

Outlook for 2026

Prospect of good carry or higher spreads?

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Marketing communication

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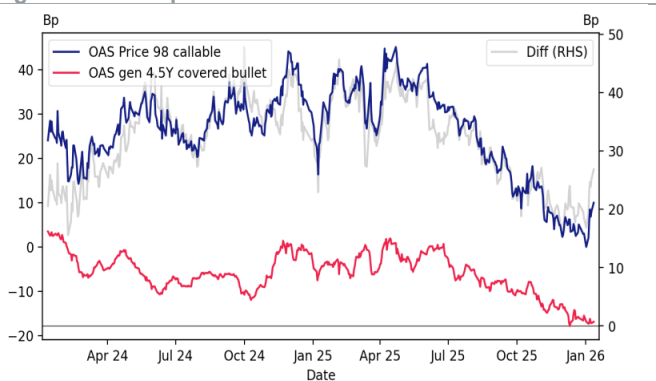
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- The performance potential of callables is low, and they are now a carry case – do investors believe in it?
- Geopolitical risks are front and centre right now – will financial markets remain resilient?
- The DKK has weakened – and a unilateral Danish interest rate hike looms in 2026

The conditions for a strong 2026 are, in some respects, weaker than they were for 2025, and geopolitical risks have intensified for Denmark. However, we find reason for restrained optimism on behalf of Danish covered bonds, and we expect 2025 to be an OK – although not impressive – (carry) year. We currently prefer 4% callables, 5Y bullets over 3Y bullets, and bullets over FRNs.

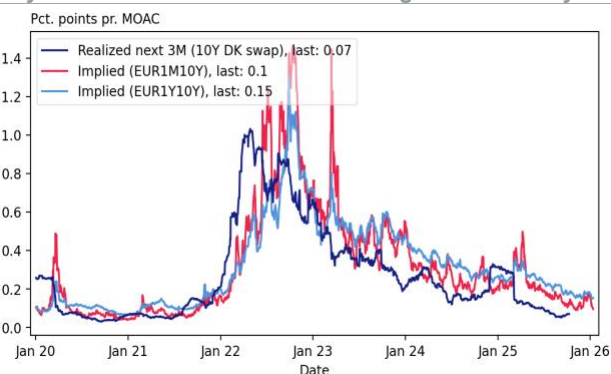
Significant OAS performance in 2025



Shows OAS swaps for OTR callables and generic bullets.

Source: Nykredit Markets

Low yield vol has led to low costs of negative convexity



Shows the "expected" cost per MOAC unit based on swaption vol and the realised cost per MOAC unit based on realised 10Y swap rate vol.

Source: Nykredit Markets

A good year – and a new starting point

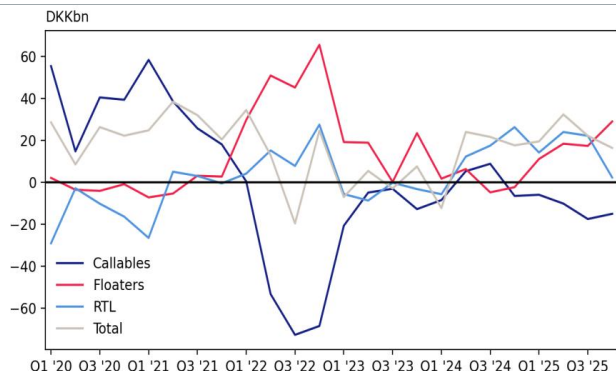
In 2025, callables had tailwinds on several fronts. We saw significant OAS performance, decreasing implied volatilities and low realised volatilities (generally lower than indicated by the implied ones). For outright investors, yield rises and a steepening of the yield curve brought some headaches towards the end of the year, but for those who hedged their interest rate risk, it is difficult to be dissatisfied.

For 5% bonds, the yield rises even prevented the prepayment "massacre" (and the issuance flood in 3.5'56) that the market feared in the wake of the yield declines in late summer of 2024. True, the outstanding amount of 5% bonds has halved since the autumn of 2024, but the massacre occurred in an orderly fashion, as prepayments were relatively moderate and stable – and 5% bonds delivered solid excess returns relative to duration-equivalent bullets. If yields had not risen in 2025, 3.5'56 would be right around a price of 99 at the current OAS level – and in that case, 5% bonds would have fared worse over the year!

In addition, the steepening of the yield curve has contributed to borrowers – including those who have refinanced 5% loans into lower coupons – moving down the curve towards the bullet and FRN segments. The issuance of callables is low, and net issuance has been negative throughout 2025 (see top chart on the next page). Thus, the callables segment shrank by almost DKK 50 billion in 2025, while the FRN and bullet segments grew by approx DKK 75 billion and almost DKK 65 billion, respectively.

These factors indicate that the steepening of the yield curve may to some extent have "made room" for the OAS performance we saw in 2025.

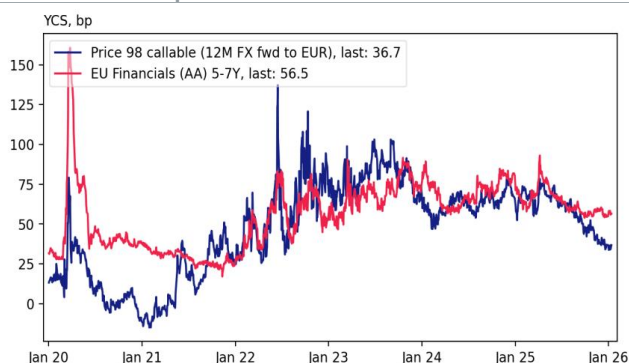
Quarterly net growth in main segments of Danish covered bonds



Q4 was impacted by JRK's refinancing of DKK 10 billion-worth of loans funded by 1Y bonds into new Cita 12M FRNs.

Source: Nykredit Markets

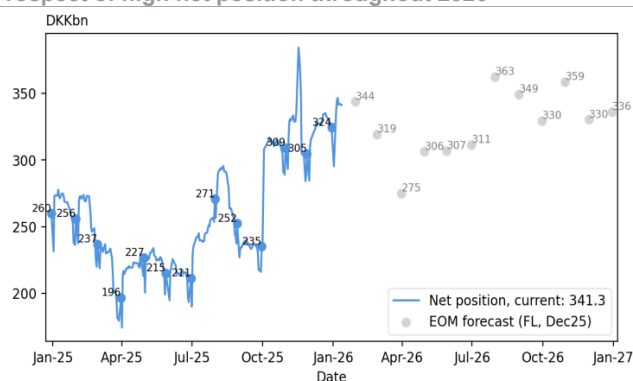
Callables look expensive relative to EU financials



Shows swap spreads with 12M FX Forward to EUR (for callables).

Source: Nykredit Markets

Prospect of high net position throughout 2026



The expected decline in the net investment position in Q1 shows recurring "seasonality" due to the timing of tax payments.

Source: Danish Ministry of Finance, Danmarks Nationalbank and Nykredit Markets

Bullets also had a decent year with significant OAS performance, and FRNs maintained low spreads vs the bullet curve, despite higher issuance in both segments. Both bullets and FRNs also started the year trading at attractive levels, after they – like EUR covered bonds – had lost value in the last few months of 2024, as a consequence of Germany's suspension of the debt brake and the prospect of increased investments in defence and infrastructure. Since then, concerns about this issuance pressure have eased, and bullets followed the spread tightening for EUR covered bonds in 2025.

Of course, there have been major and minor bumps on the road in 2025, including in connection with "Liberation Day" in early April and liquidity shortages in Q1 in particular, but as a whole, this has not prevented a good 2025.

However, the good performance in 2025 also means that, here at the beginning of 2026, the OAS levels of OTR callables and 5Y bullets are at (close to) the lowest level since the beginning of 2021 and the beginning of 2022, respectively. At the same time, the implied volatilities in the swaption market are back at the early 2022 level. In this way, the outlook for a good 2026 is not nearly as good as it was for 2025. But does this mean that there is reason for pessimism?

In the baseline scenario, 2026 looks OK!

Generally, we do not expect significant performance in callables; on the contrary, we see a risk that OAS may widen somewhat due to the current expensive relative pricing (see, for example, the chart in the middle) and diminishing tailwinds from the supply situation (see below). In 2026, callables should in our view be considered a carry case, able to tolerate some OAS widening!

However, in a baseline scenario where yields and the vol level do not change significantly, callables also have a reasonable buffer against OAS widening. For example, if we look at 4'56, it would take a 20bp OAS widening before the excess carry over one year, relative to 5Y bullets, is fully eroded (assuming unchanged OAS on 5Y bullets). This roughly corresponds to the entire OAS performance we have seen in callables relative to 5Y bullets since spring 2025 being rolled back. After all, we do not expect that to happen!

In the baseline scenario, with no significant yield decline – and potentially some spread widening – 3.5% callables are unlikely to reach sufficiently high price levels to trigger major refinancing of 5% callables into lower coupons. In this context, it should also be remembered that a change of maturity class from 2056 to 2059 will raise the bar for bringing 3.5% bonds to an attractive price level at the end of the year (the price of 3.5'59 will be approx DKK 0.90 lower than that of the existing 3.5'56). The primary prepayment traffic will therefore continue to come from fixed-to-variable refinancing.

However, fixed-to-variable refinancing will decrease in nominal terms, both because the amount of remaining 5% borrowers is shrinking from one payment date to the next, and because, all other things being equal, we expect gradually lower prepayment

rates (burnout in fixed-to-variable refinancing). As fixed-to-variable refinancing gradually becomes a smaller drain on the callables segment, the trend towards negative net growth will subside over the course of the year. In the baseline scenario, however, the net growth in the callables segment will not exceed zero.

Seen in isolation, decreasing fixed-to-variable refinancing will also weigh on the issuance of 3Y-5Y bullets compared to 2025. In addition, it will not be until 2027 that we can expect a significantly higher refinancing percentage on 5Y bullets at the refinancing auctions (until then, the loans funded by 5Y bonds being refinanced were originally raised at somewhat lower interest rate levels than the current ones). The bottom line is that the supply situation is likely to provide tailwinds for bullets.

Bullets have performed well at the start of 2026, supported by reinvestment flows from investors who considered callables to be overpriced. In addition, the bullet spreads have also been supported by continued performance in European covered bonds at the beginning of this year. Finally, the relative pricing of callables has been on the cheap side since the beginning of the autumn. So any additional OAS widening in callables does not have to rub off directly on bullets.

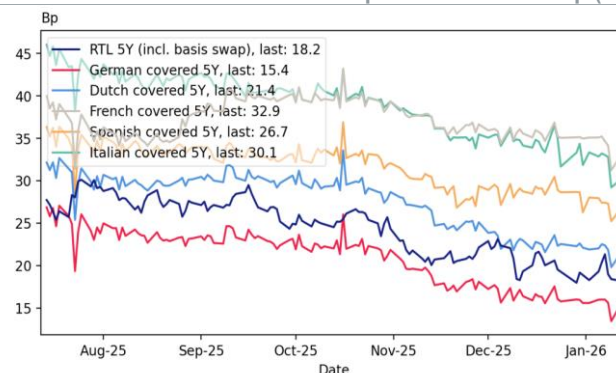
Overall, we think that the longer-dated bullets appear fairly priced at the current levels, both relative to European covered bonds and to callables, and we do not see much upside potential here either (but on the other hand greater resilience to spread widening).

However, the supply outlook suggests that 5Y bullets may outperform 3Y bullets. Continued low refinancing percentages in 5Y bullets and reduced fixed-to-variable refinancing will, all other things being equal, give rise to fewer 5Y bullet bonds. Borrowers who don't want to fund loans in 5Y bonds in connection with refinancing tend to choose loans funded by 3Y bonds instead, and there is thus no prospect of the same "shortage" in 3Y bullet bonds.

The performance of short-dated bullets in January is an expression of the liquidity abundance that prevails at the moment. However, the net position will decline notably during Q1, and even though there will be no renewed liquidity shortage, and the net position will subsequently increase again, this will likely counteract further performance in the coming months. The same applies to increased uncertainty about Denmark's Nationalbank's actions, and any potential announcement of intervention would likely cause spreads to widen.

A slight decrease in FRN coupons on CITA-FRN as a result of the elimination of the 19bp spread in the CITA fixings may boost FRN issuance slightly (however, it will not fully materialise until the middle of 2026). However, this is not expected to be of an order of magnitude that significantly affects FRN spreads. This should also be seen in light of the fact that the FRN segment (like short-dated bullets) will generally be supported by ample liquidity – as there is an immediate prospect of a high net position throughout 2026. However, we do not see great performance potential in FRNs at the current levels.

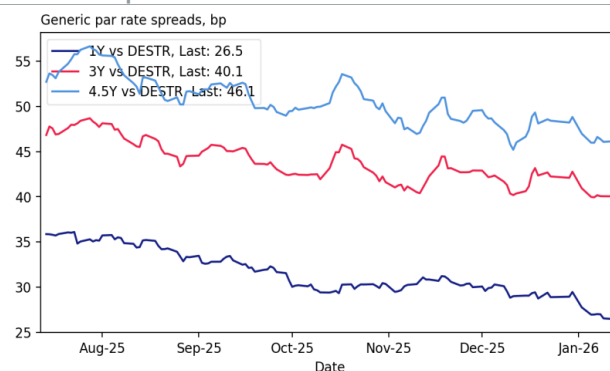
Bullets and EUR covered bonds: Spreads vs EUR swap (6M)



For bullets, the spread vs EUR swap includes basis swap.

Source: Bloomberg and Nykredit Markets

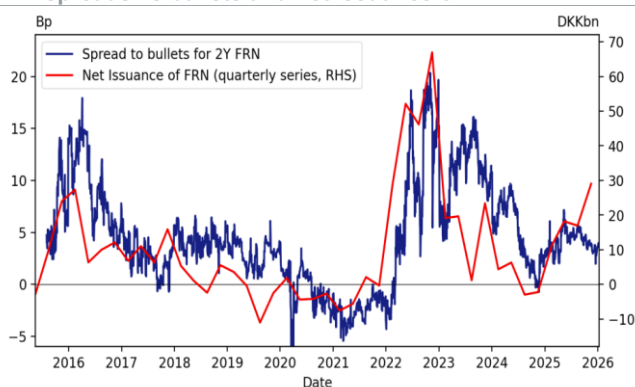
BULLETS: Spreads vs DESTR



Short-dated bullets have recently gained tailwinds from liquidity abundance.

Source: Nykredit Markets

FRN spreads vs bullets and net issuance of FRN



The increase in FRN issuance in Q4 2025 can be attributed to JRK's refinancing of DKK 10 billion of ARM loans funded by 1Y bonds in a new CITA 12M FRN.

Source: Nykredit Markets

In the short term, there is a possibility that FRNs will have to widen slightly vs bullets. First, FRN spreads vs bullets are slightly on the low side compared with the issuance level (however, this is less pronounced than indicated by the chart at the bottom of the previous page if you adjust for JRK's refinancing of DKK 10 billion of ARM loans funded by 1Y bullets in a new CITA 12M FRN). Secondly, liquidity will decline in the coming months (see above). Thirdly, in recent years, there has been a tendency for FRN spreads vs bullets to widen in the run-up to the large FRN refinancing auctions in May. Although the FRN auctions this year will be smaller (the FRN maturity for the July 2026 payment date is just over DKK 90 billion compared to DKK 115-130 billion in recent years), we find a repetition of this trend likely given the current levels. We therefore currently prefer bullets over FRNs.

Where do foreign investors currently stand?

In the second half of 2025, foreign holdings and ownership of callables were increasing slightly, partly supported by the fact that Danish callables in 2025 started to look more attractive relative to US MBS.

On the one hand, the relative attractiveness of Danish callables has been further strengthened by the fact that US President Donald Trump ordered Fannie Mae and Freddie Mac to purchase USD 200 billion in MBS to lower household interest expenses. This news has led to a pronounced drop in US MBS yields of nearly 0.2 percentage points. It is currently unclear whether (and if so, how quickly) this effect will wear off again.

On the other hand, in December, we saw Japanese investors exploit handsome returns on US equities, in particular, to realise losses in Danish low-coupon callables. In our opinion, this traffic could continue until the Japanese financial new year on 31 March. In addition, several foreign investors have indicated that the uncertainty surrounding Greenland has prompted them to remain on the sidelines until – hopefully – greater clarity and stability return to the situation.

Overall, we expect foreign demand for Danish bonds to remain limited in the near term. Should the geopolitical situation stabilise, however, it is likely that we will once again see foreign (net) purchases of callables similar to the pattern observed in mid-2025 through December, when foreign investors bought DKK 11 billion-worth of high-coupon callables while selling DKK 3.5 billion-worth of low-coupon bonds.

What is the worst-case scenario?

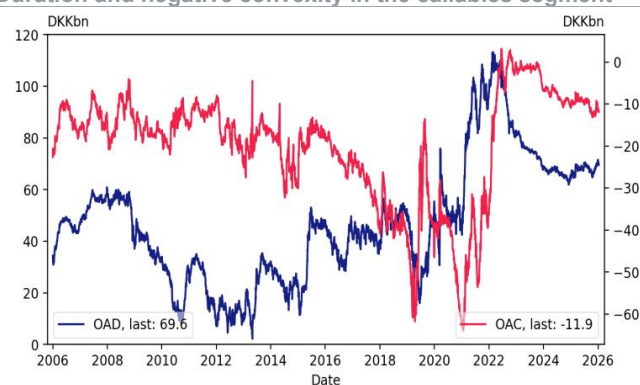
In a baseline scenario with little in the way of interest-rate changes, volatility increases or credit spread widening/risk-off, performance is likely to remain broadly satisfactory – particularly for callables. The more relevant question is therefore what potential risk factors could alter the situation relative to this otherwise favourable, if somewhat dull, baseline scenario. With low OAS levels and low (implied and realised) volatility, as the starting point, risks appear more tilted to the downside than to the upside!

Before discussing risk scenarios, it is worth noting that at least two factors suggest that risks to the callables segment are more

limited than they might otherwise have been. Firstly, the overall negative convexity remains relatively low – particularly compared with the situation at the beginning of 2021 (see the mid-left chart). As a result, sudden increases in duration should not pose a major challenge for the market as a whole.

Secondly, it would take fairly extreme scenarios for the current situation of relatively low underlying issuance in the callables segment to change materially. In our view, a meaningful shift in borrower preferences from bullets/FRNs towards callables would require issuance to move down into a 3% (or lower) callable bond at an attractive price level. We consider that highly unlikely. It is easier to see a temporary supply pressure arising from refinancing into lower coupons (likely triggered "merely" by a 3.5% trading at an attractive price), but such transitory supply pressure would likely pose only a limited challenge for the market, as long as the underlying issuance remains low. Moreover, supply pressure from the refinancing into lower coupons from 5% bonds has become a considerably smaller concern, as the outstanding amount of the 5% bonds has been reduced by half.

Duration and negative convexity in the callables segment



The negative convexity is far from the record level in 2021.

Source: Nykredit Markets

Risk I: Geopolitical situation

In 2025, financial markets have become more resilient in their reactions to geopolitical events and statements (including those from Trump). However, geopolitical trends remain a risk factor – and for Denmark in particular, the key issue is whether the US might seek to act on its desire to gain control of Greenland (and if so, in what manner).

With regard to Greenland, the primary risk from our perspective is that Trump, in an effort to exert pressure on Denmark, could attempt to target Denmark economically through tariffs or by otherwise making conditions more challenging for Danish businesses. In a worst-case scenario, this could lead to substantial (foreign) selling, higher risk premiums on Danish assets and a (further) weakening of the DKK, thereby increasing the need for unilateral Danish interest rate hikes (see also below). The situation certainly carries the risk of making 2026 a challenging year – also for the Danish covered bond market.

Nevertheless, we consider it most likely that, a year from now, we will be looking back on a 2026 in which the situation surrounding Greenland had only a limited and temporary impact on the Danish bond markets. The situation does, however, argue for adopting a somewhat cautious stance in the very short term.

Risk II: Unilateral Danish interest rate hike

Following a period in 2021 and 2022 when high freight rates and, subsequently, Novo Nordisk's export success ensured a very strong DKK rate – prompting unilateral interest rate cuts by Danmarks Nationalbank, the situation has now changed, and the DKK is trading relatively weakly against the EUR.

This has increased the likelihood that a unilateral Danish interest rate hike could come into play in the first half of 2026, a prospect that is also reflected in the DESTRE/ESTR spreads.

Prior to any Danish interest rate hike, there will be a period of currency intervention by Danmarks Nationalbank. A unilateral Danish interest rate increase would make Danish bonds – whether government bonds, bullets/FRN or callables – less attractive to foreign investors and would be expected to result in spread widening. Investors who have chosen to pay DESTRE and receive ESTR in the expectation that the yield spread would remain stable would incur a loss.

While a unilateral Danish interest rate hike is far from certain, the risk has become more tangible and is a scenario that should be taken into account. However, we do not expect that a potential unilateral interest rate increase in itself would be decisive in determining whether 2026 turns out to be a good or bad year for Danish covered bonds.

Risk III: Higher (or lower) long-term interest rates

The Dutch pension reform involves a gradual transition from defined benefit pensions to market-rate schemes, much like the shift we went through in Denmark a number of years ago. The transition reduces the pension funds' need to hedge long-term interest rate exposure. This has already contributed to a steeper EUR yield curve in 2025, and it is possible that we may see further steepening in 2026.

Further steepening of the yield curve could, of course, weigh on outright returns on callables relative to other segments – particularly on low-coupon callables, which have the greatest sensitivity at the long-term end of the curve. Curve steepening could also impact the returns on callables if the duration is solely hedged using 10Y swaps or Bunds. This may argue for considering more comprehensive hedging of the full delta vector.

A steeper curve would, to some extent, make callables less attractive relative to other loan types from a borrower's perspective (reducing supply) while making them more attractive to outright investors (increasing demand). Both factors could contribute to a steeper curve being associated with OAS performance – as we also saw in 2025. Additionally, a steeper curve has historically been correlated with lower volatility. The bottom line is that it may be sensible to hedge curve steepening to a lesser extent than the bonds' delta vector would immediately suggest, as we have also written about in this [research note](#).

This would, of course, also mean that lower long-term interest rates – which may lead to a greater supply of and lower demand for callables – are hedged to a lesser extent than indicated by the delta vector. As mentioned above, it would take a great deal to materially alter the underlying supply of callables. However, it may still be prudent to hedge against OAS widening in the event of temporary issuance pressure from refinancing into lower coupons in a scenario of declining long-term interest rates.

Risk IV: Renewed liquidity shortage

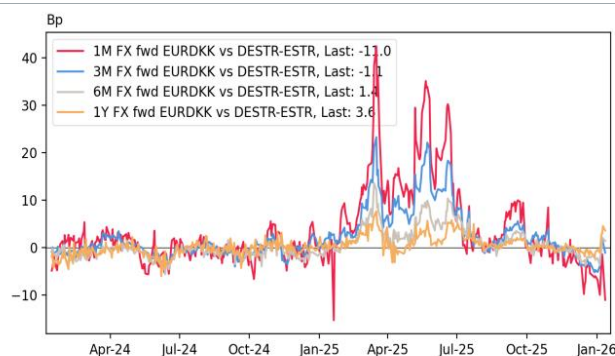
The strained liquidity situation in spring 2025 – which particularly manifested itself as FX forwards trading significantly out of line around month-end and payment dates – has subsequently been replaced by liquidity abundance.

The net position was not particularly low in 2025 from a historical perspective, but the need for liquidity has also increased. An analysis by Danmarks Nationalbank from mid-2025 shows that approx DKK 100 billion more covered bonds are now being repo-financed than just a couple of years ago. If growth in the outstanding amount of covered bonds (as expected) continues to be concentrated in the FRN and bullet segments, this could further increase the need for repo financing.

Based on, among other things, forecasts for the central government's financing requirement from the Danish Ministry of Finance and Danmarks Nationalbank, the central government borrowing strategy etc, the net position is currently expected to bottom out at around DKK 275 billion at the end of Q1 2026 (see the chart on page 2). This is roughly in line with the level observed at the end of July 2025 – at the time, this proved sufficient for the signs of liquidity shortage seen in spring to dissipate. However, it would not take a significant further downward adjustment of the outlook for the net position before liquidity shortages could again become a theme – and in previous years, we have seen a tendency for the central government's financing requirement to be revised gradually downwards, which, all else equal, puts downward pressure on the net position. We are certainly keeping a close eye on this!

Renewed liquidity shortage would particularly impact short-dated bullets, but could also exert some upward pressure on the FRNs/bullet spreads.

From liquidity shortage to ditto abundance in FX Forwards



The chart shows implied yield spread in FX Forwards vs DESTRE-ESTR.

Source: Nykredit Markets

Risk V: Higher vol and credit spreads

Market turbulence leading to higher volatility and risk premiums is, of course, always a risk factor. In this respect, it is just as much known as unknown risk factors that could prove decisive. Overall, we do not see the risk of bouts of market turbulence – or outright financial crises – as being materially different from what we have observed in recent years.

What else to keep an eye on?

In 2026, attention should also be paid to the Cibor transition – not because it is expected to take place in 2026, but because we are likely to gain a clearer picture of the timeline, as well as possible indications of what the transition will entail in more concrete terms. At this stage, the transition is expected to be unfavourable for Cibor 3M FRNs and Cibor 3M payer swaps, see also this [research note](#).

Also, keep an eye on whether, for example in connection with the upcoming change of maturity class, we gain greater clarity on the structure and timeline for the potential new 40-year loans announced by the Danish government during the municipal election campaign (but about which little has been heard since). For existing bonds, we expect the primary impact of any new 40-year loans to take the form of increased refinancing into lower coupons from 5% bonds and possibly through higher buy-backs of bonds trading below par for the purpose of refinancing into a 40-year loan.

Conclusion

Overall, we remain cautiously optimistic on Danish covered bonds in 2026 and consider it most likely that the year will pass without significant spread widening or increases in volatility. Our expectation is therefore that the outlook is for an OK, although not impressive (carry) year. As always, however, it may be prudent to remain prepared to take advantage of any bouts of spread widening.

Specifically, we have the following trade recommendations:

- We prefer 4% callables. We expect 5% bonds to perform reasonably well (though not spectacularly), while 3.5% bonds may ultimately suffer from limited series sizes (relative to the 4% segment). We believe that low-coupon bonds will face the greatest challenges, partly due to continued foreign selling. We thus open a "2026 recommendation" of NYK 4'56 vs RD 5'56 and JYSKE 1.5'53IO. However, the recommendation can also apply to other issuers and other low-coupon bonds.
- As mentioned above, we prefer 5Y bullets vs 3Y bullets, and we already have an open recommendation in this position.
- We prefer bullets over FRNs and open a recommendation of bullets over FRNs (particularly around the 3Y point where auction supply is expected to emerge).

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Recom- menda- tion	
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As at 13.12.2024

Note: Distribution of our recommendations, which therefore add up to 100%.

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