

DANMARKS NATIONALBANK

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Mortgage bonds have become longer

A rise in the long-term interest rates in February 2021 contributed to an increase in the duration of fixed-rated callable mortgage bonds from 4.8 to 6.3 years. At the end of February, the total outstanding volume of callable mortgage bonds was kr. 1,356 billion.

The duration can be interpreted as a measure of the bonds' average maturity. The rise in the interest rate in February has made it less attractive for Danish borrowers to refinance their mortgage loans into lower-rate loans. This reduces the likelihood that the underlying mortgage bonds are redeemed, which extends the expected average maturity – and thus the duration – of callable mortgage bonds.

The duration is also an expression of how sensitive the prices of bonds are to changes in interest rates, and therefore it is key to investors' portfolio management.

High duration can be self-perpetuating

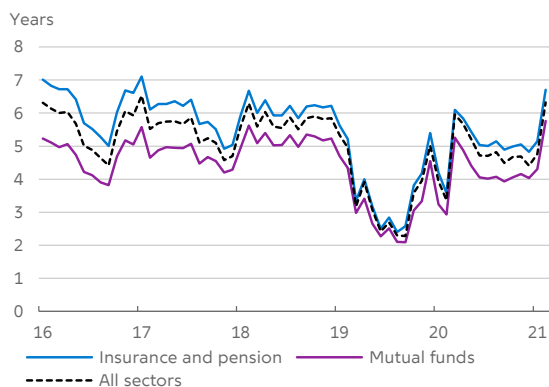
Rising interest rates and increasing duration can have a self-perpetuating effect by potentially not only reducing demand for long-term mortgage but also other long-term bonds, including government bonds. The declining demand can temporarily push up interest rates even further.

The insurance and pension sector owns a large part of the mortgage market. Their portfolio of callable mortgage bonds amounts to kr. 443 billion with a duration of 6.7 years. The sector uses long-term mortgage bonds to hedge their long-term pension agreements. However, for this purpose they also make extensive use of interest rate swaps. Therefore the sector has several ways to handle the changes in the duration of mortgage bonds.

Mutual funds follow the duration benchmark

In February, the duration of the investment funds' portfolio, which amounts to kr. 247 billion, increased from 4.3 to 5.8 years. Mutual funds typically manage their portfolio according to a given benchmark. If the duration of the actual portfolio does not match the benchmark, it may lead to the sale or purchase of long-term bonds. The effect depends on the composition of the benchmark, and the framework for how much the actual portfolio may deviate from the benchmark.

The duration of mortgage bonds increased in February 2021



Note: Duration stated in years. Insurance and pension include their capital funds. All sectors contains the total market of mortgage bonds including other domestic sector and abroad.

Source: Rio Scanrate and Danmarks Nationalbank.

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