MOODY'S
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Update

Contacts

Olivier Chemla +49.69.70730.956
VP/Senior Analyst-Sovereign
olivier.chemla@moodys.com

Diogo Capelo +44.20.3314.2027
Associate Analyst
diogo.capelo@moodys.com

Dietmar Hornung +49.69.70730.790
Associate Managing Director
dietmar.hornung@moodys.com

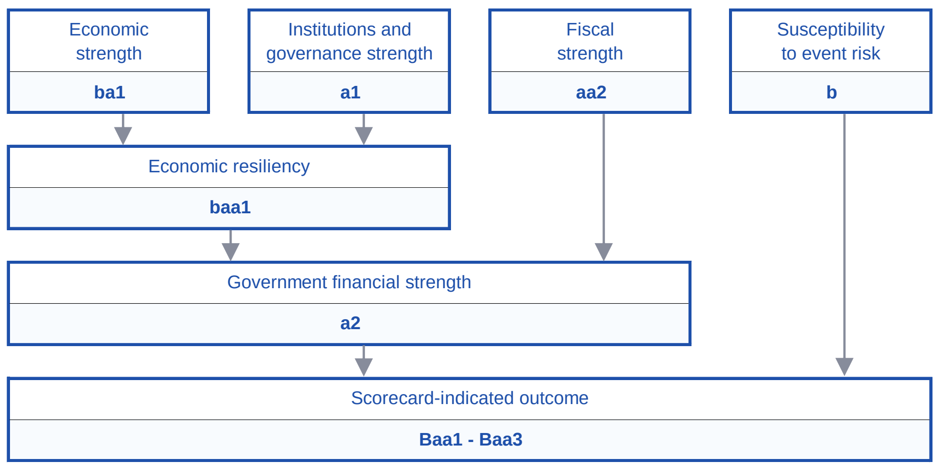
Government of Andorra – Baa2 stable

Regular update

Summary

Andorra's credit profile reflects high wealth, solid institutional and governance capacity and robust fiscal metrics. This is balanced by credit challenges such as Andorra's constrained growth potential, exposure to a very large banking sector and absence of a central bank.

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



Source: Moody's Investors Service

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 central bank

» Potential contingent liabilities stemming from a very large financial sector

Rating outlook

The stable outlook considers the intrinsic strengths of Andorra's institutions and fiscal metrics, with prudent policymaking underpinned by low political risk. This is balanced by credit challenges that relate to the economy's very small size and volatile nature, as well as to the country's very large banking sector (548% of GDP in 2022 on a consolidated basis) and fundamental limitations such as the absence of a central bank.

Factors that could lead to an upgrade

Upward pressures on the ratings might develop should Andorra lift its economic trend growth and continue to strengthen its public finances. Further diversification of the economy would be credit positive, broadening the sources of growth and making the country more resilient to shocks. The signature of the association agreement with the European Union would deepen Andorra's international integration. Finally, a stronger banking system helping to limit the sovereign's potential contingent liabilities would also be credit positive, as would the permanent access to the European Central Bank's liquidity facility.

Factors that could lead to a downgrade

Downward pressures on the ratings might result from an increase in the general government's public debt. This would reflect a deterioration in the fiscal balance stemming from unfinanced new measures and/or a permanently weaker economic environment due to larger than expected scarring from the pandemic. Given the sector's very large relative size, any deterioration in the quality of Andorra's banking system would also be credit negative.

Key indicators

Exhibit 2

Andorra	2017E	2018E	2019E	2020E	2021E	2022E	2023F	2024F
Real GDP (% change)	0.3	1.6	2.0	-11.2	8.3	8.8	1.6	2.0
Inflation rate (% change average)	2.6	1.0	0.5	0.1	1.7	6.2	5.0	3.6
Gen. gov. financial balance/GDP (%)	3.4	2.6	2.1	-2.8	-2.3	4.9	1.9	1.8
Gen. gov. primary balance/GDP (%)	3.9	3.0	2.6	-2.3	-1.7	5.7	2.7	2.7
Gen. gov. debt/GDP (%)	37.9	36.3	35.4	46.3	48.6	39.2	38.5	36.9
Gen. gov. debt/revenues (%)	99.5	94.3	93.2	113.8	131.9	101.2	98.8	94.7
Gen. gov. interest payment/revenues (%)	1.4	1.2	1.2	1.2	1.6	2.1	2.2	2.3
Current Account Balance/GDP (%)	--	18.0	18.0	15.5	14.1	17.1	17.6	18.1

Source: Moody's Investors Service

Detailed credit considerations

We assess Andorra's **economic strength** as “ba1”, balancing high per-capita GDP and very small size combined with modest trend growth. Andorra's diversification away from financial services has broadened the spectrum of economic activities in the country. 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 allowing for generalized access to the internet. Under our new methodology, the median absolute deviation (MAD) indicator results in significantly lower volatility for Andorra's growth, supporting our assessment of Andorra's economic strength.

Over the last two decades (2001-2019), average real GDP growth reached 1.7%, with a clear declining trend between the first decade (3.4% on average between 2001 and 2009) and the second (0.1% on average between 2010 and 2019) one. In 2020, the initial phase of the coronavirus pandemic had a significant impact on the Andorran economy, with real GDP contracting by 11.2%. With trade and tourism accounting for a fifth of the country's gross value added, Andorra is significantly exposed to travel restrictions. Retail activities are also largely dependent on cross-border flows from commuting visitors.

Andorra's **institutional strength** is assessed to be “a1”, with high scores on the 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 central bank is a constraint for Andorran policymakers, partly mitigated by the creation of a liquidity emergency provision mechanism in late 2022.

According to the Worldwide governance indicators (WGI) published by the World Bank, 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 common European Union (Aaa stable) standards and 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.

We assess Andorra's **fiscal strength** as “aa2” to reflect a moderate debt burden, strong debt affordability and the presence of large public sector liquid assets. Prior to the coronavirus pandemic, Andorra recorded seven years of fiscal surpluses between 2013 and 2019, reflecting the government's willingness to adopt sound fiscal policies. As a result, the general government debt-to-GDP ratio declined from 42.5% in 2013 to 35.4% in 2019. Moreover, debt affordability metrics improved, with the interest payments-to-revenues ratio declining from 3% in 2013 to 1.2% in 2019. Looking ahead, we expect the debt-to-GDP ratio to continue declining towards its pre-pandemic level in the coming three years.

Andorra's fiscal profile is enhanced by the presence of large public sector liquid assets: in 2021, these assets accounted to EUR 2.1 billion, equivalent to 76% of Andorra's GDP. While mostly earmarked to the social security system and hence not readily available in case of a shock, these accumulated resources will help contain the impact of an ageing population on Andorra's public finances.

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 548% of GDP in 2022[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.

That said, the share of financial services has halved over the past two decades, from 24% of gross valued added in 2000 to 14% in 2021. In addition, 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 reliance on volatile foreign deposits and the geographical concentration in the principality of Andorra are risks 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 Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score

CIS-2
Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Andorra's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting 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

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-3	S-2	G-1
Moderately Negative	Neutral-to-Low	Positive

Source: Moody's Investors Service

Environmental
Andorra's overall E issuer profile is moderately negative (**E-3**), reflecting the economic importance of winter tourism, a source of vulnerability in the context of climate change as warmer temperatures reduce the amount of snow available. Against this backdrop, the country has a comprehensive strategy in place to promote renewable energy and invest in the transition to a more sustainable economic model.

Social
We assess Andorra's S issuer profile score as neutral to low (S-2). This reflects very high quality of health and safety, as well as strong access to basic services and modern infrastructure including a complete 5G coverage for the population. While Andorra's population is ageing, in line with other advanced economies, high activity and employment rates are credit strength.

Governance
Andorra's high institutions and governance strength is reflected in a positive G issuer profile score (G-1). Andorra scores well on global surveys assessing voice & accountability, regulatory quality and government effectiveness. 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. Andorra's very small size leads to shortcomings in terms of data reporting, although the country's new IMF membership 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

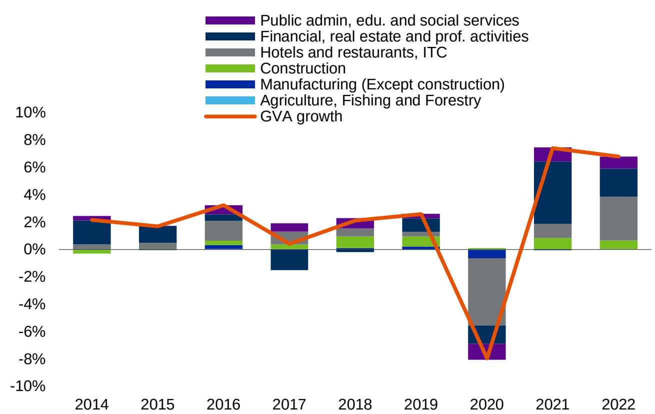
Strong economic rebound to moderate, outlook remains solid

Following the sharp contraction during the first phase of the pandemic in 2020 (-11.2%), real GDP rebounded strongly in 2021-2022, recording 8.3% in 2021 and 8.8% in 2022. In the absence of decomposition by demand factors, the Andorran statistical institute estimates GDP via a sectoral approach: construction and services were the main drivers of growth in 2022, against the backdrop of strong demand for housing and growth in retail trade as the economy gained momentum following the pandemic. Tourism figures have also strongly rebounded in the post-pandemic environment, with more than 10 overnight stays in 2022 compared to the historical record of 8.8 million in 2019. The number of tourists choosing to spend at least one night in Andorra is also increasing compared to same-day visitors, boosting expenditure in the country.

Exhibit 5

Construction, real estate and financial services are driving post-pandemic growth

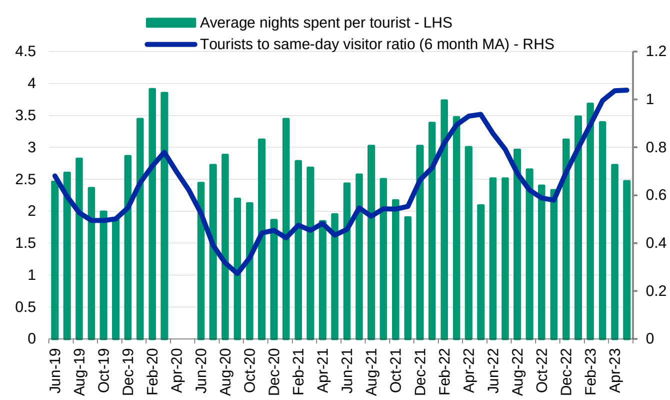
Contribution to gross value added, %



Sources: Andorra Department of Statistics and Moody's Investors Service

Exhibit 6

Tourists are increasing compared with same-day visitors



Sources: Andorra Department of Statistics and Moody's Investors Service

Against this backdrop, the labour market remains very strong, with unemployment below 2% and activity rate above 84%. The country's population continues to expand at a steady rate, with the registered population standing at 86,610 in 2022 against 76,246 a decade ago. The tension between labour shortages and the need to control population growth is being addressed jointly by the government and the business community with special permits to ease access to sectors in need of labour.

Looking ahead, we forecast real GDP to grow by 1.6% this year and 2.0% in 2024. The latest projections by the statistical institute show real GDP growth reaching 1.4% this year, 2.2% in 2024-2025 and 1.8% beyond. On inflation, we anticipate an average of 5% this year before 3.6%, while the statistical institute forecasts 4.8% this year, 3.6% next year, 2.4% in 2025 and stabilize slightly above 2% in the following years.

The country is likely to continue benefitting from regular inflows of digital nomads and wealthy consumers. Regarding the tourism sector, given capacity constraints, the country is seeking to lengthen average stays, reduce round-trip visits from Spain and France and attract tourists throughout the year. The Andorran Tourism industry has developed a comprehensive offer with cultural and sport events in complement to the country's natural attractions (hiking, biking, skiing etc.) partnering with international brands to reach a broad audience (Cirque du Soleil, National Geographic...).

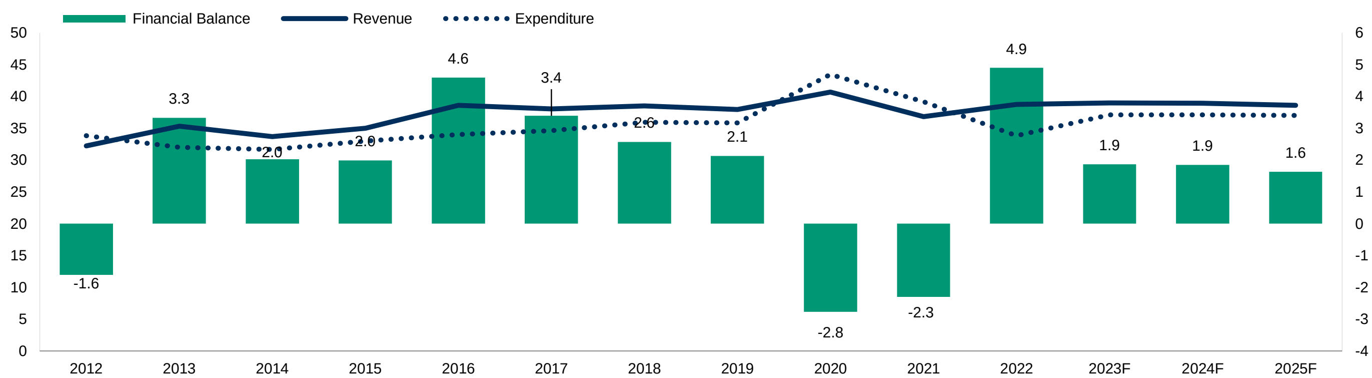
Fiscal position is improving

Following the 2.8% of GDP deficit in 2020, Andorra's public finances have improved in the last two years, with a 2.3% of GDP deficit in 2021 and a 4.9% of GDP surplus in 2022. Growth in revenues have outpaced public spending due to a strong economy and targeted support to some categories (transport sector). The overall tax intake rose from 24.7% of GDP in 2021 to 26.9% of GDP in 2022, driven by production and import taxes (+1.8% of GDP), followed by direct taxes (+0.5% of GDP). As a result, the debt-to-GDP ratio fell to 39.2% in 2022 from 48.6% in 2021. The authorities expect the debt to continue falling towards pre-pandemic levels (35.4% in 2019), with the central government budget to be broadly balanced against an initial deficit forecast of around 1% of GDP.

Exhibit 7

Improving public finances following the pandemic shock

General government balance, revenue and expenditure, % GDP



Sources: National authorities, IMF and Moody's Investors Service

We expect prudent fiscal policymaking to continue in the next 4 years following the general elections (see below) given the political commitment to ensure fiscal sustainability. Revenue-side measures include a direct taxation reform which will bring the effective tax rate to 3% (personal income tax and corporate income tax). On the expenditure side, a major priority for the government involves spending on social housing, which will increase to alleviate accessibility concerns for workers.

Finally, the cost of debt has been increasing since the 2020 trough, from 0.93% to 1.38%, but debt affordability is strong (0.8% of GDP and 2.1% of revenues). Against the backdrop of pandemic-related deficits and the willingness to issue international bonds for EUR 1.2 billion, Andorra's issuance pattern was somewhat exceptional in 2021-2022. Considering our fiscal forecast and the absence of redemptions, we anticipate that the country will have no borrowing requirements over the next three years.

Reforms to continue following general elections

At the April 2023 general elections, the Andorran democrats of outgoing Prime minister Xavier Espot won an absolute majority of 16 seats out of 28 in the country's parliament (General Council of the Valleys), ahead of Concordia (5 seats), the social democrats (3 seats), Andorra Endavant (3 seats) and the Liberals (1 seat). This is likely to support the reform momentum following the accession to the IMF in 2020 and the strengthening of the country's financial stability via the creation of an emergency liquidity mechanism.

Three "State pacts" ("Pacte d'Estat" involving the majority, the opposition and civil society forces) have been put forward by the government on structural issues: ageing, healthcare, and the association agreement with the EU. On pensions, the government ambitions to pass a reform in the course of the mandate, based on its majority in parliament and a general consensus around the need to act: according to the latest projections, the system could switch from a surplus to a deficit in 2027, with current reserves helping to plug the gap until 2038. On healthcare, the aim is to control overall spending as demand for services increase. Finally, on the association agreement with the EU, the Andorran government is seeking to secure a deal before the next EU parliament elections in the spring of 2024 at the latest. The authorities' main ambitions are to ensure a level-playing field for Andorran companies to expand abroad and regulate migration to strike a balance between business needs and social cohesion.

Moody's rating methodology and scorecard factors: Andorra - Baa2 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				ba1	ba1	50%
Growth dynamics	Average real GDP growth (%)	2018-2027F	1.8	ba3		25%
	MAD Volatility in Real GDP Growth (%)	2013-2022	1.7	ba2		10%
Scale of the economy	Nominal GDP ($ billion)	2022	3.4	ca		30%
National income	GDP per capita (PPP, Intl$)	2022	66,883.3	aaa		35%
Adjustment to factor 1	*# notches*				0	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				baa1	baa1	
Factor 3: Fiscal strength				aa2	aa2	
Debt burden	General government debt/GDP (%)	2022	39.2	a1		25%
	General government debt/revenue (%)	2022	101.2	aa2		25%
Debt affordability	General government interest payments/revenue (%)	2022	2.1	aa1		25%
	General government interest payments/GDP (%)	2022	0.8	aa1		25%
Specified adjustments	*Total of specified adjustment (# notches)*			0	0	max ±6
	Debt Trend - Historical Change in Debt Burden	2014-2022	-2.8	0	0	
	Debt Trend - Expected Change in Debt Burden	2022-2024F	-2.3	0	0	
	General Government Foreign Currency Debt/ GDP	2022	39.2	0	0	
	Other non-financial public sector debt/GDP	2022	0.0	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2022	0.0	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				a2	a2	
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	2022	548.0	>=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				Baa1 - Baa3	Baa1 - Baa3	

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.

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