

On the determinants of yield spreads between mortgage pass-through and Treasury securities

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Abstract

Yield spreads between mortgage pass-through and U.S. Treasury securities may reflect differences in taxation, phenomena affecting relative supply and demand, and compensation for default, call, and marketability risks on mortgage instruments. Our research empirically models differences in yields between pass-throughs and comparable-maturity Treasuries. We find that interest-rate volatility and the term structure of rates, factors often cited in the mortgage pricing literature as affecting the mortgage call premium, are the primary determinants of movements in these spreads. Moreover, these effects have grown in importance in recent years as exercise of the prepayment option has increased. We also find evidence that liquidity and credit concerns affect the pricing of pass-through securities.



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