

for business and consumer demand which also tends to be high at such times. With scarcity of bank reserves generally characterizing the advanced stage of cyclical recovery periods, banks tend to liquidate some of their municipal investments or at least withdraw from the market for new issues. In these periods, banks often take capital losses on their holdings of State and local bonds as well as Treasury securities in order to accommodate business and consumer borrowers. Similarly, in the early stages of a recession, State and local bond volume may be small at the very time commercial banks could use additional outlets for their funds, considering the lesser demand by private borrowers. Thus, despite the obvious investment attractions in the form of tax-exempt income and on the whole, excellent quality, municipal bonds as bank investments do not always harmonize with the responsibility of banks to accommodate first the needs of private customers.

The Department of Economics and Research of the American Bankers Association sent a questionnaire to the chief executive officers of over 300 banks across the country soliciting their views on subjects relating to municipal securities. The questionnaire, which was pre-tested, included questions pertaining to the ratios of municipal security holdings to total loans and investments, the method used in determining the volume of municipal holdings, the relationship between yields of tax-exempts and yields of taxable loans and investments, the importance of the tax exemption feature, and the means by which municipal securities can be made more attractive to investors. Apart from the questionnaire, to which there was an above average response, the Department of Economics and Research conducted comprehensive interviews with academicians, researchers, and bankers well versed in the municipal bond field, whose views and advice considerably enhanced the value of the survey results.

2. PROPORTION OF LOANS AND INVESTMENTS

According to the survey, the proportion of municipal security holdings to the holdings of all loans and investments is determined by commercial banks mainly as a result of an analysis of liquidity requirements, loan requirements, and legal needs for governments to secure government accounts. Following the satisfaction of these needs, the funds that remain are invested in bonds. Depending on the yield spreads between governments, municipals, and Federal agencies and corporations, on the relationship of a particular bank to the local government unit or home State, and on the tax position of the bank, funds are allocated accordingly. An eye is also kept on the ratio of municipals to total deposits, or some other similar ratio, and on the ratios carried by banks of comparable stature.

3. COMPETITION WITH OTHER LOANS OR INVESTMENTS

Municipal securities are not competitive with mortgage loans according to the response of surveyed bankers as a whole. In the event, for instance, of the removal of tax exemption and the subsequent lower demand for municipals, money that no longer would go into municipals would mainly be channeled into other investments; e.g., Treasury securities, rather than into loans. Of course this would depend on how loaned up the bank happened to be at the time and on the spread