EXCHANGE RATE MONTHLY

January 2006

A Year of Familiar Ranges in Prospect

- Dollar support from US monetary policy is likely to diminish over 2006 but outright US-eurozone interest rate differentials argue against a marked decline. Thus, dollar/euro could remain in familiar territory for much of the year.

- With UK rates now expected to be left on hold sterling looks less vulnerable but upside momentum is still limited.

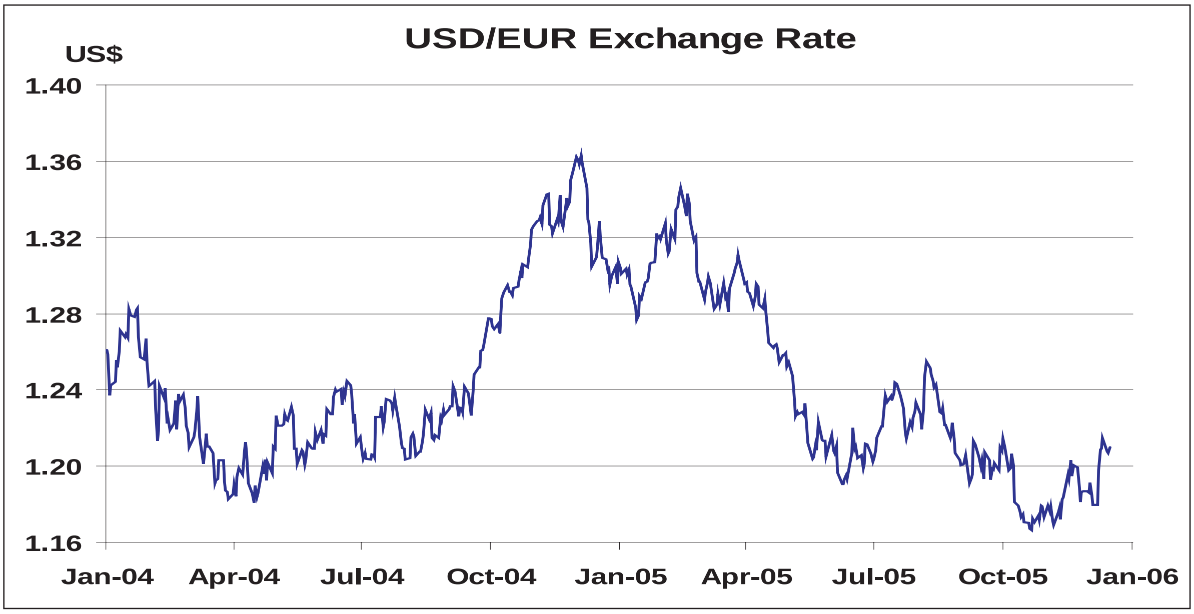
- The yen disappointed in 2005. A better performance is in prospect this year if Japanese data suggest further improvement in economic growth and the Chinese yuan continues to appreciate.

John Beggs
Chief Economist

Oliver Mangan
Chief Bond Economist

Geraldine Concagh
Senior Economist

Jenny Pollock
Senior Economist



Summary of Forecasts

Exchange Rates

Euro Versus		**Forecast Range Over The Period**			
	Current	**Q1 - 2006**	**Q2 - 2006**	**Q3 - 2006**	**Q4- 2006**
USD	1.2033	1.18-1.23	1.20-1.25	1.22-1.27	1.23-1.28
GBP	0.6830	0.67-0.69	0.67-0.69	0.67-0.69	0.67-0.69
JPY	137.39	135-139	135-139	135-139	130-135
PLN	3.784	3.75	3.75	3.90	3.90

Dollar Versus		**Forecast Range Over The Period**			
	Current	**Q1 - 2006**	**Q2 - 2006**	**Q3 - 2006**	**Q4- 2006**
JPY	114.17	112-117	112-117	108-113	105-110
GBP	1.7618	1.75-1.80	1.75-1.80	1.80-1.85	1.80-1.85
CHF	1.2850	1.27	1.27	1.25	1.25
AUD	0.7512	0.75	0.76	0.78	0.78

Official Interest Rates

		Forecast to End Period			
	Current	**Q1 - 2006**	**Q2 - 2006**	**Q3 - 2006**	**Q4- 2006**
Euro Refi Rate	2.25	2.25	2.50	2.75	2.75
US Fed Funds	4.25	4.75	5.00	5.00	5.00
UK Base Rate	4.50	4.50	4.50	4.50	4.50
Japan ODR	0.10	0.10	0.10	0.10	0.25

Growth and Inflation

		GDP			**Inflation**	
Y-on-Y% Change	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**
US	4.2	3.6	3.5	2.7	3.4	3.0
Eurozone	1.8	1.4	2.1	2.1	2.2	2.0
UK	3.2	1.6	2.2	1.3	2.1	2.0
Japan	2.6	2.4	2.4	-0.2	-0.3	0.1
Ireland	4.5	4.5	5.0	2.2	2.5	3.0

Our View In Brief

* **The world economy grew by around 4.3% in 2005 and is forecast to remain on a steady growth path in 2006 with a similar growth rate anticipated. The focus could shift outside of the US, though, as Japan and the eurozone show increasing signs of an acceleration in economic activity. Meanwhile, oil prices are expected to remain high, averaging around $60 per barrel over the year, which is close to their current level. Prices (Brent Oil) averaged $55 per barrel in 2005, compared to $38 in 2004.**

* The US economy performed impressively in 2005, despite high energy costs and a very severe hurricane season. Growth prospects remain favourable for 2006, at least for the first half of the year. Thereafter, activity may well begin to slow down as tighter monetary conditions impact, particularly on the housing market. Nevertheless, the economy is still expected to grow by around 3.5% again this year.

* Financial markets are speculating that the Fed is almost done. However, if the US economy continues to grow strongly, we feel that it will err on the side of caution. The Fed remains confident in its outlook for the economy and thus looks set to continue raising interest rates over the coming months. We expect the Fed funds rate to be at 5.00% by mid 2006.

* **The dollar has had a shaky start to the year as markets speculate that the Fed is close to ending its tightening cycle. Certainly, the level of support that the dollar receives from US monetary policy is likely to diminish over 2006, thus resulting in some appreciation of the euro. Concerns about the US current account deficit could also have a negative impact. However, the outright level of US-eurozone interest rate differentials, which are expected to remain in excess of 2%, argues against a significant decline in the dollar.**

* The eurozone economy grew at a below trend rate again in 2005. However, data in recent months suggest a better outlook for this year. In particular, sentiment surveys from Germany indicate a marked pick-up in activity. One encouraging feature of recent eurozone data is the evidence of a revival in domestic demand and there has been some rise in consumer confidence. Growth in the eurozone is expected to average 2.1% in 2006, up from 1.4% last year.

* **The ECB hiked rates by 0.25% to 2.25% in December, the first increase since 2000. With leading indicators pointing to continued improvement in growth in the months ahead further policy tightening is anticipated and rates could be at 2.75% by mid year. From an Irish perspective, this would still constitute a very accommodative policy stance.**

* The UK economy also grew below trend in 2005, undermined by a downturn in consumer spending and housing market activity. More recent data suggest that retail spending is picking up some pace while conditions in the housing market are also improving. Thus, we expect the economy to be back at trend growth levels during 2006, with GDP averaging 2.2% for the year as a whole. Financial markets are no longer discounting any further easing in UK interest rates and we expect policy to remain on hold at 4.50% over the course of the year.

* Data on the Japanese economy suggest continued strength in the economy. GDP growth is expected to average 2.4% in 2006, which is above trend. There are also signs that deflationary pressures are easing. Optimism about the economy has increased speculation that the BoJ will move away from its ultra accommodative monetary policy stance in 2006.

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Interest Rate Environment

Modest Tightening in Store in US

* As expected, the Fed raised US interest rates by another 0.25% at its policy meeting in December, bringing the Fed funds rate to 4.25%.

* The minutes of the December FOMC meeting indicated that the number of additional rate hikes required probably would not be large. As a result, financial markets have concluded that the Fed is nearly done tightening. They expect another 0.25% hike at end January and are giving just a 50:50 chance of a further increase thereafter.

* We think, though, that with the economy continuing to grow strongly and a new Fed Chairman taking office in February, the Fed will err on the side of caution. We see at least two and possibly three rate increases in H1 2005, taking the Fed funds up to a 4.75-5.0% range.

Further ECB Rate Hikes in 2006

* The ECB hiked rates by 0.25% to 2.25% in December, the first increase since 2000. With growth picking up, the ECB deemed it necessary to withdraw some of its policy accommodation to dampen upside risks to inflation. Rates were left on hold in January.

* Leading indicators point to further improvement in economic growth in the months ahead. Thus, another 0.25% rate hike is expected in March, with the market also looking for a further rate hike in Q2. Policy is expected to be put on hold in H2 2006, with inflation forecast to fall to under 2%.

* There is an outside risk that rates could rise to 3% by end 2006. However, this would be dependent on external developments, as much as a continuation of the uptrend in the eurozone economy.

BoE to Stay on Hold

* The Bank of England cut UK interest rates by 0.25% in August, bringing the repo rate down to 4.50% but has kept rates on hold since then.

* Expectations for another rate cut have all but died following recent signs of a pick up in housing activity and consumer spending.

* The BoE could remain on hold for all of 2006 as growth picks up towards trend and inflation falls back below 2%.

US Interest Rates

	Current	Mar '06	June '06	Sept '06
Fed Funds	4.25	4.75	5.00	5.00
3 Month	4.56	4.95	5.10	5.05
1 Year	4.79	5.10	5.15	5.05
2 Year*	4.82	5.05	5.15	5.10
5 Year*	4.86	5.05	5.10	5.05
10 Year*	4.94	5.10	5.10	5.00

** Swap Forecasts Beyond 1 Year*

Eurozone Interest Rates

	Current	Mar '06	June '06	Sept '06
Refi Rate	2.25	2.50	2.75	2.75
3 Month	2.37	2.60	2.85	2.85
1 Year	2.81	3.00	3.20	3.20
2 Year*	3.03	3.20	3.30	3.30
5 Year*	3.21	3.35	3.45	3.45
10 Year*	3.44	3.60	3.70	3.70

** Swap Forecasts Beyond 1 Year*

UK Interest Rates

	Current	Mar '06	June '06	Sept '06
Repo Rate	4.50	4.50	4.50	4.50
3 Month	4.52	4.55	4.55	4.55
1 Year	4.56	4.60	4.60	4.60
2 Year*	4.63	4.70	4.70	4.70
5 Year*	4.59	4.75	4.75	4.75
10 Year*	4.47	4.65	4.65	4.65

** Swap Forecasts Beyond 1 Year*

Exchange Rate Outlook

KEY ISSUES

- ***Euro Trades Above $1.20:*** The euro is above $1.20 as markets speculate that the Fed is close to ending its tightening cycle and thus is unlikely to provide the same level of support to the dollar this year.
- ***But $ Downside Risks are Limited:*** We do not envisage any significant slide in the dollar, however, which should continue to find underlying support from favourable interest rate differentials.
- ***Sterling Looks to BoE:*** Sterling looks less vulnerable versus other majors with markets no longer discounting another UK rate cut.

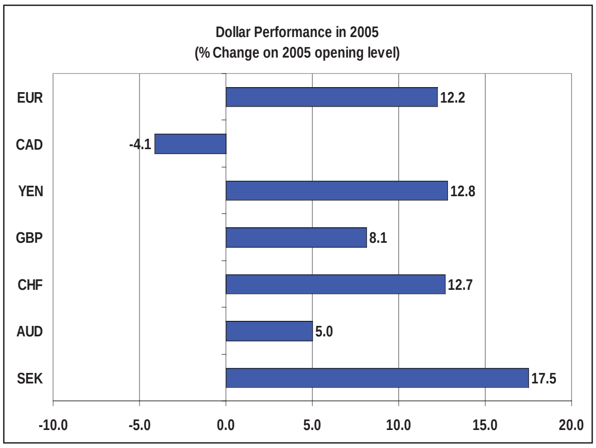
Dollar Expected to Slip Modestly in 2006

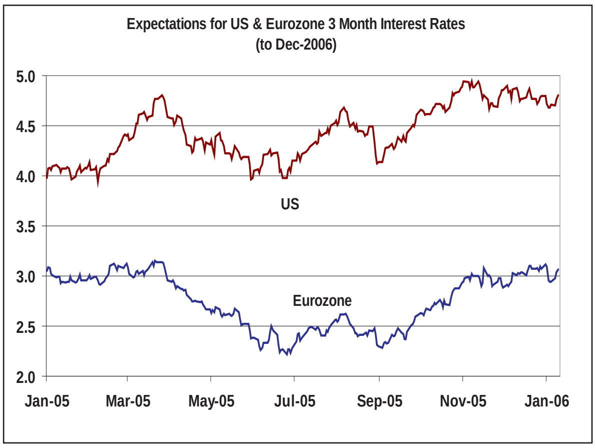
After three successive years of decline, the dollar rallied in 2005, making significant gains against a number of other majors. It finished the year up some 12% against the euro and yen, while appreciating by 8% versus sterling. However, much of the activity in dollar/euro was actually confined to the $1.19-1.25 range that typified 2004. Furthermore, the average rate in 2005 was $1.24, the same as the previous year. The dollar is showing signs of weakness in early 2006 but could yet remain in a range that does not deviate too far from this level.

The dollar's appreciation in 2005 largely reflected the impact of a yield differential that moved significantly in its favour. Indeed, last year, forex markets showed a very high sensitivity to interest rate levels and trends. A stabilisation in the US external imbalance over much of the year (in particular, the non-petroleum balance), firm oil prices and strong capital inflows under the terms of the Homeland Investment Act (HIA) also played a part.

Support from the HIA has all but evaporated at this stage, ensuring that the dollar has had a shaky start to the year. Negative sentiment has been reinforced by the tone of the minutes from the December FOMC meeting and some disappointing US data releases. These include the manufacturing ISM and non-farm payrolls surveys for December. Against this background, speculation surrounding the timing of the end of, or a pause in, the Fed's tightening cycle is dominating headlines.

Thus, the euro has gained some 3% against the dollar in the year to date, rallying from $1.18 to a high of $1.2180 in the first week of trading. The dollar could come under further pressure in the weeks ahead, particularly if any additional US data disappoint. Furthermore, the eurozone economy is showing increasing signs of recovery and the ECB is expected to increase interest rates again.





The more recent deterioration in the US trade balance (as per the October and November data) could also bring renewed focus on deficit issues in Q1. However, over the coming weeks we could see most of the activity in dollar/euro being confided to the top end of a $1.18-1.23 trading range.

We feel that the market has taken an overly benign view of December's FOMC minutes and thus is underestimating the extent of further rate hikes. Certainly the Fed is nearing the end of its tightening cycle but with US growth prospects still favourable, we expect at least two more rate hikes.

Thus, there is scope for some modest rebound in the dollar if the optimism surrounding the outlook for US interest rates proves premature and the focus returns to outright interest rate differentials, which are forecast to remain comfortably above 2% for much of 2006. Again, however, activity could be confined to a tight and familiar range centred around the $1.20 level.

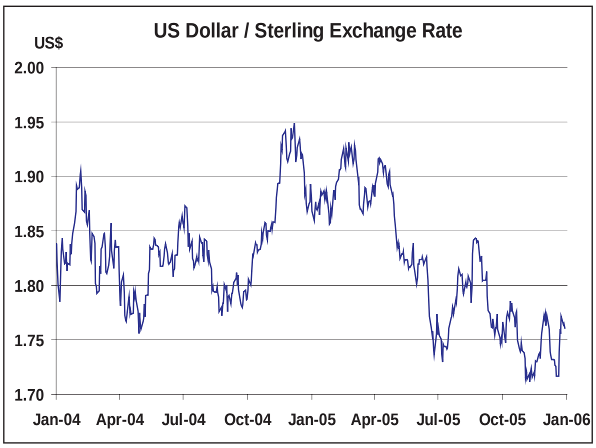
Over the second half of the year, the dollar could slip back again towards the $1.25 level and beyond. At that point the Fed will most likely have finished tightening rates while consumer spending and the housing market are expected to have cooled. Thus, with the prospect of higher interest rates no longer a dominant force markets could be paying greater attention to US fundamentals like the current account deficit in H2-2006. However, we do not envisage a major collapse in the dollar and euro upside could be limited around the $1.30 level.

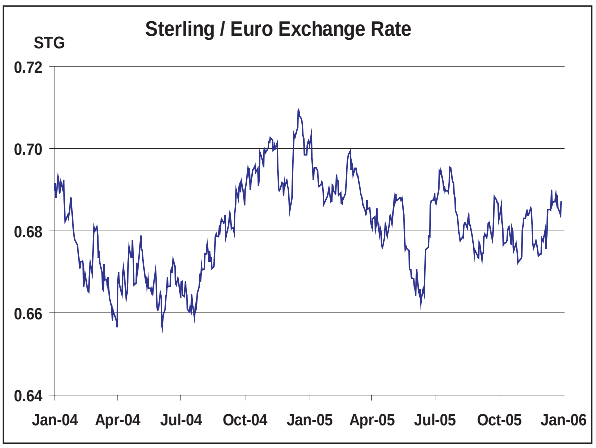
With Fed rates expected to peak at 4.75-5.00% and ECB rates likely to rise to at least 2.75%, interest rate differentials should continue to provide underlying support to the dollar. For the dollar to fall sharply the Fed would need to be easing monetary policy by end 2006.

In this regard, currency markets will be paying more than usual attention to developments in the US housing market over the coming months. There is little evidence as yet that the much talked about downturn in the housing market is about to materialise, but if this were to prove to be the case later in the year, it could be a major negative for the dollar. However, we see this as unlikely and expect no major trend in either direction in dollar/euro to materialise in 2006.

Sterling to Stage Modest Recovery Versus Dollar

Like other majors, sterling was very heavily influenced by interest rate expectations over the course of 2005. Sterling came under pressure against both the dollar and euro as the BoE cut UK interest rates in August and markets speculated about further easing before year end. While there is still some





uncertainty surrounding the outlook for the UK economy, expectations of another rate cut have all but died at this stage, as housing market activity picks up and consumer spending exhibits signs of recovery. Thus, cable has recovered well from the lows of $1.71 seen last December and it appears to be finding support above the $1.74 level. There is scope for sterling to make up further ground against the dollar in 2006, particularly in the second half of the year, when US rates have peaked

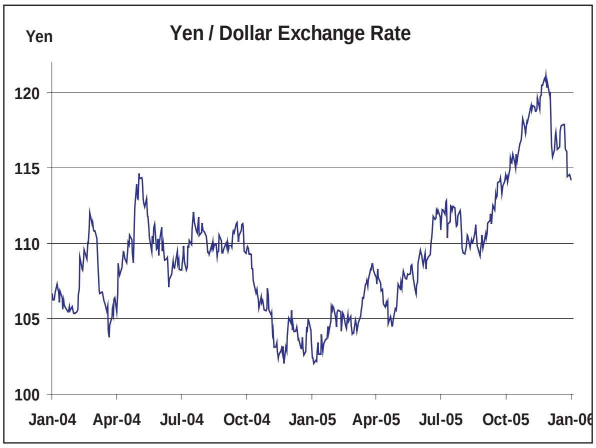
However, it is likely to prove difficult for sterling to make anything more than moderate gains versus the dollar in 2006. Even if UK rates remain on hold from here and the economy moves back to trend growth levels, interest rates in the US look set to overtake those in the UK. As outlined earlier, we expect US interest rates to rise to 4.75-5.00% but those in the UK to remain unchanged at 4.50%. Thus, sterling's upside could be confined to a $1.80-1.85 range.

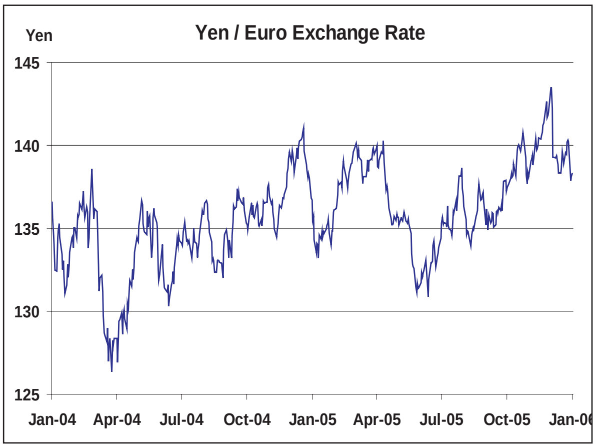
Meanwhile, beyond near-term prospects, movements in the UK-eurozone interest rate differential appear to have little bearing on the direction of sterling/euro. While sterling fell 8% against the dollar in 2005, it only lost some 3% against the euro. Instead of interest rate differentials, the performance of dollar/euro continues to be a key factor in determining the direction of sterling/euro. Thus, if the euro remains in a relatively tight range against the dollar we could see another year of range trading around the Stg69p level for sterling/euro, with higher eurozone interest rate only having a moderate impact.

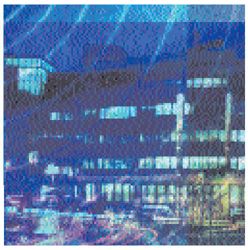
Yen to Find Support Over 2006

The yen's performance over 2005 was disappointing given the improvement in the Japanese economy and the strong equity market performance. It did, however, stage something of a recovery in the closing months of the year and has managed to hold most of these gains. This correction seems to have been primarily driven by an unwinding of carry trades as markets became concerned that the Fed could be nearing the end of its tightening campaign.

Over the short-term, the yen is unlikely to make much more headway against the dollar or euro. However, we anticipate further gains in H2 if data over the coming months bring more good news on the Japanese economy and inflation. If this is the case, the yen should be supported by expectations that the BoJ will finally start rowing back on quantative easing measures. Interest rates in Japan have been virtually at zero for the last five years in an attempt to boost the economy. The yen could also be boosted if China continues to allow its currency to gradually appreciate against the dollar. Markets expect the yuan to appreciate by about 3% over the course of the year.







KEY MARKET EVENTS

Week 1 *(16-20 January)*	**January 16**	**US**	**Market Holiday**
		UK	**Producer Prices (December)**
	January 16	**UK**	**Consumer Prices (December)**
		US	**Industrial Production & Capacity Utilisation (December)**
	January 18	**UK**	**Labour Market Report (December)**
		US	**Consumer Prices (December)**
		US	**Fed Beige Book**
	January 19	**Eurozone**	**ECB Monthly Bulletin (January)**
	January 20	**UK**	**Retail Sales (December)**
Week 2 *(23-27 January)*	**January 25**	**GER**	**Ifo Business Survey (January)**
		UK	**GDP (1st Estimate - Q4)**
		UK	**Minutes of MPC Meeting (January)**
	January 27	**US**	**GDP (1st Estimate - Q4)**
Week 3 *(30 Jan - 3 Feb)*	**January 30**	**US**	**Personal Income & Spending (December)**
	January 31	**Eurozone**	**Business & Consumer Confidence (January)**
		US	**FOMC Rate Announcement**
	February 1	**US/Eurozone/UK**	**ISM/PMI Manufacturing Surveys (January)**
		Eurozone	**ECB Rate Announcement & Press Conference**
	February 3	**Eurozone**	**HICP Flash Estimate (January)**
		US/Eurozone/UK	**ISM/ PMI Non-Manufacturing Surveys (January)**
		US	**Non-Farm Payrolls (January)**
Week 4 *(6 - 10 february)*	**February 8**	**UK**	**Industrial Production (December)**
	February 9	**Eurozone**	**ECB Monthly Bulletin (February)**
		UK	**BoE Rate Announcement**
	February 10	**US**	**Trade Balance (December)**

AIB International Centre, IFSC, Dublin 1 Tel: 353-1-8740222 Fax: 353-1-6799590