

Within debt security portfolios, moreover, municipal bond holdings showed the sharpest decline during the 1962-65 period—52 percent, compared with 11 percent for U.S. Government obligations and 10 percent for corporate bonds. The steeper decline in the industry's State and local government bond holdings stems largely from the diminished attractiveness of municipal bond yields relative to those on Treasury and corporate bonds. As shown in table 7, the yield advantage (before tax) of U.S. Government and corporate bonds over State and local government issues (Moody's Aaa) widened significantly during the 1960's. During most of the 1962-65 period, municipal bond yields were under strong downward pressure from accelerated purchases by commercial banks, which sought profitable investment outlets for their increased saving inflows.

TABLE 7.—*Selected bond yield spreads, 1946-65*
[Percent per annum]

Year	U.S. Government and municipal bonds	Corporate and municipal bonds	Year	U.S. Government and municipal bonds	Corporate and municipal bonds
1945	1.30	1.55	1956	0.57	0.85
1946	1.09	1.43	1957	.37	.79
1947	.80	1.16	1958	.51	.87
1948	.57	.95	1959	.72	1.03
1949	.66	1.01	1960	.75	1.15
1950	.76	1.06	1961	.63	1.08
1951	.96	1.25	1962	.92	1.30
1952	.88	1.16	1963	.94	1.20
1953	.63	.89	1964	1.06	1.37
1954	.51	.86	1965	1.05	1.57
1955	.66	.88			

NOTE.—Data refer to excess of U.S. Government and corporate bonds over yields on State and local government bonds, based on monthly average interest rate figures. Corporate and municipal bonds are for high-grade issues (Moody's Aaa).

RELATIVE ATTRACTIVENESS OF MUNICIPAL BOND YIELDS

While shifting yield relationships have clearly influenced savings bank municipal bond activity, their effect has hardly been static, and at times has been offset by other basic factors including: changing mortgage lending opportunities, variations in deposit flows, and competitive forces in savings markets. The specific impact of tax provisions is itself complex. The period from 1951 to 1962 witnessed two major changes in the tax treatment of mutual savings banks, both of which were preceded by uncertainty regarding the nature of the impending changes, and were succeeded by periods of adaptation to the new tax rules. Moreover, tax legislation enacted in 1962 provided for alternative bad debt reserve provisions for mutual savings banks and savings and loan associations which have different implications for the relative attractiveness of fully taxable and tax-exempt securities.

From all this, it should be apparent that a meaningful answer to the question: "At what interest rate levels are municipal securities attractive to savings banks?" requires detailed assumptions regarding a wide variety of capital market forces and income tax considerations. Under postwar conditions, municipal bond yields clearly have not been highly attractive to savings banks. Assuming no radical departures from these conditions, municipal bond yields would have to rise substantially relative to other interest rates to attract a significant volume of savings bank acquisitions.