

DANMARKS NATIONALBANK

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Higher risk premium despite unchanged risk

Equity risk premium has increased while interest rates have fallen

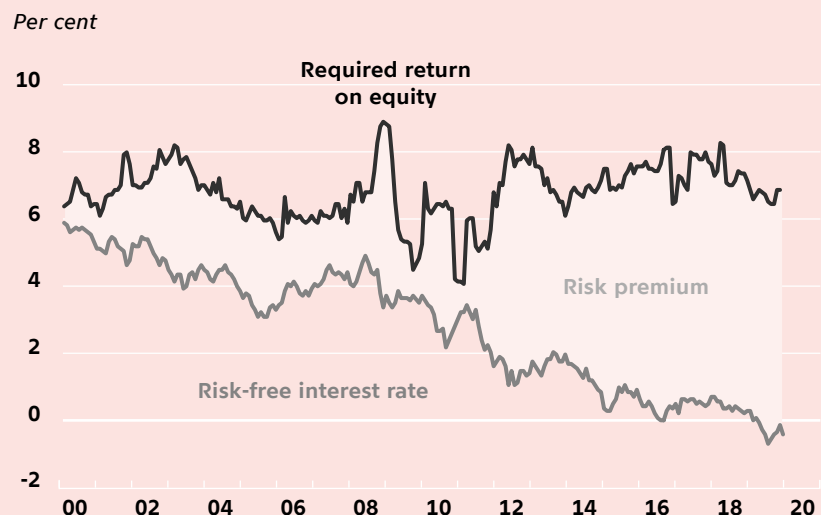
Before the financial crisis, investors typically expected an annual return on equities of around 7 per cent, while the return on 10-year treasury bonds was around 4 per cent. Today, the return on 10-year treasury bonds is close to zero, while investors still expect a return of around 7 per cent when investing in equities.

The risk premium for investing in the equity market rather than safe assets such as government bonds has thus doubled since the start of the financial crisis more than 10 years ago.

Investors are risk averse, and they therefore require a compensation for taking on a greater risk. The compensation is called a risk premium and can be defined as the excess return provided by investing in risky equities over a risk-free investment in government bonds.

The economists Søren Lejsgaard Autrup and Jonas Ladegaard Hensch from Danmarks Nationalbank analyse in a new Economic Memo whether the risk on future dividends to equities has increased and therefore can explain the higher risk premium. They

Risk premium doubled in 10 years



Source: Refinitiv Datastream and own calculations.

do not find much evidence of that. Instead, the memo presents other explanations based on how investors behave in financial markets. One explanation is that the rising aggregate savings of the society are placed in bonds and bank deposits rather than in equities. Another explanation is that investors in equities are skeptical of the currently low interest rates and just stick to requiring the same overall return on equities.

A fluctuating equity risk premium impact the financing costs of companies. This is because companies

to a large extent rely on equity financing. The increasing equity risk premium may help to explain why the increase in corporate investments has not been greater despite significant declines in interest rates after the financial crisis.

Find the new Economic Memo on the development in the equity risk premium since the start of the financial crisis on Danmarks Nationalbank's website ([link](#)).

PUBLICATIONS



NEWS

News offers a quick and accessible insight into an Analysis, an Economic Memo, a Working Paper or a Report from Danmarks Nationalbank. News is published continuously.



ANALYSIS

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REPORT

Report comprises recurring reports and reviews of the functioning of Danmarks Nationalbank. For instance Report includes the *Annual report* and the annual publication *Danish government borrowing and debt*.



ECONOMIC MEMO

Economic Memo is a cross between Analysis and Working Paper and it often shows the ongoing study of the authors. The publication series is primarily targeted at professionals and is solely available in English. Economic Memo is published continuously.



WORKING PAPER

Working Paper presents research projects by economists in Danmarks Nationalbank and their associates. The series is primarily targeted at professionals and people with an interest for academia. Working Paper is published continuously.

The news article consists of a Danish and an English version. In case of doubt regarding the correctness of the translation the Danish version is considered to be binding.

DANMARKS NATIONALBANK
HAVNEGADE 5
DK-1093 COPENHAGEN K
WWW.NATIONALBANKEN.DK



**DANMARKS
NATIONALBANK**

CONTACT

Ole Mikkelsen
Communications
and Press Officer

omi@nationalbanken.dk
+45 3363 6027

SECRETARIAT
AND COMMUNICATIONS