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CREDIT OPINION
22 January 2025

Update

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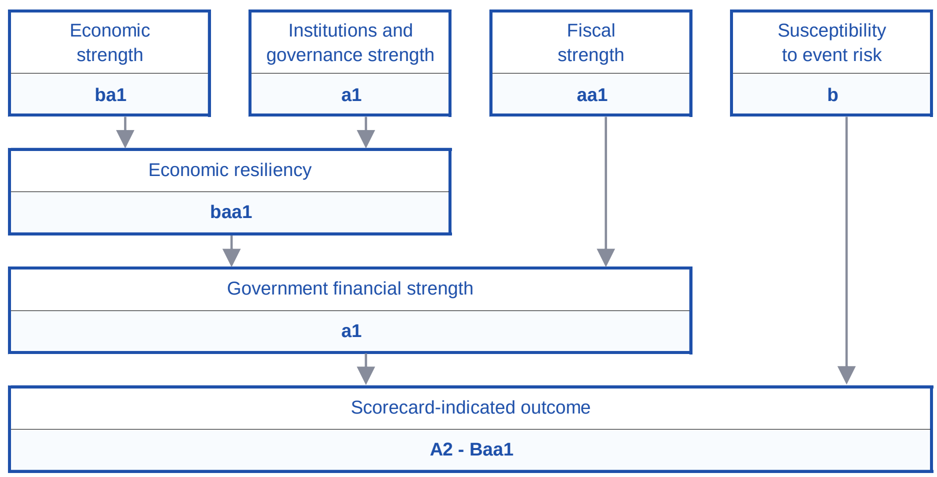
Government of Andorra – Baa1 stable

Regular update

Summary

Andorra's credit profile reflects the country's high wealth, solid institutional and governance capacity and robust fiscal metrics. This is balanced by credit challenges such as Andorra's very small size, exposure to a large banking sector and absence of a fully-fledged lender of last resort.

Exhibit 1
Andorra's credit profile is determined by four factors



Source: Moody's Ratings

Credit strengths

» Wealthy economy with high activity and employment rates

» Solid institutional and governance capacity

» Low government debt and strong debt affordability

Credit challenges

» Very small and volatile economy

» Absence of a fully-fledged lender of last resort, partly mitigated by the creation of a liquidity emergency provision mechanism in late 2022

» Potential contingent liabilities stemming from a very large financial sector

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Rating outlook

The stable outlook reflects balanced risks at the Baa1 rating level. Andorra's strong institutions and very affordable debt metrics point to a potentially faster improvement in credit metrics than we currently assume. Conversely, the country's small size and significant exposure to event risk driven by the very large (albeit profitable) banking sector (with banking assets at 535% of GDP in 2023), point to potential downside risks in the event of economic and/or banking sector shocks.

Factors that could lead to an upgrade

The adoption of further reforms in the areas of pensions and healthcare that limit the rise in ageing-related spending, and evidence that the implementation of the Association Agreement with the European Union (Aaa stable) leads to significantly higher economic growth, would put upward pressure on the rating. A reduction in the relative size of the banking sector and further evidence that the system poses lower risk to the Andorran sovereign would also be credit positive.

Factors that could lead to a downgrade

A worsening in Andorra's medium-term growth prospects relative to our baseline scenario would put downward pressure on the rating. Weaker growth and higher economic volatility would negatively affect public finances, potentially prompting government intervention that would put upward pressure on the country's borrowing needs and, eventually, public debt. A reversal of reform momentum would also be credit negative, as it would indicate a weaker institutional setup than we currently assume. Finally, a weakening of the Andorran banking sector that threatened economic growth and the health of public finances would put downward pressure on the rating.

Key indicators

Exhibit 2

Andorra	2019	2020	2021	2022	2023	2024F	2025F	2026F
Real GDP (% change)	2.0	-11.2	8.3	9.6	2.6	1.8	1.5	1.4
Inflation rate (% change average)	0.5	0.1	1.7	6.2	5.6	3.1	1.9	1.8
Gen. gov. financial balance/GDP (%)	2.3	-1.1	-1.2	4.8	2.1	2.4	1.6	1.6
Gen. gov. primary balance/GDP (%)	2.8	-0.5	-0.4	5.5	2.7	3.0	2.3	2.3
Gen. gov. debt/GDP (%)	35.4	46.4	48.6	38.9	35.5	34.5	33.7	32.7
Gen. gov. debt/revenues (%)	92.7	112.3	128.3	97.9	93.3	88.7	87.3	84.9
Gen. gov. interest payment/revenues (%)	1.2	1.4	1.9	1.8	1.5	1.6	1.8	1.8
Current Account Balance/GDP (%)	18.0	15.5	14.1	17.3	17.0	17.5	17.8	17.9

Source: Moody's Ratings

Detailed credit considerations

We assess Andorra's **economic strength** as "ba1", balancing high per-capita GDP and very small size combined with moderate trend growth. Andorra's diversification away from financial services has broadened the spectrum of economic activities in the country, although the importance of some key sectors (tourism, retail) poses a concentration risk which results in a -1 adjustment compared to the "baa3" scorecard-indicated outcome. Our economic strength assessment also incorporates the structurally low unemployment in the context of a fluid labour market. Andorra's attractiveness for foreign workers, customers and investors relies on a favourable tax system as well as modern infrastructure.

Andorra's **institutional strength** is assessed to be "a1", with high scores on the Worldwide governance (WGI) indicators and improving policymaking both with regards to fiscal framework and its enhanced banking supervision. However, the country's very small size is a fundamental constraint on key aspects, such as the availability of statistics. From a macroeconomic perspective, we note that the absence of a lender of last resort is a constraint for Andorran policymakers, partly mitigated by the creation of a liquidity emergency provision mechanism in late 2022.

According to the WGI, Andorra scores consistently high (80th to 90th percentile) for indicators both related to quality of legislative and executive institutions as well as indicators related to strength of civil society and judiciary[1]. In terms of policy effectiveness, a rules-based fiscal framework has been in place since 2014 setting clear targets for debt, deficit, current spending and direct taxes.

As regards, monetary and macro-prudential policy, Andorra has a comprehensive strategy to adopt the EU common standards and to allow for better supervision. Finally Andorra is no longer considered in the list of non-cooperative tax jurisdictions published by the European Union since 2018, and the signature of the association agreement with the EU will further strengthen Andorran institutions.

We assess Andorra's **fiscal strength** as “aa1” to reflect a moderate debt burden, strong debt affordability and the presence of large public sector liquid assets. We expect the debt-to-GDP ratio to reach its pre-pandemic level in 2025, reflecting a swift return to fiscal surpluses after two years of deficit in 2020 and 2021.

Andorra’s fiscal profile is enhanced by the presence of large public sector liquid assets: in 2024, these assets accounted to €2.2 billion, equivalent to 65% of Andorra’s GDP. While mostly earmarked to the social security system (€1.8 billion) and hence not readily available in case of a shock, the rest of the reserves (€0.4 billion) acts as an important liquidity buffer. As a result, we apply a one-notch positive adjustment to the scorecard-indicated outcome of “aa2”.

Susceptibility to event risk is assessed as “b”, driven by Banking Sector Risk. The very large relative size of the Andorran banking sector, with total assets accounting for 535% of GDP in 2023[2], represents a credit challenge for Andorra given the adverse impact a shock to the banking system would have on the economy and the country’s public finances.

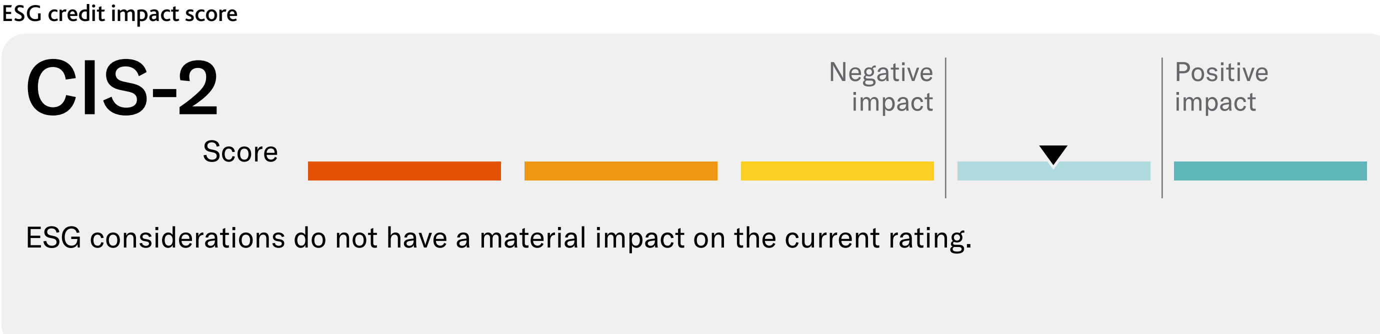
The system exhibits solid profitability and an improved tracked record since the Banca Privada d’Andorra (BPA) scandal in 2015, which had limited spillovers to the rest of banking entities. However, the system’s geographical concentration in the principality of Andorra is a risk incorporated in our assessment.

We assess government liquidity risk as “baa”, considering Andorra's limited experience with international financial markets. We assess domestic political risk as “a”, considering the very stable environment in Andorra and consensus-driven policymaking. Finally, Andorra's external vulnerability risk is very low (score of “aa”), reflecting the country's sizeable current account surplus driven by the large services surplus which more than offsets the goods deficit.

ESG considerations

Andorra's ESG credit impact score is CIS-2

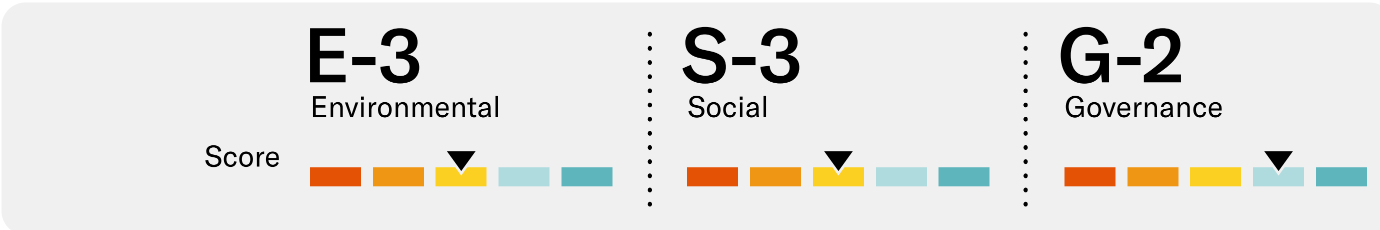
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Andorra's ESG Credit Impact Score of **CIS-2** reflects some exposure to physical climate risk, low exposure to social risks and, like many other advanced economies, strong governance and in general strong capacity to respond to shocks.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Andorra's overall environmental **E-3** issuer profile reflects the economic importance of winter tourism, a source of vulnerability in the context of climate change as warmer temperatures reduce the amount of snow. Against this backdrop, the country has a comprehensive strategy in place to promote renewable energy such as solar and wind and invest in the transition to a more sustainable economic model.

Social

Andorra's social **S-3** issuer profile score reflects the population's ageing, in line with other advanced economies, which will pressure public finances in the coming decade. On the positive side, the score considers high activity and employment rates, as well as the country's very high quality of health and safety. Moreover, Andorra's population benefits from strong access to basic services and modern infrastructure including a complete 5G coverage.

Governance

Andorra's **G-2** issuer profile score balances solid performance on global surveys assessing voice & accountability, regulatory quality and government effectiveness and the intrinsic limitations due to the country's very small size, with shortcomings in terms of data reporting. Andorra has a comprehensive strategy to adopt common EU standards and allow for better financial supervision. The effectiveness and credibility of fiscal policy is solid. Finally, the country's IMF membership since 2020 is helping to increase transparency and disclosure of information.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

Steady growth, fiscal metrics to continue improving

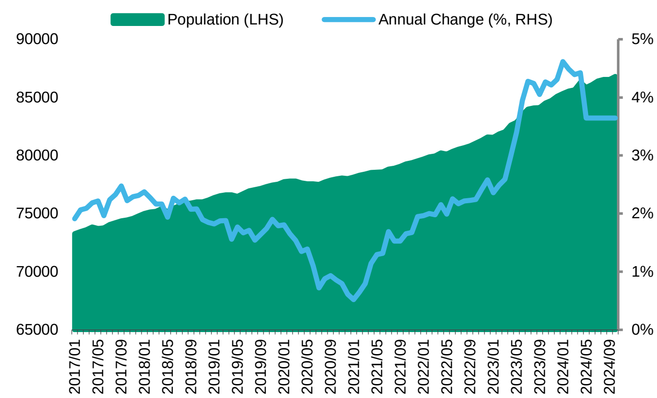
Real GDP growth reached 2.6% in 2023, down from the pandemic recovery (8.3% in 2021, 9.6% in 2022). The deceleration reflects the slowdown in the services sector, which represents around 87% of the country's gross value added, as activity normalized following two strong years, helped in particular by the tourism recovery. Overall, our forecast is for real GDP growth to reach 1.8% in 2024. We then forecast 1.4% in 2025, the country's estimated trend growth rate.

As elsewhere in Europe, inflation has been on a decelerating path (3.9% in April, following the 7% peak at the beginning of 2023), with core inflation easing from almost 7% in the summer of 2023 to 4.3% in April 2024. Most recent data point, however, to a slight pick up in the last months of 2024, with headline inflation closing the year at 2.6% in December, up from 1.7% in September. The labour market remains strong, with job creations on the rise (+3.3% on a 12-month moving average), supporting wage growth above 5%. The Andorran population continues to grow at a rapid pace, fueling the local labour market and benefitting from solid economic prospects. At the same time, demographics are putting pressure on the country's real estate market, with the government actively seeking to boost the supply of affordable housing.

On fiscal strength, the 2023 execution showed a 2.3% of GDP surplus at the general government level (4.8% in 2022), with the debt-to-GDP ratio declining to 35.5% from 38.9%. At the central government level, Andorra recorded a €23 million surplus (0.6% of GDP), better than the €27 million deficit expected (-0.8% of GDP). Revenue growth was stronger than anticipated thanks to a higher intake on tobacco taxes. On the expenditure side, capital expenditure was lower than projected due to bottlenecks in the construction sector, where the government is trying to increase housing supply. The development of social housing programs and the repurposing of buildings for residential housing are two of the measures supported by the government.

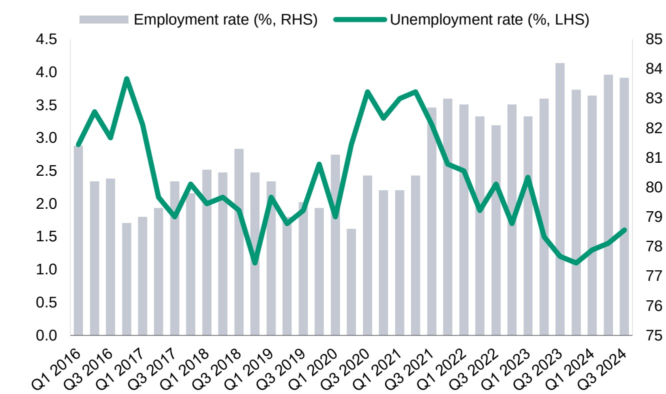
Looking ahead, the central government could once again record a modest surplus this year (€2.7 million against a €32.7 million deficit projection), before moving into a slight deficit over the coming three years (between €32 million and €40 million in 2025-2027) as revenue growth slows and the public investment programme is gradually rolled out. The government is committed to keeping the central government deficit below 1% of GDP, as per the domestic fiscal rules, resulting in an aggregate surplus at the general government level given the structural surpluses from both local governments and social security. On the Treasury side, Andorra has no borrowing needs until 2027, when the next bond comes due (EUR 500 million, 12.5% of GDP).

Exhibit 5
Andorra's population is growing steadily...



Sources: Govern d'Andorra Department of Statistics and Moody's Ratings

Exhibit 6
... fueling the labour market and benefitting from solid economic prospects



Sources: Govern d'Andorra Department of Statistics and Moody's Ratings

Association agreement with the EU remains in focus

Initially planned for the second semester of 2024, the referendum on the association agreement with the EU is now expected to happen in the course of 2025. However, the exact timing is tied to the ratification at the EU level, which could prove relatively long and delay the process beyond this year. Under our baseline scenario, we expect the agreement to be ratified on both sides although the choice of a referendum introduces some uncertainty on the Andorran side. The authorities and the business community are strongly in favour of the agreement, but the public opinion remains divided. Against the backdrop of rising real estate prices with strong population growth, a protest vote could emerge in the "No" campaign.

Andorra, San Marino and the EU had announced on December 12, 2023, an agreement at the negotiators levels regarding an associate statute for the two micro states. Presented by the European Commission as an "EEA plus" (the EEA covers the EU, Norway (Aaa stable), Iceland (A2 positive) and Liechtenstein) type of agreement, the deal negotiated since 2014 covers the internal market, financial services, and movement of people.

On the internal market, the agreement includes the progressive end of roaming and the possibility for Andorra to participate in EU flagship programmes (Erasmus, LIFE[3], Horizon for instance). Setting up a business in Andorra to operate in the EU from there could also open up growth opportunities. On migration, the agreement recognizes Andorra's specificity, granting the country a 2-year transitory period to continue regulating flows from EU citizens (no change to rules for third party countries) on the basis of a three-tier regime ("economically active" residents, "passive" and "temporary").

Regarding financial services, the deal introduces an up to 15-year transition period for Andorra to prepare for the new level-playing field, opening more opportunities for Andorran banks to operate abroad (the reciprocal risk, i.e. EU banks coming to Andorra, is seen as fairly limited given the market's extremely small size). Activities consist of banking, insurance, asset management and financial advisory, and integration can begin in any of these four segments before the others should the relevant legislation be adopted faster.

The agreement explicitly excludes the automatic access to the ECB's liquidity and lender of last resort mechanisms, but acknowledges the possibility to negotiate a separate deal on the matter.

Moody's rating methodology and scorecard factors: Andorra - Baa1 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				**baa3**	**ba1**	**50%**
Growth dynamics	Average real GDP growth (%)	2019-2028F	1.9	ba2		25%
	MAD Volatility in Real GDP Growth (%)	2014-2023	1.1	baa3		10%
Scale of the economy	Nominal GDP ($ billion)	2023	3.8	ca		30%
National income	GDP per capita (PPP, Intl$)	2023	67,396.0	aaa		35%
Adjustment to factor 1	*# notches*				-1	max ±9
Factor 2: Institutions and governance strength				**a1**	**a1**	**50%**
Quality of institutions	Quality of legislative and executive institutions			a		20%
	Strength of civil society and the judiciary			a		20%
Policy effectiveness	Fiscal policy effectiveness			aa		30%
	Monetary and macroeconomic policy effectiveness			a		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				**a3**	**baa1**	
Factor 3: Fiscal strength				**aa2**	**aa1**	
Debt burden	General government debt/GDP (%)	2023	35.5	a1		25%
	General government debt/revenue (%)	2023	93.3	aa2		25%
Debt affordability	General government interest payments/revenue (%)	2023	1.5	aaa		25%
	General government interest payments/GDP (%)	2023	0.6	aa1		25%
Specified adjustments	*Total of specified adjustment (# notches)*			0	1	max ±6
	Debt Trend - Historical Change in Debt Burden	2015-2023	-5.5	0	0	
	Debt Trend - Expected Change in Debt Burden	2023-2025F	-1.8	0	0	
	General Government Foreign Currency Debt/ GDP	2023	35.5	0	0	
	Other non-financial public sector debt/GDP	2023	0.0	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2023	0.0	0	1	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				**a1**	**a1**	
Factor 4: Susceptibility to event risk				**b**	**b**	Min
Political risk				a		
	Domestic political risk and geopolitical risk			a		
Government liquidity risk				baa	baa	
	Ease of access to funding			baa		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				b	b	
	Risk of banking sector credit event (BSCE)	Latest available	--	ba1-ba2		
	Total domestic bank assets/GDP	2023	535.3	>=400		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				aa	aa	
	External vulnerability risk			aa		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**A2 - Baa1**	**A2 - Baa1**	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Endnotes

1 The number of underlying sources is limited, ranging from 1 for most indicators to 3.

2 This ratio is calculated on a consolidated basis, including domestic and non-domestic activities.

3 The LIFE Programme is the EU's funding instrument for the environment and climate action.

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