INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/57

PRINCIPALITY OF ANDORRA

March 2024

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE PRINCIPALITY OF 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 2023 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 February 26, 2024 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 February 26, 2024, following discussions that ended on December 18, 2023, 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 February 9, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Principality of Andorra.

The documents 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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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR 24/70

IMF Executive Board Concludes 2023 Article IV Consultation with the Principality of Andorra

FOR IMMEDIATE RELEASE

Washington, DC – March 6, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Principality of Andorra.

The Andorra economy is showing resilience and is growing slightly above its long-term potential despite external headwinds. Growth is estimated at 2.3 percent in 2023, driven by the service sector and a record number of visitors. With limited economic slack, the labor market is tight with almost no unemployment (1.2 percent at 2023Q3), resulting in significant wage pressures. Inflation remained high in 2023, at 5.6 percent, driven by second-round effects from wage increases and generalized price pressure in services and imported goods. Despite a shortage in affordable housing, a substantial increase in foreign residents helped match high labor demand.

Going forward, GDP is expected to slow to its lower long-term potential, estimated at 1.5 percent. Real GDP growth is forecasted at 1.8 percent in 2024 and at 1.5 percent from 2025 onwards, comparable to average growth in the euro area. Inflation is projected to subside from 4.3 percent in 2024 to 2 percent only by end-2025, in line with price developments in neighboring countries and domestic second-round effects. Risks to the outlook are balanced, though subject to substantial uncertainty and bottlenecks. Downside risks include a slower than expected global growth, more persistent inflation, and tighter for longer monetary policy in the region. Emerging fault lines and structural bottlenecks—as housing affordability issues, labor shortages, and climate change—cloud the medium-term outlook. On the upside, greater than expected regional growth and lower inflation would increase tourist flows and investments, while the adoption of the EU Association Agreement would open up new markets over the medium-term. Solid macroeconomic buffers serve as buffers to mitigate downside risks should they materialize.

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[1] 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[2]

Executive Directors commended Andorra's resilience to external headwinds and the authorities' sound macroeconomic management, that allowed to rebuild solid buffers. While risks to the outlook are balanced, Directors noted challenges stemming from persistently high inflation, a tight labor market, and housing affordability. They emphasized the importance of preserving prudent policies and advancing structural reforms to promote economic diversification and lift medium-term growth.

Directors welcomed the authorities' commitment to fiscal prudence which together with an effective fiscal framework and proactive debt management strategy, have enabled Andorra to restore fiscal space and reduce debt. They agreed that the fiscal stance should remain tight to support disinflationary efforts and further strengthen buffers. Directors concurred that channeling available fiscal space toward higher infrastructure and affordable housing would help tackle structural bottlenecks. They also encouraged the authorities to pursue healthcare reform and build consensus to implement needed pension reforms given population aging.

Directors welcomed the strength of Andorra's financial system. They emphasized that continued monitoring of risks is needed given the large size of banks and their international exposure. They commended the introduction of the lender of last resort facility and encouraged further strengthening the resolution framework. Directors agreed that ensuring that the Andorran Financial Authority is autonomous and fully resourced is key. They welcomed the recently negotiated EU Association Agreement and encouraged the authorities to ensure its smooth implementation once adopted.

Directors emphasized the importance of removing structural bottlenecks to boost growth and diversify the economy, and noted the opportunities stemming from the EU Association Agreement. They welcomed the priority given to improving housing affordability and addressing potential labor shortages. Noting the progress made, Directors encouraged continued efforts in governance, anticorruption and AML/CFT frameworks, and in closing data gaps, with IMF technical assistance. They also encouraged enhancing digitalization and accelerating climate change adaptation efforts.

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[2] 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, 2020–28

I. Social Indicators

Population (2021)	79,535	Population at risk of poverty	13
Per capita income (2021, euros)	36,840	Human Development Index Rank	40 (out of 189)
Gini Index (2020)	32	Life expectancy at birth (2021)	82.4

II. Economic Indicators

					Projections				
	2020	2021	2022	2023	2024	2025	2026	2027	2028
NATIONAL ACCOUNTS AND PRICES	(annual change, percent, unless otherwise indicated)								
Real GDP	-11.2	8.3	9.6	2.3	1.8	1.5	1.5	1.5	1.5
Nominal GDP	-10.2	11.1	14.2	7.3	4.9	4.0	3.3	3.3	3.2
GDP deflator	1.1	2.6	4.2	4.9	3.0	2.4	1.8	1.7	1.7
	(contribution to nominal GDP growth, percentage points)								
Consumption	-0.7	7.2	7.0	5.9	3.6	2.7	2.4	2.6	2.5
Private	-3.3	6.3	6.7	3.5	1.7	1.6	1.5	1.7	1.6
Public	2.6	0.9	0.3	2.4	1.9	1.1	0.9	0.9	0.9
Investment	-3.5	-1.2	4.5	1.5	0.6	0.8	0.5	0.4	0.3
Private 1/	-3.1	-1.1	4.1	0.7	0.1	0.4	0.3	0.2	0.1
Public	-0.4	-0.2	0.4	0.9	0.6	0.4	0.2	0.2	0.2
Net exports of goods and services	-6.0	5.1	1.9	0.7	0.6	0.4	0.4	0.3	0.4
Exports	-16.8	16.9	19.8	6.7	4.2	3.2	2.9	2.8	2.8
Imports	-10.7	11.8	18.0	6.1	3.6	2.8	2.5	2.4	2.4
Prices									
Inflation (percent, period average)	0.1	1.7	6.2	5.6	4.3	2.4	2.1	1.7	1.7
Inflation (percent, end of period)	-0.5	3.3	7.2	4.6	3.8	2.0	1.7	1.7	1.7
Unemployment rate (percent)	2.9	3.3	2.1	1.5	1.5	1.5	1.5	1.5	1.5
EXTERNAL SECTOR 2/	(percent of GDP, unless otherwise indicated)								
Current account	15.5	14.1	17.3	17.3	17.5	17.6	17.7	17.7	17.8
Balance on goods and services	4.0	8.2	8.8	8.8	9.0	9.0	9.1	9.1	9.3
Exports of goods and services	63.7	72.6	80.9	81.6	81.9	81.8	82.0	82.0	82.2
Imports of goods and services	59.7	64.5	72.2	72.9	72.9	72.8	72.8	72.9	72.9
Primary income, net	13.1	7.6	9.9	10.0	10.0	10.0	10.0	10.0	10.0
Secondary income, net	-1.5	-1.7	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	17.5	13.7	17.9	17.3	17.5	17.6	17.7	17.7	17.8
Errors and omissions	1.9	-0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Gross international reserves (millions of euros) 3/	41.9	138.1	338.4	338.4	338.4	338.4	338.4	338.4	338.4
FISCAL SECTOR	(percent of GDP, unless otherwise indicated)								
General Government 4/									
Revenue	41.3	37.9	39.7	38.8	38.5	39.4	39.5	39.5	39.6
Expenditure	42.3	39.0	34.9	36.1	36.6	36.8	36.8	36.9	37.0
Interest	0.6	0.7	0.7	0.6	0.5	0.6	0.5	0.7	0.7
Primary balance	-0.5	-0.4	5.5	3.2	2.4	3.2	3.2	3.3	3.2
Net lending/borrowing (overall balance)	-1.1	-1.2	4.8	2.6	1.9	2.6	2.7	2.6	2.5
Public debt	46.4	48.6	39.1	36.4	34.7	33.4	32.3	31.3	30.8
Central Government 5/									
Revenue	20.6	19.4	21.7	19.7	20.3	20.4	20.4	20.4	20.5
Expenditure	24.6	22.0	18.7	19.3	20.0	19.9	20.1	20.0	20.2
Interest	0.5	0.7	0.7	0.5	0.5	0.5	0.5	0.5	0.7
Primary balance	-3.4	-1.9	3.6	0.9	0.8	1.0	0.9	0.9	1.0
Net lending/borrowing (overall balance)	-4.0	-2.6	2.9	0.4	0.3	0.5	0.4	0.4	0.3
Public debt	43.7	46.3	37.1	34.5	32.9	31.7	30.7	29.7	29.3
BANKING SECTOR 6/	(percent, unless otherwise indicated)								
Regulatory capital to risk-weighted assets	22.5	21.5	19.5	20.2	…	…	…	…	…
Nonperforming loans to total gross loans	6.1	5.2	3.3	3.5	…	…	…	…	…
Credit to nonfinancial private sector									
Level (percent of GDP)	150.3	135.2	116.6	102.7	…	…	…	…	…
Corporates	76.8	68.8	61.8	56.2	…	…	…	…	…
Households	73.5	66.4	54.8	46.5	…	…	…	…	…
Growth (nominal)	-0.7	-0.1	-2.4	-7.5	…	…	…	…	…
Corporates	-1.8	-0.6	1.8	-0.4	…	…	…	…	…
Households	0.6	0.4	-6.8	-14.9	…	…	…	…	…
Credit to public sector									
Level (percent of GDP)	6.1	2.7	2.2	1.8	…	…	…	…	…
Growth (nominal)	-27.2	-50.2	-8.4	-10.9	…	…	…	…	…
Memorandum Items									
Exchange rate (€/USD, period average) 7/	0.88	0.85	0.95	0.92	…	…	…	…	…
Nominal GDP (millions of euros)	2,531	2,811	3,210	3,446	3,613	3,756	3,880	4,007	4,137

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/ Balance of Payments data are only available starting from 2019, with the exception of the goods and services balance, which are available starting from 2017. Data for 2021 are an estimate.

3/ The increase of gross international reserves in 2021 is due to the general SDR allocation made in August 2021 to all IMF members. The 2021 SDR allocation for Andorra was of SDR 79.1 million. In 2022 €100 million were deposited at the Bank of Spain as gross international reserves. In addition, €40 million have been deposited at the Banque de France, and €60 million at the Nederlandsche Bank as gross international reserves.

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

5/ The central government comprises Govern d'Andorra, as well as nonmarket, nonprofit institutional units.

6/ 2023 data refers to 2023Q3, which is preliminary and not audited.

7/ The table reports the exchange rate €/USD because Andorra is a euroized economy.

PRINCIPALITY OF ANDORRA

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

February 9, 2024

KEY ISSUES

Background. After a remarkable recovery, the Andorra economy continues to grow slightly above potential despite significant external headwinds. Headline inflation is elevated amidst persistent core inflation and a tight labor market. The banking sector remains profitable, well-capitalized, and liquid.

Outlook and risks. Over the medium-term, the economy is projected to slow to its lower long-term potential level estimated at 1.5 percent, comparable to average growth in the euro area. Risks to the outlook are balanced and the economy has solid macroeconomic buffers, but there are concerns about emerging structural bottlenecks, such as the lack of affordable housing, labor shortages, and vulnerability to climate change. The recently negotiated EU Association Agreement presents an opportunity for the country to diversify its economy.

Policy priorities. After a strong growth rebound, structural reforms can raise potential growth and address emerging fault lines.

- The authorities should maintain tight fiscal policy as long as growth remains close to potential and price pressures are persistent. However, there is fiscal space for higher public investment to support potential growth and mitigate structural bottlenecks. Pension system reform is overdue to secure its long-term sustainability.

- Bank performance and prudential buffers are strong, but the supervisor should monitor the impact of widening interest rate margins on asset quality. The large size of banks remains a systemic risk and requires close supervision.

- Ambitious structural reforms to diversify the economy and address emerging bottlenecks are key. These include removing remaining constraints on investment, improving housing affordability, retaining talent, and fostering digitalization and economic efficiency. The climate change adaptation strategy should be expanded. With concluded negotiations for an EU Association Agreement, the authorities need to prepare the economy to take full advantage of the access to the single market.

- Strengthening the AML/CFT framework and continuing to close data gaps will improve governance and provide better inputs for decision makers.

Approved By	
Helge Berger (EUR) and Bergljot Barkbu (SPR)	The mission took place December 6–18, 2023 in Andorra. The staff team comprised Rodolphe Blavy (mission chief), Aidyn Bibolov, and Michelle Tejada (all EUR). Arz Murr (LEG) attended some meetings. Cristina Camp (OEDNE) joined the mission. Yueshu Zhao and Eunmi Park (EUR) supported the mission. The team met with the Minister of Finance, the Minister of Presidency, Economy, Labor and Housing, the Minister of Foreign Affairs, the Minister of Tourism, the Secretary of State for International Financial Affairs, the Director of the Andorran Financial Authority, and other senior officials. The mission also met with parliamentarians, private sector representatives, and local economists.

CONTENTS

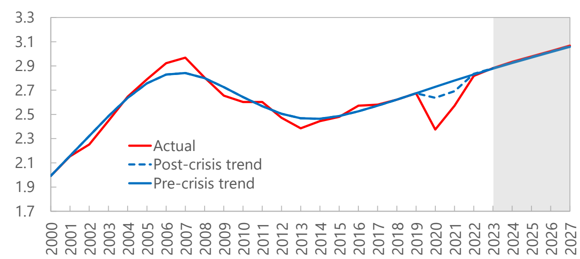
RECENT DEVELOPMENTS

1. Following the strong recovery, the Andorra economy continues to grow slightly above its potential rate of growth. The recovery closed the output gap in 2022 after a deep COVID recession. Despite external headwinds, the economy is growing at an estimated 2.3 percent in 2023, driven by the service sector and a record number of visitors.

Real GDP recovered fully to its pre-pandemic level in 2022.

Real GDP: Gap Relative to Pre-Crisis Trend

(Billion euros)

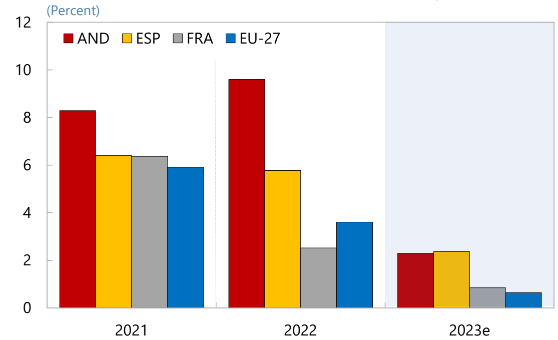


Sources: Govern d'Andorra Statistics Department and IMF staff calculations.
Note: In the case of Andorra, the gap relative to the pre-crisis trend corresponds to the difference between the projected real GDP and the Hodrick-Prescott pre-crisis trend, which is computed using historical data up to 2019 and the pre-crisis projections produced by the Andorran authorities. For other European countries, the gap relative to the pre-crisis trend is obtained from the staff reports of the 2021 Article IV consultation for each country.

Growth is converging to a low European average after a strong post-COVID rebound…

Real GDP Growth in Andorra and the Region

(Percent)

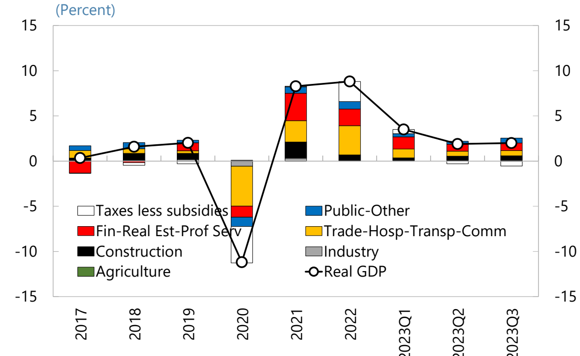


Sources: Govern d'Andorra Department of Statistics, Haver Analytics, WEO database, and IMF staff calculations.

…driven mainly by hospitality, professional services, and construction.

Contributions to Real GDP Growth

(Percent)



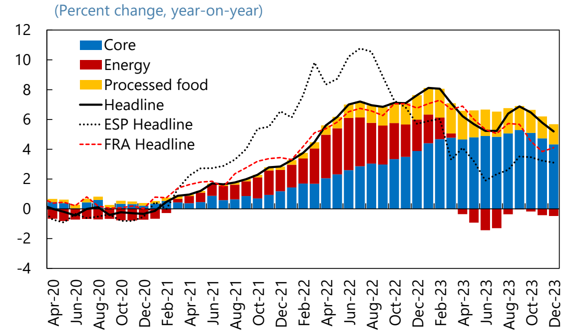
Sources: Govern d'Andorra Department of Statistics and IMF staff calculations.

2. Inflation accelerated and has remained elevated amidst persistent core inflation. Inflation rose sharply to 6.2 percent in 2022, propelled by soaring energy and food prices in the region and, to a lesser extent, by supply constraints and a mildly positive output gap. In 2023, headline inflation was influenced by global fuel prices, declining to 4.6 percent in December. After rising gradually up to the end-2022, core inflation stabilized at elevated levels—ending at 5.5 percent in December 2023—driven by

Core inflation remained elevated in 2023.

Contributions to Headline Inflation

(Percent change, year-on-year)



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

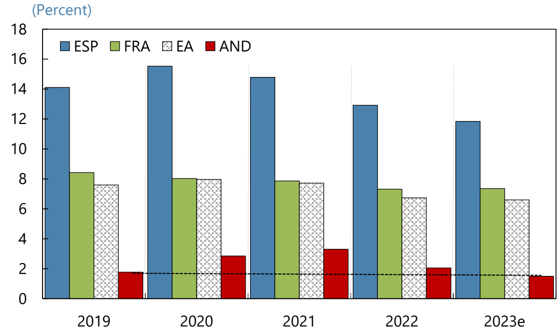
second-round effects from wage increases and generalized price pressure in services and imported goods. Headline inflation reached 5.6 percent on average in 2023.

3. The economy is experiencing a tight labor market—especially in the service sector. A steady increase in workforce demand pushed domestic labor force participation and employment above pre-pandemic levels. A large increase in residents (almost 8 percent over two years), driven by immigration, helped match high labor demand. This only partially addressed labor demand, with vacancies rising across sectors, in the hospitality industry in particular. While unemployment has historically been low (around 2 percent) in Andorra, this labor market tightness has been compounded recently by labor shortages, especially in the service sector, in neighboring countries. Unemployment declined to 1.2 percent at 2023Q3, or 266 individuals—among the lowest in Europe and in line with historical levels in Andorra. An increasing shortage of affordable housing reduces the attractiveness of Andorra for immigrant labor. To relieve labor market pressures, the authorities eased regulations for the employment of seasonal workers. Government mandated increases (close to 15 percent cumulatively) in the minimum wage in 2022–23 aimed at compensating workers for the loss of purchasing power but also at keeping the Andorran labor market competitive.

The unemployment rate has returned to its historically low level…

Unemployment Rate in Andorra and the Region

(Percent)

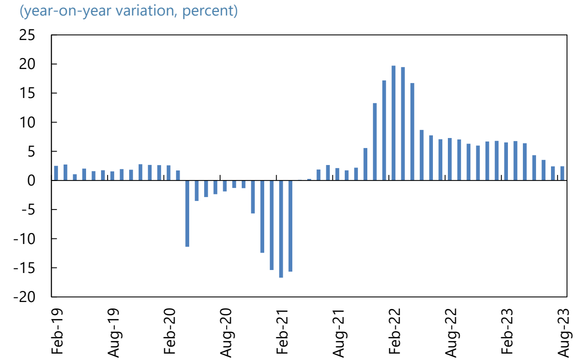


Sources: Govern d'Andorra Department of Statistics and WEO database.
Note: The number for 2023 is an estimate from WEO database.

…despite a steady increase in the domestic workforce.

Number of Workers

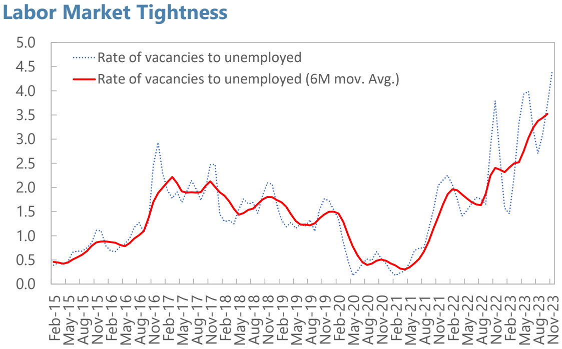
(year-on-year variation, percent)



Sources: Govern d'Andorra Department of Statistics, Haver Analytics.

The sharp increase in vacancies illustrates the tightness of the labor market…

Labor Market Tightness

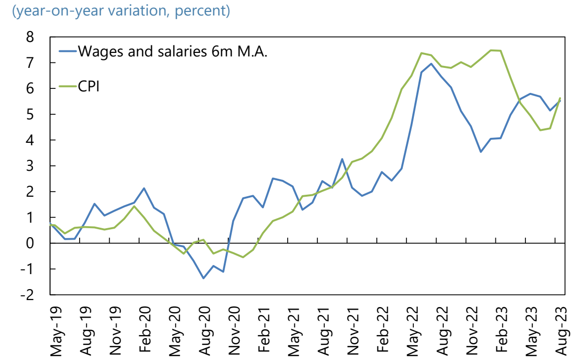


Sources: Govern d'Andorra Statistics Department and IMF staff calculations.
Note: Market tightness is calculated as the ratio between the number of vacancies posted at the Public Employment Service (PES) and the number of job searchers registered at the PES.

…driving, together with government mandated increases, wage growth.

Wages and Salaries

(year-on-year variation, percent)



Sources: Govern d'Andorra Department of Statistics, Haver Analytics.

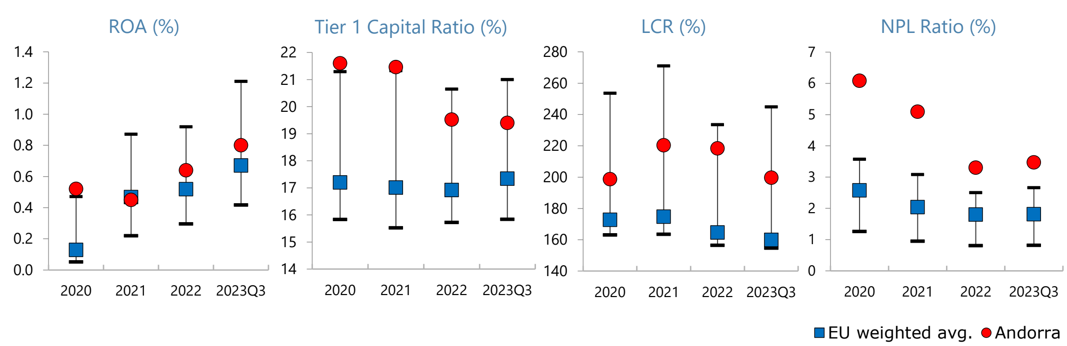
4. **On the back of the strong growth momentum, fiscal consolidation proceeded promptly, and fiscal buffers were rebuilt.** Fiscal performance surprised on the upside, with a primary surplus of 3.6 percent of GDP in 2022 and public debt down to 37.1 percent of GDP—below the 40 percent fiscal rule. Given the persistent inflation and the positive output gap, the government balanced primary fiscal surpluses with a moderate expansion in public investment (notably in social housing) in 2023. The primary balance surplus is estimated at 0.9 percent of GDP and the overall surplus at 0.4 percent of GDP. In 2022, the government introduced tourist and carbon taxes to diversify revenues and green the economy. A law on the effective tax rate was adopted in January 2023. It stipulates a minimum effective tax rate of 3 percent on the current year profits and will be applied from 2024. The government also introduced a 10 percent capital gains tax on resold properties to limit housing speculation on luxury real estate and incentivize the development of more affordable housing. Andorra completed in 2022 its debt management strategy issuing €1.2 billion in Eurobonds. This allowed the government to extend the maturity of its debt at favorable rates and diversify financing sources.

Andorra: Euro Medium Term Notes Program Summary

Month, year	April 2021	October 2021	February 2022
Amount (million Euros)	500	175	500
Maturity (years)	10	20	5
Coupon rate (percent)	1.25	1.7	1.25

5. **The banking sector strengthened, with a marked improvement in profitability.** Despite traditionally lower returns in private banking, Andorran banks profitability rose to an annualized ROA of 0.8 percent in 2023Q3, up from 0.6 percent in 2022 and 0.5 percent in 2021. An increase in interest margins drove profitability above European peers. Faster amortization of variable rate loans also resulted in a 4.7 percent decline in domestic credit during the first 9 months of 2023. After declining substantially in 2022, nonperforming loans stabilized above 3 percent in 2023. Andorra passed into law a Lender of Last Resort facility in December 2022 to provide emergency liquidity assistance to distressed but solvent banks. With a Tier 1 capital ratio at 19.4 percent and an LCR at around 200 percent at 2023Q3, Andorran banks remained significantly above regulatory requirements and European averages.

Banking Sector: Profitability, Capitalization, Liquidity and Asset Quality



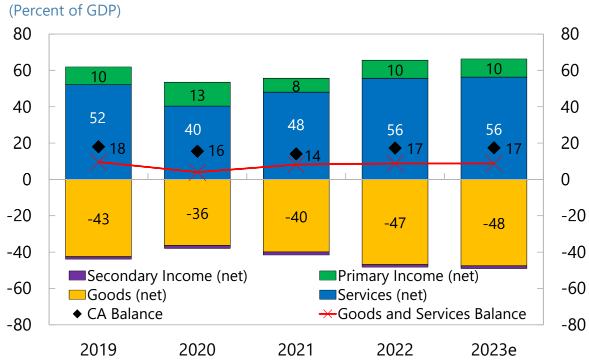
Sources: Andorran Financial Authority, EBA Risk Dashboard 2023Q1 and IMF staff calculations.
Note: The whiskers correspond to the 25th and 75th percentiles. Data for 2023 for Andorra are preliminary and unaudited, and subject to revisions.

6. The current account surplus remains large. Net exports and net primary income on average contribute almost equally to Andorra's large current account surplus. Driven primarily by tourism exports, Andorra maintains a larger trade surplus in services than its trade deficit in goods, resulting in a positive overall trade balance. The goods and services balance recovered in 2022 with the resumption of tourism and a contained rise in energy prices due to long-term supply contracts. Tourist expenditure recovered, driven by a sharp increase in expenditure per visitor. The current account balance rose to 17.3 percent of GDP in 2022, with the normalization of the tourism sector compensating the increase in both the volume and price of imported goods. The number of visitors reached a record 9.2 million during January to October of 2023, a 13 percent increase from the same period in 2022. Staff assesses the external position to be substantially stronger than the level implied by fundamentals and desirable policies (Annex I)—suggesting an imbalance in the savings-investment balance.

The current account surplus remains large, driven by both the trade balance and primary income.

Current Account Balance and Components

(Percent of GDP)

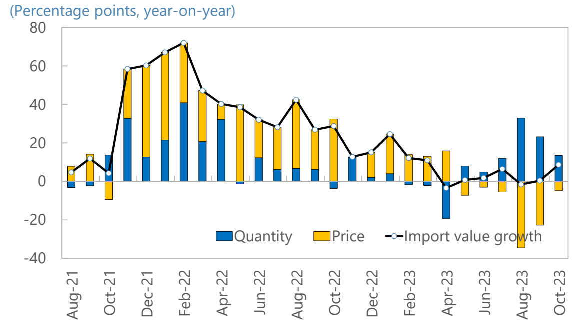


Sources: Govern d'Andorra Department of Statistics and IMF staff calculations

Imports grew in line with domestic demand and prices during the economic recovery.

Decomposition of Import Value Growth

(Percentage points, year-on-year)

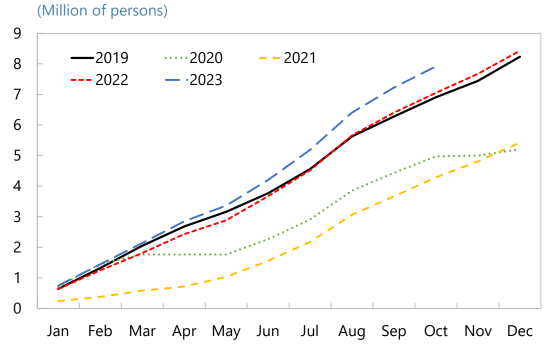


Sources: Govern d'Andorra Department of Statistics and IMF staff calculations.
Note: Data for February 2022 excludes Chapter 73 (Articles of Iron or Steel), which displayed an extraordinary change in quantity in this month.

The number of visitors has exceeded pre-COVID levels…

Number of Visitors

(Million of persons)

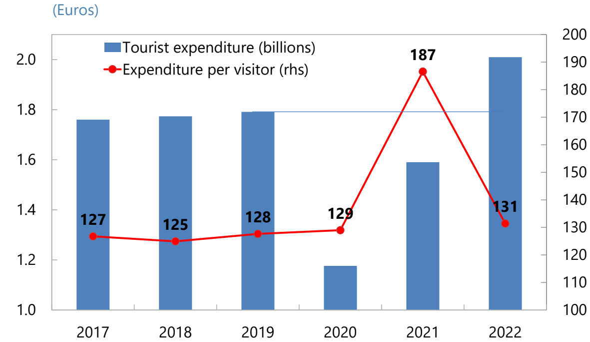


Sources: Govern d'Andorra Department of Statistics and IMF staff calculations.

…resulting in the recovery of total tourist expenditure.

Visitors Expenditure

(Euros)



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

OUTLOOK AND RISKS

7. Growth is slowing to its lower long-term potential level, with inflation receding gradually. The lower level of potential growth reflects constraints of the country's geography, the small domestic market, and low investment. Andorra has a high-income level (€39,000 GDP per capita in 2022), with a well-established business model relying on a competitive winter tourism sector. Under the staff's baseline, growth is forecasted at 1.8 percent in 2024 and at 1.5 percent from 2025 onwards, comparable to average growth in the euro area. Investment is projected to remain low. Consumption is expected to be the main driver of growth, supported by developments in the services and hospitality sectors. Headline inflation will continue to stabilize in 2024 but will remain persistently higher than previously anticipated, at a projected 4.3 percent, due to higher imported prices. The labor market is projected to remain tight and second-round effects from higher wages will also feed into inflation. Price pressure persistence suggests that both headline and core inflation are expected to stay high for longer in line with the global environment. Inflation is projected to subside to 2 percent only by end-2025 and remain slightly below 2 percent thereafter, as in the pre-COVID period.

8. Risks to the outlook are balanced, though subject to substantial uncertainty and bottlenecks (Annex II). Andorra is an open economy exposed to external challenges and its baseline forecast reflects projections for the global economy with slowing growth and prolonged inflation. Downside risks are substantial. Slower than expected global economic growth would negatively impact external demand and the number of visitors coming to Andorra and/or their spending, while more persistent inflation would dampen external and domestic demand by lowering real incomes. Tighter for longer monetary policy would also affect credit growth and credit quality, with negative effects on growth and banking soundness. In the medium term, the high reliance on winter tourism exposes the economy to climate-related risks. Emerging fault lines and structural bottlenecks—as housing affordability issues, labor shortages, and climate change—cloud the medium-term outlook. On the upside, Andorra, like other service-oriented economies in Europe, could benefit from stronger demand, and grow faster than projected. Greater than expected regional growth and lower inflation would increase tourist flows and investments, while the adoption of the EU Association Agreement would open up new markets over the medium-term. Prudent macroeconomic policies have resulted in solid macroeconomic buffers—low debt and fiscal space, newly constituted foreign reserves, a large current account surplus, and well capitalized and liquid banks—useful to mitigate downside risks should they materialize.

Andorra: IMF Baseline Forecasts 2021–28

			Projections					
	2021	2022	2023	2024	2025	2026	2027	2028
Real GDP growth (percent)	8.3	9.6	2.3	1.8	1.5	1.5	1.5	1.5
Nominal GDP growth (percent)	11.1	14.2	7.3	4.9	4.0	3.3	3.3	3.2
	(contribution to nominal GDP growth, percent)							
Consumption	7.2	7.0	5.9	3.6	2.7	2.4	2.6	2.5
Private	6.3	6.7	3.5	1.7	1.6	1.5	1.7	1.6
Public	0.9	0.3	2.4	1.9	1.1	0.9	0.9	0.9
Investment	-1.2	4.5	1.5	0.6	0.8	0.5	0.4	0.3
Private 1/	*-1.1*	*4.1*	*0.7*	*0.1*	*0.4*	*0.3*	*0.2*	*0.1*
Public	-0.2	0.4	0.9	0.6	0.4	0.2	0.2	0.2
Net exports of goods and services	5.1	1.9	0.7	0.6	0.4	0.4	0.3	0.4
Exports	16.9	19.8	6.7	4.2	3.2	2.9	2.8	2.8
Imports	11.8	18.0	6.1	3.6	2.8	2.5	2.4	2.4
CPI inflation (percent, period average)	1.7	6.2	5.6	4.3	2.4	2.1	1.7	1.7
Unemployment rate (percent)	3.3	2.1	1.5	1.5	1.5	1.5	1.5	1.5
Central government overall balance (percent of GDP) 2,	-2.6	2.9	0.4	0.3	0.5	0.4	0.4	0.3
Central government debt (percent of GDP) 2/ 3/	46.3	37.1	34.5	32.9	31.7	30.7	29.7	29.3
Current account balance (percent of GDP)	14.1	17.3	17.3	17.5	17.6	17.7	17.7	17.8
Memorandum items								
Euro Area real GDP growth (percent)	5.3	3.5	0.7	1.6	1.8	1.7	1.4	1.3
Euro Area inflation (percent, period average)	2.6	8.4	5.7	3.3	2.6	2.0	1.9	1.9
Spain real GDP growth (percent)	5.5	5.2	1.1	2.4	2.2	1.8	1.6	1.6
Spain inflation (percent, period average)	3.1	8.4	3.7	2.7	2.1	1.8	1.7	1.7

Sources: Govern d'Andorra Department of Statistics, World Economic Outlook database, 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 central government comprises Govern d'Andorra, as well as nonmarket, nonprofit institutional units.

3/ The sharp increases of debt in 2020-21 are partly explained by a pre-financing strategy to cover large amortization due in 2021-22.

Authorities' Views

9. The authorities agreed with the staff assessment of the economic outlook and balance of risks. Their near-term outlook is in line with staff estimates, but their medium-term outlook is slightly more positive. The authorities remain more optimistic than staff on the impact of diversification of the tourism sector and private investment. The authorities concur with staff on risks to the outlook and believe that tighter for longer global financial conditions would be detrimental to private credit and investment. They anticipate that the negotiated EU Association Agreement will support the diversification of the economy. Regarding the external sector assessment, the authorities see Andorra's large current account surplus as a strength of the country's economic structure while recognizing the need to continue to diversify the economy to remain competitive.

POLICY DISCUSSIONS

Public investment and ambitious structural reforms can address emerging bottlenecks and lift longer-term growth. Banks, while profitable and well capitalized, are very large and require continued close surveillance to limit financial stability risks. Diversifying the economy, increasing digitalization, strengthening governance and data reporting will help to strengthen economic resilience, improve efficiency, and empower policy making. The recently finalized EU Association Agreement should bring opportunities to Andorra with the appropriate measures for a smooth transition.

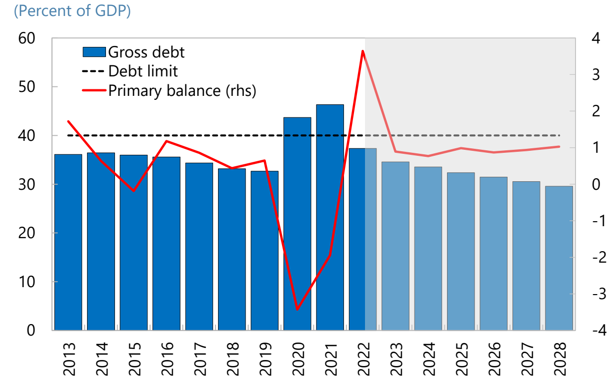
A. Fiscal Policy

10. After a rapid fiscal consolidation, the authorities have room within the fiscal framework to implement needed growth-enhancing investments, address structural bottlenecks, while maintaining appropriate fiscal discipline. The effective functioning of automatic stabilizers enabled the authorities to restore fiscal space and to decrease the debt level back to below the fiscal rule threshold in 2022. Given the positive output gap and the persistent inflation, tight fiscal policy in 2023 and 2024 is appropriate. The government is expected to continue running primary balance surpluses of about 1 percent of GDP over the medium term, resulting in a reduction of debt to about 30 percent of GDP by 2027. The fiscal framework—with a central government debt ceiling of 40 percent of GDP and an overall deficit limit of 1 percent[1]—has worked well to anchor the credibility of fiscal policy. In the absence of monetary policy tools, maintaining fiscal policy space, relying mostly on automatic stabilizers, and reducing public sector liabilities is warranted for a microstate vulnerable to external shocks. However, the fiscal rules also provide room for higher public spending, targeted towards growth-enhancing investment in social and affordable housing, in upskilling the workforce and addressing labor shortages, and in improving the connectivity of the country to support economic diversification, resilience, and lift potential growth.[2] The 2024 budget projects a welcome increase in public investment in affordable housing and infrastructure. Climate change is gaining more significance for the Andorran economy and will require stepped up adaptation measures from both the public and private sectors.

11. The authorities should continue to strengthen the public sector balance sheet through debt and reserve management. The government helpfully plans to use future surpluses to decrease the stock of outstanding debt and increase international reserves.

Debt is projected to decline supported by primary surpluses.

Central Government Debt and Deficit
(Percent of GDP)



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

- The authorities took steps to build up international reserves on a precautionary basis—adding funds from debt issuance to the 2021 allocation of IMF Special Drawing Rights (SDRs) to bring reserves up to 10 percent of GDP (Annex I).
- The authorities' debt management strategy has focused on reducing costs and lengthening maturities by tapping the international market. The average maturity of debt increased from 2.7 years in 2019 to about 8 years by end-2022. The authorities should continue the policy of diversifying debt and extending its maturity to decrease rollover risks and mitigate consequences from potential increases in interest rates.

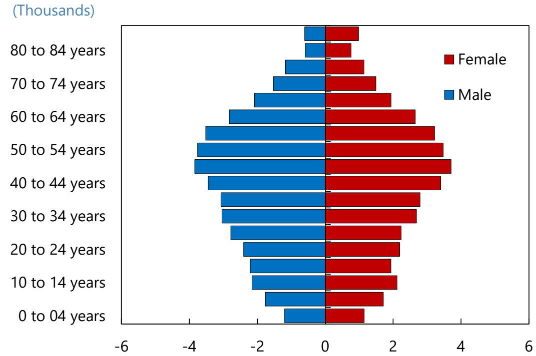
[1] For details on fiscal rules, see IMF Country Report No. 2022/179.

[2] For an assessment of the potential growth impact of public investment, see IMF Country Report No.21/108 Selected Issues Paper.

12. Over the medium term, population aging creates substantial contingent liabilities, and the pension reform should be a priority. Andorra's aging population will increase healthcare and pension costs going forward. The authorities are considering a necessary healthcare reform to address this over the medium-term. After months of discussion, concluding the reform in an expeditious and comprehensive manner is needed to ensure the sustainability of the social security fund in the long run. Andorra's aging population and its generous pension system create an unsustainable dynamic for the Andorran social security fund in the long-term. The fund is projected to accumulate deficits starting from 2026 rising to 8.2 percent of GDP by 2042 by which point its reserve fund will be depleted.[3] Public pension expenditure as a share of GDP is expected to see one of the largest increases in the region. A comprehensive reform package is needed to prevent the build-up of large contingent liabilities. There is a consensus among political parties on the need for a reform but the appropriate balance between adjustment of the contribution rate, the conversion factor, and the retirement age, together with considerations around pension adequacy and intergenerational equity, is still to be determined.

As the Andorran population is aging…

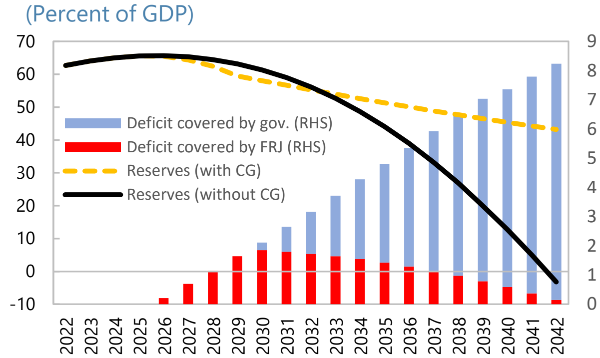
Population Pyramid
(Thousands)



Sources: Govern d'Andorra Department of Statistics and Haver Analytics.

…the social security system is expected to accumulate deficits starting in 2026.

Pension: Reserves Projections
(Percent of GDP)



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

Authorities' Views

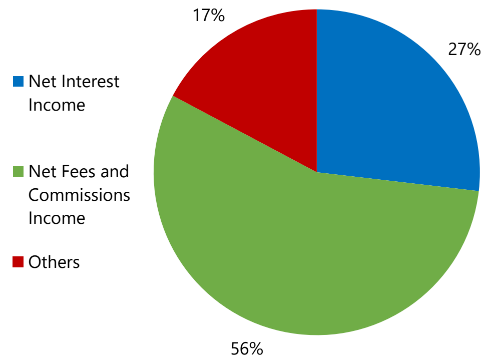
13. The authorities concurred with the staff's assessment of the fiscal policy. They view the 2024 budget as an important expansion of public investment to support key policy objectives, including housing, while preserving fiscal responsibility. The Parliamentary majority is taking the lead on the reform of the pension system, working to build a political consensus with the objective to have it approved by mid-2025. To address population aging and the associated demands on the budget, the authorities are preparing the ground for a healthcare reform over the medium-term. They also plan to invest in renewable energy and transportation to mitigate carbon emissions.

[3] For background, please see IMF Country Report No. 22/180: Principality of Andorra: Selected Issues (imf.org).

B. Financial Sector Policies

Private banking dominates banking activity in Andorra, as reflected in the share of fees in total banking income.

Banks Income Statements Decomposition
(Percent of total operating income, end-of-2022)



Sources: Annual bank reports and IMF staff calculations.

14. With a largely private banking model, banks enjoy a robust financial position, but their size and international exposure calls for vigilance. The main source of income for Andorran banks comes from private banking—a relatively lower risk business where banks earn commissions for custody and wealth management services (see a selected issues paper). However, their size is a potential risk. At the end of 2022, bank consolidated assets were 5.5 times GDP, while their off-balance sheet assets under management, largely outside Andorra, were 20 times GDP, with each of the three banks' assets exceeding the country's GDP. Bank funding significantly relies on nonresident deposits that were about 109 percent of GDP in 2022. Given the size of banks, especially compared to the domestic economy and to existing safety nets, and the large nonresident deposits, high capitalization and liquidity ratios are needed for self-insurance. The lender of the last resort facility (LOLR) put in place in 2022, allows the Andorran Financial Authority (AFA) to provide emergency liquidity assistance to viable and solvent banks against adequate collateral.[4] The introduction of the LOLR is welcome and it will help to mitigate a temporary liquidity shock to a bank. Given the systemic size of the banking sector, it is important for available tools to complement each other, i.e., for the LOLR to be supported by continued close supervision and a well-designed resolution framework to ensure that critical problems are identified and addressed early.

15. Interest rate increases helped to boost banks' profitability but can put some borrowers under pressure. Tighter monetary conditions helped to boost banks' interest margins and profitability in 2022 and 2023. The recent consolidation in the sector (reducing the number of banks from 5 to 3) should help banks cut expenses and improve their cost-to-income ratio, which reached a high average above 70 percent in 2022. Credit risks are mitigated by moderate financial intermediation and limited leverage (for corporates, retained earnings are a major source of financing). In the real estate market, the recent surge in construction and associated price increases was mostly driven by the luxury residential market targeted to foreign clients, with limited bank exposures. However, higher financing costs could increase credit risks and nonperforming loans. The AFA should monitor the effect of interest rate increases on the banks' asset quality and require

[4] Law 36/2022 established the Lender of Last Resort facility, to be activated by a special technical commission chaired by the Minister of Finance to provide temporary and exceptional liquidity to a solvent and viable bank in the event of a liquidity stress. The LOLR facility was developed in line with IMF technical assistance.

banks to act proactively in case of a significant deterioration. Large exposures and connected lending, typical in a very small economy, should be closely monitored and resolved.

16. The changing financial landscape brings opportunities and risks for banks. Andorran banks have been expanding in the EU and the US where they run independent subsidiaries focused on private banking services. Expansion abroad diversifies revenues and profits but subjects banks to additional country and reputational risks. The March 2023 banking turmoil in the US and Europe revealed how bank stress can propagate quickly due to abrupt shifts in market sentiment and customer (especially high net worth individuals) and counterparty behaviors. It also illustrated the increased speed of bank runs due to 24/7 payments, mobile banking, and the use of social media. Lessons for supervisors—relevant for the AFA—include the need to reinforce resolution planning requirements, explore the implications for deposit insurance, and work closely with foreign supervisors. Given the systemic risks associated with the banking sector, ensuring that the AFA is an autonomous, fully resourced supervisor that has the power to conduct in-depth, risk-based assessments, enforce its findings, and deploy a solid crisis management capacity if needed, is paramount. The AFA should continue its close cooperation with supervisory authorities from jurisdictions where Andorran banks operate.

17. The impact on the banking sector of the recently negotiated EU Association Agreement (among other issues raised below) is one area of attention. The agreement will simplify entrance to EU countries for Andorran banks but will also allow foreign banks expanding in Andorra and competing with domestic banks. Financial sector integration incorporates a transitional period of 15 years over which Andorra should fully adopt the EU financial sector legislation, supervision, and regulation. The agreement gives significant flexibility on the timing of the integration of each of the four subsectors covered (banking, insurance, asset management, and financial services). Implementation of the agreement will depend on an assessment of the successful transposition of the EU framework for each subsector. Ensuring that the banking system continues to provide financial services to the economy should be a key objective in the upcoming transition.

Authorities' Views

18. The authorities agreed with the thrust of staff's assessment of the financial sector and policy advice. They highlighted that the financial sector continues to be a strong and profitable part of the economy. They noted that banks are benefiting from the interest rate increase which should help to increase banks' capital further. The authorities, however, acknowledged that interest rate increases can negatively affect borrowers' ability to pay but noted that there has not been a significant deterioration in credit quality so far and that stress tests show that banks are able to withstand substantial shocks. The authorities viewed the EU Association Agreement as an opportunity to develop and integrate the financial sector within the single European market.

C. Structural Policies

19. Economic diversification and improvements in relative terms-of-trade would support real GDP and real income growth. The deep recession in 2020 illustrated the economy's exposure to the hospitality sector, and to external demand mostly coming from its two neighbors—France and Spain. The country faces multiple structural challenges, such as difficult geographic accessibility, a limited stock of affordable housing, and a small internal market. The authorities and the private sector are taking steps to extend the tourist season by offering varied summer activities and cultural and sports experiences throughout the year. Better infrastructure, notably the planned heliport, projects for tram and cable transportation and the construction of a multi-purpose arena, will enhance the attractiveness of Andorra as a tourist destination beyond the immediate neighbors. Diversification would both mitigate the country's exposure to winter tourism and reduce the seasonality of the country's economy—but remains a challenging endeavor for a microstate. Providing higher quality services and raising hospitality standards would generate higher revenues and support real income growth.

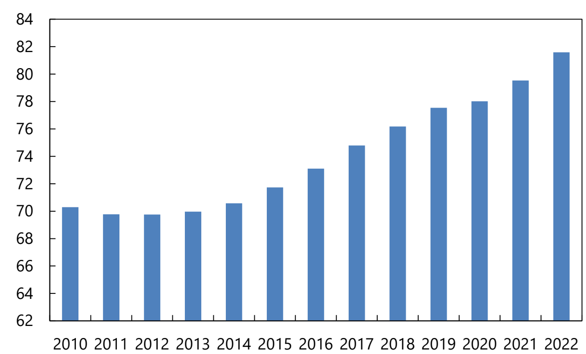
20. Creating an environment favorable to higher investment is important to raise potential growth. Investment suffers from high red tape, and difficulties to attract talent and build human capital. Reducing administrative rigidities associated with starting a business in Andorra, favoring access to alternative sources of financing, and implementing measures to attract and retain talent would support investment, notably by foreigners. Fostering coordination between the central and local governments and the ongoing digitalization of public administration will help in this direction.

21. Policies to increase digitalization are welcome steps towards diversification and greater economic efficiency. As part of Andorra's digital transformation plan, the government adopted a business digitalization program for Andorran private companies in June 2022. The December 2022 law on digital economy, entrepreneurship and innovation allows for the creation of a special economic zone where companies can develop and test digital and innovative products and creates a legal framework for incubators and digital nomads and entrepreneurs.

22. Housing affordability is an increasing social and economic concern for Andorra. In a recent survey,[5] housing affordability was noted as the most pressing economic issue for 57 percent of respondents in Andorra. A fast-growing population and increasing real estate prices and rents combine to create a housing affordability issue in Andorra—unaddressed by the recent construction boom that focused on luxury housing. Affordability tends to be lower for renters, and Andorra is an outlier in Europe with a renter-dominated real estate market—70 percent of households are tenants (see selected issues paper for details). The seasonal demand for temporary housing—for tourists and seasonal workers alike—compounds this concern and complicates the hiring of foreign workers. Furthermore, low-skilled workers and low-income households are disproportionately affected by affordability concerns. Raising the stock of rental housing is essential to improve affordability for

Population, 2010–22

(Thousands)



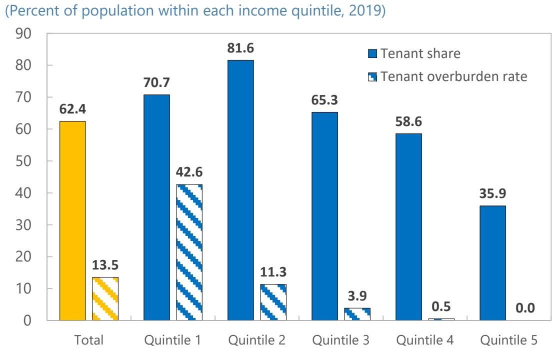
Source: Govern d'Andorra Department of Statistics.

[5] Andorra Recerca—OBSERVATORI 2023.

tenants and public investment in affordable housing is a direct answer to this issue. The authorities have started taking actions to address the issue such as easing requirements for housing support, temporary caps on rent increases, increasing the stock of social apartments, repurposing of buildings for residential housing, and slowing down construction permits for housing that is built to be sold rather to be rented. It is essential for the government to focus on temporary and well-targeted measures that minimize distortions in the housing market and restore the proper market incentives to invest in rental property development. Furthermore, measures to curb real estate speculation may redirect investment towards more affordable housing but should be consistent with other economic priorities, such as attracting foreign investment, diversifying the economy towards new sectors, and attracting highly qualified workers, such as digital nomads.

Renters dominate the housing market across income levels.

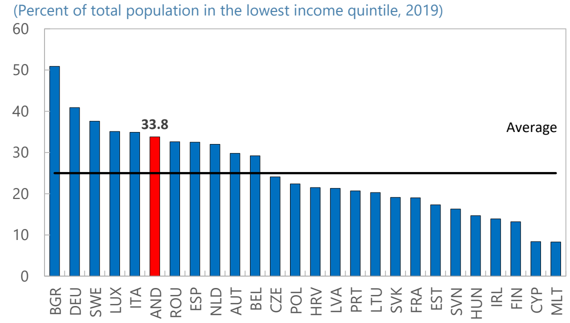
Tenant Share and Overburden Rate by Income Quintile
(Percent of population within each income quintile, 2019)



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

The housing cost overburden rate for those in the lowest income quintile was among the highest in the region.

Housing Cost Overburden Rate: Lowest Income Quintile
(Percent of total population in the lowest income quintile, 2019)



Sources: Govern d'Andorra Department of Statistics, Eurostat, and IMF staff calculations.
Note: Greece is an outlier and was excluded from the chart.

23. Climate change is macro-critical to Andorra given its dependence on winter tourism, making adaptation policies a priority. With (mostly winter) tourism accounting for one third of its economy, Andorra is directly exposed to climate change—shorter winter seasons, declining snow falls, higher costs from artificial snow making are all negatively affecting the economy's main business.[6] Because of its higher altitude, Andorra is more resilient than other winter tourism locations in the region and should use this window of opportunity to enact needed policies. The authorities' climate change strategy—with ambitious goals—is focused on mitigation but its adaptation component needs to be accelerated. The strategy seeks to reduce 37 percent of non-absorbed emissions compared to 2005 levels by 2030, and to achieve carbon neutrality by 2050. The promotion of renewable and high energy efficiency technologies, and of efficient energy use across sectors is welcome. According to the staff calculations (see selected issues paper), achieving the decarbonization objectives would require a considerable increase in the carbon tax and very substantial efficiency gains in the power, transport, and residential sectors.

[6] Trade and hospitality activity account for about 30 percent of the economy's gross value added (GVA) and 40 percent of employment. However, with various other sectors connected to tourism, the share of the latter could be more than half of the economy.

24. **The EU Association Agreement could bring substantial benefits to Andorra and support its diversification strategy by opening up new markets.** The government chose to submit its approval to a referendum, planned for the first half of 2025, subject to adoption by the Council of the European Union in 2024. The Agreement will then come into effect in 2025 or 2026. It will allow Andorra to participate in the EU's internal market alongside Norway, Iceland, Liechtenstein, and San Marino (which just finalized EU accession agreements alongside Andorra). Transitional arrangements ensure a gradual adoption of the agreement that is not disruptive, particularly in the sensitive areas of the telecom and tobacco sectors, and the financial sector. The agreement does not impose restrictions on Andorra's taxation system. On the sensitive issue of the free movement of people, a quota system for active residents, passive residents and seasonal or cross-border workers will be established. The authorities need to use the transition periods to prepare the economy to reap the benefits of the agreement while minimizing distortions.

Authorities' Views

25. **The authorities agreed on the importance of addressing structural bottlenecks and underscored the multiple actions they are taking.** Beyond a wide range of measures to support economic diversification and bring high value-added foreign investment to the country, they noted that affordable housing is at the core of the government's priorities. They recognized that housing policies are difficult, notably because of the high price of land and construction, and that distortionary actions may be needed in the short-term until the supply of affordable housing increases in the medium-term. Addressing climate change is another priority for the authorities, which remain committed to fulfilling decarbonization objectives. On mitigation, they remain optimistic and are exploring additional financing options to scale up existing measures, possibly in cooperation with the European Investment Bank. On adaptation, the authorities acknowledged the need to accelerate the pace and welcomed the small gains achieved so far to deseasonalize the tourism sector. The EU Association Agreement was presented by the authorities as a major step forward in opening up the economy to new opportunities, while minimizing the risks of distortions thanks to substantial transition periods. The authorities recognized the need to communicate well the implications of the agreement, and to prepare the economy for a smooth transition.

D. Governance, Corruption and Data Gaps

26. **Measures to counter corruption and to strengthen the transparency and accountability of public spending are critical to improve economic governance.** Ratifying the United Nations Convention Against Corruption (UNCAC) and developing an anti-corruption strategy that systematizes the efforts to combat corruption should be key priorities. The reform of the public procurement framework introduced a new contracting platform and electronic invoicing for the entire public sector. This streamlines and modernizes public procurement in Andorra, in line with European standards. In September 2022, the government launched a website, open to the public, with information on the procurement contracts made by the public sector. While this is a step in the right direction, more efforts are needed to increase transparency and accountability of public spending, notably the publication of beneficial ownership information of companies awarded

procurement contracts. This information is only available for Andorran companies from the Registry of Commerce and is disclosed upon justified request. It is recommended that beneficial ownership information is requested directly to the bidding companies (including foreigners) and made publicly available.

27. Further improving the effectiveness of the AML/CFT framework is necessary to ensure financial stability. Building on significant progress made in recent years, Andorra should continue to enhance the AML/CFT framework, particularly in managing the ML/TF risks related to cross-border flows and virtual assets. Efforts underway to develop the understanding of risks associated with cross border flows, the misuse of legal persons, and the provision of services related to virtual assets are critical to make supervision more effective. The AFA has enhanced the monitoring of cross-border flows by introducing a new quarterly reporting requirement for cross-border transactions of the supervised Andorran entities and their subsidiaries. The supervisor should continue to carefully analyze data reported by supervised entities, including on nonresident deposits, and exchange information with counterparts in relevant originating countries so as to further improve its understanding of ML/TF risks. Resources for AML/CFT supervision should be increasingly focused on higher risk areas, and sanctions for breach of regulatory requirements should be effectively imposed.

28. Continued progress in closing data gaps will support policymaking. Andorra has made significant progress in improving its data reporting since joining the IMF. Starting in 2022, Andorra maintains the National Summary Data Page that is regularly updated with macroeconomic data. With help from the IMF, the authorities are developing capacity across all macroeconomic sectors. In fiscal accounts, the authorities started producing annual time series for the general government in 2023. In the external sector, the authorities are working on improving the timeliness and frequency of the International Investments Position and the balance of payment statistics. In the monetary sector, the authorities plan to continue their work on producing the monetary and financial statistics. GDP by expenditure is not yet available and the authorities aim to start compiling it. The IMF stands ready to continue working with Andorra on strengthening its data reporting to enhance transparency and improve inputs for the decision makers.

Authorities' Views

29. The authorities underscored their commitment to improving governance, strengthening the AML/CFT framework and continuing progress in economic statistics. The authorities emphasized the solid ranking of Andorra in various governance assessments—Andorra is ranked 4th of 152 countries by the Basel AML index, and positively assessed by Moneyval. They noted political commitment to ratifying the UNCAC within the legislative term. They plan to develop an anti-corruption strategy in 2024 using an upcoming GRECO assessment in June. The authorities noted their progress in strengthening the AML/CFT framework. They agreed on the importance of continuing progress in macroeconomic data compilation and reporting, and plan to continue closing data gaps including with the IMF's technical assistance.

STAFF APPRAISAL

30. The Andorran economy continues to experience solid growth. Strong growth in 2022 closed the output gap after a deep COVID recession. Despite external headwinds, the economy is growing slightly above potential, driven by the service sector and a record number of visitors. With limited economic slack, the labor market is tight with almost no unemployment. Over the medium-term, growth is projected to converge to potential growth at around 1.5 percent. Risks to the outlook are balanced but there are concerns about still high inflation and housing affordability. Solid macroeconomic buffers serve as buffers to mitigate downside risks should they materialize.

31. The authorities should use available fiscal space to address structural bottlenecks. In the absence of monetary policy tools, maintaining fiscal policy space and reducing public sector liabilities is warranted for a microstate vulnerable to external shocks. Given the persistent inflation and the positive output gap, maintaining fiscal discipline is appropriate. Public debt is expected to fall below 30 percent of GDP by 2028. However, the fiscal framework has worked well to anchor the credibility of fiscal policy. It provides room for growth-enhancing public spending that can support economic growth and diversification.

32. Over the medium-term, population aging creates substantial contingent liabilities and pension reform should proceed without further delay. Andorra's aging population will increase healthcare and pensions costs going forward. Public pension expenditure as a share of GDP is expected to see one of the largest increases in the region and to create an unsustainable dynamic for the Andorran social security fund. Concluding the reform in an expeditious and comprehensive manner is needed to ensure its sustainability.

33. The supervisor should continue close monitoring of banking activities. While the main source of income for Andorran banks is the relatively low-risk private banking business, banks are of systemic importance. Continued closed supervision and a well-designed resolution framework are paramount to ensure that critical problems are addressed early, while the lender of the last resort facility introduced in 2022 is a useful addition to the authorities' toolkit. The supervisor should monitor the effect of interest rate increases on the banks' asset quality and require banks to act proactively in case of a significant deterioration. Ensuring that the AFA is an autonomous, fully resourced supervisor is key for financial stability.

34. Improving connectivity, addressing housing affordability, and enhancing the climate strategy can help resolve bottlenecks and lift growth. Andorra remains highly dependent on the hospitality sector. Better connectivity and infrastructure will enhance the attractiveness of Andorra for tourism and for the development of new economic activities. To tackle housing affordability, it is essential for the government to focus on temporary and well-targeted measures that minimize distortions in the housing market, restore proper market incentives to invest in rental property development, and ensure consistency with other economic priorities, such as attracting foreign investment. Climate change is a long-term challenge for Andorra and its adaptation strategy should be accelerated.

35. The recently negotiated EU Association Agreement has the potential to unlock substantial benefits by opening markets for a more diversified economy. If approved by referendum in the first half of 2025, the agreement will take effect after that and eventually result in full access to the EU market without imposing restrictions on tax policy. Significant transition periods for various sectors allow the government to prepare the economy to take full advantage of the access to the single market and to avoid disruptions, particularly in the financial sector.

36. The progress in transparency and accountability of public spending, countering corruption, and improving data should continue. The reform of the public procurement framework and the introduction of an electronic contracting and invoicing platform are welcome. Ratifying the United Nations Convention Against Corruption and developing an anti-corruption strategy are key priorities for improving governance. Further improving the effectiveness of the AML/CFT framework will reinforce financial stability. Progress in developing macroeconomic statistics, including better information exchange between central and local governments, should continue.

37. It is recommended that the next Article IV consultation with the Principality of Andorra take place on the standard 12-month cycle.

Table 1. Andorra: Selected Economic and Financial Indicators

I. Social Indicators

Population (2021)	79,535	Population at risk of poverty (percent, 2020)	13
Per capita income (2021, euros)	36,840	Human Development Index Rank (2021)	40 (out of 189)
Gini Index (2020)	32	Life expectancy at birth (2021)	82.4

II. Economic Indicators

				Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028
NATIONAL ACCOUNTS AND PRICES	(annual change, percent, unless otherwise indicated)								
Real GDP	-11.2	8.3	9.6	2.3	1.8	1.5	1.5	1.5	1.5
Nominal GDP	-10.2	11.1	14.2	7.3	4.9	4.0	3.3	3.3	3.2
GDP deflator	1.1	2.6	4.2	4.9	3.0	2.4	1.8	1.7	1.7
	(contribution to nominal GDP growth, percentage points)								
Consumption	-0.7	7.2	7.0	5.9	3.6	2.7	2.4	2.6	2.5
Private	-3.3	6.3	6.7	3.5	1.7	1.6	1.5	1.7	1.6
Public	2.6	0.9	0.3	2.4	1.9	1.1	0.9	0.9	0.9
Investment	-3.5	-1.2	4.5	1.5	0.6	0.8	0.5	0.4	0.3
Private 1/	-3.1	-1.1	4.1	0.7	0.1	0.4	0.3	0.2	0.1
Public	-0.4	-0.2	0.4	0.9	0.6	0.4	0.2	0.2	0.2
Net exports of goods and services	-6.0	5.1	1.9	0.7	0.6	0.4	0.4	0.3	0.4
Exports	-16.8	16.9	19.8	6.7	4.2	3.2	2.9	2.8	2.8
Imports	-10.7	11.8	18.0	6.1	3.6	2.8	2.5	2.4	2.4
Prices									
Inflation (percent, period average)	0.1	1.7	6.2	5.6	4.3	2.4	2.1	1.7	1.7
Inflation (percent, end of period)	-0.5	3.3	7.2	4.6	3.8	2.0	1.7	1.7	1.7
Unemployment rate (percent)	2.9	3.3	2.1	1.5	1.5	1.5	1.5	1.5	1.5
EXTERNAL SECTOR 2/	(percent of GDP, unless otherwise indicated)								
Current account	15.5	14.1	17.3	17.3	17.5	17.6	17.7	17.7	17.8
Balance on goods and services	4.0	8.2	8.8	8.8	9.0	9.0	9.1	9.1	9.3
Exports of goods and services	63.7	72.6	80.9	81.6	81.9	81.8	82.0	82.0	82.2
Imports of goods and services	59.7	64.5	72.2	72.9	72.9	72.8	72.8	72.9	72.9
Primary income, net	13.1	7.6	9.9	10.0	10.0	10.0	10.0	10.0	10.0
Secondary income, net	-1.5	-1.7	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	17.5	13.7	17.9	17.3	17.5	17.6	17.7	17.7	17.8
Errors and omissions	1.9	-0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Gross international reserves (millions of euros) 3/	41.9	138.1	338.4	338.4	338.4	338.4	338.4	338.4	338.4
FISCAL SECTOR	(percent of GDP, unless otherwise indicated)								
General Government 4/									
Revenue	41.3	37.9	39.7	38.8	38.5	39.4	39.5	39.5	39.6
Expenditure	42.3	39.0	34.9	36.1	36.6	36.8	36.8	36.9	37.0
Interest	0.6	0.7	0.7	0.6	0.5	0.6	0.5	0.7	0.7
Primary balance	-0.5	-0.4	5.5	3.2	2.4	3.2	3.2	3.3	3.2
Net lending/borrowing (overall balance)	-1.1	-1.2	4.8	2.6	1.9	2.6	2.7	2.6	2.5
Public debt	46.4	48.6	39.1	36.4	34.7	33.4	32.3	31.3	30.8
Central Government 5/									
Revenue	20.6	19.4	21.7	19.7	20.3	20.4	20.4	20.4	20.5
Expenditure	24.6	22.0	18.7	19.3	20.0	19.9	20.1	20.0	20.2
Interest	0.5	0.7	0.7	0.5	0.5	0.5	0.5	0.5	0.7
Primary balance	-3.4	-1.9	3.6	0.9	0.8	1.0	0.9	0.9	1.0
Net lending/borrowing (overall balance)	-4.0	-2.6	2.9	0.4	0.3	0.5	0.4	0.4	0.3
Public debt	43.7	46.3	37.1	34.5	32.9	31.7	30.7	29.7	29.3
BANKING SECTOR 6/	(percent, unless otherwise indicated)								
Regulatory capital to risk-weighted assets	22.5	21.5	19.5	20.2	...	...	...	...	...
Nonperforming loans to total gross loans	6.1	5.2	3.3	3.5	...	...	...	...	...
Credit to nonfinancial private sector									
Level (percent of GDP)	150.3	135.2	116.6	102.7	...	...	...	...	...
Corporates	76.8	68.8	61.8	56.2	...	...	...	...	...
Households	73.5	66.4	54.8	46.5	...	...	...	...	...
Growth (nominal)	-0.7	-0.1	-2.4	-7.5	...	...	...	...	...
Corporates	-1.8	-0.6	1.8	-0.4	...	...	...	...	...
Households	0.6	0.4	-6.8	-14.9	...	...	...	...	...
Credit to public sector									
Level (percent of GDP)	6.1	2.7	2.2	1.8	...	...	...	...	...
Growth (nominal)	-27.2	-50.2	-8.4	-10.9	...	...	...	...	...
Memorandum items									
Exchange rate (€/USD, period average) 7/	0.88	0.85	0.95	0.92	...	...	...	...	...
Nominal GDP (millions of euros)	2,531	2,811	3,210	3,446	3,613	3,756	3,880	4,007	4,137

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/ Balance of Payments data are only available starting from 2019, with the exception of the goods and services balance, which are available starting from 2017. Data for 2021 are an estimate.

3/ The increase of gross international reserves in 2021 is due to the general SDR allocation made in August 2021 to all IMF members. The 2021 SDR allocation for Andorra was of SDR 79.1 million. In 2022 €100 million were deposited at the Bank of Spain as gross international reserves. In addition, €40 million have been deposited at the Banque de France, and €60 million at the Nederlandsche Bank as gross international reserves.

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

5/ The central government comprises Govern d'Andorra, as well as nonmarket, nonprofit institutional units.

6/ 2023 data refers to 2023Q3, which is preliminary and not audited.

7/ The table reports the exchange rate €/USD because Andorra is a euroized economy.

Table 2. Andorra: General Government Operations[1]

	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections					
				(millions of euros)					
Revenue	1,044.6	1,064.7	1,275.5	1,335.4	1,390.0	1,481.1	1,531.2	1,582.4	1,636.4
Tax Revenue	352.1	402.1	523.1	539.4	571.9	598.4	620.6	641.8	665.4
Income	87.7	117.1	150.7	164.9	175.6	183.3	190.0	196.2	202.6
Goods and services	107.7	118.7	152.1	152.5	161.4	169.0	175.8	181.7	188.7
International trade	108.1	113.6	159.2	151.9	160.8	168.4	174.1	179.9	186.9
Other	48.6	52.8	61.2	70.1	74.2	77.7	80.8	84.0	87.2
Social Contributions	274.3	276.9	312.5	317.0	317.9	360.5	372.5	384.7	397.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue 2/	418.2	385.7	439.8	479.1	500.1	522.1	538.1	555.8	573.9
Expenditure	1,071.6	1,097.5	1,120.0	1,244.7	1,321.4	1,381.9	1,428.4	1,479.1	1,532.5
Current expenditure	940.8	970.9	982.4	1,079.9	1,136.7	1,182.3	1,222.0	1,265.6	1,311.8
Wages and salaries	232.2	236.0	246.7	268.9	288.2	300.5	310.4	320.6	330.9
Goods and services	138.4	151.0	161.8	172.4	180.9	185.8	190.8	195.7	200.7
Subsidies and transfers	556.0	563.3	551.2	619.0	648.0	674.3	699.5	720.0	750.0
Interest	14.3	20.5	22.7	19.7	19.5	21.8	21.3	29.3	30.2
Net acquisition of non-financial assets	130.7	126.6	137.6	164.8	184.6	199.6	206.4	213.5	220.7
Net acquisition of fixed assets	65.8	68.7	72.3	101.7	117.3	124.4	128.8	133.3	138.0
Capital transfers	64.9	57.9	65.3	63.0	67.3	75.1	77.6	80.1	82.7
Primary balance	-12.7	-12.3	178.2	110.4	88.1	121.0	124.2	132.6	134.1
Net lending/borrowing	-27.0	-32.8	155.5	90.8	68.6	99.2	102.9	103.3	103.9
Financing									
Net acquisition of financial assets	472.9	160.3	43.8	90.8	68.6	99.2	102.9	103.3	123.9
Domestic	472.9	160.3	43.8	90.8	68.6	99.2	102.9	103.3	123.9
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	499.9	193.0	-111.6	0.0	0.0	0.0	0.0	0.0	20.0
Domestic	391.5	-180.6	-615.6	0.0	0.0	0.0	0.0	0.0	20.0
New Issuances	450.0	15.5	15.5	0.0	0.0	0.0	0.0	0.0	20.0
Amortization	58.5	196.1	631.2	0.0	0.0	0.0	0.0	0.0	0.0
External	108.4	373.6	504.0	0.0	0.0	0.0	0.0	0.0	0.0
New Issuances	108.4	678.6	504.0	0.0	0.0	0.0	0.0	500.0	0.0
Amortization	0.0	305.0	0.0	0.0	0.0	0.0	0.0	500.0	0.0
				(percent of GDP)					
Revenue	41.3	37.9	39.7	38.8	38.5	39.4	39.5	39.5	39.6
Tax Revenue	13.9	14.3	16.3	15.7	15.8	15.9	16.0	16.0	16.1
Income	3.5	4.2	4.7	4.8	4.9	4.9	4.9	4.9	4.9
Goods and services	4.3	4.2	4.7	4.4	4.5	4.5	4.5	4.5	4.6
International trade	4.3	4.0	5.0	4.4	4.4	4.5	4.5	4.5	4.5
Other	1.9	1.9	1.9	2.0	2.1	2.1	2.1	2.1	2.1
Social Contributions	10.8	9.9	9.7	9.2	8.8	9.6	9.6	9.6	9.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue 2/	16.5	13.7	13.7	13.9	13.8	13.9	13.9	13.9	13.9
Expenditure	42.3	39.0	34.9	36.1	36.6	36.8	36.8	36.9	37.0
Current expenditure	37.2	34.5	30.6	31.3	31.5	31.5	31.5	31.6	31.7
Wages and salaries	9.2	8.4	7.7	7.8	8.0	8.0	8.0	8.0	8.0
Goods and services	5.5	5.4	5.0	5.0	5.0	4.9	4.9	4.9	4.9
Subsidies and transfers	22.0	20.0	17.2	18.0	17.9	18.0	18.0	18.0	18.1
Interest	0.6	0.7	0.7	0.6	0.5	0.6	0.5	0.7	0.7
Net acquisition of non-financial assets	5.2	4.5	4.3	4.8	5.1	5.3	5.3	5.3	5.3
Net acquisition of fixed assets	2.6	2.4	2.3	3.0	3.2	3.3	3.3	3.3	3.3
Capital transfers	2.6	2.1	2.0	1.8	1.9	2.0	2.0	2.0	2.0
Primary balance	-0.5	-0.4	5.5	3.2	2.4	3.2	3.2	3.3	3.2
Net lending/borrowing	-1.1	-1.2	4.8	2.6	1.9	2.6	2.7	2.6	2.5
Financing									
Net acquisition of financial assets	18.7	5.7	1.4	2.6	1.9	2.6	2.7	2.6	3.0
Domestic	18.7	5.7	1.4	2.6	1.9	2.6	2.7	2.6	3.0
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	19.8	6.9	-3.5	0.0	0.0	0.0	0.0	0.0	0.5
Domestic	15.5	-6.4	-19.2	0.0	0.0	0.0	0.0	0.0	0.5
New Issuances	17.8	0.6	0.5	0.0	0.0	0.0	0.0	0.0	0.5
Amortization	2.3	7.0	19.7	0.0	0.0	0.0	0.0	0.0	0.0
External	4.3	13.3	15.7	0.0	0.0	0.0	0.0	0.0	0.0
New Issuances	4.3	24.1	15.7	0.0	0.0	0.0	0.0	12.5	0.0
Amortization	0.0	10.9	0.0	0.0	0.0	0.0	0.0	12.5	0.0
Memorandum items									
Gross Financing Needs (millions, euros)	85.5	533.9	475.7	0.0	0.0	0.0	0.0	396.7	0.0
Percent of GDP	3.4	19.0	14.8	0.0	0.0	0.0	0.0	9.9	0.0
Public Debt (millions of euros)	1,173.2	1,366.5	1,249.3	1,254.9	1,254.9	1,254.9	1,254.9	1,254.9	1,274.9
Percent of GDP	46.4	48.6	39.1	36.4	34.7	33.4	32.3	31.3	30.8
Nominal GDP (millions, euros)	2,531.1	2,811.0	3,210.3	3,445.6	3,613.0	3,755.7	3,880.4	4,007.4	4,136.6

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

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

2/ Other revenue includes property income, sales of goods and services, voluntary transfers other than grants, and fines, penalties, and forfeits.

Table 3. Andorra: Central Government Operations[1]

	2020	2021	2022	Projections 2023	2024	2025	2026	2027	2028
					(millions, national currency)				
Revenue	521.6	544.0	695.4	679.0	731.8	765.1	792.1	818.5	847.4
Tax Revenue	306.5	353.3	468.5	476.5	505.4	528.7	548.1	566.5	587.2
Income	87.7	117.1	150.8	165.3	176.0	183.8	190.4	196.7	203.1
Goods and services	107.7	118.7	152.1	152.5	161.4	169.0	175.8	181.7	188.7
International trade	108.1	113.6	159.2	151.9	160.8	168.4	174.1	179.9	186.9
Other	3.1	3.9	6.5	6.8	7.2	7.5	7.8	8.1	8.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue 2/	215.1	190.7	226.9	202.5	226.4	236.4	244.0	252.0	260.2
Expenditure	621.8	618.3	600.8	665.9	722.0	747.4	778.3	801.5	834.4
Current expenditure	552.0	556.5	540.8	585.5	621.7	643.8	671.1	690.7	719.8
Wages and salaries	176.1	177.4	185.3	198.8	218.2	224.5	235.6	243.8	251.1
Goods and services	98.1	103.8	108.0	114.9	118.5	124.1	127.7	131.3	132.0
Subsidies and transfers	264.6	255.5	225.8	254.1	267.6	276.4	288.4	295.5	307.8
Interest	13.3	19.7	21.6	17.6	17.5	18.8	19.4	20.0	29.0
Net acquisition of non-financial assets	69.7	61.8	60.1	80.4	100.3	103.6	107.2	110.8	114.5
Net acquisition of fixed assets	38.4	29.1	26.9	41.0	56.6	58.5	60.6	62.7	64.9
Capital transfers	31.4	32.7	33.2	39.5	43.8	45.1	46.6	48.1	49.6
Primary balance	-86.8	-54.7	116.2	30.8	27.2	36.5	33.3	37.0	41.9
Net lending/borrowing	-100.1	-74.3	94.6	13.1	9.7	17.7	13.9	17.0	13.0
Financing									
Net acquisition of financial assets	410.0	121.7	-17.1	13.1	9.7	17.7	13.9	17.0	33.0
Domestic	410.0	121.7	-17.1	13.1	9.7	17.7	13.9	17.0	33.0
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	510.1	196.0	-111.6	0.0	0.0	0.0	0.0	0.0	20.0
Domestic	401.7	-177.6	-615.6	0.0	0.0	0.0	0.0	0.0	20.0
New Issuances	450.0	15.5	15.5	0.0	0.0	0.0	0.0	0.0	20.0
Amortization	48.3	193.1	631.2	0.0	0.0	0.0	0.0	0.0	0.0
External	108.4	373.6	504.0	0.0	0.0	0.0	0.0	0.0	0.0
New Issuances	108.4	678.6	504.0	0.0	0.0	0.0	0.0	500.0	0.0
Amortization	0.0	305.0	0.0	0.0	0.0	0.0	0.0	500.0	0.0
					(percent of GDP)				
Revenue	20.6	19.4	21.7	19.7	20.3	20.4	20.4	20.4	20.5
Tax Revenue	12.1	12.6	14.6	13.8	14.0	14.1	14.1	14.1	14.2
Income	3.5	4.2	4.7	4.8	4.9	4.9	4.9	4.9	4.9
Goods and services	4.3	4.2	4.7	4.4	4.5	4.5	4.5	4.5	4.6
International trade	4.3	4.0	5.0	4.4	4.4	4.5	4.5	4.5	4.5
Other	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue 2/	8.5	6.8	7.1	5.9	6.3	6.3	6.3	6.3	6.3
Expenditure	24.6	22.0	18.7	19.3	20.0	19.9	20.1	20.0	20.2
Current expenditure	21.8	19.8	16.8	17.0	17.2	17.1	17.3	17.2	17.4
Wages and salaries	7.0	6.3	5.8	5.8	6.0	6.0	6.1	6.1	6.1
Goods and services	3.9	3.7	3.4	3.3	3.3	3.3	3.3	3.3	3.2
Subsidies and transfers	10.5	9.1	7.0	7.4	7.4	7.4	7.4	7.4	7.4
Interest	0.5	0.7	0.7	0.5	0.5	0.5	0.5	0.5	0.7
Net acquisition of non-financial assets	2.8	2.2	1.9	2.3	2.8	2.8	2.8	2.8	2.8
Net acquisition of fixed assets	1.5	1.0	0.8	1.2	1.6	1.6	1.6	1.6	1.6
Capital transfers	1.2	1.2	1.0	1.1	1.2	1.2	1.2	1.2	1.2
Primary balance	-3.4	-1.9	3.6	0.9	0.8	1.0	0.9	0.9	1.0
Net lending/borrowing	-4.0	-2.6	2.9	0.4	0.3	0.5	0.4	0.4	0.3
Financing									
Net acquisition of financial assets	16.2	4.3	-0.5	0.4	0.3	0.5	0.4	0.4	0.8
Domestic	16.2	4.3	-0.5	0.4	0.3	0.5	0.4	0.4	0.8
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	20.2	7.0	-3.5	0.0	0.0	0.0	0.0	0.0	0.5
Domestic	15.9	-6.3	-19.2	0.0	0.0	0.0	0.0	0.0	0.5
New Issuances	17.8	0.6	0.5	0.0	0.0	0.0	0.0	0.0	0.5
Amortization	1.9	6.9	19.7	0.0	0.0	0.0	0.0	0.0	0.0
External	4.3	13.3	15.7	0.0	0.0	0.0	0.0	0.0	0.0
New Issuances	4.3	24.1	15.7	0.0	0.0	0.0	0.0	12.5	0.0
Amortization	0.0	10.9	0.0	0.0	0.0	0.0	0.0	12.5	0.0
Memorandum items									
Gross Financing Needs (millions, euros)	148.4	572.4	536.6	0.0	0.0	0.0	0.0	483.0	0.0
Percent of GDP	5.9	20.4	16.7	0.0	0.0	0.0	0.0	12.1	0.0
Public Debt (millions of euros)	1,106.0	1,302.0	1,190.4	1,190.4	1,190.4	1,190.4	1,190.4	1,190.4	1,210.4
Percent of GDP	43.7	46.3	37.1	34.5	32.9	31.7	30.7	29.7	29.3
Nominal GDP (millions, euros)	2,531.1	2,811.0	3,210.3	3,445.6	3,613.0	3,755.7	3,880.4	4,007.4	4,136.6

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

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

2/ Other revenue includes property income, sales of goods and services, voluntary transfers other than grants, and fines, penalties, and forfeits.

Table 4. Andorra: Balance of Payments[1]

	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections					
				(millions of euros)					
Current account	393.0	395.2	553.8	596.8	633.2	660.3	686.4	709.3	736.6
Balance of goods and services	100.3	229.3	281.3	302.2	324.3	339.2	354.6	366.6	383.0
Imports of goods	1,070.2	1,271.5	1,694.5	1,838.2	1,930.5	2,005.8	2,073.0	2,141.4	2,209.9
Exports of goods	148.3	149.5	188.6	200.2	213.1	222.1	230.4	238.0	245.9
Imports of services	442.1	540.6	622.3	671.9	703.5	728.1	753.6	780.0	807.3
Exports of services	1,464.2	1,892.0	2,409.4	2,612.1	2,745.2	2,850.9	2,950.7	3,050.0	3,154.2
Primary income, net	330.6	213.0	318.0	343.7	360.4	374.7	387.1	399.8	412.7
Secondary income, net	-37.9	-47.1	-45.4	-49.1	-51.5	-53.5	-55.3	-57.1	-59.0
Capital account	0.2	0.3	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	441.9	385.3	575.1	596.8	633.2	660.3	686.4	709.3	736.6
Direct investment, net	-122.3	-291.9	-513.1	...	...	...	...	...	...
Portfolio investment, net	-204.6	515.3	1,340.8	...	...	...	...	...	...
Financial derivatives, net	0.0	-14.2	-39.3	...	...	...	...	...	...
Other investment, net	726.9	80.0	-413.4	...	...	...	...	...	...
Reserve assets	41.9	96.2	200.0	...	...	...	...	...	...
Errors and omissions	48.7	-10.2	21.7	0.0	0.0	0.0	0.0	0.0	0.0
				(in percent of GDP)					
Current account	15.5	14.1	17.3	17.3	17.5	17.6	17.7	17.7	17.8
Balance of goods and services	4.0	8.2	8.8	8.8	9.0	9.0	9.1	9.1	9.3
Exports of goods and services	63.7	72.6	80.9	81.6	81.9	81.8	82.0	82.0	82.2
Exports of goods	5.9	5.3	5.9	5.8	5.9	5.9	5.9	5.9	5.9
Exports of services	57.8	67.3	75.1	75.8	76.0	75.9	76.0	76.1	76.3
Imports of goods and services	59.7	64.5	72.2	72.9	72.9	72.8	72.8	72.9	72.9
Imports of goods	42.3	45.2	52.8	53.4	53.4	53.4	53.4	53.4	53.4
Imports of services	17.5	19.2	19.4	19.5	19.5	19.4	19.4	19.5	19.5
Primary income, net	13.1	7.6	9.9	10.0	10.0	10.0	10.0	10.0	10.0
Secondary income, net	-1.5	-1.7	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	17.5	13.7	17.9	17.3	17.5	17.6	17.7	17.7	17.8
Direct investment, net	-4.8	-10.4	-16.0	...	...	...	...	...	...
Portfolio investment, net	-8.1	18.3	41.8	...	...	...	...	...	...
Financial derivatives, net	0.0	-0.5	-1.2	...	...	...	...	...	...
Other investment, net	28.7	2.8	-12.9	...	...	...	...	...	...
Reserve assets	1.7	3.4	6.2	...	...	...	...	...	...
Errors and omissions	1.9	-0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items									
Nominal GDP (millions, euros)	2,531	2,811	3,210	3,446	3,613	3,756	3,880	4,007	4,137
Gross international reserves (millions, euros) 2/	41.9	138.1	338.4	338.4	338.4	338.4	338.4	338.4	338.4
Gross international reserves (months of imports)	0.3	0.9	1.8	1.6	1.5	1.5	1.4	1.4	1.3
Total external debt (millions, euros)	4,956	5,088	5,252	...	...	...	...	...	...
of which: Short term (millions, euros)	3,302	3,001	2,869	...	...	...	...	...	...

Sources: Andorran authorities and IMF staff calculations.

1/ Balance of Payments data are only available starting from 2019, with the exception of the goods and services balance, which is available starting from 2017.
2/ The increase of gross international reserves in 2021 is due to the general SDR allocation made in August 2021 to all IMF members. The 2021 SDR allocation for Andorra was of SDR 79.1 million. In 2022 €100 million were deposited at the Bank of Spain as gross international reserves. In addition, €40 million have been deposited at the Banque de France, and €60 million at the Nederlandsche Bank as gross international reserves.

Table 5. Andorra: Financial Soundness Indicators

	2019	2020	2021	2022	2023Q1	2023Q2	2023Q3
			(percent)				
Core FSIs for Deposit takers							
Regulatory capital to risk-weighted assets	21.8	22.5	22.2	19.5	19.9	20.1	20.2
Regulatory Tier 1 capital to risk-weighted assets	21.0	21.6	21.5	18.7	19.1	19.3	19.4
Nonperforming loans net of provisions to capital	21.4	17.7	15.4	10.7	10.8	10.7	10.7
Nonperforming loans to total gross loans	7.3	6.1	5.1	3.3	3.5	3.6	3.5
Sectoral distribution of loans to total loans							
Residents	61.9	55.8	55.3	58.6	58.0	59.0	58.3
Deposit-takers	3.0	1.8	0.4	0.3	0.6	0.7	0.6
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	1.8	2.0	2.5	3.2	2.5	2.9	2.9
General government	3.0	2.0	1.0	1.0	1.0	1.2	1.0
Nonfinancial corporations	28.0	25.6	26.3	28.7	29.2	29.5	29.4
Other domestic sectors	26.1	24.5	25.1	25.5	24.7	24.7	24.4
Nonresidents	38.2	44.2	44.7	41.4	42.1	41.0	41.7
Return on assets	0.7	0.5	0.5	0.6	0.2	0.4	0.6
Return on equity	6.0	4.5	4.0	6.6	2.0	3.9	5.8
Interest margin to gross income	21.6	21.2	22.2	29.2	45.9	48.5	50.4
Noninterest expenses to gross income	74.6	75.1	77.4	79.0	70.9	73.1	74.3
Liquidity coverage ratio (LCR) 1/	201.7	198.7	220.3	218.3	207.3	202.7	199.6
Liquid assets to short-term liabilities	16.9	14.4	11.9	11.7	12.0	11.0	10.3
Net open position in foreign exchange to capital	0.9	0.0	0.0	0.0	0.0	0.0	0.1
Encouraged FSIs for Deposit takers							
Capital to assets	11.0	11.5	11.2	9.7	9.9	10.0	10.3
Large exposures to capital	131.1	118.2	138.7	181.2	168.1	168.9	161.3
Gross asset position in financial derivatives to capital	8.7	13.5	12.9	22.9	19.5	19.1	21.1
Gross liability position in financial derivatives to capital	10.9	13.4	9.6	13.7	11.4	11.4	13.5
Trading income to total income	10.8	13.9	10.3	9.7	5.1	3.5	3.5
Personnel expenses to noninterest expenses	48.8	48.9	49.8	47.8	49.0	47.3	46.3
Customer deposits to total (noninterbank) loans	149.2	150.7	159.2	181.0	178.5	170.8	168.0
Foreign-currency-denominated loans to total loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign-currency-denominated liabilities to total liabilities	22.5	21.6	20.8	20.4	19.7	20.2	21.3

Source: Andorran authorities.

Note: Data for 2023 are preliminary and unaudited, and subject to revisions.

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

Annex I. External Sector Assessment

Overall Assessment: *The external position of Andorra in 2023 was substantially stronger than the level implied by fundamentals and desirable policies.* With one of the world's largest current account surpluses, this result is in line with expectations. Yet, data limitations suggest caution in interpreting it: Andorra started producing Balance of Payment (BOP) and International Investment Position (IIP) data only in recent years with technical assistance from the IMF; and BOP and IIP data is only available from 2017 and 2018, respectively. IMF staff projects current account data but do not project the financial account and IIP.

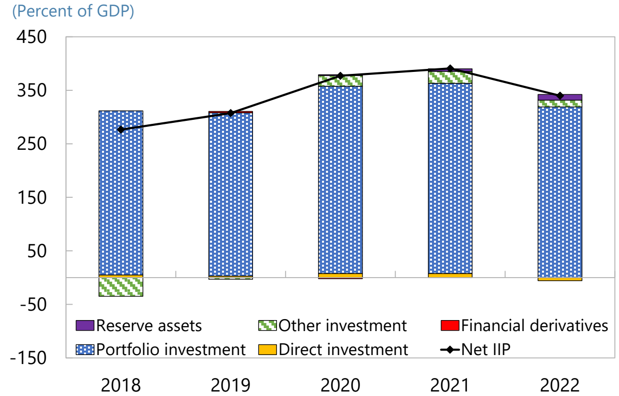
Potential Policy Responses: Having one of the highest current account surpluses in the world shields the economy against balance of payments financing risks but calls for rebalancing the economy towards greater investment. A direct implication of a current account surplus above the level suggested by fundamentals is that the savings-investment gap is larger than desirable. While some level of savings is desirable as a protection against population aging and external shocks, especially for a microstate like Andorra, excess savings and/or low investment limit potential growth in the medium-term. This suggests that Andorra has room to increase investment and would benefit from policies conducive to higher private and public investment. Therefore, creating an environment favorable to higher investment is important to raise potential growth. Higher investment could support policy goals such as economic diversification and resilience of the tourism sector and help address structural bottlenecks such as the lack of affordable housing.

Foreign Assets and Liabilities: Position and Trajectory

Background. Andorra's strong net asset position is consistent with its large and steady current account surplus and the sizable financial sector. Andorra has a large net asset position in portfolio investment held mostly in euro area countries and a net asset position in other investment (currency and deposits), albeit smaller. The IIP position peaked at 390.9 percent of GDP in 2021 and declined to 339.9 percent of GDP in 2022. The assets and liabilities in Foreign Direct Investment (FDI) were broadly balanced. More than half of the total liabilities owed by Andorra were concentrated in currency and deposits from non-residents (estimated at 106.9 percent of GDP), which can pose liquidity risk.

International Investment Position

(Percent of GDP)



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

Assessment. Andorra has a large net asset IIP. However, high gross other investment liabilities stemming from dependence of the banking sector on foreign depositors warrants attention. Andorra passed into law a Lender of Last Resort facility in December 2022 to provide emergency liquidity assistance to distressed but solvent banks—which is a welcome additional safety net. Effective supervision to address any emerging banking risks is essential to ensure the stability of the domestic banking sector.

Andorra: International Investment Position, 2019–22

(In percent of GDP)

ASSETS	2019	2020	2021	2022
Total	537.0	635.9	636.5	577.3
Direct investment	38.1	49.7	52.6	49.1
Equity	38.0	49.8	52.6	49.1
Debt	0.1	-0.2	0.0	0.0
Portfolio investment	332.3	369.6	391.0	365.5
Equity	148.6	182.6	191.1	147.3
Debt	183.7	186.9	199.9	218.2
Financial derivatives	6.7	5.1	5.4	8.1
Other investment	159.9	209.9	182.5	144.0
o/w Currency and deposits	124.0	173.2	146.8	115.4

LIABILITIES	2019	2020	2021	2022
Total	229.5	258.8	245.6	237.4
Direct investment	35.2	42.0	44.8	54.9
Equity	35.5	42.2	44.7	54.7
Debt	-0.3	-0.2	0.1	0.1
Portfolio investment	27.0	19.5	35.6	46.5
Equity	22.1	13.7	15.0	14.3
Debt	4.9	5.8	20.6	32.2
Financial derivatives	4.1	7.1	4.8	4.8
Other investment	163.1	190.3	160.3	131.3
o/w Currency and deposits	136.2	156.4	128.0	106.9

Source: Andorran authorities and IMF staff calculations.

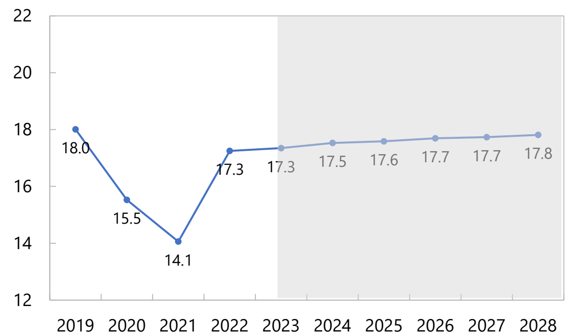
2022 (% GDP)	NIIP: 339.9	Gross Assets: 577.3	Debt Assets: 218.2	Gross Liab.: 237.4	Debt Liab.: 32.2

Current Account

Background. Andorra has one of the largest current account surpluses in the world and it is projected to remain high. Net exports and net primary income on average contribute almost equally to the country's large current account surplus. Driven primarily by tourism exports, Andorra maintains a larger trade surplus in services than its trade deficit in goods, resulting in a positive overall trade balance.

Current Account Balance

(Percent of GDP)



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

After deteriorating amid the COVID crisis, the current account balance has recovered with the resumption of tourism and a contained rise in energy prices due to long-term supply contracts. While the number of visitors remained well-below 2019 levels in 2022, tourists' expenditure partially recovered, driven by sharp increase in expenditure per visitor. As a result, the current account balance rose from 14.1 percent of GDP in 2021 to 17.3 in 2022 and in 2023, with the normalization of the tourism sector compensating the increase in both the volume and price of imported goods. The number of visitors reached a record 9.2 million during January to October of 2023, a 13 percent increase from the same period in 2022. The CA surplus is projected to increase to 17.8 percent of GDP by 2028.

Assessment. The CA model suggests that the external position of Andorra, at 17.3 percent of GDP in 2023 is substantially stronger than the level implied by fundamentals, estimated at 12.6 percent of GDP. Structural factors, such as Andorra's status as a financial center and private banking model, the size of the tourism sector, a historically strong fiscal position, and demographic trends are the main drivers of Andorra's strong external position and large current account norm. Beyond this norm, the current account gap is estimated at 5.1 percent of GDP and the corresponding REER undervaluation at 11.4 percent of GDP. The current account relative policy gap is estimated at 5.1 percent of GDP (relative to policy gaps across the world), mostly reflecting a looser world average fiscal stance and lower than desirable credit level in Andorra, which contributes to the large savings-investment gap.

Andorra: Model Estimates for 2023

(In percent of GDP)

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**17.3**	
Cyclical contributions (from model) (-)	-0.4	
Natural disasters and conflicts (-)	0.0	
Adjusted CA	**17.7**	
CA Norm (from model) 2/	**12.6**	
Adjusted CA Norm	**12.6**	
CA Gap	**5.1**	**3.9**
o/w Relative policy gap	5.1	
Elasticity	-0.4	
REER Gap (in percent)	**-11.4**	**-8.8**

1/ Based on the EBA-lite 3.0 methodology

2/ Cyclically adjusted, including multilateral consistency adjustments.

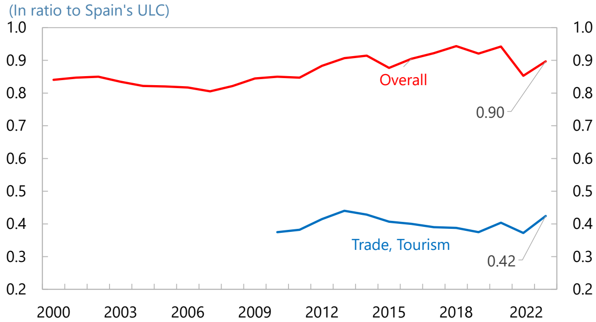
Real Exchange Rate

Background. Data limitations, including the fact that the existing measures of REER do not include services that are data sensitive, makes the REER model less reliable for Andorra. The assessment is therefore complemented with an array of measures of price competitiveness, which corroborate the assessment of the CA model that Andorra's external position is stronger than the level implied by fundamentals and desirable policies. The CPI-based REER depreciated by 13 percent between end-2020 and November 2023, partly because headline inflation in the euro area remained above Andorra's level. Measures of Unit Labor Costs (ULC) show that Andorra's ULC are about 42 percent of Spain's in trade and tourism. Moreover, the "1-week Cost of Ski Vacation" index shows that Andorra is an inexpensive destination compared with other European ski destinations, especially in hotel cost comparisons. These price competitiveness measures suggest that Andorra's REER is undervalued, corroborating the overall results of both the CA and the REER models.

Assessment. Staff assess the REER to be substantially stronger than fundamentals and desirable policy settings, based on the CA model. The REER gap suggested by the CA gap model indicates an undervaluation of 11.4 percent and a current account gap of 51 percent of GDP. The REER index model suggests an undervaluation of 8.8 percent and a current account gap of 3.9 percent of GDP.

Unit Labor Cost (ULC)

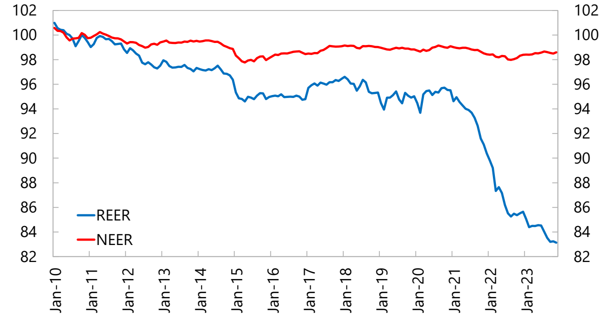
(In ratio to Spain's ULC)



Sources: Govern d'Andorra Department of Statistics, Eurostat, Haver Analytics, and IMF staff calculations.
Note: ULC=nominal wages*employment/real gross value added.

REER and NEER

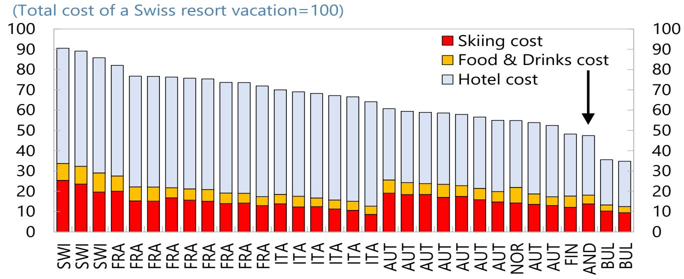
(Index: 2010M6=100; increase = appreciation)



Sources: Govern d'Andorra Department of Statistics and IMF staff calculations.
Note: REER: Real Effective Exchange Rate; NEER: Nominal Effective Exchange Rate. The weights for trading partners are based on goods trade only.

"1-Week Cost of Ski Vacation" Index, 2023

(Total cost of a Swiss resort vacation=100)



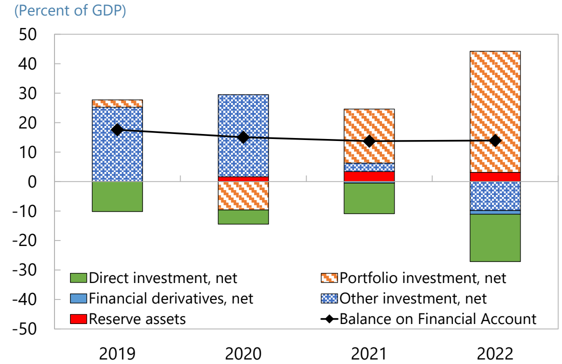
Sources: U.K. Post Office Travel Money Ski Resort Report 2023, US Department of State, and IMF staff calculations.
Note: The "1-Week Cost of Skiing Vacation" is inspired by the "A Week@Beach Index (Laframboise et al., 2014). Each bar represents a ski resort, and total cost of a week's ski vacation in one of Switzerland's resorts is indexed to 100. The costs are based on options for a UK-based traveler. "Skiing cost" includes cost of ski equipment rentals/lessons/pass. Hotel cost is based on US State Department rates for hourly nightly rates. Air travel cost and taxi costs are not included.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account position remains strong at 17.9 percent of GDP in 2022. After declining in 2020, net portfolio investment increased significantly in 2021 and 2022, reaching 41.8 percent of GDP in 2022. This increase was partially offset by a decline in other investment and FDI inflows.

Financial Account Balance and Components

(Percent of GDP)



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

Assessment. Despite Andorra's strong external position as shown by the large positive financial account, it could still be subject to balance of payments-related shocks given the openness of the economy, large off-balance-sheet assets under management, and the large share of non-resident deposits which leaves the banking sector subject to liquidity shocks in the event of a capital flight.

FX Intervention and Reserves Level

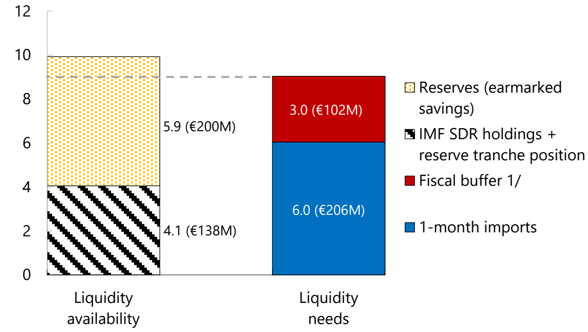
Background. The 2021 allocation of IMF Special Drawing Rights (SDRs) increased international reserves to about 5 percent of GDP. An additional €100 million (equivalent to 3.7 percent of GDP) from the debt issued in 2021 were deposited in a euro system reserve management account at the Bank of Spain in March 2022, bringing the reserves up to the reference level calculated by IMF staff. In addition, €40 million were deposited at the Banque de France, and €60 million at the Nederlandsche Bank as gross international reserves in 2022. No additional reserves have been deposited since and, as of end-2023, the total level of international reserves amount to 10 percent of GDP.

Andorra's legal tender is the euro, and the current classifications of Andorra's de jure and de facto exchange rate arrangements are "no separate legal tender".

Assessment. The authorities have taken steps to build up international reserves on a precautionary basis. Staff assess that the reserves should amount to 9 percent of GDP in 2023 under the assumption that banks have enough high-quality liquid assets to cover their liquidity needs (See 2022 Article IV Staff Report - Annex IV for calculations). They have already accumulated this amount. In addition, they are exploring additional funding sources to continue expanding the stock of reserves and are negotiating opening additional accounts at central banks of other euro area members.

Government Liquidity Needs and Availability

(Percent of 2023 GDP)



Sources: Andorran authorities and IMF staff calculations.
1/ The fiscal buffer is equivalent to one month of total government spending.

Annex II. Risk Assessment Matrix[1]

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Global Risks			
Intensification of regional conflict(s)	**High.** Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	**Low.** The war in Ukraine has only indirect effects on the Andorran economy, due to the limited direct linkages with Russia and Ukraine. It would affect the economy through higher inflation in the region and lower tourism flows.	• Implement policies to cope with rising and volatile food and energy prices. • Implement policies to diversify the tourism sector, improve its standards and remain competitive.
Commodity price volatility	**High.** A succession of supply disruptions (e.g., due to conflicts, uncertainty, and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, contagion effects, and social and economic instability.	**Medium.** Higher energy and food prices continue to push up headline and core inflation in the region and could weigh on tourism from neighboring countries and growth. Domestically, the exposure to energy price volatility is partially mitigated by long-term contracts with energy suppliers. However, core inflation could remain persistently high for longer and wage increases tend to follow the CPI. Higher inflation disproportionately affects low-income households, with a negative social impact and higher inequality.	• Implement policies to cope with rising and volatile food and energy prices, including consumption moderation. • Continue setting long-term contracts with energy suppliers, to the extent possible. • Accelerate planned reforms to reduce the share of imported energy and boost domestic energy production.
Abrupt global slowdown or recession	**Medium.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation causing sudden stops in EMDEs. In Europe, intensifying fallout from the war in Ukraine, recurrent energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns, and housing and commercial real estate market corrections.	**High.** A slowdown or recession in the region could create disruptions in the hospitality sector and weaken economic growth.	• Accelerate policies to diversify the economy and increase the resilience of the tourism sector. • Stand ready with targeted fiscal and financial support measures.
Monetary policy miscalibration	**Medium.** Amid high economic uncertainty and financial sector fragility, major central banks pause monetary policy tightening or pivot to loosen policy stance prematurely, de-anchoring inflation expectations, triggering a wage-price spiral and spillovers to financial markets.	**Medium.** Inflation expectation could be de-anchored, and second-round effects from additional wage increases lead to an inflation spiral with potential spillover to the financial markets. As a microstate, Andorra is directly impacted through imported prices.	• Given the importance of imported inflation, tight fiscal policy, intensified financial supervision, and structural reforms will be useful but of limited impact. • Policies to mitigate the social impact of lasting inflation, including targeted social support, will be important.

[1] 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.

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Extreme climate events.	Medium. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	Medium. Climate change is affecting Andorra's ski slopes. An increase in temperatures reduces the amount of snow, leading to shorter ski seasons and negatively impacting the Andorran tourism-based economy. This is partly mitigated by Andorra's higher slopes and its early investments in artificial snow-making equipment, which gives it a comparative advantage over its competitors.	• Develop adaptation policies to respond to climate change. • Provide targeted and temporary support to ski-related businesses, as needed.
Domestic Risks			
Labor shortages	Medium. Andorra's hospitality sector relies heavily on foreign seasonal workers. Labor shortages are amplified by shortages of affordable housing for these temporary workers, labor market rigidities, and difficulty attracting workers from traditional workers.	Medium. Labor shortages could impact output, efficiency, and profitability of firms, particularly in the tourism sector which relies heavily on seasonal workers. It could also affect foreign investment decisions for companies that cannot secure the necessary skilled workforce, thus limiting potential growth. The labor market remains tight and wage further increasing wage pressures.	• Policies to continue encouraging domestic labor force participation. • Policies to reduce labor market rigidities. • Policies to improve the attractiveness of the Andorran labor market, including housing support, training, etc.
Housing affordability worsen	High / Medium. Real estate and rent prices continue to increase and the housing cost overburden rate worsens as the supply of affordable houses does not keep up with the demand.	High / Medium. The lack of affordable housing increases inequality and makes the labor market less attractive, especially for foreign and seasonal workers. At worst, it may affect foreign investment decisions for companies that cannot secure housing for their workers, thus limiting potential growth. Inequality increases as affordability is mostly an issue among low-skilled and low-income households.	• Policies should focus on improving affordability for tenants. • Income support programs, rent controls, and landlord-tenant regulation could provide temporary relief. • Implement measures to boost rental availability from the existing housing stock. • Raising the low stock of rental housing and access to it is essential.
Reputational shock to the banking sector	Low. Reputational shocks—including due to ML/TF risks—can affect large banks focused on private banking and dependent on large foreign deposits. Recent progress in addressing ML/TF concerns since the 2015 crisis has contained this risk.	High / Medium. With large banks focused on private banking and dependent on large foreign deposits, Andorra could be subject to deposit flight. A banking failure would have a considerable economic impact. Mitigating factors include well capitalized and liquid banks and limited sovereign-bank nexus. a	• Further improve the effectiveness of the ML/TF framework and continue to effectively monitor cross border flows. • Keep fiscal and external buffers to mitigate a potential effect on the economy.

Annex III. Sovereign Risk and Debt Sustainability Assessment

Andorra's overall risk of sovereign stress is low. Public debt is expected to decline to about 30 percent of GDP on the back of primary surpluses over the medium term. A proactive debt management strategy strengthened the government's balance sheet—extending the average maturity of public debt and taking advantage of favorable international financial conditions. The risk from gross financing needs is low. Given that Andorra is a small, open euroized economy that is exposed to external shocks, fiscal buffers are important to build resilience against potential shocks. Fiscal policy is anchored to an effective fiscal framework that prescribes a central government public debt ceiling of 40 percent of GDP.

1. **Public debt decreased after rising during the pandemic.** Andorra's public debt increased during the pandemic primarily reflecting the deterioration of the primary balance and the authorities' pre-financing strategy. The 2021–22 Euro Medium Term Notes issuance program allowed the government to borrow €1.175 billion at favorable rates. The program allowed to substitute short-term debt for longer term notes with 5 to 20 years maturity, extending average debt maturity from 2.7 years in 2019 to 8 years at the end of 2022. Steady fiscal consolidation during the rapid recovery from the pandemic and accumulation of primary surpluses allowed to decrease both the general government and the central government debt level to below 40 percent of GDP in 2022, in line with the fiscal framework (under the fiscal rules, established debt ceilings are 40 percent of GDP for the central government debt and 55 percent of GDP for the general government debt).

2. **Debt is projected to decrease further.** Under the baseline scenario, growth will continue at a slower pace over the medium-term, down to a long-term potential of 1.5 percent. Projected primary surpluses will allow the government to decrease public debt further to about 31 percent of GDP by 2028. The proactive debt strategy during the pandemic allowed to lock in favorable rates and reduce debt service. The first large rollover comes in 2027 for €500 million notes. The assumption is that the government will roll over its maturing debt into the same instruments with some uncertainty about the rollover rates. The authorities borrowed €17 million from the Council of Europe Development Bank during 2020–22 for infrastructural needs.

3. **Risks to the debt profile are manageable.** The modules of the Sovereign Risk and Debt Sustainability Framework suggest that the risks to the public debt trajectory are low at all time horizons. The major risk comes from refinancing of notes in 2027 and 2031 at potentially higher rates than when borrowed in 2021–22. Baseline macroeconomic assumptions forecast a gradual reduction in interest rates globally over the medium-term, making the debt rollover in 2027 manageable. The fiscal framework anchors fiscal policy credibility, and the authorities proved their commitment to fiscal discipline by reducing debt level 48.6 percent of GDP in 2021 to below 40 percent of GDP in 2022. In the longer term, Andorran social security fund is projected to be depleted by 2040 due to an unsustainable pension system that could affect fiscal position and borrowing needs. The pension reform, currently under debate, needs to be approved soon to prevent spillovers to the otherwise solid debt profile of the country.

Figure 1. Andorra: Risk of Sovereign Stress

Andorra: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a low level of vulnerability across all time horizons.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low, consistent with the declining debt-to-GDP ratio supported by primary balance surpluses.
Fanchart	Low	...	
GFN	Low	...	
Stress test		...	
Long term	...	Low	Long-term risks are assessed as low.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Andorra is at a low risk of sovereign stress. Recovery from the pandemic enabled returning the debt ratio below 40 percent of GDP. Primary balances are projected to support reduction of debt-to-GDP ratio over the medium-term.

Source: Fund staff.
Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Andorra: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

Coverage	#	Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	No	Not applicable
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-government Debt Holdings

Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt									0
2 Extra-budget. funds									0
3 Social security funds									0
4 State govt.									0
5 Local govt.									0
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	0	0	0	0	0	0	0	0	0

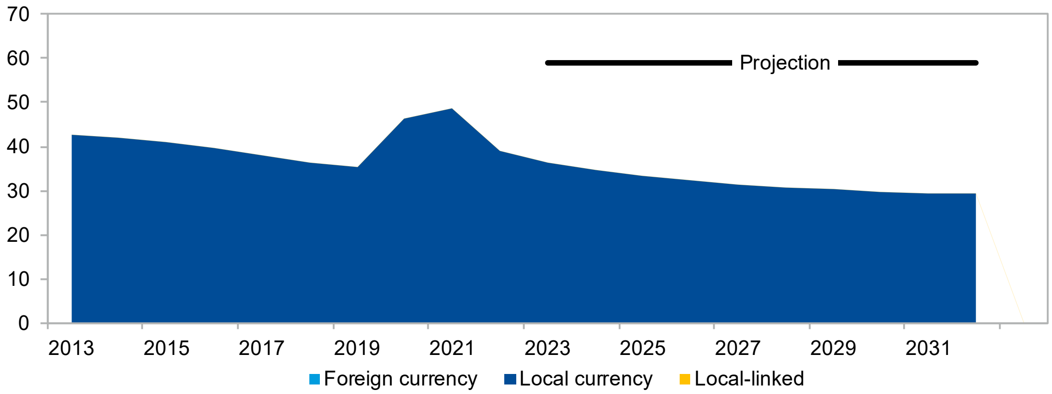
(Issuer rows 1–3: CG; rows 1–5: GG: expected; rows 1–6: NFPS; rows 1–8: CPS.)

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: 95 percent of debt is issued at the central government level.

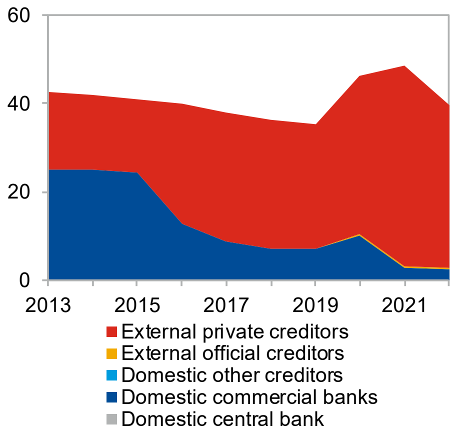
Figure 3. Andorra: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



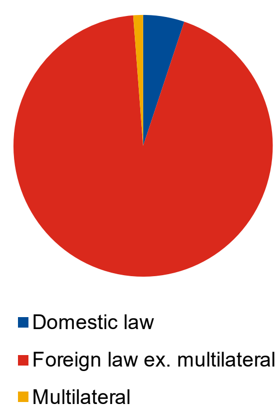
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



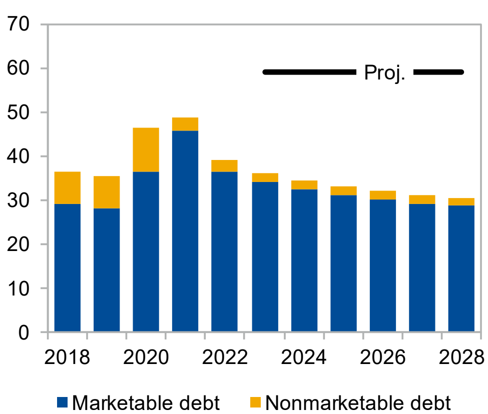
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2022 (percent)



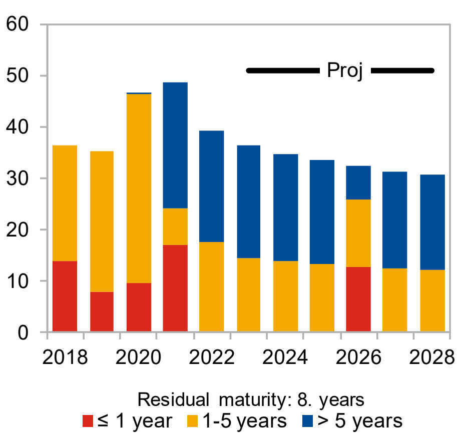
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: Andorra has replaced short-term domestic issuances with longer maturity external bond issuance, for most of its financing needs. The average maturity of debt lengthened substantially as a result.

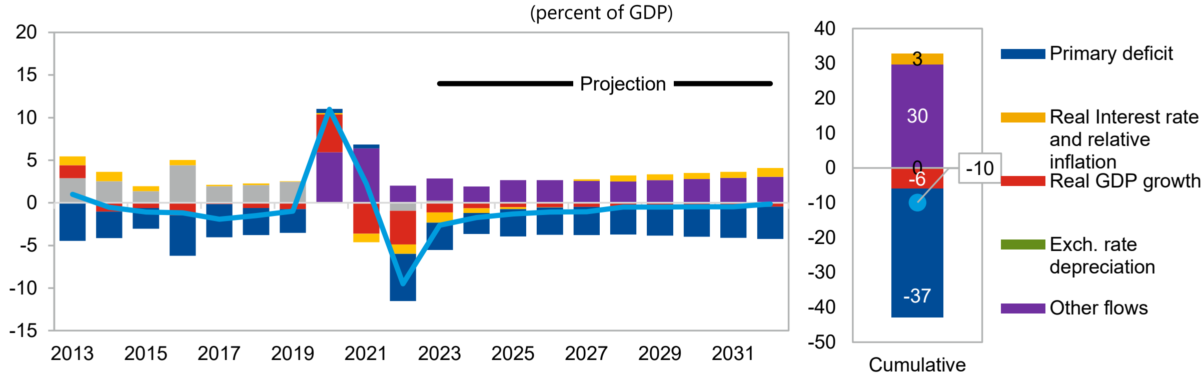
Figure 4. Andorra: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	39.1	36.4	34.7	33.4	32.3	31.3	30.8	30.3	29.9	29.4	29.3
Change in public debt	-9.5	-2.6	-1.7	-1.3	-1.1	-1.0	-0.5	-0.5	-0.5	-0.5	-0.1
Contribution of identified flows	-8.6	-2.9	-1.7	-1.3	-1.1	-1.0	-0.5	-0.5	-0.5	-0.5	-0.1
Primary deficit	-5.5	-3.2	-2.5	-3.2	-3.2	-3.3	-3.3	-3.4	-3.5	-3.7	-3.8
Noninterest revenues	39.7	38.8	38.5	39.4	39.5	39.5	39.6	39.6	39.7	39.8	39.8
Noninterest expenditures	34.2	35.6	36.0	36.2	36.3	36.2	36.3	36.3	36.2	36.1	36.1
Automatic debt dynamics	-5.0	-2.3	-1.2	-0.7	-0.5	-0.3	0.2	0.3	0.3	0.3	0.6
Real interest rate and relative inflation	-1.1	-1.2	-0.5	-0.2	0.0	0.2	0.7	0.7	0.7	0.7	1.0
Real interest rate	-1.1	-1.2	-0.5	-0.2	0.0	0.2	0.7	0.7	0.7	0.7	1.0
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-3.9	-1.1	-0.6	-0.5	-0.5	-0.5	-0.5 .	-0.5	-0.4	-0.4	-0.4
Real exchange rate	0.0	...	...	...	...	...	... .	...	...	...	...
Other identified flows	2.0	2.6	1.9	2.7	2.7	2.6	2.5	2.7	2.8	2.9	3.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	2.0	2.6	1.9	2.7	2.7	2.6	2.5	2.7	2.8	2.9	3.1
Contribution of residual	-0.9	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	14.5	-2.6	-1.9	-2.7	-2.7	9.9	-1.4	-1.6	-1.5	9.5	0.0
of which: debt service	20.1	0.6	0.5	0.6	0.6	13.2	1.8	1.8	2.0	13.1	3.7
Local currency	20.1	0.6	0.5	0.6	0.6	13.2	1.8	1.8	2.0	13.1	3.7
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	8.8	3.0	1.8	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Inflation (GDP deflator; percent)	4.2	4.9	3.1	2.4	1.8	1.8	1.7	1.7	1.7	1.7	1.7
Nominal GDP growth (percent)	14.2	7.3	5.0	3.9	3.3	3.3	3.2	3.2	3.2	3.2	3.2
Effective interest rate (percent)	1.7	1.6	1.6	1.7	1.7	2.3	4.0	4.1	4.1	4.2	5.4

Contribution to Change in Public Debt

(percent of GDP)

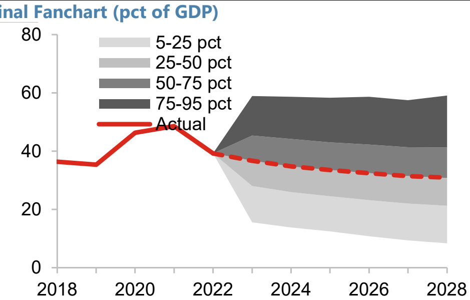


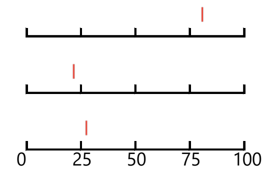
Commentary: Public debt will gradually decline on the back of primary balance surpluses and growth. Other flows reflect accumulation of asset buffers by the government not explicitly dedicated to a particular purpose. Historical data on net acquisition of financial assets and other debt-creating flows prior to 2020 are not included, resulting in a relatively large residual.

Figure 5. Andorra: Medium–Term Risk Assessment

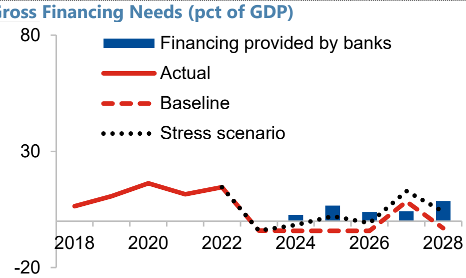
	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	50.7	0.7	
Probability of debt non-stabilizaiton *(percent)*	0.0	0.0	
Terminal debt-to-GDP x institutions index	5.4	0.1	
Debt fanchart index (DFI)		0.9	
Risk signal: 3/		Low	
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	-1.9	-0.6	
Initial Banks' claims on the gen. govt *(pct bank assets)*	0.4	0.1	
Chg. In banks' claims in stress *(pct banks' assets)*	2.7	0.9	
GFN financeability index (GFI)		0.4	
Risk signal: 4/		Low	

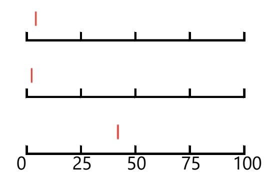
Final Fanchart (pct of GDP)





Gross Financing Needs (pct of GDP)

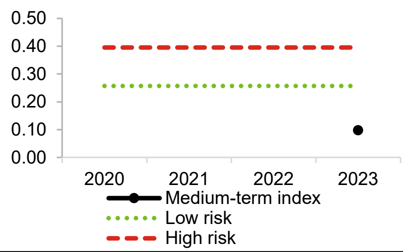




Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (index number)



Medium-term risk analysis

	Value	Value (normalize	Weight	Contribution
Debt fanchart index	0.9	0.2	0.5	0.1
GFN finaceability index	0.4	0.0	0.5	0.0
Medium-term index		0.1		
Risk signal: 5/		Low		
Final assessment:		Low		

Prob. of missed crisis, 2023-2028, if stress not predicted: 0.0 pct.
Prob. of false alarms, 2023-2028, if stress predicted: 89.8 pct.

Commentary: Medium-term risks are assessed as low, consistent with the mechanical signal. Lack of historical data magnifies the impact of debt fluctuations during the pandemic (including due to debt pre-financing by the authorities in 2020-22), resulting in a wide fan chart.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure 6. Andorra: Realism of Baseline Assumptions

Forecast Track Record 1/	t+1	t+3	t+5
Public debt to GDP			
Primary deficit			
r - g			
Exchange rate depreciaton			
SFA			
	real-time	**t+3**	**t+5**
Historical Output Gap Revisions 2/			

Comparator Group:

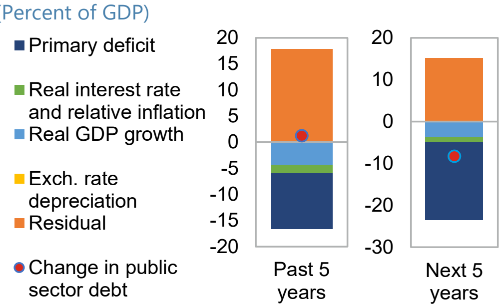
Advanced Economies, Non-Commodity Exporter, Surveillance

Color code:

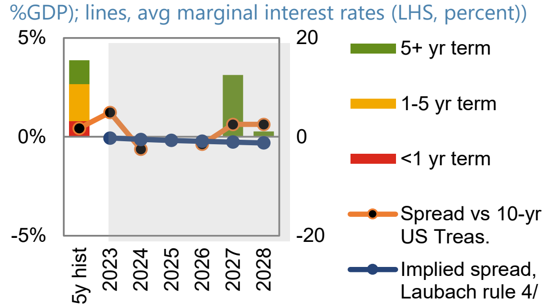
Optimistic: > 75th percentile; 50-75th percentile

Pessimistic: 25-50th percentile; < 25th percentile

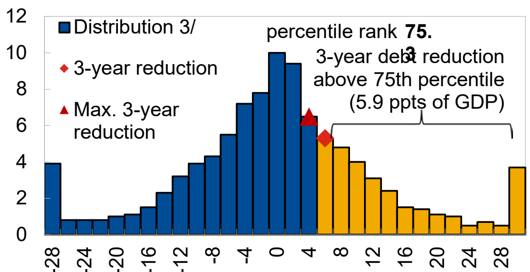
Public Debt Creating Flows
(Percent of GDP)



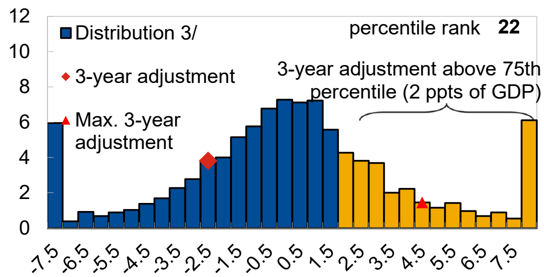
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



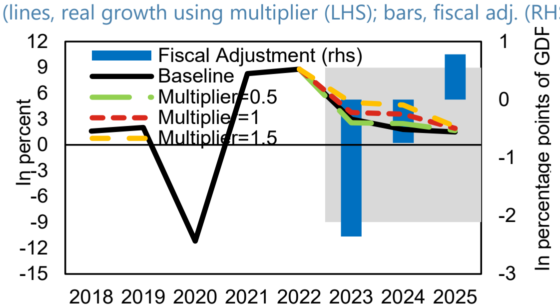
3-Year Debt Reduction
(Percent of GDP)



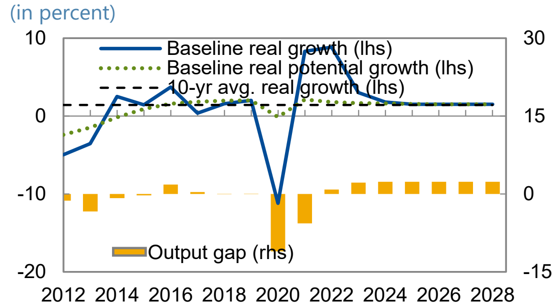
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth
(in percent)



Commentary: Rapid recovery from the pandemic enabled swift reduction in debt. Realism analysis does not reveal any systematic biases and the projected fiscal adjustment is within norms. Residuals reflect accumulation of asset buffers by the government. Future bond issuances are projected to roll over existing bonds.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage. Program status not used in creating comparator group due to lack of data.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 7. Andorra: Triggered Modules

Large amortizations	Pensions	Climate change: Adaptation	Natural Resources
	Health	Climate change: Mitigation	

Andorra: Long-Term Risk Assessment: Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Overall Risk Indication		

Annex IV. Authorities' Response to Past IMF Policy Recommendations

IMF 2022 Article IV Recommendations	Policy Actions
Fiscal Policy	
The authorities should stand ready to reinstate COVID-related support measures if the recovery falters. If warranted, they should provide targeted support to sectors that are still emerging from the pandemic to prevent long-term scarring.	The economy recovered strongly in 2021–22 and no support measures were needed.
The right balance needs to be found between consolidation to meet the fiscal rule targets and allowing for growth-enhancing spending.	Fiscal consolidation proceeded swiftly. However, the central government investment remains low, though there are plans to increase it in the next few years.
Continue to diversify Andorra's debt in both the international and domestic markets, with a focus on maintaining low gross financing needs.	The authorities have completed their medium-term issuance program in 2022. The program enabled them to lock in favorable rates and increase debt maturity.
Reform the pension system to ensure its sustainability.	The reform has been delayed and is currently being discussed by the legislators.
Financial Sector	
Continue close monitoring of the banking sector after the full withdrawal of COVID-related support.	The supervisor closely monitors asset quality at banks including its early indicators.
Further reinforce the supervision of liquidity risk including by enhancing the monitoring and stress testing of net liquidity outflows.	The AFA is closely following movements of deposits and exposures to counterparties. It completed a comprehensive liquidity stress test in 2023, that demonstrated banks resilience to liquidity shocks.
Structural Policies	
Improve country connectivity and infrastructure to boost and diversify tourism.	The authorities are investing in a heliport to be completed by 2025. Measures (notably for foreign seasonal workers) support diversification of the tourism sector.
Create a favorable environment for investment in high value-added sectors.	The government adopted a program to help private businesses with digitalization efforts. The new law on digital economy, entrepreneurship and innovation provides for creation of a special economic zone to develop and test digital and innovative products.
Invest in education, vocational training, and reskilling to prepare workers for the shift to high-skilled jobs.	
Improve housing supply—tax empty properties more heavily and increase the social housing stock to expand the supply of rental housing.	The authorities have started taking actions to address the issue such as easing requirements for housing support, temporary caps on rent increases, increasing tax on empty properties, increasing the stock of social apartments, repurposing of buildings for residential housing, and slowing down construction permits for housing that is built to be sold rather to be rented.
Build resilience to climate change.	A comprehensive adaptation strategy still needs to be drawn out. Measures to foster mitigation are being adopted.

Governance and Transparency	
Further align Andorra's anti-corruption framework to international standards: ratify the United Nations Convention Against Corruption, develop an anti-corruption strategy, advance the reform of the public procurement framework, and publish beneficial ownership information.	No action has been taken.
Continue efforts to close data gaps to enhance transparency and improve surveillance.	The authorities have been making progress in improving data quality across all sectors supported by IMF technical assistance.

INTERNATIONAL MONETARY FUND

PRINCIPALITY OF ANDORRA

February 9, 2024

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION —INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of November 8th, 2023)

Membership Status: Joined October 16th, 2020, Article VIII.

General Resources Account:	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

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	114.44	100.00
Holdings	93.77	81.98

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund
(SDR Million; based on present holdings of SDRs)

	Forthcoming				
	2022	**2023**	**2024**	**2025**	**2026**
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.05	0.07	0.07	0.07	0.07
Total	0.05	0.07	0.07	0.07	0.07

2023 Article IV Consultation: This is Andorra's third Article IV consultation. Discussions were held on December 6–18, 2023, in Andorra.

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. Andorra has accepted the obligations under Article VIII, Sections 2, 3 and 4 of the IMF's Articles of Agreement and maintains an exchange system free of multiple currency practices and of restrictions on the making of payments and transfers for current international transactions, except for those measures imposed solely for security reasons which have been notified to the Fund pursuant to Executive Board Decision No. 144 (52/51). The current classifications of Andorra's de jure and de facto exchange rate arrangements are "no separate legal tender."

Technical Assistance:

Year	**Department/Purpose**
2020–23	STA External Sector Statistics
2021	MCM Bank Supervision
2021	STA e-GDDS
2022	MCM Systemic Liquidity Management: lender of last resort framework
2023	Government Finance and Public Sector Debt Statistics

Resident Representative: None

STATISTICAL ISSUES

(As of November 8th, 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance, but widespread data gaps exist. Significant 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.
National Accounts: The level of annual GDP disaggregated by economic activities is only available in nominal terms and published with a one-year lag. For the real GDP by economic activities 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. The Andorran Statistics Department will extend backwards the series of GDP growth at quarterly frequency to start in 2002 (and not in 2010). It is also planning to publish expenditure and income components of GDP starting from 2024. The authorities started producing a monthly value unit index of goods exports and imports in 2022:Q3.
Price Statistics: The consumer price index (CPI) and components are published at a monthly frequency within two weeks after the reference period. The weights are updated annually based on household budget surveys. Owner-occupied housing is included in the CPI using the rental equivalence approach. A producer price index is not compiled.
Government Finance Statistics: 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 not available, and quarterly fiscal data can be provided by the authorities only upon request and with a three-month delay. 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.
Monetary Statistics: More granularity is 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.
Financial Sector Surveillance: The authorities provide FSIs at a quarterly frequency. Staff identified inconsistencies on reporting of credit growth between the FSI data and monetary statistics. FSIs are not directly reported to the IMF's Statistics Department. Data on the financial

health of corporates and households is not available yet; the authorities will start publishing aggregate company financial statistics and financial ratios, at annual frequency, starting from 2022:Q3. Real estate prices, residential and commercial, are available at quarterly frequency.	
External Sector Statistics: The Andorran Statistics Department successfully disseminated its first annual BoP statistics in May 2021 (with 2019 data). Since then, the BoP data has been extended to 2022 and the coverage and quality were improved with support from IMF's Statistics Department. The authorities also made progress on the development of International Investment Position (IIP) statistics and data is available for 2019–22. The authorities are working to start compiling quarterly BoP and IIP by end-2024.	
II. Data Standards and Quality	
The Andorran authorities implemented the Enhanced General Data Dissemination System (e-GDDS) by launching a National Summary Data Page, a one-stop shop for data dissemination, on May 6, 2022.	No data ROSC available.

Table 1. Andorra: Common Indicators Required for Surveillance

(As of November 8th, 2023)

	Date of latest observation	Date received	Frequency of Data[8]	Frequency of Reporting[8]	Frequency of publication[8]
Exchange Rates[1]	NA	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	2022	November 2023	M	M	M
Reserve/Base Money[1]	NA	NA	NA	NA	NA
Broad Money[1]	NA	NA	NA	NA	NA
Central Bank Balance Sheet[1]	NA	NA	NA	NA	NA
Consolidated Balance Sheet of the Banking System	2021	January 2022	A	A	A
Interest Rates[3]	NA	NA	NA	NA	NA
Consumer Price Index	2023:M10	November 2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	2022	October 2023	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	2022	October 2023	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[6]	2022	October 2023	A	A	A
External Current Account Balance	2022	November 2023	A	A	A
Exports and Imports of Goods and Services	2022	November 2023	A	A	A
GDP/GNP	2022	March 2023	A	A	A
Gross External Debt	2022	November 2023	A	A	A
International Investment Position[7]	2022	November 2023	A	A	A

[1] Monetary and financial statistics (MFS) are not reported to IMF's Statistics Department due to capacity constraints. IMF Technical Assistance in this area is planned for 2024.
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions—update definition.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.
[7] Includes external gross financial asset and liability positions vis a vis nonresidents.
[8] 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 Cristina Camp, Advisor to the Executive Director
February 26, 2024

On behalf of the Andorran authorities, we would like to thank Mr. Blavy and his team for their hard work and constructive and positive exchanges during the Article IV mission to the Principality of Andorra. We welcome the insights and policy advice in the staff report and the set of papers produced, including the high-quality Selected Issues Papers (SIP) on (i) the Andorran Banking sector, (ii) climate change, and (iii) housing affordability. The Andorran authorities broadly agree with staff's appraisal and will carefully consider their thoughtful policy advice.

Macroeconomic Outlook

The Andorran economy has demonstrated resilience, experiencing strong growth following the COVID-19 crisis. The Andorran economy grew in real terms by 8.3 percent in 2021 and 9.6 percent in 2022. GDP growth in 2023 is, with 2.3 percent, still among the highest in Europe, primarily driven by the service sector. A record number of tourists (12 million overnight stays in 2023 against 10 million in 2022 and 8.8 million in 2019) visited Andorra in 2023. In 2024, growth is expected to slow slightly but will remain above potential (1.5 percent). Growth also contributed to an increase in the number of jobs, with job growth being 10.5 percent in 2021/2022 and 5.4 percent in 2022/2023. Unemployment is almost nonexistent in Andorra (1.7 percent in 2023) and remains well below the eurozone average due to the specific nature of Andorra's labor market. Inflation is declining after having reached its peak in 2022 (7.1 percent) and it's expected to reach the target level of 2 percent in 2025. Despite long-term energy contracts containing imported inflation for some time, inflation started to accelerate in 2021, mostly influenced by global supply constraints following COVID-19 and Russia's war against Ukraine which impacted energy and food prices.

The authorities agree with staff that risks are balanced. Addressing housing and labor shortages continues to be a top policy priority to support the economy. Solid fiscal and financial buffers such as low public debt and foreign reserves as well as well-capitalized and liquid banks can mitigate downside risks.

Fiscal policies

Fiscal discipline has contributed to strong fiscal buffers. After 2 years of modest fiscal deficits, Andorra's general government balance returned to a large surplus in 2022 (4.8 percent) and 2023 (2.6 percent). Solid revenue growth was driven by higher-than-expected direct tax collection following higher-than-expected growth outturns. The authorities agree with staff that there is room within the fiscal framework to implement needed growth-enhancing investment. Nonetheless, the authorities do caution that in a small country like Andorra, multiplier effects might be more subdued than expected.

Andorra has an effective debt management strategy, resulting in low financing costs and low debt rollover risks. Andorra's general government debt ratio is 36.4 percent (2023), having reached its peak in 2021 (48.6 percent). Primary balance surpluses of about 1 percent are expected over the medium-term, which could bring the debt level below 30 percent by 2028. The average interest rate for government debt in 2023 has been 1.34 percent with an average maturity of 7.3 years. The government has no financing needs until 2027. Yet, the Andorran authorities remain dedicated to their debt management efforts. The authorities agree with staff that in the medium- to longer-term, debt sustainability faces challenges from demographic pressures and increased age-related spending. Thus, pension and healthcare system reforms are key priorities for the government. In January 2024 the Andorran Government announced the key features of the healthcare system National Pact and the Parliamentary majority is currently working to build a political consensus on a reform of the pension system.

Financial sector

The Andorran banking sector remains well-capitalized, liquid, and profitable. Andorran banks exceed regulatory requirements and European averages (Tier 1 capital ratio on an aggregate individual basis of 19.4 percent and an LCR of approximately 200 percent as of 2023Q3) and profitability has improved from 0.5 percent in 2021 and 0.6 percent in 2022 to an annualized ROA of 0.8 percent in 2023Q3.

There are several macroprudential instruments available to the Andorran Financial Authority (AFA) to safeguard financial stability. These instruments include the capital conservation buffer, the countercyclical capital buffer, the capital buffer for systemically important institutions, and the systemic risk buffer. Additionally, the AFA's supervision model is based on the Core Principles for Effective Banking Supervision published by the Basel Committee on Banking Supervision and is built on their guidelines for common procedures and methodologies for supervisory reviews and evaluation processes (SREP), and stress testing. Moreover, to improve Andorra's financial resilience in the event of a liquidity shock in the financial sector, also after benefiting from IMF Technical Assistance (TA), a bill establishing the legal framework for setting a Lender of Last Resort mechanism entered into force in December 2022. It replicates the emergency liquidity assistance model of the European Central Bank (ECB) and is, comparable to international peers. In addition, the ECB has agreed to extend the maturity of the temporary liquidity line (up to € 35 million) with the AFA until 31 January 2025.

Governance and transparency

Andorra is strongly committed to the highest governance and transparency standards. The authorities have taken many steps to further strengthen the AML/CFT framework and fully aligned it with international best practices, including FATF recommendations. Andorra is subject to periodic evaluations by the Council of Europe, undertaken by the Committee of Experts on anti-money laundering and the financing of terrorism measures (Moneyval). Currently, Andorra is rated Fully Compliant (C) and Largely Compliant (LC) in 37 of the 40 recommendations. Since the 2016 Moneyval assessment, the authorities have updated the Andorran National Risk Assessment and scaled up on-site inspections. Moreover, Andorra fully implemented the AML/CFT European regulations. The authorities reiterate their firm commitment to further strengthening their national anticorruption framework and are currently considering the ratification of the UN Convention against Corruption.

The Andorran authorities welcome the policy advice and recommendations of the IMF. Andorra's international reserves currently include € 138 million in SDRs and over € 200 million in reserves deposited at the central banks of Spain, France, and the Netherlands, thereby meeting the IMF's calculated potential FX-liquidity needs of up to 9 percent of GDP in 2023. Additionally, several advances have been made in closing data gaps since its membership and after benefiting from IMF TA, including the publication of the Balance of Payments and the International Investments Position statistics, and the implementation of the Enhanced General Data Dissemination System (e-GDDS). The latter by launching a National Summary Data Page in May 2022 and in 2023 initiating the production of fiscal accounts for the general government in the form of annual time series.

Structural reforms

As also noted by staff, Andorra's economy will benefit from the Association Agreement with the European Union, ensuring Andorra's participation in the EU's internal market which has the potential to unlock substantial benefits by opening markets for a more diversified economy. In December 2023, an agreement was reached at the level of negotiators between the Andorran Government and the EU. In line with the 2014 negotiating directives, the Association Agreement will take into account the particular situation of Andorra, its specificities (geography, size, and relatively small population), and transition periods, particularly in the financial sector. This will allow the government to prepare the economy to maximize the benefits of accessing the single market and proactively mitigate any potential disruptions.

The authorities welcome staff's SIP on the various macro-critical structural reforms and policies, **particularly concerning housing affordability and climate change**. Housing affordability is a key priority for the current government. The government announced the development of new houses (some projects have already commenced in early 2024) and an extension of lease contracts until 2027 to ensure sufficient affordable housing. As for climate change, Andorra has been part of the United Nations Framework Convention on Climate Change since 2011, and in 2016, the General Council (the Andorran Parliament) unanimously approved the ratification of the Paris Agreement and is committed to reducing emissions by 55 percent by 2030 and achieving carbon neutrality by 2050. Towards this end, the government implemented a carbon tax in 2021. Additionally, public programs support the improvement of building energy efficiency and the acquisition of electric vehicles. Furthermore, the state-owned energy enterprise is actively investing in the production of green energy in cooperation with its neighboring countries.