction effort following the earthquake should continue to support growth. Meanwhile, the inflation rate is in mildly positive territory.

Despite this the Bank of Japan is not expected to row back on this ultra accommodative monetary policy stance for some time yet, with rates expected to remain on hold until well into 2013 at least. However, while yield differentials and a weaker global economy (which would impact negatively on Japanese exports) could work against the yen over the longer term, near term we expect that risk sentiment will dominate.

Key Forecasts

		Q4-2011	Q1-2012	Q2-2012	Q3-2012
YEN/US\$	76.85	74-79	74-80	75-85	77-87
YEN/EUR	103.92	97-110	97-110	100-120	115-125
YEN/GBP	121.19	120	119	124	137



Australian Dollar/ New Zealand Dollar

Last month proved to be yet another very volatile one for the AUD, though it has still managed to recover from yearly lows of \$0.953 seen versus the US dollar at the beginning of October. For the most part the currency continues to be driven by risk sentiment and thus has suffered from the ongoing worries surrounding Europe's sovereign debt problems, as well as concerns about a slowing in the global economy and in particular China.

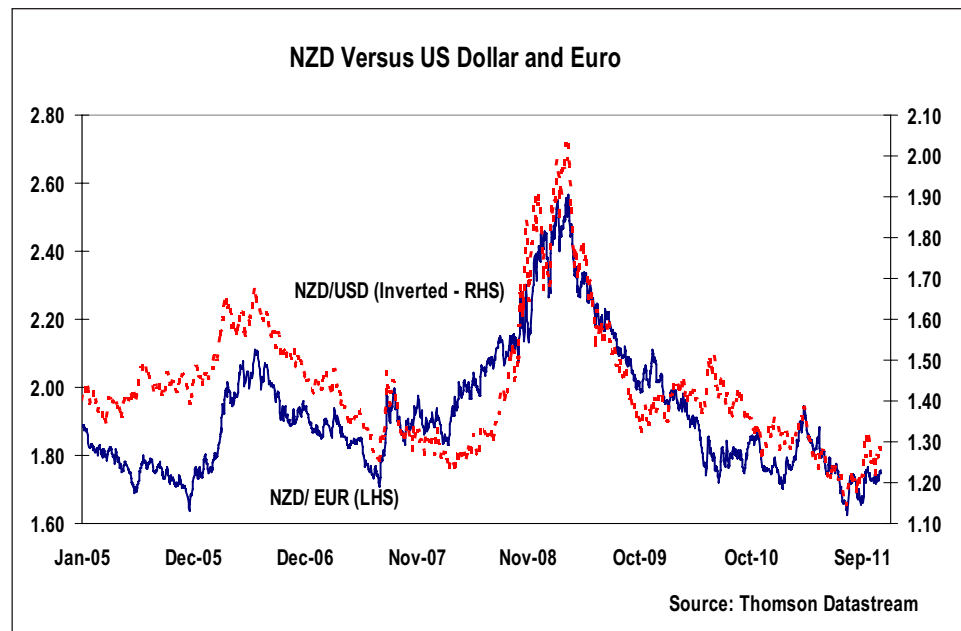
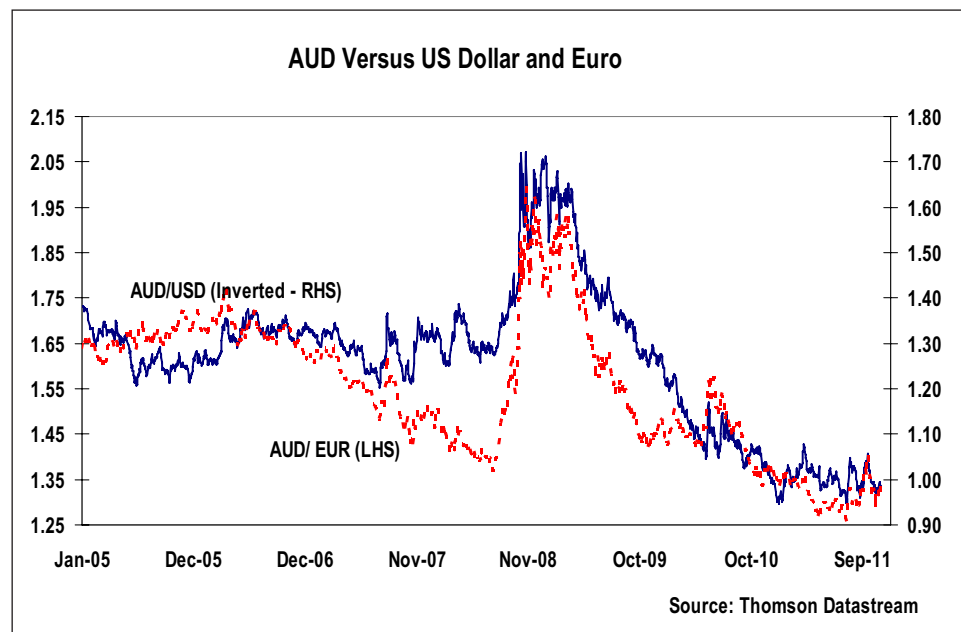
Falls in commodity prices have also weighed, as well as the decision by the Reserve Bank of Australia (RBA) in early November to embark on a rate cutting cycle. With monetary policy still restrictive and the global outlook still very uncertain further rate cuts are expected near term, which could weigh on the AUD. Nonetheless, the currency remains generally strong and is likely to continue to be underpinned by interest rate differentials, despite talk of further action from the RBA. Official rates currently stand at 4.50%, which still leaves them well above other those of other majors.

The NZD follows a similar path to the AUD in terms of its movements versus the USD. Thus, it has also lost some ground versus over more recent times. As well as generally higher risk aversion, a recent credit rating downgrade is also likely to have hit sentiment. However, it too remains at elevated levels and should continue to be supported by relatively higher interest rates.

In response to earthquakes in September last year and early this year, interest rates were cut by 0.50% to 2.50% in March, with policy on an extended pause since then. However, the economy is recovering well from the natural disasters and while the renewed slowing in the global economy is likely to impact, GDP prospects for this year and next are pretty favourable. Inflation is also running at its highest level since late 2008. Thus, the market believes that once market conditions stabilise the central bank will resume its tightening cycle. While this may not be until 2012, the prospect of higher rates at some point should provide underlying support to the currency.

Key Forecasts

		Q4-2011	Q1-2012	Q2-2012	Q3-2012
AUD/USD	1.003	1.00	1.01	1.01	1.03
NZD/USD	0.759	0.79	0.80	0.82	0.83
AUD/EUR	1.35	1.35	1.34	1.34	1.33
NZD/EUR	1.782	1.71	1.69	1.65	1.65



Key Events/Diary

Week 1 (21st - 25th November)

Nov 22	US	Q3 GDP (2nd Estimate)
	Eurozone	Consumer Confidence (November)
Nov 23	Eurozone	Flash PMIs (November)
	UK	Minutes of BoE November Meeting
	US	Personal Income & Spending (October)
Nov 24	Eurozone	German Q3 GDP Details
	Eurozone	German Ifo Index (November)
	UK	Q3 GDP (2nd Estimate)

Week 2 (28th November - 2nd December)

Nov 28	Eurozone	M3 Money Supply (October)
	UK	CBI Distributive Trades (November)
	US	New Home Sales (October)
Nov 30	US	ADP Employment Report (November)
	UK	Consumer Confidence (November)
1 Dec	US/UK/Eurozone	Manufacturing PMIs/ISMs (November)
2 Dec	US	Non- Farm Payrolls (November)

Week 3 (5th - 9th December)

Dec 5	US/UK/Eurozone	Service PMIs/ISMs (November)
	Eurozone	Retail Sales (October)
	US	Durable Goods (October)
Dec 6	Eurozone	Q3 GDP (2nd Estimate)
Dec 7	UK	Industrial Production (October)
Dec 8	Eurozone	ECB Policy Announcement & Press Conf
	UK	BoE Policy Announcement
Dec 9	Japan	Q3 GDP (2nd Estimate)

Week 4 (12th - 16th December)

13 Dec	UK	Consumer Prices (November)
	Eurozone	German ZEW Index (December)
	US	Retail Sales (November)
14 Dec	UK	Unemployment (November)
15 Dec	Japan	Tankan Survey (Q4)
	Eurozone	Flash PMIs (December)
	UK	Retail Sales (November)

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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