

# Institutional Liquidity Fund

## Monthly Market Commentaries

APRIL 2010

For Professional Investors Only

# BLACKROCK

### US Dollar Market Review

The Federal Open Market Committee (FOMC) maintained the Federal Funds target rate at 0.00% to 0.25% at the April 18 meeting, again citing low rates of resource utilisation, subdued inflation trends and stable inflation expectations. The FOMC also retained and reiterated that economic conditions are “likely to warrant exceptionally low levels of the Federal Funds rate for an extended period” of time. However, the continuing strength in economic activity and improvements in the labour market were acknowledged and the FOMC stated that while “growth in household spending has picked up recently”, it remained constrained by “high unemployment, modest income growth, lower housing wealth, and tight credit” lending and conditions. The statement highlighted that given the improvements in financial market conditions, all but one of the Federal Reserve liquidity facilities that were created for registered 2a7 Funds to support the markets have been successfully closed. The remaining facility, the Term Asset-Backed Securities Loan Facility, is scheduled for closure on June 30th.

Libor settings rose as much as 10 basis points in April, with the largest increases observed in longer-dated tenors. The slope of the Libor curve, as measured from one month to one year, steepened to 74 basis points from 67 basis points the prior month.

During April, yields on Treasury bills out to three months were unchanged amidst high overnight financing levels and a saturation of supply. The 6-month sector, which remained unchanged in April, served as the fulcrum of the yield curve. The longer end of the curve was only modestly higher by one basis point. Net Treasury bill supply increased by \$39 billion in April. The Treasury’s Supplementary Financing Program increased to \$200 billion in April. The programme is now in its weekly rollover phase, which is expected continue into 2011. The Federal Funds open averaged 0.20% on the month and consequently, pressured financing levels for the second straight month with yields on repurchase agreements trading at an average of 0.18% for Treasury collateral and 0.19% for mortgage collateral.

### Euro Market Review

The European Central Bank (ECB) kept interest rates unchanged during April, which was widely expected by the market. The main refinancing and deposit rates remain at their historical lows of 1.00% and 0.25% respectively. Increasing turbulence in the euro zone overshadowed the markets during the month, led by ongoing challenges in Greece. Although a substantial aid package was announced for Greece at the end of the month, markets are increasingly concerned that contagion could spread to other European countries, particularly those with large fiscal imbalances and looming re-financing pressures. This has caused significant tiering between various sovereigns in the euro zone, with core countries such as Germany, France and the Netherlands benefitting from a flight to quality, while peripheral countries such as Greece, Portugal, Ireland, Spain and Italy face declining demand and rising risk premiums. Uncertainty is likely to remain high in the weeks ahead, as many countries deal with the competing challenges of rising fiscal pressures and significant borrowing needs, against a backdrop of sluggish economic activity and delicate financial markets. Based on these conditions, the ECB is likely to proceed slowly and cautiously with any significant future changes to monetary policy and liquidity support mechanisms.

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## Euro Market Review - continued

Economic activity was lacklustre in the euro zone during the month, along with continued low inflation pressures. Fourth quarter gross domestic product was revised down to zero from 0.1%, as corporate investment declined by a larger degree. Retail sales fell by 1.1% in February, bringing the year-over-year decline in sales to 0.6%. Manufacturing and service sector activity continued to expand by a modest degree, while unemployment remained unchanged at 10.0%. Inflation measures increased during the month on the back of rising energy prices, but remain well below the ECB's inflation target of 2.0%. Overall inflation rose by 0.9% during March to 1.4% annualised while core prices increased by a rate of 1.0% annualised. The ECB reiterated its expectations for "real GDP growth to continue to expand at a moderate pace in 2010" and that "price developments are expected to remain moderate over the policy-relevant horizon".

Euro money market yields rose slightly during April as risk premiums came under pressure in line with increasing market turbulence. The money market yield curve remains steep, due to the significant amount of excess liquidity that remains in the financial system. This has caused short-term euro rates to yield significantly below the 1.00% refinancing rate, while longer-term rates remain higher. Additionally, most high quality money market issuers continue to yield at levels significantly below LIBOR rates due to high demand and limited supply conditions across the maturity spectrum. One, three, six and twelve-month LIBOR rates ended the month at 0.38%, 0.61%, 0.91% and 1.22% respectively.

## Sterling Market Review

The Bank of England (BOE) kept both interest rates and quantitative easing unchanged at its April meeting, which was widely expected by the market. The Monetary Policy Committee (MPC) voted unanimously to maintain official rates at their historical low of 0.50% and the size of the Asset Purchase Facility at £200 billion. Minutes from the meeting indicated growing uncertainty over the balance of risks in the UK economy. Some members of the committee expressed concerns over rising short-term inflation pressures, which could lead to higher inflation expectations, while others worried that increasing turbulence in Europe could further downside risks to growth and the financial market recovery. Furthermore, with increasing uncertainty over the upcoming election in May, details of the fiscal impact on the UK economy are still unknown. Based on these conditions, the MPC is likely to continue to proceed slowly and cautiously with any future changes to monetary policy. The market continues to expect that interest rates will remain on hold for at least the next six months.

UK economic activity was mixed during the month, along with signs of rising short-term inflation pressures. First quarter GDP was weaker than expected at 0.2%, after having expanded by 0.4% in the prior quarter. Service and manufacturing sector activity continued to expand by a modest degree, while housing prices remained firm as surveys pointed to rising prices during the month. Retail sales were weaker than expected during March, but advanced by 0.4% for the month, while unemployment jumped by 0.2% to 8.0%. Overall consumer prices rose sharply during March, by 0.6%, bringing annualised inflation measures to 3.4%. The larger than expected increase is due predominantly to the recent rise in energy prices. Despite the increase in short-term pricing pressures, along with growing concerns from the MPC over upside risks to inflation, the committee continued to reiterate that "inflation would moderate later during 2010, reflecting the influence of prices of the significant margin of spare capacity in the economy".

Sterling money market yields rose slightly during April as risk premiums came under pressure in line with the increasing market turbulence. Three-month LIBOR rose by 0.03% to 0.68%, as the yield curve steepened in comparison to overnight base rates. Longer-term money market yields rose by 0.04% to 0.05% with six-month and one-year LIBOR ending the month at 0.93% and 1.37% respectively. The increase in market volatility and risk aversion has caused price tiering to increase between various money market issuers. High quality issuers from well regarded countries continue to yield at levels below LIBOR rates, while lower quality issuers, especially those from less regarded countries, experienced rising risk premiums during the month.

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