



# PRINCIPALITY OF ANDORRA

June 2021

## 2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ANDORRA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with the Principality of Andorra, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 7, 2021 consideration of the staff report that concluded the Article IV consultation with the Principality of Andorra.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 7, 2021, following discussions that ended on April 8, 2021, with the officials of the Principality of Andorra on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 18, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Principality of Andorra.

The document listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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## IMF Executive Board Concludes 2021 Article IV Consultation with the Principality of Andorra

FOR IMMEDIATE RELEASE

**Washington, DC – June 11, 2021:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with the Principality of Andorra.

The COVID-19 pandemic has hit Andorra's society and economy severely following a broad-based, job-rich growth in 2019. Tourism and domestic services fell with the stringency of containment measures in the first half of 2020 but rebounded strongly during the summer with the arrival of tourists and a temporary ease of stringency. With French and Spanish borders closed until recently, especially during the height of the ski season in the first quarter of 2021, hotels and ski resorts have already lost a major share of their annual revenue.

Universal testing might have enabled more targeted containment measures compared to the region. Despite the very high prevalence of COVID-19 cases per capita, fatality rates are among the lowest in the world as hospital capacity and protective equipment were quickly scaled up in response to the pandemic. So far, the pace of vaccination has been comparable to that of EU countries, and about 40 percent of the population have received at least one dose so far.

In response to the virus outbreak, the authorities undertook mitigating fiscal and financial sector measures. Expenditure measures worth 2.2 percent of GDP and revenue measures worth 0.4 percent of GDP included healthcare spending and financial support for pandemic-affected sectors and households. In addition, government guarantees worth 9 percent of GDP were made available for bank loans to liquidity-strapped companies. In the financial sector, debt moratoria provided relief to private sector borrowers. The COVID-related measures and lower revenues reduced the central government balance to -4.3 percent of GDP and increased government debt to about 48 percent of GDP in 2020.

Activity is estimated to have fallen by about 12 percent in 2020 and, under a baseline scenario without new widespread containment measures, is projected to partially recover by about 6 percent in 2021. The recovery rests on a strong rebound in private consumption and return of tourism. Government debt is expected to rise further to about 54 percent of GDP in 2021, before descending to the fiscal rule limit of 40 percent of GDP in the medium-term. The outlook is highly uncertain, with risks heavily tilted to the downside in the near-term and will crucially depend on the containment of the waves of infections in Andorra and the region; as well as on the success of policy measures to mitigate the scarring effects of the crisis.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

## Executive Board Assessment<sup>2</sup>

Executive Directors noted that the COVID-19 pandemic has hit Andorra severely, and commended the authorities for the preparedness of the healthcare system, the targeted containment measures, and the swift emergency policy support saving lives and livelihoods. With risks to the outlook tilted to the downside, Directors emphasized the need for maintaining emergency lifelines until the pandemic recedes and the recovery is firmly underway.

Directors noted that fiscal policy should remain supportive in the near-term and allow for higher public investment in the medium-term. While fiscal adjustment will eventually be necessary to bring the deficit and debt back to the fiscal rule limits, they considered that there is room for frontloading some of the public investment projects to accelerate the recovery while preserving debt sustainability. In particular, Directors welcomed the authorities' environmental, digitalization, and diversification plans, which should support the recovery and long-term green growth.

Directors underscored the importance of building international reserves on a precautionary basis to cope with future liquidity needs of the government in the event of balance of payments stresses. They commended the authorities for their intention to promptly close existing liquidity gaps and noted that the expected general allocation of SDRs would help in this regard. In the absence of a lender of last resort, Directors called for strong supervision of banks' liquidity risks.

Directors noted that banks have performed well in the past year, albeit with slow credit growth due to low demand. They encouraged the authorities to thoroughly assess the impact of the pandemic on bank capital and to continue monitoring and managing risks stemming from large exposures and related party lending. Directors also encouraged the authorities to further improve compliance with the AML/CFT framework, in particular in the area of the monitoring of cross-border flows to further guard against money-laundering risks.

Directors recognized the authorities' commitment to transparency, commending them for producing balance of payments statistics in record time and for intending to participate in the Enhanced General Data Dissemination System. Directors encouraged further efforts to improve governance, including by ratifying the United Nations convention against corruption.

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<sup>2</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

## Andorra: Selected Social and Economic Indicators

I. Social Indicators			
Population (2019)	77,543	Poverty Rate (percent, 2019)	13
Per capita income (2019, euros)	36,335	Human Development Index Rank (2019)	36 (out of 189)
Gini Index (2019)	35	Life expectancy at birth (2011)	81.9

II. Economic Indicators											
	2017	2018	2019	Estimate	2020	2021	2022	2023	2024	2025	2026
				Estimate		Projections					
	(annual change, percent, unless otherwise indicated)										
<b>NATIONAL ACCOUNTS AND PRICES</b>											
Real GDP	0.3	1.6	2.0	-11.8	5.8	4.1	3.6	2.8	1.5	1.5	
Nominal GDP	1.5	2.6	3.4	-11.9	6.5	5.3	5.0	4.6	3.2	3.2	
GDP deflator	1.1	1.0	1.4	-0.1	0.6	1.1	1.4	1.7	1.7	1.7	
(contribution to nominal GDP growth, percentage points)											
Consumption	...	3.4	2.5	-3.5	4.5	3.5	3.2	3.0	1.9	1.9	
Private	...	1.8	1.6	-5.7	3.4	2.8	2.7	2.6	1.5	1.5	
Public	...	1.6	1.0	2.2	1.2	0.7	0.5	0.5	0.4	0.4	
Investment	...	2.3	1.8	-3.9	0.2	0.5	0.5	0.4	0.4	0.4	
Private 1/	...	1.8	1.6	-2.5	-0.8	0.4	0.4	0.3	0.2	0.2	
Public	...	0.5	0.2	-1.4	1.0	0.1	0.1	0.2	0.2	0.2	
Net exports of goods and services	...	-3.0	-1.0	-4.5	1.7	1.3	1.3	1.1	0.9	0.9	
Exports	...	0.8	1.1	-6.8	4.5	4.0	3.7	3.1	2.3	2.3	
Imports	...	3.8	2.0	-2.3	2.8	2.7	2.3	2.0	1.4	1.4	
Prices											
Inflation (percent, period average)	2.6	1.3	0.7	0.3	0.5	0.9	1.3	1.6	1.7	1.7	
Inflation (percent, end of period)	2.4	0.8	1.0	-0.2	0.6	1.1	1.3	1.6	1.7	1.7	
Unemployment rate (percent)	1.7	1.5	1.8	2.9	3.0	2.4	2.0	1.8	1.7	1.7	
<b>EXTERNAL SECTOR</b>											
(percent of GDP, unless otherwise indicated)											
Current account	...	...	18.0	14.2	15.5	16.4	17.3	18.0	18.5	19.1	
Balance on goods and services	14.2	10.9	9.6	5.8	7.1	8.0	8.9	9.6	10.1	10.7	
Exports of goods and services	76.6	75.4	74.0	76.3	75.9	75.9	75.8	75.5	75.4	75.2	
Imports of goods and services	62.4	64.6	64.4	70.5	68.8	68.0	67.0	65.9	65.2	64.6	
Primary income, net	...	...	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	
Secondary income, net	...	...	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	
Capital account	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Financial account	...	...	18.1	14.2	15.5	16.4	17.3	18.0	18.5	19.1	
Errors and omissions	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Gross international reserves (millions of euros)	...	...	0.0	61.6	61.6	61.6	61.6	61.6	61.6	61.6	
<b>FISCAL SECTOR</b>											
(percent of GDP, unless otherwise indicated)											
General Government 2/											
Revenue	38.0	38.5	38.0	41.1	38.4	38.6	38.7	38.8	39.0	39.1	
Expenditure	34.6	35.7	35.6	44.0	40.8	38.0	36.7	36.1	35.9	35.6	
Interest	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	
Primary balance	4.0	3.4	2.9	-2.3	-1.7	1.2	2.6	3.3	3.8	4.1	
Net lending/borrowing (overall balance)	3.3	2.8	2.4	-2.9	-2.3	0.6	2.0	2.7	3.2	3.5	
Public debt	37.8	36.3	35.4	51.5	56.7	51.9	43.0	41.0	39.5	38.1	
Central Government 3/											
Revenue	19.6	19.6	19.5	20.6	18.8	19.2	19.3	19.4	19.5	19.6	
Expenditure	19.3	19.7	19.3	24.9	22.1	20.5	19.4	18.9	18.7	18.5	
Interest	0.5	0.5	0.4	0.5	0.6	0.5	0.4	0.4	0.4	0.4	
Primary balance	0.8	0.4	0.6	-3.8	-2.8	-0.9	0.3	1.0	1.3	1.5	
Net lending/borrowing (overall balance)	0.3	-0.1	0.2	-4.3	-3.3	-1.4	-0.1	0.5	0.9	1.1	
Public debt	34.3	33.2	32.7	48.4	53.8	49.1	40.4	38.4	37.1	35.7	
<b>BANKING SECTOR</b>											
(percent, unless otherwise indicated)											
Regulatory capital to risk-weighted assets	...	20.4	21.8	21.7	...	...	...	...	...	...	
Nonperforming loans to total gross loans	...	7.1	7.3	6.1	...	...	...	...	...	...	
Credit to nonfinancial private sector											
Level (percent of GDP)	...	147.9	135.9	151.4	...	...	...	...	...	...	
Corporates	...	72.0	70.3	76.5	...	...	...	...	...	...	
Households	...	75.9	65.6	74.8	...	...	...	...	...	...	
Growth (nominal)	...	...	-5.0	-1.8	...	...	...	...	...	...	
Corporates	...	...	0.9	-4.0	...	...	...	...	...	...	
Households	...	...	-10.6	0.6	...	...	...	...	...	...	
Credit to public sector											
Level (percent of GDP)	...	7.5	7.5	6.2	...	...	...	...	...	...	
Growth (nominal)	...	...	3.0	-27.2	...	...	...	...	...	...	
<b>Memorandum items</b>											
Exchange rate (€/USD, period average)	0.89	0.85	0.89	0.88	0.82	0.81	0.81	0.81	0.81	0.81	
Nominal GDP (millions of euros)	2,656	2,725	2,818	2,484	2,645	2,784	2,924	3,058	3,155	3,256	

Sources: Govern d'Andorra Department of Statistics, Andorran authorities, Eurostat, and IMF staff calculations.

1/ The contribution of private investment is derived as a residual. Since the fiscal accounts are covered at the general government level, investments of state-owned enterprises are subsumed under private investment.

2/ The general government comprises the central government, local governments and the social security fund.

3/ The central government The central government comprises Govern d'Andorra, as well as non-market public corporations and nonprofits.



# PRINCIPALITY OF ANDORRA

## STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

May 18, 2021

### KEY ISSUES

**Context.** Andorra, the IMF's newest member since October 2020, participated in its first Article IV consultation with a commitment to further enhance transparency. Tourism and banking-related services dominate economic activity in the euroized economy. The country enjoys long-standing political stability, a good track-record of fiscal discipline, a gender-balanced work force, and internationally competitive ski resorts.

**COVID-19.** The authorities are managing the pandemic well with universal testing and expanded hospital capacity that kept fatality rates very low despite high case-loads. The testing strategy helped Andorra implement more targeted internal restrictions than in neighboring countries. At the same time, emergency fiscal measures stabilized real incomes and supported firms.

**Outlook and risks.** Real GDP growth is projected to rebound this year in line with the region, amid huge uncertainty, and risks are tilted to the downside in the near-term. Slower than planned vaccination rates in Andorra and neighboring countries is one of the main risks. Over the medium term, GDP growth is expected to converge to regional averages, given comparable per capita incomes.

**Policy recommendations aim to support a lasting recovery.** Emergency *fiscal* support should remain in place until a recovery has set in. Increasing public investment would strengthen the recovery and contribute to higher long-term growth while maintaining debt at manageable levels. The fiscal authorities would also need to build up international reserves gradually. In the *financial sector*, bank capital appears adequate to absorb the pandemic shock but the full impact of the crisis should be carefully evaluated as the policy measures expire. In the medium-term, bank capital buffers should be re-assessed in light of risks associated with large domestic exposures to a few clients, related party lending, and a sizeable nonresident deposit base. Building on important efforts, further improving the effectiveness of *anti-money laundering* supervision would strengthen financial stability. Disseminating official *statistics* according to international standards will enhance transparency and aid policy-making and surveillance.

Approved By  
**Mahmood Pradhan**  
**(EUR) and Gavin Gray**  
**(SPR)**

Discussions were held virtually on March 19–April 8, 2021. The staff team comprised Srobona Mitra (head), Ana Lariau, Michelle Tejada, Jenny Lee (all EUR), Joji Ishikawa (STA), and Arz Murr (LEG). Maksym Markevych (LEG) attended some meetings. Dries Cools (OED) participated in the discussions. Mahmood Pradhan (EUR) and Paul Hilbers (OED) met with the authorities. Dilcia Noren (EUR) supported the mission. The team met with the Minister of Finance, the Secretary of State for International Financial Affairs, the Minister of Presidency, Economy & Business Affairs, the Minister of Foreign Affairs, the Minister of Tourism, the Minister of Social Affairs, Housing & Youth, and the Minister of Civil Service and Reform of the Administration; the Director of Andorran Financial Authority; banks and various other government and private sector representatives; economists and academia.

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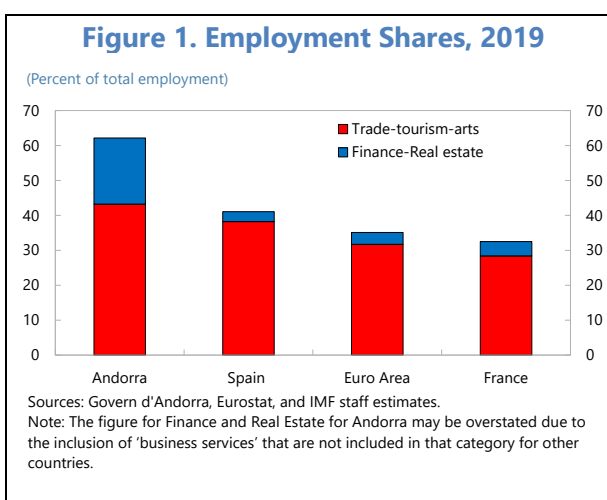
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## MACROECONOMIC BACKGROUND

**1. The Principality of Andorra, the IMF's newest member since October 2020, participated in its first Article IV consultation.** The authorities are committed to further enhance transparency as they integrate into the international financial community. A coalition government took office in April 2019 with Prime Minister Xavier Espot Zamora from the Democrats for Andorra at the helm. The country enjoys political stability and has a good track-record of fiscal discipline, a gender-balanced work force, and ski resorts not dependent on air travel. The authorities successfully tested the appetite of foreign investors through successful private debt placements in 2020 and issued its first public international bond in late April 2021.

**2. Banking services and tourism dominate economic activity and employment.** With consolidated bank assets over 500 percent of GDP, jobs in finance and real estate comprise 20 percent of employment, a disproportionate size compared to the region (Figure 1). Trade and tourism activity, accounting for a fifth of the economy's gross value added (GVA) and 40 percent of employment, is comparable to Spain's. However, with various other sectors connected to tourism, the share of the latter could be more than half of the economy.

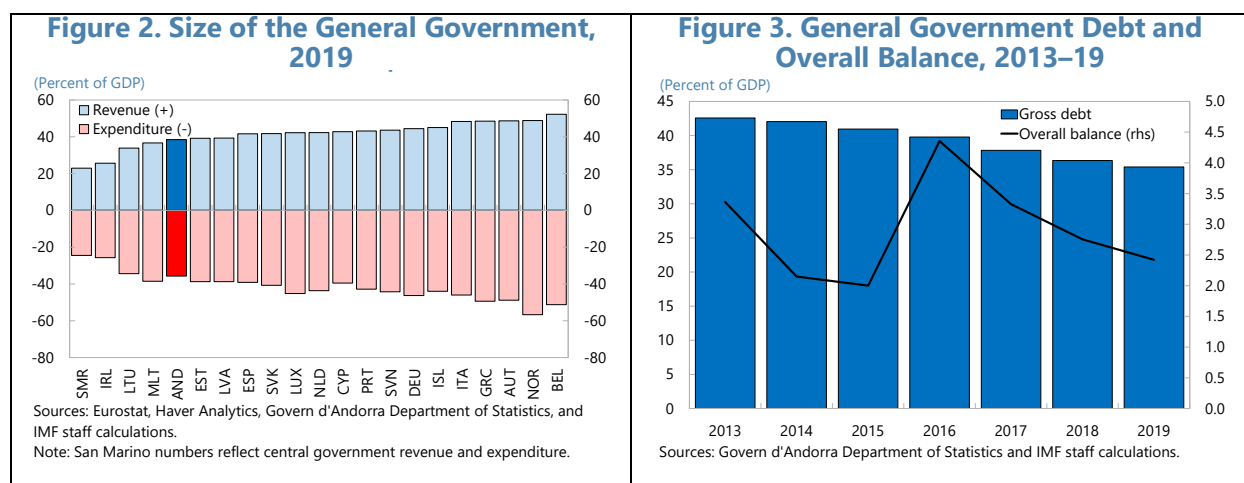


**3. The euro has served well as a monetary anchor as the economy trades extensively with the eurozone, especially Spain.** The formal use of the euro is enshrined in a Monetary Agreement with the EU—that allows for a limited circulation of euro coins with Andorran themes in exchange for strict laws against counterfeiting and money-laundering, and for full adoption of EU's financial sector legislations—while Andorra negotiates an Association Agreement to gain full access to the EU's single market (Annex I). The economy imports two thirds of the value of goods from Spain, ranging from food to electricity. Spaniards accounted for half of the 8.2 million people visiting Andorra in 2019, followed by the French. Reflecting the close integration, annual GDP growth since 2013 has averaged 1.5 percent, similar to that of the euro area. Inflation is in line with neighbors', not only in the headline rate but also in tourism-related services. The unemployment rate is the lowest in the region—averaging 3.4 percent in 2013–2019—and cross-border workers from France and Spain help meet the high demand for labor during the busy tourist season.

**4. Fiscal policy, the main lever in the euroized country without a central bank, is prudent and anchored in a medium-term framework.** The size of the general government seems small by European comparisons, with both expenditure and revenue below 40 percent of GDP in 2019 (Figure 2). Refinancing needs have been high, averaging 13 percent of GDP in 2018–19, with average maturity of debt falling over the years, reaching 2½ years by end-2019. The authorities have stayed

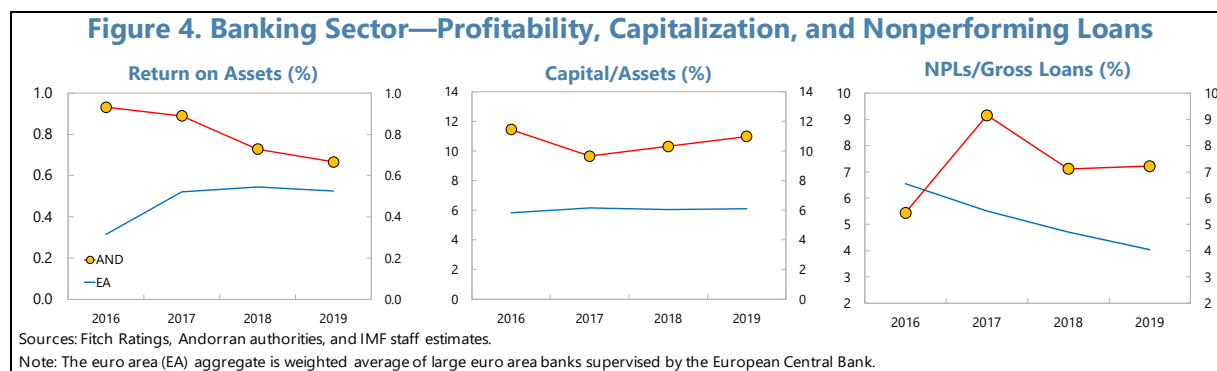


within the remit of the “fiscal rule”—limits on debt, deficit, current spending and revenue—since its inception in 2014 (Annex II). The central government has been running primary surpluses, averaging 0.7 percent of GDP in 2015–2019. With interest payments averaging 0.6 percent of GDP during this period, the overall deficit and debt were well within the fiscal rule limits. Since the local government also ran surpluses, the general government had positive overall balances in the past seven years (Figure 3).

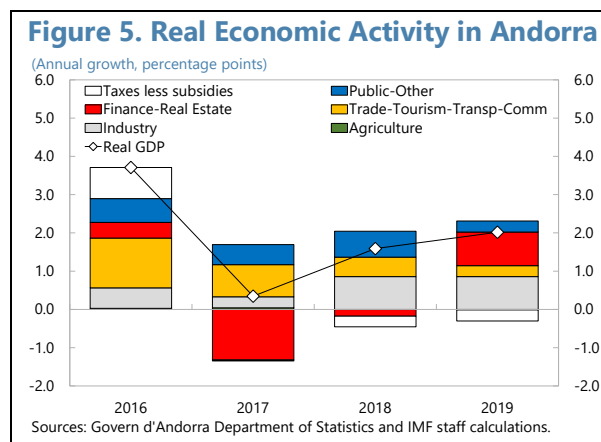


**5. The broader public sector operates well and a reform of the pensions system is about to begin.** The two largest state-owned enterprises (SOEs)—the electricity company (FEDA) and Andorra Telecom—are profitable with investment strategies mostly financed from retained earnings. The SOEs have a revenue-sharing policy with the central government. The Andorran social security fund—under the mandatory “first pillar” defined contribution pension system—is, however, in need of reform as a depletion of the reserves fund by 2038 is projected in the latest actuarial study. The government has announced a public consultation aiming to enact a new law within a year to restore the pension fund to long-term sustainability.

**6. Banks entered the pandemic with high reported capital and profits, but with increasing nonperforming loans.** The banking system—four Andorran banks and one Spanish subsidiary—is diversified both geographically and in income models. Almost 60 percent of assets operate in 13 other countries—including Spain and Luxembourg—and almost 80 percent of income is based on non-interest income sources, which is typical in private banking. The diversification has served the sector well, delivering higher profits than in eurozone banks (Figure 4). Capitalization has grown over time, partly due to falling private sector loans due to domestic deleveraging. Nonperforming loans (NPLs) are, however, high—partly due to a large stock of legacy NPLs from a bank undergoing resolution after an anti-money laundering (AML)/Countering Financing of Terrorism (CFT) breach—and projected to increase further as the pandemic-related policies expire.



**7. On the eve of the COVID-19 pandemic, economic growth bucked regional trends.** Real GDP grew by 2 percent in 2019 even as growth in the euro area and Spain slowed. On the production side, services contributed significantly, particularly in the financial sector that recovered after two years of declining performance, and construction continued to contribute sizably to the growth in industry (Figure 5). While data on real expenditure components are not available, nominal growth seemed to have been broad-based. Private consumption, in particular, grew with higher minimum and real public sector wages, and was supported by bank credit. However, staff estimates in the absence of data show that private investment seems to have fallen along with banks’ business lending (Tables 2 and 3). Even though the stock of domestic private sector credit is high, at 136 percent of GDP in 2019, banks cited lack of demand from firms as the main reason for low credit growth.



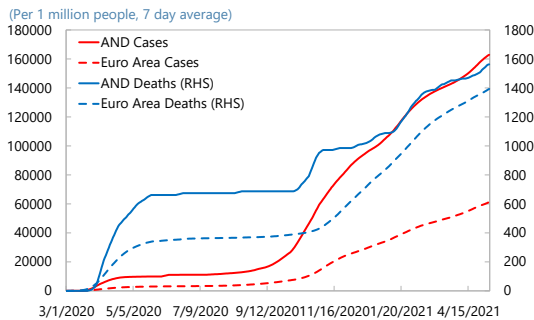
**8. The current account surplus is estimated to be large.** The Statistical agency started producing balance of payments data with technical assistance from IMF’s Statistics Department. The estimates show that the current account balance was close to 18 percent of GDP in 2019, with net exports and net investment income contributing almost equally (see Selected Issues Paper (SIP): [Current Account Balance and External Competitiveness](#)). While not all components are available for earlier years, net exports had remained stable from 2018. In line with the current account surplus in 2019 and historically large surpluses in net exports, staff estimates of the international investment position shows a positive net asset position, but with a fairly high gross other investment liabilities stemming from banks’ dependence on foreign depositors.

# IMPACT OF THE PANDEMIC

**9. Andorra has been hit hard by the pandemic, but the authorities managed the health crisis well with universal testing and revamped hospital capacity.** Tourism and domestic services fell with the stringency of containment measures in the first half of 2020 but rebounded strongly during the summer with the arrival of tourists and a temporary ease of stringency (Figure 6 and Annex III). With French and Spanish borders closed until recently, especially during the height of the ski season in the first quarter of 2021, hotels and ski resorts have already lost a major share of their annual revenue. In comparison to neighboring regions though, universal testing might have enabled more targeted containment measures (Annex III). Despite the very high prevalence of COVID-19 cases per capita (Figure 6), fatality rates are among the lowest in the world as hospital capacity and protective equipment were quickly scaled up in response to the pandemic. So far, the pace of vaccination has been comparable to that of EU countries facing similar problems of supply, and doses for half the population have arrived. About 35 percent of the population have received at least one dose so far [May 12].

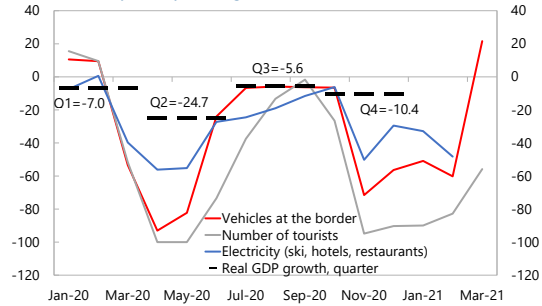
**Figure 6. The Impact of the Pandemic and Lockdowns on Health and Activity**  
*Case-fatality rates are low, despite high number of cases. Activity rebounded strongly when lockdowns were lifted.*

**COVID-19 Indicators**



Sources: Bloomberg Finance L.P., Blavatnik School of Government at University of Oxford, Our World in Data, and IMF staff calculations.

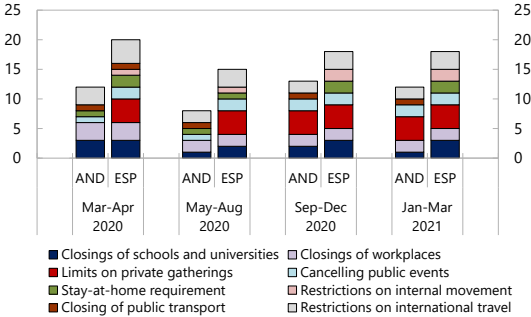
**Andorra: Output, Electricity, Tourists, Border Vehicles, 2020**  
 (Percent, year-on-year change)



Sources: Govern d'Andorra Department of Statistics and IMF staff calculations.

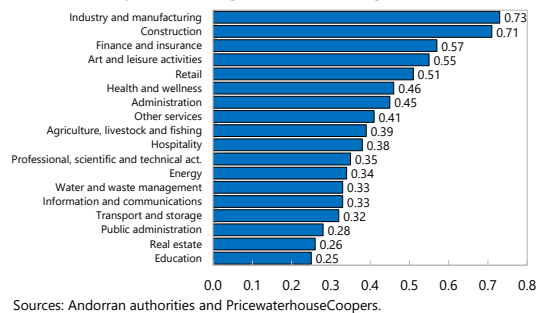
*Containment measures were fewer and more targeted... ...using information on sectoral multipliers on output.*

**COVID-19 Containment Measures**



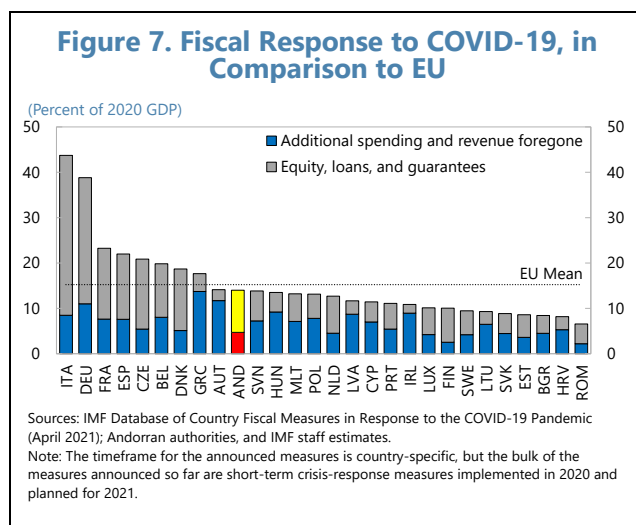
Source: Oxford COVID-19 Government Response Tracker, Blavatnik School of Government.

**Andorra: Additional Goods and Services Generated in Other Sectors through Supply Chain Effects**  
 (Ranking by sectors: For each € invested how many € of additional goods and services are generated)



Sources: Andorran authorities and PricewaterhouseCoopers.

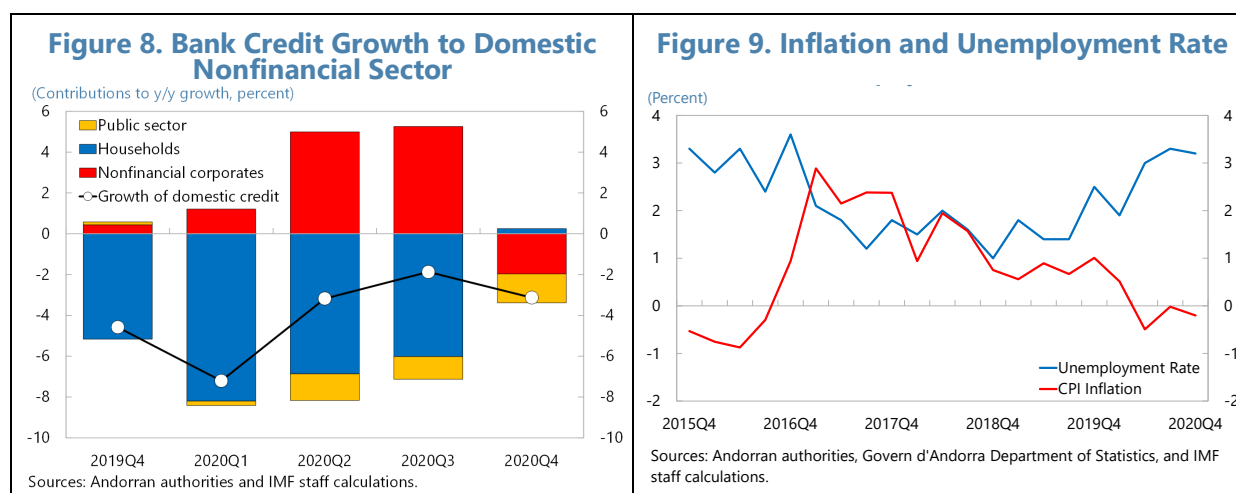
**10. In response to the outbreak, the authorities undertook mitigating fiscal measures anchored in their medium-term framework.** Expenditure measures worth 2.2 percent of GDP and revenue measures worth 0.4 percent of GDP were lower than neighbors owing to fear of financing constraints during the pandemic’s first wave (Figure 7). The measures included healthcare spending and financial support for pandemic-affected sectors and households (Table 1). In addition, government guarantees worth 9 percent of GDP were made available for bank loans to liquidity-strapped companies. A 60 percent take-up of guarantees enabled a sharp increase of bank credit to firms by about 11½ percent y/y in 2020:Q2 but offset by a decline in credit to households and the public sector, as the central government diverted to other funding sources later in the year (Figure 8). The COVID-related measures and lower revenues reduced the central government balance to -4.3 percent of GDP in 2020. The measures provided about one percentage point boost to GDP growth last year, assuming an average multiplier of one across COVID-related spending categories.



FISCAL MEASURES				MONETARY AND MACRO-FINANCIAL MEASURES			
		2020		2021			
		€ million	% of GDP	€ million	% of GDP		
<b>Central Government</b>		<b>65.0</b>	<b>2.6</b>	<b>37.5</b>	<b>1.4</b>	<b>Moratoria to provide repayment relief</b>	
<i>Revenue</i>						- Legislative moratoria approved by the government (April 18th, 2020), guidelines from the European Banking Authority	
	Relaxation of tax obligations for households and corporations	9.1	0.4	0.0	0.0	- Non-legislative sector-wide moratoria approved by the Andorran Banking Association (June 11th, 2020), with application deadline extended until March 31st, 2021	
<i>Expenditure</i>	Increased healthcare spending	15.2	0.6	16.7	0.6	<b>Supervisory, regulatory and macroprudential policy action by the Andorran Financial Authority</b>	
	<i>Acquisition of tests, vaccines, and medical supplies, transfers to the healthcare system</i>					- Limit onsite examinations and postpone the non-priority ones to 2021	
	Financial assistance to households	11.7	0.5	11.2	0.4	- Postpone stress tests to 2021 if conditions allow	
	<i>Unemployment benefits, subsidies to self-employed</i>					- Postpone the requirement for banks to establish a capital buffer for systemic risks	
	Financial assistance to corporations	29.0	1.2	9.6	0.4	- Recommend banks to not distribute dividends	
	<i>ERTO, social security contributions, rent/mortgage support 1/</i>					- Extend the deadline for banks to report on their audited balance sheets	
<b>Public Enterprises</b>	Direct support and discounts on the telecommunications and electricity bills of firms	<b>5.1</b>	<b>0.2</b>	<b>6.0</b>	<b>0.2</b>		
<b>Loan Guarantees</b>	Government guarantees for new bank loans to businesses 2/	<b>135.8</b>	<b>5.5</b>	<b>94.2</b>	<b>3.6</b>		

1/ ERTO stands for 'temporary employment regulation' and comprises the temporary suspension of work contracts and the reduction of working hours.  
 2/ In 2020, the government made available €230 million (equivalent to 9 percent of GDP) of loan guarantees to businesses. The table shows the amount taken up in 2020, and the amount that remains available from the total envelope in 2021 (the actual take-up could be lower).

**11. Inflation moved into negative territory in mid-2020 as the unemployment rate increased.** Sharp declines in energy prices led to negative inflation in transport and recreation sectors that account for a third of the weight in the consumer price index (CPI) (Figure 9). Moreover, restrictions on services activities and social distancing further slowed inflation in restaurants and hotels through the end of 2020. Meanwhile, the unemployment rate increased to 3.2 percent in 2020:Q4, a sharp increase over 2019 but was buffered by the introduction of job retention schemes (“ERTO”). Even though the ERTO benefitted 10,181 workers in May-December, employment in hospitality and personal services sectors declined by 7.3 percent in 2020.



## OUTLOOK AND RISKS

**12. In the near-term, despite the projected rebound, economic activity is likely to remain subdued and well below 2019 levels.** Under staff's baseline, real GDP is projected to rise by 5.8 percent in 2021, from an estimated drop of 11.8 percent in 2020 (Table 2). Private consumption will recover as lockdowns ease and vaccinations for more than half of the Andorran population reduces local transmission by mid-2021. Furthermore, higher minimum wages announced for 2021 and the availability of unemployment benefits and salary support at least until June will stabilize real incomes despite record-high unemployment. Tourism, and thus net exports, are projected to recover sooner than in other countries once mobility at the borders is fully restored, since most tourists do not travel to Andorra by air. Pent-up demand for tourism and ski vacations is expected to add back to tourism receipts later this year. But, the lasting effects of the reduction in public investment in 2020, together with the planned rollback of some COVID-19 measures after June 2021, will work toward a slightly slower recovery in GDP growth than its neighbors (Table 2). Real GDP is projected to remain almost 7 percent below 2019 levels in 2021.

**Table 2. Andorra: IMF Baseline Forecasts**

	Estimate		Projections					
	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP growth (percent)	2.0	-11.8	5.8	4.1	3.6	2.8	1.5	1.5
Nominal GDP growth (percent)	3.4	-11.9	6.5	5.3	5.0	4.6	3.2	3.2
	(contribution to nominal GDP growth, percent)							
Consumption	2.5	-3.5	4.5	3.5	3.2	3.0	1.9	1.9
Private	1.6	-5.7	3.4	2.8	2.7	2.6	1.5	1.5
Public	1.0	2.2	1.2	0.7	0.5	0.5	0.4	0.4
Investment	1.8	-3.9	0.2	0.5	0.5	0.4	0.4	0.4
Private 1/	1.6	-2.5	-0.8	0.4	0.4	0.3	0.2	0.2
Public	0.2	-1.4	1.0	0.1	0.1	0.2	0.2	0.2
Net exports of goods and services	-1.0	-4.5	1.7	1.3	1.3	1.1	0.9	0.9
Exports	1.1	-6.8	4.5	4.0	3.7	3.1	2.3	2.3
Imports	2.0	-2.3	2.8	2.7	2.3	2.0	1.4	1.4
CPI inflation (percent, period average)	0.7	0.3	0.5	0.9	1.3	1.6	1.7	1.7
Unemployment rate (percent)	1.8	2.9	3.0	2.4	2.0	1.8	1.7	1.7
Central government overall balance (percent of GDP)	0.2	-4.3	-3.3	-1.4	-0.1	0.5	0.9	1.1
Current account balance (percent of GDP)	18.0	14.2	15.5	16.4	17.3	18.0	18.5	19.1
<i>Memorandum items</i>								
Euro Area real GDP growth (percent)	1.3	-6.6	4.4	3.8	1.9	1.6	1.4	1.3
Euro Area inflation (percent, period average)	1.2	0.3	1.4	1.2	1.4	1.6	1.7	1.8
Spain real GDP growth (percent)	2.0	-11.0	6.4	4.7	2.8	2.4	1.4	1.4

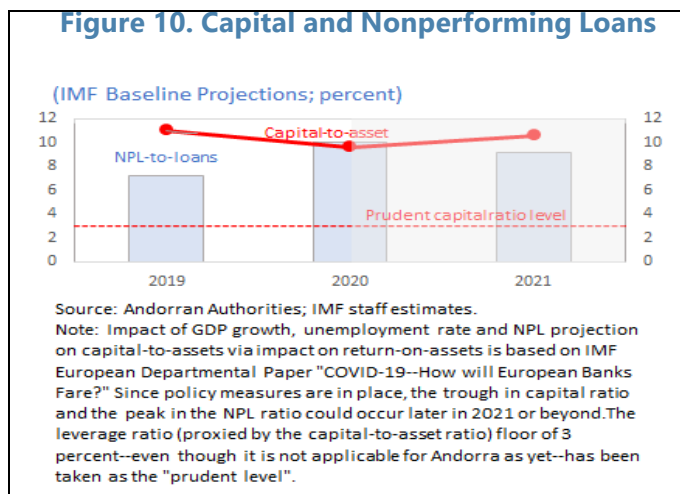
Sources: Govern d'Andorra Department of Statistics, and IMF staff calculations.

1/ The contribution of private investment is derived as a residual. Since the fiscal accounts are covered at the general government level, investments of state-owned enterprises are subsumed under private investment.

**13. Banks are expected to be resilient in the baseline, supporting credit growth, although they face risks.**

On the credit supply side, even though bank profitability initially is expected to fall due to higher loan-loss provisions and lower noninterest earnings through 2021, reducing banks’ ability to grow capital organically, banks would remain sufficiently capitalized to continue lending. However, beyond the immediate liquidity needs of some nonfinancial corporates, firms’ credit demand for private

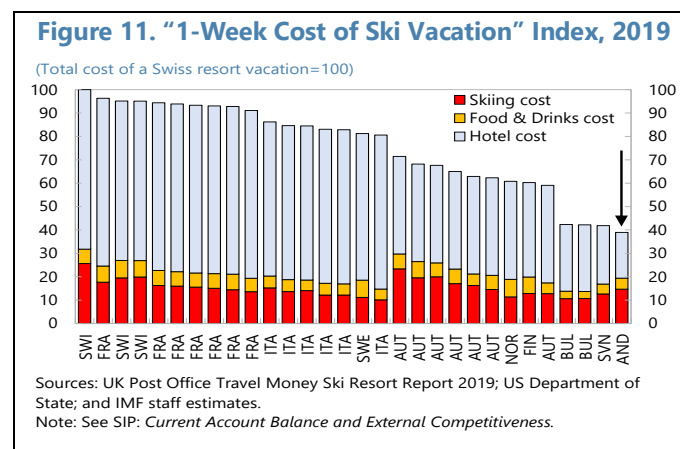
investment is likely to remain lackluster. Under staff’s baseline, NPLs are expected to grow to about 9 percent of loans due to the pandemic (Figure 10). This baseline assessment is, however, subject to considerable risks (see below and policy section).



**14. In the medium-term, under significant uncertainty, GDP growth is expected to converge to the euro area average by 2026.** Growth is projected to remain strong as the world economy recovers fully from the pandemic and consumer confidence continues to improve with lower unemployment. In keeping with its per capita income higher than the eurozone average, Andorran growth is expected to eventually converge near the euro area’s by 2026. Inflation is projected to remain subdued, slowly rising toward EA levels by 2026.

**15. The current account balance seems to have moderated slightly in 2020 but is expected to rise to pre-pandemic levels by 2026.** The current account surplus—based on newly produced statistics by the Andorran authorities—was 18 percent of GDP in 2019 (see SIP: [Current Account Balance and External Competitiveness](#)). High frequency indicators show that while the number of tourists fell by almost 40 percent in 2020, the large share of imported food and other necessity items, including medical supplies, have kept imports persistently high, reducing the current account balance to about 14.2 percent of GDP in 2020. With a full resumption of tourism, and a fairly flat demand for imports of necessary goods, the current account surplus is projected to increase to 19.1 percent of GDP by 2026.

**16. The tourism sector in Andorra is competitive, especially in skiing.** While a norm for the current account cannot be established, various measures of the real exchange rate suggest that Andorra fares well in external competitiveness, with low relative prices of exportable services and rising export market shares of tourism. A new index, developed by staff, shows that the relative price of a ski vacation in



Andorra is on the lower side among European peers (Figure 11). The ongoing increase in higher minimum wages and plans to create luxury ski-tourism products are not expected to reduce the competitiveness of this sector over the medium-term.

**17. Risks to the outlook are substantially skewed to the downside in the near-term (Annex IV):**

- **Resurgence of the virus.** Vaccination efforts may falter with inadequate supply of doses or if the number of new cases and strains exceeds the vaccination rate in Andorra and its neighbors. These possibilities would entail protracted lockdowns in 2021 and a slower economic recovery in the region and in tourism. Increased firm bankruptcies and unemployment in the retail and tourism sectors would lead to additional scarring in the medium term.
- **Banking stress.** Banks' capitalization could come under intense pressure as loan and insolvency moratoria are lifted, and fiscal measures in the corporate sector expire to reveal sizeable loan losses for banks. While banks are assumed to weather losses well using analysis based on euro area loan-loss sensitivities of capital, these sensitivities could be more acute in Andorra due to its structural features (see policy section). Sizeable increases in NPLs in the banking sector and reduced capital buffers could make banks reluctant to lend sufficiently for recovery in private domestic demand.
- **Sovereign stress.** Most debt is short-term and gross financing needs are high in the near-term (see policy section). Increasing stress in the real sector could entail a large call on government guarantees, substantially increasing gross financing needs in 2021 (Annex V). Moreover, banking sector stress could further increase contingent liabilities of the government—due to the systemic nature of banks and absence of lender of last resort facilities—and could raise the risk of sharply higher refinancing costs for the private and public sectors. Sudden increases in gross financing needs could put temporary stops to government programs leading to a weaker recovery.

**18. Upside risks are related to both Andorra and the region.** A successful deployment of vaccines covering the entire adult population in Andorra and neighbors is a clear upside risk. Moreover, policies that lead to a more rapid recovery in the eurozone and Spain would help Andorran GDP growth through a stronger rebound in tourism.

**Authorities' Views**

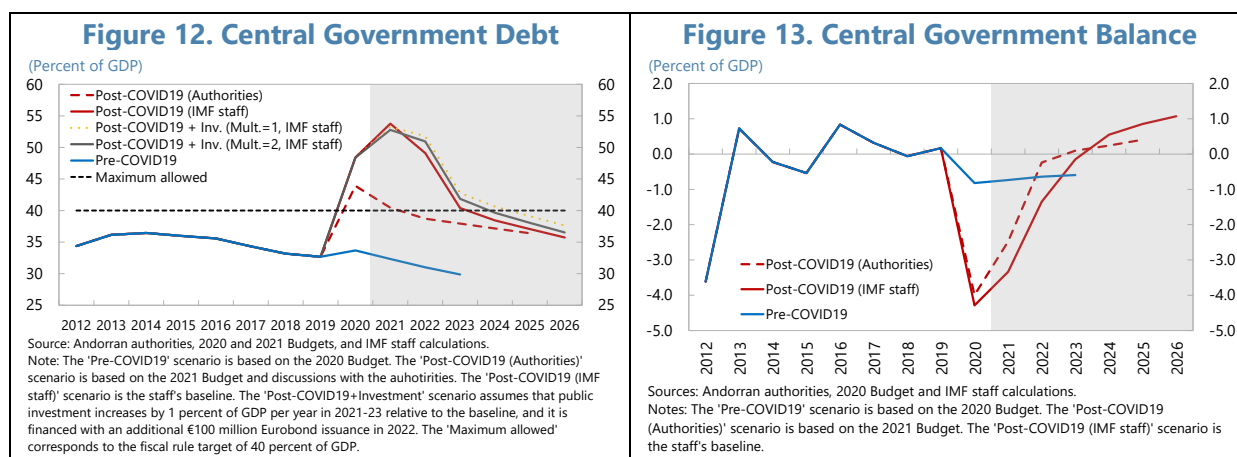
**19. The authorities broadly shared staff's views on the economic outlook and balance of risks.** While their forecast for 2021 is more pessimistic than staff's, they are currently assessing the full outturn of the first quarter of 2021 and might revise their projections accordingly. They are optimistic about another summer rebound in tourism as they expect that 60–70 percent of the Andorran as well as the regional population (as projected by the EU authorities) will be vaccinated by the summer.

# POLICIES: FROM PANDEMIC SUPPORT TO STEERING THE NEW ECONOMY

## A. Fiscal Policy

Staff supports the fiscal rule as a medium-term anchor. However, the authorities' ambitious consolidation plans could be costly for the recovery. The fiscal measures related to the pandemic provided strong support to household incomes and firms' liquidity, while maintaining debt sustainability. Public support will need to continue until the recovery firmly sets in, and public investment, at least on maintenance projects, could increase while the authorities diversify funding sources. Investing in tourism, electricity, and environmentally-sustainable projects will not only lift growth but also boost private investment while bringing the unemployment rate half-way down to 2019 levels. Andorran public debt would remain sustainable in such a higher-public-investment scenario. In the medium-term, as primary fiscal balances turn positive, the authorities will need to build international reserves on a precautionary basis.

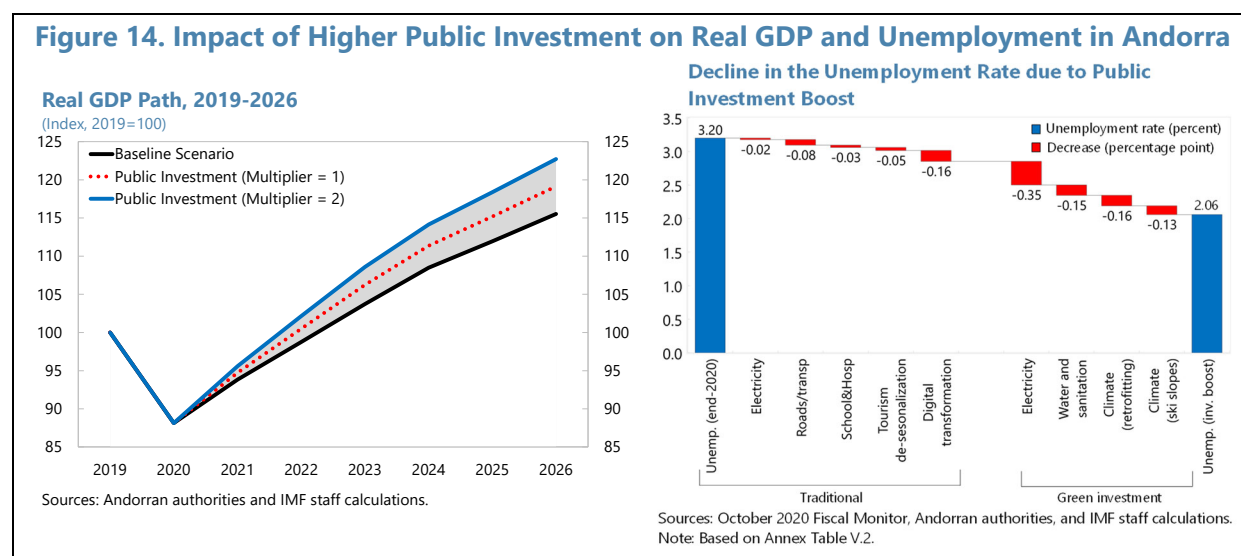
**20. Public debt increased beyond the fiscal rule limit in 2020 but remains sustainable.** The worsening of the fiscal balance and large debt repayments resulted in gross financing needs of the central government of 18 percent of GDP in 2020. The gross financing needs are lower for the general government since the local government and the social security administration run surpluses. To cover these needs, but also as a pre-financing strategy partly to cover large amortizations due in 2022, the central government issued new debt accessing both domestic and external sources. As a result, central government debt increased to 48.4 percent of GDP in 2020 (Figure 12), supported by activation of the escape clause embedded in the fiscal rule (Annex II). Higher revenues during the recovery and roll-back of COVID-19 measures will lead to primary surpluses from 2023 (Figure 13). Furthermore, the 10-year maturity of the €500 million Eurobond issuances will reduce debt service substantially in the short-to-medium term. The combined effects will see debt reaching the fiscal rule target of 40 percent of GDP by 2024.





**21. In the near-term, fiscal policy should evolve in line with the demands of the pandemic, and the authorities should not prematurely withdraw stimulus.** The authorities are planning to maintain the healthcare spending to finance the purchase of vaccines and tests, and the operation of the COVID Office (Table 1). They are also keeping in place most support measures to households, while those to firms—particularly ERTO—are being rolled back as the economy is projected to recover. The risk of renewed lockdowns and uncertainty with various virus strains call for maintaining emergency lifelines, particularly for firms. These could only be rolled back gradually, reducing the coverage and generosity of programs if local transmission is low and activity has begun to normalize. Acquisition of vaccines for the entire population is necessary.

**22. The scaling back of public investment in 2020 could hurt the recovery and should be reversed as soon as feasible.** Planned public investment spending was cut back by about 0.4 percentage points of GDP in 2020, while it increased on average in the EU (See SIP: *Public Investment to Catalyze Andorra’s Recovery*). Even though there were some offsetting investments in digital and sustainable-energy infrastructure, the cuts in a few construction projects could reduce growth prospects assuming reasonable multiplier effects (October 2020 *IMF Fiscal Monitor*). Furthermore, in the 2021 budget, public investment is projected to stall in 2021–2023, which could significantly drag down medium-term growth. Staff analysis shows that a modest increase in public investment—around 1 percent of GDP per year in 2021–23, financed by issuing €100 million extra debt—could raise real GDP level by 3 to 6 percent in the medium-term, compared to staff’s baseline projections (Figure 14). Moreover, greater job-creating capacities of climate-mitigating green investments—such as adopting renewable energy sources and retrofitting buildings—would enable a faster return to the precrisis unemployment rate (Figure 14 and SIP: *Public Investment to Catalyze Andorra’s Recovery*), while boosting private investment. Public debt is expected to remain sustainable in this higher public investment scenario (Annex V).



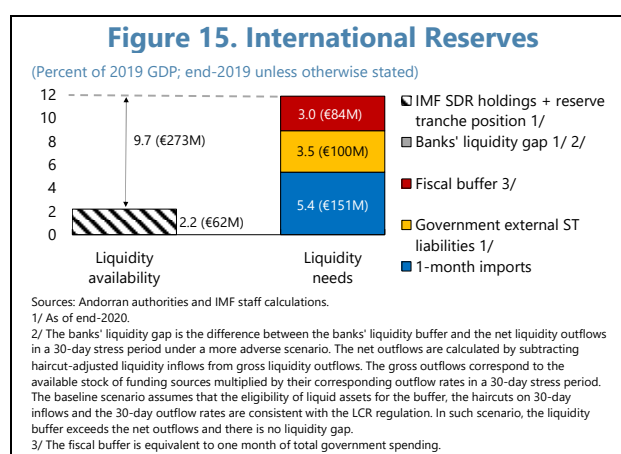
**23. In the medium-term, more infrastructure spending could increase long-term growth by strengthening Andorra's position in tourism and adapting to climate change.** The authorities already have plans to diversify the tourism season by offering varied summer activities. While planned investments in climate mitigation are welcome, the authorities will need to adapt to climate change as ski slopes become warmer. Additional investments in artificial snow-making machines—either directly or through incentivizing private investment—could help Andorra's competitiveness in tourism even further and lead to more sustainable fiscal revenues. Moreover, the authorities have been weighing the costs and benefits of train connections with Barcelona and French cities as a form of green investment. The authorities should continue to carefully assess the viability of these investment strategies along with costs and ensure proper governance arrangements on public procurement.

**24. The authorities should continue diversifying funding sources and lengthening debt maturities.** In the midst of the pandemic, the authorities borrowed externally for the first time in 2020, with Spanish and French banks as lenders and as intermediaries for private debt placement, which was oversubscribed. The government is also trying to secure long-term financing from multilateral banks such as the European Investment Bank and the Council of Europe Development Bank. Importantly, the government successfully floated Andorra's first international bond on April 27, with a rating of BBB+ (Fitch) and BBB (S&P), worth €500 million with a maturity of 10 years. At a yield of 1.25 percent, this bond was oversubscribed.

**25. Over time, the fiscal authorities will need to build international reserves to cover their liquidity needs on a precautionary basis.** Staff assesses such reserves needs to be about 12 percent of GDP or €334 million in the baseline scenario (Figure 15 and SIP: [Gross International Reserves](#)), provided that the banking system is liquid and its liquidity risks are well supervised. Using detailed bank-by-bank data on liquidity, staff assessed the liquidity gap to be zero based on the definition of liquidity coverage ratio (LCR) adopted from

EU regulations. According to this metric, high-quality liquid assets are more than sufficient to cover net outflows of liabilities over a 30-day period. Against the government's liquidity needs, available reserve assets with the IMF amount to 2 percent of GDP, equivalent to €62 million. The "shortfall" of €273 million could be built up over time. The allocation of IMF Special Drawing Rights (SDRs), expected later this year, would increase available reserves by almost 4 percentage points of GDP.

**26. Different options are available for accumulating reserves, which need to meet certain qualifications.** The government could increase the contribution rate to the compensation account under the fiscal rule, save all future fiscal surpluses starting in 2023, or issue debt. To qualify as



international reserves, these assets need to be under the legal and managerial control of the central government and invested abroad in highly liquid assets (SIP: [Gross International Reserves](#)).

### **Authorities' Views**

**27. The authorities broadly agreed with the assessment and policy recommendations on the fiscal front.** They reiterated their commitment to fiscal discipline and to bring the debt level below their fiscal debt limits, while taking advantage of the favorable financial conditions and exploring alternatives to build international reserves. The authorities highlighted that the COVID-related measures limited the loss in households' income and businesses' bankruptcies. The authorities welcomed staff assessment on the need to boost public investment to support the economic recovery and aid the economic transformation. They noted that, despite the investment cuts in 2020–21, the government has well-developed public investment plans for the coming years that can be fast-tracked. However, they would like to balance the implementation pace with their medium-term fiscal goals. They also noted that the public investment multiplier in Andorra could be lower than in peer countries given the small size and openness of the economy.

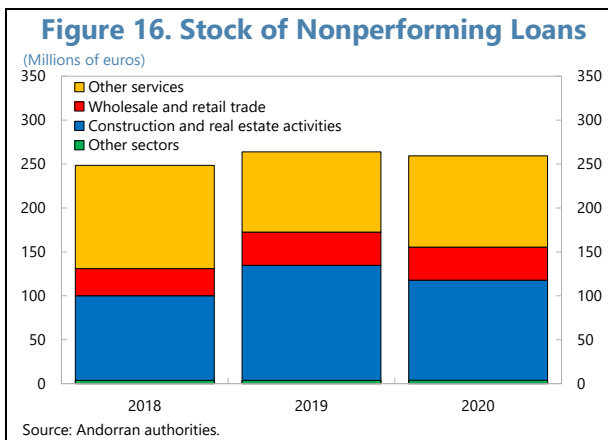
## **B. Financial Sector Policies**

*Banks have weathered the pandemic well so far, with high levels of profitability and capital buffers and pandemic policies in place. However, reliance on foreign deposit funding, loans to banks' own shareholders and other related parties, as well as large exposures to the domestic economy carry substantial risks. The Andorran Financial Authority (AFA) should carefully assess the capital needs in light of the structural risks and the impact of the policy measures adopted during the pandemic. Technical assistance from IMF's Monetary and Capital Markets Department will take a close look at the structural risks and provide detailed recommendations on bank supervision later this year.*

**28. The banking sector seems to be weathering the pandemic well, while fiscal and financial sector policies are still in place, amid a lack of credit demand for investment purposes.** The emergency fiscal measures are providing substantial support to household incomes and firms' expenses during the pandemic. Still, borrowers took up the offer of moratoria on about 8 percent of GDP worth of loans. Similarly, firms have accessed credit from banks using loan guarantees from the government to tide over liquidity needs. However, in such an uncertain environment, businesses—especially in the tourism sector—are reluctant to borrow more for investment purposes. Bank capital has been holding up well so far due to very few loan losses in the pandemic and the presence of the insolvency moratoria.

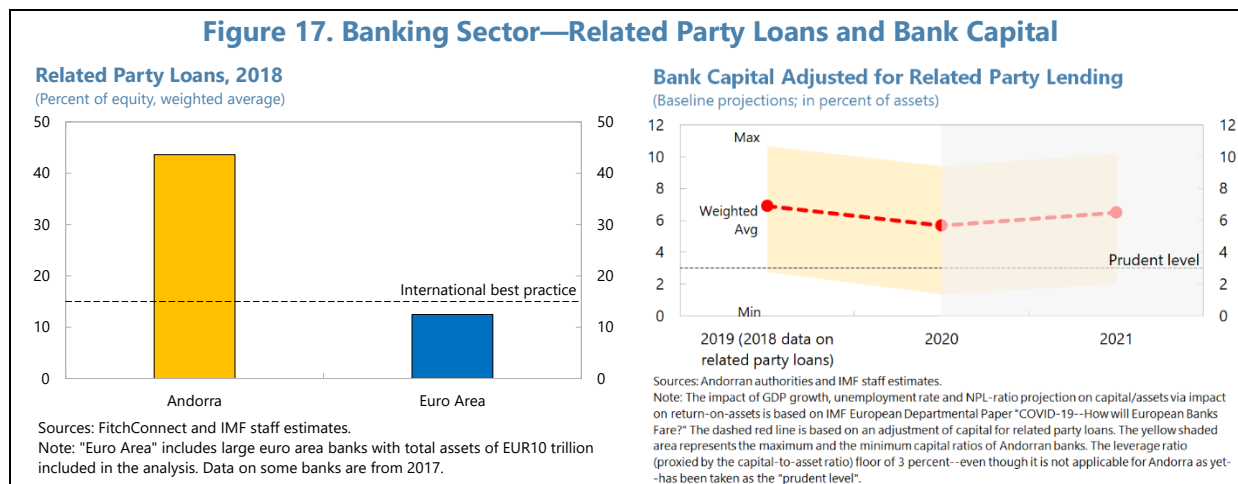
**29. The stock of NPLs remains high and is concentrated in the services sector.**

The high ratio of NPLs is partly due to legacy loans from *Banca Privada d'Andorra*, which is under resolution since 2015 after an AML/CFT breach. When adjusted for these legacy assets, the NPL ratio is close to 3 percent of gross loans, and near the regional average. Part of the recent increase in NPLs is also due to the adoption of new regulation that modified the classification of such loans. The nominal stock of NPLs remain concentrated in services and construction/real estate sectors and a market for NPLs do not exist (Figure 16). The NPLs usually are resolved by prolonged work-outs.



**30. Banks' capital adequacy needs to be assessed in light of related party lending and large exposures.**

As in many small countries with a non-diversified economic base and large banking sector, Andorran banks are exposed to domestic credit risks from large exposures to a few clients. These features could lead to a higher sensitivity of loan losses to the economic downturn. Moreover, a considerable share of loans goes to banks' "related parties" such as shareholders (Figure 17). This poses risks to the measurement of bank capital, which needs to be adjusted for such transactions. To illustrate the issue, staff analysis shows that deducting the full amount of related party loans from total capital would reduce the capital-to-asset ratio by almost 3 percentage points. This adjustment would decrease the projected capital-to-asset ratio of a portion of the banking sector below the 3 percent threshold—used in the illustrative analysis as a proxy for the leverage ratio floor—exposing a capital ratio gap of about 2 percent of GDP.



**31. Banks remain highly liquid, but dependence on foreign funding requires continuous vigilance.** Due to the adoption of the EU's bank liquidity rules, Andorran banks need to have an LCR of 100 percent since January 2021. Against this requirement, Andorran banks have an LCR close to 200 percent, assuming liquidity outflows specified in the regulation and consistent with regional crisis scenarios. Staff's liquidity stress test based on detailed bank-by-bank data suggests, however, that banking system's liquidity gap could go up to 6.8 percent of GDP in an extremely adverse scenario where liquidity outflows of stable and unstable deposits occur at up to thrice the rate assumed in the baseline. The Andorran Financial Authority (AFA) will need to monitor the liquidity situation very closely, paying special attention to banks that are most exposed to this risk.

**32. In the near-term, the AFA should assess the impact of the pandemic on bank capital.** The temporary moratoria on debt service might have made bank balance sheets less transparent, even though the take-up was limited, and AFA should ensure that loan classifications and provisioning are continuing in a proper manner. Good provisioning practices are also needed in the absence of an NPL resolution market since banks would eventually need to mostly absorb the cost through write-offs. If the economic outlook worsens, loan moratoria should only be extended by banks on a case-by-case basis to eligible clients. Borrowers would seem to meet loan commitments if the fiscal support to households and firms is extended. Blanket moratoria would reduce bank income prospects and regulatory forbearance on loan classification would obscure bank balance sheets.

**33. In the medium-term, AFA needs to manage three key risks.** First, it needs strengthened rules on related party lending aiming to disincentivize banks from such loans. It could consider additional capital in the form of "Pillar II" on related party exposures of specific banks. Second, it needs to continue vigilance on liquidity risks to ensure an adequate level of liquid assets to meet short-term runs from foreign depositors. Third, the authorities should strengthen the monitoring of cross-border flows, including through cooperation with foreign counterparts, and continue deepening the understanding of money-laundering risks.

### ***Authorities' Views***

**34. The authorities concurred with the assessment of the financial sector risks highlighted by staff and offered important nuances.** The AFA closely monitors loans to related parties and acknowledged that an increase in capital requirements might be necessary to mitigate the associated risk. The supervisor stressed that NPLs declined in 2020 and that it did not expect them to increase when the COVID measures are lifted, arguing that most firms faced liquidity issues but not solvency problems. On NPL resolution, the AFA explained that there is a good share of restructuring to support the companies' deleveraging process and that, as a result, foreclosures are not usual. And, even when these happen, it is easy and profitable to sell a foreclosed property, given the current conditions in the real estate market. They attributed falling corporate credit growth over the years to low demand, and the reluctance of firms to accumulate debt in an uncertain environment, and instead preferring to use their own resources to finance investments.

## C. Governance and Transparency

*Indicators of government effectiveness, such as voice and accountability, rule of law, and political stability, compare or exceed those in the region. But Andorra is yet to ratify the United Nations convention against corruption. The authorities should build on the important progress made on the production of balance of payments statistics to close remaining data gaps.*

### Governance

**35. Further efforts to improve good governance are encouraged.** While a reform of the public procurement framework is underway, information on the beneficial ownership of entities—that were awarded contracts, including COVID-related ones—should be collected and published to increase transparency and accountability of public spending. In the absence of an anti-corruption strategy, the authorities should further strengthen the coordination of measures to combat corruption and identify areas for priority action. Andorra should ratify the United Nations Convention against Corruption (UNCAC) and adopt the bills on asset declaration and public access to information.

**36. The effectiveness of the AML/CFT framework needs to build on the important progress made so far.** Since 2018, the understanding of ML risks in the banking sector has been improving. An update of the national risk assessment is being finalized. UIFAND's AML/CFT supervision is risk-sensitive, but it mostly focuses on risks related to crimes committed in Andorra. To deepen the understanding of ML risks, the monitoring of cross-border flows, including through cooperation with foreign counterparts, should be further developed. Moreover, focusing the allocation of resources to higher risk areas would increase the effectiveness of AML/CFT supervision.

### Data Gaps

**37. Closing data gaps and publishing statistics according to international standards are key to achieving transparency.** There is room for improving Andorra's statistical system in several dimensions. Various data gaps need to be closed, including in real expenditure components of GDP, international investment position, and data on financial soundness for banks and the private sector (see *Informational Annex*). Preparing an advance release calendar containing release dates for major macroeconomic statistics would also help transparency and surveillance. The authorities may benefit from using the Enhanced General Data Dissemination System (e-GDDS), which is the first tier of IMF data sharing standard for macroeconomic data essential for policy making and surveillance, to further develop Andorra's statistical system and improve data transparency. The IMF can provide technical assistance on the various areas if requested.

### Authorities' Views

**38. The authorities consider the risk of corruption in Andorra to be moderate.** They also concur with the view that the publication of information on beneficial ownership of entities that were awarded procurement contracts would strengthen transparency. AML/CFT supervisors agree

that the understanding of ML/TF risks of cross-border flows in banking sector need to be properly evaluated.

**39. The authorities plan to continue working with the IMF in further developing Andorra's statistical system and to participate in e-GDDS.** They are interested in requesting further technical assistance from the IMF to improve their data transparency.

## STAFF APPRAISAL

**40. The pandemic has taken a considerable economic toll but the authorities managed the health crisis well.** Universal testing and expanded hospital capacity kept fatality rates very low despite a high number of cases. This strategy helped Andorra implement more targeted internal restrictions than the neighboring countries. At the same time, emergency fiscal measures stabilized real incomes and supported firms. The authorities are highly engaged in transitioning to a green and digitalized economy and more diversified tourism services.

**41. Fiscal policy should remain supportive in the near-term and allow for higher public investment in the medium-term.** The fiscal rule has served well as a medium-term anchor and offers space for a slower consolidation than the authorities' plans. The risk of renewed lockdowns and uncertainty with various virus strains call for maintaining emergency lifelines. These should only be rolled back gradually, reducing the coverage and generosity of programs if local transmission is low and activity begins to normalize. Some of the planned investments in digital technologies and in climate adaptation and mitigation could be brought forward in 2021 to support the recovery. Frontloading the planned public investment could boost private investment in tourism-related sectors, which are reluctant to invest during uncertain times.

**42. Over time, the fiscal authorities will need to build international reserves to cover their liquidity needs in the event of future crises.** IMF staff assess such reserves needs to be about 12 percent of GDP, which would be sufficient to cover one month of imports, fiscal revenue fluctuations, and short-term external debt service. Against these liquidity needs, the currently available liquidity is limited to the reserve assets with the IMF, worth two percent of GDP at this stage. Various options are available to build up the remaining 10 percent of GDP over time. Bank liquidity risks need to be intensely supervised to make sure reserve needs of the government do not rise.

**43. AFA should ensure banks' sound health in the near-term and manage three structural risks in the medium-term.** The supervisors should assess the impact of the pandemic on bank capital so that banks are strong enough to support the recovery and respond to increased demand for credit. Moratoria should be extended only to eligible clients, if needed. In the medium-term, AFA needs to consider stronger rules against related party lending and additional capital in the form of "Pillar II" on related party exposures of specific banks. It should continue to ensure that there are no liquidity gaps in banks. Moreover, the authorities should strengthen the monitoring of cross-border flows and continue deepening the understanding of money-laundering risks.

**44. The authorities should develop a strategy to increase the effectiveness of measures to counter corruption.** To strengthen the anti-corruption legal framework, Andorra should ratify the UNCAC, establish an assets declaration framework for politically exposed persons, and ensure appropriate public access to information in line with the UNCAC.

**45. The authorities already recognize the importance of publishing statistics according to international standards.** They are making rapid strides in further developing more comprehensive data on Andorra's economy to help policy-making and to improve surveillance. They produced balance of payments statistics, with support from the IMF, within a few months of membership. Other external, real, fiscal, and financial sector statistics need to be compiled and reported according to international standards. The authorities plan to work with the IMF in this area and participate in the Enhanced General Data Dissemination System.

**46. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.**



**Table 3. Andorra: Selected Economic and Financial Indicators**

<b>I. Social Indicators</b>											
Population (2019)	77,543									Poverty Rate (percent, 2019)	13
Per capita income (2019, euros)	36,335									Human Development Index Rank (2019)	36 (out of 189)
Gini Index (2019)	35									Life expectancy at birth (2011)	81.9
<b>II. Economic Indicators</b>											
	2017	2018	2019	Estimate 2020	2021	2022	Projections				
							2023	2024	2025	2026	
<b>NATIONAL ACCOUNTS AND PRICES</b>											
(annual change, percent, unless otherwise indicated)											
Real GDP	0.3	1.6	2.0	-11.8	5.8	4.1	3.6	2.8	1.5	1.5	
Nominal GDP	1.5	2.6	3.4	-11.9	6.5	5.3	5.0	4.6	3.2	3.2	
GDP deflator	1.1	1.0	1.4	-0.1	0.6	1.1	1.4	1.7	1.7	1.7	
(contribution to nominal GDP growth, percentage points)											
Consumption	...	3.4	2.5	-3.5	4.5	3.5	3.2	3.0	1.9	1.9	
Private	...	1.8	1.6	-5.7	3.4	2.8	2.7	2.6	1.5	1.5	
Public	...	1.6	1.0	2.2	1.2	0.7	0.5	0.5	0.4	0.4	
Investment	...	2.3	1.8	-3.9	0.2	0.5	0.5	0.4	0.4	0.4	
Private 1/	...	1.8	1.6	-2.5	-0.8	0.4	0.4	0.3	0.2	0.2	
Public	...	0.5	0.2	-1.4	1.0	0.1	0.1	0.2	0.2	0.2	
Net exports of goods and services	...	-3.0	-1.0	-4.5	1.7	1.3	1.3	1.1	0.9	0.9	
Exports	...	0.8	1.1	-6.8	4.5	4.0	3.7	3.1	2.3	2.3	
Imports	...	3.8	2.0	-2.3	2.8	2.7	2.3	2.0	1.4	1.4	
Prices											
Inflation (percent, period average)	2.6	1.3	0.7	0.3	0.5	0.9	1.3	1.6	1.7	1.7	
Inflation (percent, end of period)	2.4	0.8	1.0	-0.2	0.6	1.1	1.3	1.6	1.7	1.7	
Unemployment rate (percent)	1.7	1.5	1.8	2.9	3.0	2.4	2.0	1.8	1.7	1.7	
<b>EXTERNAL SECTOR</b>											
(percent of GDP, unless otherwise indicated)											
Current account	...	...	18.0	14.2	15.5	16.4	17.3	18.0	18.5	19.1	
Balance on goods and services	14.2	10.9	9.6	5.8	7.1	8.0	8.9	9.6	10.1	10.7	
Exports of goods and services	76.6	75.4	74.0	76.3	75.9	75.9	75.8	75.5	75.4	75.2	
Imports of goods and services	62.4	64.6	64.4	70.5	68.8	68.0	67.0	65.9	65.2	64.6	
Primary income, net	...	...	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	
Secondary income, net	...	...	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	
Capital account	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Financial account	...	...	18.1	14.2	15.5	16.4	17.3	18.0	18.5	19.1	
Errors and omissions	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Gross international reserves (millions of euros)	...	...	0.0	61.6	61.6	61.6	61.6	61.6	61.6	61.6	
<b>FISCAL SECTOR</b>											
(percent of GDP, unless otherwise indicated)											
General Government 2/											
Revenue	38.0	38.5	38.0	41.1	38.4	38.6	38.7	38.8	39.0	39.1	
Expenditure	34.6	35.7	35.6	44.0	40.8	38.0	36.7	36.1	35.9	35.6	
Interest	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	
Primary balance	4.0	3.4	2.9	-2.3	-1.7	1.2	2.6	3.3	3.8	4.1	
Net lending/borrowing (overall balance)	3.3	2.8	2.4	-2.9	-2.3	0.6	2.0	2.7	3.2	3.5	
Public debt	37.8	36.3	35.4	51.5	56.7	51.9	43.0	41.0	39.5	38.1	
Central Government 3/											
Revenue	19.6	19.6	19.5	20.6	18.8	19.2	19.3	19.4	19.5	19.6	
Expenditure	19.3	19.7	19.3	24.9	22.1	20.5	19.4	18.9	18.7	18.5	
Interest	0.5	0.5	0.4	0.5	0.6	0.5	0.4	0.4	0.4	0.4	
Primary balance	0.8	0.4	0.6	-3.8	-2.8	-0.9	0.3	1.0	1.3	1.5	
Net lending/borrowing (overall balance)	0.3	-0.1	0.2	-4.3	-3.3	-1.4	-0.1	0.5	0.9	1.1	
Public debt	34.3	33.2	32.7	48.4	53.8	49.1	40.4	38.4	37.1	35.7	
<b>BANKING SECTOR</b>											
(percent, unless otherwise indicated)											
Regulatory capital to risk-weighted assets	...	20.4	21.8	21.7	...	...	...	...	...	...	
Nonperforming loans to total gross loans	...	7.1	7.3	6.1	...	...	...	...	...	...	
Credit to nonfinancial private sector											
Level (percent of GDP)	...	147.9	135.9	151.4	...	...	...	...	...	...	
Corporates	...	72.0	70.3	76.5	...	...	...	...	...	...	
Households	...	75.9	65.6	74.8	...	...	...	...	...	...	
Growth (nominal)	...	...	-5.0	-1.8	...	...	...	...	...	...	
Corporates	...	...	0.9	-4.0	...	...	...	...	...	...	
Households	...	...	-10.6	0.6	...	...	...	...	...	...	
Credit to public sector											
Level (percent of GDP)	...	7.5	7.5	6.2	...	...	...	...	...	...	
Growth (nominal)	...	...	3.0	-27.2	...	...	...	...	...	...	
<b>Memorandum items</b>											
Exchange rate (€/USD, period average)	0.89	0.85	0.89	0.88	0.82	0.81	0.81	0.81	0.81	0.81	
Nominal GDP (millions of euros)	2,656	2,725	2,818	2,484	2,645	2,784	2,924	3,058	3,155	3,256	

Sources: Govern d'Andorra Department of Statistics, Andorran authorities, Eurostat, and IMF staff calculations.

1/ The contribution of private investment is derived as a residual. Since the fiscal accounts are covered at the general government level, investments of state-owned enterprises are subsumed under private investment.

2/ The general government comprises the central government, local governments and the social security fund.

3/ The central government The central government comprises Govern d'Andorra, as well as non-market public corporations and nonprofits.

Table 4. Andorra: General Government Operations

	2017	2018	2019	Estimate 2020	Projections					
					2021	2022	2023	2024	2025	2026
	(millions national currency)									
Revenue	1,008.5	1,048.6	1,071.4	1,021.8	1,016.9	1,075.6	1,131.3	1,187.5	1,231.4	1,273.2
Tax Revenue	398.2	409.1	416.3	359.4	383.5	416.7	441.0	464.6	482.5	500.4
Income	71.2	84.3	88.0	96.3	81.4	89.1	93.7	98.2	102.0	105.3
Goods and services	135.1	128.5	132.9	107.7	117.9	128.3	136.0	143.5	149.0	154.8
International trade	154.0	156.2	150.9	108.1	133.2	145.0	153.7	162.2	168.4	174.8
Other	37.8	40.2	44.5	47.4	51.1	54.3	57.5	60.7	63.0	65.5
Social Contributions	249.9	263.9	274.2	269.0	268.4	277.7	289.4	302.7	312.4	322.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	360.4	375.6	381.0	393.4	364.9	381.3	400.9	420.2	436.5	450.5
Expenditure	920.1	973.6	1,003.2	1,093.2	1,078.4	1,057.8	1,071.7	1,105.2	1,131.5	1,160.1
Current expenditure	799.5	839.7	863.7	960.5	938.6	923.6	932.8	962.1	985.1	1,008.7
Wages and salaries	212.3	219.4	226.8	236.0	240.1	247.8	252.6	257.5	262.4	267.5
Goods and services	127.5	136.6	138.4	156.2	164.5	164.8	165.7	166.5	167.3	168.2
Subsidies and transfers	441.5	467.3	485.0	553.7	517.9	494.1	496.8	519.6	536.2	553.3
Interest	18.0	16.4	13.6	14.5	16.0	16.9	17.7	18.5	19.1	19.7
Net acquisition of non-financial assets	120.6	133.9	139.5	132.7	139.8	134.2	138.9	143.2	146.4	151.4
Net acquisition of fixed assets	66.9	80.1	88.2	62.8	78.6	80.2	82.2	85.1	88.0	91.1
Capital transfers	53.8	53.8	51.3	69.9	61.2	54.0	56.7	58.1	58.4	60.2
Primary balance	106.4	91.4	81.8	-56.8	-45.5	34.7	77.4	100.8	119.0	132.8
Net lending/borrowing	88.4	75.1	68.2	-71.3	-61.5	17.8	59.7	82.2	99.9	113.1
Financing										
Net acquisition of financial assets	...	...	...	210.4	158.0	-37.2	-126.1	76.4	94.1	107.3
Domestic	...	...	...	210.4	158.0	-37.2	-126.1	76.4	94.1	107.3
External	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	...	...	...	281.7	219.5	-55.1	-185.8	-5.8	-5.8	-5.8
Domestic	...	...	...	169.7	-180.5	-655.1	-185.8	-5.8	-5.8	-5.8
New Issuances	...	...	...	515.5	15.5	15.5	15.5	15.5	15.5	15.5
Amortizations	...	...	...	345.8	196.0	670.6	201.3	21.3	21.3	21.3
External	...	...	...	112.0	400.0	600.0	0.0	0.0	0.0	0.0
New Issuances	...	...	...	112.0	500.0	600.0	0.0	0.0	0.0	0.0
Amortizations	...	...	...	0.0	100.0	0.0	0.0	0.0	0.0	0.0
	(percent of GDP)									
Revenue	38.0	38.5	38.0	41.1	38.4	38.6	38.7	38.8	39.0	39.1
Tax Revenue	15.0	15.0	14.8	14.5	14.5	15.0	15.1	15.2	15.3	15.4
Income	2.7	3.1	3.1	3.9	3.1	3.2	3.2	3.2	3.2	3.2
Goods and services	5.1	4.7	4.7	4.3	4.5	4.6	4.7	4.7	4.7	4.8
International trade	5.8	5.7	5.4	4.4	5.0	5.2	5.3	5.3	5.3	5.4
Other	1.4	1.5	1.6	1.9	1.9	1.9	2.0	2.0	2.0	2.0
Social Contributions	9.4	9.7	9.7	10.8	10.1	10.0	9.9	9.9	9.9	9.9
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	13.6	13.8	13.5	15.8	13.8	13.7	13.7	13.7	13.8	13.8
Expenditure	34.6	35.7	35.6	44.0	40.8	38.0	36.7	36.1	35.9	35.6
Current expenditure	30.1	30.8	30.6	38.7	35.5	33.2	31.9	31.5	31.2	31.0
Wages and salaries	8.0	8.1	8.0	9.5	9.1	8.9	8.6	8.4	8.3	8.2
Goods and services	4.8	5.0	4.9	6.3	6.2	5.9	5.7	5.4	5.3	5.2
Subsidies and transfers	16.6	17.1	17.2	22.3	19.6	17.8	17.0	17.0	17.0	17.0
Interest	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Net acquisition of non-financial assets	4.5	4.9	5.0	5.3	5.3	4.8	4.8	4.7	4.6	4.6
Net acquisition of fixed assets	2.5	2.9	3.1	2.5	3.0	2.9	2.8	2.8	2.8	2.8
Capital transfers	2.0	2.0	1.8	2.8	2.3	1.9	1.9	1.9	1.9	1.9
Primary balance	4.0	3.4	2.9	-2.3	-1.7	1.2	2.6	3.3	3.8	4.1
Net lending/borrowing	3.3	2.8	2.4	-2.9	-2.3	0.6	2.0	2.7	3.2	3.5
Financing										
Net acquisition of financial assets	...	...	...	8.5	6.0	-1.3	-4.3	2.5	3.0	3.3
Domestic	...	...	...	8.5	6.0	-1.3	-4.3	2.5	3.0	3.3
External	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	...	...	...	11.3	8.3	-2.0	-6.4	-0.2	-0.2	-0.2
Domestic	...	...	...	6.8	-6.8	-23.5	-6.4	-0.2	-0.2	-0.2
New Issuances	...	...	...	20.8	0.6	0.6	0.5	0.5	0.5	0.5
Amortizations	...	...	...	13.9	7.4	24.1	6.9	0.7	0.7	0.7
External	...	...	...	4.5	15.1	21.6	0.0	0.0	0.0	0.0
New Issuances	...	...	...	4.5	18.9	21.6	0.0	0.0	0.0	0.0
Amortizations	...	...	...	0.0	3.8	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items</b>										
Gross Financing Needs (millions of euros)	...	...	...	417.2	357.5	652.8	141.7	0.0	0.0	0.0
Percent of GDP	...	...	...	16.8	13.5	23.5	4.8	0.0	0.0	0.0
Public Debt (millions of euros)	1,004.6	990.5	997.7	1,279.4	1,498.9	1,443.8	1,258.0	1,252.2	1,246.4	1,240.6
Percent of GDP	37.8	36.3	35.4	51.5	56.7	51.9	43.0	41.0	39.5	38.1
Nominal GDP (in millions of euros)	2,655.8	2,725.3	2,818.4	2,484.2	2,644.7	2,783.6	2,923.5	3,057.5	3,155.2	3,256.3

Sources: Government of Andorra Department of Statistics, Andorran authorities and IMF staff calculations.

Note: The general government comprises the central government, local governments and the social security fund.

Table 5. Andorra: Central Government Operations

	2017	2018	2019	Estimate	Projections					
				2020	2021	2022	2023	2024	2025	2026
(millions national currency)										
Revenue	519.9	533.9	549.6	511.6	497.5	534.1	564.0	593.1	616.0	637.8
Tax Revenue	364.2	372.6	375.1	306.5	334.7	361.8	382.9	403.3	418.8	434.3
Income	71.3	84.4	88.1	87.7	80.5	85.2	89.6	93.9	97.6	100.7
Goods and services	135.1	128.5	132.9	107.7	117.7	128.1	135.8	143.3	148.8	154.5
International trade	154.0	156.2	150.9	108.1	133.2	145.0	153.7	162.2	168.4	174.8
Other	3.8	3.6	3.3	3.1	3.3	3.5	3.7	3.9	4.1	4.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	155.7	161.3	174.5	205.1	162.8	172.3	181.1	189.8	197.2	203.5
Expenditure	511.5	535.6	544.9	618.2	585.7	571.7	568.4	576.4	589.2	603.0
Current expenditure	462.9	487.8	487.0	549.3	515.2	514.1	510.4	523.6	534.6	546.5
Wages and salaries	159.7	165.6	170.3	176.1	178.3	182.5	186.0	189.6	193.2	197.0
Goods and services	88.3	95.3	92.3	95.4	108.2	102.8	100.7	101.0	101.5	102.0
Subsidies and transfers	201.0	213.7	212.0	264.6	214.1	214.9	210.5	220.1	227.2	234.5
Interest	13.8	13.1	12.5	13.2	14.7	13.9	13.2	12.8	12.6	13.0
Net acquisition of non-financial assets	48.6	47.8	57.8	68.9	70.5	57.6	58.0	52.8	54.6	56.5
Net acquisition of fixed assets	42.4	40.5	47.9	37.4	37.2	40.9	43.4	45.1	46.7	48.3
Capital transfers	6.2	7.4	9.9	31.4	33.3	16.7	14.6	7.6	7.9	8.1
Primary balance	22.3	11.5	17.2	-93.3	-73.5	-23.7	8.8	29.6	39.5	47.9
Net lending/borrowing	8.5	-1.7	4.8	-106.5	-88.2	-37.6	-4.4	16.8	26.9	34.9
Financing										
Net acquisition of financial assets	...	...	...	175.2	131.3	-92.7	-190.2	11.0	21.1	29.1
Domestic	...	...	...	175.2	131.3	-92.7	-190.2	11.0	21.1	29.1
External	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	...	...	...	281.7	219.5	-55.1	-185.8	-5.8	-5.8	-5.8
Domestic	...	...	...	169.7	-180.5	-655.1	-185.8	-5.8	-5.8	-5.8
New Issuances	...	...	...	515.5	15.5	15.5	15.5	15.5	15.5	15.5
Amortizations	...	...	...	345.8	196.0	670.6	201.3	21.3	21.3	21.3
External	...	...	...	112.0	400.0	600.0	0.0	0.0	0.0	0.0
New Issuances	...	...	...	112.0	500.0	600.0	0.0	0.0	0.0	0.0
Amortizations	...	...	...	0.0	100.0	0.0	0.0	0.0	0.0	0.0
(percent of GDP)										
Revenue	19.6	19.6	19.5	20.6	18.8	19.2	19.3	19.4	19.5	19.6
Tax Revenue	13.7	13.7	13.3	12.3	12.7	13.0	13.1	13.2	13.3	13.3
Income	2.7	3.1	3.1	3.5	3.0	3.1	3.1	3.1	3.1	3.1
Goods and services	5.1	4.7	4.7	4.3	4.5	4.6	4.6	4.7	4.7	4.7
International trade	5.8	5.7	5.4	4.4	5.0	5.2	5.3	5.3	5.3	5.4
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	5.9	5.9	6.2	8.3	6.2	6.2	6.2	6.2	6.3	6.3
Expenditure	19.3	19.7	19.3	24.9	22.1	20.5	19.4	18.9	18.7	18.5
Current expenditure	17.4	17.9	17.3	22.1	19.5	18.5	17.5	17.1	16.9	16.8
Wages and salaries	6.0	6.1	6.0	7.1	6.7	6.6	6.4	6.2	6.1	6.0
Goods and services	3.3	3.5	3.3	3.8	4.1	3.7	3.4	3.3	3.2	3.1
Subsidies and transfers	7.6	7.8	7.5	10.7	8.1	7.7	7.2	7.2	7.2	7.2
Interest	0.5	0.5	0.4	0.5	0.6	0.5	0.4	0.4	0.4	0.4
Net acquisition of non-financial assets	1.8	1.8	2.1	2.8	2.7	2.1	2.0	1.7	1.7	1.7
Net acquisition of fixed assets	1.6	1.5	1.7	1.5	1.4	1.5	1.5	1.5	1.5	1.5
Capital transfers	0.2	0.3	0.4	1.3	1.3	0.6	0.5	0.3	0.3	0.3
Primary balance	0.8	0.4	0.6	-3.8	-2.8	-0.9	0.3	1.0	1.3	1.5
Net lending/borrowing	0.3	-0.1	0.2	-4.3	-3.3	-1.4	-0.1	0.5	0.9	1.1
Financing										
Net acquisition of financial assets	...	...	...	7.1	5.0	-3.3	-6.5	0.4	0.7	0.9
Domestic	...	...	...	7.1	5.0	-3.3	-6.5	0.4	0.7	0.9
External	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	...	...	...	11.3	8.3	-2.0	-6.4	-0.2	-0.2	-0.2
Domestic	...	...	...	6.8	-6.8	-23.5	-6.4	-0.2	-0.2	-0.2
New Issuances	...	...	...	20.8	0.6	0.6	0.5	0.5	0.5	0.5
Amortizations	...	...	...	13.9	7.4	24.1	6.9	0.7	0.7	0.7
External	...	...	...	4.5	15.1	21.6	0.0	0.0	0.0	0.0
New Issuances	...	...	...	4.5	18.9	21.6	0.0	0.0	0.0	0.0
Amortizations	...	...	...	0.0	3.8	0.0	0.0	0.0	0.0	0.0
Memorandum items										
Gross Financing Needs (millions of euros)	...	...	...	452.4	384.2	708.2	205.7	4.5	0.0	0.0
Percent of GDP	...	...	...	18.2	14.5	25.4	7.0	0.1	0.0	0.0
Public Debt (millions of euros)	911.8	904.0	920.8	1,202.5	1,422.0	1,367.0	1,181.2	1,175.4	1,169.6	1,163.8
Percent of GDP	34.3	33.2	32.7	48.4	53.8	49.1	40.4	38.4	37.1	35.7
Nominal GDP (in millions of euros)	2,655.8	2,725.3	2,818.4	2,484.2	2,644.7	2,783.6	2,923.5	3,057.5	3,155.2	3,256.3

Sources: Govern d'Andorra Department of Statistics, Andorran authorities and IMF staff calculations.

Note: The central government comprises Govern d'Andorra, as well as non-market public corporations and nonprofits.

**Table 6. Andorra: Balance of Payments**

	2017	2018	2019	Estimate 2020	Projections					
					2021	2022	2023	2024	2025	2026
(millions national currency)										
Current account	...	...	507.6	353.9	409.7	455.7	504.7	549.4	585.0	621.6
Balance of goods and services	376.7	296.6	270.5	144.9	187.2	221.5	258.8	292.2	319.5	347.6
Imports of goods	1,242.7	1,292.6	1,316.5	1,310.6	1,355.2	1,408.0	1,455.9	1,500.1	1,534.3	1,570.9
Exports of goods	106.3	112.3	116.1	142.9	122.0	128.4	132.9	137.3	141.6	146.1
Imports of services	415.5	466.8	498.8	439.8	465.4	484.4	501.9	516.1	523.8	531.5
Exports of services	1,928.5	1,943.7	1,969.6	1,752.4	1,885.7	1,985.5	2,083.7	2,171.1	2,236.0	2,304.0
Primary income, net	...	...	274.4	241.9	257.5	271.0	284.6	297.7	307.2	317.0
Secondary income, net	...	...	-37.3	-32.9	-35.0	-36.8	-38.7	-40.5	-41.7	-43.1
Capital account	...	...	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	...	...	509.2	353.9	409.7	455.7	504.7	549.4	585.0	621.6
Direct investment, net	...	...	-286.1	...	...	...	...	...	...	...
Portfolio investment, net	...	...	83.8	...	...	...	...	...	...	...
Financial derivatives, net	...	...	N.A.	...	...	...	...	...	...	...
Other investment, net	...	...	711.6	...	...	...	...	...	...	...
Reserve assets	...	...	N.A.	...	...	...	...	...	...	...
Errors and omissions	...	...	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(in percent of GDP)										
Current account	...	...	18.0	14.2	15.5	16.4	17.3	18.0	18.5	19.1
Balance of goods and services	14.2	10.9	9.6	5.8	7.1	8.0	8.9	9.6	10.1	10.7
Imports of goods	46.8	47.4	46.7	52.8	51.2	50.6	49.8	49.1	48.6	48.2
Exports of goods	4.0	4.1	4.1	5.8	4.6	4.6	4.5	4.5	4.5	4.5
Imports of services	15.6	17.1	17.7	17.7	17.6	17.4	17.2	16.9	16.6	16.3
Exports of services	72.6	71.3	69.9	70.5	71.3	71.3	71.3	71.0	70.9	70.8
Primary income, net	...	...	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7
Secondary income, net	...	...	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Capital account	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	...	...	18.1	14.2	15.5	16.4	17.3	18.0	18.5	19.1
Direct investment, net	...	...	-10.2	...	...	...	...	...	...	...
Portfolio investment, net	...	...	3.0	...	...	...	...	...	...	...
Financial derivatives, net	...	...	...	...	...	...	...	...	...	...
Other investment, net	...	...	25.2	...	...	...	...	...	...	...
Reserve assets	...	...	...	...	...	...	...	...	...	...
Errors and omissions	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items</b>										
Nominal GDP (in millions of euros)	2,656	2,725	2,818	2,484	2,645	2,784	2,924	3,058	3,155	3,256
Gross international reserves (in millions of euros)	...	0.0	0.0	61.6	61.6	61.6	61.6	61.6	61.6	61.6
Gross international reserves (in months of imports)	...	0.0	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total external debt (in millions of euros)	5,343	4,977	4,251	...	...	...	...	...	...	...
of which: Short term (in millions of euros)	3,511	3,370	3,134	...	...	...	...	...	...	...

Source: Andorran authorities and IMF staff calculations.

**Table 7. Andorra: Financial Soundness Indicators**  
(in percent)

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
<b>Core FSIs for Deposit takers</b>									
Regulatory capital to risk-weighted assets	20.4	20.1	20.4	19.9	21.8	20.3	21.3	20.9	21.7
Regulatory Tier 1 capital to risk-weighted assets	20.1	19.8	20.0	19.1	21.0	19.4	20.4	20.0	20.8
Nonperforming loans net of provisions to capital	21.6	21.2	23.4	23.2	21.4	20.7	19.6	19.7	18.4
Nonperforming loans to total gross loans	7.1	7.1	7.6	7.0	7.3	6.3	6.5	5.9	6.1
Sectoral distribution of loans to total loans									
Residents	62.0	63.7	59.4	58.3	61.8	55.3	58.3	52.7	55.8
Deposit-takers	1.0	1.6	1.6	3.7	3.0	2.2	2.0	3.1	1.8
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	1.2	1.4	1.2	1.2	1.8	1.5	2.0	1.6	2.6
General government	2.9	3.0	3.0	2.7	3.0	2.7	2.3	1.9	2.0
Nonfinancial corporations	27.8	27.0	24.8	23.9	28.0	25.4	27.4	24.4	25.0
Other domestic sectors	29.2	30.6	28.8	26.9	26.1	23.5	24.7	21.7	24.5
Nonresidents	35.4	36.0	39.6	41.7	38.2	44.7	41.7	47.3	44.2
Return on assets	0.7	0.2	0.3	0.3	0.7	0.2	0.4	0.5	0.5
Return on equity	7.1	2.1	2.6	3.3	6.0	2.2	3.3	4.3	4.4
Interest margin to gross income	22.9	20.4	22.2	23.5	21.6	19.9	21.2	22.0	21.2
Noninterest expenses to gross income	76.1	71.1	78.4	80.6	74.6	65.8	71.0	76.2	75.2
Liquidity coverage ratio (LCR) 1/ 2/	235.9				223.0				187.1
Liquid assets to short-term liabilities 2/	23.2	24.2	21.6	21.8	15.0	22.4	17.5	20.0	14.4
Net open position in foreign exchange to capital	0.0	73.0	5.3	13.5	0.9	4.9	0.0	0.0	0.0
<b>Encouraged FSIs for Deposit takers</b>									
Capital to assets	10.3	10.6	10.4	10.5	11.0	10.7	11.2	10.8	11.5
Large exposures to capital	137.0	133.7	140.1	140.0	134.0	142.9	132.8	147.1	104.7
Gross asset position in financial derivatives to capital	8.9	8.1	8.9	9.3	8.7	16.5	14.6	14.2	13.5
Gross liability position in financial derivatives to capital	12.7	12.3	12.3	13.3	10.9	18.7	16.6	16.7	13.4
Trading income to total income	10.2	12.3	10.0	11.4	10.8	4.0	14.7	14.2	13.9
Personnel expenses to noninterest expenses	48.1	46.5	46.3	46.1	48.8	49.6	47.8	48.4	48.9
Customer deposits to total (noninterbank) loans	146.5	149.0	148.2	149.3	149.2	154.7	152.8	153.8	150.7
Foreign-currency-denominated loans to total loans	0.0	0.1	0.0	1.2	0.1	0.8	0.0	0.0	0.0
Foreign-currency-denominated liabilities to total liabilities	18.2	16.0	21.4	23.8	22.6	23.8	24.5	24.0	21.6

Source: Andorran authorities.

1/ The LCR is defined as the ratio between high-quality liquid assets and net liquidity outflows in a 30-day stress period.

2/ The definition of liquid assets has changed in 2019 from including all exchange-traded securities to including only those financial assets that are held for trading.

## Annex I. Arrangements with the European Union

### Monetary Agreement

**The agreement permits the Banque de France (BdeF) and Banco de España (BdeE) to issue low-denomination euro coins on Andorra’s behalf since 2012.** In return, Andorra has committed to adopt all EU banking and financial sector directives and regulations within a 10-year horizon. It has also committed to prevent counterfeiting and to address AML/CFT risks. Banking supervisors are eligible for technical assistance from the ECB under this agreement.

**Andorra adopted Basel III capital rules through the EU’s Capital Requirements Directive (CRD IV) and Regulation (CRR) in 2019, phasing in a proportionate set of rules for its banks and investment firms through 2022.** Most of the other legislations have already been transposed. The legal text of the agreement makes it clear that the eurosystem will not deal with or accept Andorran securities for eurozone monetary policy purposes.

**A Joint Committee for the Monetary Agreement—comprising representatives from Andorra, the European Commission (EC), the European Central Bank (ECB), BdeF, and BdeE—meets once a year.** The Andorran delegation is represented by the Ministries of Finance, Foreign Affairs, and Justice and Interior; Andorran Financial Authority (AFA), which is the single supervisor for all financial institutions; Agència Estatal de Resolució de Entitats (AREB) which is the bank resolution authority, and Unitat d’Intelligence Financera d’Andorra (UIFAND) which is in charge of AML/CFT supervision and enforcement. The Committee assesses Andorra’s progress on adopting financial sector legislations and decides on the maximum amount of issuance of euro coins for Andorra.

### Association Agreement

**Andorran authorities have been discussing progressive access to the EU internal market since December 2014.** The aim of this agreement is to enable small states such as Andorra to participate in the EU’s single market while respecting their specificities, in line with the Declaration 3 of Article 8 of the Treaty of the Functioning of the European Union. Their level of market access should, in due course, be comparable to that enjoyed by the European Economic Area Members—EU member states, and Iceland, Liechtenstein and Norway.

**The Andorran government views the Association agreement as an opportunity to diversify the economy and considers it to be a priority.** In return, Andorra is fully committed to the international standards of transparency and exchange of information. In this regard, the Andorran authorities have committed to improve their legal framework according to the international standards while ensuring a level playing field. So far, the EU and the Andorran authorities have been able to agree on the institutional framework and the free movement of goods (among the four freedoms of goods, services, capital, and labour enshrined in the EU Treaty).

## Annex II. Fiscal Rule

**A set of rules ensure fiscal discipline and sustainability in Andorra since 2014 after the Global Financial Crisis.** The law (Law 32/2014), and subsequent modifications, introduced a multi-annual budget framework that covers the four-year central and local governments' mandates and is updated every year. It sets limits to debt, deficit, current spending, and revenue. The Court of Auditors is responsible for controlling the compliance with the obligations established by the Law.

Items	Limits under the Law
<b>Debt</b>	
General government 1/	55 percent of nominal GDP
Central government 2/	40 percent of nominal GDP
Public or para-public institutions associated with the central government	50 percent of each institution's own equity
Local government (incl. public and para-public institutions associated with the local government)	200 percent of the average budgeted revenues in the preceding 3 years
<b>Deficit</b>	
Overall deficit of the central government 2/	1 percent of nominal GDP
Overall deficit of the local government (incl. public and para-public institutions associated with the local government)	No limit, as long as the local government complies with the debt limit
<b>Current Spending</b>	
Growth of current primary spending of the general government 1/ 3/	Up to the nominal GDP growth if positive, or zero otherwise; the limit does not apply to the local government if its debt (incl. public and para-public institutions associated with the local government) is below 180 percent of the average budgeted revenue in the preceding three years
<b>Revenue</b>	
Direct Taxes	40 percent of total tax collection (excluding taxes from international trade)
1/ For the purpose of this annex, the general government includes the central and local governments and excludes the pension fund. 2/ The central government, for the purpose of this annex, corresponds to Govern d'Andorra and any public or para-public institutions associated with it. 3/ Current primary spending is defined as the sum of wages and salaries, goods and services and current transfers.	

**The fiscal framework includes an escape clause, which was activated in 2020 due to the fiscal impact of the COVID-19 pandemic.** The debt and spending limits associated with the central government can only be exceeded under extraordinary circumstances, comprising natural disasters, serious emergencies, and extraordinary events, including those of economic nature. When this happens, the General Council of the Parliament should approve: (i) an extraordinary budget that exceeds the debt and spending limits established by the Law; and (ii) a plan that sets the path to return to compliance with the debt and spending limits within six years. To finance the extraordinary expenses, the Law creates a structural fund (*'compte de compensació'*) that should be endowed with an amount equivalent to 0.1 percent of the total budgeted expenses of the central and local governments. The escape clause does not apply to the local governments, which should always comply with the limits established by the Law. If under exceptional circumstances the budget allocation for the local governments is not enough, the extraordinary need should be covered by the central government.

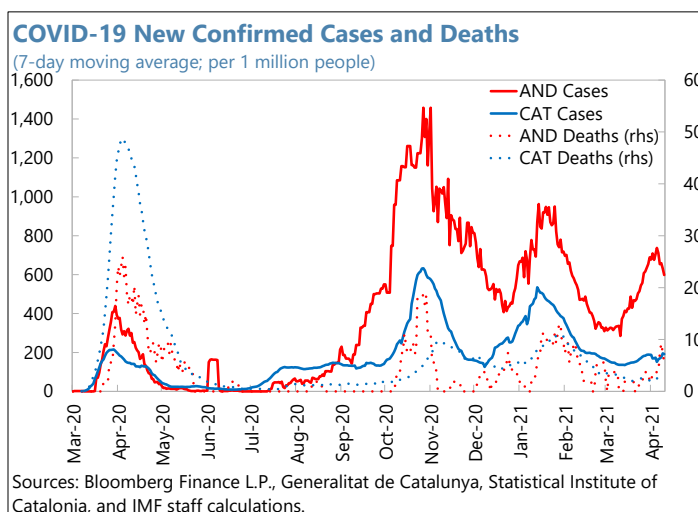
## Annex III. COVID-19 Cases and Economic Impact: is Universal Testing Helping Andorra?<sup>1</sup>

*Andorra was hit hard by COVID-19, but universal testing allowed the country to adopt less stringent measures than Spain. Compared to the neighboring Spanish region, Catalonia, Andorran activity was recovering better, while the neighbors had their borders open, with contained death rates.*

### Universal testing partly explains the high number of confirmed cases in Andorra.

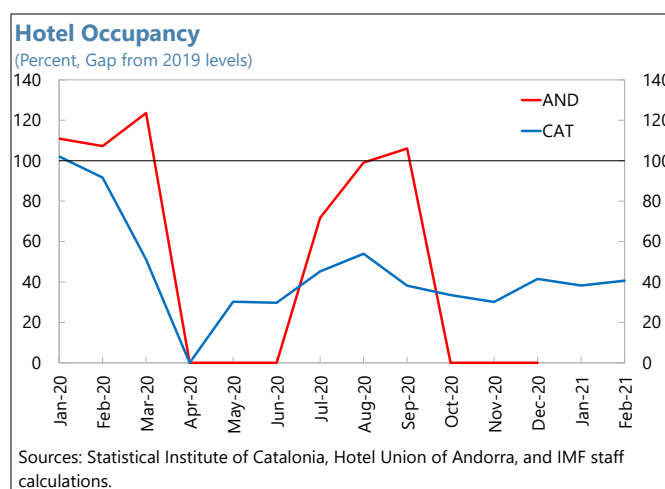
The authorities made testing the centerpiece of their prevention strategy. Andorra has among the highest rates of testing in Europe, with about 2.5 tests per person on average, while Catalonia’s rate is only one test per person. The phased reopening that started in May 2020 was accompanied by widespread testing, with enough tests for the entire Andorran population. The strategy for the winter season involved regular screenings in schools, long-term

care, and healthcare facilities, and in retail and tourism firms. In addition, three rapid, self-administered antigen tests were distributed for free to all residents over the age of six to prevent the spread of the disease during the winter holidays.



### Large testing efforts with data-driven policy decisions, as well as the spillovers from higher stringency in the neighboring countries, allowed Andorra to adopt less stringent containment measures (Figure 6).

An analysis of linkages between economic sectors informed the authorities’ decisions during the reopening phase to focus on those sectors that are more connected to the rest of the economy and that have a high impact on employment. Furthermore, [Doorley et al. \(2021\)](#), as part of a joint



project between Andorra’s [Innovation Hub and MIT](#), find that the spread of the virus was highly correlated with inter-parish transmission and with crowding episodes, and less related to tourism. These findings may have been used by the government to promote the arrival of tourists under strict health protocols during the summer and to limit social gatherings and other spreading events

<sup>1</sup> Prepared by Ana Lariau (EUR).

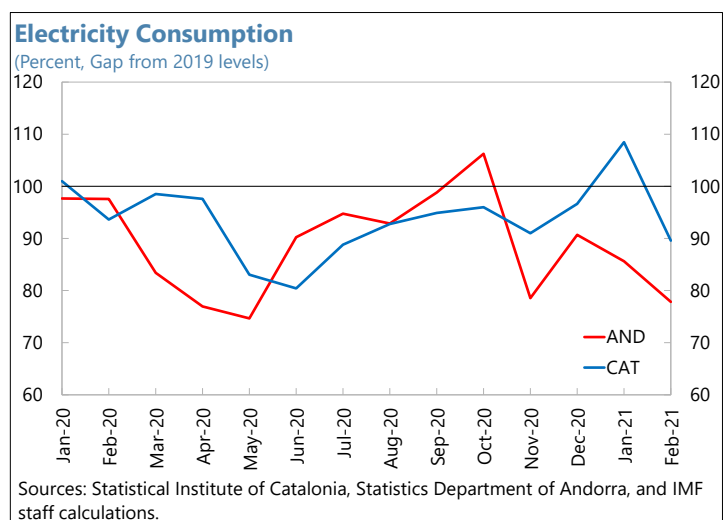


to control the sharp increase in cases since September. In addition, analysis of high-frequency health data not only supported an active communication campaign but also helped the authorities to make quick decisions on the relaxation or tightening of containment measures.

**High frequency indicators show that Andorra’s economy suffered less than Catalonia when borders were open.**

More widespread and rapid testing, while increasing the statistics on cases, can help contain the spread of the virus and cushion the economic shock ([Dizioli, Andrie, and Bluedorn, 2020](#)). While hotel occupancy in April 2020 was zero in both Andorra and Catalonia, Andorra's occupancy rate quickly recovered to pre-crisis levels during the summer season (keeping death/cases low) but

Catalonia’s remained subdued, at about half the levels observed in previous years. In September, electricity consumption in Andorra had already caught up to 2019 levels, while Catalonia’s was still 5 percent short. These trends reversed since October 2020 due to France and Spain’s decision to close their borders until early-April, amid the several waves of infections. While tourism in Andorra has been completely disrupted—including during the peak of the ski season in the first quarter of 2021—Catalonia’s economy was supported by internal tourism.



Annex IV. Risk Assessment Matrix<sup>1</sup>

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
<b>Conjunctural Risks</b>			
<b>Unexpected shift in the Covid-19 pandemic</b>	<b>Medium Downside.</b> The disease proves harder to eradicate, requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. Prolonged support is needed to cushion the economy but exacerbates stretched asset valuations, fueling financial vulnerabilities. <b>Upside.</b> Pandemic is contained faster than expected due to the rapid production and distribution of vaccines.	<b>High Downside.</b> Protracted containment measures and a slower reactivation of the tourism sector would delay the recovery and produce greater scarring effects. Deterioration in banks' asset quality would lead to capital shortfalls and limit the lending channel. Prolonged fiscal support and lower revenues would put further pressure on fiscal accounts and debt. <b>Upside.</b> Faster-than-expected recovery would boost confidence and economic activity, though some scarring effects would remain.	<ul style="list-style-type: none"> <li>Scale up measures already in place.</li> <li>Realign policy support measures towards incentivizing reallocation of resources while supporting affected workers during the transition.</li> <li>Ensure the financial sector's capacity to support the real economy through credit growth.</li> <li>Accelerate the unwinding of rescue measures, while ensuring that it does not disrupt the recovery process.</li> </ul>
<b>Sharp rise in global risk premia</b>	<b>Medium.</b> A reassessment of market fundamentals (e.g., in response to adverse Covid-19 developments) triggers a widespread risk off event, exposing financial and fiscal vulnerabilities.	<b>High.</b> Higher risk premia could generate financing difficulties for firms and households, and a wave of bankruptcies could erode banks' capital buffers. Government financing may become scarcer and more costly as the government accesses international markets for the first time. Bank profitability—given the private banking model—could come under pressure.	<ul style="list-style-type: none"> <li>Continue to diversify the government's financing base and reducing gross financing needs.</li> <li>Build reserve assets to cushion for possible liquidity shortages faced by the government.</li> </ul>
<b>Structural Risks</b>			
<b>Higher frequency and severity of natural disasters related to climate change</b>	<b>Medium.</b> Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruption.	<b>High.</b> Climate change is affecting Andorra's ski slopes. An increase in temperatures reduce the amount of snow, leading to shorter skiing seasons and negatively impacting the Andorran tourism-based economy.	<ul style="list-style-type: none"> <li>Adopt policies to adapt to climate change while transitioning to greener goals.</li> <li>Provide targeted support to most vulnerable sectors, particularly tourism.</li> </ul>
<b>Domestic Risks</b>			
<b>Higher-than-expected call on government guarantees</b>	<b>Medium.</b> Increasing stress in the real sector could impose a larger call on government guarantees.	<b>High.</b> A sudden increase of the government's gross financing needs, without a well-diversified funding base, could require temporary stops to government funding/transfer programs leading to an even weaker recovery.	<ul style="list-style-type: none"> <li>Maintain fiscal sustainability by continuing to adhere to the fiscal rule.</li> <li>Continue diversifying the government's funding base and reducing gross financing needs.</li> </ul>
<b>Excessive stress on the banking sector</b>	<b>Medium.</b> The lifting of loan and insolvency moratoria, as well as the expiration of fiscal measures in the corporate sector, may reveal large loan losses for banks. Sizeable gross external liabilities would pose systemic liquidity risks.	<b>High.</b> Increase in capital needs of banks. Due to the size and systemic nature of banks, this could increase contingent liabilities of the government and lead to higher funding costs for the private and public sectors.	<ul style="list-style-type: none"> <li>Assess bank capital needs</li> <li>Strengthen bank supervision to reduce related party risks and liquidity risks.</li> </ul>
<b>Setbacks in closing AML/CFT gaps</b>	<b>Medium.</b> Delays in aligning the Andorran AML/CFT legal framework with FATF standards.	<b>High.</b> Reputational damage, reduced external funding and access to international financial services, higher borrowing costs, and increased scrutiny of Andorran entities.	<ul style="list-style-type: none"> <li>Strengthen AML/CFT risk-based supervision, the sanctioning of ML activities and the recovery of proceeds of crime.</li> </ul>

<sup>1</sup> The Risk Assessment Matrix shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. "Low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more.

## Annex V. Public Debt Sustainability Assessment

*Andorran public debt remains sustainable under the baseline scenario and under a high public investment scenario. Debt increased beyond the fiscal debt limits in 2020 reflecting the deterioration of the primary balance, the accumulation of debt repayments, and the authorities pre-financing strategy. Starting in 2022, the debt ratio is set to decline rapidly to pre-pandemic levels, a sizable but credible consolidation effort supported by the authorities track-record of prioritizing fiscal discipline. With careful consideration of gross financing needs and projects' soundness, the authorities have adequate space to increase infrastructure spending beyond the baseline levels, while also building fiscal buffers. However, a negative shock to real GDP growth or a sharp increase in contingent liabilities could slow the consolidation pace and worsen debt dynamics even though debt remains sustainable under such scenarios.*

### A. Background

**This DSA is produced in the context of Andorra's first Article IV Consultation.** The DSA covers the general government debt, encompassing the central government debt, and the local government debt, and social security funds.<sup>1</sup> Over 90 percent of the public debt is owed by the central government. Central government guarantees of up to €230 million are not included in the baseline scenario, but a contingent liability shock—based on calls on guarantees—has been included as part of the analysis. The Law 32/2014, and subsequent modifications, aimed at ensuring fiscal discipline in Andorra sets limits to the debt of general government (excluding pension fund) and the central government at 55 and 40 percent of GDP, respectively, among other fiscal rules (Annex II). These limits can be exceeded only under extraordinary circumstances by activating an escape clause. This happened in 2020 due to the fiscal impact of the COVID-19 pandemic but the authorities aim to be below the limit within three years.

**Public debt levels prior to the pandemic remained well below the debt limits imposed by the fiscal rule, reflecting Andorra's strong fiscal position.** The general government debt stock averaged 39.2 percent of GDP in 2010–2018, reaching a peak of 42.5 percent of GDP in 2013 and gradually declining to 35.4 percent of GDP in 2019. However, debt rose sharply in 2020 to 51.5 percent of GDP reflecting the deterioration of the primary balance amidst the COVID-19 crisis, the accumulation of debt repayments; as well as part of the authorities' pre-financing strategy that leads to a large but temporary increase in net acquisition of financial assets to be used for future debt service.

**However, due to the short maturity of debt, gross financing needs have been relatively high historically, despite the government efforts to persistently sustain primary surpluses.** Historical debt stocks consisted primarily of domestic bonds with average maturity of about three years which

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<sup>1</sup> Historical data on debt stocks and flows are preliminary at this stage. The mission is working closely with the authorities to verify the composition of the debt stocks and flows by instrument, and to incorporate data on net acquisition of financial assets and other debt-creating flows.

were typically rolled over at the time of maturity. These dynamics, while not substantially increasing public debt over time, resulted in average annual gross financing needs of 8.8 percent of GDP in 2010–2019.

## B. Baseline Scenario

**Public debt is projected to increase further in 2021—due to the authorities pre-financing strategy—and to decline rapidly afterwards.** The authorities issued Eurobonds worth €500 million in 2021, with a maturity of 10 years, as part of a program totaling €1.2 billion over 2021–22. Such a debt reprofiling would help to diversify funding sources and lower annual gross financing needs in coming years, while taking advantage of favorable market conditions. Even though this strategy increases central government’s debt by 10 percentage points of GDP to 56.7 percent of GDP in 2021, the debt service will decline significantly from 2023 onwards, freeing fiscal resources for other needs including for the gradual buildup of fiscal buffers. Moreover, the positive impact on revenue of the recovery of economic activity, coupled with the rollback of the COVID-19 related measures, will lead to general government primary surpluses starting from 2022, and central government primary surpluses starting from 2023. The combined effect of improved fiscal balances and lower debt service is expected to put debt on a declining path, reaching the fiscal rule target of the general government by 2022 and of the central government by 2024. Under the baseline scenario, gross general government debt is expected to reach 38.1 percent by 2026 and continue its declining path over the long-term.

### Underlying Assumptions and Realism of Projections

**Although with high uncertainty, the baseline scenario assumes significant scarring in the medium-term and convergence to the Euro Area (EA) average GDP growth rate by 2025.**

Following an estimated fall of 11.8 percent in 2020, real GDP is projected to recover by 5.8 percent in 2021, remain strong in 2022 as the world economy recovers fully from the pandemic, and eventually converge to the EA average by 2026. Higher revenues during the recovery and the roll-back of COVID-19 measures will lead to primary surpluses from 2022 in line with the authorities’ plan to rapidly consolidate and reduce its public debt stock. Inflation for 2021 is estimated at 0.3 percent, and projected to remain subdued in the short-term, only slowly rising toward EA levels by 2025. Sovereign borrowing spreads are assumed to be uniformly 147 bps above German yields for all maturities in line with the actual yield on privately placed external bonds in April 2021.

**Assessing the realism of projections, cross-country experience suggests that Andorra’s projected adjustment is credible yet sizable.** The projected adjustment and level of the cyclically-adjusted primary balance (CAPB) are below the threshold that would cast doubt on the feasibility of the adjustment, based on high-debt country experience.<sup>2</sup> The near-term adjustment in the CAPB is large compared with cross-country experience but reflect the sizable but temporary COVID-19 measures, which are largely assumed to expire in 2021 followed by rapid consolidation and decline

<sup>2</sup> In the absence of potential output estimate due to data constraints, it is not possible to estimate the CAPB. The current estimate reflects the actual primary balance.

in gross financing needs. The credibility of the consolidation effort is also supported by the authorities track-record of staying within the broad parameters of their medium-term fiscal framework, which prioritizes debt sustainability.

### **Stress Tests and Alternative Scenarios**

#### **Standard stress tests' scenarios suggest that a shock to real GDP growth would significantly worsen debt dynamics, slowing debt consolidation and increasing gross financing needs.<sup>3</sup>**

Under this scenario: (i) public debt declines only to 51.2 by 2026 (compared to 38.1 under the baseline); (ii) gross debt in percent of revenue declines from 147.4 in 2021 to 131 in 2026, instead of 97.5 percent under the baseline; and (iii) gross financing needs peak at 27.4 percent of GDP in 2022, compared to 23.7 under the baseline scenario. Alternatively, shocks to the primary balance, the real exchange rate, or the real interest rate do not lead to significant deviations from the baseline.

**Moreover, an alternative scenario of a contingent liability shock would also result in higher debt ratios and gross financing needs.** The contingent liability shock assumes a one-time increase in non-interest expenditures equivalent to 1 percent of banking sector assets leading to a real GDP growth shock. This represents a call on 25 percent of €135 million worth of outstanding public guarantees provided for bank loans to liquidity-strapped companies as part of the COVID-19 related measures, and additional 2 percent of GDP for the case of an adverse shock in the banking sector. Under this scenario, gross financing needs peak at 30.8 percent of GDP in 2022. This is 7.1 percentage points higher than the baseline, of which 5.1 percentage points of GDP result from the outstanding public guarantees.

**In contrast, a modest increase in public investment financed with new debt could support the economic recovery and would not lead to significant increases in public debt.** Assuming an increase of around 1 percent of GDP in 2021–2023—financed by issuing €100 million extra long-term debt—would keep debt ratios close to the baseline scenario as the positive impact on GDP growth outweighs the burden of the additional cost (see main text, Figure 12). If carefully selected, public investment projects could support the economic recovery as the fiscal multiplier of investment and job-creating potential are assumed to be high in the post-pandemic recovery phase, and improved infrastructure would in turn positively affect long-term potential growth and strengthen the resilience and sustainability of the country.

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<sup>3</sup> The shock to real GDP growth assumes that real GDP growth in 2021 and 2022 is lower than in the baseline by one standard deviation; which in turn leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth), and the deterioration in primary balance lead to higher interest rate.

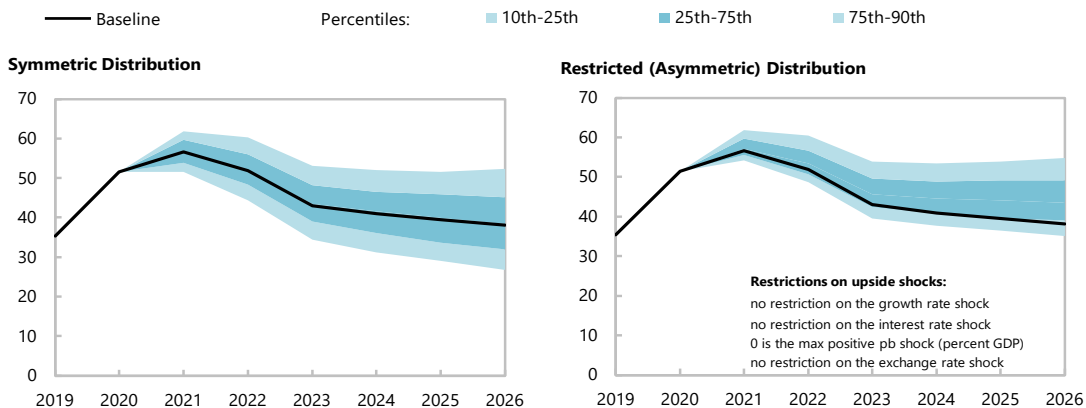
### Annex Figure V.1. Andorra: Public DSA Risk Assessment

#### Heat Map

Debt level <sup>1/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs <sup>2/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile <sup>3/</sup>	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

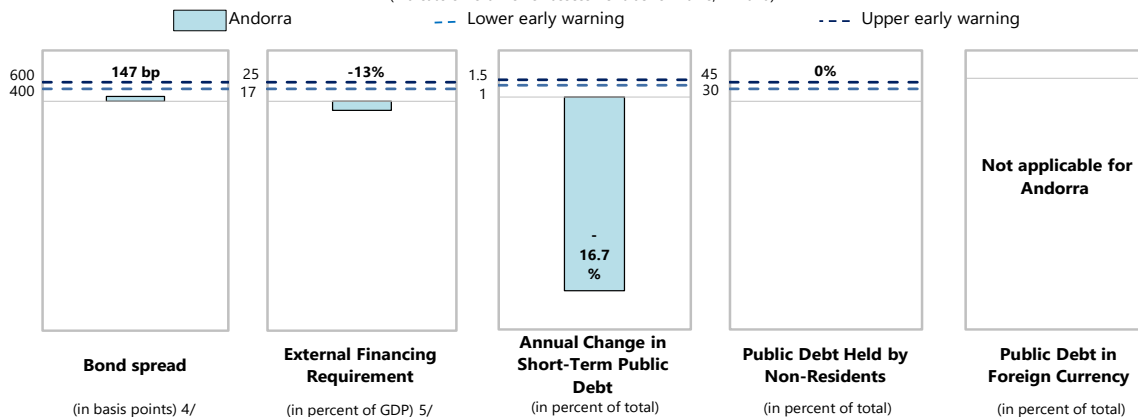
#### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



#### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

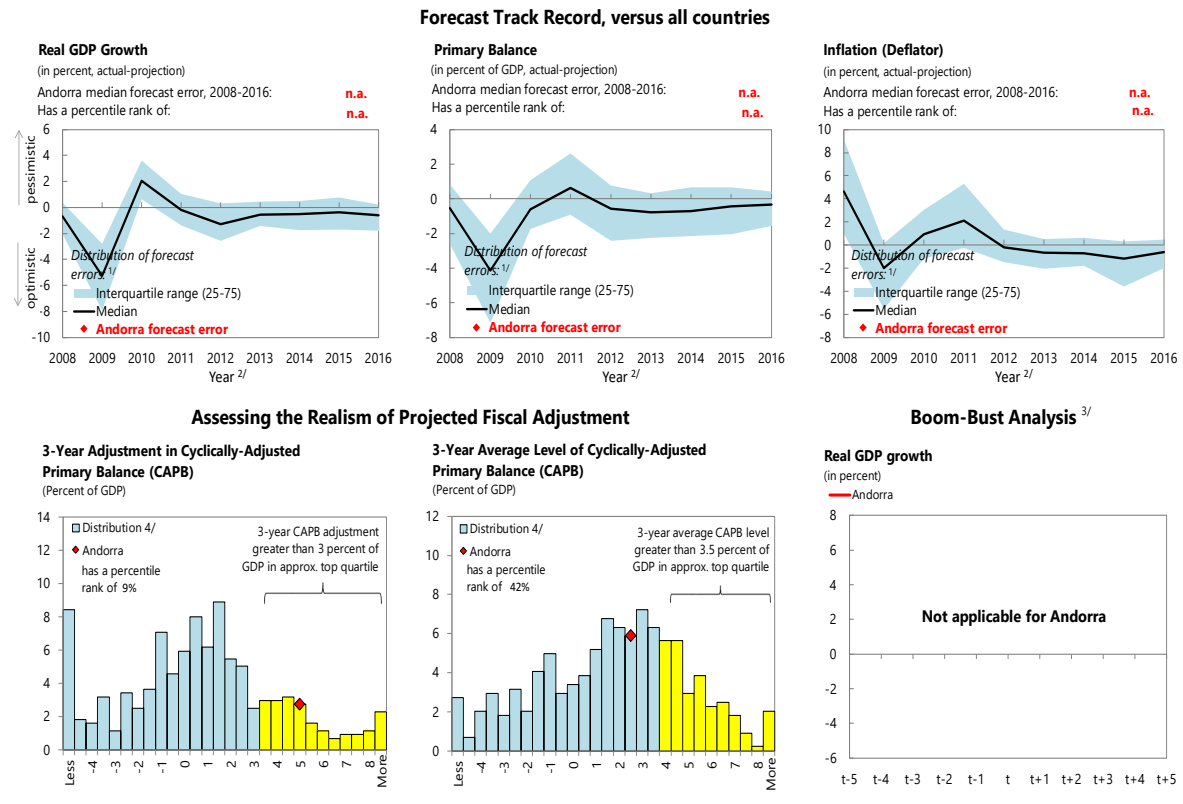
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 02-Feb-21 through 03-May-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

### Annex Figure V.2. Andorra: Public DSA—Realism of Baseline Assumptions

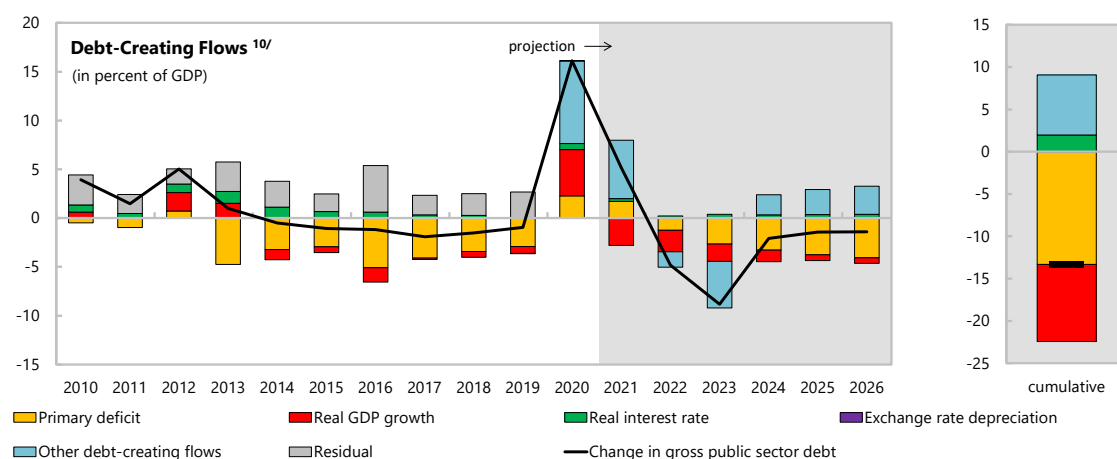


Source : IMF Staff.  
 1/ Plotted distribution includes all countries, percentile rank refers to all countries.  
 2/ Projections made in the spring WEO vintage of the preceding year.  
 3/ Not applicable for Andorra, as it meets neither the positive output gap criterion nor the private credit growth criterion.  
 4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

### Annex Figure V.3. Andorra: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario (in percent of GDP unless otherwise indicated)

	Debt, Economic and Market Indicators <sup>1/</sup>										As of May 03, 2021			
	Actual		Est.		Projections					Sovereign Spreads				
	2010-2018 <sup>2/</sup>	2019	2020	2021	2022	2023	2024	2025	2026	EMBIG (bp) <sup>3/</sup>	5Y CDS (bp)	Ratings	Foreign	Local
Nominal gross public debt	39.2	35.4	51.5	56.7	51.9	43.0	41.0	39.5	38.1					
Public gross financing needs	8.6	10.1	16.8	13.5	23.7	5.3	-1.5	-2.0	-2.4					
Real GDP growth (in percent)	-0.1	2.0	-11.8	5.8	4.1	3.6	2.8	1.5	1.5			Moody's	n.a.	n.a.
Inflation (GDP deflator, in percent)	0.5	1.4	-0.1	0.6	1.1	1.4	1.7	1.7	1.7			S&Ps	BBB	BBB
Nominal GDP growth (in percent)	0.4	3.4	-11.9	6.5	5.3	5.0	4.6	3.2	3.2			Fitch	BBB+	BBB+
Effective interest rate (in percent) <sup>4/</sup>	2.3	1.4	1.5	1.3	1.5	2.2	2.6	2.6	2.7					

	Contribution to Changes in Public Debt										debt-stabilizing primary balance <sup>9/</sup>
	Actual		Est.		Projections					cumulative	
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026		
Change in gross public sector debt	0.6	-0.9	16.1	5.2	-4.8	-8.8	-2.1	-1.4	-1.4	-13.4	
Identified debt-creating flows	-2.0	-3.6	16.1	5.2	-4.8	-8.8	-2.1	-1.4	-1.4	-13.4	
Primary deficit	-2.7	-2.9	2.3	1.7	-1.2	-2.6	-3.3	-3.8	-4.1	-13.3	2.7
Primary (noninterest) revenue and grants	34.3	38.0	41.1	38.4	38.6	38.7	38.8	39.0	39.1	232.8	
Primary (noninterest) expenditure	31.6	35.1	43.4	40.2	37.4	36.1	35.5	35.3	35.0	219.4	
Automatic debt dynamics <sup>5/</sup>	0.7	-0.7	5.3	-2.5	-2.0	-1.4	-0.8	-0.2	-0.2	-7.1	
Interest rate/growth differential <sup>6/</sup>	0.7	-0.7	5.3	-2.5	-2.0	-1.4	-0.8	-0.2	-0.2	-7.1	
Of which: real interest rate	0.7	0.0	0.6	0.3	0.2	0.4	0.3	0.4	0.4	2.0	
Of which: real GDP growth	0.0	-0.7	4.7	-2.8	-2.2	-1.8	-1.2	-0.6	-0.6	-9.1	
Exchange rate depreciation <sup>7/</sup>	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	8.5	6.0	-1.6	-4.8	2.0	2.5	2.9	7.1	
Net acq. of financial assets (negative)	0.0	0.0	8.5	6.0	-1.6	-4.8	2.0	2.5	2.9	7.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes <sup>8/</sup>	2.6	2.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as  $[(r - \pi(1+g) - g + ae(1+r)] / (1+g+\pi+g\pi)$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

10/ Historical data on net acquisition of financial assets and other debt-creating flows prior to 2020 are not included, resulting in a relatively large residual.

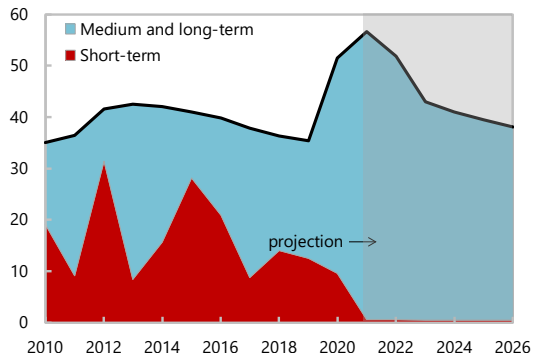


### Annex Figure V.4. Andorra: Public DSA—Composition of Public Debt and Alternative Scenarios

#### Composition of Public Debt

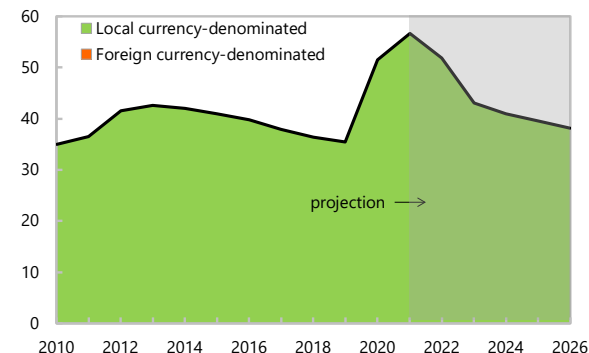
##### By Maturity

(in percent of GDP)



##### By Currency

(in percent of GDP)



#### Alternative Scenarios

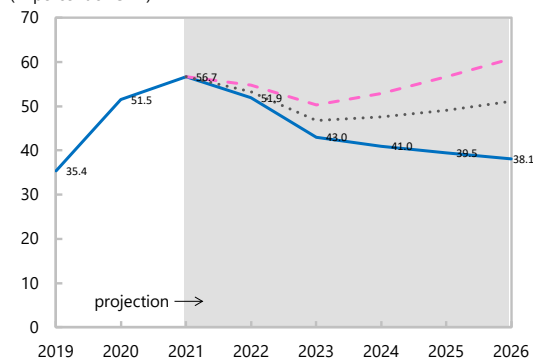
— Baseline

..... Historical

- - - Constant Primary Balance

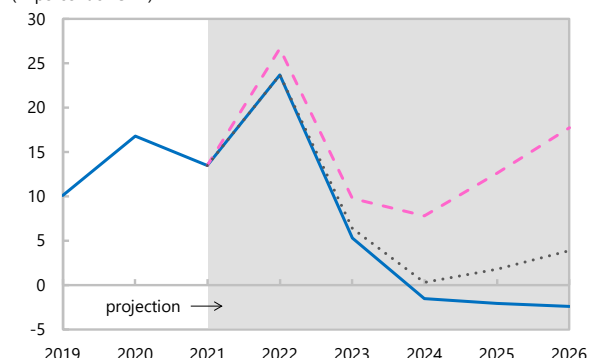
##### Gross Nominal Public Debt

(in percent of GDP)



##### Public Gross Financing Needs

(in percent of GDP)



#### Underlying Assumptions

(in percent)

##### Baseline Scenario

	2021	2022	2023	2024	2025	2026
Real GDP growth	5.8	4.1	3.6	2.8	1.5	1.5
Inflation	0.6	1.1	1.4	1.7	1.7	1.7
Primary Balance	-1.7	1.2	2.6	3.3	3.8	4.1
Effective interest rate	1.3	1.5	2.2	2.6	2.6	2.7

##### Constant Primary Balance Scenario

Real GDP growth	5.8	4.1	3.6	2.8	1.5	1.5
Inflation	0.6	1.1	1.4	1.7	1.7	1.7
Primary Balance	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	1.3	1.5	2.1	2.3	2.2	2.1

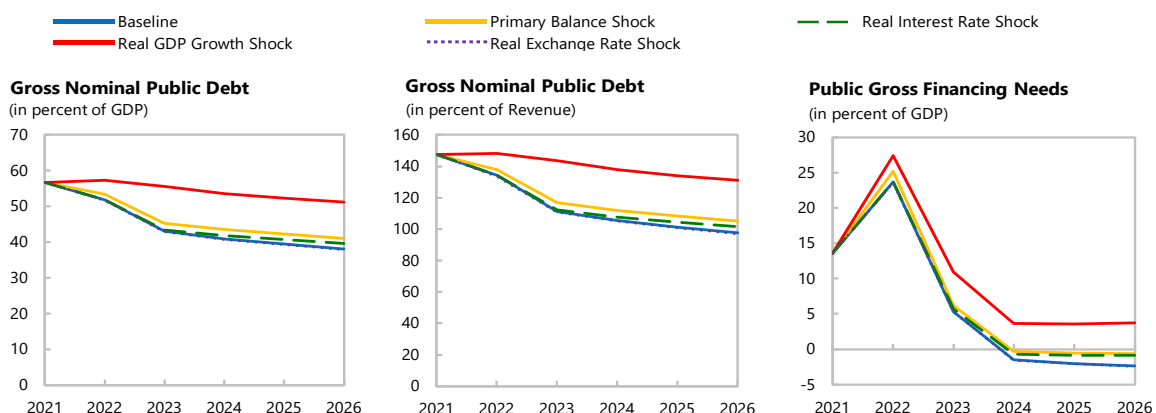
##### Historical Scenario

	2021	2022	2023	2024	2025	2026
Real GDP growth	5.8	-0.9	-0.9	-0.9	-0.9	-0.9
Inflation	0.6	1.1	1.4	1.7	1.7	1.7
Primary Balance	-1.7	2.4	2.4	2.4	2.4	2.4
Effective interest rate	1.3	1.5	2.5	2.9	2.9	2.9

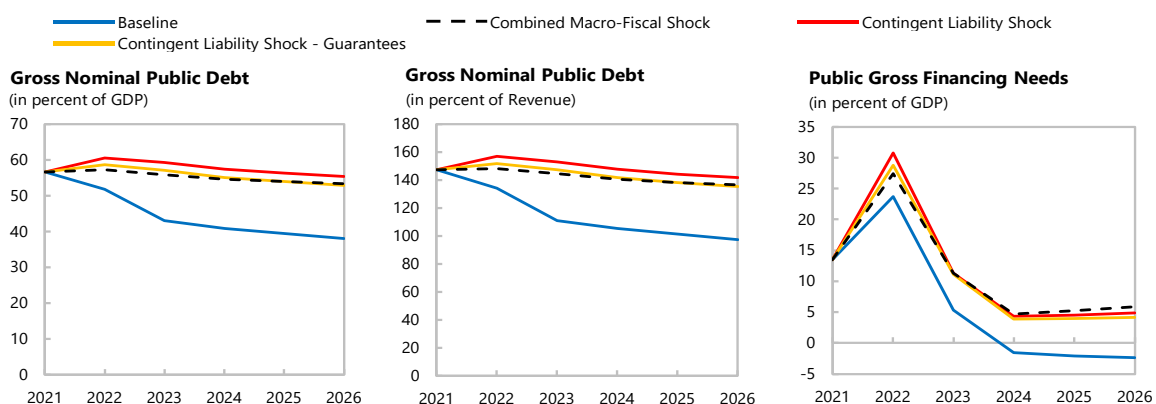
Source: IMF staff.

### Annex Figure V.5. Andorra: Public DSA—Stress Tests

#### Macro-Fiscal Stress Tests



#### Additional Stress Tests <sup>1/</sup>



#### Underlying Assumptions (in percent)

	2021	2022	2023	2024	2025	2026
<b>Primary Balance Shock</b>						
Real GDP growth	5.8	4.1	3.6	2.8	1.5	1.5
Inflation	0.6	1.1	1.4	1.7	1.7	1.7
Primary balance	-1.7	-0.2	1.9	3.0	3.5	3.9
Effective interest rate	1.3	1.5	2.3	2.7	2.7	2.8
<b>Real Interest Rate Shock</b>						
Real GDP growth	5.8	4.1	3.6	2.8	1.5	1.5
Inflation	0.6	1.1	1.4	1.7	1.7	1.7
Primary balance	-1.7	1.2	2.6	3.3	3.8	4.1
Effective interest rate	1.3	1.5	3.0	3.5	3.6	3.6
<b>Combined Shock</b>						
Real GDP growth	5.8	-0.6	-1.1	2.8	1.5	1.5
Inflation	0.6	-0.1	0.2	1.7	1.7	1.7
Primary balance	-1.7	-1.0	-1.8	3.0	3.5	3.9
Effective interest rate	1.3	1.5	3.0	3.3	3.4	3.4
<b>Contingent Liability Shock - Guarantees</b>						
Real GDP growth	5.8	-0.6	-1.1	2.8	1.5	1.5
Inflation	0.6	-0.1	0.2	1.7	1.7	1.7
Primary balance	-1.7	-2.4	-1.8	3.3	3.8	4.1
Effective interest rate	1.3	1.5	2.5	2.8	2.8	2.8
<b>Real GDP Growth Shock</b>						
Real GDP growth	5.8	-0.6	-1.1	2.8	1.5	1.5
Inflation	0.6	-0.1	0.2	1.7	1.7	1.7
Primary balance	-1.7	-1.0	-1.8	3.3	3.8	4.1
Effective interest rate	1.3	1.5	2.4	2.6	2.6	2.7
<b>Real Exchange Rate Shock</b>						
Real GDP growth	5.8	4.1	3.6	2.8	1.5	1.5
Inflation	0.6	1.5	1.4	1.7	1.7	1.7
Primary balance	-1.7	1.2	2.6	3.3	3.8	4.1
Effective interest rate	1.3	1.5	2.2	2.6	2.6	2.7
<b>Contingent Liability Shock</b>						
Real GDP growth	5.8	-0.6	-1.1	2.8	1.5	1.5
Inflation	0.6	-0.1	0.2	1.7	1.7	1.7
Primary balance	-1.7	-4.4	-1.8	3.3	3.8	4.1
Effective interest rate	1.3	1.6	2.8	3.0	3.0	3.0

Source: IMF staff.  
 1/ The "contingent liability shock" assumes the combination of a one-time increase in non-interest expenditures equivalent to 1.02% of banking sector assets (25% of €135 million outstanding with public guarantees plus 2% of GDP) and a standard real GDP shock, in which real GDP growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; level of non-interest expenditures is the same as in the baseline (plus the contingent liability); deterioration in primary balance lead to higher interest rate; decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth). The "contingent liability shock - guarantees" assumes the combination of a one-time increase in non-interest expenditures equivalent only to the public guarantees portion and a standard real GDP shock.



# PRINCIPALITY OF ANDORRA

May 18, 2021

## STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

### CONTENTS

FUND RELATIONS	2
STATISTICAL ISSUES	4

## FUND RELATIONS

(As of March 31<sup>st</sup>, 2021)

**Membership Status:** Joined October 16<sup>th</sup>, 2020.

<b>General Resources Account:</b>	SDR Million	Percent of Quota
Quota	82.50	100.00
IMF's holdings of currency	61.88	75.00
Reserve tranche position	20.63	25.00
<b>SDR Department:</b>	SDR Million	Percent of Allocation
Net cumulative allocation	35.37	100.00
Holdings	14.75	41.69
<b>Outstanding Purchases and Loans:</b>	None	
<b>Latest Financial Arrangements:</b>	None	

<b>Projected Payments to Fund</b>					
(SDR Million; based on present holdings of SDRs)					
	<b>Forthcoming</b>				
	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.01	0.01	0.01	0.01	0.01
<b>Total</b>	0.01	0.01	0.01	0.01	0.01

**2021 Article IV Consultation:** This is Andorra's first Article IV consultation. Discussions were held virtually on March 19–April 8, 2021.

**Exchange Rate Arrangements:** Andorra's legal tender is the euro. There is no central monetary institution. On June 30, 2011, Andorra signed a monetary agreement with the EU (in effect on April 1, 2012) which authorizes Andorra to use the euro as its official currency, grants legal tender status to euro banknotes and coins, and as of July 1, 2013, authorizes Andorra to issue limited quantities of euro coins. Andorra is not permitted to issue euro banknotes. The monetary agreement does not prejudice the right of Andorra to continue issuing collector coins denominated in diners, permitting the *Banque de France* and *Banca de España* to do so on Andorra's behalf in the absence a central bank. Foreign exchange transactions are conducted through commercial banks and other financial entities (e.g. financial investment companies, financial investment agencies and payment service providers) without restrictions and at market rates. There are no taxes or subsidies on purchases or sales of foreign exchange. Staff are currently conducting a comprehensive review of the exchange system to assess jurisdictional implications. The current classifications of Andorra's de jure and de facto exchange rate arrangements are "no separate legal tender."

**Technical Assistance:**

<b>Year</b>	<b>Department/Purpose</b>
2020–21	STA Balance of Payments Statistics
2021	MCM Bank Supervision (not yet started)

**Resident Representative:** None

## STATISTICAL ISSUES

(as of April 27<sup>th</sup>, 2021)

<b>I. Assessment of Data Adequacy for Surveillance</b>
<p><b>General:</b> Data provision is broadly adequate for surveillance, but widespread data gaps exist. Progress has been made since Andorra's membership to the IMF, particularly regarding Balance of Payments (BoP) statistics, but important weaknesses remain. GDP statistics are reported with lags, and the disaggregation by expenditure components is not available. Fiscal and monetary statistics are available with delays, at low frequency and level of disaggregation, and do not follow international dissemination standards as yet. While the reporting of Financial Soundness Indicators (FSIs) is adequate, there are inconsistencies with monetary statistics. An advance release calendar containing release dates for major macroeconomic statistics is not published. The authorities are planning to participate in the IMF's Enhanced General Data Dissemination System (e-GDDS).</p>
<p><b>National Accounts:</b> The level of GDP by economic sector at annual frequency is only available in nominal terms and published with a one-year lag. For the real GDP by economic sector only growth rates (not levels) are published, at quarterly frequency, with a lower level of disaggregation than the annual nominal series and with a three-month lag. Series of GDP by expenditure components are not available, neither in nominal nor in real terms.</p>
<p><b>Price Statistics:</b> The consumer price index and components are published at a monthly frequency.</p>
<p><b>Government Finance Statistics:</b> Fiscal data, at annual frequency, is reported with a three-to-six-month delay once the audit of the public sector accounts is complete. Detailed reports on monthly revenue collection and expenditure execution are needed for surveillance; the authorities shared data at quarterly frequency, covering only the central government, and with a three-month lag. Periodic reports on scheduled future debt service, distinguishing between amortization and interest payments, for both the central and the general government, are also needed; the authorities only shared future debt service data for the central government.</p>
<p><b>Monetary Statistics:</b> The authorities shared balance sheet data of banks for 2016–20, but with a low level of disaggregation. More granularity would be needed to produce the Other Depository Corporation survey according to international standards. The monetary and financial statistics (MFS) are not reported to IMF's Statistics Department.</p>
<p><b>Financial Sector Surveillance:</b> The authorities provided FSIs at quarterly frequency for the period 2018:Q4–2020:Q4; pre-2018 FSIs are not available due to significant changes in reporting. Staff identified inconsistencies on reporting of credit growth between the FSI data and monetary statistics. Data on financial health of corporates and households are not available. Real estate prices, residential and commercial, are only available on an annual basis. FSIs are not reported to IMF's Statistics Department.</p>

**External Sector Statistics:** Andorra has just started producing BoP statistics at annual frequency for 2019. While the Statistics Department of Andorra also started compiling International Investment Position (IIP) statistics, they are still at a preliminary stage and remain work in progress. In the meanwhile, IMF staff made an initial attempt to reconstruct IIP statistics by combining banking sector data received from the authorities with mirror data from the IMF's Coordinated Direct Investment Survey (CDIS) and the BIS' Locational Banking Statistics (see Selected Issues Paper: *Current Account Balance and External Competitiveness*).

## II. Data Standards and Quality

The authorities are planning to participate in the Enhanced General Data Dissemination System (e-GDDS).

No data ROSC available.

**Andorra: Common Indicators Required for Surveillance**(As of April 27<sup>th</sup>, 2021)

	<b>Date of latest observation</b>	<b>Date received</b>	<b>Frequency of Data<sup>7</sup></b>	<b>Frequency of Reporting<sup>7</sup></b>	<b>Frequency of publication<sup>7</sup></b>
Exchange Rates	NA	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	March 31, 2021	April 2021	M	M	M
Reserve/Base Money	NA	NA	NA	NA	NA
Broad Money	NA	NA	NA	NA	NA
Central Bank Balance Sheet	NA	NA	NA	NA	NA
Consolidated Balance Sheet of the Banking System	2020	April 2021	A	A	A
Interest Rates <sup>2</sup>	NA	NA	NA	NA	NA
Consumer Price Index	2021:M3	April 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	2019	January 2021	A	A	A
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	2020:Q4	January 2021	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	2020	January 2021	A	A	A
External Current Account Balance	2019	April 2021	A	A	A
Exports and Imports of Goods and Services	2019	April 2021	A	A	A
GDP/GNP	2020	April 2021	A	A	A
Gross External Debt	NA	NA	NA	NA	NA
International Investment Position <sup>6</sup>	2019	April 2021	A	A	A

<sup>1</sup>Includes reserve assets pledged or otherwise encumbered as well as net derivative positions—update definition.

<sup>2</sup>Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup>Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup>The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup>Including currency and maturity composition.

<sup>6</sup>Includes external gross financial asset and liability positions vis a vis nonresidents.

<sup>7</sup>Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).



**Statement by Paul Hilbers, Executive Director for the Principality of Andorra,  
and Dries Cools, Advisor to the Executive Director  
June 7, 2021**

On January 3, 2020, the Principality of Andorra applied for Fund membership. Ten and a half months later, on October 16, 2020 Andorra became the 190th member of the Fund. Five months after that, Andorra had its first Article IV mission. The Andorran authorities want to express their gratitude to Mission Chief Ms. Srobona Mitra and her team, as well as all involved departments, for having steered the authorities through this momentous period with highly valuable policy advice. They agree with the trust of the staff report and its Selected Issues Paper. They want to thank staff for having taken the time to meet with a wide range of public and private stakeholders to gain an in-depth understanding of the Principality. Finally, after many virtual meetings, the authorities are eager to meet the IMF team in person.

Membership to the Fund is a step in a deeper process of engagement with the world, which gained speed since Andorra's constitutional referendum in 1993, the year in which Andorra also joined the United Nations and the Council of Europe. This year was followed by a process of regional integration with the European Union, through a Monetary Agreement involving Andorra's two neighbors, Spain and France, with whose economies the Andorran economy is deeply integrated. Under this agreement, Andorra is committed to transpose and implement EU financial law. An important next step in Andorra's regional integration is the ongoing negotiation of an Association Agreement with the EU, which will make Andorra effectively a part of the EU internal market and help diversify the Andorran economy. This integration into the broader world also extends to tax issues. Ten years ago, Andorra introduced corporate income tax, followed by personal income tax in 2015. Since then, Andorra has among others ratified OECD standards on exchange of information and is negotiating double tax treaties.

### **A Commitment to Transparency**

The accession to the Fund is the logical next step. As staff writes, it is inspired by the authorities' desire to increase transparency about the Andorran economy. Transparency will help Andorra secure favorable market access. In April this year, Andorra had an oversubscribed 10-year bond issuance of EUR 500 million. This issuance was historic in many ways. It was not only Andorra's first international issuance, it was also its first green and sustainable bond. While this issuance has led to a temporary increase in Andorra's public debt, it will also considerably lengthen the maturity profile.

Thanks to the Fund's technical assistance, Andorra has been able to publish balance of payment statistics on May 7, 2021, for the first time in its history. These BoP statistics reveal a sizeable current account surplus. Together with a prudent rules-based fiscal policy and the absence of exchange rate risk, Andorra's solid competitiveness position is one of the key strengths of the Andorran economy. More transparency about the economic fundamentals can only be beneficial, for Andorra and the outside world. The authorities are therefore developing IIP statistics and look forward to receiving Fund TA to help close the remaining statistical gaps.

## Outlook – COVID-19

IMF accession and the first Article IV mission took place against the background of the COVID-19 crisis. Universal testing strategy and expanded hospital capacity have kept the number of fatalities low and allowed the authorities to target containment strategies as much as possible. Nonetheless, the 12% fall in GDP in 2020 has been momentous, given the inevitable travel restrictions and the fall in tourism revenues.

Andorra's solid fiscal starting position has facilitated the support of households and businesses through the crisis. This support included measures of temporary unemployment, loan guarantees and rent subsidies. Firms' strong levels of capitalization going into the crisis have also helped them to weather the crisis. The authorities agree with staff's advice to withdraw these measures gradually. Much will depend on how the summer tourism season will turn out. In light of the improving Covid situation in Europe, the authorities are hopeful about the coming summer. The authorities expect to have 60% of the population vaccinated by the beginning of the summer.

## Harnessing Stability

To cement economic and financial stability, the authorities are committed to 1) further improve financial sector oversight, 2) reform the pension system, and 3) build international reserves.

**First, Andorra is committed to continue strengthening its financial sector oversight.** MCM's Technical Assistance in that respect is much appreciated. Since the conclusion of the Article IV mission, the Andorra Financial Authority (AFA) has undertaken four relevant initiatives:

1. **Lending related to Covid:** AFA is currently conducting a banking-sector wide inspection in order to validate that (i) processes to extend Covid soft loans have been correctly implemented, and (ii) that Covid related lending, as well as moratoria are correctly reflected in banks' balance sheets. AFA teams are carrying out onsite inspections to that effect.
2. **Related party financing:** AFA has undertaken two measures to mitigate risks linked to related party financing:
  - a) Pilar II, issued in April, a few weeks after the Article IV Mission, includes a specific mention to related party financing for banking entities with a related party lending level above market standards.
  - b) AFA has indicated to these banks that it expects them to comply with a 15% related-party-financing-to-own-funds limit.
3. **Cross-border funds:** AFA and Andorra's Financial Intelligence Unit, UIFAND, have developed a Technical Communique requiring all banking entities to report detailed cross-border transfer information on a regular basis.
4. **Liquidity:** AFA has set up a specific Liquidity Coverage Ratio (LCR) dashboard that will be reported to the Banking Supervision Team and will be reviewed each month by AFA's General Management.

**Andorra is firmly resolved to meet the highest international standards to fight money laundering and terrorism financing.** The authorities are determined to further improve their anti-money laundering framework and its implementation. Since the 2016 Moneyval Assessment, the authorities have updated their national Risk Assessment and have scaled up on-site inspections. Additionally, they have further enhanced and developed cooperation networks at international level to improve the prevention of criminal use of the banking system for money laundering. Transposition of the 5th EU Anti-money laundering Directive is entering its final phase. The authorities are also committed to further strengthen their national anticorruption framework and are currently considering the ratification of the UN Convention against Corruption.

**Second, the authorities remain committed to prudent fiscal policies.** To control medium-term fiscal risks, the authorities plan to reform the pension system. Short- and medium-term risk arising from high roll-over needs have been substantially addressed with the recent 10-year bond issuance. The authorities take good note of staff's assessment that public debt remains sustainable even under a higher public investment scenario, and that under that scenario the public debt limit of 40% of GDP will be reached in 2025, only one year later than in the baseline scenario. In this vein the authorities are currently working together with international financial institutions on a number of targeted initiatives to develop key projects, including digitalization and sustainable infrastructure, that would further enhance Andorra's connectivity with the countries within its immediate vicinity. The authorities take good note of staff's assessment that it is possible to both frontload investment as well as to build the required level of international reserves by 2026, while remaining committed to fiscal prudence.

The authorities strongly agree that front-loaded investments should focus on the transition towards a green, digital and sustainable economy. The authorities do caution nonetheless that in a small country like Andorra, multiplier effects might be more subdued than expected. They take note of staff's concern about the 0.4% reduction in public investment in 2020, but also argue that the public investment level in 2019 was unusually high. In addition, while unemployment has increased in 2020, it still remains low at 3.0%. Finally, Andorra's two SOEs have an investment capability as high as the central government.

**Third, the authorities agree with staff's recommendation to build international reserves of 12% of GDP by 2026.** They concur with staff's methodology, taking into account euroization and the absence of a lender of last resort. The authorities also consider the timing to be feasible, and will reflect on the various options to reach the reserves target. The expected SDR allocation will be a helpful first step.

### **Structural Challenges**

As the recovery is taking roots, the authorities are committed to address Andorra's structural challenges. Diversifying the economy is high on the government's agenda. A key step will be the finalization of the Association Agreement with the EU which will provide greater market access (in and out). Andorra's strategy to diversify the tourism industry as well as the roll-out of its Horizon 2023 digitalization Strategy are key priorities for the Government. Finally, on climate, the authorities are very much aware of the impact climate change can have on Andorra's mountain ecosystems. They are a strong supporter of the Paris Climate Accord and are committed to becoming carbon neutral by 2050. The authorities are currently preparing a carbon tax proposal, the proceeds of which will serve to upgrade public transport and retrofit buildings, among others.