A Letter to Standard & Poors

Gentlemen,

Allow me to suggest that downgrading a sovereign's local currency debt, when exchange rate policy is a floating exchange rate, on 'ability to pay' is clearly an error of comprehension on your part.

With a floating exchange rate, local currency 'financial pressure' is expressed via a change in the exchange rate. Actual ability to make local currency payments is always a matter of crediting an account at the central bank or, in primitive cultures, simply printing the currency owed to make the required payments. With a floating exchange rate, 'ability to pay' in local currency is beyond question and unlimited. Yes, 'abuse' will lead to inflation and currency depreciation, but it will not reduce actual 'ability to pay' a notional sum.

Willingness to pay is a different problem for you to assess. I'm sure you recall the incident a few years ago when the US Congress expressed a strong willingness NOT to pay. Only 'sleight of hand' by Robert Rubin prevented a US default that week.

To repeat, downgrading Japan on current or future 'ability to pay' is necessarily an error and shows a lack of understanding of the operation of a currency such as the yen with a floating exchange rate policy in place. A downgrade on 'willingness to pay' is plausible in theory, but I emphatically doubt you have any evidence of this in Japan at present. The notion that future financial ratios would result in a reduced 'willingness to pay' is at best far fetched and not deserving of comment.

A final possibility for such a downgrade would be the intention to shift to a fixed exchange rate, again an absurd supposition in the case of Japan.

Gentlemen, you have made an error which is proving severely disruptive to the financial fabric of the global financial system. Rather than continue to be 'part of the problem' I implore you to reconsider your position and proceed to become 'part of the answer.' There is enough actual risk in today's financial structure without the rating agencies fabricating additional disruptions.

Sincerely,

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