municipalities will become dangerously overextended. In such an event, it would only take one large default to bring about a drastic revision of investor sentiment adverse to all types of lower quality municipals. This would quickly result in drastic repricing of lower and medium quality municipals to wider or perhaps very wide spreads from prime municipals. In this way the new issues of industrial bonds or risky revenue bonds could damage the market for a very wide range of general obligations.

Medium quality and low quality municipals will in the years ahead be importantly influenced by the fluctuations discussed above for prime municipals, but they will also be influenced by changes in the market's appraisal of the risk factor. Since at present the risk differential is at a minimum, it is apt to widen. This means that the market for medium grade and second grade municipals should do distinctly worse than the market for primes.

Shorter Maturity Municipals

The yields of municipal bonds differ not only because of differences in quality but also because of differences in maturity. This is again illustrated by Table I in Appendix C, while the yield spreads according to maturity are tabulated in Table III of Appendix C and are charted in Chart IV on page 24.

It will be seen that prime 30 year maturity municipals have usually sold to yield 100-185 basis points more than one year municipals of the same quality and that this differential was usually spread over the entire yield curve so that two year bonds yielded more than one year bonds, and five year bonds more than two year bonds, etc. It will also be seen in Table III that this differential by maturity has come down sharply during the past two years and has now all but vanished. The table also shows that the differential by maturity for good grade bonds has usually been even larger than the differential for prime bonds and it has also come down sharply during recent years.