

DANMARKS NATIONALBANK

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SECURITIES, MARCH 2019

Large decline in mortgage bond duration

A fall in the long-term interest rates in March contributed to a decline in the average duration of fixed-rate callable mortgage bonds of 1.8 years to 3.1 years. Since the end of last year the duration has fallen by 2.8 years. Callable bonds total kr. 1,043 billion.

Duration is a measure of the average maturity of the mortgage bonds.¹ The fall in the long-term interest rates in March reduced the duration of fixed-rate callable mortgage bonds as it became more attractive for borrowers to convert their mortgage loans. This increased the likelihood of the underlying bonds being called.

The duration of the insurance and pension sector's, I&P's, fixed-rate callable mortgage bonds is more or less halved since the end of last year and is currently 3.3 years. I&P owns 34 per cent of the fixed-rate callable bonds.

For F&P it is crucial to have long assets, e.g. long bonds, to match the long-term liabilities. I&P may counter the reduction in duration of mortgage bonds by buying long bonds or by entering into interest-rate swaps where they receive long interest rates and pay a short interest rate.

Fluctuations in the long-term interest rates have also previously led to large changes in the duration of fixed-rate callable mortgage bonds. At the beginning of last year, an increase in the interest rates led to an increase in the duration. Fluctuations in interest rates and accompanying changes in the duration may lead to self-reinforcing effects on the interest rates. A fall in the interest rates and the duration may e.g. increase the demand for long-term mortgage bonds by investors who look for a long duration. The increased demand may push the interest rates further down.²

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Decline in the duration of fixed-rate callable mortgage bonds



Note: I&P's investments through Danish investment funds are included.

Source: Rio Scanrate and Danmarks Nationalbank.

¹ However, the duration is lower than the maturity as the timing of the payments on the bond, including installments, and the fact that the bonds may be called are taken into account.

² Cf. Box 1 in Danmarks Nationalbank, Optimism in the banking sector provides breeding ground for increased risk-taking, *Danmarks Nationalbank Analysis (Financial Stability - 1st half)*, no. 11, June 2017.