

AIB Global Treasury Services



Exchange Rate

Monthly



APRIL 2004

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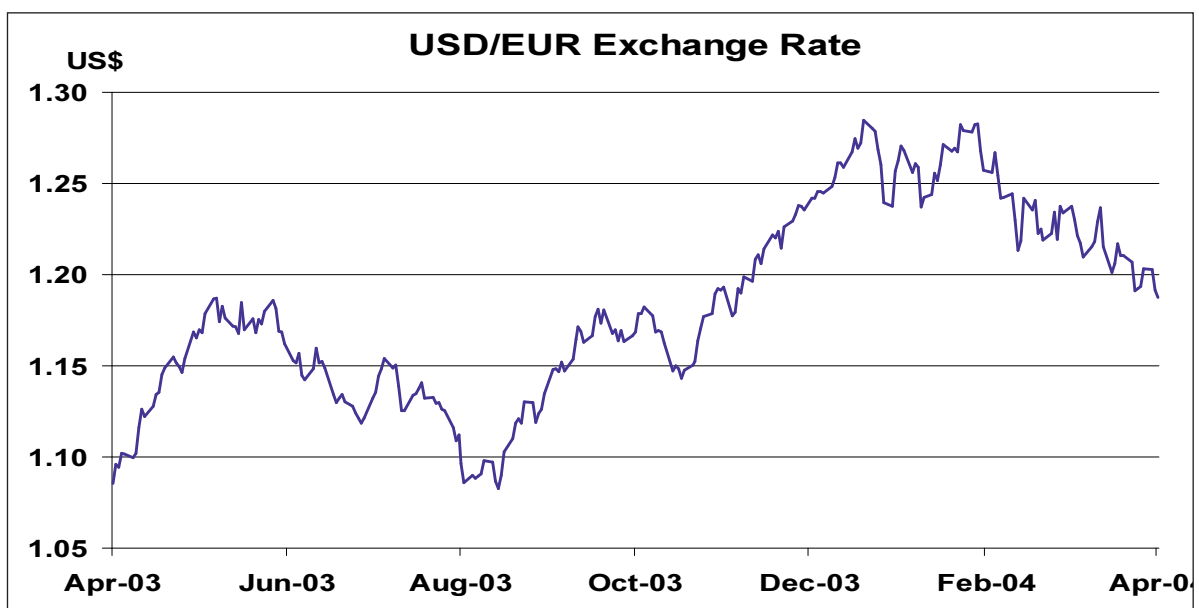
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EXCHANGE RATE MONTHLY

Dollar to make more gains

- Stronger economic activity in the US saw the euro fall below the \$1.20 mark in April. Though still volatile, this period of dollar recovery could be extended towards the \$1.15 level (see page 6).
- Sterling has lost ground versus both the US dollar and the euro. However, with brighter UK economic prospects and higher UK interest rates, a fresh move by sterling/euro towards £0.65 could be on the cards (see page 7).
- Stronger than expected economic growth and inflation data in the US point to higher official US rates. We look for the first move by August (see page 4).



Summary of Forecasts

Latest View

- Dollar consolidating awaiting fresh US non-farm payrolls data.
- ECB on hold as Fed mulls fresh data.
- Sterling has room to gain on euro.

Exchange Rates

Euro Versus		Forecast Range Over The Period				
	Range Over the Last Month	Current	May-July 04	Aug-Oct 04	Nov-Jan 05	Feb-May 05
USD	1.18-1.24	1.1820	1.17-1.22	1.15-1.20	1.18-1.23	1.18-1.25
GBP	0.65-0.67	0.6690	0.66-0.68	0.65-0.67	0.64-0.67	0.65-0.68
JPY	126-132	129.60	127-132	124-129	124-129	125-130
CHF	1.55-1.57	1.5520	1.54	1.50	1.53	1.58
NOK	8.25-8.52	8.2510	8.30	8.40	8.50	8.50
SEK	9.14-9.28	9.1445	9.15	9.05	9.00	8.90

Dollar Versus		Forecast Range Over The Period				
	Range Over the Last Month	Current	May-July 04	Aug-Oct 04	Nov-Jan 05	Feb-May 05
JPY	103-110	109.60	105-110	105-110	103-108	103-108
GBP	1.76-1.86	1.7645	1.75-1.80	1.75-1.80	1.80-1.85	1.80-1.85
CHF	1.26-1.32	1.3130	1.29	1.27	1.27	1.30
CAD	1.31-1.37	1.3630	1.36	1.37	1.35	1.34
AUD	0.72-0.75	0.7250	0.72	0.72	0.73	0.73

Official Interest Rates

	Forecast to End Period				
	Current	Jun 04	Sept 04	Dec 04	Mar 05
Euro Refi Rate	2.00	2.00	2.00	2.00	2.00
US Fed Funds	1.00	1.00	1.50	2.25	2.75
UK Base Rate	4.00	4.25	4.50	4.75	5.00
Japan ODR	0.10	0.10	0.10	0.10	0.10

Growth and Inflation

Y-on-Y% Change	GDP			Inflation		
	2003	2004	2005	2003	2004	2005
US	3.1	4.7	3.7	2.3	2.0	2.0
Eurozone	0.4	1.5	2.3	2.1	1.9	1.8
UK	2.2	3.2	2.8	1.4	1.4	1.8
Japan	2.7	3.0	2.2	-0.2	-0.2	-0.1
Ireland	1.4	4.0	5.0	3.5	1.9	2.7

Our View In Brief

- * The outlook for the global economy remains positive with evidence of strong growth in Asia and in the US. Recent economic indicators in the US have largely surprised on the upside **altering expectations about the timing of increases in official interest rates by the US Federal Reserve.**
- * We expect the US economy to grow by 4.7% in 2004 and to slow to 3.7% in 2005. The latter would still represent above trend growth for the US economy and would require **some interest rate tightening over the next 18 months.**
- * We expect that the Fed will hike rates from their current exceptionally low level of 1% to 2.25% before the end of the year. **The first rise could come in August.**
- * Growth in the UK remains firm, though Q1 2004 data suggest some modest deceleration from the rapid expansion of the second half of 2003. Nevertheless, **with a robust housing market, more UK interest rate increases are on the way. Despite benign short-term inflationary pressures, the next move is widely expected in May.**
- * Eurozone economic growth continues to disappoint. Growth is likely to be no higher than 1.5% in 2004. With the US economy heating up, **the ECB is expected to refrain from cutting euro area interest rates.** However, there is little risk of an official rate rise this year. *For more details of our interest rate view please see our latest **Fixed Income Monthly Monitor**, available on www.johnbeggs.com.*
- * The world economy continues to be beset with the risks from terrorism and other geopolitical factors. Commodity prices continue to rise at a very fast pace, with oil prices remaining over \$30 per barrel.
- * **Forex markets remain very volatile**, though perhaps a little less so than in the first quarter of 2004. With signs of a more robust US labour market, the **US dollar has found some support as the markets come to price in the prospect of higher interest rates.** The dollar has also benefited from a whiff of higher inflation in the US.
- * Further favourable economic data could see the dollar make additional gains, with dollar/euro consolidating within a \$1.15-1.20 range. However, the dollar is still beset by fundamental problems and we would be reluctant to call the euro much below \$1.15 on a sustained basis over the balance of 2004.
- * **Sterling has suffered some recent declines as the dollar's fortunes picked up.** Cable has fallen in the wake of the dollar's generalised advance against major currencies. However, sterling has also lost some ground recently against the euro, fluctuating in a £0.65-£0.67 range in the first half of April. Given the UK's superior economic fundamentals we expect sterling/euro to continue trading in a £0.65-0.67 range near term, perhaps moving to £0.64-0.66 in the latter part of the year.
- * **The dollar has also made ground against the yen** even though the Japanese economy exhibits signs of more sustainable recovery. However, monetary policy in Japan will remain unchanged this year. Near-term, we expect dollar-yen to trade in a Y105-110 range, with scope for yen appreciation within a Y103-108 range towards year end.

22 April 2004

Interest Rate Environment

Rise In US Rates In August

- * Stronger than expected US labour market, consumer spending and inflation data have heightened expectations that the Fed will move to raise rates this year. The next labour market data due on 7 May will be very important to the timing of any increase.
- * Markets are currently discounting that the Fed will start to increase official rates possibly as early as June but definitely by August and that the current rate of 1% will hit 2% by end year.
- * We believe that the Fed will wait until August to hike rates but we look for rates to end the year at 2.25%. Longer term rates have rebounded in the past month and we look for further increases in the months ahead.

US Interest Rates				
	Current	Jun 04	Dec 04	Dec 05
Fed Funds	1.00	1.00	2.25	3.50
3 Month	1.17	1.30	2.50	3.75
1 Year	1.70	2.00	3.00	4.20
2 Year*	2.50	2.80	3.70	4.50
5 Year*	3.90	4.10	4.60	5.20
10 Year*	4.85	5.00	5.50	5.80

* Swap Forecasts Beyond 1 Year

Euro Rates Probably At Standstill

- * The ECB disappointed the market in early April by leaving official rates unchanged at 2%. Furthermore, at his press conference, the ECB President, Jean-Claude Trichet gave little away about the prospect of a cut in the months ahead.
- * The market has now ruled out the prospect of an interest rate cut. We agree with this view. Official rates are now expected to stay on hold at 2% over the balance of the year. However, the balance of risk remains to the downside, due to the weakness of the eurozone economy.
- * As in the US, longer term rates have risen sharply over the past month. The expectation is that longer term eurozone rates will continue to shadow rising US long term rates over the next 6-9 months. In the short term, therefore, the gap between short and longer term rates will widen.

Eurozone Interest Rates				
	Current	Jun 04	Dec 04	Dec 05
Refi Rate	2.00	2.00	2.00	3.00
3 Month	2.06	2.10	2.10	3.40
1 Year	2.20	2.20	2.50	3.70
2 Year*	2.60	2.70	3.20	4.00
5 Year*	3.50	3.70	4.10	4.70
10 Year*	4.30	4.50	4.80	5.20

* Swap Forecasts Beyond 1 Year

UK Rates To Rise Further

- * The Bank of England left official rates unchanged in April at 4% against the backdrop of a strong housing market and rising consumer debt.
- * We concur with the market view that official rates will rise again by mid-year, probably by 0.25% in May, which will coincide with the publication of the May inflation report.
- * We expect further increases in the second half of 2004, bringing official rates to 4.75% by end year.

UK Interest Rates				
	Current	Jun 04	Dec 04	Dec 05
Repo Rate	4.00	4.25	4.75	5.25
3 Month	4.39	4.65	5.05	5.35
1 Year	4.82	5.05	5.40	5.40
2 Year*	4.98	5.25	5.65	5.80
5 Year*	5.20	5.40	5.70	5.80
10 Year*	5.27	5.40	5.70	5.80

* Swap Forecasts Beyond 1 Year

Exchange Rate Outlook

KEY ISSUES

- **Euro falls below \$1.20:** The euro has fallen against the dollar, breaking through the \$1.20 level. The next payroll data due on 7 May will be key to whether the dollar can make further gains.
- **Sterling on uncertain course:** Sterling has lost some ground not only against the advancing dollar but also against the euro.
- **Fed to hike rates in 2004:** It is now fairly certain that the US Federal Reserve will increase official interest rates before the US Presidential election in November. This should support the dollar.

Euro Under Pressure As Dollar Makes Comeback

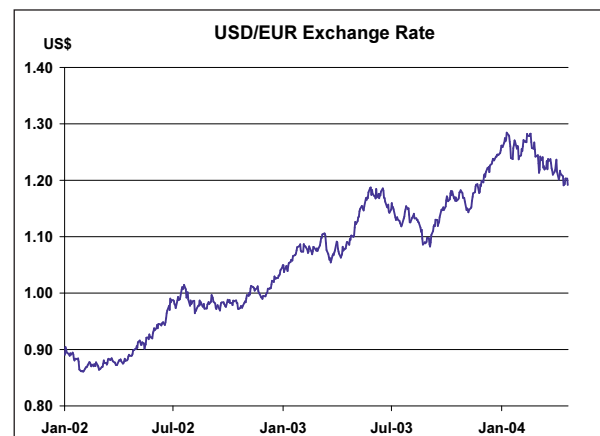
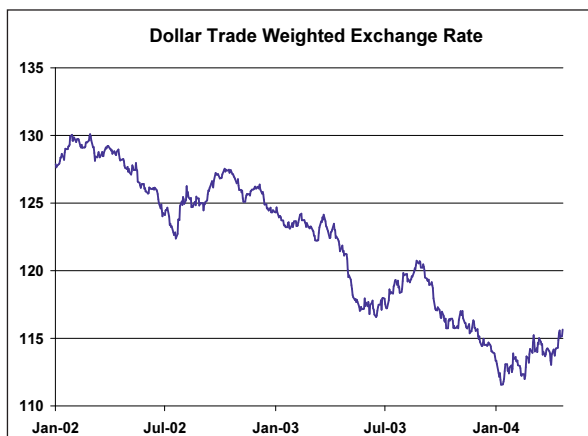
The recent performance of the US dollar, where it has pushed the euro back below the \$1.20 level, has raised expectations that the US currency may be about to make a more sustained comeback.

The dollar has also recovered from almost \$1.86 against sterling to close on \$1.76 and to above Y109 from a low of under Y104. On a trade weighted basis, the dollar's broad index increased by 1.9% in the first half of April and is 3.3% above the lows reached in January.

From its all-time high in February 2002, the dollar's broad trade weighted index is down less than 12%. This limited downward adjustment comes after a 37% gain in the index between 1995 and 2002, which left the dollar overvalued.

Recent US economic data have been generally more supportive of the dollar, particularly since the publication of the stronger than expected non-farm payrolls for March on 2 April. The data showed a very large rise in employment of 308,000 and there were also large revisions to the data for the first quarter as a whole. These figures suggested that the market's impression of the US economy's so-called "jobless recovery" was wrong.

Other data, such as the ISM surveys and retail sales, also supported the view that the US economy is growing strongly. On top of these buoyant real economy data, the very latest inflation data pointed to the possibility of the early re-emergence of inflation. All of these figures were positive for the dollar in April, though more recent industrial production and consumer confidence figures were less supportive, keeping it close to \$1.20 versus the euro. However, it has since gained fresh impetus on firming expectations that US interest rates will be raised this year.



This change in the dollar's fortunes comes against the background of a continuation of exceptionally high fiscal and current account deficits in the US. The dollar's overall trade weighted adjustment to date is insufficient to bring about a fall in the US current account deficit of 5% of GDP towards a more sustainable level of about 3%.

The consensus view remains that the dollar/euro exchange rate will reach between \$1.25-\$1.30 in 2005. We do not agree with this view. **We see an average level of below \$1.20 next year.**

In the near term, the dollar is on a somewhat more firmer footing, pushed along by heightened market expectations about the US economy.

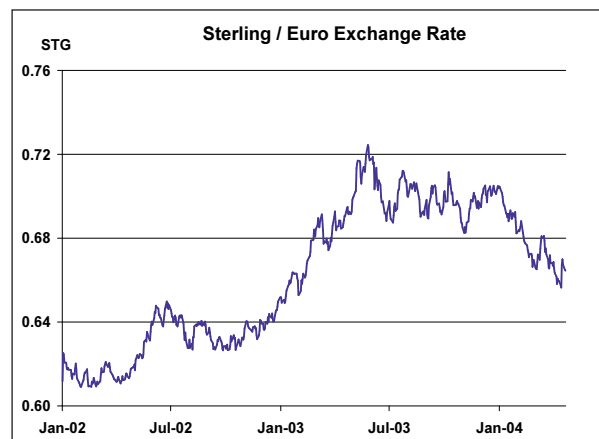
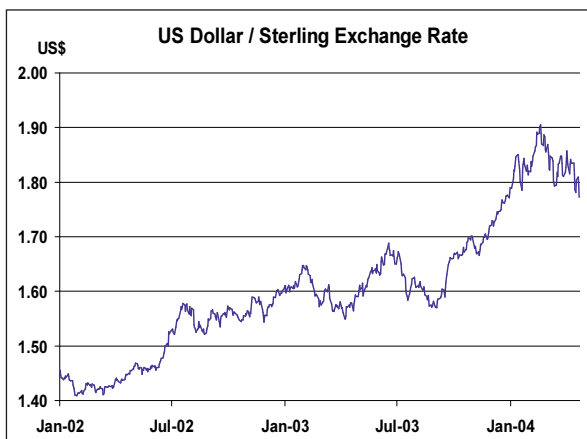
We have always been confident that the US expansion would eventually deliver on the jobs front. Indeed, we had consistently highlighted the many labour market indicators that pointed to an imminent pick up in non-farm payrolls. This, in turn, had always coloured our view that the dollar's downside would be limited, particularly as the ECB and eurozone government politicians had indicated their resistance to the euro going above the \$1.30 level.

Though market conditions will remain volatile, the dollar should have more upside potential in the near term, particularly if upcoming data are supportive. The next big test will be April's non-farm payrolls on 7 May. Another favourable number should consolidate dollar/euro within a \$1.15-1.20 range. This range may persist for some time.

However, in light of the dollar's more fundamental problems and the possibility that the growth in the US economy could peak around mid-year, **we are reluctant to call the euro much below the \$1.15 level on any sustained basis over the balance of 2004.**

Sterling Correction On Dollar Rebound

The dollar's recovery saw sterling lose ground in common with other high yielders with the UK currency falling to \$1.76 from a peak of \$1.905 in mid-February. However, sterling has also eased against the euro recently, after several moves towards the £0.65 level proved unsuccessful. On a trade weighted basis, sterling is 1.3% below its highest point in April.



Sterling also weakened slightly when the Bank of England failed to raise official interest rates in early April. Some recent economic data have also been disappointing. However, the housing market and consumer debt data continue to be very strong. **Expectations, therefore, that official interest rates will be raised in May should help support sterling.**

As we envisage that the dollar could retain its recent momentum, **there is scope for cable to fall to the bottom of a \$1.75-\$1.80 range over the next three months.** A similar range could persist over the following three month period. However, **there is room for renew dollar weakness towards the end of the year which would push cable back to within \$1.80-\$1.85.**

Sterling's weakness against the dollar brought about a fall versus the euro which tended to go against economic fundamentals. Factors such as the weaker euro area economy relative to the much healthier UK economy and the positive interest rate gap in sterling's favour should re-establish themselves in due course. As a result, **we expect that sterling/euro will trade within a £0.65-£0.67 range over the next three months and possibly move to £0.64-£0.66 on a 3-6 month view.**

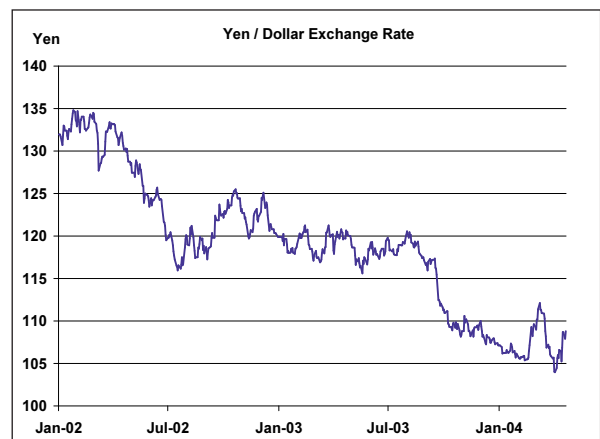
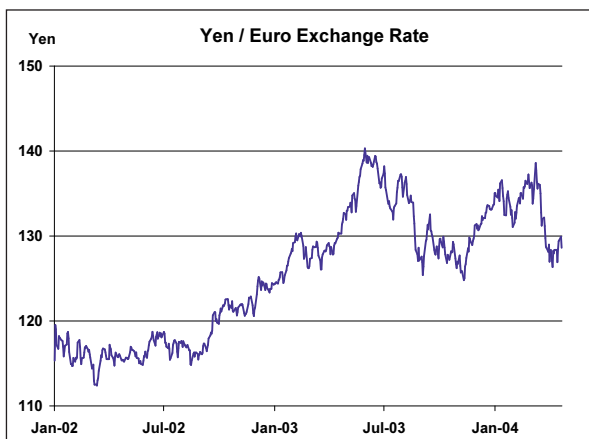
Yen Has Scope For Gains Versus Dollar

It was envisaged that the recovery in the Japanese economy would provide scope for the yen to appreciate further versus the dollar, thus providing the US currency with some relief in Asian markets. However, the general rebound in the dollar saw it rise to above Y109 in mid-April.

Conditions have changed in relation to this currency pairing. There is obviously less intervention by the Bank of Japan and the dollar has found renewed support in US economic data. On the other hand, the increasing signs of Japanese economic recovery should allow the yen to gain on the dollar, thus contributing towards a correction of the significant US current account deficit.

It is clear that in the short term, upcoming US economic data will carry greatest weight on the direction of the dollar-yen exchange rate. We expect the dollar to trade within a Y105-Y110 range over the next few months. Beyond that we see scope for yen appreciation within a Y103-Y108 range.

Finally, recent G7 statements indicate that there is now general satisfaction with the balance of currency relationships, even if the dollar's overall decline is insufficient to remove a key global imbalance as represented by the US current account deficit.



KEY MARKET EVENTS

Week 1 <i>(26-30 Apr)</i>	April 27	Eurozone	German Ifo Business Survey (Apr) Lead indicator of the strength of the German/eurozone economy. Weak growth is pressurising ECB to cut rates.
	April 29	US	GDP (Q1 Advance) GDP growth expected to have remained firm, which could provide further support to the dollar.
	April 30	Eurozone	HICP (April Flash) Could show inflation picking up towards 2% again.
Week 2 <i>(3-7 May)</i>	May 3	US	Manufacturing ISM/NAPM (Apr) Important lead indicator of US economic activity.
	May 4	Eurozone	Manufacturing PMI (Apr) Important indicator given the concerns about the strength of the eurozone economy.
		US	FOMC Policy Meeting No change in rates expected but any change in the accompanying statement will be important.
	May 5	US	Non-Manufacturing ISM/PMI (Apr) Strength of the employment component will be of particular interest ahead of the April payrolls numbers.
	May 5/6	UK	BoE Policy Meeting (2 Day) Rate hike of 0.25% widely anticipated.
	May 6	Eurozone	Services PMI (Apr) Has fallen back in recent months so needs to show renewed strength to bolster economic recovery hopes.
	May 6	Eurozone	ECB Policy Meeting & Press Conference ECB likely to resist pressure to cut rates but tone of press conference will be important.
	May 7	US	Non-Farm Payrolls (Apr) Another good number following the strong March data would add to expectations of a summer rate hike in the US.
Week 3 <i>(10-14 May)</i>	May 11	UK	Manufacturing Output (Mar) Looking for a pick up in activity after the poor data for Jan and Feb. Important for UK rates.
	May 12	US	Trade Balance (Mar) Given the continuing focus on the current account, an important event for the dollar.
	May 12	UK	BoE Quarterly Inflation Report Important event for sterling and UK interest rates.
	May 13	US	Retail Sales (Apr) The strength of March sales may not be maintained.
	May 14	US	Consumer Prices (Apr) Signs of strengthening inflationary pressures in the March data make this a key report.

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