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Summary:
Andorra

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Issuer Credit Rating	BBB/Positive/A-2

Key Rating Factors

Institutional and economic profile

Steady progress on negotiations with the IMF and EU and continuous alignment to international standards, although economic activity is slowing from the estimated peak in 2019

- Successful negotiations with the IMF and EU would increase Andorra's resilience to financial crises.
- Alignment towards international standards would improve transparency and quality of statistical data and help reduce latent reputational risks.
- S&P Global Ratings forecasts the country's economic growth returning to a similar trend as that estimated for its main trading partners after its solid 2019 performance.

Flexibility and performance profile

Sound fiscal performance and reducing general government debt would ensure Andorra's net asset position, although high contingent liabilities remain.

- Alignment to the prudent fiscal policies approved by previous government alongside higher-than-expected economic growth ensure the country's solid net asset position.
- Our assessment of high contingent liabilities from Andorra's large financial sector constrain the rating.
- Lack of sufficient external data hamper our assessment of the country's external position.

Outlook

The positive outlook reflects our view that we could raise our ratings on Andorra within the next 18 months if

Andorran authorities make faster progress with respect to strengthening its resilience to deal with a potential financial crisis as well as greater availability of statistical data, for example via IMF membership.

We could revise the outlook to stable if Andorra underperforms our economic and fiscal expectations. We could also revise the outlook to stable if the country's financial sector faces heightened risks or if the government halts the alignment to international financial standards, its accession to the IMF, or association agreement with the EU.

Rationale

The rating on Andorra is supported by our expectation that the authorities will continue to pursue an association agreement with the EU and IMF membership for which they have shown steady progress under its new government. Following the 2015 crisis when a major financial institution failed, Andorra has continued converging with international standards of financial reporting and supervision, which we expect this government to continue endorsing.

We anticipate sound improvement in the government's budgetary position, supported by its alignment to a conservative fiscal sustainability law and greater-than-expected economic performance.

These credit strengths are counterbalanced by Andorra's large financial sector compared with the size of its economy and its lack of monetary flexibility.

Institutional and economic profile: Conservative fiscal policies and steady progress on negotiations with the IMF and EU in a greater than previously expected economic environment.

The government, led by Prime Minister Xavier Espot, has shown continuity on key priorities of opening the economy to foreign investors and reforming the tax system and financial sector regulations to bring them in line with international standards.

In parallel, Andorra has progressed steadily in negotiating IMF accession and EU association. Both could increase the country's resilience to financial crises and help reduce the latent reputational risks. Of note, in our view, both could improve the quality, transparency, and comparability of the country's statistical information, which has hampered some of our rating assessments.

On Jan. 3, 2020, the government sent a formal petition for adhering to the IMF, a step that raises the likelihood of completing the process in the next 12-18 months. Working toward the adhesion to the IMF has fostered works to improve the quality of statistical data; in 2018, parliament approved the statistical plan with specific targets in data production that kick in this year.

In our view, the banking crisis that followed the 2015 Banca Privada d'Andorra (BPA) failure led to an accelerated convergence of the country's banking sector and its regulation and supervision toward international standards, in particular those related to the sovereign's monetary agreement with the EU. We expect this government to continue endorsing these.

Andorra was removed from the list of noncooperative tax jurisdictions in 2018, and received the Organisation for Economic Co-operation and Development's ratification in 2018 that the country's preferential regimes are not harmful tax practices.

We estimate Andorra's economic growth will return to a pace similar to that of its main trading partners, Spain and France, both economies that still have proven more resilient and for which we have a more positive view on economic growth in the eurozone. On the positive side, those two countries are growing at above-eurozone average rates. Andorra outperformed our previous 2019 economic growth estimatesthanks to a more dynamic performance in the construction sector.

Andorra's dependence on Spain is particularly acute--over half of the country's exports are to (57%) and 64% of its imports come from Spain. Therefore, for 2020-2021 our base-case projects average real GDP growth of 1.8% in Andorra, slowing down from an a 2019 estimate of 2.3%. We expect unemployment to remain at about a very low 2%, supported by greater, albeit slowing, economic activity.

The government has been promoting economic diversification. However, in our base-case scenario, we expect Andorra's economy to continue highly concentrated in financial services, tourism, and commerce; they represent approximately 75% of gross value added of the entire economy.

Flexibility and performance profile: Sound fiscal performance supports the government's net asset position but high contingent risks remain.

Alignment to the 2014 Fiscal Sustainability Law (FSL), alongside the country's economic performance, support our estimation that gross government debt will decline to below 30% of GDP by 2021 from above 40% before 2016. In this context, we expect the central government to broadly balance budgets on average over 2020-2022, with headroom against the 1% maximum deficit prescribed in the FSL. Local governments, meanwhile, will continue posting lower-but-still-positive fiscal balances that will ensure their debt continues to decline.

Social security reserves have had a positive performance as of October 2019, picking up from slight losses reported at year-end 2018. We therefore anticipate they will average about €1.4 billion for fiscal years 2019 and 2020 and represent about 52% of our GDP estimate for the period. As a result, we expect Andorra will maintain its net asset position.

Both public companies, Andorra Telecom and Forces Elèctriques d'Andorra (FEDA), continue to be profitable and distribute regular dividends to the central government (instead of requiring transfers). Andorra Telecom transfers 100% of its dividends while FEDA transfers 30%. As of September 2019, both companies kept large reserves for funding capital investments (€195 million for Andorra Telecom and €51 million for FEDA).

Therefore, we expect central government debt to increase marginally to cover forecast fiscal deficits at the state level but local government debt to decrease, albeit gradually. Accounting for robust level of reserves, we expect Andorra's general government position to remain in a net asset position.

In 2019, Andorra's government issued three bonds amounting to €350 million. The government's financial policy will continue focusing on increasing the average maturity of its outstanding debt, which is low relative to other European sovereigns, and lowering the cost of debt. Average debt maturity as of September 2019 was 2.7 years and the average cost of debt now stands near 0.9%, representing a significant reduction since 2013. We estimate that the government's refinancing needs for 2020 amount to about €325 million.

In the coming years, we expect net financing needs to remain relatively low, although subject to the conclusion of the IMF membership process, the sovereign may require additional borrowing in order to fund its quota payment to the IMF. Given the sovereign's solid net asset position and the benefits of the IMF membership, we will not likely consider this borrowing to be credit-negative.

The high contingent liabilities from Andorra's large financial sector constrain our debt assessment. As of year-end 2018, assets under management represented 16x our estimated 2018 GDP, while banking assets accounted for about 5x GDP. Financial institutions' claims on the resident nongovernment sector, at about 1.4x 2018 GDP, are among the highest of the sovereigns we rate. Andorra's financial sector contributes about 18% of total GDP and approximately 4% of salaried employment.

While the financial sector has stabilized following the banking crisis triggered by BPA's collapse in 2015 and subsequent policy actions, future banking crises could have important repercussions for the local economy, likely negatively affecting the country's budgetary position and leading to debt accumulation. In our view, convergence with international norms and transparency standards should lower the risk from the banking sector but will test Andorran banks' business models by competing more directly 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, which has been based on the monetary agreement with the EU since 2011. Although Andorra lacks a lender of last resort, we recognize that Andorran banks have indirect access to liquidity from the European Central Bank through their subsidiaries in the eurozone, although we consider this support limited.

Because of a lack of sufficient external data, we evaluate Andorra's external position starting from our view of Spain, the country to which its economy is most closely tied, then adjust our view to reflect the lack of data. We understand the Andorran government is actively working to address this deficiency, through the approval of the Statistic Plan for 2018-2021 and a strengthening of the country's statistical services, which we believe will benefit from IMF membership and related technical assistance on statistics.

Table 1

Andorra -- Selected Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)										
Nominal GDP (bil. €)	3	3	3	3	3	3	3	3	3	3
Nominal GDP (bil. $)	3	3	3	3	3	3	3	3	4	4
GDP per capita (000s $)	43.6	36.1	36.8	37.7	40.3	39.4	40.4	42.7	45.6	47.1
Real GDP growth	2.3	0.8	1.9	1.7	1.6	2.3	1.8	1.8	1.8	1.8
Real GDP per capita growth	1.1	(0.5)	1.6	(0.7)	1.5	2.2	1.7	1.7	1.7	1.7
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	5.8	4.1	3.5	2.4	2.0	2.0	2.0	2.0	2.0	2.0
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

Table 1

Andorra -- Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Narrow net external debt/CAPs	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
Net external liabilities/CAPs	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. $)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiscal indicators (general government; %)										
Balance/GDP	3.2	2.5	5.4	4.6	0.7	5.6	2.9	2.8	2.7	2.6
Change in net debt/GDP	(1.8)	(2.3)	(4.6)	(5.8)	(0.2)	(5.6)	(2.9)	(2.8)	(2.7)	(2.6)
Primary balance/GDP	4.1	3.2	6.1	5.2	1.1	6.1	3.4	3.2	3.1	3.0
Revenue/GDP	22.1	22.8	25.1	24.4	21.4	21.5	21.5	21.5	21.5	21.5
Expenditures/GDP	18.9	20.3	19.7	19.8	20.7	15.9	18.6	18.7	18.8	18.9
Interest/revenues	4.2	3.2	2.7	2.2	1.7	2.4	2.2	2.1	2.0	1.9
Debt/GDP	41.0	40.6	40.0	37.6	36.1	32.6	30.9	29.3	27.7	26.2
Debt/revenues	185.8	178.5	159.4	153.9	168.6	151.7	143.9	136.2	128.9	122.0
Net debt/GDP	(1.9)	(4.2)	(8.7)	(14.3)	(14.2)	(19.3)	(21.7)	(23.8)	(25.7)	(27.5)
Liquid assets/GDP	43.0	44.9	48.7	51.9	50.3	51.9	52.6	53.1	53.4	53.7
Monetary indicators (%)										
CPI growth	(0.1)	(1.1)	(0.4)	2.6	1.3	0.8	1.1	1.3	1.5	1.5
GDP deflator growth	(0.1)	(0.5)	0.7	1.1	0.9	0.8	1.1	1.3	1.5	1.5
Exchange rate, year-end (€/$)	0.82	0.92	0.95	0.83	0.87	0.89	0.89	0.86	0.83	0.83
Banks' claims on resident non-gov't sector growth	(2.6)	(4.0)	(9.2)	(8.6)	(0.3)	0.0	0.0	0.0	0.0	0.0
Banks' claims on resident non-gov't sector/GDP	198.0	189.3	167.5	149.0	144.9	140.5	136.5	132.3	128.1	124.0
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

Sources: Department D'Estadistica (Economic Indicators), Autoritat Financera Andorrana, European Central Bank (Monetary Indicators), and Ministry of Finance (Fiscal Indicators).
Adjustments: N/A.
Definitions: 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. N/A--Not applicable. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. 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.

Table 2

Andorra -- Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	3	Generally effective policymaking in recent years promoting sustainable public finances and balanced economic growth as reflected by the government's efforts to continue negotiations with the IMF and EU.
Economic assessment	2	Based on GDP per capita (US$) and growth trends as per Selected Indicators in Table 1.
		Volatile and concentrated economy in the financial sector that represents around one third of economic activity.
External assessment	5	The sovereign has limited external data. We therefore assign an initial assessment that is the same as the initial assessment that we could apply to Spain.
		The sovereign's external data lack consistency as there is lack of reliable and sufficient external accounts information.
Fiscal assessment: flexibility and performance	1	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
		Based on liquid assets/GDP as per Selected Indicators in Table 1, which are at over 50% of GDP.
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
		Contingent liabilities are high. The size of Andorra's banking sector is large with assets of around 5x GDP or about 16x when considering off-balance sheet assets under management.
Monetary assessment	5	The euro is a reserve currency. CPI as per Selected Indicators in Table 1.
		The central bank has the ability to act as lender of last resort for the financial system. No monetary flexibility, but inflation is under control.
Indicative rating	bbb+	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	-1	The notch of flexibility down captures additional factors that have an impact on creditworthiness and are not fully reflected in the indicative rating. Mainly uncertainties remain in the banking sector, in particular regarding medium-term strategic challenges following the introduction of international standards and the still-ongoing litigation of the BPA case.
Final rating		
Foreign currency	BBB	
Notches of uplift	0	Default risks do not apply differently to foreign and local currency debt.
Local currency	BBB	

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). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings Score Snapshot, Jan. 2, 2020
- Sovereign Risk Indicators, Dec. 12, 2019. Interactive version available at http://www.spratings.com/sri
- Sovereign Ratings History, Dec. 4, 2019
- Sovereign Ratings List, Dec. 4, 2019
- European Economic Snapshots: Domestic Demand Still A Safety Net, April 12, 2019