FOR PROFESSIONAL CLIENTS AND QUALIFIED INVESTORS ONLY

European Central Bank (ECB) Commentary

December 2020

In its final meeting of the year, the Governing Council of the European Central Bank (ECB) agreed some key changes to its monetary policy stance. While key interest rates remain unchanged, additional measures were announced relating to the pandemic emergency purchase programme (PEPP) and targeted longer-term refinancing operations (TLTROs), among others.

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Key highlights

The European Central Bank expanded its massive monetary stimulus program by another 500 billion euros (USD $605 billion), as a second wave of lockdown measures weighs on the euro area's economic recovery.

The total asset purchase value is now 1.85 trillion euros, and the ECB extended the horizon for purchases under the PEPP to March 2022. Reinvestments of assets maturing from the PEPP have also been extended until the end of 2023. In addition, the total amount that counterparties could borrow in TLTRO III has been increased to 55% of their stock of eligible loans.

In a statement following the decision, the ECB said it would conduct net purchases until its Governing Council judges that the "coronavirus crisis phase is over," and restated that interest rates would remain at their current low levels until the central bank sees the inflation outlook "robustly converge" to its target of "close to, but below" 2%.

The ECB said it would "continue to monitor developments in the exchange rate with regard to their possible implications for the medium-term inflation outlook." ECB President Christine Lagarde restated in a subsequent news conference that the euro zone's central bank does not target the exchange rate.

During the press conference, President Lagarde outlined the central bank's new economic forecasts, including small reductions in inflation expectations for 2021 and 2022. The new forecast for GDP growth this year is -7.3%, with 3.9% expected in 2021 and 4.2% in 2022.

These changes were expected given the second wave of the virus spreading throughout Europe. Uncertainty remains high and risks remain tilted to the downside, while inflation is likely to remain negative into early 2021, when the temporary German VAT reduction ends, before rebounding. ECB President Lagarde then went on to say that price pressures are likely to remain subdued due to the higher exchange rate (€ @ USD$1.21) and weaker demand.

In Money Markets the PEPP is likely to keep a lid on credit spreads whilst the TLTRO's are likely to keep downward pressure on Euribors throughout the whole of next year and in to 2022. Previously there was an expectation that with the end of the special interest rate period in June 21 we may have seen yields begin to pick up, this has now been pushed to mid 2022.

Rates	**Current (10 December 2020)**	**Previous (30 October 2020)**
Overnight repo rates	**-0.68% - -0.58%**	**-0.63% - -0.54%**
Overnight deposit rates	**-0.65% - -0.55%**	**-0.6% - -0.53%**
3 month indicative Euro Commercial Paper (ECP) level	**-0.69% - -0.56%**	**-0.54 - -0.62**
1 year indicative ECP level	**-0.53 – -0.61%**	**-0.55% –0.49%**

Source: BlackRock, using Bloomberg data, as at 10 December 2020. Where $ is used, this refers to US Dollars.

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Strategy for the Institutional Cash Series (ICS)

BlackRock ICS Euro Government Liquidity Fund

Short-Term Public Debt Constant NAV (CNAV) Fund

November saw positive news of vaccine testing pushing rates initially higher before being tempered by the reality that rates will still need to remain low for some time to deal with the economic fallout of COVID. In the Euro bill market this was reflected in cheaper auctions for the first two weeks of the month but then saw levels trend back to the -0.65% to -0.70% range for core Sovereigns. With year-end now the major focus we expect bills to continue to richen as we move into December with negative supply dynamics expected. Fund AUM in November remained range-bound between €100 million to €110 million. The fund favours French bonds and bills currently due to better relative value characteristics along with continued allocations to overnight repurchase agreements seeking to maintain good liquidity. With some risks fading we have marginally extended fund weighted average maturity's (WAM's) closer to the 40-day range and looking forward will expect to maintain this duration as we manage potential year-end flows and more stressed market conditions.

BlackRock ICS Euro Liquidity Fund / BlackRock ICS Euro Liquid Environmentally Aware Fund (LEAF)

Short-Term Low Volatility NAV (LVNAV) Fund / Short-Term Variable NAV (ST VNAV) Fund

There were strong inflows in the last two weeks of the month, as the risk-on move sparked by the outcome of the US election and positive vaccine news was replaced by the reality that rates will need to remain low for some time to deal with the economic fallout of COVID. Financials continued to richen throughout November, helping to drive Euribors down to yet new all-time lows, whilst rate cut expectations faded with most commentary from the ECB falling on the side of changes to the PEPP and TLTRO's. With some of the risks we had been positioning for fading, and with an eye on year-end, we reduced weekly liquidity from 60% down to 50%, whilst increasing Weighted Average Maturity's from 35 to 45 days. The ECB signified their willingness to maintain a dovish stance tweaking both PEPP and TLTRO's. This should keep downward pressure on rates as we head into next year. With issuance likely to deteriorate towards the end of December we will be targeting WAM's around 45 days and weekly liquidity in the 45% to 50% range, with the onus being on managing liquidity over year-end.

BlackRock ICS Euro Ultra Short Bond Fund

Standard Variable NAV (VNAV) Fund

With the US elections behind us and the positive developments of a series of coronavirus vaccines we have turned more positive and have started to add back small amounts of risk in the portfolio.

Against this backdrop, we have reduced our daily liquidity from around 28% to 22% but it remains overall relatively high. Early November, we added duration by buying 1y and 9m ECPs and have also increased the spread duration by participating in a Floating Rate Note new issue. The remaining investments were done in the lower credit tier, A2/P2 at the front end of the curve, typically within 3-month maturity. As a consequence, our duration increased marginally from 0.14y to 0.17y over the month but remains short mainly due to low yields and the market exception of a rate cut. The ECB signified their willingness to maintain a dovish stance tweaking both PEPP and TLTRO's. This should keep downward pressure on rates as we head into next year. The spread duration of the fund stands at 0.50y at the end of the month, slightly higher than 0.47y for the previous month.

European Commercial Paper (ECP) levels stabilized in November with most of the ECP yields being unchanged to 1 bp lower while credit spreads tightened during the month on the back of the vaccine news, which should have a positive impact on this month's performance.

A Money Market Fund (MMF) is not a guaranteed investment vehicle. An investment in MMFs is different from an investment in deposits; the principal invested in an MMF is capable of fluctuation and the risk of loss of the principal is to be borne by the investor. The MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilising the NAV per share.

Source: BlackRock, using Bloomberg data, as at 10th December 2020.

The opinions expressed are as of 10 December 2020 and are subject to change at any time due to changes in market or economic conditions. There is no guarantee that any forecasts made will come to pass.

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Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

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Short-Term Money Market Funds do not generally experience extreme price variations. Changes in interest rates will impact the Fund. Standard Money Market Funds do not generally experience extreme price variations. Changes in interest rates will impact the Fund. Levels of credit risk are affected by longer weighted average maturity and weighted average life of the Fund.

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Important information

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Important information

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