S&P Global
Ratings

RatingsDirect®

Research Update:

Principality of Andorra Upgraded To 'BBB/A-2' From 'BBB-/A-3' On Economic Recovery; Outlook Stable

Primary Credit Analyst:
Alejandro Rodriguez Anglada, Madrid (34) 91-788-7233; alejandro.rodriguez.anglada@spglobal.com

Secondary Contact:
Marko Mrsnik, Madrid (34) 91-389-6953; marko.mrsnik@spglobal.com

Table Of Contents

Overview

Rating Action

Outlook

Rationale

Key Statistics

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

Principality of Andorra Upgraded To 'BBB/A-2' From 'BBB-/A-3' On Economic Recovery; Outlook Stable

Overview

- Andorra's economy is recovering, underpinning improving fiscal performance.
- We are raising our long- and short-term ratings on Andorra to 'BBB/A-2' from 'BBB-/A-3'.
- The stable outlook reflects the balance between risks arising from Andorra's large international financial sector and ongoing improvements in financial oversight that may mitigate these risks.

Rating Action

On July 28, 2017, S&P Global Ratings raised its long- and short-term foreign and local currency sovereign ratings on the Principality of Andorra to 'BBB/A-2' from 'BBB-/A-3'. The outlook is stable.

The rating action reflects the resilience of Andorra's economy and public finances in the face of the collapse of Banca Privada d'Andorra (BPA).

Outlook

The stable outlook reflects our opinion that the risks to Andorra's creditworthiness will be balanced between recovering growth and strong public finances, offset by remaining structural risks emanating from its large financial sector.

We could consider raising our ratings on Andorra if:

- Andorra's ongoing negotiations with the EU concluded favorably, and we estimated that the terms of its association agreement were favorable for Andorra;
- Andorra strengthened its access to international institutions that could provide the country with emergency funding in case of any future financial crises; or
- We gained greater visibility about the country's external position, thanks to an improvement in its statistics, and it turned out to be stronger than we currently estimate.

Conversely, we could lower the ratings on Andorra if:

- The country's economy underperformed our expectations, and we expected structural repercussions on income levels or fiscal outcomes;
- We perceived heightened risks in the country's financial sector, and we believed this could have a material impact on the country's economy and the government's fiscal prospects; or
- We expected that ongoing litigation arising from the BPA case could have a material impact on government finances.

Rationale

The upgrade reflects Andorra's strengthening economy, and its proven track record of maintaining large liquid financial buffers invested abroad. These average close to 50% of GDP. While most of these assets are held in Andorra's social security funds, we think they could be used to finance the broader public sector in the event of an external shock.

Andorra's creditworthiness is also supported in our view by its high wealth levels and strong fiscal position, as well as its stable and mature political institutions. However, its economy is concentrated, depending on a few sectors and only a handful of major trading partners (primarily Spain and France). The large size of Andorra's financial sector is, in our view, a source of risk, which may generate contingent liabilities for the sovereign, tempering our view about an otherwise significant net asset position of the general government sector. Moreover, given Andorra's small size, the country lacks a central bank. Andorra uses the euro as its official currency under its monetary agreement with the European Union, signed in 2011. In our opinion, Andorra's creditworthiness also suffers from the limited visibility about the country's external accounts. Most of its commercial banks are financed by deposits, including substantial stocks of nonresident deposits, which can be volatile.

Institutional and Economic Profile: Ongoing economic recovery amid continuing reforms

- We expect Andorra's economy to continue recovering from a long period of crisis, with low unemployment levels and rising incomes.
- Andorra's government will likely continue with its reform agenda, aimed at improving the country's convergence with the requirements of international institutions.

We expect Andorra's real GDP to expand by an average of 1.4%, and its nominal GDP by about 2.4% over our forecasting period of 2017 to 2020. In our view this economic recovery will be sustained by the favorable economic environment in neighboring Spain, which is Andorra's main trading partner and the source of most of its visitors. The tourism and commerce sectors have continued to recover with a 5% year-on-year increase in tourists in 2016 versus 2015. In our view, this may sustain a gradual increase in Andorra's GDP per capita, which could rise from about $36,500 in 2016 to about $41,500 by 2020, while unemployment levels remain at historically low levels, below 4% of Andorra's active population. Nevertheless, we continue to view Andorra's economy as concentrated, with a dependence on tourism and commerce--which are closely correlated--and finance.

The Andorran government is likely to continue pursuing its comprehensive agenda of institutional reforms, which have led it in recent years to overhaul the tax system, reform key pieces of legislation, and push the country toward convergence with international practices of financial regulation and supervision. In particular, we expect Andorra will continue to negotiate toward an association agreement with the EU, which may give the country access to the EU's internal markets. We understand the negotiating parties aim to conclude negotiations before 2019. Moreover, we understand that the Andorran government is continuing to explore ways to improve cooperation with international financial institutions, like the International Monetary Fund. In our opinion, if successful, these initiatives could improve the country's ability to avoid future financial crises or better deal with their repercussions.

Flexibility and Performance Profile: Despite positive fiscal outcomes, Andorra is still constrained by structural weaknesses arising from its limited size and large financial sector

- The economic recovery is allowing the government to achieve strong budgetary outcomes and accumulate assets in the country's social security fund.
- We expect the financial sector will remain a source of potential risk for the country, although the government is making significant efforts to improve the monitoring of risks and the comparability of financial reporting.
- Andorra's creditworthiness remains constrained by its lack of monetary instruments, and the absence of visibility about the country's external accounts, although we understand efforts to improve the latter are underway.

We expect Andorra will continue posting positive budgetary results at the general government level, on the back of rising revenues brought about by the ongoing economic recovery and bolstered by continued spending moderation.

We assume a central government deficit of about 0.3% of GDP on average in 2017-2020, while the general government would likely post moderate surpluses of about 2% of GDP, above our previous estimate of about 1.3% of GDP. We expect the central government may increase debt slightly to finance deficits, but debt reduction at the local government level and the social security system's continued accumulation of assets should strengthen the general government's net asset position, which could reach about 16% of GDP by 2020.

We estimate that the Andorran government's refinancing needs for 2018 amount to about €205 million (8% of GDP). We expect the central government will roll over these debt instruments, chiefly held by Andorran banks and individuals.

Nevertheless, we estimate this favorable debt position needs to take into account the risk from what we view as potentially high contingent liabilities emanating from the financial services sector. Andorran banks' assets under management at year-end 2016 represented 18x GDP, and their deposits about 4.2x GDP. In our view, any potential banking crisis could have repercussions in the country's budgetary outcomes and potentially lead to debt accumulation. Moreover, the BPA resolution process remains subject to litigation, which we understand could potentially impose costs on the sovereign budget in case of an adverse court ruling.

We continue to consider that Andorran banks' very large size and international expansion expose the Andorran government to high potential contingent liabilities. Financial institutions' claims on the resident nongovernment sector, at about 170% of 2016 GDP, are among the highest of the sovereigns we rate. Andorra's financial sector contributes about 20% of total GDP and approximately 5% of salaried employment (at year-end 2016), which highlights the country's vulnerability to any potential turbulence in this sector.

We recognize that, as a consequence of the BPA case, Andorran authorities and the banks have stepped up their efforts to improve their risk-management policies, while supervisors (Institut Nacional Andorrà de Finances) and financial intelligence unit (Unitat d'Intel·ligència Financera d'Andorra) have expanded their resources. We also note that Andorran banks are slated to adopt International Financial Reporting Standards-9 (IFRS-9) as of Jan. 1, 2018, which should make their financials comparable with international peers.

Nevertheless, we continue to view the international footprint of Andorran banks as a potential source of risk, and we estimate the banks' activity outside of Andorra continues to increase its weight over the total banking business of the sector.

In our view, convergence with international norms and transparency standards will tend to lower the risk arising from the banking sector, but at the same time, we believe it may challenge the business model of Andorra's banks, which will now have to compete on an even field with much larger global players.

Our view of Andorra's creditworthiness remains constrained by the country's lack of an independent monetary policy, given its use of the euro as the official currency. While Andorra lacks a lender of last resort, we do recognize that Andorran banks have indirect access to liquidity from the European Central Bank through their subsidiaries in the eurozone.

Andorra lacks sufficient external data, and we therefore evaluate its external position starting from our view on Spain's, the country to which its economy is most closely tied, and we then adjust our view further to reflect the lack of data. We understand the Andorran statistics agency is actively working to fill this gap, with the assistance of international statistics bodies.

Key Statistics

Table 1

Principality of Andorra Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. €)	2.48	2.46	2.47	2.53	2.54	2.58	2.64	2.71	2.78	2.85
Nominal GDP (bil. $)	3.45	3.16	3.28	3.36	2.81	2.86	2.91	3.06	3.16	3.27
GDP per capita ($000s)	44.1	41.5	43.1	43.6	36.1	36.5	37.1	38.9	40.2	41.5
Real GDP growth	(4.6)	(1.6)	0.4	2.3	0.8	1.2	1.3	1.4	1.5	1.5
Real GDP per capita growth	3.8	0.8	0.5	1.1	(0.5)	0.9	1.1	1.2	1.3	1.3
Real investment growth	N.A.	N.A.	N.A.	N.A.	N.A.	N.A	N.A.	N.A.	N.A.	N.A.
Investment/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

Table 1

Principality of Andorra Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Savings/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exports/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Real exports growth	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Unemployment rate	4.1	6.0	6.5	5.8	4.1	3.6	3.5	3.5	3.5	3.5
EXTERNAL INDICATORS (%)										
Current account balance/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Current account balance/CARs	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CARs/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Trade balance/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Net FDI/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Net portfolio equity inflow/GDP	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Gross external financing needs/CARs plus usable reserves	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Narrow net external debt/CARs	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Net external liabilities/CARs	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Short-term external debt by remaining maturity/CARs	N.A.	N.A.	N.A.	N.A	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Usable reserves/CAPs (months)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Usable reserves (mil. $)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
FISCAL INDICATORS (%, General government)										
Balance/GDP	0.2	(0.1)	4.9	3.0	2.4	5.3	2.2	2.1	2.0	1.9
Change in debt/GDP	1.6	3.2	(0.1)	0.4	(0.1)	0.4	(0.5)	(0.4)	(0.3)	(0.3)
Primary balance/GDP	1.1	1.3	5.9	3.9	3.1	6.0	2.9	2.8	2.6	2.5
Revenues/GDP	19.3	22.5	24.2	22.0	22.7	25.2	23.1	23.0	23.0	23.0
Expenditures/GDP	19.1	22.6	19.3	19.0	20.3	19.9	20.9	21.0	21.0	21.1
Interest/revenues	4.8	6.0	4.3	4.1	3.2	2.7	3.1	3.0	2.9	2.8
Debt/GDP	38.3	41.7	41.4	41.0	40.7	40.3	38.9	37.6	36.3	35.1
Debt/revenues	198.6	185.3	171.2	186.3	179.3	159.7	168.5	163.2	157.9	153.0
Net debt/GDP	2.9	3.2	(0.1)	(2.0)	(4.1)	(8.8)	(10.8)	(12.6)	(14.2)	(15.8)
Liquid assets/GDP	35.3	38.5	41.6	43.0	44.9	49.1	49.7	50.2	50.5	50.9
MONETARY INDICATORS (%)										
CPI growth	2.5	1.6	0.5	0	(1.1)	(0.5)	1.0	1.0	1.0	1.0
GDP deflator growth	2.5	1.1	0.0	(0.1)	(0.5)	0.7	1.0	1.0	1.0	1.0
Exchange rate, year-end (€/$)	0.77	0.76	0.73	0.82	0.92	0.95	0.89	0.88	0.88	0.87
Banks' claims on resident non-gov't sector growth	0.7	(5.4)	(5.3)	(2.6)	(4.0)	(9.2)	1.0	1.4	1.6	1.6
Banks' claims on resident non-gov't sector/GDP	231.7	220.3	207.8	198.0	189.3	168.6	166.5	164.8	163.4	161.9

Table 1

Principality of Andorra Selected Indicators (cont.)										
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Foreign currency share of claims by banks on residents	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Foreign currency share of residents' bank deposits	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Real effective exchange rate growth	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. N.A.--Not available. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Principality of Andorra Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Neutral
Economic assessment	Strength
External assessment	Weakness
Fiscal assessment: flexibility and performance	Strength
Fiscal assessment: debt burden	Neutral
Monetary assessment	Weakness

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23,2014
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18,2009

1892074 | 301634411

- General Criteria: Use Of CreditWatch And Outlooks - September 14,2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07,2017

Related Research

- Global Sovereign Rating Trends Midyear 2017 - July 12, 2017
- Sovereign Ratings History - July 12, 2017
- Sovereign Risk Indicators - July 06, 2017. An interactive version is also available at http://www.spratings.com/sri
- Banking Industry Country Risk Assessment Update: July 2017 - July 06, 2017
- 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions - April 18, 2017
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions - April 03, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion - February 23, 2017
- Research Update: Principality of Andorra 'BBB-/A-3' Ratings Affirmed; Outlook Stable - January 27, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that the economic assessment had improved. All other key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

	Rating	
	To	From
Andorra (Principality of)		
Sovereign Credit Rating		
Foreign and Local Currency	BBB/Stable/A-2	BBB-/Stable/A-3
Transfer & Convertibility Assessment	AAA	AAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Additional Contact:
SovereignEurope; SovereignEurope@spglobal.com

Copyright © 2017 by Standard & Poor’s Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.