Research Update:

Andorra 'BBB/A-2' Ratings Affirmed; Outlook Stable

January 15, 2021

Overview

- We believe that Andorra has sufficient fiscal headroom to manage the economic consequences of the COVID-19 pandemic.
- Risks concerning the magnitude of the economic downturn persist, but we expect the economy to rebound by 5.0% in 2021 and 2.3% in 2022.
- In our view, Andorra's IMF membership, achieved in October 2020, could anchor the country's economic and budgetary policy and contribute to economic resilience.
- We are affirming our 'BBB/A-2' long- and short-term ratings on Andorra and maintaining the stable outlook.

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Rating Action

On Jan. 15, 2021, S&P Global Ratings affirmed its 'BBB/A-2' long- and short-term foreign and local currency sovereign credit ratings on Andorra. The outlook is stable.

Outlook

The stable outlook balances downside risks related to the pandemic with the positive impact of the expected economic rebound over the next two years.

Downside scenario

We could lower the rating if the economic impact of COVID-19 is more severe or prolonged than our forecasts, putting Andorra's budgetary position under further pressure. We could also lower the rating if the country's financial sector faced heightened risks, or if the government halts the alignment toward international financial standards or the association agreement with the EU.

Upside scenario

We could raise the rating if Andorra's budget deficits decline faster than we currently expect. Greater availability of statistical data could support its creditworthiness and prompt us to improve our assessment of Andorra's external position.

Rationale

We affirmed our rating on Andorra because of our expectation of an economic rebound following the temporary economic shock induced by the SARS-CoV-2 pandemic. Moreover, we believe that the recently achieved IMF membership could act as a policy anchor contributing to the country's economic and budgetary resilience. We also expect the authorities will continue to pursue an association agreement with the EU and to further efforts to converge with international standards on financial reporting and supervision, which have increased since the 2015 crisis when one of its major financial institutions failed.

All economic sectors in Andorra have contracted as of the third quarter of 2020 and, while the economy's performance appears to be slightly better than that of its key trading partners Spain and France, we estimate Andorra's GDP will have contracted by 12.9% in real terms in 2020. Our estimate is based on the large concentration of the economy in the services sector, particularly tourism, which has been severely affected by the pandemic.

Over the past several years, Andorra has strengthened its fiscal position, which has led to declining general government debt, in nominal terms from 2016-2018 and has increased government liquid assets. This has, in our view, provided the authorities with fiscal space to adopt budgetary measures in response to the adverse economic impact of COVID-19. Although this entails large fiscal deficits in 2020 and 2021, the country secured various funding sources during 2020 and diversified its funding base away from the local capital market.

These credit strengths are counterbalanced by Andorra's relatively large financial sector compared with the size of its economy, the potential deterioration in asset quality, and its lack of monetary flexibility.

Institutional and economic profile: Following the pandemic-induced GDP contraction, we expect the economy to grow by about 3.4% on average during 2021-2022

- Andorra's economy remains highly concentrated in financial services, tourism, and commerce, which exacerbates the adverse impact of SARS-CoV-2.
- Following the large GDP contraction in 2020, we expect the economy to rebound in 2021 and reach the pre-crisis GDP level in 2019.
- On Oct. 16, 2020, Andorra joined the IMF, which could improve the country's economic resilience.

Andorra appears to have been relatively successful in containing the spread of the novel coronavirus. Even during the second wave of infections, the health care system has maintained ample capacity. As of Dec. 3, 2020, around 16% of intensive care facilities were in use. The government has also greatly increased efforts to conduct testing to around 40% of the country's population per week.

However, the impact of the national lockdown measures on economic activity in Andorra has been compounded by the pandemic's impact in neighboring Spain and France, especially in the tourism sector. Spain represents the largest share of visitors to Andorra. Although tourism resumed in July 2020 when the border with France and Spain reopened, tourist numbers had declined 21.8% year on year as of Sept. 20, 2020.

Andorra's real GDP growth in the third quarter of 2020 contracted by a further 3.3% after a sharp fall of 21.6% in the second quarter. Although the economic contraction up to the fourth quarter appears to have been slightly milder in Andorra than in Spain and France, the importance of these economies for Andorran economic activity is very high. For example, Spain represents 71% of Andorra's exports and 72% of its imports. Therefore, we estimate GDP contraction for Andorra in 2020 at about 12.9%, slightly deeper than our forecast contraction for Spain. At the same time, we now expect a more moderate rebound in Andorra's economy, by 5.0% in 2021 and 2.3% in 2022.

The second wave of COVID-19 infections has changed our economic outlook for the eurozone. The impact on Spain of this second spike and containment measures has led us to revise the economic growth forecast to a deeper contraction of 11.3% with a more moderate recovery of 6.5% than we had previously forecast. This is the deepest contraction we expect for countries in Europe. At the same time, we have revised down our estimate of economic growth for France; we now believe the recession in 2020 reached 9% and that recovery will be more modest at 6.2%.

In addition, we have changed our forecast of population growth because we have evidence that, unlike during other crises, Andorra has not reported high emigration. In fact, its population grew in the third quarter of 2020 by 1.1%. This has changed our estimated GDP per capita to $36,500 in 2020 and to $40,700 this year. That said, we are revising down our estimated unemployment rate, given that support packages from the government have buoyed employment levels. Therefore we estimate 2020 unemployment will rise to around 2.0% from 1.8% in 2019.

The government has been promoting economic diversification. However, in our base-case scenario, we expect Andorra's economy to remain highly concentrated in financial services, tourism, and commerce; these represent approximately 75% of gross value added for the entire economy. In our view, this exacerbates the adverse impact of the COVID-19 pandemic on the Andorran economy. Moreover, in the longer term, Andorra's renowned winter tourism season could come under pressure from global warming, resulting in additional challenges for the sector.

On a positive note, the government, led by Prime Minister Xavier Espot, has shown commitment to its key priorities: Opening the economy to foreign investors and reforming the tax system and financial sector regulations to bring them in line with international standards.

Andorra joined the IMF on Oct. 16, 2020, achieving one of the key ambitions of the coalition government formed in 2019. Officially the country applied for membership on Jan. 3, 2020, and its parliament approved the €100 million accession quota on July 1, 2020, of which €25 million is held in IMF accounts and €75 million in Andorran accounts, both counting toward Andorra's national reserves. We believe the IMF membership could contribute to the sovereign's economic resilience against potential future economic or financial crises by providing a policy anchor, including access to technical assistance and potentially benefiting from financial support.

Moreover, as part of the efforts to diversify its sources of funding, Andorra became the 42nd member of the Council of Europe Development Bank on May 26, 2020, and on Sept. 25, 2020, closed its first transaction dedicated to COVID-19-related medical expenditure.

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, particularly those related to the sovereign's monetary agreement with the EU. We expect this government to continue endorsing these international standards, despite negotiations being delayed due to the pandemic.

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

Flexibility and performance profile: Fiscal headroom to manage the economic consequences of the pandemic, but limited visibility on the government's external position

- Andorra still has robust fiscal headroom to manage the economic impact of the SARS-CoV-2 pandemic.
- Robust levels of reserves support the government's net asset position.
- Its large banking sector exposes Andorra to high contingent liabilities and constrains the sovereign rating.

Andorra entered the economic recession triggered by the pandemic from a robust position, thanks to posting general government budget surpluses over the past seven years, which has led to a declining trend on the gross general government debt to GDP ratio since 2017 and to increased government liquid financial assets. The fiscal consolidation was fostered by the Fiscal Stability Law the government approved in 2014, which prohibited gross general government debt from rising above 40% of GDP. Andorra has complied with this limit since then.

The government's initial budgetary support package to counter the economic impact of the pandemic has not been fully used and, therefore, we have revised downward our 2020 general government budget deficit forecast to 3% of GDP from around 7%. We forecast the government will in 2021 post a small budget deficit but run a budget surplus of about 3.3% per year during 2022-2024. As a result, we estimate gross general government debt at around 48% of GDP in 2020, increased from 35% in 2019. Given the current extraordinary circumstances, Andorra's parliament has temporarily removed the Fiscal Sustainability Law limits, providing the government room to implement its fiscal stimulus plan. We anticipate gross general government debt will remain at 48% of GDP in 2021, then gradually decline to about 41% by year-end 2024.

Meanwhile, we expect local governments to continue posting lower, but still positive, fiscal balances that will ensure their debt continues to decline, given that the fiscal stimulus is fully implemented by the central government.

Andorra Telecom and electricity supplier Forces Elèctriques d'Andorra (FEDA) continue to be profitable and distribute dividends to the central government. Andorra Telecom transfers 100% of its dividends to the government and FEDA transfers 30%. Moreover, both companies have already transferred €30 million of their available reserves to fund part of the 2020 central government deficit. Reserves at Andorra Telecom and FEDA are very high. After the aforementioned transfers, reserves--which they use to fund capital investments--stand at €213 million for Andorra Telecom and €49 million for FEDA as of June 30, 2020. Particularly important are investments related to the energy transition in which FEDA will play a very important role. Andorra Telecom is heavily investing in technological transformation.

After the weaker performance experienced in the first quarters of 2020 owing to market volatility, the social security balance recovered toward the year-end. As of Oct. 31, 2020, social security reserves reached €1.4 billion. We expect the reserves will represent about 56% of GDP in 2021. Given the relatively high level of reserves, we expect Andorra's general government accounts will remain in a net asset position. The government has been diversifying its funding sources, which currently include a €50 million credit facility from local banks, bond issuance, and multilateral funding.

The government's financial policy will continue to focus on increasing the average maturity of its outstanding debt, which is lower than that of other European sovereigns, and lowering the cost of debt. The average margin on its outstanding debt has reduced significantly, to 0.93% in December 2020 from 2.29% in 2013.

The substantial contingent liabilities from Andorra's large financial sector constrain our debt assessment. As of year-end 2019, assets under management represented 17x our estimated 2019 GDP, while banking assets accounted for about 5x GDP. Andorra's financial sector contributes about 18% of total GDP and approximately 4% of salaried employment.

Although 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, which could weigh on the country's budgetary position and lead 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 forcing them to compete more directly with much larger global players.

Our view of Andorra's sovereign creditworthiness remains constrained by the country's lack of an independent monetary policy. It has used the euro as its official currency, as part of its 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 by approving the statistics plan for 2018-2021 and strengthening the country's statistical services. We believe the statistical services will also benefit from IMF membership and related technical assistance.

Key Statistics

Table 1

Andorra Selected Indicators

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic indicators (%)										
Nominal GDP (bil. LC)	2.5	2.6	2.7	2.7	2.8	2.5	2.6	2.7	2.7	2.8
Nominal GDP (bil. $)	2.8	2.9	3.0	3.2	3.2	2.8	3.1	3.2	3.3	3.4
GDP per capita (000s $)	38.9	39.6	40.1	42.3	40.7	36.5	40.7	41.8	42.3	42.9
Real GDP growth	1.4	3.7	0.3	1.6	1.8	(12.9)	5.0	2.3	0.9	0.9
Real GDP per capita growth	(0.2)	1.8	(1.9)	(0.3)	0.1	(12.0)	5.5	1.3	(0.1)	(0.1)
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	4.1	3.0	1.7	1.5	1.8	2.0	2.2	2.1	2.0	2.0

Table 1

Andorra Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
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
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. $)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiscal indicators (general government; %)										
Balance/GDP	2.5	5.4	4.7	0.7	6.7	(3.1)	(0.1)	3.0	3.4	3.4
Change in net debt/GDP	(2.3)	(4.6)	(5.9)	(0.2)	(4.7)	6.6	0.1	(3.0)	(3.4)	(3.4)
Primary balance/GDP	3.3	6.0	5.2	1.3	7.2	(2.7)	0.4	3.5	3.8	3.8
Revenue/GDP	22.9	25.0	24.6	21.6	27.3	22.8	22.3	24.6	24.5	24.5
Expenditures/GDP	20.4	19.6	19.9	20.8	20.5	25.9	22.4	21.6	21.2	21.1
Interest/revenues	3.2	2.7	2.3	2.4	1.7	1.8	2.0	1.9	1.8	1.7
Debt/GDP	41.0	39.8	37.8	36.4	35.4	48.1	47.9	45.5	43.4	41.3
Debt/revenues	178.5	159.3	153.8	168.5	130.0	210.8	214.8	184.8	176.8	168.8
Net debt/GDP	(4.3)	(8.7)	(14.5)	(14.3)	(18.5)	(14.7)	(13.8)	(16.3)	(19.3)	(22.3)
Liquid assets/GDP	45.2	48.5	52.3	50.6	53.9	62.8	61.7	61.9	62.7	63.5
Monetary indicators (%)										
CPI growth	(1.1)	(0.4)	2.6	1.3	0.8	(0.2)	0.8	1.3	1.3	1.3
GDP deflator growth	0.7	0.3	1.1	1.0	1.5	(0.2)	0.8	1.3	1.3	1.3
Exchange rate, year-end (LC/$)	0.92	0.95	0.83	0.87	0.89	0.81	0.83	0.83	0.83	0.83

Table 1

Andorra Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Banks' claims on resident non-gov't sector growth	(4.0)	(9.2)	(8.6)	(0.3)	0.0	0.0	0.0	0.0	0.0	0.0
Banks' claims on resident non-gov't sector/GDP	190.9	166.5	150.1	145.8	141.0	162.2	153.2	147.9	144.6	141.4
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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. 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

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 complete accession to the IMF and continue negotiations with the EU. Parliament has ensured expedited processes in approving all COVID-19-related government plans.
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, which are greater than 50%, as per Selected Indicators in Table 1.

Table 2

Andorra Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in Table 1.
		Contingent liabilities are high. The size of Andorra's banking sector is large--total assets under management stood at 17x GDP in 2019, when considering off-balance-sheet assets under management.
Monetary assessment	5	The euro is a reserve currency. Consumer price index is 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+	
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 around the economic recovery after the impact of the COVID-19 pandemic.
Sovereign credit 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, Jan. 7, 2021
- Sovereign Ratings List, Jan. 7 2021
- Sovereign Ratings Score Snapshot, Jan. 5, 2021
- Sovereign Risk Indicators, Dec. 14, 2020. A free interactive version is available at http://www.spratings.com/sri

- Default, Transition, and Recovery: 2019 Annual Sovereign Default And Rating Transition Study, May 18, 2020

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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

Ratings Affirmed	
Andorra	
Sovereign Credit Rating	BBB/Stable/A-2
Transfer & Convertibility Assessment	AAA