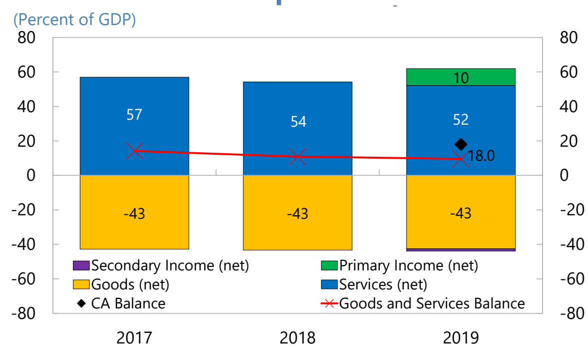
CURRENT ACCOUNT BALANCE AND EXTERNAL COMPETITIVENESS[1]

The authorities have just started producing Balance of Payments data with technical assistance from the IMF's Statistics Department. Preliminary compilation shows that the current account surplus was 18 percent of GDP in 2019 and could have moderated in 2020. While a current account norm is hard to establish, the current account surpluses over the medium-term are appropriate in a euroized country without official international reserves. Analyses of various real exchange rates—including a new "1-week cost of skiing vacation" index—suggest that Andorra fares well in external competitiveness.

Current Account Balance

1. The current account (CA) balance, with newly produced data, was 18 percent of GDP in 2019. Andorra has a trade surplus in services and a trade deficit in goods, resulting in a positive balance of goods and services that has somewhat deteriorated in 2017–19 (Figure 1). Tourism exports, which comprise 60 percent of GDP, have slightly declined in 2019 as the number of visitors from Spain and France fell with a slowdown in regional GDP growth. In 2019, net exports and net primary income contributed almost equally to the current account surplus; data on primary and secondary income for previous years is not available.

Figure 1. Current Account Balance and Components



Sources: Govern d'Andorra Department of Statistics and IMF staff calculations.
Note: Primary and secondary income not available for 2017-2018.

2. The CA balance seems to have slightly moderated in 2020 but is expected to rise to pre-pandemic levels by 2026. Preliminary high frequency indicators show that while the number of tourists fell by almost 40 percent, fuel imports declined sizably by 35 percent. However, the large share of food and other necessity items, including medical supplies, have kept imports persistently high, resulting in a slight deterioration of the current account to 14 percent of GDP in 2020 (see Table 6 in the Staff Report (IMF, 2021)). With a full resumption of tourism, and a fairly flat demand for imports of necessary goods, the CA surplus is foreseen to increase back to 19.1 percent of GDP by 2026 (see Tables 2–3 and 6 in the Staff Report (IMF, 2021)).

3. A CA norm is hard to establish, but the persistence of CA surplus over the medium-term appears appropriate. The sizeable surplus provides comfort against balance of payments financing worries in a euroized economy without a lender of last resort and where sufficient

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international reserves are yet to be built (see Selected Issues Paper (SIP): *Gross International Reserves*).

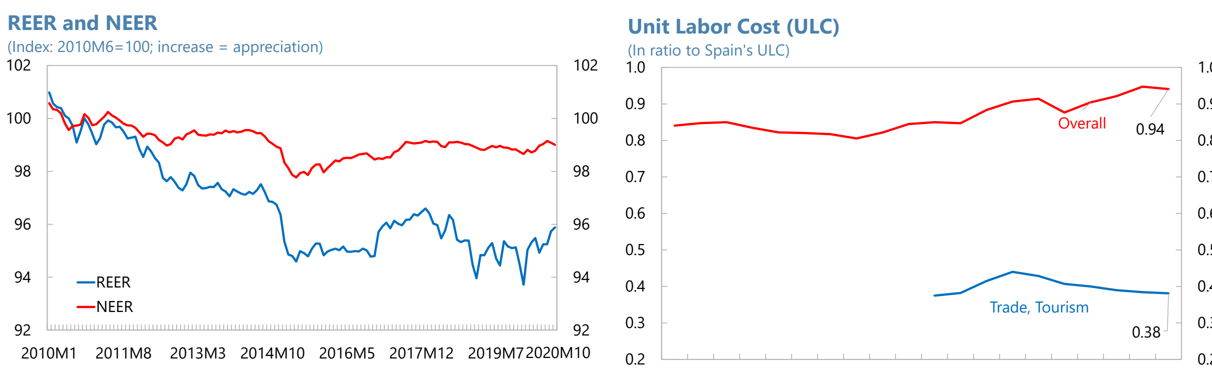
4. The balance of payments data for 2019 indicated that the CA surplus resulted in strengthening Andorra's external position through the financial account transactions. The financial account showed that Andorran households and enterprises repaid loans received from banks abroad, and that Andorran banks purchased debt securities issued by non-residents. These transactions increased Andorra's net asset international investment position further.

Real Exchange Rate and External Competitiveness

5. The CPI-based Real Effective Exchange Rate (REER) has been falling since 2018, as headline inflation increased slowly in the euro area and Spain, while Andorra's fell. Declining energy costs pushed down prices of transport and recreation sectors in Andorra that account for a third of the domestic CPI index. While the NEER and REER trade weights are based on goods trade only (Figure 2, left), Spain remains the main trading partner for both goods and services trade, especially in tourism.

6. Comparing Andorra's unit labor cost—the wage bill for producing a unit gross value added of trade and tourism output—with Spain's could provide meaningful measures of competitiveness in the tourism sector. Such comparisons show that Andorra's ULC is only about 40 percent of Spain's in trade and tourism, and the ratio has been falling since 2013 despite similar productivity growths. This is in contrast to the growing ratio of overall ULCs between the two countries, although Andorran ULC remained below Spain's.

Figure 2. Real and Nominal Exchange Rates



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.

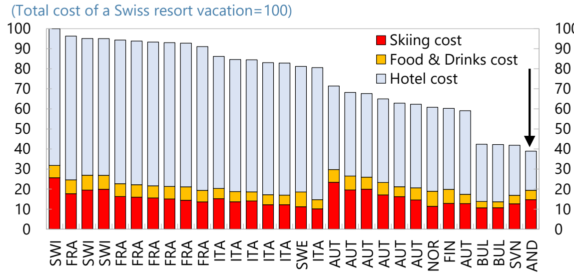
Sources: Govern d'Andorra, Eurostat, Haver Analytics, and IMF staff calculations.
Note: ULC=nominal wages*employment/real gross value added.

7. A new "1-week Cost of Skiing Vacation" index shows that Andorra is a fairly cheap destination, especially in hotel cost comparisons. Inspired by the "Week@theBeach" index (Lafambroise et al., 2014), the nominal cost of a six-day ski vacation can be calculated based on the cost of ski equipment rentals/lessons/ski pass, food and drinks, and hotel costs. Indexed to the cost of an expensive Swiss resort, the "1-week cost of skiing vacation" shows that Andorra compares favorably with other European ski destinations (Figure 3). The export market share, based on tourist arrivals, has also steadily increased in Andorra since 2014, notwithstanding the slight fall since 2018, demonstrating high and rising competitiveness.

Figure 3. External Competitiveness of the Tourism Sector

"1-Week Cost of Ski Vacation" Index, 2019

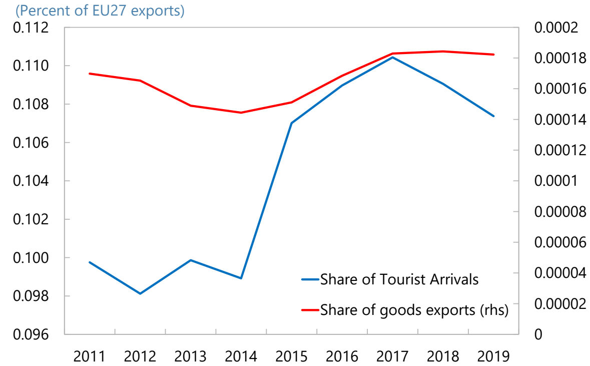
(Total cost of a Swiss resort vacation=100)



Sources: U.K. Post Office Travel Money Ski Resort Report 2019, 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.

Andorra: Export Market Shares

(Percent of EU27 exports)



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

8. **In sum, the levels of various real exchange rates suggest Andorran exports are competitive.** The norm for the CA balance is hard to estimate in the absence of reliable real sector and balance of payments data. However, analysis of the real exchange rate both in terms of weighted-average of goods-trading partner CPI, and in terms of relative unit labor costs in tourism services trade with Spain shows that Andorran trade is competitive, with rising market share of tourists. In fact, relative tourism wages are lower than relative productivity growth vis-à-vis Spain. The cost of ski vacation is also among the lowest in the region, mainly due to hotel costs.

International Investment Position

9. **Andorra has taken first steps to produce international investment position (IIP) statistics.** Currently, external position data are available for banks and other entities for which banks provide custody or management services. Staff supplemented these data with mirror data from the IMF's Coordinated Direct Investment Survey (CDIS) and the BIS' Locational Banking Statistics (LBS), albeit with limited coverage. In CDIS and LBS, participating countries report their positions in direct and other investments with Andorra. These positions reported by Andorra's partner countries were aggregated and consolidated with the data received from Andorran banks (Table 1).

10. **The results show that Andorra has a positive (net asset) position while it is vulnerable to withdrawals of deposits by non-residents.** Andorra's net asset position is consistent with its steady current account surplus, and it strengthened in 2019. Andorra had a net asset position in portfolio investment but a net liability position in other investment. The assets and liabilities in FDI were broadly balanced. More than half of the total liabilities held by Andorra were concentrated in deposits that Andorran banks received from non-residents, and this poses risks (see SIP: *Gross International Reserves*).

Table 1. Andorra: Estimated International Investment Position (2018–2019) 1/

(Percent of GDP)

ASSETS	2018	2019	LIABILITIES	2018	2019
Total	**447.4**	**455.2**	**Total**	**273.8**	**245.9**
Direct investment	**41.7**	**38.1**	**Direct investment**	**36.6**	**35.2**
Equity	41.6	38.0	Equity	36.3	35.5
Debt	0.1	0.1	Debt	0.3	-0.3
Portfolio investment	**273.2**	**282.1**	**Portfolio investment**	**47.5**	**50.3**
Equity	118.9	122.4	Equity	36.1	38.7
Debt	154.3	159.8	Debt	11.4	11.6
Other investment	**132.5**	**135.0**	**Other investment**	**189.7**	**160.4**
Loans	32.4	33.9	Loans	30.8	10.5
Currency & Deposits	100.1	101.1	Currency & Deposits	142.0	133.7
			Insurance	16.8	16.2

Sources: IMF CDIS, Bank of International Settlements (BIS), Andorran authorities, and IMF staff calculations.
1/ Issues in the coverage include countries' limited participation in the CDIS and LBS (e.g., some major offshore centers do not participate in the CDIS) and confidentiality of data (e.g., some countries do not disclose its direct investment assets and liability positions to Andorra, given that the data might reveal the investment by individual investors). The asset and liability positions in direct and other investments could increase if these issues are addressed. The equity component of direct investment is derived by deducting the debt component from the total direct investment positions for some countries. Debt positions in direct investment could be negative when subsidiaries or associates invest in their direct investors (i.e., parent companies). Debt securities (liabilities) in portfolio investment are reported only for banks.

11. **The authorities need to continue developing data on IIP by filling remaining data gaps.** In particular, the authorities need to improve and utilize the information from their business surveys and business registry. Potential source data at the Tax Office, Ministry of Finance, and other government agencies should also be explored. Euro currency circulating in Andorra needs to be estimated and added to currency and deposits (assets) in other investment. In addition to direct, portfolio, and other investments, asset and liability positions in financial derivatives also need to be compiled. The IMF is ready to provide technical assistance on the compilation of macro-economic statistics for Andorra.

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