S&P Global Ratings

RatingsDirect®

Research Update:

Andorra Outlook Revised To Stable On Successful Resolution Of BPA; 'BBB-/A-3' Ratings Affirmed

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

Research Update:

Andorra Outlook Revised To Stable On Successful Resolution Of BPA; 'BBB-/A-3' Ratings Affirmed

Overview

- In our opinion, the resolution process implemented by the Andorran authorities regarding Banca Privada d'Andorra has largely succeeded in limiting further adverse effects on Andorra's economic growth prospects and government finances.
- As a result, we are revising the outlook on Andorra to stable from negative and affirming our 'BBB-/A-3' long- and short-term foreign and local currency sovereign credit ratings on the principality.
- The stable outlook balances remaining risks arising from Andorra's very large financial sector against our view that Andorra's economy will continue to recover, allowing the general government to post broadly balanced budget outcomes, while its net asset position gradually improves.

Rating Action

On July 29, 2016, S&P Global Ratings revised its outlook on the Principality of Andorra to stable from negative. At the same time, we affirmed our 'BBB-/A-3' long- and short-term foreign and local currency sovereign credit ratings on Andorra.

Rationale

The outlook revision reflects our view that the Banca Privada d'Andorra (BPA) resolution process should limit any further adverse impact to Andorra's economic growth prospects and government finances.

In 2015, following the state intervention in BPA, Andorra's banking resolution authority (AREB) created Vall Banc as a bridge bank, in application of Andorra's Law on Restructuring and Resolution of Banking Entities. As a result, and following a full review of BPA's accounts, its assets and liabilities that were not under suspicion of being related to money laundering were transferred to Vall Banc. Vall Banc is now an operational entity, providing most banking services to its clients after having secured agreements with all necessary service providers, including correspondent banks, and its customers are gradually recovering access to their full balances, which were transformed into term deposits.

On Feb. 19, 2016, the U.S. FinCEN, one of the U.S. Department of Treasury's lead agencies in the fight against money laundering, withdrew its findings and proposed rulemaking notices regarding BPA, stating explicitly that the steps taken by the Andorran authorities had sufficiently protected the U.S. financial system from the money laundering risks they previously associated with the bank. FinCEN also stated that no measures would apply to Vall Banc, following the transfer of accounts from BPA. In our view, this decision by FinCEN cleared the way for the full implementation of the resolution plan and the sale of Vall Banc. The accounts that have not been cleared remain frozen at BPA, pending further investigation and potential judiciary action if appropriate.

In July 2016, Vall Banc was sold to the U.S. investment firm JC Flowers. In our understanding, this sale limits the potential that the Andorran government may have to incur any additional costs regarding the BPA resolution. Ultimately, direct costs to the government have so far been limited. The government incurred about €4 million in advisory costs during 2015, mostly in the few months that followed BPA's intervention in March 2015. Vall Banc was recapitalized with €30 million through the Andorran Fund for the Resolution of Banks (FAREB), which is managed by AREB, but was endowed by the country's remaining private banks. The Andorran government did not contribute. Finally, other costs of the resolution process, mostly related to the audit of client accounts, were financed through a loan taken by the Andorran government from the country's banks, and onlent to AREB. We expect the proceeds of the sale of Vall Banc will be sufficient for AREB to repay the €18.5 million outstanding of this loan.

The government also faces possible contingent liabilities of up to €360 million (approximately 14% of GDP), in the event that Andorran courts award former owners of BPA the compensation that they are requesting. Should this be the case, we understand the compensation would have to be paid directly by the central government, and would be worth almost as much as the entire budget for one year of revenues (approximately €400 million). Our current base-case estimates do not incorporate these or any other further direct costs from the BPA resolution process in the government's accounts.

Following the economic recovery in Andorra in 2014, we believe that the BPA case affected consumption and investment in 2015, slowing economic growth both in real and nominal terms. We estimate that the Andorran economy grew 1.4% in real terms in 2015 (0.3% in nominal terms) and will expand by only 1%-2% through our 2016-2019 forecast horizon, absent further destabilizing factors.

In this environment of weaker growth, tax collection was weaker than initially expected in 2015. In response, the authorities controlled operating expenditure growth and postponed investment projects, while increasing the payout of dividends from state-owned telecommunications company Andorra Telecom.

We estimate a central government deficit in 2015 of 0.5% of GDP, slightly below our previous estimate of a 0.9% of GDP deficit. Between 2016 and 2019, we expect the general government will post moderate surpluses of about 1% of GDP, with central government deficits of about 1% of GDP offset by combined local governments and social security of about 2% of GDP. We expect the central government will continue to accumulate debt, 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 8% of GDP by 2019.

With information as of May 31, 2016, we estimate that the Andorran government's financing needs for the remainder of 2016 amount to about €350 million (14% of GDP).

Andorra needs to cover a further €260 million in early 2017, with the remaining bullet maturities of €100 million coming due in 2018. We expect the central government will roll over these debt instruments, chiefly held by Andorran banks and individuals.

We continue to consider that Andorran banks' very large size in relation to the overall size of the economy (assets worth over 560% of GDP in 2015) and international expansion exposes the Andorran government to high potential contingent liabilities. Financial institutions' claims on the resident nongovernment sector, at about 190% of 2015 GDP, are among the highest of the sovereigns we rate. We estimate that as of the end of 2015, assets under management at Andorran banks and their international subsidiaries amounted to about €48.7 billion, or 19x domestic GDP. Andorra's financial sector contributes about 20% of total GDP, and approximately 5.1% of salaried employment (at year-end 2015), which highlights the country's vulnerability to any potential turbulence in this sector.

In our opinion, banks' operations in several jurisdictions (such as Spain, the U.S., Switzerland, Panama, and the Bahamas) increase their complexity, putting additional demands on supervisory authorities. We understand Andorra is seeking to enhance financial institutions' resources and capabilities, while advancing toward international standards of legislation on anti-money laundering. Progress on this front is monitored and supervised through successive rounds of review by the Council of Europe's committee on the evaluation of anti-money laundering legislation (Moneyval).

In order to improve the stability of its financial system, we understand that the Andorran government intends to explore a closer 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 potential future crises, or better deal with their repercussions.

Andorra has no monetary flexibility, in our view. Under a 2011 monetary agreement with the EU, Andorra can use the euro as its official currency, and mint coins. However, the principality has no central bank or other lender of last resort to provide emergency financing to its very large banking system. Andorran banks have only indirect liquidity access to the European Central Bank through the possibility of discounting eligible securities held at eurozone subsidiaries. Andorra's government is therefore the de facto financial backstop for Andorran banks, and the sector constitutes an important contingent liability for the sovereign, which if materialized could have a large impact on the government's balance sheet.

Our ratings on Andorra are supported by the country's stable political institutions, although our assessment of Andorra's institutional strength is constrained by the coverage and reliability of statistical information. Andorra's economy benefits from relatively high levels of GDP per capita, which we estimate at about $36,000 in 2016, but is still vulnerable to its concentration in financial services and tourism, as well as its dependence on its main trading partners, France and Spain.

Andorra's authorities do not publish a complete balance of payments statement or data regarding its international investment position. The ad hoc publication of economic indicators can influence our credit appraisal more markedly than when dissemination of economic data is more frequent and plentiful.

Outlook

The stable outlook balances remaining risks arising from Andorra's very large financial sector against our view that Andorra's economy will continue to recover, allowing the general government to post broadly balanced budget outcomes, while its net asset position gradually improves.

We could lower the rating if:

- We viewed an increased likelihood that other Andorran financial institutions could face similar situations as the one BPA experienced, and we deemed this could have a material impact on the country's economy and the government's fiscal prospects;
- Andorra reversed course in its reform path aimed at converging with international standards of financial reporting and risk monitoring; or
- We expected that ongoing litigations arising from the BPA case could result in the central government having to pay compensations that had a material impact on its finances, such that we had to revise downward our fiscal performance and/or debt assessments.

Conversely, we could consider raising our ratings on Andorra if economic recovery is stronger and more broad based than we currently expect.

Key Statistics

Table 1

Principality of Andorra Selected Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	3	2	2	2	3	3	3	3	3	3
Nominal GDP (bil. $)	3	3	3	3	3	3	3	3	3	3
GDP per capita (000s $)	39.5	44.1	41.5	43.1	43.6	36.1	36.0	35.2	36.8	37.6
Real GDP growth	(5.4)	(4.6)	(1.6)	0.4	2.3	0.8	1.0	1.1	1.2	1.3
Real GDP per capita growth	(6.4)	3.8	0.8	0.5	1.1	(0.6)	0.8	0.9	1.0	1.1
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
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	3.1	4.0	6.1	5.9	4.5	4.1	3.7	3.5	3.5	3.5

Table 1

Principality of Andorra Selected Indicators (cont.)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
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
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
Reserves/CAPs (months)	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	0.8	0.2	(0.1)	4.9	3.0	2.4	1.4	1.2	1.1	1.0
Change in debt/GDP	3.5	1.6	3.2	(0.1)	0.5	(0.2)	0.1	0.3	0.4	0.5
Primary balance/GDP	1.4	1.1	1.3	6.0	3.9	3.3	2.2	2.0	1.9	1.8
Revenue/GDP	19.4	19.2	22.5	24.2	22.0	22.7	22.0	22.0	22.0	21.9
Expenditures/GDP	18.6	19.1	22.6	19.3	19.0	20.3	20.6	20.8	20.9	20.9
Interest /revenues	2.9	4.8	6.1	4.7	4.2	3.6	3.6	3.6	3.5	3.5
Debt/GDP	35.8	38.3	41.7	41.4	41.0	40.7	40.2	39.7	39.2	38.8
Debt/Revenue	184.6	199.0	185.3	171.2	186.6	179.4	182.7	180.5	178.8	177.1
Net debt/GDP	3.0	2.9	3.2	(0.1)	(1.9)	(4.1)	(5.4)	(6.5)	(7.5)	(8.3)
Liquid assets/GDP	32.9	35.3	38.5	41.6	43.0	44.8	45.6	46.2	46.7	47.1
MONETARY INDICATORS (%)										
CPI growth	1.6	2.5	1.6	0.5	(0.0)	(1.1)	0.5	1.0	1.0	1.0
GDP deflator growth	1.6	2.5	1.1	0.0	(0.1)	(0.4)	0.5	1.0	1.0	1.0
Exchange rate, year-end (LC/$)	0.75	0.77	0.76	0.73	0.82	0.92	0.93	0.95	0.92	0.92
Banks' claims on resident non-gov't sector growth	3.9	0.7	(5.4)	(5.3)	(2.6)	(4.0)	0.5	1.0	1.4	1.6
Banks' claims on resident non-gov't sector/GDP	224.9	231.7	220.3	207.9	198.1	189.4	187.5	185.5	184.0	182.7
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. LC--Local currency. 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	Neutral
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 For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18, 2009

Related Research

- Research Update: Ratings On Andorra Affirmed At 'BBB-/A-3'; Outlook Still Negative, Feb. 12, 2016
- Default, Transition, and Recovery: 2015 Annual Sovereign Default Study And Rating Transitions, May 24, 2016

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 economy assessment has strengthened.

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-3	BBB-/Negative/A-3
Transfer & Convertibility Assessment	AAA	AAA
Senior Unsecured		
Local Currency	BBB-	BBB-

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