S&P Global Ratings

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Andorra

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Andorra

Key Rating Factors

Sovereign Credit Rating
BBB/Stable/A-2

Institutional and economic profile	Flexibility and performance profile
Steady progress on IMF membership amid COVID-19-linked GDP contraction. • Despite slightly less negative GDP output for first-quarter 2020 than anticipated, we expect Andorra's economy to contract by 10.8% in real terms this year. • Andorra's economy remains highly concentrated on financial services, tourism, and commerce, which exacerbates the adverse effects of the COVID-19 pandemic. • Andorra has made landmark progress in its application for IMF membership.	Fiscal headroom to manage the economic consequences of the pandemic, but limited visibility on the government's external position. • Andorra has entered the economic downturn from a robust fiscal and debt position. • Its parliament has given the government room to implement its economic stimulus measures by approving a rise in general government debt to above 40%, from 35% as of end-2019. • Our assessment of high contingent liabilities from Andorra's large financial sector constrains the rating.

Outlook

The stable outlook reflects a balance of significant pandemic-related downside risks against the positive effects of IMF membership.

Downside scenario

We could lower the ratings if the economic impact of COVID-19 is more severe or prolonged than we currently forecast, putting Andorra's budgetary position under further pressure. We could also lower the ratings if its financial sector faces heightened risks, or if the government halts the alignment toward international financial standards, its accession to the IMF, or the association agreement with the EU.

Upside scenario

We could raise the ratings if Andorra's economy proves more resilient than we forecast and resumes fiscal consolidation sooner. We may also see economic resilience strengthening after Andorra completes its association agreement with the EU or its accession to the IMF. Greater availability of statistical data could prompt us to improve our assessment of Andorra's external position, which could also support its creditworthiness.

Rationale

Our rating on Andorra is supported by our expectation that the authorities will continue to pursue an association agreement with the EU, and IMF membership. The government has made steady progress in both instances and recently approved the IMF membership fees. Since the 2015 crisis, when a major financial institution failed, Andorra has been converging with international standards on financial reporting and supervision, and we expect this government to continue to endorse this strategy.

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

All economic sectors in Andorra have contracted as of first-quarter 2020, resulting in a real GDP contraction of 3.5%. While this outcome is better than that of key trading partners Spain and France, we forecast a deep GDP contraction of 10.8% for 2020 given the economy's large concentration in the services sector.

Andorra has, over the last few years, strengthened its fiscal position and has sufficient fiscal headroom to manage the COVID-19 pandemic. We estimate that the government's fiscal packages to stimulate the economy will increase government debt. That said, we believe Andorra's large government liquid assets will cushion the government debt burden against the pandemic's economic and budgetary effects.

Institutional and economic profile: Steady progress on negotiations with the IMF, but COVID-19 will trigger a deep GDP contraction

By the start of July 2020, Andorra's health authorities had been successful in stabilizing the contagion curve. The ample capacity of the healthcare system, combined with Andorra's small size, have helped contain the virus. Andorra has tested for antibodies twice its entire population, which has then supported the opening of almost all sectors of the economy (except those that require large group attendance). Its borders with France and Spain have opened and tourism is resuming.

The pandemic has substantially changed the economic outlook in the eurozone. This particularly affects Andorra's main trading partners--we anticipate an economic contraction of 9.5% in France and 9.8% in Spain for 2020, followed by steady and sufficient recoveries in the following two years.

Andorra's real GDP growth as of the first quarter of 2020 has contracted by 3.5%, lower than France (5.3%) and Spain (4.1%). However, Andorra's dependence on Spain is particularly acute--62% of the country's exports go there, and 64% of its imports come from Spain. Tourists from Spain also represent the largest share of visitors to Andorra. Therefore, we anticipate that GDP will contract by 10.8% this year, a significant reduction from our 2019 estimate of 1.9% growth. That said, we forecast a steady recovery of 6.2% in 2021 and 3.1% in 2022.

As in past crises, we expect Andorra's population to decline in 2020 by around 5%, due to its large share of temporary workers emigrating. We therefore expect GDP per capita for 2020 to fall slightly below $40,000. We anticipate unemployment to rise to about 2.3%, from 2.0% in 2019, because Andorra has a large share of temporary workers exiting the labor force due to emigration.

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 effects of the COVID-19 pandemic on the Andorran economy.

On a positive note, the government, led by Prime Minister Xavier Espot, has shown commitment on 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.

In parallel, Andorra has progressed steadily in negotiating its IMF membership and EU association. Both could increase the country's resilience to financial crises and help reduce latent reputational risks. We expect both could also improve the quality, transparency, and comparability of the country's statistical information. Limitations in this area have hampered some aspects of our analysis.

Despite COVID-19-related uncertainties, the government is expecting to complete its membership application to the IMF in October 2020. Andorra's government approved the accession fee on July 1, 2020. Working toward IMF membership has fostered steps to improve the quality of statistical data; in 2018 the parliament approved the statistical plan, which includes specific targets in data production that kick-started in 2019.

Moreover, as part of efforts to diversify its sources of funding, Andorra became the 42nd member of the Council of Europe Development Bank on May 26, 2020.

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. In the same year it received the Organization for Economic Co-operation and Development's ratification 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

Over the past few years, Andorra has consolidated and strengthened its fiscal position, as demonstrated by its seven consecutive years of general government surpluses. As a result, general government debt has been declining since 2017 and its fiscal reserves have been increasing. In 2014, the government approved its Fiscal Stability Law, which prevented general government debt from rising above 40% of GDP, and has complied with this limit since then.

Consequently, Andorra has entered the pandemic-related economic downturn in a robust fiscal and debt position. In the current extraordinary circumstances, Andorra's parliament has approved a potential breach of the Fiscal Sustainability Law limits, giving the government room to implement its economic stimulus measures.

Two packages of fiscal stimulus have been approved. These primarily entail tax deferrals and the government is not expecting to change its tax structure. As a result, we now expect that the central government will post a fiscal deficit of about 7% of GDP for 2020 and that it will slowly consolidate, reaching a balanced position in 2022. Consequently, we assume fiscal deficits will push central government debt to around 45% of GDP on average for 2020 and 2021 before starting to decline again.

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

Social security reserves performed positively up to December 2019, picking up from slight losses reported at year-end 2018. However, given market volatility, they have reported slight losses in the first quarter; we estimate still slight losses this year and a small surplus in 2021. We therefore anticipate that reserves will average about €1.4 billion for fiscal years 2020 and 2021 and represent about 56% of our GDP estimate for the period.

Both public companies, Andorra Telecom and FEDA continue to be profitable and distribute dividends to the central government (instead of requiring revenues from it). Andorra Telecom transfers 100% of its dividends while 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 these companies are still very high; after transfers Andorra Telecom has €200 million and FEDA €45 million as of June 2020. They use these to fund their capital investments. We expect these rates to continue, although profits will likely be hit by electricity and phone bill discounts designed to support the economy.

We therefore expect central government debt to increase to cover forecast fiscal deficits at the state level but local government debt to decrease, albeit gradually. The government has different sources of funding, one of them being a €50 million credit facility from the local banks. Accounting for robust levels of reserves, we expect Andorra's general government to maintain its net asset position.

Andorra retains good market access. The government issued €125 million on April 9, 2020, to refinance an existing bond maturity in line with the plans set out in its annual budget. The issuance was successful and closed at competitive rates.

The government's financial policy will continue to focus on increasing the average maturity of its outstanding debt, which is lower than other European sovereigns, and lowering its cost of debt. The average debt maturity in December 2019 was 2.7 years and the average cost of debt was close to 0.9%, representing a significant reduction since 2013. The government's most recent issuance, this April, secured a 0.75% margin.

The high 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. 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.

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. This 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 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 its 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 these services will also benefit from IMF membership and the related technical assistance the IMF can offer.

Key Statistics

Table 1

Andorra Selected Indicators

Mil. €	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Economic indicators (%)										
Nominal GDP (bil. LC)	2	3	3	3	3	3	3	3	3	3
Nominal GDP (bil. $)	3	3	3	3	3	3	3	3	3	3
GDP per capita (000s $)	46.4	38.9	39.6	40.1	42.3	40.7	38.3	41.9	42.5	42.8
Real GDP growth	2.5	1.4	3.7	0.3	1.6	1.8	(10.8)	6.2	3.1	1.9
Real GDP per capita growth	1.6	(0.2)	1.8	(1.9)	(0.3)	0.1	(6.1)	5.1	2.1	0.9
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	2.1	2.3	2.3	2.3	2.2
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

Table 1

Andorra Selected Indicators (cont.)

Mil. €	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
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. $)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiscal indicators (general government; %)										
Balance/GDP	3.3	2.5	5.4	4.7	0.7	6.7	(6.9)	(2.8)	2.7	3.7
Change in net debt/GDP	(1.9)	(2.3)	(4.6)	(5.9)	(0.2)	(4.5)	8.2	2.0	(2.2)	(3.1)
Primary balance/GDP	4.2	3.3	6.0	5.2	1.3	7.2	(6.5)	(2.4)	3.1	4.1
Revenue/GDP	22.6	22.9	25.0	24.6	21.6	27.2	14.8	17.8	21.8	22.5
Expenditures/GDP	19.4	20.4	19.6	19.9	20.8	20.5	21.7	20.6	19.2	18.8
Interest/revenues	4.2	3.2	2.7	2.2	2.4	1.7	2.7	2.3	2.0	1.8
Debt/GDP	42.0	41.0	39.8	37.9	36.3	35.4	44.8	45.1	42.1	38.6
Debt/revenues	185.7	178.5	159.3	153.9	168.5	129.8	302.8	253.5	192.7	171.7
Net debt/GDP	(2.0)	(4.3)	(8.7)	(14.4)	(14.3)	(18.3)	(12.3)	(9.5)	(11.2)	(14.0)
Liquid assets/GDP	44.0	45.2	48.5	52.3	50.6	53.7	57.1	54.5	53.3	52.6
Monetary indicators (%)										
CPI growth	(0.1)	(1.1)	(0.4)	2.6	1.3	0.8	0.3	1.1	1.3	1.4
GDP deflator growth	(0.1)	0.7	0.3	1.1	1.0	1.5	0.3	1.1	1.3	1.4
Exchange rate, year-end (LC/$)	0.82	0.92	0.95	0.83	0.87	0.89	0.87	0.88	0.89	0.91
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	203.1	190.9	166.5	150.1	145.8	141.0	157.5	146.7	140.5	136.0
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 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 continue negotiations with the IMF and EU. Parliament has ensured expedite process 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
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--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. 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 List, July 8, 2020
- Sovereign Ratings History, July 8, 2020
- Sovereign Ratings Score Snapshot, July 7, 2020
- Credit Conditions In Europe Find Some Respite As Curve Flattens And Recovery Unlocks, Report Says, June 30, 2020
- Economic Research: Eurozone Economy: The Balancing Act To Recovery, June 25, 2020
- Default, Transition, and Recovery: 2019 Annual Sovereign Default And Rating Transition Study, May 18, 2020
- Sovereign Risk Indicators, April 24, 2020; a free interactive version is available at http://www.spratings.com/sri

Ratings Detail (As Of July 17, 2020)*	
Andorra	
Sovereign Credit Rating	BBB/Stable/A-2
Transfer & Convertibility Assessment	AAA
Sovereign Credit Ratings History	
24-Apr-2020	BBB/Stable/A-2
19-Jul-2019	BBB/Positive/A-2
28-Jul-2017	BBB/Stable/A-2
29-Jul-2016	BBB-/Stable/A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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