



## RATING ACTION COMMENTARY

# Fitch Revises Andorra's Outlook to Positive; Affirms at 'BBB+'

Fri 14 Jan, 2022 - 17:02 ET

### Related Fitch Ratings Content:

[Andorra - Rating Action Report](#)

Fitch Ratings - Frankfurt am Main - 14 Jan 2022: Fitch Ratings has revised the Outlook on Andorra's Long-Term Foreign-Currency Issuer Default Rating (IDR) to Positive from Stable and affirmed the IDR at 'BBB+'.

A full list of rating actions is at the end of this rating action commentary.

## KEY RATING DRIVERS

The revision of the Outlook reflects the following key rating drivers and their relative weights:

### High

Andorra's public finances have been resilient to the Covid-19 pandemic. The general government recorded a fiscal deficit of 1% of GDP in 2020, which we expect to widen to 3.5% of GDP in 2021, significantly below the 'BBB' rated median at 5.8% in 2020 and 5.0% in 2021 and the eurozone's weighted average of 7.3% and 6.7% of GDP, respectively. We expect the recovery in GDP growth and decline in fiscal support to underpin a return to a general government fiscal surplus in 2022.

The relative resilience of Andorra's public finances amid the pandemic stems from buoyant tax receipts from foreign trade, reallocation of capital to current spending and large fiscal reserves at SOEs. In 2022, we expect direct tax revenues to benefit from the high employment rate, which was at its highest level in 10 years in 3Q21 (85% of the total labour force). The government's finances will additionally benefit from two new revenue streams. The planned increase in environmental taxation is estimated to add around EUR8 million (0.3% of GDP) in additional revenue and the tourist tax, which will apply from mid-2022, is expected to bring another EUR6 million (0.2% of GDP).

Andorra entered the pandemic with ample fiscal space. A record of stable fiscal surpluses averaging 1.9% of GDP in the decade prior to the pandemic resulted in a very low gross general government debt (GGGD)-to-GDP ratio, at only 35.4% of GDP before the pandemic hit. We estimate the GGGD-to-GDP will have peaked at 50.4% of GDP in 2021 before falling to 46.7% of GDP in 2022 and 41.2% of GDP in 2023, compared with 56.6% of GDP for the 'BBB' rated median and 58.6% of GDP for the 'A' rated median in 2023. According to Andorra's fiscal rules, central government debt can exceed 40% of GDP only under exceptional circumstances. When this threshold was breached in 2020, the government approved a financial sustainability plan, which targets bringing the central government debt burden back to a level below 40% by 2023.

At the same time, progress on Andorra's financial diversification strategy has succeeded in broadening financing sources and helped lengthen the average maturity of its debt. Following its debut on the international bond markets with a 10-year EUR500 million in April 2021, Andorra made a private placement for EUR175 million 20-year Eurobond in October with a coupon of 1.7%. The Eurobond issuances have lengthened Andorra's average debt maturity to 6.7 years from 2.3 years, substantially lowering the government's rollover requirement. They also lowered the cost of debt servicing, with the average cost of debt declining to 0.9% from 1.5%.

## Medium

The recent publication of balance-of-payments statistics bolstered our confidence in the strength of Andorra's external position. The initial data snapshot published for 2019 revealed that the economy was in a sizable current account surplus, amounting to 18% of GDP. In line with our expectations, the substantial current account surplus was driven in equal parts by the positive balance on the trade of goods and services as well as the primary income balance. These reflect Andorra's large tourism and banking sectors.

Andorra has also taken the first steps to produce international investment position (IIP) statistics. These initial estimates published by the IMF show potentially a very positive net IIP position, at around 210% of GDP, which is consistent with the accumulation of

large and stable current account surpluses over time. The IIP data published by the IMF is only an initial estimate, but if confirmed, Andorra's net IIP position would stand well above the current 'BBB' median at -40% of GDP in 2019.

Finally, membership of the IMF resulted in a build-up of foreign exchange (FX) reserves, which further strengthen Andorra's external position and improve its shock-absorption capacity. The FX reserves currently include the IMF quota equal to EUR140 million (5.5% of GDP) but the government plans to increase them to a total of EUR340 million (12% of GDP) by end-1Q22, in line with the IMF's advice. The 12% of GDP recommended by the IMF covers one month of imports, the government's short-term external liabilities and a fiscal buffer of one month of government spending.

The 'BBB+' IDRs also reflect the following key rating drivers:

Andorra's credit profile is supported by high GDP per capita (more than three times the 'BBB' median), favourable governance indicators and high debt affordability. These positive credit features are set against risks to the economy and sovereign balance sheet from a very large banking sector and the absence of a lender-of-last-resort.

A more favourable economic outlook with receding risks relating to the coronavirus reinforce the likelihood that further substantial fiscal support will not be needed. We revised our real GDP growth forecasts upwards to 6.6% in 2021 and 5.0% in 2022, from a previously more conservative 4.5% and 5.2%, respectively. The forecast revision mainly reflects a strong recovery in tourist arrivals, which reached their 2019 levels in June as the second wave of Covid-19 infections subsided and mobility restrictions were eased. The high vaccination rate (78% of the total population), ample ICU capacity and widespread testing were effective at mitigating the economic impact of the pandemic in 2021. Strong tourist inflows continued in the winter months despite the rise in Omicron cases, and we expect the economy to be broadly resilient to the Omicron variant unless mobility restrictions at the borders are restored.

The improved recovery momentum has enabled the government to withdraw most of the fiscal support to the economy. Since June 2021, less than 0.1% of the labour force has been supported by the wage support scheme and the unemployment rate started trending down to 2.9% in 3Q21 after peaking at 3.3% in the quarter before. Loans under moratoria declined to EUR45 million (1.7% of GDP or 0.7% of loanbook). The outstanding amount of government-guaranteed soft loans has been unchanged since the first wave of the pandemic, at EUR126 million (equal to 4.7% of GDP, 2% of the loanbook or 55% of the total envelope). Until now, only 0.3% of the loans defaulted against the government's conservative assumption of 18% defaults.

The banking system has so far remained resilient to the pandemic and we believe the sector has adequate headroom to withstand the pressures on revenues and asset quality due to the pandemic, assuming there are no further mobility restrictions at the borders with France and Spain. Banks maintain satisfactory capital buffers above minimum requirements, which is supported by resilient profitability. Banks funding is dominated by a stable customer deposits base and liquidity is adequate and conservatively managed.

There has been consolidation in the banking sector recently, with Mora Banc (BBB-/Stable) having acquired Banc Sabadell Andorra and the acquisition of Vall Banc by Credit Andorra (BBB-/Negative) pending regulatory approval. We view these acquisitions as positive for banks' earnings prospects although Credit Andorra might face short-term negative pressure on its credit profile, particularly capitalisation, which we expect to be restored in the medium to long term.

We expect Credit Andorra to address Vall Banc's problem assets ahead of the acquisition, which would lead to a reduction in the total exposure to non-performing loans for the whole banking sector. The banking sector's impaired loan ratio declined to 6.2% in 3Q21 (3.8% excluding Vall Banc's portfolio in run-off) from 7.3% at end-2020 (4.4% excluding Vall Banc's portfolio) but we expect it to increase moderately in 2022 as the impact of the pandemic unfolds.

ESG - Governance: Andorra has an ESG Relevance Score (RS) of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption, as is the case for all sovereigns. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Andorra has a high WBGI ranking at 91.4 percentile, well above the 'BBB' median, reflecting strong institutional capacity and effective rule of law.

## **RATING SENSITIVITIES**

### **Factors that could, individually or collectively, lead to negative rating action/downgrade:**

-Macro: Severe and prolonged economic weakness, for example due to a resurgence of the pandemic that would lead to a renewed contraction in the tourism sector.

-Public Finances: Failure to stabilise general government debt/GDP, for example due to another severe shock to the tourism sector, or materialisation of contingent liabilities.

### **Factors that could, individually or collectively, lead to positive rating action/upgrade:**

- Public Finances: A sustained decline in the debt-to-GDP ratio, for example through a sustained economic recovery and consolidation of public finances.

-External Finances: Greater confidence in the strength of the external position, evidenced, for example, in the construction and publication of additional balance of payments and IIP statistics as well as further build-up of FX reserves.

-Structural Features: Improved resilience of the banking sector and associated vulnerabilities of the sovereign balance sheet, evidenced for example through tangible improvements to the banking supervision framework and sufficient access to financing facilities to mitigate the lack of a credible lender-of-last-resort.

## **SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)**

Fitch's proprietary SRM assigns Andorra a score equivalent to a rating of 'BBB+' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

- Structural: -1 notch, to reflect the relatively large banking sector and lack of a credible lender-of-last-resort that leaves the economy and the sovereign balance sheet vulnerable to shocks.

- Macro: +1 notch, to offset the deterioration in the SRM output driven by the pandemic shock, including from the growth volatility variable. The deterioration of the GDP growth and volatility variables reflects a very substantial and unprecedented exogenous shock that has hit the vast majority of sovereigns, and Fitch believes that Andorra has the capacity to absorb it without lasting effects on its long-term macroeconomic stability.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on

historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

A number of data series that feed into our credit analysis are not available or only partially available for Andorra, principally on the Balance of Payments and External Balance Sheet. This is addressed by the use of estimates of key data items, and conservative assumptions e.g. on sovereign external debt, augmented by qualitative discussions with the Andorran authorities, the IMF and independent banking sector analysts. These give us sufficient information to assess with reasonable confidence the impact of Andorra's external finances on the overall rating. The main data adjustments are:

- CAB: Data quality is improving as we now have 2019 data following the recent publication and we have supplemented this with estimates for 2020 provided by the IMF;
- FDI: assumed to be 0% apart from 2019, for which the statistics are available, given the high volatility of FDI flows;
- External interest service: assumed to be the same as the 'BBB' median projections for the three-year average centred on 2021 (4.4% of current account receipts);
- Broad money estimates are unavailable; we have used information from the consolidated balance sheets of Andorran banks as a proxy.

## **ESG CONSIDERATIONS**

Andorra has an ESG Relevance Score of '5[+]' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Andorra has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Andorra has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key

rating driver with a high weight. As Andorra has a percentile rank above 50 for the respective Governance Indicators, this has a positive impact on the credit profile.

Andorra has an ESG Relevance Score of '4[+]' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Andorra has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Andorra has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Andorra, as for all sovereigns. As Andorra has track record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Andorra	LT IDR	BBB+ Rating Outlook Positive		BBB+ Rating Outlook Stable
		Affirmed		
	ST IDR	F2	Affirmed	F2
	Country Ceiling	A+	Affirmed	A+
senior unsecured	LT	BBB+	Affirmed	BBB+

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**[Country Ceilings Criteria \(pub. 01 Jul 2020\)](#)[Sovereign Rating Criteria \(pub. 26 Apr 2021\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**



Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.2 (1)

Debt Dynamics Model, v1.3.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.12.2 (1)

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Andorra

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