

DANMARKS NATIONALBANK

LIQUIDITY IN THE DANISH MORTGAGE BOND MARKET

CCBS Workshop for Heads of Financial Stability 23 February 2016, Peter Ejler Storgaard

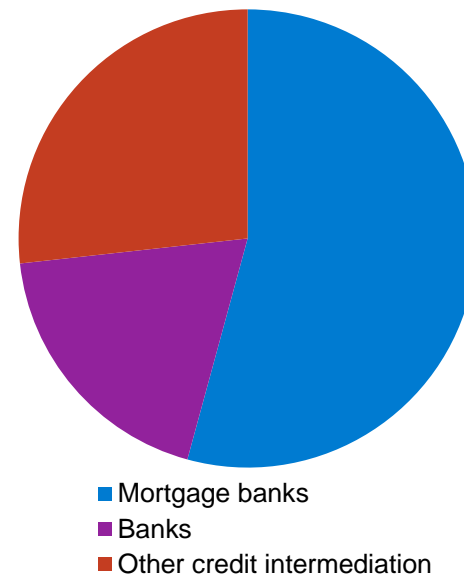


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Market liquidity in focus

- International focus on development of market liquidity
- Decline and/or less resilient?
- Causes?
 - Changing market structures?
 - New regulation?
- In Denmark
 - Mortgage bonds are central in Danish credit market
 - Liquidity in this market important for financial stability

Credit intermediation in Denmark



Source: Danmarks Nationalbank, third quarter 2015

Key questions and analytical framework

Key questions:

- Has market liquidity of Danish mortgage bonds declined?
- How does the Danish market structure affect liquidity?

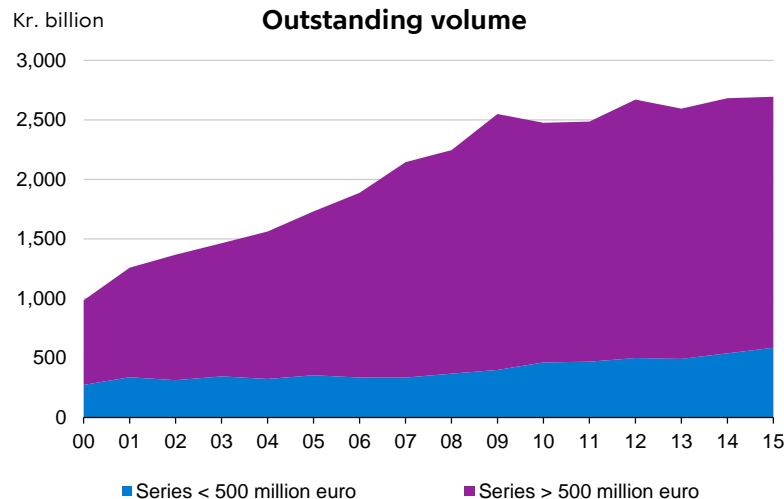
Analysis:

- Estimation of liquidity measures
- Based on MiFID transaction reports
- Supplemented by working group with market participants

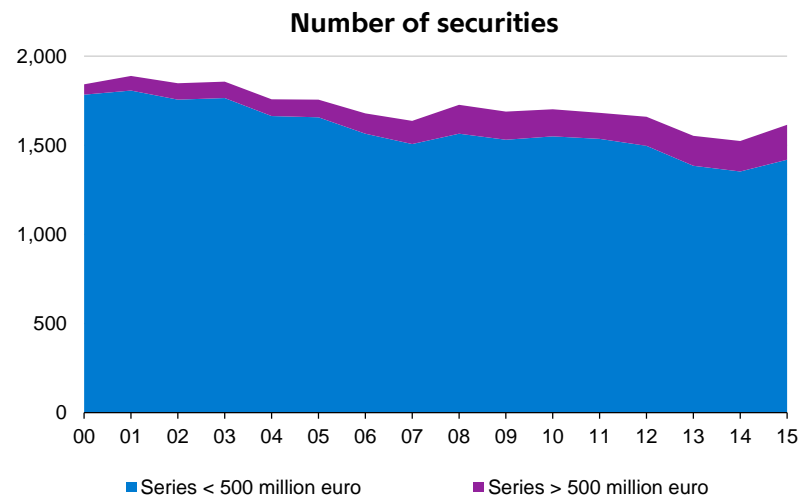


A quick overview of the Danish mortgage bond market

Outstanding volume concentrated in large series

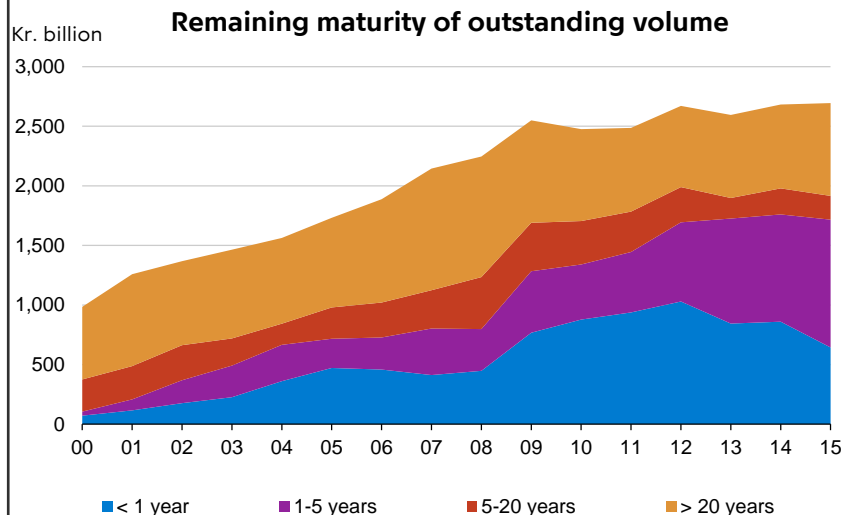


But still a large number of small series

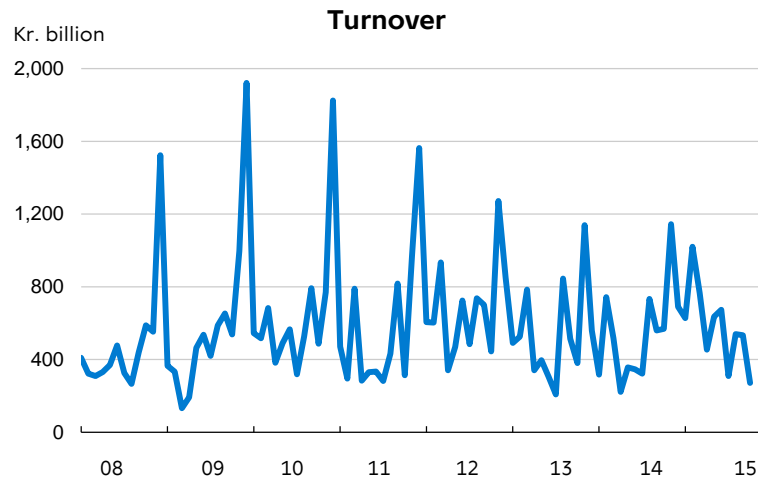


Refinancing risk and turnover

Maturities of outstanding volume has increased in recent years



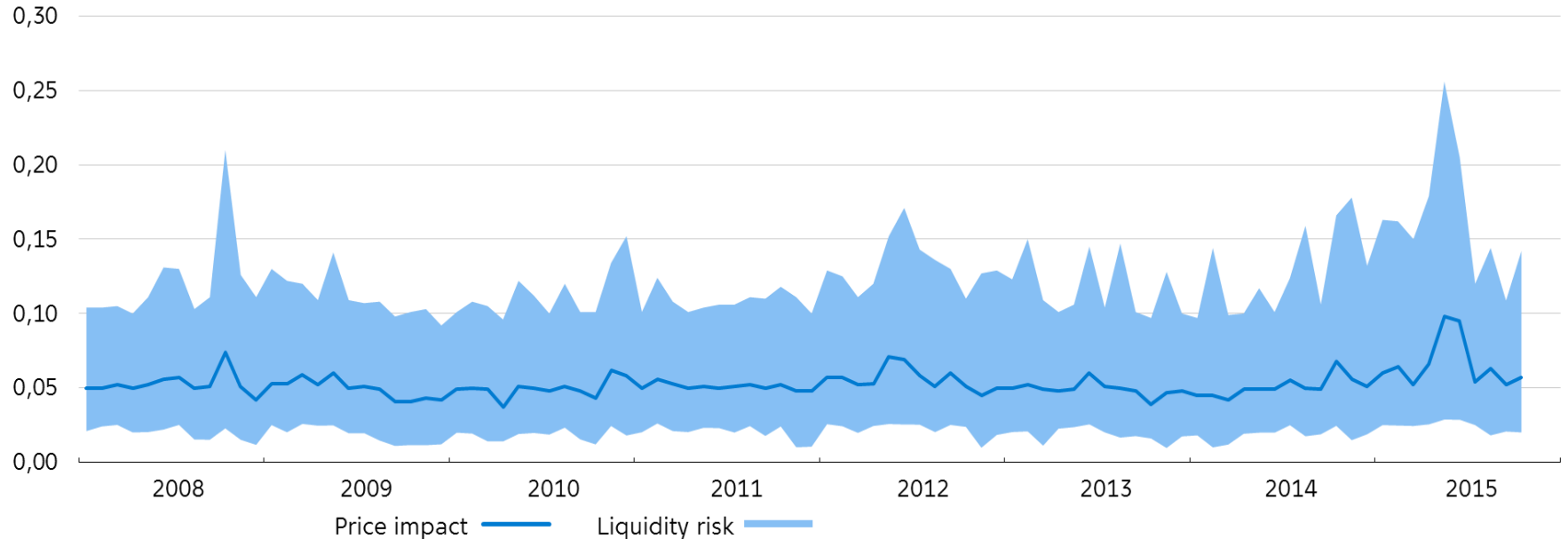
Refinancing auctions has been spread out



Liquidity measure stable over time – but volatility has increased from 2014

Price impact of trades

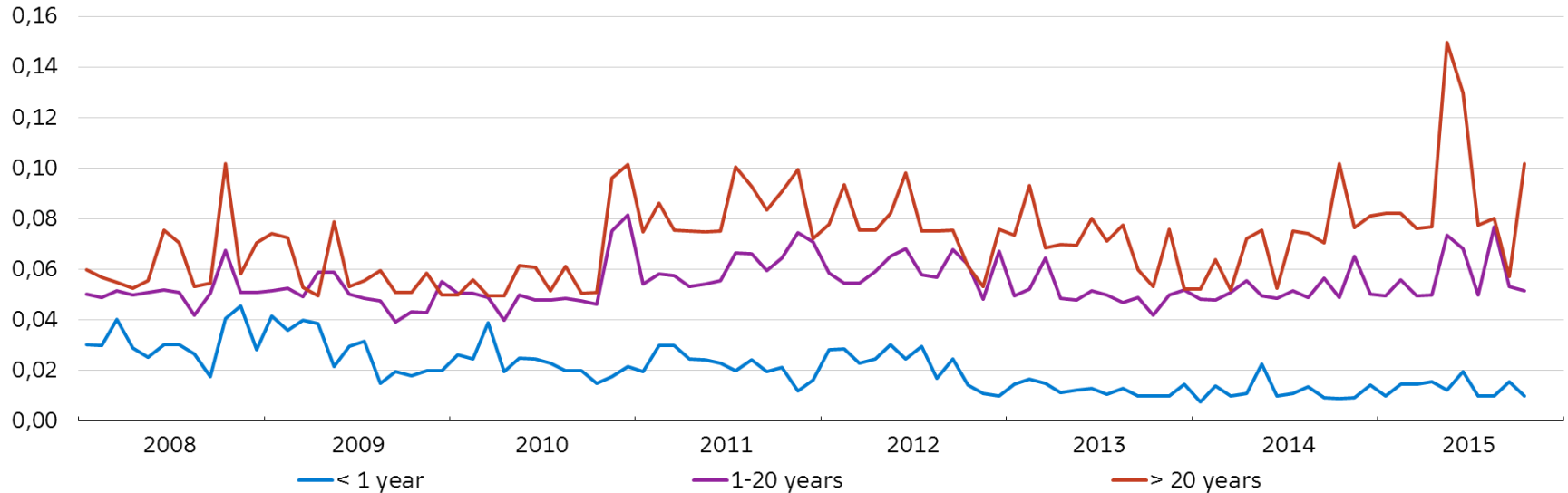
Per cent of market value



Source: MiFID transaction reports

Price impact of trades across maturities

Per cent of market value

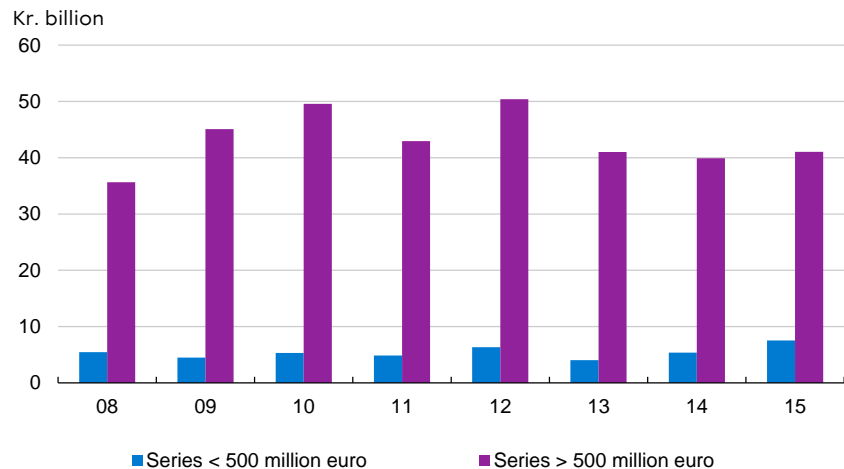


Source: MiFID transaction reports

Liquidity across series volumes

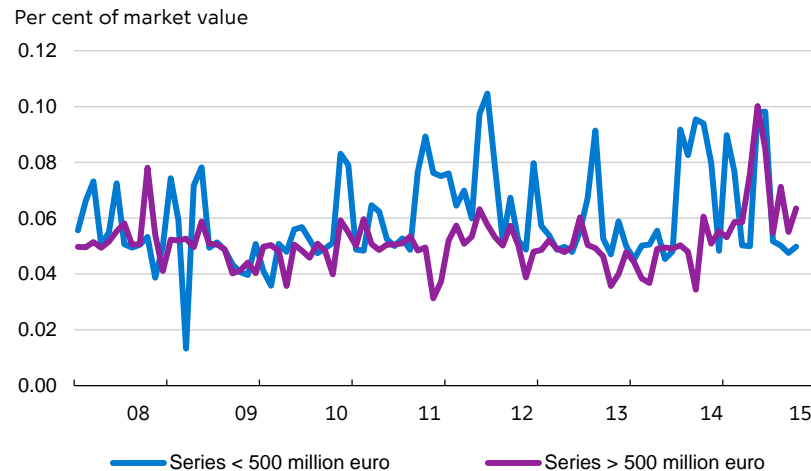
No significant decrease in turnover

Average monthly turnover



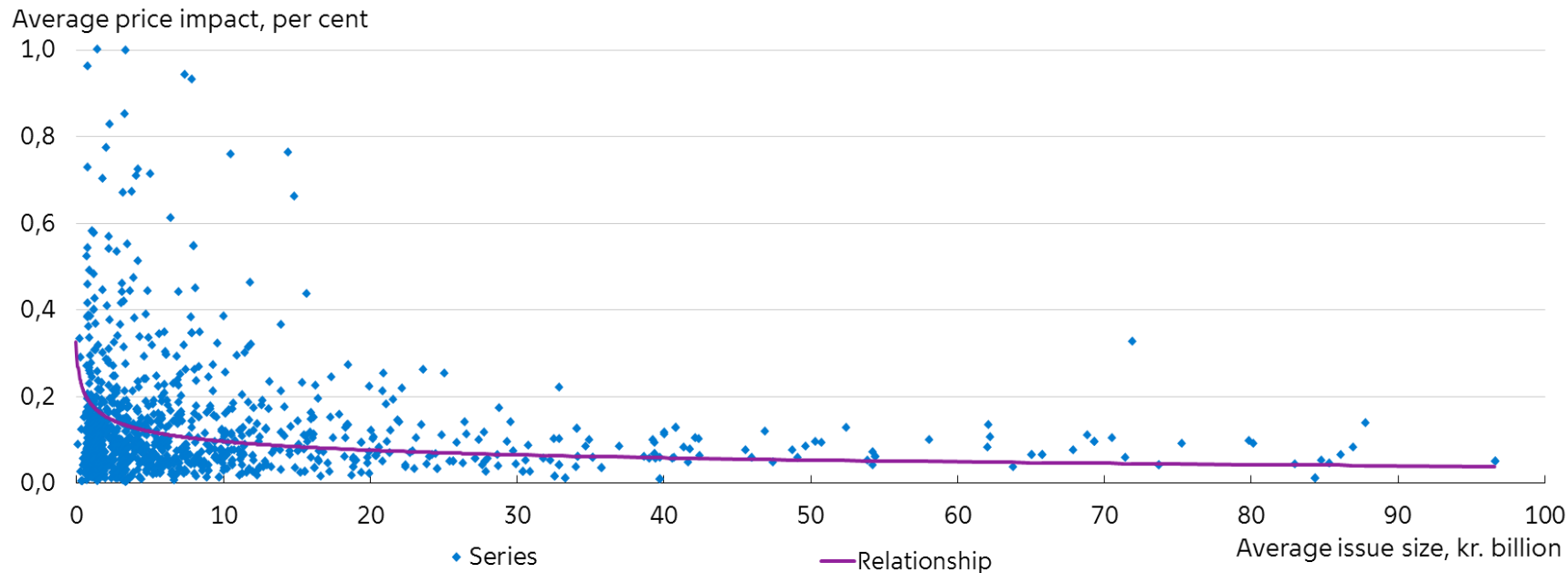
Small difference in liquidity between small and large series

Price impact of trades



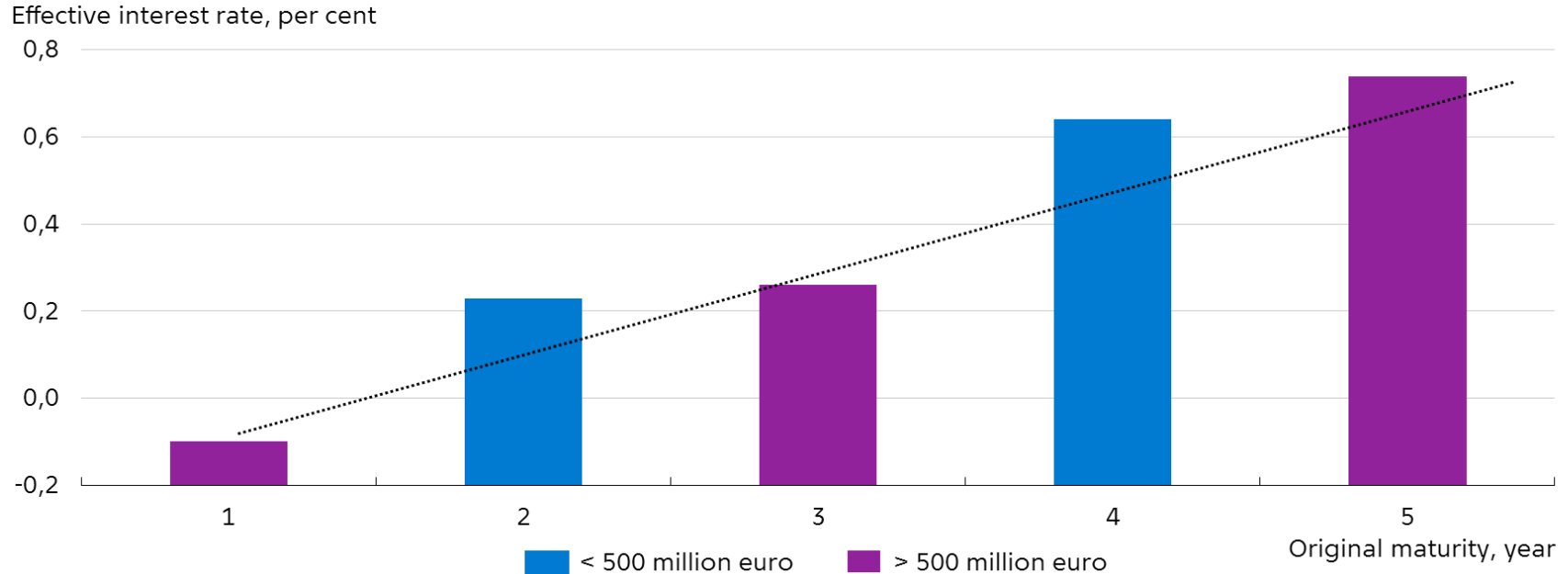
Lower liquidity in the smallest series of all

Cross-section of 1-year bonds



Source: MiFID transaction reports

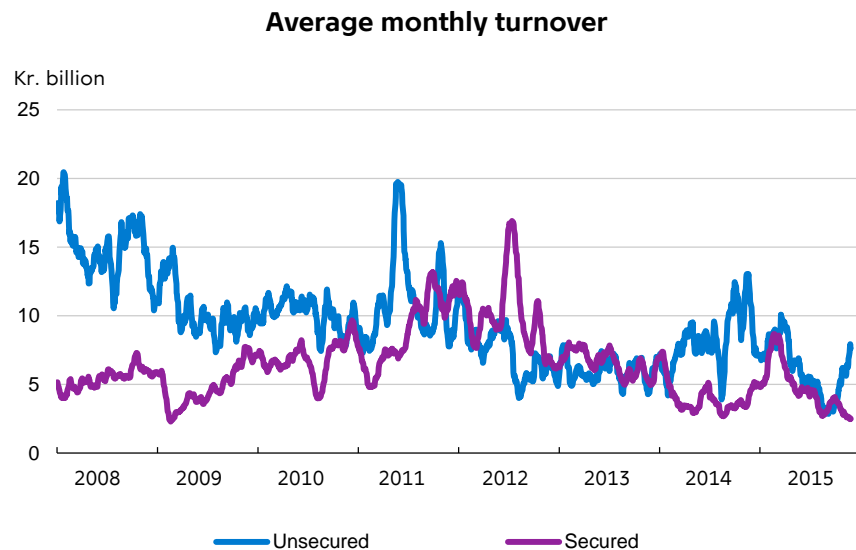
Premium on small bond series



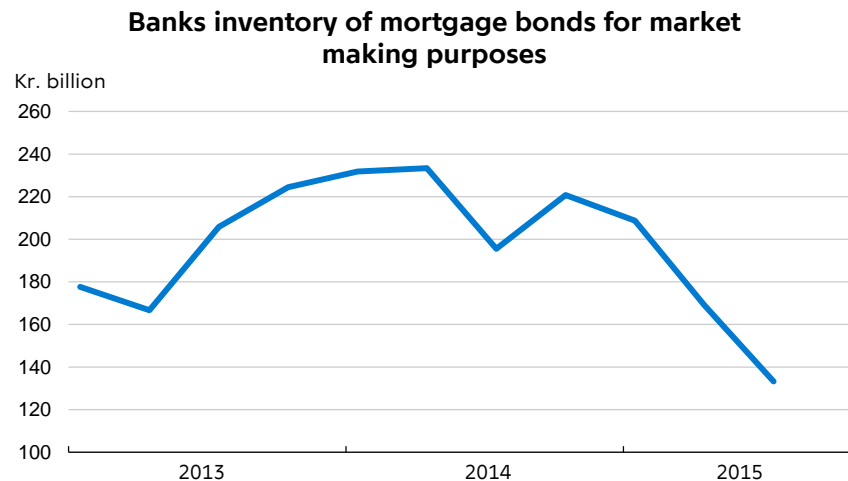
Note: The chart shows the effective interest rate on five Realkredit Danmark issuances of SDROs at refinancing auctions in the period 17-18 November 2015.
Source: Realkredit Danmark og Nykredit Markets

Banks are reducing market making

Turnover in repo market is decreasing



Sharp decline in banks market making inventories



Main conclusions

- The overall level of liquidity in the Danish mortgage bond market is still high, but volatility seems to have increased.
- Liquidity is slightly lower in smaller bond series, but has not decreased in recent years.
- It cannot be excluded that execution of trades has become more time-consuming.
- Decline in market support of liquidity?
 - Decreasing turnover in repo markets
 - Banks reduce market making inventories