

Panama: 2009 Article IV Consultation—Staff Report; Staff Statement and Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Panama

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 2009 Article IV consultation with Panama, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 24, 2009, with the officials of Panama on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 6, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of June 1, 2009, updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 1, 2009, discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Panama.

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PANAMA

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with Panama

Approved by Miguel A. Savastano and Michele Shannon

May 6, 2009

- **Background.** Panama is facing the global financial crisis from a position of strength, reflecting several years of rapid economic growth and fiscal consolidation, as well as a strong banking system. Although the spillovers have thus far been limited, some strains are becoming evident.
- **Prospects.** Economic activity is set to slow significantly owing to the deterioration in the external environment, but growth is expected to remain in positive territory due to the strong growth momentum and ongoing Panama Canal expansion. The government's financing needs for 2009 have been met. The banking system, while robust, may be vulnerable to further deterioration in international financial conditions.
- **Policy issues and main recommendations.** The scope for countercyclical policies is limited owing to the absence of a national currency and fiscal deficit limits established by a new fiscal responsibility law. Main recommendations are: (i) adhere to the fiscal deficit mandated by the fiscal responsibility law; (ii) develop guidance to operationalize the fiscal responsibility law to allow for rapid adjustment when growth decelerates more rapidly than envisaged; and (iii) develop contingency plans to address pressures on the banking system.
- **2008 Article IV consultation.** During the July 2008 Board discussion, Directors recommended the adoption of a stronger fiscal stance to contain excess demand and inflationary pressures while providing room for additional measures to ease the impact of inflation on the poor. Directors also stressed the need for continued financial sector vigilance. In line with these recommendations, the government maintained the fiscal accounts in surplus and stepped up the monitoring of the banking system.
- **Mission.** The 2009 Article IV consultation discussions took place during March 11–24; the mission comprised of Ms. Gold (head), Messrs. Alichí, Dehesa, and Ms. Shi (all WHD). Mr. Wezel (MCM) joined the mission in its second week.

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I. BACKGROUND AND NEAR TERM OUTLOOK

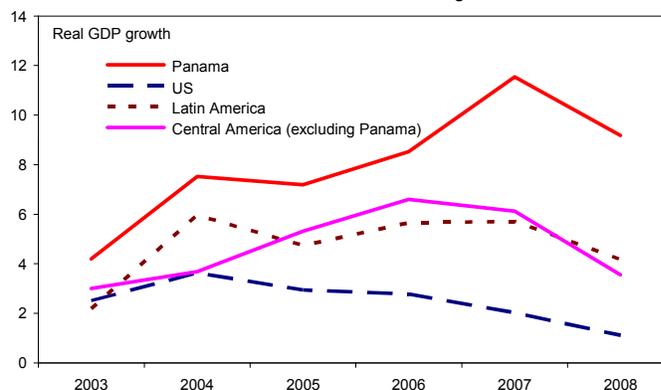
Strong domestic fundamentals helped contain the impact of the global financial crisis but the rapid deterioration in the global environment has weakened the economic outlook.

1. ***Strong growth performance but a slowdown unavoidable.*** Real GDP growth during 2004–08 averaged 8.8 percent as Panama benefited from the favorable external environment including a high level of foreign direct investment. Construction, transportation and communications sectors helped maintain real GDP growth above 9 percent in 2008, but these sectors, together with financial services, are likely to be among the most adversely affected by the decline in global trade and the slowdown of credit in 2009 (Box 1).¹ Growth in 2009–10 is projected to slow to 3–4 percent.

2. ***Inflation on a downward path.*** Inflation peaked at 10 percent in September 2008, reflecting high international food and fuel prices, as well as demand pressures. In line with global trends, inflation is declining rapidly, falling to 3.7 percent by March 2009, and is projected to fall to about 3 percent by end–2009.

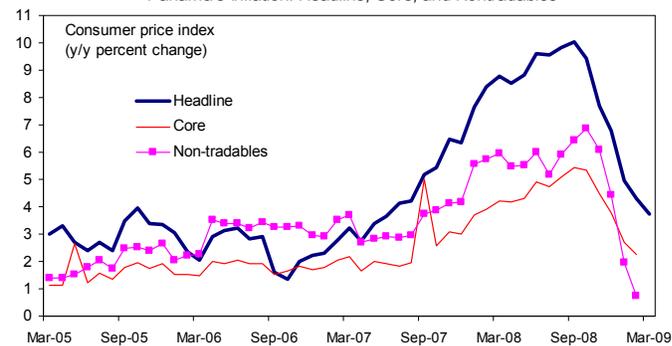
3. ***Presidential elections scheduled for May 3, 2009.*** Polls indicate that the candidate of the opposition party (Cambio Democrático) has made substantial gains on the candidate of the ruling Partido Revolucionario Democrático. Both parties have similar economic platforms that are not expected to alter the broad direction of economic policies, although the opposition party is campaigning on important tax changes, including the introduction of a flat tax.

Economic Growth in the Region



Sources: World Economic Outlook; and Fund staff estimates.

Panama's Inflation: Headline, Core, and Nontradables



Source: Panamanian authorities, and Fund staff estimates.

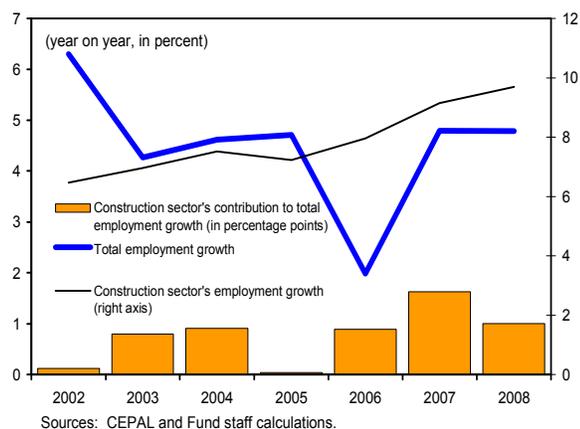
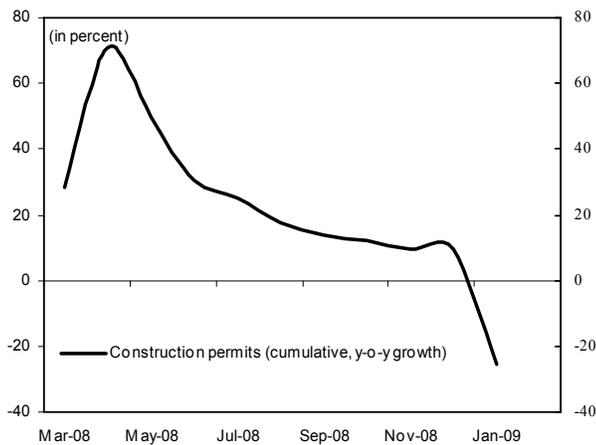
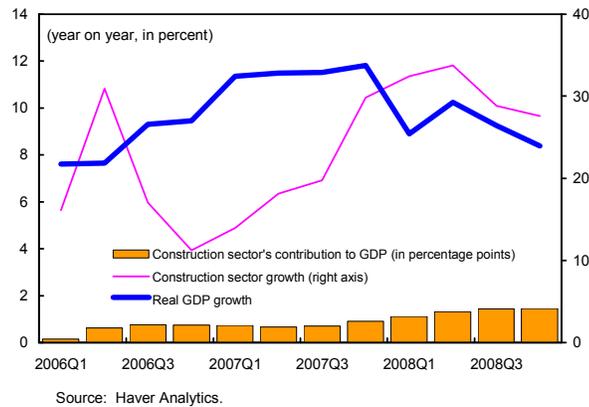
¹ Preliminary real GDP data indicates a significant slowdown in financial services in 2008 largely due to shortcomings in estimating the sector's deflator. An IMF STA mission that visited in March 2009 recommended several modifications to the methodology that would lead to a substantive upward revision in the sector's and real GDP growth.

Box 1. Panama: The Slowdown in Construction

The construction sector has become an increasingly important engine of growth for the Panamanian economy. In recent years, construction activity has picked up steadily, with annual growth reaching 34 percent in the second quarter of 2008. Accordingly, construction's contribution to GDP growth rose from ½ percentage point in 2006 to nearly 1½ percentage points in 2008.

Reduced foreign demand and credit availability led to a slowdown in construction activity in the second half of 2008. Construction permits, a leading indicator, fell sharply in January 2009, signaling further slowdown in the months ahead. However, there are several mitigating factors that may contain the collapse of construction, including the Panama Canal expansion (which is expected to pick up in late 2009), a large increase in government spending on infrastructure, and increased funding for construction of middle and low-income housing.

The slowdown in the construction sector may create pressures on the labor market and on banks. The contribution of the construction sector to total employment growth rose from 0.1 percentage points in 2002 to 1.6 percentage points in 2007, when it accounted for one-third of total employment growth (4.8 percent). In 2008, construction's contribution to employment growth dropped to 1 percentage point. The effect of slower growth in construction on the unemployment rate may be partially mitigated by a decline in the reliance on foreign workers, which has increased in recent years. Further, some banks have sizable exposure to the construction sector and are likely to experience a deterioration in loan quality.



4. ***A resilient regional banking sector.*** Panama's banking system consists of 43 private domestically licensed banks and 2 state banks.² Banks are well-capitalized, liquid, are subject to effective supervision and have strong financial soundness indicators.³ The banking system's role in the region has expanded in recent years, in a broadly balanced manner, with nonresidents deposit growth providing the main source of expansion for nonresidents credit (Box 2). A new Banking Law (drafted with technical assistance from the Fund) became effective in August 2008. The law strengthens the legal basis for consolidated cross-functional supervision, extends banks' supervision to financial conglomerates, improves the bank resolution framework, and enhances risk adjusted capital requirements. The new bank resolution framework provides the Superintendent of Banks far-reaching powers to request troubled banks to adopt corrective measures, and to reorganize or liquidate non-compliant institutions.

5. ***However, the financial system has not been immune to global developments.*** Following the intensification of the global financial crisis in September 2008, Panamanian banks, like other banks in the region, experienced difficulties in accessing foreign credit lines.⁴ In addition, anecdotal evidence suggests that there was some flight to quality and heightened concerns about possible adverse spillovers. However, bank deposits remained stable and credit growth bottomed out by end 2008. The non-banking financial sector, including the stock exchange, is small, and has not been affected much by the global financial crisis.

6. ***The government took quick steps to contain the impact of the crisis.*** In early October, the President formed a high-level crisis committee, the Superintendency of Banks (SBP) increased its scrutiny of banks, and the Banco Nacional de Panama (BNP) established a collateralized line of credit of US\$400 million for banks affected by the reduced access to foreign credit. The SBP also enacted temporary changes in regulations to reduce the impact of the global financial volatility on banks' equity positions.⁵ In January, to address continued concerns about the limited access to foreign credit, the government announced a stimulus package, Financial Stimulus Program (PEF), for a total of US\$1.1 billion for on-lending for productive investment and working capital. The program is funded by loans from the IDB (US\$500 million) and CAF (US\$210 million) as well as BNP resources. However, legal and institutional challenges resulting from not having a central bank, and government efforts to make the assistance congruent with market needs delayed the availability of PEF resources until April 2009. In February, the SBP took administrative control of Stanford

² In addition, there are 30 offshore banks, which are not allowed to accept domestic deposits, and 15 representative offices.

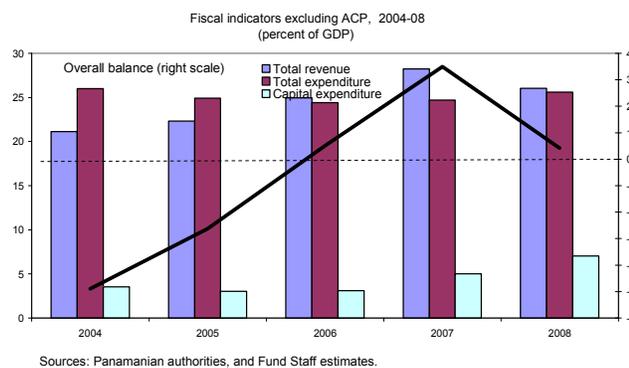
³ The 2006 Financial Sector ROSC (IMF Country Report No. 07/66) noted that the regulatory and supervisory framework for banks showed a high level of observance of the Basel Core Principles for banking supervision.

⁴ The lower access was a consequence of prohibitive pricing, requests by correspondent banks to not activate lines or instructions from parent banks that operations be locally funded.

⁵ In particular, Agreement No. 8-2008 permits the transfer of certain securities from the "available for sale" category to the "held to maturity" category.

Bank-Panama, following a deposit run prompted by the allegation of fraud by the Stanford group made by the U.S. Securities and Exchange Commission. The closing of Stanford Bank-Panama, together with general uncertainty about the health of banks, fueled two small deposit runs, which were quickly contained after the Superintendency of Banks gave firm public assurances about the banks' soundness.

7. **Public finances on a strong footing.** The nonfinancial public sector (NFPS) surplus, excluding the Canal Authority (ACP), declined from 3.5 percent of GDP in 2007 to 0.4 percent of GDP in 2008, despite continued robust revenues. A large increase in public investment—from 5 percent to 7 percent of GDP—and measures to mitigate the effects of higher food and oil prices (equivalent to about 1 percent of GDP) explain the lower surplus.⁶ The Panama Canal expansion, estimated to cost US\$5.3 billion, is broadly on track with the government about to decide the winning bid for the construction of the locks, the most complex and costly component of the project. The high output growth and modest surplus led to a further decline in the public debt-to-GDP ratio (39 percent by end-2008).



8. **Significant progress in reforming the public finances.** A new Social and Fiscal Responsibility Law (SFRL), which sets a ceiling on the fiscal deficit, was enacted in June 2008 (Box 3), and the government is finalizing a Public-Private Partnership (PPP) law that would provide a legal framework for PPP projects.

9. **A weakened external position.** The external current account deficit deteriorated to 12½ percent in 2008 (7.3 percent of GDP in 2007), as a result of strong domestic demand, high fuel and food prices in the first half of the year, and a sharp decline in net exports from the Colon Free Zone. The large current account deficit was fully financed by ample foreign inflows, including foreign direct investment, which rose to US\$2.4 billion (10.4 percent of GDP) despite the adverse external environment in the second half of the year.

⁶ In dollar terms, the capital expenditures of the nonfinancial public sector have more than tripled since 2004, increasing by about 70 percent in 2008 alone.

Box 2. The Increased Regional Role of Panama's Banks

Panama's banking system has become increasingly integrated with other countries in the region.

Deposits from and credit to nonresidents have grown rapidly in recent years. As of end-2008, total deposits from and credit to nonresidents represented 59 percent and 66 percent of GDP, respectively. These transactions take place in the onshore banks, and include the operations of a trade credit bank domiciled in Panama. The domestic banking system does not include operations from offshore banks, which have deposits and credit from nonresidents equivalent to about 30 percent of Panama's GDP.

The banks' expansion in the region, while welcome, increases risks.

While the expansion of credit and deposits in both segments of the market (residents and nonresidents) has been broadly balanced, Panama's banks are increasingly vulnerable to developments in other countries. Much lower economic growth in other countries of the region for example, could lead to a rise in delinquencies on Panama's loans to nonresidents. Conversely, countries in the region are increasingly vulnerable to possible transmission of shocks from Panamanian banks.

Panama: Evolution of Credit and Deposits in the Banking System 1/

	2004	2005	2006	2007	2008
	(Percent change)				
Credit	13.8	15.4	14.0	20.3	17.2
Credit to residents	10.4	13.3	12.9	18.2	14.6
Credit to nonresidents	19.8	18.8	15.7	23.5	21.0
Deposits	9.8	6.0	18.0	22.9	25.3
Deposits from residents	8.0	8.7	21.8	16.0	18.6
Deposits from nonresidents	13.0	1.3	11.1	36.8	36.9
Banks	23.3	3.8	-2.6	17.5	38.4
Individuals	-0.2	-2.8	34.1	60.4	25.4
	(In percent)				
Memorandum items:					
Credit/GDP	139	147	151	160	158
Credit to nonresidents /GDP	52	57	59	64	66
Deposits/GDP	124	121	128	139	147
Deposits from nonresidents /GDP	46	42	42	51	59
GDP (million U.S. dollars)	14,179	15,465	17,134	19,485	23,088

Sources: Superintendency of Banks; and Fund staff estimates and projections.
1/ Includes interbank deposits, which are very sizable in case of a few banks.

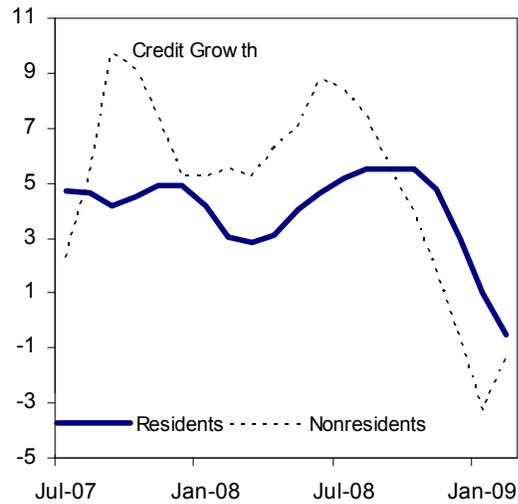
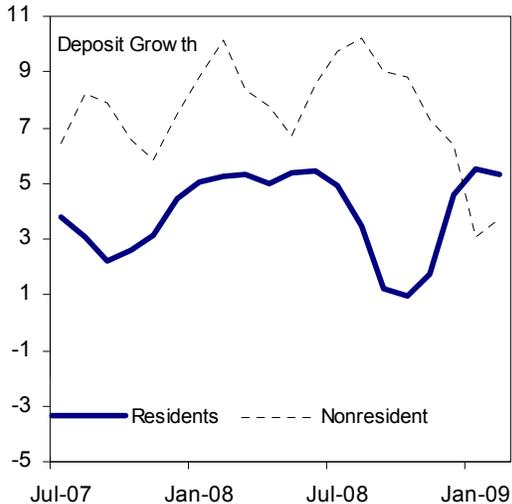
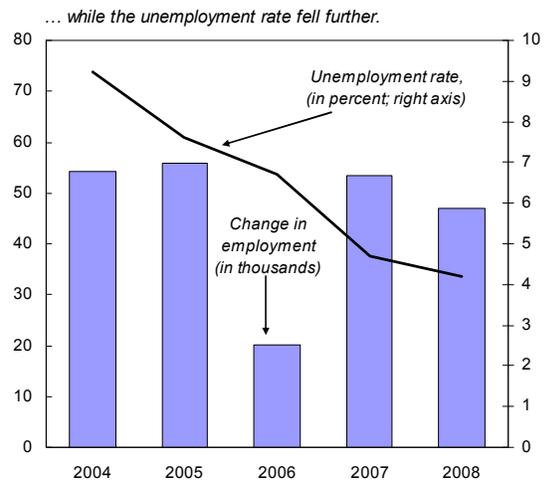
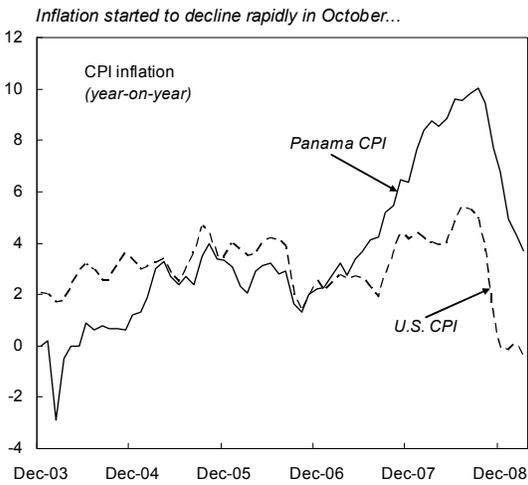
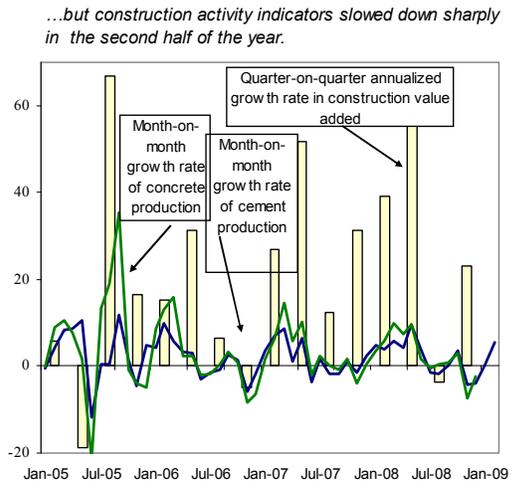
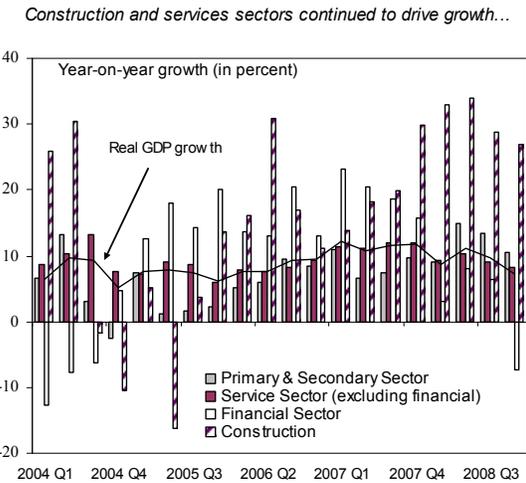
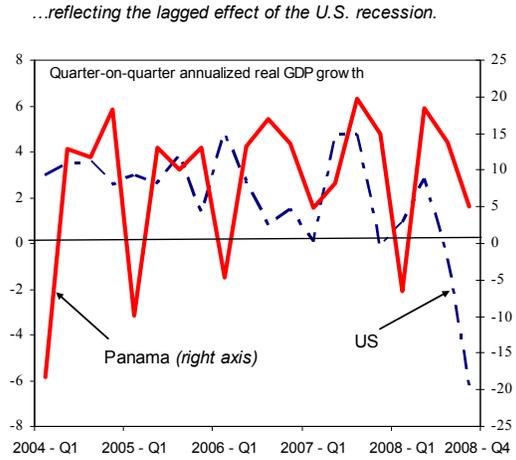


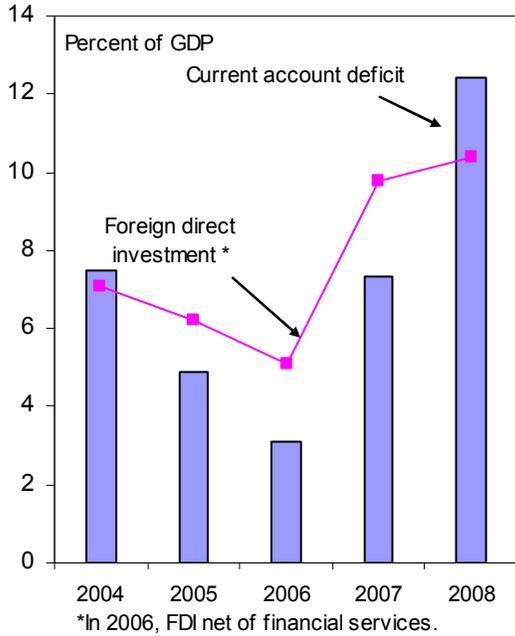
Figure 1. Panama: Recent Economic Performance



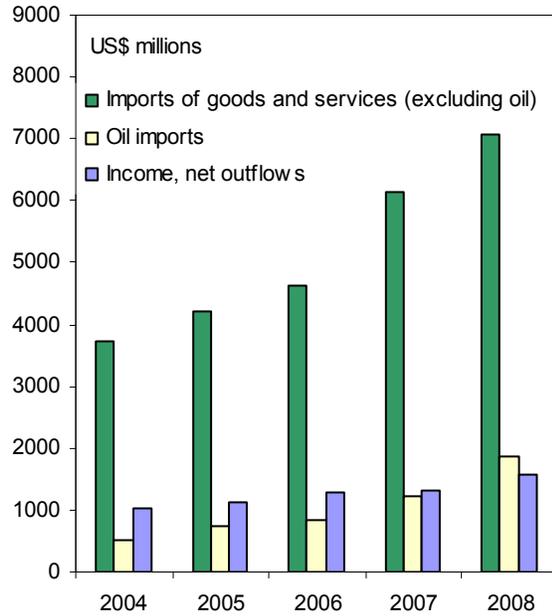
Sources: Office of the Comptroller General; and Fund staff estimates.

Figure 2. Panama: External Current Account Developments, 2004-08

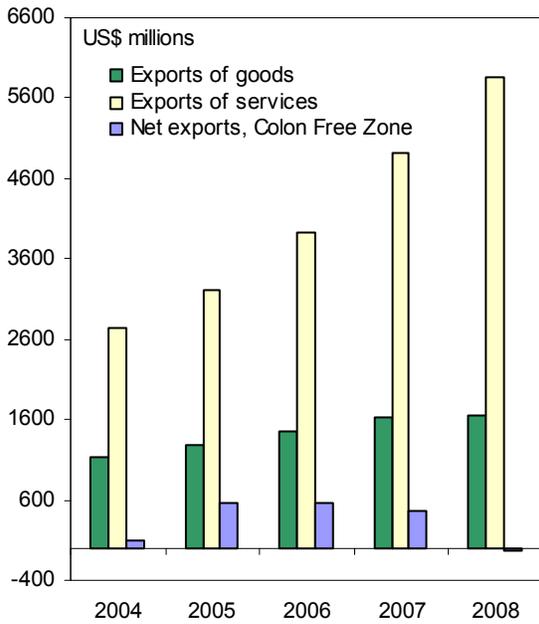
The widening of the current account deficit in 2007-08 was mainly financed by FDI...



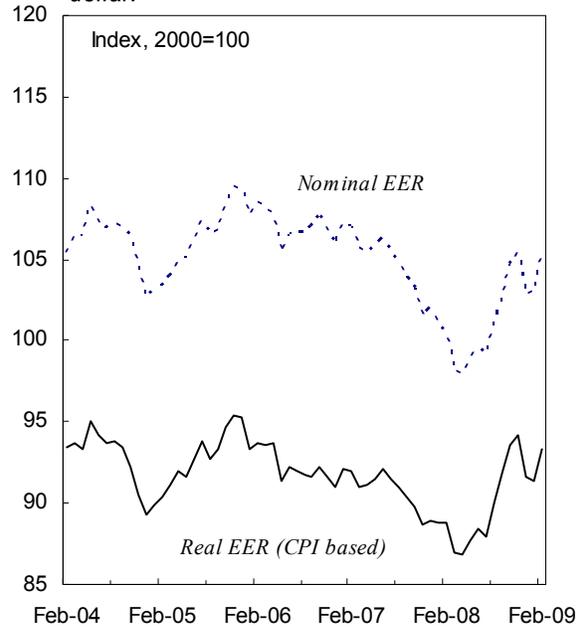
...that fueled strong import growth, including of capital goods...



...which outpaced the growth of exports of goods and services.

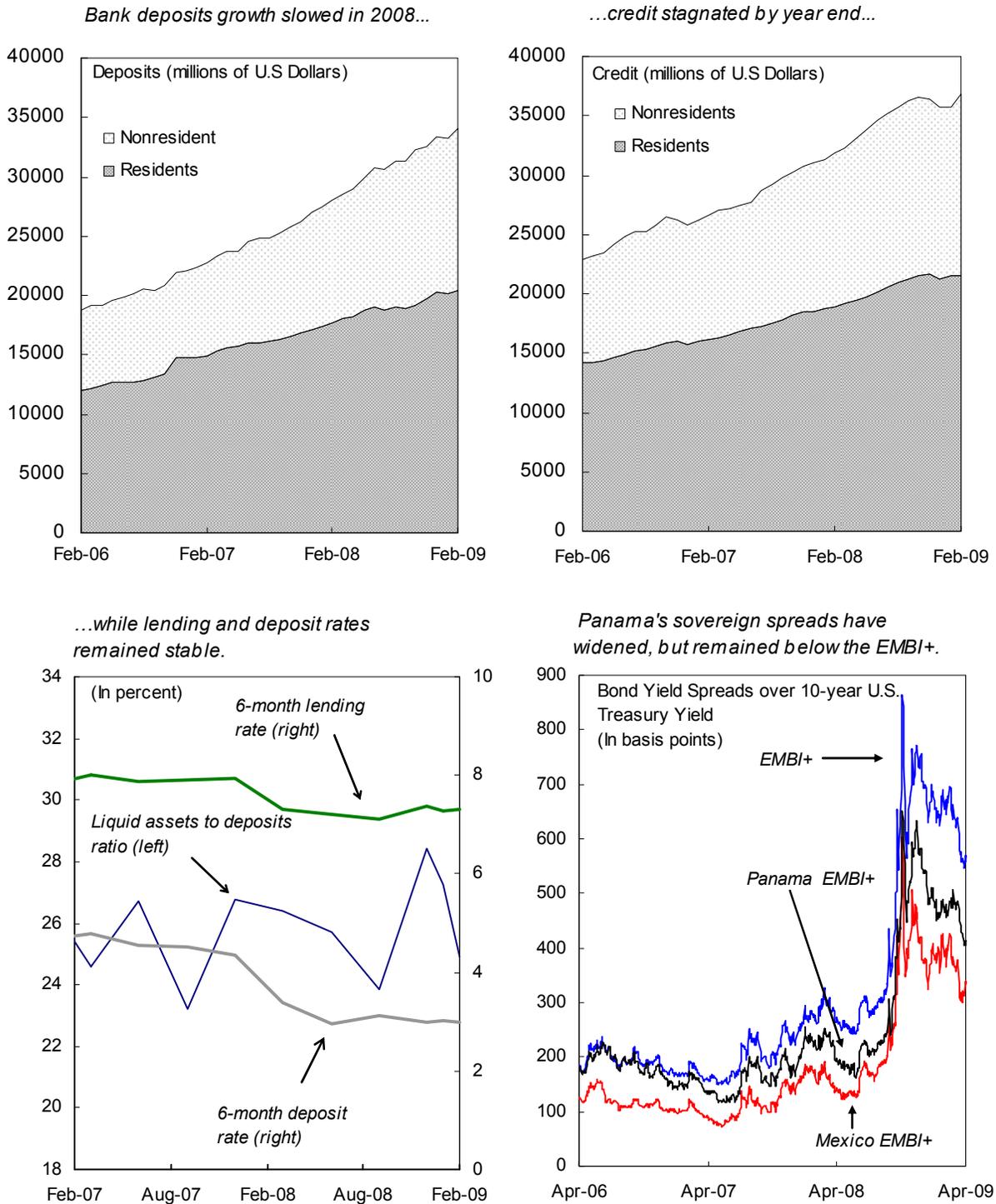


Nominal and real effective exchange rates appreciated during 2008 in line with the U.S. dollar.



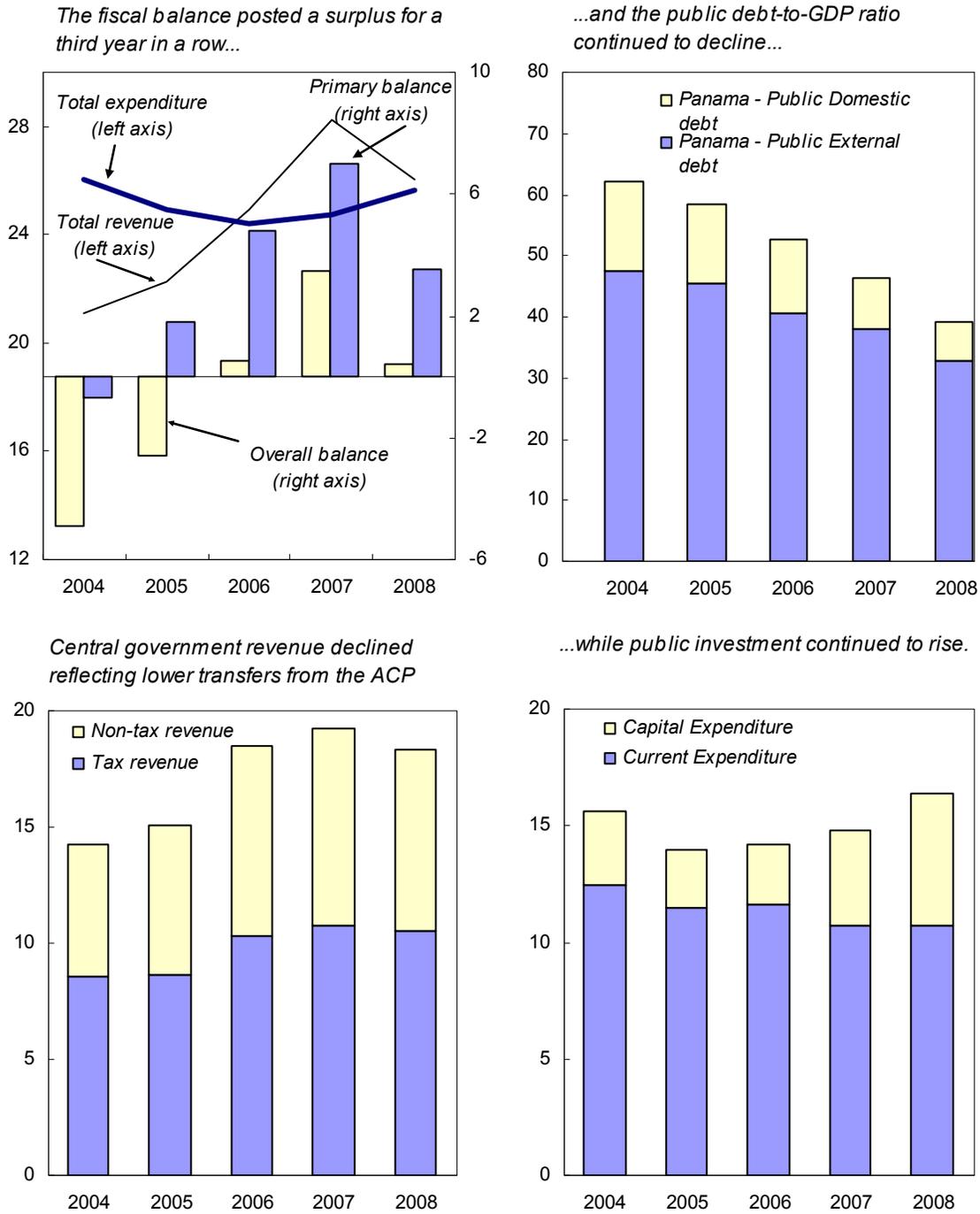
Sources: Office of the Comptroller General; Superintendency of Banks; and Fund staff estimates.

Figure 3. Panama: Financial Sector Developments, 2006-08



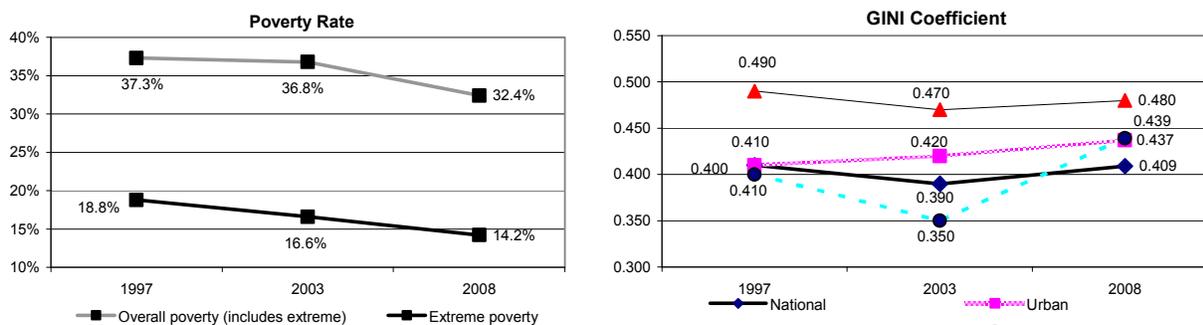
Sources: Office of the Comptroller General; Superintendency of Banks; Fund staff estimates; and Bloomberg.

Figure 4. Panama: Fiscal Developments, 2004-08
(In percent of GDP)



Sources: Office of the Comptroller General; and Fund staff estimates.

10. **Significant decline in poverty.** A recent household expenditure survey, conducted with the assistance of the World Bank found that poverty rates declined from 37 percent in 2003 to 32 percent in 2008, while extreme poverty fell from 17 percent to 14 percent. A CEPAL study based on income finds an even larger decline in poverty and extreme poverty between 2001 and 2007. These findings are consistent with the sharp fall in the open unemployment rate (from 10.9 percent at end-2003 to 4.2 percent in August of 2008). While inequality seems to have increased somewhat, indicators of extreme poverty, literacy and longevity are reasonably good compared to the rest of the region.



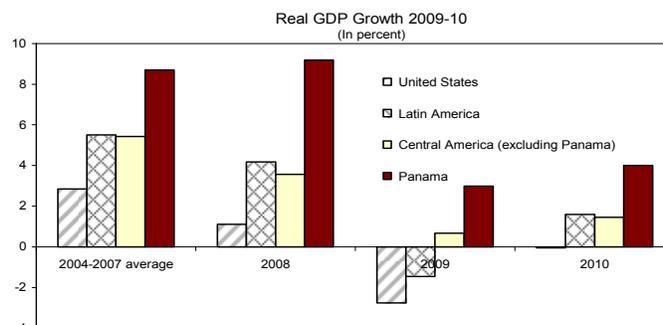
Sources: Panamanian authorities and the World Bank.

II. POLICY DISCUSSIONS

The impact of the ongoing global financial and economic crisis on Panama and the appropriate policy response were the focus of discussions during the consultation. The staff reviewed the risks to the outlook, discussed the scope for counter cyclical fiscal policy measures, and proposed steps to further protect the banking system.

A. Outlook and Risks

11. **Panama's strong ties with the global economy will contribute to dampen output growth and slow inflation.** Staff envisages that real GDP growth will slow to 3–4 percent in 2009–10, and thereafter rise gradually to 7 percent. Inflation is projected to fall to about 2.5 percent by 2010, above the long-term average of 2 percent. The slowdown is likely to impact many sectors, with communications and transportation, financial services, and the Colon Free Zone being the most affected owing to their strong external links. In addition, residential construction (a key driver of the recent high growth) is also likely to slow significantly.



Source: IMF, *World Economic Outlook*.

12. **Important mitigating factors would help sustain growth above the region's average.**

First, the expansion of the Panama Canal, for which financing from multilateral development banks (MDBs) and the Japan Bank for International Cooperation (JBIC) has already been secured, will be moving into high gear in 2009–10.⁷ Estimates show that this ambitious project can boost real GDP growth by about 1 percent annually over the seven-year construction period. Second, the significant acceleration of government investment that started in the second half of 2008 will help sustain construction activity in face of falling foreign demand. And third, although expected to decline somewhat, FDI is still projected to remain high (at about 7 percent of GDP in 2009–10).

Table. Panama: Selected Economic Indicators

	2007	2008	Proj.					
			2009	2010	2011	2012	2013	2014
	(Annual percentage change)							
Production and prices								
Real GDP (1996 prices)	11.5	9.2	3.0	4.0	6.5	7.0	7.0	6.5
Consumer price index (end of year)	6.4	6.8	3.2	2.5	2.5	2.5	2.5	2.5
	(In percent of GDP)							
Public finances								
NFPS primary balance (excluding PCA)	7.0	3.5	2.2	2.1	1.9	1.7	1.4	1.1
NFPS overall balance (excluding PCA)	3.5	0.4	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
NFPS overall balance	4.8	2.5	-0.9	-3.1	-3.2	-3.5	-1.9	-1.1
Total public debt 1/	46.4	39.0	38.4	38.9	38.6	38.5	36.7	34.7
External sector								
Current account	-7.3	-12.4	-9.7	-11.4	-9.9	-9.1	-7.4	-6.2
Foreign direct investment	9.8	10.4	6.5	7.0	7.2	7.3	7.4	7.5

Sources: Office of the Comptroller General; Superintendency of Banks; and Fund staff estimates and projections.

1/ Excludes debt held by the Fiduciary Fund (3.8 percent of GDP in 2008).

13. **The growth outlook, however, is subject to considerable risk.** The depth and length of Panama's slowdown will depend on the magnitude and duration of the recession in the U.S. and the rest of the region; on the absence of adverse shocks to confidence; and on the resilience of FDI. A stronger-than-envisaged decline in credit growth could also result in slower than projected output growth. The authorities were in broad agreement with the staff's growth outlook for the short and medium term. They indicated that aggregate demand had held up surprisingly well, and argued that the construction sector would likely be protected from declining foreign demand by the higher government investment and the pent-up demand for housing.

B. Scope for Counter-cyclical Fiscal Policy

14. **Notwithstanding significantly slower growth, the 2009 budget deficit target of 1 percent of GDP seems achievable.** The revenue projections underlying the budget prepared in mid-2008 were conservative and are broadly consistent with those of the staff. Revenues are projected to decline by 2 percentage points of GDP relative to 2008 as a result of slower growth and lower capital revenues.⁸ Despite projected lower traffic in the Panama Canal, transfers to the government are

⁷ External financing for this project of US\$2.3 billion was secured in October 2008, with the JBIC and the European Investment Bank providing the largest share (with US\$800 and US\$500 million respectively). Repayment terms for the total amount of borrowing are: 20-year amortization, and 10 years grace, with an average spread above LIBOR of 93 basis points.

⁸ Capital revenues in 2007-08 were particularly large due to sales of airport concessions, telecommunications bands, and other government assets.

expected to remain at about the 2008 level due to a planned increase in tariffs (of about 15 percent) and some additional cost saving measures.⁹ With these projected revenues, achieving the budget target stipulated in the SFRL (1 percent of GDP) would require reducing total government expenditures by ½ percent of GDP relative to their 2008 level. The capital spending budget for 2009, which is lower than the outturn for 2008, would help accommodate the deficit target.¹⁰ The projected deficit for 2009 will be externally financed, including through the placement of bonds in international markets and loans from the IDB and World Bank.¹¹

15. The mission argued that adhering to the SFRL in the current juncture was feasible and appropriate. The SFRL law aims to institutionalize fiscal discipline, and enhance transparency and accountability by establishing a ceiling for the fiscal deficit (excluding the ACP) of 1 percent of GDP, unless real GDP growth is 1 percent or less. By design, the SFRL limits the scope for fiscal stimulus in low-growth periods.

The staff recommended adherence to the fiscal deficit limits set in the SFRL in 2009, notwithstanding its possible limitations in a severe downturn, noting that non-compliance with the new rule so soon after its introduction could weaken policy credibility and market perceptions.¹² In addition, staff noted that the target would allow for some fiscal stimulus because the overall fiscal balance

(including the ACP) is projected to shift from a surplus of 2.5 percent of GDP in 2008 to a deficit of 1 percent of GDP, an expansion of about 3½ percentage points; adjusting for the cyclical impact and one-off revenues, those projections would imply a fiscal impulse of about 1 percentage point in 2009. The authorities agreed with this assessment, and noted that that the Canal expansion would more than offset the moderate reduction planned in government capital spending.

	NFPS Cyclically Adjusted Balance Excluding Transfers from ACP and One-off Revenue				
	2006	2007	2008	Proj.	
				2009	2010
NFPS balance	0.5	3.5	0.4	-1.0	-1.0
Canal fees and dividends	3.5	4.3	3.0	2.9	2.7
One off revenue	1.3	1.2	1.0	0	0
Cyclical adjustment	-0.1	0.4	0.2	0.1	0
Cyclically adjusted balance, excl. ACP transfers and one off revenue	-4.2	-2.5	-3.8	-4.0	-3.7
Output Gap	-0.5	1.9	1.2	0.4	0.2
NFPS balance, including ACP	1.2	4.8	2.5	-0.9	-3.1
External ACP Expenditures related to expansion	0.0	0.0	0.3	1.4	2.6
One off revenue	1.3	1.2	1.0	0	0
Cyclical adjustment	-0.1	0.4	0.2	0.1	0
Cyclically adjusted balance, excl. one off revenue and external expenditure on expansion	0.0	3.3	1.6	0.5	-0.5
Output Gap	-0.5	1.9	1.2	0.4	0

Sources: Panamanian authorities; and Fund staff estimates.

⁹ The ACP projects a decline in traffic of 6 percent, following a decline of 2 percent in 2008. In the ACP's view, the decline in trade volumes have had a less than proportional effect on traffic through the Canal. The staff's projections are based on a more conservative forecast of a 10 percent decline in traffic.

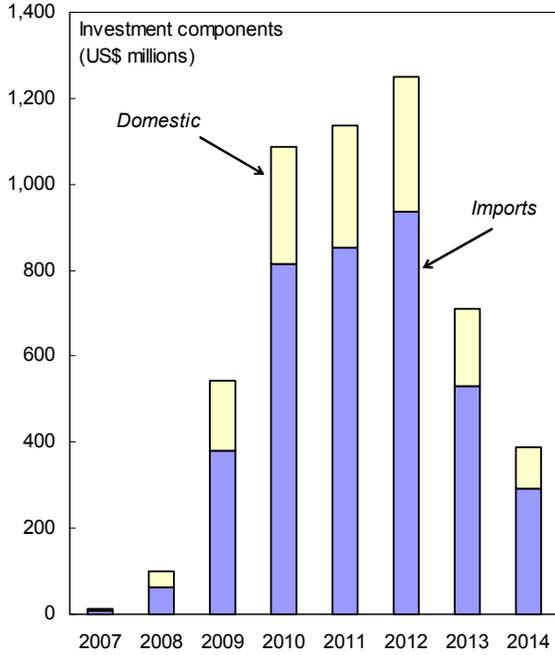
¹⁰ The authorized capital expenditure in 2008 was increased through supplementary budget authorization bills in light of stronger-than-expected revenue performance.

¹¹ The government took advantage of a rally in the international bond markets in March 2009, and placed US\$323 million through the reopening of bonds falling due in 2015, at a yield of 7.04 percent.

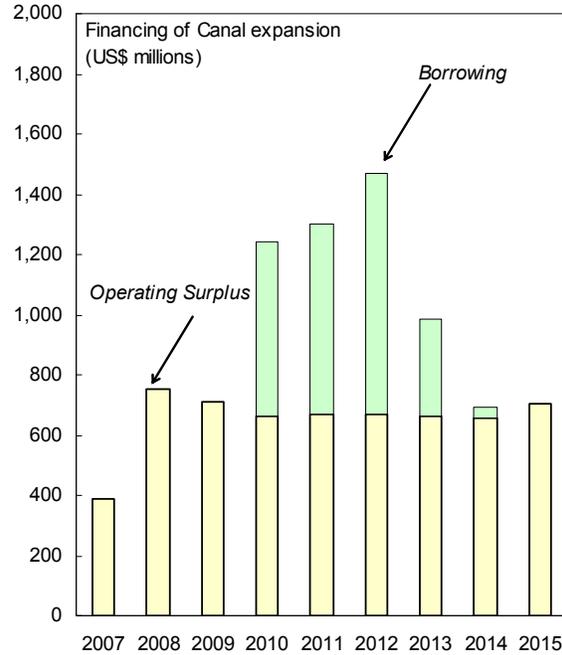
¹² In February 2009 Fitch Ratings confirmed Panama's long-term foreign currency and local currency issuer ratings at "BB+", one grade below investment grade, with positive outlooks.

Figure 5. Panama: Canal Expansion Project

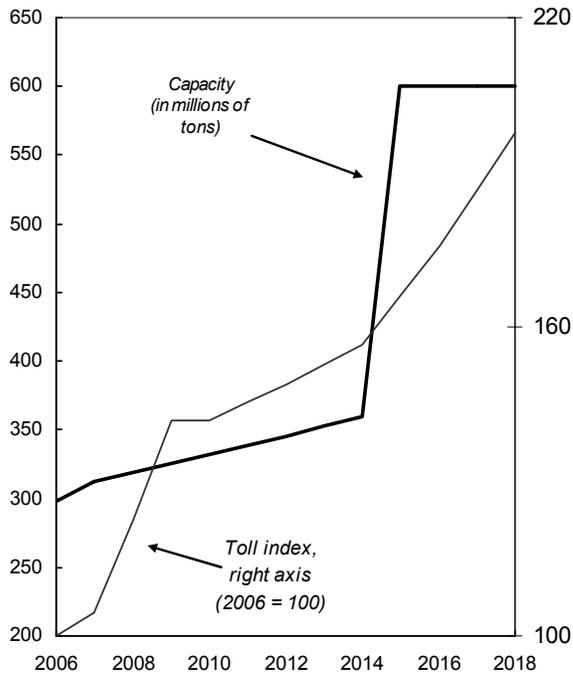
The canal's expansion is projected to cost US\$5.25 billion over 8 years.



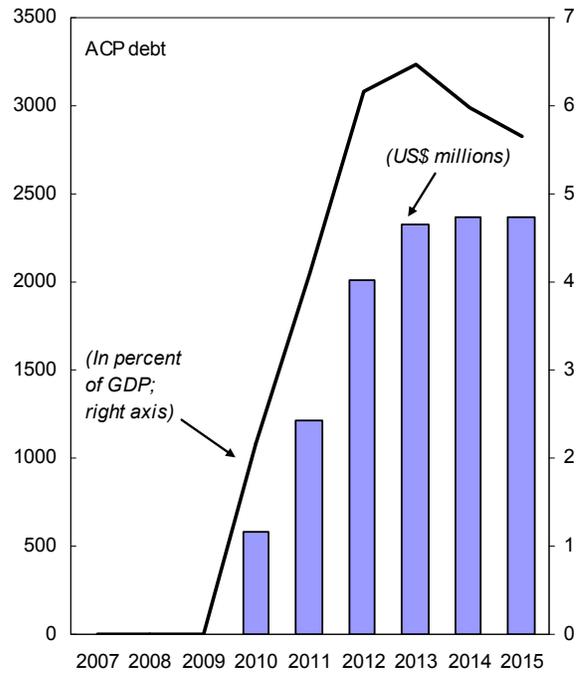
The expansion will largely be financed by revenue from operations...



...generated from toll increases...



... and the remainder by borrowing by the Panama Canal Authority.



Sources: National Public Services Authority, Ministry of Economy and Finance; ACP; and Fund staff estimates and projections.

Box 3. The Social and Fiscal Responsibility Law

The Social and Fiscal Responsibility Law (SFRL) was approved by the National Assembly in June 2008 (Law No. 34) and became effective on January 2009. The law, which replaced the 2002 Fiscal Responsibility Law, sets a fiscal rule that limits the deficit of the nonfinancial public sector (NFPS), excluding the ACP, at 1 percent of GDP, and sets a target for total public debt (including debt held by the Social Security Agency but excluding debt held by the Fiduciary Fund) of 40 percent by 2014.^{1 2} The law allows the government to deviate from the fiscal rule in the event of (i) natural disasters, (ii) national state of emergency, and (iii) an economic recession. Any deviations require the approval of the National Assembly. The law contains some built-in room for counter-cyclical fiscal policy, allowing for an increase in the NFPS deficit to up to 3 percent of GDP in cases where real GDP growth falls to one percent or less, and 2 percent in the following year.

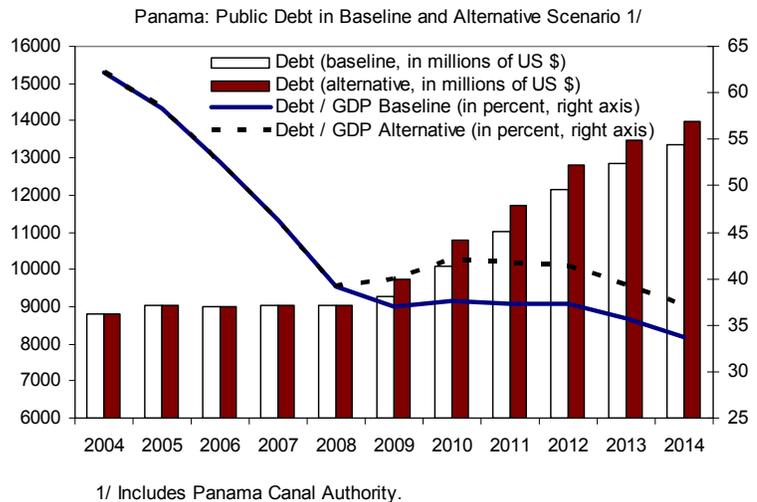
The law defines clearly the coverage of the NFPS and measures the deficit on a cash basis using international accounting principles. Other requirements specified in the law include provisions for new administrations to publish a medium term fiscal framework (including a public investment plan) and a social strategy program within six months of assuming office.

¹ Under Panamanian law, the Panama Canal authority (ACP) is an autonomous legal entity, with a budgetary process that is distinct from that of the government. The Fiduciary Fund is a trust established in the 1990s to invest privatization proceeds; as of end-2008, the Fund held about US\$890 million in Panamanian global bonds.

² The debt-to-GDP ratio corresponding to the definition in the SFRL was 49 percent of GDP at end-2007, which declined to 41 percent by end-2008.

16. **The staff argued that the government should be prepared to take action quickly, within the context of the SFRL, if the output slowdown is stronger than envisaged.** Although the law allows for a higher deficit when output growth is at or below 1 percent, it does not provide clear guidance on how to take account of the slowdown as it is taking place. The staff urged the authorities to issue guidelines clarifying the data and methodology that is to be used to decide whether the fiscal stance should be relaxed, noting that a rapid reaction by the government would be critical in a downturn. Concretely, the mission recommended the adoption of a forward-looking framework that would take account of preliminary growth estimates from the previous two quarters and growth forecasts based on leading indicators. It also suggested that an independent body of experts (composed of representatives from the government, the private sector, think tanks, and academia) could furnish the government with an independent forecast for growth, as is the case in other countries. The government agreed with the staff's recommendations, and planned to issue regulations that would allow them to modify the fiscal stance in a timely manner.

17. **The mission argued that adhering to the SFRL would help ensure fiscal sustainability even in a low growth scenario.** The mission discussed an alternative scenario, with output growth of 0 percent in 2009 and 1 percent in 2010, and a deficit in line with the SFRL. The scenario showed that the higher fiscal deficit allowed by the SFRL would not pose major risks for debt sustainability, as the increase in public debt-to-GDP ratio in the initial three years would be reversed once the borrowing for the Canal expansion is completed. The additional financing needed to cover the higher deficit could be secured from domestic sources, taking advantage of the pent-up demand for government paper. The standard debt sustainability analysis on the baseline scenario yielded similar results, as it showed that only a prolonged shock to output growth would place Panama's debt-to-GDP ratio on a non-declining path (Figure 6).

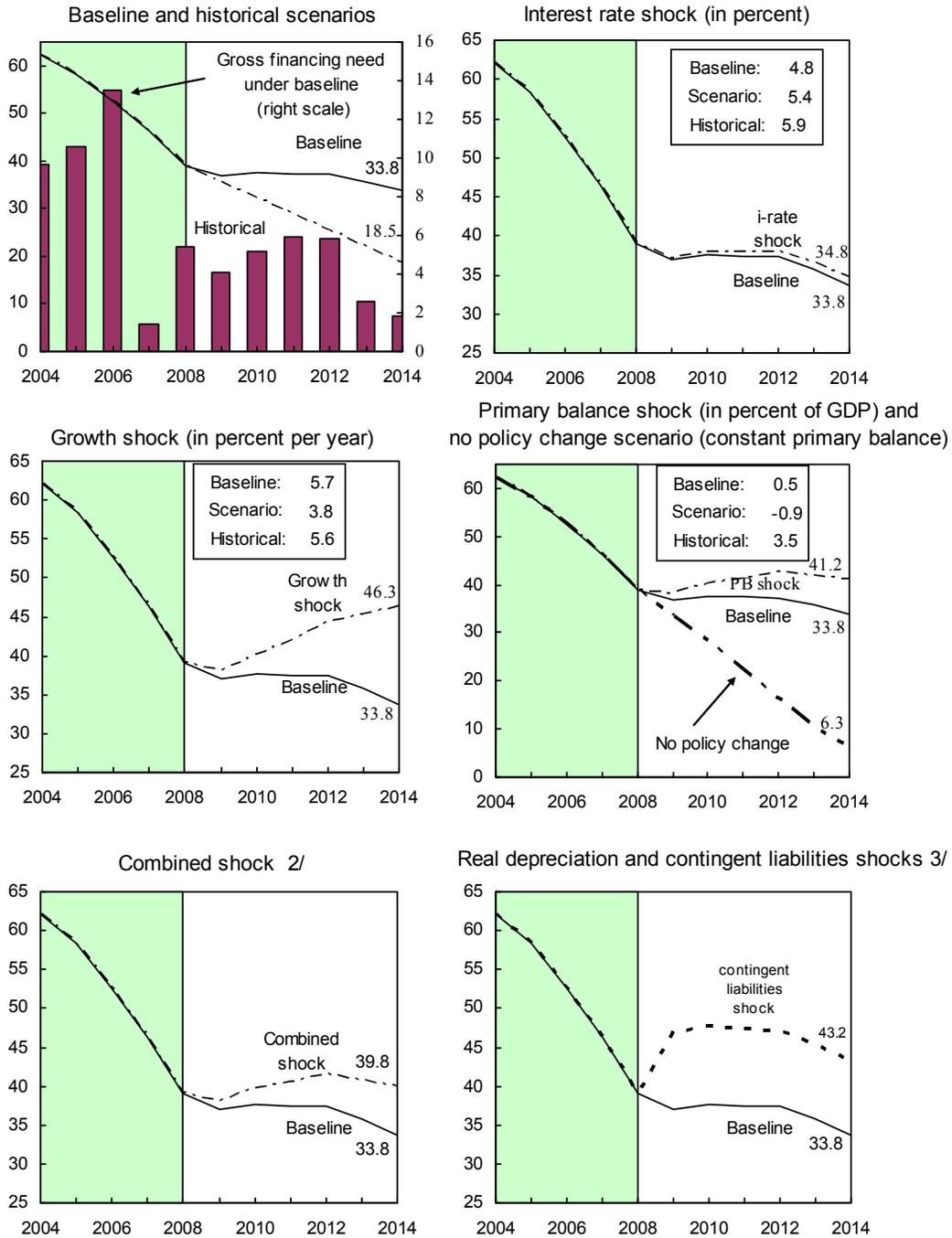


18. **The mission recommended that the higher government spending be geared at supporting domestic economic activity and protecting the poor.** Staff noted that there is broad agreement that public spending on goods and services has larger multiplier effects and stronger first-round impact effect than transfers or tax cuts. In view of this, staff recommended that priority be given to maintaining existing social programs, including by providing transfers to sub-national government agencies that are facing financing constraints.

C. Financial System Risks

19. **The mission and the authorities agreed that Panama's financial system has fared well during this crisis thus far, but continues to face risks.** In particular, the system remains vulnerable to exogenous shocks and a sudden loss of confidence; risks that are heightened by the significant presence of foreign banks and the size of foreign deposits in the onshore banking system. Nearly 60 percent of Panama's banking system is foreign-owned, and is thus exposed to risks from further deterioration of the parent banks, notwithstanding the soundness of the local subsidiaries. In addition, nearly 30 percent of bank deposits (40 percent including interbank deposits) are owned by foreigners and, therefore, are also sensitive to developments in their home countries. Lastly, banks face the risk of a deterioration in their asset quality in light of lower growth in Panama and the region.

Figure 6. Panama: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: Ministry of Finance and Fund staff estimates.

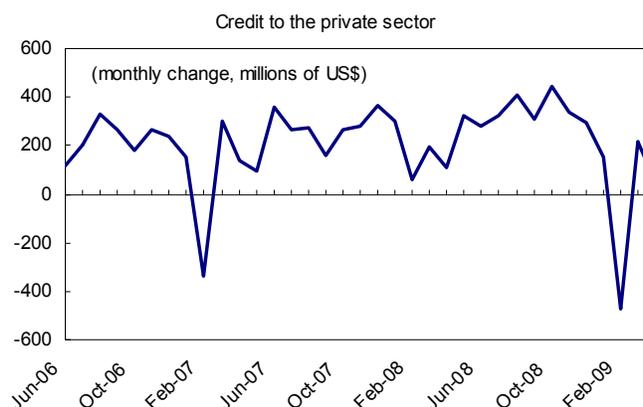
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

20. **The mission noted that the absence of a central bank and the relatively large size of the banking system (in terms of GDP) exacerbated the risks.** Panama lacks an institution that can play the role of lender of last resort in case banks experience liquidity shortages, including due to deposit withdrawals. Moreover, the sheer size of the banking system, with deposits of about 130 percent of GDP (excluding interbank deposits), poses serious challenges to the authorities' capacity to provide a credible safety net to safeguard confidence.

21. **The banks' response to the heightened uncertainty, while appropriate, could exacerbate the economic slowdown.** The mission noted that banks had increased their already high liquidity ratios (from about 58 percent in November 2008, to above 64 percent by mid-April 2009) to self-insure against shocks, including possible deposit withdrawals. The authorities indicated that Panama's banking system requires that each bank takes measures to ensure its own viability under all circumstances. However they acknowledged that the lack of a safety net may be causing the banking system as a whole to extend less credit than what it would have done if banks had recourse to emergency liquidity support.



22. **Possible actions to reduce uncertainty and facilitate credit expansion were discussed.** The staff recommended the development of contingency plans to provide emergency liquidity support to deal with large or systemic liquidity shortages through a temporary facility. It indicated that such a facility would need to be guided by clear and transparent rules (including the type of collateral to be posted, and the magnitude that would be available to each bank) to provide assurances to banks. The staff commended the authorities for the rapid creation of the collateralized credit line from the BNP, but noted that the delays in finalizing the terms had created uncertainties among banks and raised questions about its likely effectiveness. Staff urged the authorities to clarify the terms of operation of the BNP credit line, and make public those terms as soon as possible. The authorities agreed that establishing an effective system of liquidity support for banks was a priority at this time, but noted that this would require additional external financing as the BNP resource were not freely available.¹³ They also noted that the delays in activating the BNP line reflected the complexities of the Panamanian market, including difficulties in establishing a framework for liquidity support-type lending in the absence of a central bank.

¹³ A large share of BNP's foreign assets are the counterpart of deposits from the ACP and the Social Security System.

23. **The mission emphasized that the weak growth outlook for the country and the region posed additional challenges.** The mission indicated that stress tests conducted by the mission showed that the banking system would remain adequately capitalized even under severe shocks to loan quality, although a few banks with a high exposure to the construction and household sectors could face some distress in the event of a severe economic downturn.¹⁴ The mission commended the Superintendency of Banks for its stepped-up monitoring of banks, and noted the continued importance of timely interventions. In this regard, the mission welcomed the swift action on the Stanford Bank-Panama, which had prevented contagion to the rest of the banking system. The mission cautioned the authorities against a relaxation of the prudential framework (which should only be considered in the context of a wider strategy of emergency support), and encouraged the authorities to take advantage of the Financial Sector Assessment Program (FSAP) mission planned for 2009–10 to discuss these issues further.

24. **The inclusion of Panama in a list of tax havens poses an additional challenge.** Banks were concerned that such designation could have adverse consequences for Panama’s financial industry. The authorities have started a dialogue with the private sector to agree on a strategy to address Panama’s inclusion in the list. The strategy could involve changes to financial industry regulations in line with an earlier agreement with the OECD that had been only partially implemented. Other options being considered include reforms that have been adopted in other jurisdictions, notably limitations to the use of bearer shares, modifications in bank secrecy regulations, and permission to exchange tax information. The mission strongly endorsed the authorities’ cooperative approach, and took note of their concern about the lack of a level playing field in this area.

D. External Competitiveness

25. **The mission and the authorities agreed that Panama’s external current account deficit will remain above its medium-term norm while the Canal expansion is underway.** The staff noted that the external current account deficit is likely to remain high for several years, reflecting the Canal expansion and the large imbalance recorded in 2008 (12.4 percent of GDP). Despite this,

Panama: Composition of Balance of Payments
(In percent of GDP)

	Average 1998–2006	2007	2008	Avg. Proj. 2009–14
Current account balance (actual)	-5.3	-7.3	-12.4	-9.0
Panama Canal-related investment	0.0	0.0	0.3	2.1
FDI (above underlying level)	0.0	3.2	4.4	1.2
FDI (actual)	6.0	9.2	10.4	7.2
FDI (underlying level)	6.0	6.0	6.0	6.0
Current account balance (adjusted)	-5.3	-4.1	-7.7	-5.6
Imports (above underlying level) 1/	-0.1	1.0	1.6	-0.1
Non-oil imports (excluding Canal)	-17	-19.4	-20.7	-18.3
Non-oil imports (adjusted for cyclical position)	-17	-18.4	-19.1	-18.5
Underlying current account balance	-5.4	-3.1	-6.1	-5.8
Memorandum item:				
Output gap	-0.2	2.5	4.0	-0.4

Sources: Panamanian authorities, and Fund staff estimates.

1/ Assumes a propensity to import of 0.4.

¹⁴ The tests suggest, however, that most of those banks would stay above the minimum required regulatory capital even under those conditions.

staff analysis suggests that Panama's competitiveness has improved (Box 4). Moreover, the analysis shows that the underlying current account balance, adjusted for the expansion of the Canal and high level of FDI, would remain broadly in line with the historical norm. Once the Canal expansion is completed in 2014, the current account deficit is envisaged to decline below 6 percent of GDP, a level consistent with Panama's investment needs and potential growth rate (Table 10).

26. **Panama's role as a regional banking center together with the offshore banks implies a high level of foreign debt.** Deposits from nonresidents and interbank credit lines account for more than 2/3 of Panama's external debt. Those bank deposits and credit lines, representing close to 120 percent of GDP, are mostly on-lent to nonresidents. Excluding banks, Panama's external debt as of December 2008 is estimated at 50 percent of GDP, of which close to 80 percent is owned by the government and has an average maturity of 7 years. Nonbank external debt has fallen in recent years and is expected to decline as a share of GDP over the medium term.

27. **Despite delays in the finalization of the free trade agreement with the U.S., trade links to the region have strengthened.** Panama ratified the agreement with the U.S. in July 2007, but ratification by the U.S. is pending. Progress on other fronts has proceeded at a faster pace and include the conclusion of trade agreements with all Central American countries. This has paved the way for Panama joining the framework agreement for the establishment of a Central America Customs Union, and participating discussions on an Association Agreement between the region and the EU. Negotiations with Mexico and Canada on bilateral free-trade agreements are also underway.

Box. 4. External Stability

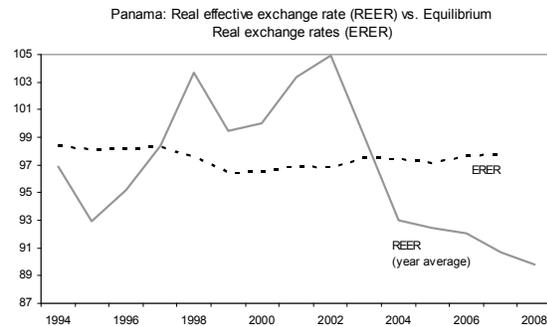
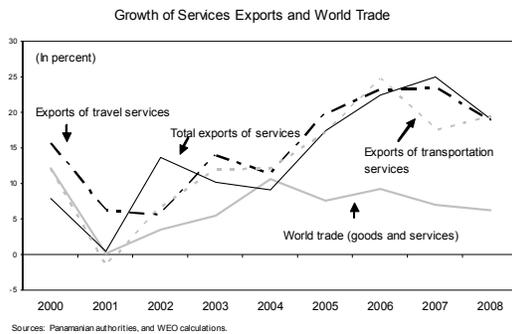
Despite the slowdown in global trade, Panama remains competitive. Panama has capitalized on the rapid expansion in global commerce and many key sectors (transportation, communication, financial services, and tourism) have gained market share. In recent years, Panama's real effective exchange rate depreciated in line with the U.S. dollar and Panama's low inflation rate. The depreciation was partially reversed in the second half of 2008, following the strengthening of the U.S. dollar and high inflation differential, although the REER remains below its equilibrium level. Staff estimates suggest that the real effective exchange rate is undervalued by about 5–10 percent.¹

Panama: Indicators of Competitiveness

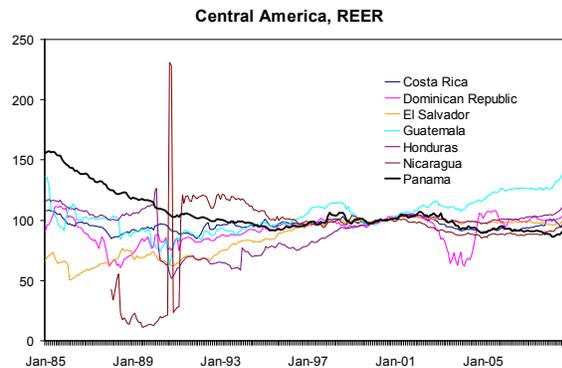
	2005	2006	2007	2008
REER, annual average (2000=100)	92.5	92.1	90.7	89.8
REER, end of period	95.1	90.7	88.9	93.9
Equilibrium REER (2000=100)	100.6	101.2	101.3	101.2
Terms of Trade, goods and services (1996=100)	109.5	109.4	109.3	106.5
Exports of goods (volume change; percent)	7.7	8.0	5.9	-5.9
Exports of services (volume change; percent)	13.1	15.6	18.5	10.9
Imports of goods (volume change; percent)	10.0	11.6	33.3	11.9
Imports of services (volume change; percent)	17.4	-8.4	15.5	15.0

Sources: Panamanian authorities; WEO, and IMF staff estimates.

Note: Imports and exports exclude the Colon Free Zone.



Compared with developments in other countries in the region, Panama's REER has shown remarkable stability since the mid 1990s, and the one-to-one link to the dollar does not seem to have adversely affected its competitiveness relative to its neighbors.



¹ The staff updated the REER analysis presented during the 2008 Article IV consultation. As then, the equilibrium real exchange rate was calculated using the coefficients from the estimations developed by the RES's Consultative Group on Exchange Rate Issues (CGER) (available via the Internet: www.imf.org/external/np/pp/eng/2006/110806.pdf) and Panama data from 1994 to 2008.

III. STAFF APPRAISAL

28. **Panama is facing the global economic crisis from a position of strength.** Rapid growth, a strong and well regulated banking sector, a solid fiscal position, and the Canal expansion project will help Panama face the challenges posed by the difficult external environment. Panama's growth outlook for 2009 is less favorable than in recent years, but is expected to be stronger than in the rest of the region. However, as in all countries closely integrated to the global economy, downside risks are high.

29. **Economic performance in 2008 remained strong, but the external balance showed some strain.** Real GDP grew by more than 9 percent reflecting strong domestic demand and high foreign direct investment (which started to taper off towards the end of the year). Inflation reached a 30-year high of 10 percent in August 2008, but decelerated thereafter in line with lower international fuel and food prices. The external current account deficit widened to 12.5 percent of GDP, reflecting both high import prices and volumes and weak export performance (in particular from the Colon Free Zone), as a result of lower external demand.

30. **Rapid economic growth helped strengthen the fiscal position.** Continued strong revenue performance and one-off-factors created room for higher government spending to mitigate the effects of the high oil and food prices and increase government investment, while keeping the overall fiscal balance in surplus. The increase in capital spending in the second half of the year was well timed and helped support growth. Public sector debt-to-GDP ratio declined to 39 percent, one third lower than in 2005.

31. **Staff supports the government's intention to adhere to the Social and Fiscal Responsibility law in 2009.** The limits for the overall fiscal deficit established in the law, including under cyclical downturns, will contribute to solidify Panama's fiscal prudence and maintain public debt on a sustainable path. Staff considers that a fiscal deficit target of 1 percent of GDP for 2009 is appropriate. The conservative revenue projections used in the formulation of the budget will allow the authorities to attain the deficit target despite the weaker growth outlook. Given the downside risks, the staff encourages the authorities to carefully monitor revenue performance, and be prepared to restrain expenditure if revenues are weaker than envisaged. Staff commends the authorities for having secured the external financing needed to finance the 2009 deficit, including through borrowing from international markets at relatively favorable terms.

32. **Panama's large financial system has demonstrated its resilience in the current global financial turmoil.** Aside from lower access to foreign credit lines, domestic banks' balance sheets have not been severely affected by the global crisis, and bank deposits have continued to support positive credit growth. Staff commends the authorities for the stepped-up monitoring of banks, the steps to augment liquidity, and the prompt intervention of Stanford Bank-Panama early this year.

33. **However, continued external turbulence could cause strains on the banking system.** The large share of foreign banks in the system and the significant amount of deposits owned by foreigners are two potential channels of transmission of external disturbances that make banks maintain high levels of liquidity. Staff encourages the authorities to accelerate its plans to establish a safety net for banks, including through the creation of a contingent credit line. Staff welcomes the credit facility under the Financial Stimulus Program (PEF), and encourages the authorities to monitor its operations to ensure its effective use.

34. **Panama's external competitiveness continues to improve, notwithstanding the recent increase of the external current account deficit.** The rapid expansion of export services and the high levels of foreign direct investment reflect improvements in its external competitiveness. The relatively large external current account deficits projected for the near term are largely related to the expansion of the Panama Canal and the continued high level of FDI, and do not pose a risk to external sustainability. After adjusting for these factors, the underlying current account balance is projected to converge to its historic norm without major policy adjustments.

35. **Panama's economic statistics and data provision are broadly adequate for surveillance.** Panama is in the process of updating the CPI based on a new Household, Income, and Expenditure Survey, and is also preparing to change the base year of the national accounts statistics. A new law (Law 10), in effect since January 2009, will provide the National Institute of Statistics and Census greater administrative and resource autonomy. The authorities welcomed STA technical assistance to address the under-estimation of the real value added in the Financial Services; staff encourages the government to implement the proposed recommendations of the technical assistance mission as soon as possible.

36. It is proposed that the next Article IV consultation with Panama takes place on the standard 12-month cycle.

Table 2. Panama: Summary Operations of the Nonfinancial Public Sector 1/
(In percent of GDP)

	2005	2006	2007	2008	Proj.	
					2009	2010
Revenues	22.3	24.9	28.2	26.0	24.0	23.9
Current revenue	22.1	24.7	26.8	24.6	23.7	23.6
Tax revenue	8.7	10.3	10.7	10.6	9.9	10.2
Nontax revenue of central government	6.0	7.7	8.0	6.7	6.5	6.2
<i>Of which:</i> Panama Canal fees and dividends	2.6	3.5	4.3	3.0	2.9	2.7
Extraordinary revenue 2/	...	0.6	0.0	0.0	0.0	0.0
Social security agency	5.3	5.2	5.7	5.8	5.7	5.6
Public enterprise operating balance	1.0	0.7	0.8	1.2	1.2	1.2
Other 3/	1.2	0.8	1.6	0.4	0.4	0.4
Capital revenue	0.2	0.2	1.3	1.1	0.2	0.2
Expenditure	24.9	24.4	24.7	25.6	25.0	24.8
Current primary expenditure	17.5	17.1	16.2	15.5	15.3	15.3
Central government	8.7	8.8	8.3	8.3	8.1	8.1
Rest of the general government	8.7	8.3	7.9	7.2	7.2	7.2
Social security agency	7.7	7.3	7.1	6.5	6.5	6.5
Decentralized agencies	1.0	0.9	0.8	0.7	0.7	0.7
Interest 4/	4.4	4.3	3.5	3.1	3.1	3.0
Capital	3.0	3.1	5.0	7.0	6.6	6.6
Overall balance, excluding ACP	-2.6	0.5	3.5	0.4	-1.0	-1.0
Panama Canal Authority (ACP)						
Revenue	7.8	8.7	9.0	8.7	8.1	7.5
Current expenditure	3.3	3.3	2.7	2.4	2.3	2.3
Transfers to the government	2.6	3.5	4.3	3.0	2.9	2.7
Capital expenditure	1.0	1.2	0.6	1.2	2.7	4.6
Overall balance	1.0	0.7	1.3	2.1	0.1	-2.2
Overall balance, including ACP	-1.6	1.2	4.8	2.5	-0.9	-3.1
Net financing, excluding ACP	2.6	-0.5	-3.5	-0.4	1.0	1.0
External	5.1	0.1	2.4	0.7	1.9	0.9
Domestic	-2.3	-0.5	-6.0	-1.2	-0.9	0.1
Memorandum items:						
Savings (including ACP)	2.9	5.3	9.2	9.6	8.3	7.8
Primary balance (including ACP)	3.4	5.5	8.3	5.6	2.2	-0.1
Primary balance (excluding ACP)	1.8	4.8	7.0	3.5	2.1	2.0
Public debt	58.3	52.6	46.4	39.0	36.9	37.6
GDP (in millions of US\$)	15,465	17,134	19,485	23,088	25,051	26,852

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Official presentation excludes the operations of the ACP which reverted to Panama on December 31, 1999.

2/ One-off payment from the Panama Ports Company.

3/ Includes the balances of the nonconsolidated public sector and revenue of the decentralized agencies.

4/ Includes interest payments made to the Fiduciary Fund which are excluded from external interest in Table 7.

Table 3. Panama: Summary Operations of the Central Government
(In percent of GDP)

	2005	2006	2007	2008	Proj.	
					2009	2010
Revenues	15.1	18.6	19.5	19.7	17.8	17.7
Current revenue	15.1	18.5	19.2	18.3	17.5	17.4
Taxes	8.7	10.3	10.7	10.6	9.9	10.2
Direct taxes	4.3	5.7	5.6	5.4	5.2	5.2
Income tax	3.8	5.1	5.1	4.9	4.7	4.6
<i>Of which</i> : Capital gains	...	0.7	0.0	0.0	0.0	0.0
Tax on wealth	0.6	0.5	0.6	0.5	0.5	0.6
Indirect taxes	4.3	4.6	5.1	5.1	4.7	4.9
Import tax	1.6	1.6	1.4	1.8	1.6	1.7
ITBMS	1.7	1.9	2.6	2.3	2.1	2.2
Petroleum products	0.4	0.5	0.5	0.4	0.4	0.4
Other tax on domestic transactions	0.6	0.6	0.7	0.7	0.7	0.7
Nontax revenue	6.4	8.2	8.5	7.8	7.6	7.3
Dividends	2.1	3.4	3.7	2.9	3.0	2.9
<i>Of which</i> : Panama Canal Authority	1.3	2.0	2.5	1.5	1.6	1.5
Panama Canal Authority: fees per ton 1/	1.3	1.6	1.8	1.5	1.3	1.3
Transfers from decentralized agencies	1.3	1.3	1.3	1.8	1.8	1.8
Extraordinary revenue 2/	...	0.6	0.0	0.0	0.0	0.0
Other	1.8	1.3	1.7	1.5	1.4	1.3
Capital revenue	0.0	0.1	0.1	1.1	0.2	0.2
Total expenditure	18.3	18.4	18.3	19.5	18.8	18.7
Current	15.9	15.9	14.2	13.9	13.9	13.9
Wages and salaries	5.0	4.7	4.5	4.1	4.1	4.1
Goods and services	1.7	1.8	1.5	1.8	1.7	1.7
Pensions	2.0	2.1	1.8	1.9	2.2	2.2
Transfers to public and private entities	2.8	3.0	3.0	3.0	2.9	2.9
Interest	4.4	4.2	3.5	3.1	3.1	3.0
Domestic	0.8	1.0	0.4	0.4	0.4	0.4
External	3.6	3.2	3.1	2.7	2.6	2.6
Capital	2.5	2.5	4.1	5.6	4.9	4.8
Savings 3/	-0.7	2.6	5.2	4.8	3.7	3.6
Overall balance	-3.2	0.2	1.2	0.3	-1.0	-1.0
Financing (net)	3.2	-0.2	-1.2	-0.3	1.0	1.0
External	4.6	0.5	4.7	0.6	1.9	0.9
Domestic	-1.5	-0.7	-6.0	-0.8	-0.9	0.1
Memorandum items:						
Primary balance	1.2	4.4	4.7	3.4	2.0	2.0
GDP (in millions of US\$)	15,465	17,134	19,485	23,088	25,051	26,852

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Includes public service fees.

2/ One-off payment from the Panama Ports Company.

3/ Revenues and grants less current expenditure.

Table 4. Panama: Monetary Accounts 1/

	2005	2006	2007	2008	Proj.	
					2009	2010
(In millions of U.S. dollars at end-period)						
Net foreign assets	2,922	4,113	5,257	6,017	6,489	6,880
Short-term foreign assets, net	2,945	4,131	5,272	6,027	6,499	6,890
National Bank of Panama	1,218	1,421	2,028	2,672	2,872	3,172
Rest of banking system	1,728	2,710	3,244	3,355	3,627	3,718
Long-term foreign liabilities	23	18	14	10	10	10
National Bank of Panama	23	18	14	10	10	10
Net domestic assets	9,270	10,694	11,911	14,755	15,639	16,839
Public sector (net credit) 2/	-1,251	-1,442	-2,435	-2,782	-2,572	-2,061
Central government (net credit)	358	134	-314	-457	-435	-405
Rest of the public sector (net credit)	-1,609	-1,577	-2,121	-2,324	-2,137	-1,656
Private sector credit	13,892	15,681	18,540	21,243	21,824	23,789
Private capital and surplus	-3,537	-3,917	-5,578	-6,419	-6,764	-7,250
Other assets (net)	165	372	1,383	2,713	3,152	2,361
Liabilities to private sector	12,192	14,807	17,167	20,334	22,129	23,719
Total deposits 2/	12,103	14,739	17,100	20,273	22,063	23,649
Demand deposits	1,911	2,615	3,042	3,762	4,082	4,375
Time deposits	7,595	9,283	10,536	12,165	13,199	14,148
Savings deposits	2,597	2,840	3,522	4,347	4,782	5,126
Bonds	89	68	67	61	66	70
(12-month change in relation to liabilities to the private sector at the beginning of the period)						
Net foreign assets	1.5	9.8	7.7	4.4	2.3	1.8
Net domestic assets	7.0	11.7	8.2	16.6	4.3	5.4
Public sector credit (net) 2/	-4.9	-1.6	-6.7	-2.0	1.0	2.3
Private sector credit	14.5	14.7	19.3	15.7	2.9	8.9
Private capital and surplus	2.0	3.1	11.2	4.9	1.7	2.2
Other assets (net)	-0.6	1.7	6.8	7.7	2.2	-3.6
Liabilities to the private sector	8.5	21.5	15.9	18.4	8.8	7.2
(12-month percent change)						
Memorandum items:						
M2 3/	8.5	21.5	15.9	18.4	8.8	7.2
Private sector credit	13.3	12.9	18.2	14.6	2.7	9.0
(In percent of GDP)						
Total deposits	78.2	86.0	87.8	87.8	88.1	88.1
Private sector credit	89.7	91.5	95.2	92.0	87.1	88.6
Demand deposits/total deposits	15.8	17.7	17.8	18.6	18.5	18.5

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and Fund staff estimates and projections.

1/ Domestic banking system only; comprises general license banks; does not include offshore banks; deposits from and credit to nonresidents reported in the net foreign assets.

2/ Projections for 2009-10 do not include onlending by the government to BNP for the stimulus package.

3/ M2 consists of bank deposits only; estimates of U.S. currency in circulation are not available.

Table 5. Panama: Commercial Bank Performance Indicators 1/
(In percent; end-of-period)

	2005	2006	2007	2008			
				Mar.	Jun.	Sep.	Dec.
Asset quality							
Nonperforming loans as percent of total loans							
Banking system	1.8	1.4	1.3	1.4	1.2	1.4	1.6
Domestic banks	2.8	2.2	1.5	1.6	1.4	1.6	1.7
Foreign banks	0.8	0.6	1.2	1.2	1.1	1.3	1.7
Ratio of provisions to nonperforming loans							
Banking system	116.2	128.5	141.7	131.2	141.5	125.4	104.8
Domestic banks	97.9	108.5	147.8	130.0	149.1	129.1	120.2
Foreign banks	158.1	219.5	136.0	132.3	134.9	122.1	93.5
Profitability							
Pretax return on average assets							
Banking system	2.1	1.7	2.0	2.5	2.6	2.4	2.2
Domestic banks	2.1	1.2	1.9	2.1	1.9	2.4	2.9
Foreign banks	2.1	2.4	2.1	2.8	3.1	2.8	2.7
Liquidity							
Ratio of liquid assets to total deposits							
Banking system	24.0	27.0	26.8	26.4	25.7	23.9	28.4
Domestic banks	21.7	26.9	26.1	25.2	25.6	23.1	25.9
Foreign banks	27.2	27.1	27.3	27.4	25.9	24.5	30.6
Ratio of liquid assets plus marketable securities to total deposits 2/							
Banking system	39.9	41.9	40.9	41.4	40.8	39.1	43.0
Domestic banks	41.0	42.0	39.5	39.4	40.1	36.9	39.0
Foreign banks	38.3	41.8	41.9	43.0	41.4	40.9	46.2
Ownership							
Foreign banks' share of banking system assets	42.0	43.0	57.6	58.2	57.7	57.8	57.5

Sources: Superintendency of Banks; and Fund staff estimates.

1/ Domestic banking system only, comprises general license banks; does not include offshore banks.

2/ Liquid assets, as defined in Article 48 of the Banking Law, also include marketable short-term securities.

Table 6. Panama: Balance of Payments

	2005	2006	2007	2008	Proj.	
					2009	2010
(In millions of U.S. dollars)						
Current account	-759	-535	-1,430	-2,863	-2,407	-3,051
Trade balance excluding Colón Free Zone	-1,892	-2,287	-3,642	-4,749	-4,767	-5,736
Exports, f.o.b.	1,282	1,466	1,638	1,656	1,476	1,606
Imports, f.o.b.	-3,174	-3,753	-5,280	-6,405	-6,243	-7,342
Net exports from Colón Free Zone	576	575	459	-26	354	379
Re-exports, f.o.b.	6,309	7,012	7,700	8,634	7,605	8,184
Imports, f.o.b.	-5,733	-6,437	-7,241	-8,660	-7,251	-7,805
Services, net	1,436	2,210	2,818	3,262	3,161	3,583
Travel, net	509	689	878	1,042	989	1,079
Transportation, net	837	1,265	1,396	1,586	1,500	1,777
Other services	90	257	544	633	672	726
Income, net	-1,125	-1,286	-1,318	-1,589	-1,414	-1,555
Private sector	-680	-848	-877	-1,109	-814	-887
Public sector	-445	-438	-442	-480	-600	-668
Of which: NFPS interest	-566	-558	-598	-622	-662	-719
Current transfers, net	245	253	253	238	259	277
Capital and financial account	2,320	154	3,154	2,958	2,607	3,351
Capital account (public sector grants)	0	15	44	57	57	57
Financial account	2,320	138	3,110	2,901	2,550	3,294
Public sector	1,397	-419	473	180	827	811
Nonfinancial public sector	908	-101	481	187	479	818
National Bank of Panama 1/	-8	-9	-9	-7	348	-7
Other net flows	497	-309	0	0	0	0
Private sector, medium and long-term	399	2,222	1,458	1,446	1,452	1,516
Direct investment	962	2,498	1,907	2,402	1,627	1,884
Portfolio investment	-1,103	-674	-1,125	-526	-482	-702
Loans	539	399	676	-429	307	334
Short-term flows	524	-1,665	1,179	1,275	270	967
Errors and omissions	-1,100	850	-1,107	553	0	0
Overall balance	461	469	617	649	200	300
Financing	-461	-469	-617	-649	-200	-300
Net foreign assets of the BNP	-584	-203	-607	-644	-200	-300
(In percent of GDP)						
Memorandum items:						
Merchandise exports	8.3	8.6	8.4	7.2	5.9	6.0
Merchandise imports	-20.5	-21.9	-27.1	-27.7	-24.9	-27.3
Net exports from Colón Free Zone	3.7	3.4	2.4	-0.1	1.4	1.4
Current account	-4.9	-3.1	-7.3	-12.4	-9.6	-11.4
Direct foreign investment	6.2	14.6	9.8	10.4	6.5	7.0

Sources: Comptroller General; and Fund staff estimates and projections.

1/ Includes US\$355 millions of loans in 2009 from multilateral development banks for the stimulus package (PEF).

Table 7. Panama: Gross External Debt Flows of the Nonfinancial Public Sector
(In millions of U.S. dollars)

	2005	2006	2007	2008	Proj.	
					2009	2010
Total disbursements 1/	466	2,294	670	1,113	603	950
Multilaterals	111	177	192	259	280	296
IBRD	17	15	74	99	111	133
IDB	88	136	76	141	111	47
IMF	0	0	0	0	0	0
Others	6	27	41	19	58	117
Bilateral and guaranteed suppliers	2	1	0	3	0	25
Commercial banks	70	439	8	165	0	0
Global bonds	282	1,676	471	686	323	50
ACP 2/	0	0	0	0	0	578
Total debt service	746	2,591	704	1,482	688	724
Multilaterals	203	277	217	217	181	188
IBRD	57	52	56	59	35	34
IDB	121	195	126	137	138	136
IMF	12	11	11	5	0	0
Others	14	18	23	17	8	17
Bilateral and guaranteed suppliers	35	32	32	31	23	22
Commercial banks	2	442	1	6	9	9
Brady bonds	25	377	0	0	0	0
Global bonds 3/	480	1,462	455	1,228	475	489
ACP	0	0	0	0	0	16
Amortization	184	2,100	176	926	124	132
Multilaterals	145	215	151	151	104	113
IBRD	45	41	43	46	24	23
IDB	79	150	82	90	78	79
IMF	10	10	10	5	0	0
Others	12	14	17	10	2	11
Bilateral and guaranteed suppliers	26	24	25	24	17	16
Commercial banks	0	440	0	2	2	2
Brady bonds	13	359	0	0	0	0
Global bonds 4/	0	1,062	0	749	0	0
ACP	0	0	0	0	0	0
Interest	562	490	528	556	565	592
Multilaterals	58	62	65	66	77	74
IBRD	12	11	13	13	11	11
IDB	42	45	45	47	60	58
IMF	2	1	1	0	0	0
Others	2	5	7	6	6	6
Bilateral and guaranteed suppliers	9	8	7	7	6	5
Commercial banks	2	2	1	4	8	8
Brady bonds	12	18	0	0	0	0
Global bonds 3/	480	400	455	479	475	489
PAC expansion	0	0	0	0	16	23
Memorandum items:						
Debt service						
As percent of exports of goods and services	27.1	43.3	10.0	19.8	9.3	8.9
As percent of GDP	9.8	15.1	3.6	6.4	2.7	2.7
Exports of goods and services	3,977	5,076	5,979	7,022	7,493	7,431
GDP	15,465	17,134	19,485	23,088	25,051	26,852

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Excludes multilateral financing of the stimulus package (PEF).

2/ Reflects disbursements from multilateral development banks and JBIC for the Panama Canal expansion.

3/ Excludes estimated interest payments made on bonds held by Fondo Fiduciario.

4/ Includes debt exchange operations.

Table 8. Panama: Debt of the Nonfinancial Public Sector

	2005	2006	2007	2008	Proj.	
					2009	2010
(In millions of U.S. dollars)						
External debt 1/	7,030	6,933	7,404	7,586	8,066	8,884
Multilaterals 2/	1,136	1,183	1,235	1,350	1,526	1,708
IBRD	212	188	217	271	358	468
IDB	818	883	891	948	981	949
IMF	24	15	5	0	0	0
Others	83	96	122	130	186	292
Bilateral and guaranteed suppliers	259	237	224	210	193	202
Commercial banks	80	8	6	170	168	166
Brady bonds	359	0	0	0	0	0
Global bonds	5,196	5,505	5,938	5,856	6,179	6,229
ACP 3/	0	0	0	0	0	578
Domestic debt 4/	1,991	2,080	1,632	1,419	1,190	1,209
Private creditors	1,261	1,313	995	828	698	717
Public financial institutions	731	768	636	591	492	492
Total	9,022	9,013	9,035	9,005	9,255	10,092
(In percent of GDP)						
Total	58.3	52.6	46.4	39.0	36.9	37.6
External	45.5	40.5	38.0	32.9	32.2	33.1
Domestic	12.9	12.1	8.4	6.1	4.7	4.5
Memorandum items:						
Held by Fiduciary Fund	3.6	5.0	4.5	3.9	3.6	3.3
Held by Social Security Agency	3.9	3.4	2.9	2.3	2.1	1.9
GDP (in millions of U.S. dollars)	15,465	17,134	19,485	23,088	25,051	26,852

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Excludes assets held by the Fiduciary Fund.

2/ Excludes multilateral financing of the stimulus package (PEF).

3/ Reflects disbursements from multilateral development banks and JBIC for the Panama Canal expansion.

4/ Excludes government debt held by the Social Security Agency.

Table 9. Panama: Indicators of the External Position and Financial Vulnerability

	2004	2005	2006	2007	2008
Financial indicators					
Broad money (12-month percent change)	8.6	8.5	21.5	15.9	18.4
Private sector credit (12-month percent change)	10.4	13.3	12.9	18.2	14.6
Deposit rate (6-month; in percent) 1/	2.1	3.2	5.1	4.6	3.8
External indicators					
Merchandise exports (12-month percent change)	15.6	11.9	14.3	11.7	1.1
Merchandise imports (12-month percent change)	12.9	14.3	18.2	40.7	21.3
Current account balance (in percent of GDP)	-7.5	-4.9	-3.1	-7.3	-12.4
Capital and financial account balance	3.0	15.0	0.9	16.2	12.5
<i>Of which</i> : direct investment	7.1	6.2	14.6	9.8	10.4
Public sector external debt	47.6	45.5	40.5	38.0	32.9
In percent of exports of goods and services 2/	169.8	138.5	115.9	105.4	101.2
External interest payments (in percent of Exports of goods and services) 2/	12.4	10.2	8.2	7.5	7.4
External amortization payments (in percent of Exports of goods and services) 2/	14.7	19.7	35.1	2.5	12.4
REER, percent change (depreciation -) 3/	-4.9	6.5	-4.7	-2.0	-2.0
Gross international reserves at end of period					
In millions of U.S. dollars 4/	657	1,236	1,440	2,044	2,693
In months of imports of goods and services	1.6	3.0	3.2	3.3	3.6
In percent of broad money	5.8	10.1	9.7	11.9	13.2
In percent of short-term public external debt 5/	356.9	119.1	817.8	539.9	2177.4
	(In millions of U.S. dollars)				
Memorandum items:					
Nominal GDP	14,179	15,465	17,134	19,485	23,088
Exports of goods and services	3,977	5,076	5,979	7,022	7,493

Sources: Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ One-year average for the banking system, comprising of general license banks, excluding offshore banks.

2/ Includes net exports of the Colón Free Zone.

3/ Data for end of period.

4/ Corresponds to net foreign assets of the National Bank of Panama (a publicly-owned commercial bank).

5/ Short-term public external debt includes amortization in the following year. Excludes global bonds debt exchange operations.

Table 10. Panama: Medium-Term Macroeconomic Framework

	2007	2008	Proj.					
			2009	2010	2011	2012	2013	2014
(percent change)								
Economic growth and prices								
Real GDP at market prices	11.5	9.2	3.0	4.0	6.5	7.0	7.0	6.5
GDP deflator	2.0	8.5	5.3	3.0	3.2	3.2	3.2	3.2
CPI (period average)	4.2	8.8	3.7	2.8	2.5	2.5	2.5	2.5
CPI (end of period)	6.4	6.8	3.2	2.5	2.5	2.5	2.5	2.5
(percent of GDP)								
Savings and investment								
National savings	16.2	13.7	16.8	17.6	17.4	16.0	16.5	17.6
Public sector	9.2	9.6	8.3	7.8	7.7	7.4	7.5	7.3
Private sector	7.0	4.0	8.6	9.8	9.7	8.6	9.1	10.2
Gross domestic investment	23.5	26.1	26.5	28.9	27.3	25.1	23.9	23.8
Public sector	5.6	8.2	9.3	11.1	11.1	11.0	9.5	8.8
<i>Of which: Canal Expansion</i>		0.4	2.2	4.0	3.8	3.8	2.0	1.0
Private sector	17.9	17.9	17.1	17.8	16.2	14.1	14.4	14.9
External savings	-7.3	-12.4	-9.6	-11.4	-9.9	-9.1	-7.4	-6.2
Nonfinancial public sector, excluding ACP								
Revenue	28.2	26.0	24.0	23.9	24.0	23.9	24.0	23.9
Revenue, excluding ACP transfers	23.9	23.0	21.1	21.1	21.3	21.3	21.5	21.5
Expenditure	24.7	25.6	25.0	24.8	25.0	24.9	25.0	24.9
Primary balance	7.0	3.5	2.1	2.0	1.8	1.6	1.3	1.0
Overall balance	3.5	0.4	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Net external financing	2.4	0.7	1.9	0.9	0.8	0.7	0.5	1.0
Net domestic financing	-6.0	-1.2	-0.9	0.1	0.2	0.4	0.5	0.2
Public debt 1/	46.4	39.0	36.9	35.4	33.3	31.2	29.2	27.8
Panama Canal Authority (ACP)								
Revenue	9.0	8.7	8.1	7.5	7.3	7.0	6.7	6.5
Current expenditure	2.7	2.4	2.3	2.3	2.4	2.4	2.4	2.4
Transfers to the government	4.3	3.0	2.9	2.7	2.7	2.6	2.5	2.4
Interest payments	0.0	0.0	0.0	0.1	0.1	0.2	0.3	0.4
Capital expenditure	0.6	1.2	2.7	4.6	4.3	4.3	2.4	1.6
Overall balance	1.3	2.1	0.1	-2.2	-2.1	-2.5	-0.9	-0.1
Net financing	0.0	0.0	0.0	2.2	2.1	2.5	0.9	0.1
Debt	0.0	0.0	0.0	2.2	4.1	6.2	6.5	6.0
Nonfinancial public sector, including ACP								
Overall balance	4.8	2.5	-0.9	-3.1	-3.2	-3.5	-1.9	-1.1
Total public debt	46.4	39.0	36.9	37.6	37.4	37.3	35.7	33.8
External								
Exports, f.o.b., excluding Colón Free Zone	8.4	7.2	5.9	6.0	6.2	6.6	7.0	7.5
Imports, f.o.b., excluding Colón Free Zone	-27.1	-27.7	-24.9	-27.3	-25.8	-24.6	-22.8	-22.0
Net exports of Colón Free Zone	2.4	-0.1	1.4	1.4	1.7	2.1	2.5	3.0
Current account balance	-7.3	-12.4	-9.6	-11.4	-9.9	-9.1	-7.4	-6.2
Foreign Direct Investment	9.8	10.4	6.5	7.0	7.2	7.3	7.4	7.5
(In millions of U.S. dollars)								
Memorandum items:								
Nominal GDP	19,485	23,088	25,051	26,852	29,507	32,571	35,956	39,536
Potential GDP growth (percentage change)	8.0	7.6	6.9	6.4	6.3	6.3	6.4	6.4
External Debt (excluding banks, percent of GDP)	54.2	49.5	50.0	50.2	49.9	49.7	47.9	46.1
External Debt (including banks, percent of GDP) 2/	180.2	171.2	166.1	165.8	166.4	167.3	166.2	165.0
Gross financing requirements								
Total (excluding ACP)	-134	1,162	879	721	1,085	1,075	611	766
<i>Of which: External</i>	649	829	374	390	778	705	479	552
ACP financing requirements	0	0	0	578	631	801	318	34

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Excludes global bonds held by the Fiduciary Fund (3.9 percent of GDP in 2008).

2/ Includes offshore banks.

Table 11. Panama: Medium-Term Balance of Payments

	2007	2008	Proj.					
			2009	2010	2011	2012	2013	2014
	(In millions of U.S. dollars)							
Current account	-1,430	-2,863	-2,407	-3,051	-2,907	-2,959	-2,657	-2,450
Trade balance excluding Colón Free Zone	-3,642	-4,749	-4,767	-5,736	-5,785	-5,866	-5,673	-5,739
Exports, f.o.b.	1,638	1,656	1,476	1,606	1,823	2,150	2,522	2,965
Imports, f.o.b.	-5,280	-6,405	-6,243	-7,342	-7,608	-8,016	-8,195	-8,703
<i>Of which</i> : related to canal expansion	-8	-61	-381	-814	-851	-937	-532	-292
Net exports from Colón Free Zone	459	-26	354	379	510	680	913	1,202
Re-exports, f.o.b.	7,700	8,634	7,605	8,184	11,032	14,739	19,798	26,055
Imports, f.o.b.	-7,241	-8,660	-7,251	-7,805	-10,522	-14,058	-18,884	-24,853
Services, net	2,818	3,262	3,161	3,583	3,855	4,035	4,182	4,275
Travel, net	878	1,042	989	1,079	1,170	1,308	1,464	1,647
Transportation, net	1,396	1,586	1,500	1,777	1,872	1,809	1,678	1,486
Other services	544	633	672	726	812	918	1,040	1,142
Income, net	-1,318	-1,589	-1,414	-1,555	-1,790	-2,145	-2,450	-2,597
Private sector	-877	-1,109	-814	-887	-1,054	-1,200	-1,365	-1,607
Public sector	-442	-480	-600	-668	-736	-945	-1,086	-990
<i>Of which</i> : NFPS interest	-598	-622	-662	-719	-784	-938	-1,034	-920
<i>Of which</i> : related to Canal Expansion					-23	-73	-121	-143
Current transfers, net	253	238	259	277	305	336	371	408
Capital and financial account	3,154	2,958	2,607	3,351	3,207	3,259	2,957	2,750
Financial account	3,110	2,901	2,550	3,294	3,150	3,202	2,900	2,693
Public sector	473	180	827	811	858	1,006	499	419
Nonfinancial public sector	481	187	479	818	865	1,013	506	426
National Bank of Panama 1/	-9	-7	348	-7	-7	-7	-7	-7
Other net flows	0	0	0	0	0	0	0	0
Private sector, medium and long-term	1,458	1,446	1,452	1,516	1,545	1,761	2,006	2,063
Direct investment	1,907	2,402	1,627	1,884	2,134	2,382	2,660	2,962
Portfolio investment	-1,125	-526	-482	-702	-946	-997	-1,051	-1,318
Loans	676	-429	307	334	357	376	397	419
Short-term flows	1,179	1,275	270	967	747	435	394	211
Errors and omissions	-1,107	553	0	0	0	0	0	0
Overall balance	617	649	200	300	300	300	300	300
Financing	-617	-649	-200	-300	-300	-300	-300	-300
Net foreign assets of the BNP	-607	-644	-200	-300	-300	-300	-300	-300
Memorandum items:	(In percent of GDP)							
Merchandise exports	8.4	7.2	5.9	6.0	6.2	6.6	7.0	7.5
Merchandise imports	-27.1	-27.7	-24.9	-27.3	-25.8	-24.6	-22.8	-22.0
Net exports from Colón Free Zone	2.4	-0.1	1.4	1.4	1.7	2.1	2.5	3.0
Current account	-7.3	-12.4	-9.6	-11.4	-9.9	-9.1	-7.4	-6.2
<i>Of which</i> : related to Canal Expansion		-0.3	-1.5	-3.0	-3.0	-3.1	-1.8	-1.1
Direct foreign investment	9.8	10.4	6.5	7.0	7.2	7.3	7.4	7.5

Sources: Office of the Comptroller General; and Fund staff estimates and projections.

1/ Includes US\$355 millions of loans in 2009 from multilateral development banks for the stimulus package (PEF).

Table 12. Panama: International Investment Position (IIP)
(In percent of GDP)

	2005	2006	2007	2008	Proj.	
					2009	2010
Net international position	-74.0	-69.7	-68.7	-71.6	-73.1	-71.9
Nonbanks	-102.5	-101.6	-98.7	-99.6	-103.4	-103.3
Assets	23.3	28.7	31.0	23.9	21.3	23.7
Portfolio investment abroad	1.5	3.8	1.7	1.5	1.5	1.6
Other investment	21.8	24.9	29.3	22.4	19.8	22.1
Liabilities	125.8	130.3	129.6	123.5	124.8	127.0
Direct investment inward	66.0	74.6	75.4	74.0	74.7	76.7
Portfolio investment	39.5	37.1	35.1	30.4	30.0	29.8
Other investment	20.3	18.6	19.1	19.1	20.0	20.4
Banks	28.5	31.9	30.0	28.1	30.4	31.3
Assets	134.0	139.5	156.0	149.8	146.5	146.8
Portfolio investment	32.9	31.1	34.8	31.5	30.9	31.3
Other investment	85.4	93.2	104.7	101.6	99.5	99.4
<i>Of which</i> : Loans	56.3	61.2	75.1	67.8	67.0	67.7
Currency and deposits	24.7	28.8	26.8	31.5	30.2	29.4
Reserve assets	15.7	15.2	16.4	16.7	16.2	16.2
Liabilities	105.5	107.6	126.0	121.7	116.1	115.5
Other investment	105.5	107.6	126.0	121.7	116.1	115.5
<i>Of which</i> : Loans	27.9	30.1	33.7	24.2	21.7	21.6
Currency and deposits	73.9	74.8	89.8	93.8	90.9	90.7

Sources: Panamanian authorities, other reporting agencies; and Fund staff calculations.

Table 13. Panama: Public Sector Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/ -0.8
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
Baseline: Public sector debt 1/	62.2	58.3	52.6	46.4	39.0	36.9	37.6	37.4	37.3	35.7	33.8	
o/w foreign-currency denominated	47.6	45.5	40.5	38.0	32.9	32.2	33.1	33.0	29.9	27.1	24.7	
Change in public sector debt	2.1	-3.8	-5.7	-6.2	-7.4	-2.1	0.6	-0.2	0.0	-1.6	-1.9	
Identified debt-creating flows (4+7+12)	-1.4	-3.6	-6.9	-11.2	-9.8	-2.2	0.6	-0.2	0.0	-1.6	-1.9	
Primary deficit	-0.3	-2.8	-5.5	-8.3	-5.6	-2.2	0.1	0.3	0.6	-0.8	-1.1	
Revenue and grants	23.0	24.3	26.8	30.2	29.3	26.8	26.3	26.3	25.9	25.8	25.5	
Primary (noninterest) expenditure	22.6	21.5	21.4	21.9	23.7	24.6	26.4	26.5	26.5	25.0	24.4	
Automatic debt dynamics 2/	-1.1	-0.7	-1.4	-2.9	-4.1	0.0	0.6	-0.5	-0.7	-0.9	-0.8	
Contribution from interest rate/growth differential 3/	-1.1	-0.7	-1.4	-2.9	-4.1	0.0	0.6	-0.5	-0.7	-0.9	-0.8	
Of which contribution from real interest rate	3.1	3.4	3.1	2.5	-0.5	1.1	1.9	1.7	1.7	1.5	1.3	
Of which contribution from real GDP growth	-4.1	-4.1	-4.5	-5.3	-3.6	-1.1	-1.4	-2.2	-2.4	-2.4	-2.1	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	3.5	-0.3	1.2	5.0	2.4	0.1	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	270.5	240.3	196.0	153.4	133.1	137.7	142.7	142.3	144.0	138.2	132.2	
Gross financing need 6/	9.6	10.6	13.5	1.5	5.4	4.1	5.2	5.9	5.8	2.6	1.8	
in billions of U.S. dollars	1366.5	1632.3	2318.9	284.0	1255.6	1019.5	1385.1	1739.3	1898.2	938.6	727.9	
						10-Year	10-Year					
Scenario with key variables at their historical averages 7/						35.7	32.2	28.8	25.4	22.0	18.5	0.0
Scenario with no policy change (constant primary balance) in 2009-2014						Historical	Standard					0.1
						33.5	28.4	22.4	16.4	10.4	6.3	
Key Macroeconomic and Fiscal Assumptions Underlying Baseline						<u>Average</u>	<u>Deviation</u>					
Real GDP growth (in percent)	7.5	7.2	8.5	11.5	9.2	5.6	3.4	3.0	4.0	6.5	7.0	6.5
Average nominal interest rate on public debt (in percent) 8/	7.7	7.8	8.1	7.5	7.9	7.1	0.8	8.6	8.8	8.5	8.4	7.9
Average real interest rate (nominal rate minus change in GDP d	5.7	6.0	6.0	5.6	-0.6	5.9	1.0	3.3	5.8	5.3	5.3	4.7
Nominal appreciation (increase in US dollar value of local currer	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.0	1.7	2.1	2.0	8.5	1.2	1.0	5.3	3.0	3.2	3.2	3.2
Growth of real primary spending (deflated by GDP deflator, in p	3.0	1.5	8.0	14.4	18.1	9.7	13.2	7.2	11.6	6.9	7.1	0.9
Primary deficit	-0.3	-2.8	-5.5	-8.3	-5.6	-3.5	2.6	-2.2	0.1	0.3	0.6	-0.8

1/ Gross nonfinancial public sector debt including the ACP.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\epsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

ANNEX I. SUMMARY OF ANNEXES

Fund Relations

As of February 28, 2009, Panama did not have any outstanding purchases or loans. The latest precautionary SBA expired on March 29, 2002. The last Article IV consultation was completed by the Executive Board on July 27, 2008. Panama has received wide-ranging TA over time including most recently on national accounts statistics to evaluate the compilation of valued added of financial services in March 2009. The last safeguards assessment was completed on July 12, 2001, and concluded that the National Bank of Panama external audit mechanism was at the time adequate. There is no resident representative.

Relations with the World Bank

The World Bank Board endorsed a Country Partnership Strategy (CPS) for Fiscal Years (FY) 2008–10 in October 2007. The CPS includes a lending envelope of US\$390–465 million over FY08–10, divided into three Development Policy Loans (DPLs), seven new poverty-focused investment projects, and one Technical Assistance (TA) loan. The *Competitiveness and Public Financial Management* Development Policy Loans DPL (US\$100 million) was approved by the World Bank Board in December 2008 while the *Protecting the Poor under Global Uncertainty DPL* (US\$80 million) was approved on April 21, 2009.

Relations with the Inter-American Development Bank

A policy dialogue planned with the incoming government in May–June 2009 will set the stage for the elaboration of a new 2010–14 country strategy by end-2009. The 2009 lending program to Panama envisages 3 project loans and 2 program loans amounting to US\$700 million including the *Liquidity and Growth Support Program* (a publicly-guaranteed emergency loan to the state-owned National Bank of Panama in support of on-lending to private firms amounting to US\$500 million). The latter was approved by the Executive Board on April 15, 2009.

Statistical Issues

Panama's economic statistics and data provisions have some shortcomings, but are broadly adequate for surveillance.

INTERNATIONAL MONETARY FUND

PANAMA

Staff Report for the 2009 Article IV Consultation

Informational Annex

Prepared by Western Hemisphere Department

(In collaboration with other departments)

May 6, 2009

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ANNEX I—RELATIONS WITH THE FUND

(As of February 28 , 2009)

I. Membership Status: Joined March 14, 1946; Article VIII**A. Financial Relations**

II. General Resources Account:	SDR Million	Percent of Quota
Quota	206.60	100.00
Fund holdings of currency	194.75	94.27
Reserve position in the Fund	11.86	5.74

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	26.32	100.0
Holdings	0.45	1.70

IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
None		

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	06/30/00	03/29/02	64.00	0.00
EFF	12/10/97	06/20/00	120.00	40.00
Stand-By	11/29/95	03/31/97	84.30	84.30

VI. Projected Obligations to the Fund: (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Principal					
Charges/interest	0.11	0.15	0.15	0.15	0.15
Total	0.11	0.15	0.15	0.15	0.15

VII. Safeguards Assessment

The National Bank of Panama (BNP) was subject to the transitional procedures with respect to the Stand-By Arrangement approved on June 30, 2000. The assessment, which only required a review of the BNP's external audit mechanism, was completed on July 12, 2001 and concluded that BNP's external audit mechanism was at the time adequate.

B. Nonfinancial Relations

VIII. Exchange Rate Arrangement:

Panama uses the U.S. dollar as the primary means of payment in the local economy. Its national currency (balboa) is issued in the form of coins only and serves as a unit of account. The exchange rate of the balboa is fixed at B 1 per U.S. dollar. Panama has accepted the obligations of Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

IX. Last Article IV Consultation:

The 2008 Article IV consultation was concluded on July 3, 2008. Panama is on the standard 12-month consultation cycle.

X. Technical Assistance:

STA: March 2009, National Accounts statistics mission to improve the compilation of output and value added of financial services. March 2007, assistance to improve and regionally harmonize monetary and financial statistics reporting. December 2006, assistance to improve fiscal data quality.

FAD: 2007-2009, development of a medium-term expenditure frameworks within a regional context. October 2005, fiscal ROSC assessment mission.

MCM: February 2008, in conjunction with WHD, a mission to assess the implications of the increased presence of foreign banks in Central America for bank supervision. October/November 2007, assistance with drafting a revised Bank Law; May/June 2005 and November 2005, an assessment of financial sector supervision and regulation. May/June 2005, Offshore Financial Sector Initiative mission to follow-up on the evaluation of the 2001 Module 2 assessment.

XI. Resident Representative: None

ANNEX II—RELATIONS WITH THE WORLD BANK

1. The World Bank Board endorsed a Country Partnership Strategy (CPS) for Fiscal Year (FY) 2008–10 in October 2007.¹ This followed the satisfactory implementation of the FY 2006–07 Interim Strategy Note. The CPS aims to provide selective, demand-driven assistance that deepens the Panama-Bank partnership and helps the government achieve its poverty and inequality reduction goals. The World Bank opened a resident mission in Panama in October 2007 as a reflection of the strengthened partnership with the government and a rapidly expanding project portfolio.
2. The CPS includes a lending envelope of US\$390–465 million over FY 2008–10, divided into three Development Policy Loans (DPLs), seven new poverty-focused investment projects, and one Technical Assistance (TA) loan. The current portfolio consists of nine IBRD projects and one GEF donation under implementation, totaling US\$379.5 million, of which about US\$287 million are undisbursed (owing mainly to the relatively recent build-up of the portfolio). The second Competitiveness and Public Financial Management DPL (US\$100 million) was approved by the World Bank Board in December 2008. In addition, two new investment loans were approved in FY 2009: the Health Equity and Performance Improvement Project (US\$40 million) and Basic Education Quality Improvement Project (US\$35million). *Protecting the Poor under Global Uncertainty DPL* (US\$80 million) is being considered for approval in April 2009 to support country efforts to mitigate the impact of economic shocks on the poor through improved targeting and coverage of social sector programs. The existing project portfolio consists of the Social Protection Project, the Water and Sanitation Project, the Basic Education Project II, the Public Policy Reform Technical Assistance Loan, the Land Administration Project, the Rural Productivity Project, and the Global Environment Facility Rural Productivity Project.
3. Four new investment loans are currently in the preparation stage and are expected to be presented to the Board in FY 2010. These include: the Sustainable Tourism Project (US\$30 million), Access to Land (US\$45 million), Rural Micro Finance Project (US\$25 million), and the Urban Transport Project (US\$50 million).
4. The Bank is also providing research and analytical and technical assistance to Panama. A draft Country Economic Memorandum, including an Investment Climate Assessment, was prepared and was presented to the government. A Country Environment Analysis was delivered FY 2008. For FY 2009, the Bank will prepare a Poverty Assessment and an Urban Development for FY 2010. A set of Policy Notes are also being prepared to support the government transition by providing presidential candidates with an additional source of information on key development challenges and on-going policies and programs.

¹ The World Bank's FY 2009 starts in July 2008 and ends in June 2009.

5. The Staffs of the World Bank and the IMF are working in close collaboration, including frequent exchange of data and information and coordination of policy advice. Most recently, Fund staff contributed to two Policy Notes on inflation and financial sector stability.

Panama: Financial Relations with the World Bank Group

(In millions of U.S. dollars)

A. Active IBRD Operations									
(As of March 16, 2009)									
IBRD projects					Commitment				Undisbursed
1	Basic Education II				40.0				4.2
2	Social Protection				24.0				23.4
	2nd Competitiveness and Public Financial								
3	Management DPL				100.0				100.0
4	Public Policy Reform TA				15.2				4.2
5	Land Administration				47.9				10.9
6	Rural Productivity				39.4				35.1
7	Water and Sanitation				32.0				29.7
8	GEF Rural Productivity				6.0				4.9
9	Health Equity and Performance Improvement				40.0				40.0
10	Basic Education Quality Improvement				35.0				35.0
	Total				379.5				287.4

B. IBRD Loan disbursements								
(Fiscal Year)								
	2001	2002	2003	2004	2005	2006	2007	2008
Number of projects	9	10	8	4	3	3	4	6
Commitment amount	270.4	280.9	220.9	97.7	93.4	93.4	138.8	199.8
Total of undisbursed balance	143.3	122.6	97.2	68.1	60.3	51.4	78.9	118.7

ANNEX III—RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

The IDB country strategy with Panama for 2005–09 aims at supporting sustainable economic growth and reducing poverty. Two specific objectives have been formulated: (i) boosting the economy’s competitiveness; and (ii) developing the country’s human and productive capital. The strategy also incorporates efforts to strengthen governance and transparency. Specifically, loans will finance infrastructure and projects related to the investment climate and adjustment to free trade agreements, competitiveness and growth, social sector development, modernization of the state and its regulatory framework, and capacity building for trade negotiations and regional integration. A policy dialogue planned with the incoming government in May–June 2009 will set the stage for the elaboration of a new 2010–14 country strategy by end-2009.

The 2008 lending program to the sovereign included six new project loans approved amounting to US\$125.2 million:

- Technological Transformation Program, phase I: US\$19.7 million
- Housing Conditions Improvement Program: US\$30 million
- Colon Province Sustainable Development: US\$20 million
- Development Program for the Central Provinces: US\$43 million
- ETESA Investment and Corporate Transformation Program I: US\$12.5 million

Moreover, the IDB’s private-sector lending arm approved a loan to the Panama Canal Authority for US\$400 million to help finance the expansion of the Canal. Other loans to the private sector (for an outstanding stock of US\$150 million) include four lines of credit under the Regional Trade Finance Facilitation Program (TFFP).

The 2009 lending program to the sovereign envisages 3 project loans and 2 program loans amounting to US\$700 million. These are (respectively).

- Support of IDAAN’s Investment Program: US\$40 million
- Transportation Loan phase II: US\$ 50 million
- National Tourism Program: US\$10 million
- Support of the Consolidation of the Energy Sector I: US\$100 million
- Liquidity and Growth Support Program (a publicly-guaranteed emergency loan to the state-owned National Bank of Panama in support of on-lending to private firms for working capital, commercial credits and trade credits, given tighter global credit conditions resulting from the current crisis): US\$500 million.

The IDB plans to approve 5 loans to the private sector, including a line of credit to extract wood (US\$22.7 million), and lines of credit to banks for specific sectors (US\$15 million to BBVA, 2 loans totaling US\$13 million to BAC Panamá S.A. and 1 loan for US\$8 million to Multibank, Inc.. The latter two loans are under the TFFP.

The following table summarizes Panama's loan portfolio with the IDB as of March 23, 2009

Panama: Financial Relations with the Inter-American Development Bank

(In millions of U.S. dollars)

IDB Lending Operations (as of March 23, 2009)	Disbursed	Undisbursed
Ongoing Operations		
Agricultural-Rural Development	23.1	50.9
Education	40.3	17.8
Energy-Electricity	3.1	69.4
Environment/Sustainable Development	91.5	102.8
Health	35	0
Reform and Modernization of the State/Business Climate	19.3	103.8
Science and Technology/Competitiveness	0	19.7
Social Development	50	49.0
Tourism	-	-
Transportation	43.8	63.2
Urban Development	9	31
Water Supply and Sewerage	16	29
Total	331.1	536.6
IDB loans approved since 1960	Total	
Total Operations 1/	3,710.8	
Of which: public and publicly guaranteed	2,671.7	
Cancellations 1/	457.7	
Principal payments 1/	1,299.7	
Debt outstanding 1/	1,006.7	
Commitments 2008	675.2	
of which: public and publicly-guaranteed	125.2	
New Commitments CY 2009 2/	100.0	
Disbursements CY 2009 1/	36.6	
of which: public and publicly-guaranteed	16.5	

Source: The Inter-American Development Bank.

1/ As of February 28, 2009.

2/ As of March 23, 2009.

ANNEX IV—STATISTICAL ISSUES

1. Substantial progress has been achieved in improving the accuracy, timeliness, and publication of economic statistics. Data provided to the Fund are generally adequate for surveillance. However, there is a need to improve coordination between the Comptroller General's Office, which is responsible for official economic statistics, and other government entities, including the Ministry of Economy and Finance. Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000. The metadata and plans for improving the statistical system that are posted on the Dissemination Standards Bulletin Board (DSBB) need updating.

Real Sector

2. The authorities completed a revision of the national accounts in 2004, based on the 1993 *SNA*, with a change in the base year from 1982 to 1996. Revised data are available for the period 1996–2008 from the Comptroller General's Office (CGO) (www.contraloria.gob.pa). In 2005, the authorities introduced quarterly GDP estimates beginning in 1996. Current data are released with a lag of approximately three months. In addition, the index of monthly economic activity is released with a lag of up to two months. Although the timeliness of real sector data provision has improved, the data are often subject to sizable revisions. The World Bank is supporting a project for changing the base year of the national accounts to 2007, which is in its initial phase.

3. The IMF national accounts technical assistance mission conducted in March 2009 noted the limited coverage of financial activity as well as the overestimation of the deflator used to calculate the financial services output at constant prices. The revised financial activity GDP estimates, and the related overall GDP revision, will be published in October 2009.

4. A new Household Income and Expenditure Survey was conducted during 2007–08, and the National Institute of Statistics and Census is in the process of updating the base, basket, and weights of the CPI. The Household Income and Expenditure Survey also provided new data on poverty levels, which were last estimated in 2003.

Government Finances

5. The Ministry of Finance compiles budget execution data for the central government and data on nonfinancial public sector operations (central government, public enterprises, and agencies) on a cash basis. Monthly and quarterly data have been reported up to December 2008 for the budgetary central government operations (www.mef.gob.pa).

6. Further efforts are needed to improve the quality of fiscal data. Apart from timeliness, data consistency in terms of transfers between public sector units should be improved; and the coverage of the investment program should be made universal. Since September 2004, the operational balance of the Panama Canal Authority (PCA) was excluded from the official definition of the nonfinancial public sector used for fiscal policy purposes. Information on the Panama Canal Authority (PCA) is only available in the Annual Report posted in its website (www.pancanal.com) on a fiscal year basis. There is a need to ensure a consistent and timely flow of PCA statistics on a calendar year basis. The authorities have received technical assistance from STA to implement the government *Finance Statistics Manual 2001 (GFSM 2001)* and a FAD fiscal ROSC mission took place in October 2005. In February 2004 a STA mission undertook a comprehensive review of the coverage and methodology of fiscal data, and suggested a tentative timetable to migrate to the *GFSM 2001* but resource constraints prevented substantial progress.

Monetary Accounts

7. Panama has been publishing financial sector data based on the new standardized report forms (SRFs) for monetary statistics in the IFS Supplement since March 2007 and participates in a regional project for harmonizing monetary and financial statistics in Central America and the Dominican Republic. The aim is to facilitate cross-country comparison and regional analysis. Provision of monthly data by the two public financial institutions, the National Bank of Panama and the Savings Bank (*Caja de Ahorros*), is regular and prompt. Monthly data on the operations of the domestic and international commercial and savings banks is prepared by the Superintendency of Banks, and posted on its website (www.superbancos.gob.pa) and reported to STA with a lag of one to two months. The state-owned development banks, the Agricultural Development Bank, and the Mortgage Bank are not regulated by the Superintendency of Banks and no data is reported to the Fund.

Balance of Payments

8. Quarterly data is available with a delay of about one quarter, and is subject to revisions thereafter. Revised estimates in key trade and investment data may result in substantial revisions of the current account of the balance of payments. These revisions may reflect improvements in coverage, but they also suggest that there is room for improvement in quality control procedures. Data are not yet available on nonfinancial private sector debt and transactions involving financial derivatives, resulting in large swings in errors and omissions. Quarterly International Investment Position (IIP) data have been compiled since 2002, and annual data are available since 1998. The most recent balance of payments and IIP data pertain to December 2008.

PANAMA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(AS OF APRIL 2, 2009)

	Date of latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶	Memo Items:	
						Data Quality–Methodological Soundness ⁷	Data Quality–Accuracy and Reliability ⁸
Exchange Rates	Fixed	NA	NA	NA	NA		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	2/2009	03/2009	M	M	A		
Reserve/Base Money	NA	NA	NA	NA	NA	NA, O, NA, LO	LO, O, O, O, NA
Broad Money	2/2009	3/2009	M	M	M		
National Bank of Panama Balance Sheet	2/2009	3/2009	M	M	A		
Consolidated Balance Sheet of the Banking System	2/2009	3/2009	M	M	M		
Interest Rates ²	2/2009	3/2009	M	M	M		
Consumer Price Index	2/2009	3/2009	M	M	M	O, LNO, LO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	12/2008	3/2009	Q	Q	Q	LO, LNO, LO, O	O, LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing ³ –Central Government	12/2008	3/2009	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/2008	3/2009	M	M	M		
External Current Account Balance	12/2008	3/2009	Q	Q	Q	LO, LO, O, LO	LO, O LO, LO, LNO
Exports and Imports of Goods and Services	12/2008	3/2009	M	M	M		
GDP/GNP	2008	3/2009	Q	Q	Q	O, O, O, LO	LO, LO, LNO, LO, LNO
Gross External Debt	12/2008	3/2009	M	M	M		
International Investment Position ⁹	2008	3/2009	A	A	A		

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

³Foreign, domestic bank, and domestic nonbank financing.

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

⁵Including currency and maturity composition.

⁶Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

⁷Reflects the assessment provided in the data ROSC, published in October 2006 based on the findings of the mission that took place during February 7–23, 2006. For the dataset corresponding to the variable in each row, the assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁸Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

⁹Includes external gross financial asset and liability positions vis-à-vis nonresidents, including of offshore bank.

**Statement by the IMF Staff Representative on Panama
June 1, 2009**

1. This statement summarizes key developments in Panama since the issuance of the staff report for the 2009 Article IV Consultation. It does not change the thrust of the staff appraisal.
2. **Ricardo Martinelli, the candidate from Cambio Democrático (CD), the opposition party, won the May 3 presidential election by a large margin.** The CD alliance also won 42 of the 71 seats in congress. The new administration is scheduled to take office on July 1 and is expected to continue with policies that promote private-sector led growth and foreign investment. In addition, the new government plans to carry out a revenue neutral tax reform (with a view to introduce a single income tax rate) and increase investment on infrastructure.
3. **The latest indicators on activity are somewhat mixed but, on the whole, remain consistent with the staff's projections of real GDP growth of 3 percent in 2009.** The monthly indicator of economic activity (IMAE) increased by 2.9 percent (cyclically adjusted) in the first quarter of March 2009 compared to a year earlier. First quarter data for tax revenue, social security contributions, bank credit, and bank deposits all showed growth in the low double digits, in stark contrast with other countries in the region. Other sectors, including transportation, communication, tourism, and retail sales also posted positive growth. Nonetheless, first quarter data for some sectors (i.e., the Colon Free Zone, residential construction, nontraditional agriculture, and auto sales) showed a decline in activity.
4. **Although the pace of disinflation has slowed, inflation remains in line with staff's projection for end-2009 (3.2 percent).** Inflation in April was 3.7 percent (y/y), the same as in March, owing to a relatively high monthly rate (0.4 percent) driven by increases in the prices of fuel and education.
5. **Fiscal data for the first quarter remains broadly consistent with the target of an overall fiscal deficit of 1 percent of GDP in 2009.** The balance of the nonfinancial public sector (NFPS) excluding the Canal Authority (ACP) for the first quarter was 0.6 percent of GDP, similar to the 2008 outturn. While tax revenues were 13 percent higher than those in the first quarter in 2008, nontax revenues were significantly lower.
6. **Traffic through the Canal has declined much less than global trade.** In the first quarter of 2009, the number of vessels and cargo tonnage declined by 1½ percent and 3.3 percent, respectively, compared to their levels in the same period of 2008. At the same time, total revenues from the Canal increased by nearly 12 percent as a result of higher tariffs (tariffs were further increased in May, as had been scheduled).
7. **The new government is planning to cancel the US\$500 million loan approved by the IDB in April 2009 for on-lending to banks.** The banks have indicated that the cost of these IDB funds is too high and that they do not foresee any demand for them. On a related development, preliminary data suggest that correspondent bank credit lines have returned to normal levels in recent weeks.



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IMF Executive Board Concludes 2009 Article IV Consultation with Panama

On June 1, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Panama.¹

Background

Strong economic fundamentals helped contain the adverse impact of the global economic downturn and financial turmoil. Real GDP in 2008 grew by 9.2 percent, following an annual average growth of 8.8 percent in 2004–07. However, a decline in global trade and tighter credit conditions are becoming evident and real growth in 2009 is projected to slow to 3 percent. The high-growth period has led to a significant fall in poverty and a sharp decline in the unemployment rate, from 10.9 percent at the end of 2003 to 4.2 percent in August of 2008. Inflation, after peaking at 10 percent in September 2008, driven by the spike in international food and fuel prices and demand pressures, has declined rapidly and reached 3.7 percent in March 2009. The external current account deficit widened to 12.5 percent of GDP in 2008, as imports continued to increase at a relatively fast pace while exports slowed reflecting lower trade in the Colon Free Zone and a decline in external demand.

Panama's large banking system has weathered the global financial crisis relatively well. The system is well-capitalized, highly liquid, and has strong financial soundness indicators. In addition, recent assessments by the Superintendency of Banks has not revealed exposure

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. 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.

to complex structured assets. Following the intensification of the global financial crisis in September 2008, access to foreign credit lines declined, but the situation stabilized, and deposits and credit have been broadly stable. At the same time, banks have increased their holdings of liquidity partly to self insure and in response to higher perceived risk.

Public finances remained on strong footing and the nonfinancial public sector had a positive balance for the third subsequent year, albeit more modest than in 2007. Excluding the Panama Canal Authority (ACP), the nonfinancial public sector surplus in 2008 was equivalent to 0.4 percent. Continued robust revenues enabled a further large increase in public investment—from 5 percent of GDP in 2007 to 7 percent in 2008—and allowed for an increase in social spending of about 1 percent of GDP to partially offset the rapid increase in the cost of living. The rapid GDP growth, combined with the fiscal surplus, led to a further decline in the public debt-to-GDP ratio to 39 percent by end-2008. The Panama Canal expansion, estimated to cost US\$5.3 billion, is broadly on track, and the external financing for the project has been secured on very favorable terms. A new Social and Fiscal Responsibility Law (SFRL)—enacted in June 2008—and a Public-Private Partnership (PPP) draft law that is being finalized, are important reforms that will further strengthen fiscal management over the medium term.

Executive Board Assessment

Executive Directors noted that Panama is facing the global economic crisis from a position of strength, with sound economic fundamentals helping to contain the adverse impact of the world economic downturn and financial turmoil. In particular, Directors commended the well-regulated banking sector, sustained fiscal consolidation, and Canal expansion project, which will allow Panama to preserve macroeconomic stability and continue growing during 2009, albeit at a slower pace than in recent years.

Directors noted the widening of the external current account deficit and the rise in inflation during 2008 was influenced by transitory factors. High imports and weak export performance were partly a reflection of the world food and fuel shock and the slowdown of external demand. Buoyant capital inflows, including foreign direct investment, more than financed the current account deficit, and inflation fell rapidly as world prices normalized. Looking forward, Directors noted that downside risks remain given the difficult global environment.

Directors commended the authorities for the fiscal consolidation of recent years and the associated rapid decline in the public debt-to-GDP ratio. They welcomed the continued strong revenue performance and one-off factors that had allowed a substantial increase in capital spending and social programs, which had supported activity and helped protect the poor despite the deterioration in the external environment. Directors also commended the authorities for securing external financing for the Panama Canal expansion project on very favorable terms, and for making good progress in the implementation of the project.

Directors welcomed the effective adoption of the Social and Fiscal Responsibility Law (SFRL) to help strengthen fiscal discipline, and enhance transparency and accountability. While recognizing the challenges of adhering to a fiscal deficit target of 1 percent of GDP

during 2009, Directors encouraged the authorities to persevere in their efforts to comply with the target stipulated in the SFRL in order to bolster credibility of Panama's new fiscal framework. Directors recommended that the authorities quickly adopt guidelines that would allow rapid modification of the fiscal deficit target should growth decelerate more rapidly than envisaged.

Directors welcomed the resilience of Panama's financial system to the global financial crisis reflecting, in part, the relatively strong liquidity position of banks. They noted that reduced access to external credit lines had not unduly hampered the normal functioning of the system, and that while deposit and credit growth had slowed, they remained positive. Directors welcomed the steps taken to allow more timely monitoring of banks' liquidity, asset quality, and risk management practices, as well as the rapid resolution of Stanford Bank-Panama. They also welcomed the timely adoption of the new Bank Law that will enhance cross border supervision and improve the bank resolution framework.

In light of ongoing external vulnerabilities and the absence of a lender of last resort, Directors encouraged continued vigilance and further strengthening of the banking system. They noted the authorities' interest in creating a mechanism to provide emergency liquidity support for transitory liquidity shortages, which could reduce the banks' need to self-insure.

Directors observed that the inclusion of Panama in a list of tax havens released by the OECD presented additional challenges. They welcomed the authorities' intention to respond constructively, and called upon them to reach agreement on the steps needed to normalize its status.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Panama: Selected Economic Indicators

	2004	2005	2006	2007	2008	Proj. 2009
	(Annual percentage change)					
Real economy						
Nominal GDP	9.6	9.1	10.8	13.7	18.5	8.5
Real GDP (1996 prices)	7.5	7.2	8.5	11.5	9.2	3.0
Consumer price index (end of year)	1.6	3.4	2.2	6.4	6.8	3.2
Unemployment (open)	9.2	7.6	6.7	4.7	4.2	...
Money and credit						
Broad money	8.6	8.5	21.5	15.9	18.4	8.8
Private sector credit	10.4	13.3	12.9	18.2	14.6	2.7
Average deposit rate (1 year)	2.5	3.2	5.1	4.6	3.8	...
Average lending rate (1 year)	8.1	8.2	8.6	9.0	8.5	...
	(In percent of GDP)					
Saving and investment						
Gross domestic investment	18.7	18.4	19.5	23.5	26.1	26.5
Gross national saving	11.2	13.4	16.3	16.2	13.7	16.8
External sector						
Current account	-7.5	-4.9	-3.1	-7.3	-12.4	-9.6
Capital and financial account	-1.2	15.0	0.9	16.2	12.8	10.4
Real effective exchange rate (depreciation -)	-4.9	6.5	-4.7	-2.0	-2.0	...
External public debt	47.6	45.5	40.5	38.0	32.9	32.2
Nonfinancial public sector						
Revenue and grants	21.1	22.3	24.9	28.2	26.0	24.0
Expenditure	26.0	24.9	24.4	24.7	25.6	25.0
Balance, excluding Canal Authority	-4.9	-2.6	0.5	3.5	0.4	-1.0
Balance, Canal Authority 1/	1.0	1.0	0.7	1.3	2.1	0.1
Balance, including Canal Authority	-3.9	-1.6	1.2	4.8	2.5	-0.9
Total Public Debt	62.2	58.3	52.6	46.4	39.0	36.9
Memorandum item:						
GDP, in millions of US\$	14,179	15,465	17,134	19,485	23,088	25,051

Sources: Office of the Comptroller General; Superintendency of Banks; and Fund staff estimates and projections.

1/ Balance of Canal Authority, after transfers of Canal fees and distribution of profits to the government.

**Statement by Paulo Nogueira Batista, Executive Director for Panama
and Alfredo Maciá, Advisor to Executive Director
June 1, 2009**

1. On behalf of the Panamanian authorities, we would like to express our sincere appreciation of Mrs. Judith Gold's policy advice and her trustworthiness as Mission Chief to Panama. During this time, her support has been valuable, constructive, and crucial in guiding policy implementation and also in the preparation of legislation. The authorities asked us to convey their best wishes to her on her new assignments.

2. The Panamanian economic performance in 2008 remained robust with GDP growing as much as 9.2 percent supported by strong domestic demand. Although tourism, port activities, free zone trade, construction, and bank intermediation did well last year, these sectors will be adversely affected during 2009 by the global economic slowdown. During the first quarter of 2009, the Colon Free Zone (CFZ) activity was down 4.3 percent, new car sales fell by 20 percent, but tourism was up 3.2 percent compared to 2008. With the Canal expansion in high-spending gear during 2009-2012, a public works program estimated at 6 percent GDP, and FDI at about 7 percent of GDP, the authorities expect a soft-landing in 2009 with GDP growth above 3 percent. The projections of the Economic Council for Latin America and the Caribbean (CEPAL) for 2009 indicate that Panama will grow by 4 percent, the highest rate in the region. The WEO projections indicate 3 percent growth for Panama in 2009, the second highest in the Western Hemisphere after Peru. Inflation eased to 3.7 percent at end-March 2009 from 8.3 percent at end-2008 as oil and commodity prices receded. Open unemployment is down to 4.2 percent from 11 percent in 2004. According to CEPAL, poverty fell from 37 percent to 29 percent of total population, and extreme poverty from 19 percent to 12 percent. The authorities remain committed to reducing poverty.

3. The policies implemented to protect the purchasing power of low income groups and assist the most vulnerable in facing the rise in food and oil prices up to mid-2008 will be continued. On the supply side, the "consumers assistance program"(PAC) discussed in our last Article IV consultation, which included the elimination of import duties on agricultural inputs and price support policies as well as low interest rates on agricultural loans, helped Panama achieve over 90 percent self-sufficiency in rice in the 2008-09 crop season. The cash-transfer program "Red de Oportunidades", the school feeding-programs, subsidies on cooking gas and electricity, and low-pension retiree adjustments are included in the 2009 budget. Lower fuel prices have allowed the diesel-subsidy for public transportation to be reduced, supporting policy efforts for improving the targeting of subsidies.

4. The sharp increase of food and fuel prices until mid-2008 exerted pressure on Panama's external position. In addition, the 2008 surge of 26 percent in FDI and the enhanced public works investments drive pushed up domestic demand. This combination of events widened the current account deficit to 12.5 percent GDP in 2008 from 9 percent in the previous year. This deficit was fully covered by FDI and other capital inflows. The Canal expansion has a high import-content and will continue to exert pressure on the current account in the medium term.

5. The non-financial public sector (NFPS) posted a surplus for a third consecutive year in 2008, in spite of increased expenditures with public works projects and vulnerable-group programs. The surplus was due to high tax revenues and a one-off inflow from cell phone concessions. The primary balance of the NFPS was 3.6 percent of GDP in 2008 and remained positive in the first quarter of 2009. NFPS total revenues increased 9.4 percent in relation to 2007, with tax revenues rising 16.5 percent and non-tax revenues 8.1 percent. The authorities maintained a prudent wage control policy. The central government's ratio of wages to current revenues declined from 43 percent in 2004 to 26 percent in 2008. The ratio of interest payments to current revenues decreased from 29 percent in 2004 to 17 percent in 2008. Revenue projections for 2009 are on the conservative side, in line with Staff's views.

6. The authorities are committed to a NFPS deficit of 1 percent of GDP for 2009, as called for in the new fiscal responsibility law (SFRL) approved in mid-2008. The new SFRL sets a cap of 50 percent on the commitment of operating expenditures to provide the incoming administration with adequate budget support until end-2009. This cap does not apply to public investments and debt interest payments.

7. Net public debt of the NFPS has fallen from 62 percent of GDP in 2004 to 40.2 percent at end-2008. The authorities have consistently pursued a debt-reduction policy. In the beginning of this year, Standard and Poors (S&P) rated the sovereign BB+ with a stable outlook, and Fitch Ratings ratified Panama's long-term debt BB+ with a positive outlook.

Investment Activity

8. The expansion of the Panama Canal (PCA) involves a peak construction period in 2009-2012, with an average investment of over US\$850 million per annum. In 2008, the expansion represented 2.2 percent of GDP, and should reach 3.5 percent of GDP in 2009 constituting an important anti-cyclical fiscal effort. The largest contract of over US\$3 billion for the "locks construction" received three tenders from international consortiums in March 2009. The technical and financial tenders are under evaluation for a final selection by mid-2009. PCA assured its full financing needs of US\$2.3 billion last October 2008 from five multilateral organizations. Revenues for FY2008-09 are expected to increase

about 4 percent as new tariffs fall in place in May and October 2009. These revenue expectations should materialize in spite of an expected drop of 5 percent in tonnage for the period.

9. During 2008, the government remained committed to a robust public investment policy as the global crisis exerted pressure on the economy. The Tocumen International Airport (US\$200 million) was mostly concluded by end-2008. The Panama-Colon Highway (US\$270 million) and the Balboa Avenue coastal-extension (US\$200 million) are to be concluded in June 2009. The Bay of Panama sewage and drainage project of over US\$500 million, financed through multilaterals, is under construction. Private sector investments, which carry strong FDI support, are concentrated in energy, telecom, ports, and tourism. In the energy sector, French Suez concluded two thermo-projects in 2008 and one hydro project will go on stream in 2009 for a total investment of US\$650 million. The energy regulatory authority informed investments of US\$1.3 billion in hydro and US\$520 million in thermo projects with S\$970 million to be implemented during 2009. Petroterminales' oil pipeline and storage facilities, a US\$500 million project, began to be constructed in 2008. In telecoms, Digicel (Ireland) and Claro (Mexico) cellular concessions started their operations in December 2008 and in April 2009 with investments of US\$350 and US\$150 million, respectively. In so far as the expansion of ports is concerned, a total of US\$760 million in investments is expected during the 2008-2010 period. Hotel construction is estimated at US\$200 million in 2009, according to the American Chamber of Commerce. The construction sector is expected to target the high demand for "middle and low-income housing" estimated at 140,000 units and to move away from high-rise condos that dominated the sector during 2007-08. This wide range of public investments sets the stage for private investments in 2009.

Financial Sector and Other Issues

10. The banking sector has remained fairly untouched by the sub-prime crisis. It continues to be profitable, highly liquid and well supervised. The capital adequacy ratio remained at 14 percent. Absence of a lender of last resort in the system induced banks to strengthen their liquidity levels in face of the present external conditions. Liquidity levels in the system have increased from 58 percent in November 2008 to 62.7 at end-March 2009. Non-performing loans (NPL) increased slightly from 1.1 percent at end-2007 to 1.3 percent at the end of the first quarter 2009, according to the Superintendency of Banks (SB). Given the strong presence of foreign banks in the system, parent banks' liquidity deterioration in 2008 had a significant effect in Panama, forcing partial tightening of credit access for trade and commerce. In response, the authorities activated a US\$1.1 billion stimulus package (PEF) supported by IDB, CAF and Banco Nacional (Banconal). The SB has confirmed that banks are now requesting access to PEF funds. In addition, foreign banks have already started to ease access to their credit lines. Banking sector performance registered promising advances in the first quarter of 2009,

according to the SB report. Foreign deposits have increased 30 percent. Despite the increase in liquidity levels, total new credits are up 7.3 percent in the first quarter 2009 compared to 2008, with credit to industry, commerce and mortgages increasing considerably. Construction credit also went up 13 percent, though personal credit has decreased 13 percent.

11. Authorities are cognizant of the risks related to the continued world economic slowdown and have expressed interest in pursuing the establishment of a safety net to preserve the existing high confidence level in the financial sector and enhance its capacity to withstand unforeseen liquidity stresses should external conditions deteriorate further. The incoming administration will evaluate if circumstances warrant such a decision.

12. Panama has taken a positive view to improving its cooperation on internationally agreed tax standards and other issues. This cooperation was agreed with the OECD in 2002. The authorities will share with the incoming administration their views on possible future actions in this area.

13. The new administration will start on July 1st. Its top priority is to sustain strong economic growth in the medium term. This will be supported by strong public investment programs, including the construction of an inner-city Metro system, the expansion of transport infrastructure, as well as the continuation of the Panama Canal expansion. One of the main fiscal pillars is a new tax reform to introduce a flat-tax, simplify the tax system to curtail evasion, improve the effectiveness of tax collection, and maintain a strong fiscal stance. Social programs will be supported and expanded. The new administration sees the approval of the FTA with the United States as a crucial step to support growth and private investment opportunities in Panama.