INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/337

PANAMA

November 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2016 Article IV consultation with Panama, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 23, 2016 consideration of the staff report that concluded the Article IV consultation with Panama.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 23, 2016, following discussions that ended on March 18, 2016, 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 5, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Panama.

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

Selected Issues

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

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 16/276
FOR IMMEDIATE RELEASE
June 10, 2016

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with Panama

On May 23, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Panama.

Panama has had the highest average growth in the region over the past decade and is expected to continue to have one of the strongest growth rates in Latin America, set against a backdrop of low inflation, a stable financial system, and a declining current account deficit. GDP grew by 5.8 percent in 2015, and growth is projected to remain around 6 percent in 2016 and over the medium term. The economy will be supported by the expected opening of the expanded canal and lower fuel prices, which will counterbalance the effects of slowing global growth and U.S. dollar appreciation. Over the medium term, the increase in canal transit, a dynamic service sector, and investments in the energy, mining, and logistics sectors should help maintain vibrant growth. Inflation is expected to remain subdued in 2016.

The overall fiscal deficit fell to 2.8 percent of GDP in 2015 and is expected to consolidate to 1.2 percent of GDP over the medium term. Public debt is projected as sustainable. Debt of the Non-Financial Public Sector was 39 percent of GDP in 2015 and is projected to fall below 35 percent of GDP over the medium term. The current account deficit, which declined significantly in 2015 to 6.5 percent of GDP, is expected to fall to 3 percent of GDP in the medium term, financed by broad-based foreign direct investment inflows.

Since Financial Action Task Force (FATF) included Panama in the list of countries with strategic deficiencies in the area of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) in June 2014, the authorities implemented an action plan agreed with the FATF. The FATF recognized the progress by removing Panama from the list in February 2016. Going forward, Panama is scheduled to undergo an assessment against the prevailing 2012 FATF standard in mid-2017, where the focus will be on the effective implementation of the AML/CFT regime. In addition, after the leak of the documents from the law firm Mossack Fonseca in April 2016, the government has announced the creation of an independent commission of international experts to evaluate the practices of the Panamanian financial center and propose measures to strengthen transparency of the financial and legal systems. The

[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.

government has also committed to the bilateral Automatic Exchange of Information related to tax matters, following the OECD's Common Reporting Standards by 2018. In May 2016, the U.S. imposed sanctions under the U.S. Foreign Narcotics Kingpin Designation Act on the Waked Money Laundering Organization for laundering narcotics and other illicit proceeds. This action prompted Panama's Superintendent of Banks subsequently to take operating control of a local bank that was designated by the U.S. authorities as part of that organization, and also triggered the opening of criminal investigations, taking control of a local brokerage house, and beginning extraordinary inspections of nonfinancial entities by the Panamanian authorities.

Strong integration with the global trade and financial system brings substantial benefits to Panama, but increases the country's vulnerability to external shocks. A weakening of global growth could dampen canal revenues and precipitate weaker capital inflows. Tighter and/or more volatile global financial conditions would quickly feed into the local financial system. However, the strong fundamentals of the banking sector and the room to implement a countercyclical fiscal response would help mitigate the impact of either shock on the domestic economy. Evolving business models for banks, changes in capital regulations, concerns over compliance with international standards on financial integrity and transparency, and increased due diligence by foreign banks have curtailed some smaller Panamanian banks' access to correspondent banks; the risk could be more extensive going forward.

Executive Board Assessment[2]

Directors commended Panama's dynamic macroeconomic performance, set against the backdrop of low inflation and unemployment, and a declining current account deficit. While the medium-term outlook remains favorable, Directors noted that the uncertain external environment poses downside risks. Against this background, they encouraged further efforts to enhance financial transparency, strengthen the fiscal framework, build larger buffers, and promote inclusive growth.

Directors stressed the importance of strengthening the AML/CFT framework in line with international standards and ensuring its effective implementation, especially in light of recent revelations. While noting Panama's removal from the FATF list of countries with strategic deficiencies in AML/CFT, they called on the authorities to improve financial integrity and transparency, which would place Panama in a strong position ahead of the next FATF assessment and safeguard Panama's role as an international financial hub. Directors welcomed the authorities' commitment to the automatic exchange of tax information and urged them to expand these agreements with other jurisdictions. Measures to mitigate the impact of de-risking were encouraged, but will require greater international efforts to fully address.

Directors underlined the need to continue strengthening the transparency and accountability of the fiscal framework. They encouraged the authorities to introduce mechanisms to enhance incentives for compliance with fiscal rules and promptly detect and correct slippages. Directors

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

welcomed the authorities' openness to introduce a multi-year budgeting process, establish an independent fiscal council, and safeguard capital spending. Pension reform is encouraged, given large unfunded future liabilities, and to preserve space for other components of public spending. Welcoming the authorities' efforts to modernize revenue administration, Directors underscored the need to broaden the tax base, develop appropriate incentives for tax compliance, and refrain from tax amnesties.

Directors noted that Panama's financial sector is generally healthy, while certain areas require greater vigilance. In the absence of a lender of last resort, they emphasized the need to develop contingency plans to address systemic shocks and to ensure larger liquidity buffers, including through an alignment of the liquidity regulation with the Basel III framework and the establishment of a temporary liquidity facility for banks. Directors encouraged the authorities to fully implement FSAP recommendations, enhance cross-border supervision and systemic risk monitoring, and strengthen supervision of nonbank financial institutions.

Directors highlighted that human capital enhancements are essential for sustaining high and inclusive growth and encouraged the authorities to move forward with the envisaged measures to improve education quality, reduce skills shortages, and strengthen productivity. They welcomed the significant poverty reduction over recent years, while underlining that social assistance will be essential to address the needs of the indigenous and other socially-vulnerable groups for achieving more inclusive growth.

Panama: Selected Economic Indicators*

	2012	2013	2014	2015	Proj. 2016	2017
	(Annual percentage change)					
Real economy						
Nominal GDP	16.2	12.3	9.6	6.0	6.9	8.5
Real GDP	9.2	6.6	6.1	5.8	6.1	6.4
Consumer price index (average)	5.7	4.0	2.6	0.1	0.8	2.0
Consumer price index (end-of-year)	4.6	3.7	1.0	0.3	0.8	2.0
Money and credit						
Private sector credit	14.1	12.1	9.1	11.4	2.8	7.1
Broad money	10.3	8.6	8.1	4.5	6.9	8.5
Average deposit rate (1-year)	2.7	2.7	2.7	2.7	…	…
Average lending rate (1-year)	7.2	7.2	7.4	7.7	…	…
	(Percent of GDP)					
Saving and investment						
Gross domestic investment	44.4	45.8	47.0	47.5	46.0	44.0
Gross national saving	34.0	36.0	37.3	41.0	39.8	39.0
Public sector 1/						
Revenue and grants	25.8	25.3	23.7	23.6	23.4	23.1
Expenditure	28.9	29.4	28.3	27.7	26.9	24.8
Current, including interest	18.0	17.2	17.5	18.1	18.5	18.3
Capital	10.9	12.2	10.8	9.6	8.3	6.4
Overall balance	-3.0	-4.1	-4.6	-4.1	-3.5	-1.7
Overall balance, excluding ACP	-1.5	-2.3	-3.2	-2.8	-3.1	-2.1
External sector						
Current account	-10.5	-9.8	-9.8	-6.5	-6.2	-5.0
Foreign direct investment	8.7	8.1	8.1	8.7	8.8	8.7
Real effective exchange rate (depreciation -)	3.9	4.5	-2.0	1.3		
Non-financial public sector external debt	27.0	27.3	29.2	30.0	30.1	27.2
Memorandum items:						
GDP (in millions of US$, current price)	39,955	44,856	49,166	52,132	55,755	60,510

Sources: National Authorities and IMF staff estimates.
* All figures are based on data available prior to the meeting of the Executive Board.
1/ Non-Financial Public Sector and Panama Canal Authority (ACP).

INTERNATIONAL MONETARY FUND

PANAMA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

May 5, 2016

KEY ISSUES

Background. GDP grew by 5.8 percent in 2015. Inflation has declined to close to zero owing to lower oil prices and the strong dollar. Unemployment remains low. The external current account deficit has been moderating and is being financed by FDI inflows. Fiscal consolidation since mid-2014 helped to achieve a lower-than-budgeted deficit of 2.8 percent of GDP in 2015.

Risks. Near-term risks mostly relate to global economic and financial conditions. Panama is a highly open economy and therefore vulnerable to external shocks. A sharper-than-expected global growth slowdown represents a downside risk to canal revenues and to capital inflows. Tighter and/or more volatile global financial conditions would quickly feed into the local financial system. Under these circumstances, the strong fundamentals of the banking sector and the room to implement a countercyclical fiscal response will help mitigate the impact on the domestic economy. Correspondent banking relationships by global banks have decreased, reducing smaller Panamanian banks' access to international financial services. A more significant loss of correspondent banking services would have negative implications for the economy and needs careful monitoring. The leak of the "Mossack Fonseca documents" and recent U.S. sanctions against the laundering of drug trafficking proceeds by a Panamanian conglomerate, bank, and citizens, have led to elevated scrutiny and higher reputational and economic risks for Panama. In mid-2017, Panama will face a reassessment of its AML/CFT framework relative to a more demanding standard that includes strengthened provisions on beneficial ownership and control of legal persons and arrangements and which add tax crimes as a predicate offense to money laundering.

Policy advice. Despite being removed from the "gray list" of the Financial Action Task Force (FATF), continued enhancements – particularly on issues of tax and entity transparency and ensuring effective implementation and enforcement of the AML/CFT rules –will likely be required to bring the AML/CFT framework in line with the prevailing FATF standard. The transparency and accountability of the fiscal framework should be strengthened, and parametric reform is needed to ensure the financial sustainability of the pension system. Supervision of the financial sector should be fully aligned with Basel standards, particularly as relates to liquidity, and the financial safety net should be strengthened. Further investment in education and vocational training would raise labor productivity and promote inclusive growth.

Approved By
Nigel Chalk and Masato Miyazaki

Discussions took place in Panama City during March 7–18, 2016. The staff team comprised Valerie Cerra (head), Fang Yang, Metodij Hadzi-Vaskov, Andras Komaromi (all WHD), and Torsten Wezel (MCM). Alfredo Macia (OED) also participated in the meetings. The team met with Minister of Economy and Finance Dulcidio De La Guardia, Minister of Labor Luis Ernesto Carles, Minister of Social Development Alcibíades Vásquez Velásquez, other senior public officials, and private sector representatives.

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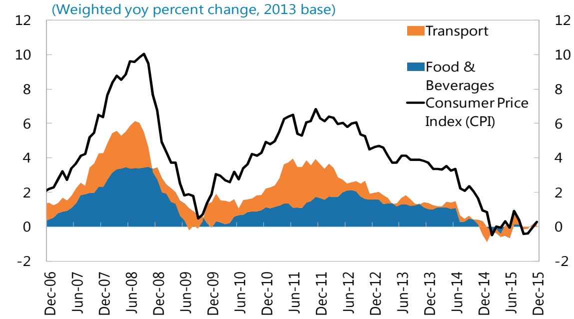
ANNEXES

BACKGROUND AND ECONOMIC DEVELOPMENTS

1. **Panama's growth has slowed to its robust medium-term potential.** Real GDP decelerated from an average of 8.2 percent during 2006–2012 to around 6 percent in 2014 and 2015 (Table 1), mainly reflecting the winding down of the canal expansion project and a normalization of public investment from the high levels of recent years. While most sectors in the service-driven economy remain buoyant, activities in the Colon Free Zone (CFZ) continue to decline, in part due to difficulties in trade relations with Venezuela and Colombia[1] and lower demand from the region. Unemployment has risen to 5.1 percent but remains below the average of the past decade.

2. **Inflation is moderating.** As a result of the strong dollar and lower oil prices, inflation decelerated from 2.6 percent (period average) in 2014 to 0.1 percent in 2015. The government has taken advantage of lower oil prices to reduce energy subsidies. The minimum wage increased by 8.5 percent in 2016 compared with 2014,[2] but real unit labor costs have declined over the past several years.

CPI Contribution
(Weighted yoy percent change, 2013 base)



Sources: Panama National Authorities, and IMF staff estimates.

3. **The fiscal consolidation since mid-2014 has helped contain the fiscal deficit**. In 2015, tax revenue increased 0.8 percent from the previous year. Capital expenditures declined by 4.8 percent, while current expenditure increased by 6 percent. The annual overall deficit of the Non-Financial Public Sector (NFPS) was 2.8 percent of GDP, below the budget of 3.7 percent of GDP. The adjusted deficit is estimated at below 2 percent of GDP[3], in compliance with the Social Fiscal Responsibility Law (SFRL).

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[1] The difficulties were caused by the controls on foreign exchange payments in Venezuela, and the import tariffs imposed by Colombia on textile and footwear.

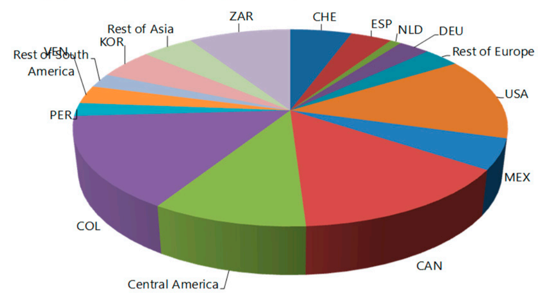
[2] The minimum wage is re-negotiated every two years between the employers and the workers as represented by the National Council of Organized Workers (Consejo Nacional de Trabajadores Organizados) and the National Confederation of Independent Unions (Confederación Nacional de Unidad Sindical Independiente). The government will set the minimum wage if the two sides fail to reach an agreement.

[3] The adjusted balance is the overall fiscal deficit adjusted by the difference between the actual canal contribution to the treasury and a threshold of 3.5 percent of GDP.

4. The external current account deficit has declined and is being financed by FDI inflows. Due in part to slowing growth, the completion of large investments (e.g. the canal locks), and the decline in oil prices, the current account deficit declined from the elevated level of close to 10 percent of GDP in the previous years, to 6.5 percent of GDP in 2015. The deficit is expected to further contract to around 3 percent of GDP in the medium term as other large investment projects wind down and start exporting. Robust and diversified foreign direct investment is projected to continue to finance the current account deficit.

FDI Is Well Diversified

Geographic Composition (Average 2011-14)

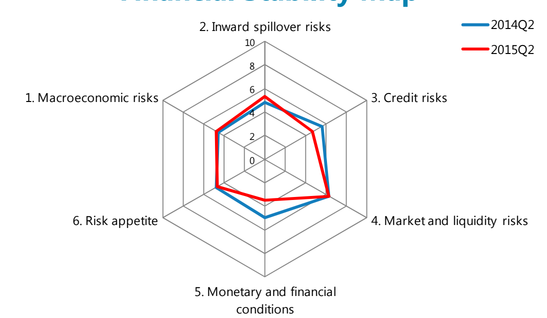


Sources: Panama National Authorities; and IMF staff calculations.

5. Private sector credit conditions remain supportive of economic activities. Overall credit to the private sector grew faster than nominal GDP (see Figure 3). However, growth in credit to commerce slowed sharply since 2013 (-30 percent y-o-y in 2015) largely due to the difficulties in the CFZ. Banks have increased provisions against their exposure to CFZ companies and intensified scrutiny on loans to CFZ. Mortgage and consumer loans maintained their strong growth.

6. Formal progress in improving financial integrity and transparency has been recently acknowledged by the FATF. Panama was put on the FATF "gray list" in June 2014 due to strategic deficiencies identified in the AML/CFT assessment. An action plan was agreed between the authorities and the FATF to enhance compliance with the standard. The FATF conducted an on-site visit in January and removed Panama from its "gray list" on February 18, 2016 after steps were taken by the authorities to implement items of the action plan, notably in the form of legislative reform (Box 1).

Financial Stability Map



Note: Away from center signifies higher risks, easier monetary and financial conditions, or

Sources: IMF Staff Calculations

Text Table 1. Heatmap of Financial Sector Risks

Panama	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4
Credit cycle	L	L	L	L	L	L	L	L	L	M	H	H
Change in credit / GDP ratio (pp, annual)	1.6	2.0	0.5	0.8	0.2	-0.2	0.7	1.7	0.9	3.2	6.5	7.7
Growth of credit / GDP (%, annual)	1.6	2.0	0.5	0.8	0.2	-0.2	0.7	1.6	0.9	3.5	7.0	8.3
Credit-to-GDP gap (st. dev)	-1.2	-0.2	-0.5	-1.1	-1.6	-1.6	-1.2	-1.2	-1.5	-0.3	0.0	0.1
Balance Sheet Structural Risk	L	L	L	L	L	L	L	L	L	L	L	L
Deposit-to-loan ratio	106.7	106.8	105.3	107.6	109.4	109.6	109.2	108.9	109.6	108.0	106.8	105.2
Balance Sheet Buffers	L	L	L	L	M	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	10.4	10.2	10.2	9.9	10.2	10.2	10.3	10.1	10.1	10.1	10.1	10.0
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	1.5	1.5	1.4	1.4	1.6	1.5	1.5	1.5	1.5	1.4	1.5	1.4
ROE	13.1	14.0	12.6	13.8	15.5	15.0	14.4	15.0	14.7	13.9	14.5	14.1
Asset quality	L	L	M	L	H	M	L	M	L	L	M	L
NPL ratio	1.0	1.0	1.2	1.1	1.4	1.2	1.1	1.3	1.1	1.1	1.2	1.2
NPL ratio change (%, annual)	-23.3	-13.7	17.7	-10.5	40.0	10.8	-14.0	18.5	-17.9	-5.2	15.4	-11.2

Source: National authorities and staff calculations.

*Based on the credit cycle and financial soundness indicators heatmap developed by the IMF's Monetary and Capital Markets Department.

**Credit cycle risk is assessed as: low (L) when the change in credit/GDP ratio is less than 3 percent; medium (M) when it is between 3 and 5 percent; and high (H) when it is above 5 percent or when the credit-to-GDP 'gap' is above 1.5 s.d. and the growth of credit/GDP is above 10 percent. Balance sheet structural risk is L when deposit-to-loan ratio is above 100 percent; M when it is below 100, but above 85; and H when it is equal or lower than 85 percent. Leverage risk is L when the leverage ratio is above 7 percent; M when it is between 3 and 7 percent; and H when it is below 3 percent. Profitability risk is H when ROA or ROE is negative. Asset quality risk is L when the change in the NPL ratio is below 5 percent; M when it is between 5 and 20 percent; and H when the NPL ratio is in the top 10th percentile of a pooled distribution or the change in the NPL ratio is over 20 percent.

7. However, the "Mossack Fonseca documents" and recent U.S. sanctions related to the laundering of drug trafficking proceeds by Panamanian entities point to important remaining deficiencies in the AML/CFT and transparency frameworks and in their implementation. In April 2016, a leak of 11.5 million documents from the law firm Mossack Fonseca detailed nearly four decades of global business practices related to the establishment of opaque offshore companies for clients around the world (Box 2). In May 2016, the U.S. imposed sanctions under the U.S. Foreign Narcotics Kingpin Designation Act on the Waked Money Laundering Organization, targeting the activities of two Panamanian citizens, six Panamanian-based associates (including two attorneys involved in incorporating shell companies), and 68 companies in laundering narcotics and other illicit proceeds. Panama's Superintendent of Banks (SBP) subsequently took operating control of a local bank that was designated by the U.S. authorities as part of that money laundering organization. This also triggered the opening of criminal investigations, taking control of a local brokerage house, and beginning extraordinary inspections of nonfinancial entities by the Panamanian authorities.

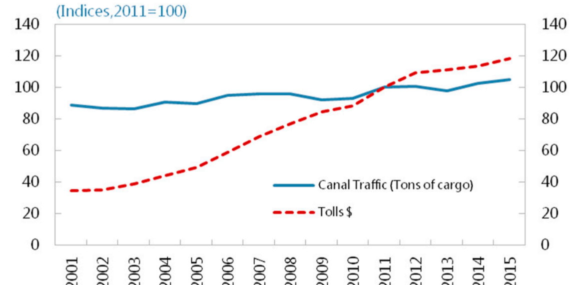
OUTLOOK AND RISKS

8. In the medium term, growth is expected to remain in the 6–7 percent range. The canal represents 16 percent of Panama's diversified services exports (travel, tourism, commercial, and financial services), and it continues to play an important role in economic development. The expanded canal (expected to become operational in June 2016) will open up new capacity and accommodate larger ships, including to facilitate the emerging trade of liquefied natural gas and liquefied petroleum gas between North America and Asia. Future investments, both public and private, are oriented towards developing Panama into a logistics hub, providing essential services on the trade routes passing through the country. Construction of a major copper and gold mine is ongoing with an estimated annual export capacity of about US$2 billion that will start in 2018. Investment projects that tackle capacity constraints in energy, infrastructure, and housing will directly support economic activity in the medium term, while preserving the country's long-term growth potential.

9. Public debt to GDP is sustainable. The NFPS debt-to-GDP ratio, at 39 percent in 2015, is expected to decline to about 35 percent in the medium term (Annex III). This projection is consistent with the policies outlined in the Government Strategic Plan (2015–2019). Stress tests show that public debt remains sustainable even after applying shocks to output and financial conditions, as well as adding in contingent liabilities.

10. The external position is broadly consistent with fundamentals and desirable policy settings. Although the current account deficit is somewhat higher than the value explained by fundamentals and desirable policies, the gap can be explained by the temporarily high import demand of large investment projects, mainly linked

Panama Canal Traffic and Toll Revenue
(Indices, 2011=100)



Sources: Panama National Authorities; and IMF staff calculations.

to the canal expansion. In the medium term the current account deficit is expected to decline from 6.5 percent to around 3 percent of GDP. Furthermore, the recent appreciation of the real exchange rate does not appear to be out of line with fundamentals given continued strong productivity growth and the positive terms of trade shock Panama experienced due to lower oil prices. In addition, Panama has maintained good performance in global competitiveness indicators (Annex III).

11. Near-term risks mostly relate to global economic and financial conditions. The country is highly vulnerable to external shocks given its globally integrated financial system and reliance on canal traffic and other services exports. Full dollarization also limits the scope for adjustment to external shocks. A sharper-than-expected global growth slowdown represents a downside risk to canal revenues and to capital flows. Tighter and/or more volatile global financial conditions would quickly feed into the local financial system. Under these circumstances, the strong fundamentals of the banking sector and the room to implement a countercyclical fiscal response will help mitigate the impact on the domestic economy.

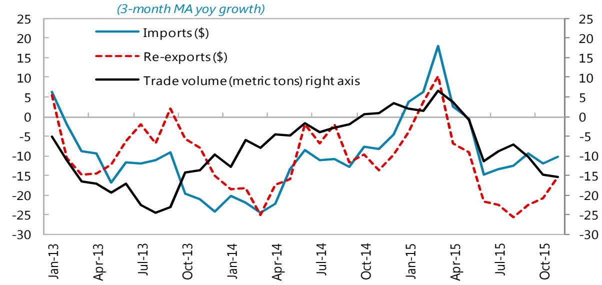
12. Withdrawal from correspondent banking relationships by global banks is perceived as reducing access to international financial services. Changes in capital regulations in source countries, concerns over compliance with tax rules and international standards on financial sector integrity, and increased due diligence by foreign banks, particularly with links to the U.S., have curtailed some smaller Panamanian banks' access to correspondent banks. According to data provided by the authorities, the total number of correspondent bank relationships has remained stable at 463-464 between March 2015 and end-February 2016, as 62 relationships have been lost, while Panamanian banks have managed to establish 63 new relationships. A significant loss of correspondent banking services could restrict access to global capital, cross-border payments, and trade finance, with negative implications for the economy. In addition, concerns over the complete loss of correspondent relations could compromise the day-to-day operations at certain banks, which could have repurcussions on the rest of the banking system through contagion effects. The authorities and local banks are in dialogue with the global banks and their home country regulators on this issue.

13. Fallout from the release of the "Mossack Fonseca documents" and concerns linked to recent U.S. Office of Foreign Assets Control sanctions could restrict access to global capital, cross-border payments, and trade finance, with negative macrofinancial implications. In particular, a loss of correspondent relations or the provision of a range of financial services to Panamanian entities by globally active banks could worsen the funding situation at certain banks, and have repurcussions on the rest of the banking system through contagion effects. It could affect the cost and availability of external financing and have unpredictable effects on the economy.

14. The contraction in trading partners exacerbates the difficulties of the CFZ. The CFZ accounts for 60 percent of Panama's merchandise trade, 6 percent of the workforce in nonfinancial companies, and 20 percent of the banking system's commercial loan exposure. In this context, the continuing dispute with Colombia on the tariffs imposed on textiles and footwear imports from CFZ is worrisome.[4] Meanwhile, low commodity prices and the associated prolonged stagnation of the economies in the region—particularly in Venezuela—could further damage trade activities in the CFZ. Continued deterioration in the value of collateral in the CFZ would also have negative effects on the asset quality of the banking sector.

Activities in the Colon Free Zone Declined

(3-month MA yoy growth)



Sources: Panama National Authorities; and IMF staff calculations.

15. Climate change could disrupt the water supply for the canal operation. Canal operations currently share the same water source with the civilian water supply. Civilian water usage increased strongly along with economic expansion during the past decade. On the supply side, droughts related to El Niño have threatened to disrupt the canal operation. The ACP announced that it will impose draft restrictions starting on April 18, 2016 due to low water levels. Meanwhile, the authorities are considering investments to develop alternative water sources to ensure a secure and uninterrupted supply of water.

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[4] In November 2015 a WTO panel ruled in favor of Panama in the dispute filed against Colombia in 2013. The panel recommended that Colombia modify its tariffs so as to conform to its obligations with the WTO. However, there is no timetable for Colombia to alter the tariff, nor specific actions stated.

Box 1. Panama: Key Measures in the Action Plan to Improve the AML/CFT Framework

After June 2014, the authorities implemented an action plan agreed with FATF to address the strategic deficiencies in Panama's AML/CFT framework against the previous FATF standard. In particular, Panama approved a set of 7 laws related to AML/CFT issues in February–April 2015. Some of these actions specifically aim to address shortcomings in two key areas: regulation and monitoring of operations performed by nonfinancial entities (lawyers, accountants, notaries, casinos, construction and real estate firms, and others) and improving the framework for identification of beneficial owners.

Nonfinancial entities	Extended the scope of covered entities for customer due diligence (CDD) by including nonfinancial entities in addition to all financial institutions
	Introduced suspicious transaction reporting (STR) requirements for all nonfinancial entities
	Established an intendancy for supervision and regulation of nonfinancial entities (Law 23 from 2015)
	Adjusted the legal framework to grant the financial intelligence unit (FIU) access to information maintained by all nonfinancial entities and resident agents
Identification of beneficial ownership	Amended the legal provisions to ensure identification of beneficial owners of all customers (natural and legal) in trust companies and associated services
	Introduced mandatory identification of all parties to a trust client and covered them by the CDD obligations
	Restricted the existence of bearer shares by creating a legal obligation for all bearer shares to be delivered to a custodian or to be replaced by registered share certificates
	Obliged all resident agents to gather and maintain information on beneficial ownership

In addition, the legal and regulatory amendments adopted in 2015 aim to tackle a broad set of AML/CFT-related issues and strengthen the overall framework.

Criminalize ML/TF	Extended the scope of covered entities for customer due diligence (CDD) by including nonfinancial entities in addition to all financial institutions
	Included missing predicate offenses to ML under the previous FATF standard: piracy, forgery, forgery of money, smuggling, etc.
Freezing of terrorist assets	Mechanisms to freeze terrorist assets in accordance with UN guidelines without delay and outside of criminal court context
	Adopted procedure to freeze terrorist assets for cases initiated under other jurisdictions

Box 1. Panama: Key Measures in the Action Plan to Improve the AML/CFT Framework (Concluded)

Strengthen the FIU	Enhanced financial and human resources in line with its expanded responsibilities for new reporting entities
	Set the FIU as the central agency that receives STRs; strengthened STR quality by providing feedback to reporting entities and coordination with other supervisors
International cooperation	Explicit legal provision to regulate the principles and procedures for international legal cooperation in the absence of a treaty
	Engaged in signing MoUs with foreign FIUs

The implementation of these measures is part of an ongoing process. In this context, starting in the second half of 2015, the authorities indicated that emphasis has been put on facilitating the implementation of the adopted legal changes by hiring more staff, and providing training and capacity development to staff at the competent supervisory institutions. In addition, they indicated that reporting entities, including nonfinancial institutions, have been receiving training on the format and practice of reporting suspicious transactions.

FATF removed Panama from the gray list in February 2016 in recognition of Panama's progress. This decision was based on a targeted review of technical items included in the previous FATF standard, and is not indicative of Panama's level of compliance with the prevailing FATF standard, adopted in 2012. In fact, the "Mossack Fonseca documents" highlight potential deficiencies in the implementation of the AML/CFT controls by lawyers, as required by the FATF standard, as well as a lack of transparency of legal persons and arrangements established in Panama, which could make these sectors especially vulnerable to money laundering.

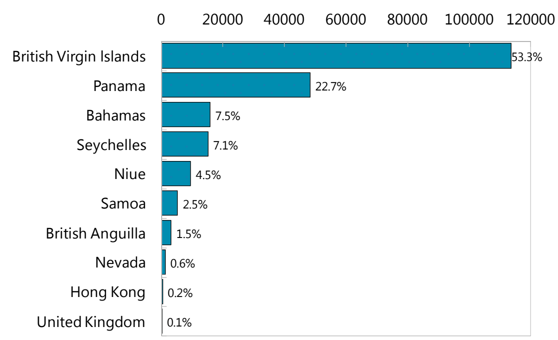
Panama is scheduled to undergo an assessment against the prevailing 2012 FATF standard in mid-2017, where the focus will be on the effective implementation of the AML/CFT regime. In addition, the 2012 FATF standard places a greater emphasis on a risk-based approach, according to which the authorities are expected to understand their ML/TF risks and, where appropriate, coordinate domestically the actions to combat ML/TF. The revised standard also adds tax crimes as predicate offenses of ML.

Box 2. Mossack Fonseca Documents: Global Dimensions and Impact on Panama

The leak of about 11.5 million documents from *Mossack Fonseca* provided detailed information and unprecedented insights into the practice of setting up over 214,000 offshore companies over the period 1977–2015. *Mossack Fonseca* is a law firm specializing in commercial law, trust services, wealth management, and international business structures. It was founded in 1977 in Panama and has a global network of 34 offices in 26 jurisdictions. The investigation of the firm's leaked archives was coordinated by the International Consortium of Investigative Journalists (ICIJ), and involved around 400 journalists from more than 100 media organizations in over 80 countries.

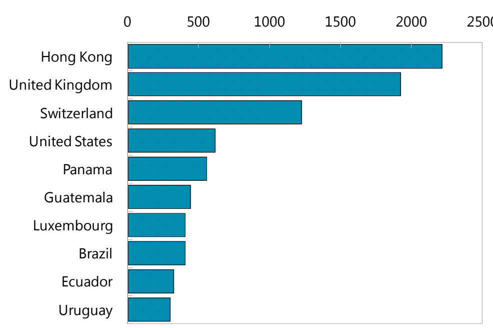
Although the law firm is Panamanian, the leaked documents shed light on a global phenomenon. According to the ICIJ, more than 75 percent of the companies in Mossack Fonseca's files were established in other jurisdictions outside Panama, with more than half of the companies incorporated in the British Virgin Islands. Mossack Fonseca worked with more than 14,000 banks, law firms, company incorporators, and other agents to set up companies, foundations and trusts for customers. The majority of these intermediaries are headquartered in advanced economies, such as the United Kingdom, Switzerland, and the United States. ICIJ's analysis also suggests that more than 500 banks, their subsidiaries and branches registered shell companies for clients with Mossack Fonseca. Several large European banks are included on the released list of financial institutions that requested the most offshore companies for their clients.

Jurisdiction of incorporation



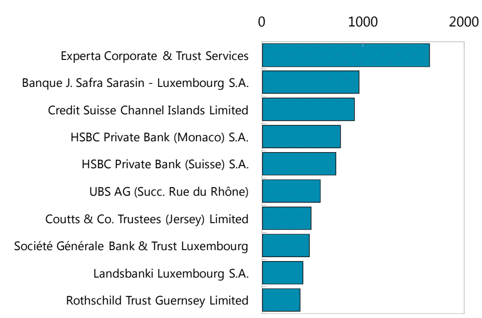
Source: ICIJ

Top 10 countries where intermediaries operate



Source: ICIJ

Banks requesting the most offshore companies for clients



Source: ICIJ

The direct macroeconomic impact of the leak on Panama has been limited, but reputational risks have risen. Legal services related to incorporations (the establishment and selling of companies, foundations, and trusts) are estimated to represent only around 0.7% of GDP and are associated with a very small cluster of business activities. However, the reputational damage raises unpredictable risks for customer relationships and external funding for other Panamanian activities, including by further increasing the due diligence costs of correspondent banks that may, in turn, respond by lowering their exposure to the Panamanian financial system. More broadly, Panamanian law firms, banks, and companies are likely to come under increased scrutiny by foreign governments, regulators, and international bodies with uncertain economic effects.

Box 2. Mossack Fonseca Documents: Global Dimensions and Impact on Panama (Concluded)

Following the leak of the "Mossack Fonseca documents", the authorities reaffirmed their commitment to ensure financial integrity and tax transparency. The Attorney General's Office opened a criminal investigation into the activities of *Mossack Fonseca* and stated that all treaties and conventions for international cooperation will be used to obtain information from other jurisdictions. The firm has also been under investigation since January based on allegations from Brazilian authorities of the firm's involvement in money laundering. The recently established Intendancy for Supervision and Regulation of Non-Financial Institutions initiated additional audits of law firms to verify their compliance with the requirements of the new AML/CFT legislation, particularly those related to strengthened due diligence. The government announced the creation of an independent "blue-ribbon" commission of international experts to evaluate the practices of the Panamanian financial center and propose measures to strengthen the transparency of the financial and legal systems, which will be shared with other countries.

POLICY DISCUSSIONS

The discussions focused on reforms to strengthen the fiscal framework and address the financing gaps in the pension system; to align the financial system with evolving global transparency and supervisory standards and to ensure a smooth transition to a robust medium-term growth path.

A. Ensuring Fiscal Sustainability

16. The current fiscal stance is appropriate. Staff project the fiscal deficit for 2016 to be 3.1 percent of GDP, consistent with the fiscal rule and with a projected decline of debt-to-GDP of the NFPS in the medium term. Given that growth is high and stable and inflation is subdued, there is no compelling reason at this time to deviate from the medium-term fiscal consolidation path for economic stabilization goals.

17. The current fiscal framework has played an important role in strengthening fiscal discipline and maintaining fiscal sustainability. Since the current fiscal framework became effective in 2009, the primary balance and debt-to-GDP ratio of the NFPS on average have improved significantly compared with those in 2000–2008. The Social and Fiscal Responsibility Law (SFRL) and the Savings Fund Law have established an operating target—deficit ceilings for the NFPS—with the objective of preserving debt sustainability in the medium term. The deficit ceilings reflect the government's intention to consolidate the fiscal position in the medium term. The framework also provides flexibility to respond to shocks, by allowing the fiscal balance to exceed these ceilings during large economic downturns and/or adverse external shocks.

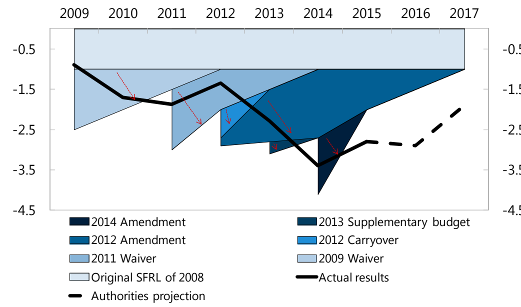
Comparison of Fiscal Policy Stance
(as percent of GDP)

	2000-2008	2009-2015
Average Overall Fiscal Balance 1/	-1.5	-2.0
Average Primary Balance	-5.8	-0.2
Average Structural Balance 2/	-5.9	-0.2
Average NFPS Debt	60.2	39.4

1/ In 2000-2008, budget relied heavily on one-off privatization proceeds, resulting in better overall fiscal balance but worse primary and structural balance.
2/ Cyclically adjusted primary balance.
Source: Panama National Authorities and IMF Staff calculation.

18. Nonetheless, the fiscal framework has a number of shortcomings. The objective of maintaining net debt below 40 percent of GDP is merely an "indicative" target that does not provide sufficient guidance for setting deficit ceilings given that current net debt is already below 40 percent of GDP. The definition of net debt does not encompass a range of relevant government assets and liabilities.[5] Since the SFRL came into force in 2009, deficit ceilings have been repeatedly relaxed through waivers and amendments to the law, signaling a weakness in the accountability framework. The SFRL does not provide for any sanctions in such cases and does not have any automatic mechanisms for detecting and correcting slippages during the budget year so as to avert deviations by year-end. The deficit ceiling target lacks transparency, given that the deficit target is allowed to increase by the amount that the canal contribution to the budget falls below an assumed long run average (3.5 percent of GDP) that has become unrealistic. In addition, the combination of deficit ceilings and rapid growth of operating expenses has been putting pressure on capital spending. Lastly, although the medium-term fiscal plan and the five-year investment plan are publicly available, they are not binding when the budget is formulated.

Deficit Ceilings as % of GDP
(Percent, annual)



Sources: Panama National Authorities; and IMF staff estimates.

19. There was agreement on the need to improve the fiscal framework and establish an independent assessment of compliance with the fiscal rule. The authorities committed to abide by the deficit ceiling targets without additional waivers. They also plan to implement a top-down budgetary process to curb the excessive expansion of operational expenditure and would like to establish limits on its growth rate. They intend to publish the liabilities of the state-owned enterprises and those derived from turn-key projects. The authorities are considering establishing an independent fiscal council to evaluate macroeconomic projections and underlying assumptions in the budget. The fiscal council could also be charged with monitoring and assessing the implementation of the fiscal rule, including reviewing the structural contributions from the canal and the link between the net debt target and the future path of deficit targets. The authorities are willing to consider introducing a multi-year budgetary process to provide guidance to policy makers and ensure that they are accountable for adhering to targets.

20. There is an urgent need to strengthen revenue administration. Tax compliance is considered low for a country with the level of development and dynamism of Panama. Panama's revenue-to-GDP ratio was 9.6 percent in 2014, while the average for CAPDR and South American countries was 13.9 and 20.3 percent, respectively. VAT evasion has been estimated at about 40 percent and the tax authorities have applied three tax amnesties in the past six years. The authorities have taken a number of measures to increase revenue collection. A mechanism for partial VAT withholding by the 160 largest companies was implemented in February 2016 to assist the revenue authority in collecting VAT with an estimated collection of US$100–200 million (0.2–0.4 percent of GDP). The revenue authority also set up a call center to notify taxpayers of their pending obligations and speed up collection. The authorities also plan to launch a new tax filing

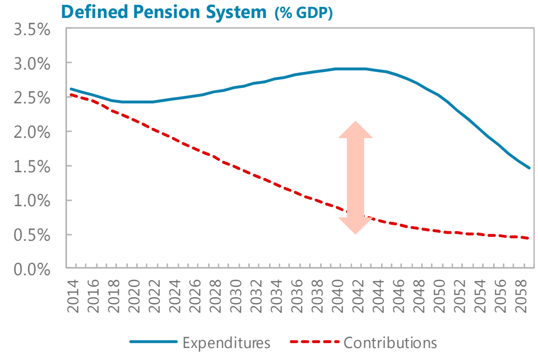
[5] The indicative target on net debt is defined as NFPS debt net of the assets of the Trust Fund for Development, which was later transformed into the sovereign wealth fund. The target of 40 percent of GDP effectively became applicable since 2008.

system (eTax II) to facilitate tax compliance. They also recognize that tax amnesties erode tax compliance and undermine the credibility of the tax authority when used repeatedly. Efforts to enhance the human capital of the revenue administration are ongoing. There is no plan, however, to review and streamline the numerous and complicated schemes of tax exemptions.

21. The authorities are working to improve public services and strengthen public procurement. The investment and maintenance of water and sanitation infrastructure has not kept pace with economic and residential development, partly due to low and outdated tariffs. The authorities plan to improve the reliability and access to public services through investments in infrastructure. In an effort to combat corruption and increase transparency, the authorities proposed a modification to public procurement processes, including to identify contractors' beneficiary owners and to eliminate the practice of holding abbreviated and urgent tenders that had lower standards for eligibility of contractors, auction tendering procedures, and transparency.

22. Addressing the unfunded liabilities of the pension system will be needed to avoid crowding out other components of public spending. The pension system includes two subsystems: a subsystem of defined benefit and a subsystem of mixed defined benefit and defined contribution.[6] Actuarial studies indicate that, absent parametric reforms, the exclusively defined benefit subsystem starts to incur cash losses in 2015, and reserves will be depleted in 2027. Between 2027 and 2060, expenditure of the defined benefit subsystem would impose fiscal pressure of 1–2 percentage points of GDP. Parametric reform is needed to ensure adequate financing of the pension system.[7] Staff suggested reform options that include increasing the retirement age and reducing the replacement rate. There would also be merit in combining the reserves of the two systems, so as to take a consolidated approach to asset-liability management.

Expected Cash Deficities of the Exclusively Defined Pension System (% GDP)



Sources: Panama National Authorities, and IMF staff estimates.

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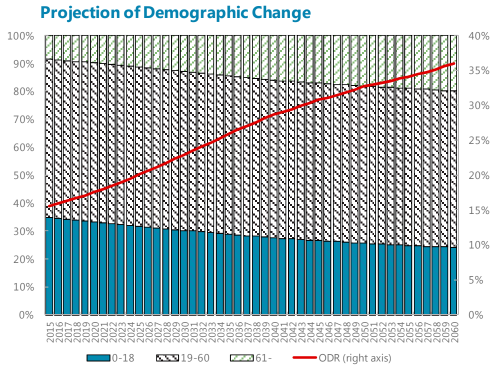
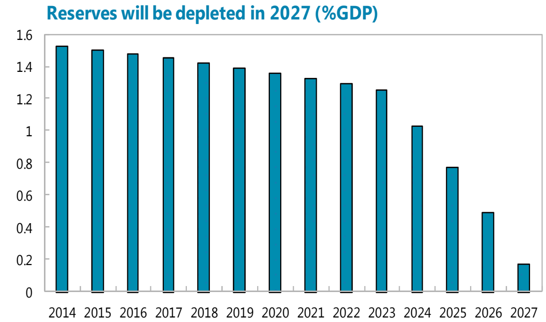
[6] Starting in 2008, all new affiliates entering the system started to contribute to the new subsystem of mixed defined benefit and defined contribution. For affiliates under the old system, workers earning less than US$500 a month as well as workers older than 35 years of age continued to contribute to the exclusively defined benefit scheme. Workers below 35 years of age and earning more than US$500 a month had the option of either staying in the old system or contribute to the new system. Reserves in one subsystem cannot be used to finance the other subsystem.

[7] The current dependency ratio is about 16 percent (ratio of population aged 60 years and above to those aged between 19 and 60) and is projected to reach 36 percent in 2060.



Sources: Panama National Authorities; and IMF staff calculations.



Sources: Panama National Authorities; and IMF staff calculations.

B. Bolstering Financial System Resilience and Enhancing Transparency

23. **While progress has been made, there appear to still be important shortcomings in the financial integrity and AML/CFT framework.** The FATF recognized the progress in the AML/CFT framework by removing Panama from the "gray list" at the February 18 plenary meeting. Going forward, the government and regulators are now working to bring the framework into line with the revised 2012 FATF standard, including the designation of tax-related crimes as a predicate offense to money laundering. Panama is scheduled to undergo an assessment against the revised 2012 FATF standard in mid-2017. However, the recent designation by the U.S. Office of Foreign Assets Control of an extensive money laundering operation involving Panamanian corporate and financial institutions indicates there is an urgent need to both enhance the framework and more assertively enforce its provisions. The authorities reiterated that they see substantial long-term benefits in having a financial sector grounded in transparency and were committed to that end goal. They believe that ongoing improvements in the AML/CFT framework will help banks withstand pressures from global de-risking, and noted that some foreign credit lines and new correspondent banking relatonships have been established after Panama's removal from the FATF gray list. The authorities are also enhancing financial integrity in the context of their anti-corruption efforts and measures to combat tax evasion.

24. **Panama's approach to sharing information related to tax issues has evolved with the recent initiatives to strengthen tax transparency.** A recent OECD report to the G-20 Finance Ministers had listed Panama as one of the few countries that had not been willing to adhere to the Common Reporting Standard (CRS) proposed by the OECD (Box 3). In April 2016, the Communique of G20 Finance Ministers and Central Bank Governors called on all relevant countries, including all financial centers and jurisdictions, to commit to implement the standard on automatic exchange of information by 2017 or 2018 and to sign the Multilateral Convention. The Communique further indicated that the G20 will consider defensive measures against noncooperative jurisdictions if progress is insufficient (as assessed by the Global Forum on Transparency and the Exchange of Information for Tax Purposes). Subsequent to the OECD report, on April 14, the Panamanian authorities announced their full commitment to the bilateral Automatic Exchange of Information (AEOI), following the OECD's Common Reporting Standard by 2018 and that the government intends to immediately begin implementing the CRS regulatory framework. The authorities

underlined that they would work on a bilateral and reciprocal basis with other jurisdictions in the automatic exchange of information. In late April they initiated a number of bilateral negotiations, including with Colombia, France, Germany, and Japan on tax information sharing. On April 27, Panama and the United States signed an intergovernmental agreement for the automatic exchange of tax information, governed by the U.S.'s Foreign Account Tax Compliance Act (FATCA)**.**

25. The changing global environment may ultimately lead to consolidation in the banking sector. Discussions with Panamanian banks revealed their expectation that there would be consolidation going forward, partly as a result of the challenges faced by certain banks in conducting international business. A healthy legal and regulatory environment would help ensure an orderly consolidaton process without major interruption to the banking system as a whole. Staff and the authorities agreed that Panama should first and foremost continue to improve domestic implementation of relevant international standards, as well as expand its outreach to regional banks, supervisors, the U.S. Treasury, and foreign correspondent banks to better understand the drivers of the loss of correspondent banking relationships. Staff also encouraged the authorities to develop a graduated contingency plan to handle the eventuality of a broader loss of correspondent banking relations, should that occur.

Box 3. Panama: Tax Transparency and Exchange of Information

Several initiatives using different approaches have been employed to strengthen tax transparency and facilitate exchange of information among jurisdictions in recent years.

Global Forum and Common Reporting Standard: The Global Forum on Transparency and Exchange of Information for Tax Purposes, which includes 133 jurisdictions as members and 15 international organizations participate as observers, aims to ensure high standards of tax transparency and exchange of information. In 2014 the OECD developed the Common Reporting Standard in response to a G-20 request for putting in place a global standard for automatic exchange of information. The Global Forum initiated a commitment process among its members for adoption of the CRS, and until now, 98 member jurisdictions have committed to implementing the CRS by 2017 or 2018.

2015 Financial Secrecy Ranking

	Jurisdiction	FSI
1	Switzerland	1466.1
2	Hong Kong	1259.4
3	USA	1254.7
4	Singapore	1147.1
5	Cayman Islands	1013.1
6	Luxembourg	816.9
7	Lebanon	760.2
8	Germany	701.8
9	Bahrain	471.3
10	UAE (Dubai)	440.7
11	Macao	420.1
12	Japan	418.3
13	**Panama**	**415.6**
14	Marshall Islands	405.5
15	United Kingdom	380.2

Source: Tax Justice Network.

FATCA: In 2010 the U.S. Congress enacted the Foreign Account Tax Compliance Act (FATCA) to target noncompliance by U.S. taxpayers using foreign accounts. This act requires foreign financial institutions to report to the U.S. tax authorities information on accounts held by U.S. taxpayers or on foreign entities with substantial ownership interest of U.S. taxpayers. As of April 2016, the U.S. has negotiated Intergovernmental Agreements (IGA) to implement FATCA with 113 jurisdictions (of which 55 entered in force, 27 were signed, and 31 were agreed in substance). Not being included in the list of countries that have committed to implement the CRS, the U.S. has indicated that it is undertaking automatic exchange of information pursuant to FATCA from 2015 and has entered into IGAs to do so.

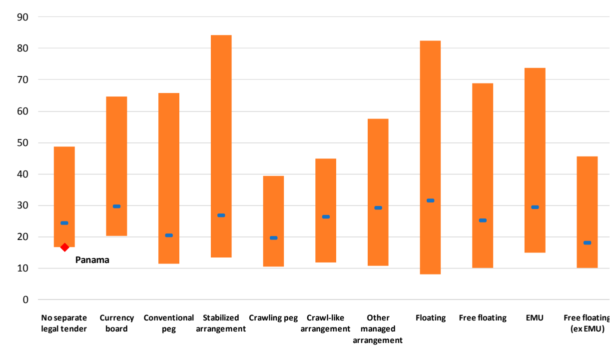
Panama has been addressing international tax cooperation and exchange of information on bilateral and reciprocal basis and the authorities stated that over 30 bilateral Tax Treaties and Tax Information Exchange Agreements (TIEA) have been signed since 2009. In 2010, Panama also signed a TIEA with the U.S. that entered into force in 2011. On April 14, 2016 the Panamanian authorities affirmed that Panama would be fully and immediately committed to the bilateral Automatic Exchange of Information related to tax matters, following the OECD's Common Reporting Standards.

Box 3. Panama: Tax Transparency and Exchange of Information (Concluded)

Financial Secrecy Index (FSI), prepared by the Tax Justice Network, aims to rank jurisdictions according to their financial secrecy and the scale of their offshore financial activities. Although it is difficult to evaluate the representativeness of this index, the 2015 FSI places Panama among the most secretive jurisdictions, though it ranks Panama as less secretive than several major economies.

26. The banking sector remains generally healthy, but certain business lines will require greater vigilance. The banking system is well capitalized and profitable, with an overall nonperforming loan ratio of below 2 percent. However, some banks have significant exposures in the CFZ where economic activity and property prices have been declining in recent years. In light of some signs of overcapacity in the commercial real estate market (office space, hotels, and shopping malls) and saturation in the high end of residential property, staff flagged possible risks of significant correction in prices. Anecdotal evidence suggests that some banks are competing aggressively in the low-income residential mortgage market by offering financing with high LTVs. The authorities are closely monitoring these developments and introduced preemptive measures such as requiring additional loan-loss provisions for exposures in the CFZ and imposing higher risk weights for high LTV loans. They also underlined that banks' exposure to commercial real estate is rather limited, as project developers typically provide most of the financing, and pointed out that the expected release of a real estate price index in mid-2016 should help them improve monitoring.

Liquid Assets to Total Assets (%)



Sources: Financial Soundness Indicators (FSI), Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER), and Fund staff calculations.

27. In the absence of a lender of last resort and deposit insurance, regulatory requirements need to be adapted to generate larger liquidity buffers. At around 60 percent of deposits (twice the required 30 percent), liquidity appears high according to an official definition. However, supervisory data collection and liquidity regulation are not in line with the Basel III framework, which makes a comprehensive assessment of bank liquidity difficult. For example, the current regulation allows the inclusion of all assets receivable within 186 days in the liquid assets and certain below-investment-grade assets, which has the effect of inflating the liquidity ratio. Moreover, liquid assets to total assets of Panama's banking system are relatively low compared with other countries that have a similar exchange rate regime (see figure). Staff urged the authorities to harmonize liquidity regulation with Basel III standards, including through a more stringent definition of liquid assets, a broader interpretation of short-term bank liabilities, and collecting more granular sectoral and maturity breakdowns of balance sheet exposures.

28. Although significant progress has been made, various steps remain from the 2011 FSAP recommendations (Annex I). Complementing an effective microprudential liquidity regulation, an immediate priority is to establish a temporary liquidity facility for banks to address systemic shocks. The authorities also need to enhance cross-border supervision and monitoring of systemic risk. Since risks deriving from nonbank financial institutions can potentially spill over to the banking sector and threaten financial stability, the supervision of the nonbank financial institutions needs to be significantly strengthened.

29. The authorities agreed on the need to modernize financial supervision according to international standards and to strengthen the financial safety net. They pointed to recent efforts to adopt parts of Basel II/III banking regulations, including a pilot project exploring the implementation of the Liquidity Coverage Ratio. In addition, they agreed on the need to establish a liquidity facility for banks and to develop a plan to coordinate the response to a large unexpected adverse shock to the financial system. Nevertheless, the authorities pointed out that the Panamanian banking sector has been remarkably stable, including during the 2008–09 global financial crisis, so they do not perceive significant financial stability risks at present. The authorities shared staff's concern about the slow progress towards risk-based supervision of nonbank financial intermediaries, pointing to capacity constraints as an important impediment.

C. Ensuring a Sustainable and Inclusive Growth Path

30. The authorities emphasized that achieving more inclusive growth is one of their top strategic objectives. Strong economic performance led to significant poverty reduction over the last decade, but important challenges remain for achieving a more inclusive growth path. In particular, indigenous areas continue to experience substantially higher poverty and worse social outcomes than the rest of the country. While the authorities have increased public policy attention to address the specific needs of the indigenous communities, progress has been limited, partly due to low connectivity and the difficulty of accessing public services from remote locations. More broadly, the government has undertaken measures to improve the targeting and effectiveness of social assistance programs, strengthen the monitoring of conditional cash transfers, and provide specific support for the elderly and the disabled. The authorities reiterated their strong commitment to ensuring full access to public services and social assistance to the indigenous communities and other socially vulnerable groups.

31. Staff and the authorities agreed that enhancing human capital is crucial for sustaining high and inclusive growth in the future. There is significant scope to improve the quality of public education, as Panama lags behind peer countries on student achievement scores, school enrollment, and education spending (Figure 6). The shortage of adequate skills in the labor market poses constraints on dynamic segments of the economy, impedes competitiveness, and limits social mobility prospects. The authorities agreed with staff that enhancing the quality of public education is crucial for improving competitiveness, and underlined that education reforms are one of the key priorities in the Government Strategic Plan. In particular, they aim to advance the education reform package, which is especially focused on indigenous and remote rural areas, and includes higher investment in education infrastructure, renovation of schools and classrooms, introduction of an extended school day, upgraded training curricula for teachers, and specific programs to improve foreign language and technical skills. In addition, recent initiatives to put greater focus on vocational training programs and foster closer collaboration between education institutions and companies will help narrow skills gaps and facilitate the reallocation of labor, particularly following the completion of large infrastructure projects. Strengthened assessment and accountability at different stages of the education process will help translate reform efforts into desirable outcomes.

D. Other Issues

32. **Staff encouraged the authorities to discontinue the price controls.** Motivated by concerns about noncompetitive behavior of food retailers, the authorities introduced price controls on particular varieties of 22 basic food products in July 2014 for an initial period of six months and repeatedly extended them afterwards. Staff underscored that price controls distort market conditions, give misleading signals, and are often ineffective tools to tackle the lack of competition, and advised the authorities to take advantage of the declining international food and fuel prices to phase them out. The authorities emphasized that currently they do not have plans to discontinue the price controls as concerns about the lack of competition in food retail persist.

33. **Further improvements in timeliness and consistency of data reporting will help macroeconomic surveillance and assessment of risks.** The publication of the full 2007-base national accounts was a notable improvement in data reporting. However, weaknesses still remain in the availability, timeliness, and consistency of statistics relevant for macroeconomic monitoring. The authorities are receiving technical assistance to improve capacity in a number of areas. Gaps in financial sector data (such as housing prices and corporate leverage) limit the ability to properly assess risks. The authorities pointed out that they are currently preparing an index of real estate prices and aim to continue improving data reporting standards. Improvement in the timeliness, coverage and consistency of socio-economic indicators will help the design of public policy.

STAFF APPRAISAL

34. **Panama remains one of the most dynamic economies in the region.** Economic growth was the highest in the region over the past decade, and the economic outlook remains favorable. Robust growth is expected to be set against a backdrop of low inflation, declining public debt-to-GDP ratio, a stable financial system, and a declining current account deficit. Although the uncertain external environment poses risks, Panama's buffers are well placed to cope, should negative external shocks materialize.

35. **The authorities should enhance and ensure the effective implementation of the AML/CFT framework, particularly in light of recent revelations.** The removal from the FATF list of countries with strategic deficiencies in AML/CFT should not lead to complacency. This was forcibly highlighted by the recent announcement of U.S. sanctions against an extensive narcotics money laundering network based in Panama. To safeguard the role of Panama as a regional financial center, the authorities will need to energetically enhance the financial integrity and transparency framework—particularly on issues of tax and entity transparency—and ensure it is fully aligned with international standards and rigorously enforced. Doing so would place Panama in a strong position

in advance of the next FATF assessment in mid-2017 which will inevitably be judging Panama relative to a more demanding AML/CFT standard.

36. The automatic exchange of tax information needs to be strengthened. Panama's commitment to the bilateral Automatic Exchange of Information, following the OECD's Common Reporting Standard by 2018 is a welcome step forward and should be complemented with a rapid expansion of bilateral agreements with other jurisdictions to counter globalized tax avoidance and evasion.

37. Important advances have been made in the fiscal policy framework but additional reforms are needed to strengthen the fiscal framework. The institutional weakness of the current fiscal framework reveals the need for a simpler and more effective accountability framework, without the constant loosening through shortfalls of contributions from the canal. Mechanisms should be put in place to make the cost of noncompliance with the fiscal rules explicit and to detect and correct slippages in a timely fashion. Staff welcome the authorities' openness to introduce a multi-year budgeting process, establish an independent fiscal council to monitor and assess implementation of the framework, and combine the fiscal balance rule with a limit on the growth of current expenditure to help safeguard resources for capital investment. Staff encourage the authorities to publish an assessment of the consolidated assets and liabilities of the public sector and conduct an analysis of all contingent liabilities to ensure the debt target is consistent with maintaining adequate buffers, especially in the context of a dollarized economy.

38. Large unfunded liabilities of the pension system need to be addressed to avoid crowding out other components of public spending. In the absence of parametric reforms, reserves of the defined benefit system will be depleted in about a decade, and funding pension obligations thereafter would lead to an annual cost to the budget of 1–2 percent of GDP. Staff welcome an informed national dialogue to push forward reform. Early progress on reform would minimize the adjustment and transition costs while maintaining space for other much needed spending initiatives. Reform options to ensure adequate financing of the pension system could include a gradual increase in the retirement age (to reflect increasing life expectancy) and a reduction in the replacement rate. There would also be merit in exploiting economies of scale by taking a consolidated approach to the management of the assets and liabilities of the pension sub-systems.

39. Developing a strategy to strengthen and modernize the revenue administration is essential. The institutional capacity of the revenue agencies needs to be strengthened. The authorities' efforts to improve revenue administration, including through VAT retention measures, the development of an improved electronic tax platform, and enhancements to human resources are welcome. These measures should be complemented by developing a tax compliance strategy, broadening the tax base, improving the availability and quality of data, and developing the proper incentives for tax compliance. Staff encourage the authorities to refrain from tax amnesties as they erode tax discipline and undermine the credibility of the tax administration when used repeatedly.

40. Work should be continued to fully implement the FSAP recommendations. Efforts are underway to improve banking regulations to comply with Basel II. Cross-border supervision and systemic risk monitoring need to be enhanced by increasing information exchange with home supervisors of foreign institutions. Since risks deriving from nonbank financial institutions can potentially spill over to the banking sector and threaten financial stability, the supervision of the nonbank financial institutions needs to be strengthened by moving expeditiously to risk-based supervision.

41. In the absence of a lender of last resort and deposit insurance, regulatory requirements need to be adapted to generate larger liquidity buffers against systemic shocks. Panama's banking system appears highly liquid according to the official definition. However, local liquidity regulation is not in line with the Basel III framework, which makes a comprehensive assessment difficult. The authorities should aim to align financial regulation with the Basel III liquidity framework to ensure banks maintain sufficient high quality liquid assets against liquidity shocks. In addition, the authorities should establish a temporary liquidity facility for banks to address systemic shocks and should develop a plan to coordinate the response to a large unexpected adverse shock to the financial system.

42. Strong growth performance led to significant poverty reduction, but specific challenges remain for achieving a more inclusive growth path. In particular, poverty in the indigenous areas remains substantially higher than in the rest of the country, partly due to low connectivity and the difficulty of accessing public services from remote locations. In this context, continued efforts to strengthen the effectiveness of social assistance, and improve the provision of public services that address the specific needs of the indigenous communities and other socially vulnerable groups will help the authorities attain their strategic objective of achieving more inclusive growth.

43. Greater focus on enhancing human capital is crucial for sustaining high and inclusive growth in the future. There is significant scope to improve the quality of public education in line with the objectives of the Government's Strategic Plan. In particular, progress with the envisaged measures to renovate schools and classrooms, introduce the extended school day, enhance the qualifications of teachers, and revamp programs that improve foreign language and technical skills will help improve education quality, reduce skills shortages, and improve competitiveness. Strengthened assessment and accountability at different stages of the education process will help translate reform efforts into desirable outcomes.

44. The low-inflation environment provides a timely opportunity to discontinue price controls. Price controls are rarely effective tools to tackle non-competitive behavior, while they distort market conditions, and provide misleading signals to market participants. Concerns about the lack of competition in the retail sector can be addressed more effectively through the anti-trust legal framework.

45. The external position is broadly consistent with fundamentals and desirable policy settings. With the winding down of large investment projects, mostly related to the canal expansion, the current account is expected to approach its norm determined by fundamentals and desirable policies.

46. Further improvements in timeliness, coverage, and consistency of statistics will help macroeconomic surveillance and assessment of risks. Building on recent progress, continued focus to strengthen data reporting will also help improve the formulation of public policy.

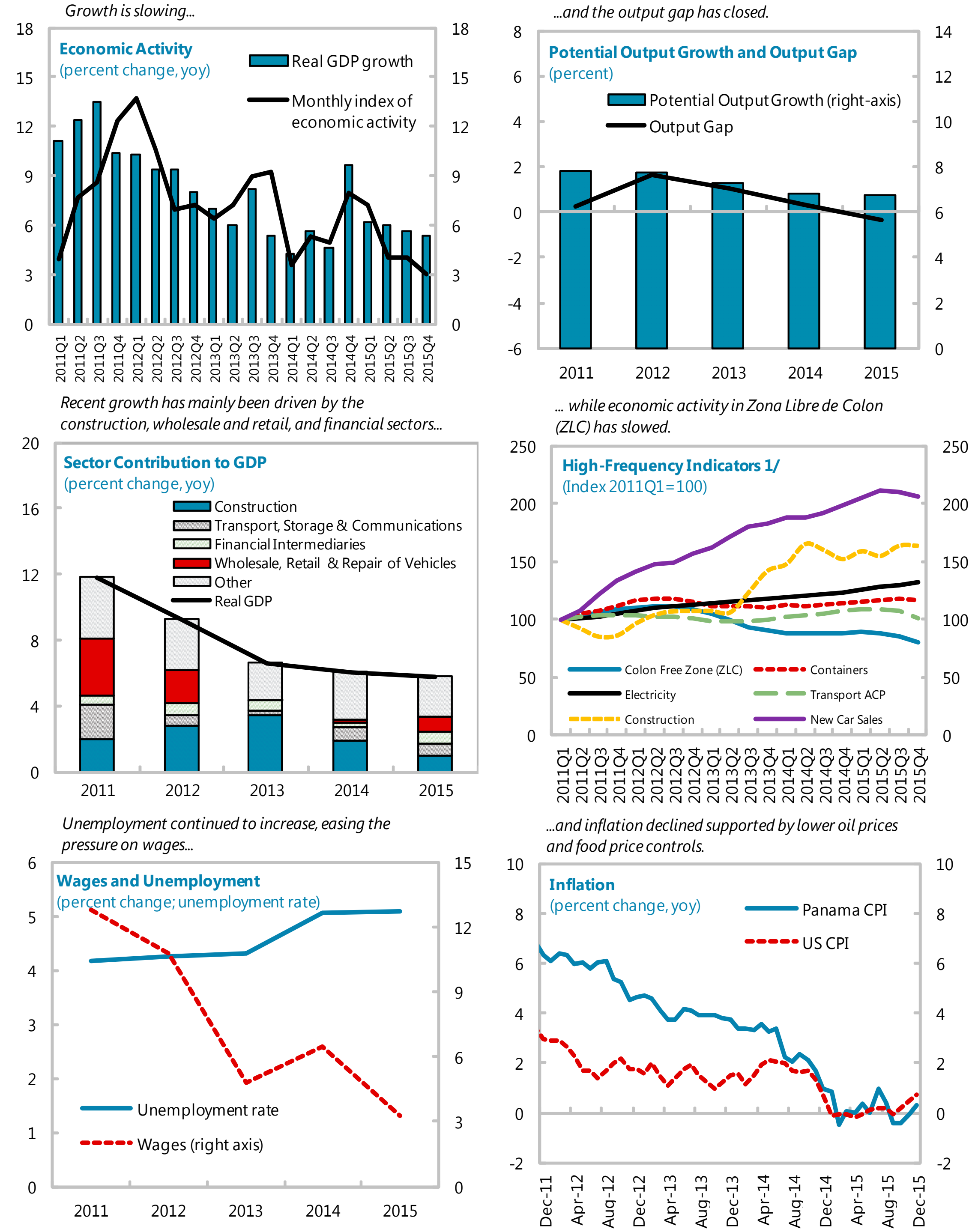
47. Staff propose that the next Article IV consultation takes place on the standard 12-month cycle.

Panama: Risk Assessment Matrix[1]

Nature/Source of Main Threats	Risk	Impact	Effect	Policy Response
External				
Tighter or more volatile global financial conditions.	M	M	Reduction in capital inflows/increase in capital outflows; difficulty in rolling over financing; freeze of foreign credit lines. Rise in spreads and domestic rates.	Deficit financing more tilted to domestic market. The fiscal deficits will need to be adjusted in order to avoid sharp increase in domestic rates and possible crowding out of private investment. Current account to adjust automatically through lower imports.
Sharper-than-expected global growth slowdown:				
• Significant China slowdown	L/M	M	• Reduction in receipts from the canal and exports.	Need to move energetically forward with structural reforms to improve productivity and strengthen competitiveness. Current account to adjust automatically through lower imports.
• Significant slowdown in other large EMs/frontier economies	M	H	• Slower growth, weaker exports and lower Canal revenues. Staff's scenario implies that a sharp slowdown in EMs to the levels experienced after the Asian and the global financial crisis would lead to 1.8 pp lower growth, 0.5 percent of GDP higher fiscal deficit and 0.6 percent of GDP higher current account	Same as above.
• Structurally weak growth in key advanced and emerging economies.	H/M	M	• Reduction in receipts from the canal and exports. Growth deceleration.	Same as above.
Dislocation in capital and labor flows, in particular through reduced financial services by global/regional banks ("de-risking").	M	H	Difficulties in accessing international finance and higher financing costs. Potential capital outflows.	The authorities need to intensify monitoring and supervision, and improve transparency. Financial sector consolidation.
Persistently lower energy prices, triggered by supply factors reversing only gradually.	H	L	Panama benefits from lower energy prices as a net importer of oil. More room to eliminate energy subsidies.	Need to reduce/eliminate energy subsidies. Use the opportunity to facilitate investment in energy sector to reduce energy costs when prices reverse.
Domestic				
Fallout from the "Mossack Fonseca documents," delays in strengthening the AML/CFT framework, or delays in reaching agreements for the automatic exchange of tax information (AEOI).	M	H	Reputational damage, reduced external funding and access to international financial services, higher borrowing costs, and increased scrutiny of Panamanian entities.	Enhance efforts in improving transparency and comply with international standards. Include tax crimes as a predicate offence for ML. Rapidly expand agreements for AEOI with countries.
Relaxation of fiscal policy/deficit ceilings.	L	H	Larger borrowing and contribution to fiscal vulnerability. Reduced market confidence.	Build fiscal buffers and commit to fiscal targets below the SFRL ceilings.
Climate change and possible insufficient supply of water for canal operation.	M	M	Disruption of canal transit and negative impact on growth.	Strengthen water management. Invest in alternative water sources to ensure uninterrupted canal operation.
Further disruption to the Canal expansion.	L	L	Negative effects on growth and employment in the short term and exports and revenues in the medium term.	Improve efficiency of public investment. Review the fiscal framework, in particular the structural revenue from the canal.

1 The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

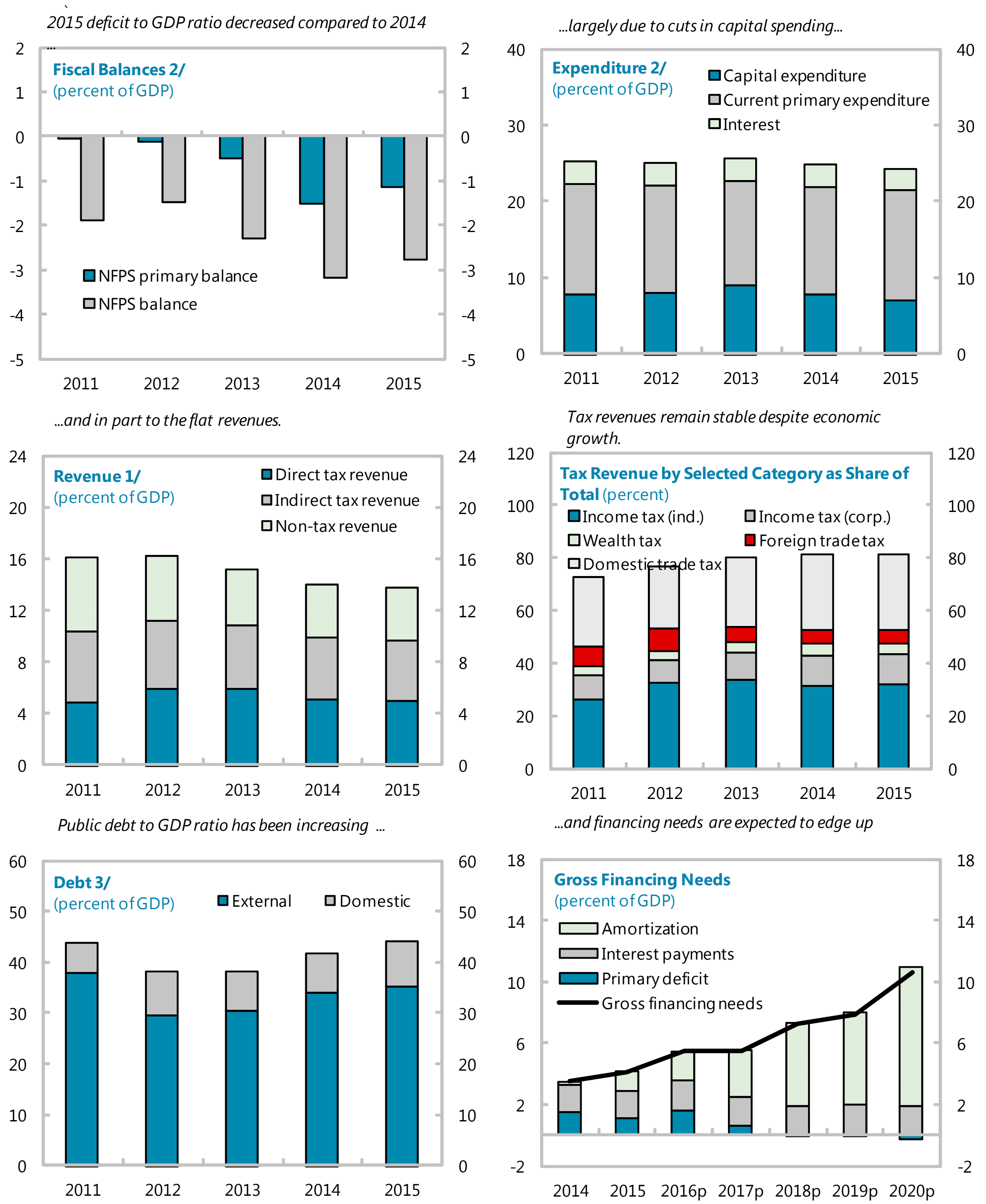
Figure 1. Panama: Real Sector Developments



Source: National Authorities; and IMF staff calculations.

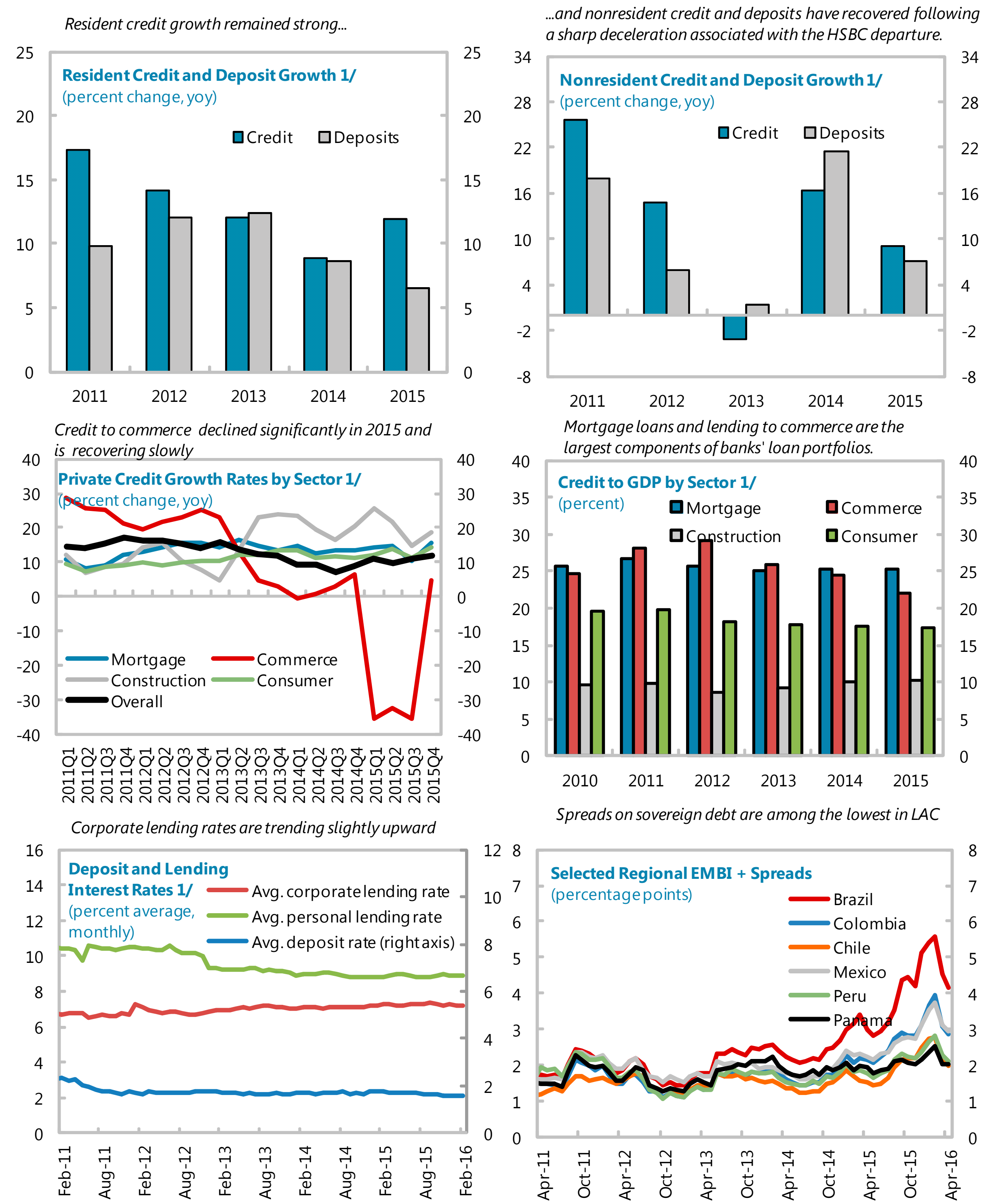
1/ 4-quarter moving averages. Zona Libre de Colon (ZLC) measured in gross metric tons; and electricity consumption in kWh.

Figure 2. Panama: Fiscal Developments



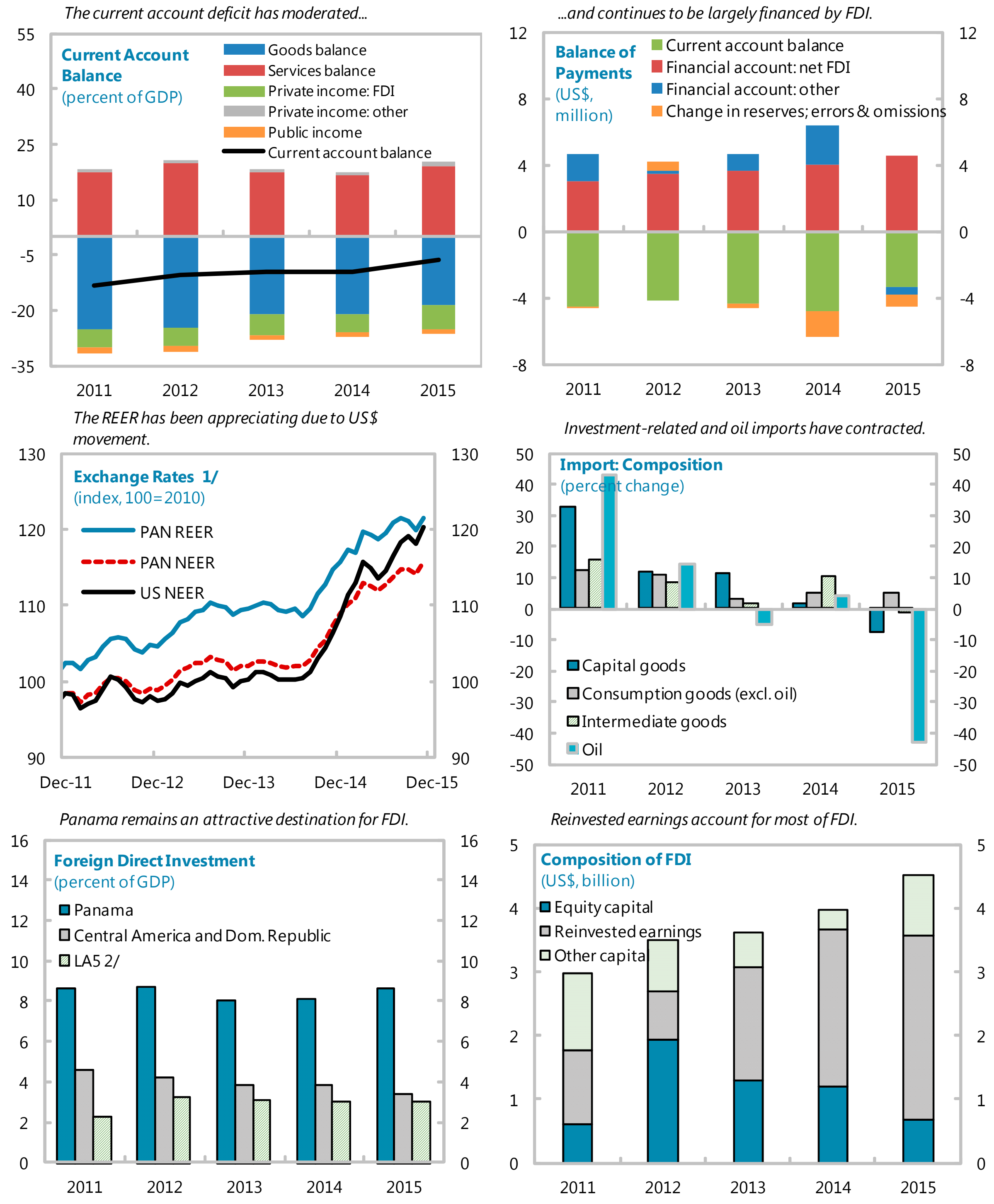
Sources: National Authorities; and IMF staff calculations.
1/ Data refer to the Central Government.
2/ Non-financial Public Sector.
3/ Includes external debt for the Canal expansion.

Figure 3. Panama: Financial Sector Developments



Source: National Authorities; Bloomberg; and IMF staff calculations.
1/ Banks with general licenses.

Figure 4. Panama: External Sector Developments



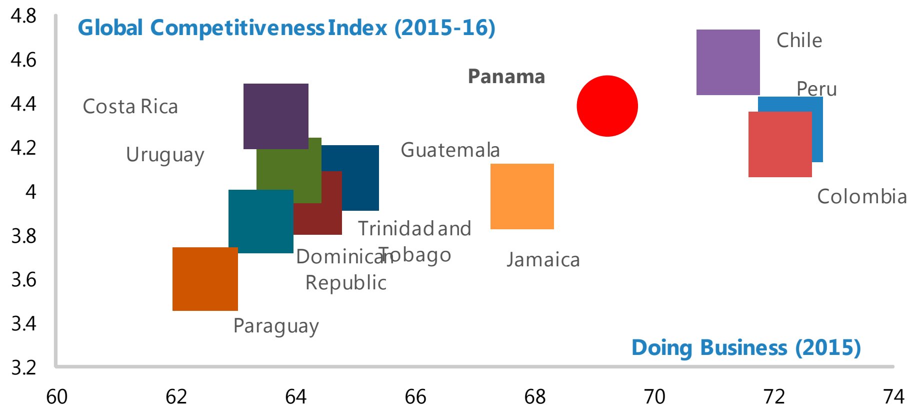
Source: National Authorities; WEO; and IMF staff calculations.

1/ Excluding Venezuela.

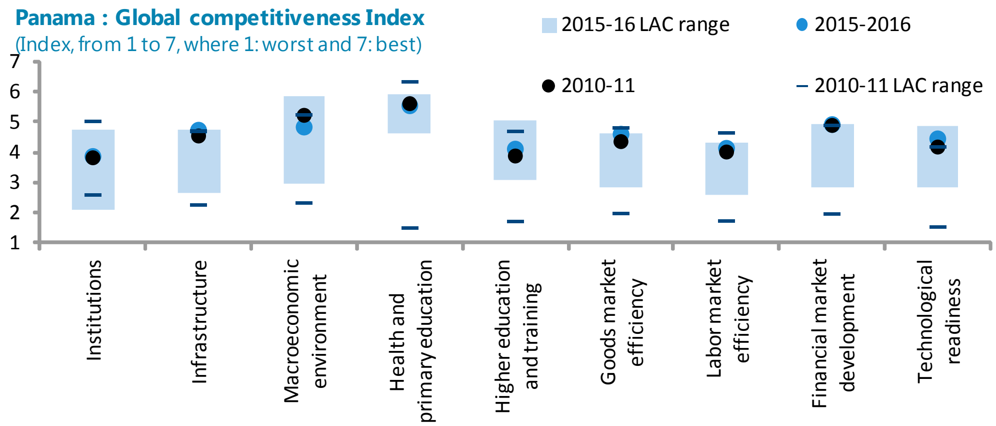
2/ LA5 refers to Brazil, Chile, Colombia, Mexico, and Peru (WEO).

Figure 5. Panama: Structural and Competitiveness Indicators

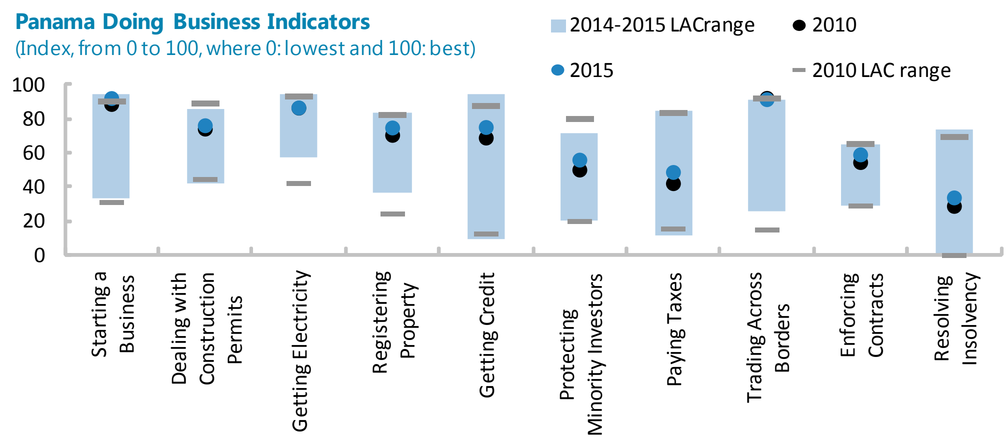
Panama's competitiveness and business environment remain among the best in LAC...



...while improvements in education and training can further enhance its competitive position...



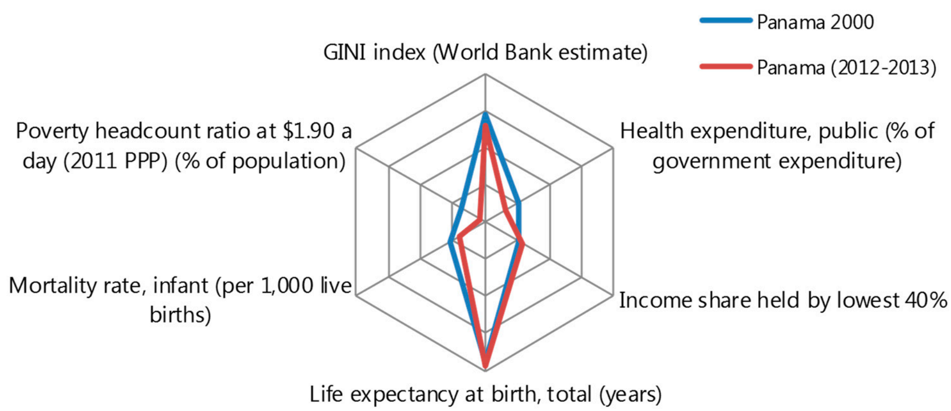
...and strengthening tax discipline and insolvency resolution will help preserve the strong business environment.



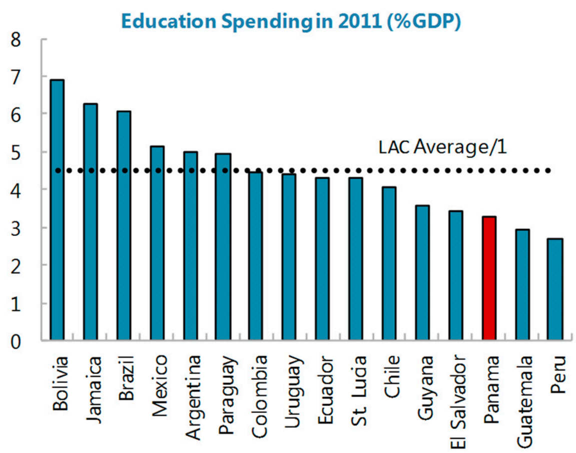
Source: World Bank Doing Business and World Economic Forum Global Competitivness and Fund Staff calculations.

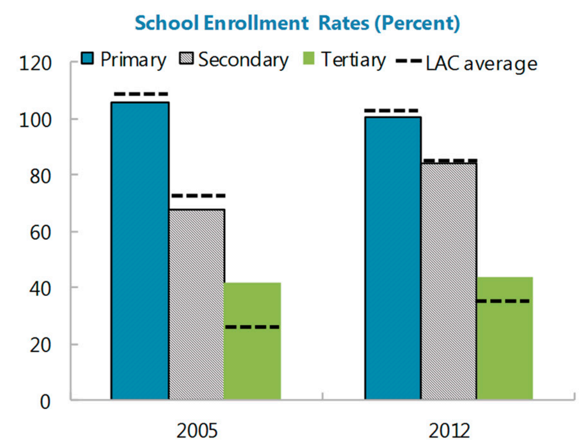
Figure 6. Panama: Social and Labor Indicators

Strong economic performance helped significantly reduce poverty, and improve inclusiveness somewhat...

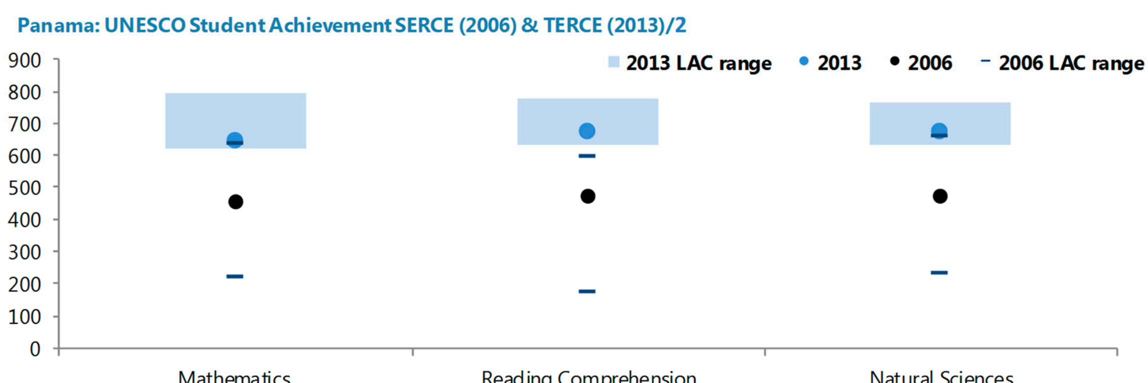


...though education spending and school enrollment are lagging behind...





...which is reflected in student underperformance relative to LAC countries.



Sources: World Bank's World Development Indicators, UNESCO Second and Third Regional Comparative Studies on Primary Education SERCE, TERCE, and Fund Staff calculations.

1/Simple average for selected countries from LAC with available data.

2/Scores for 6th grade students.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2013)	3.9	Poverty line (percent, 2013)	25.8
Population growth rate (percent, 2013)	1.7	Adult literacy rate (percent, 2010)	94.0
Life expectancy at birth (years, 2012)	77.0	GDP per capita (USD, 2013)	11,649
Total unemployment (August, 2015)	5.1	IMF Quota (SDR, million)	206.6

				Est.	Proj.	
	2012	2013	2014	2015	2016	2017
			(Percent change)			
Production and prices						
Real GDP	9.2	6.6	6.1	5.8	6.1	6.4
Consumer price index (average)	5.7	4.0	2.6	0.1	0.8	2.0
Consumer price index (end-of-year)	4.6	3.7	1.0	0.3	0.8	2.0
Domestic demand						
Public consumption	1.9	2.1	3.0	6.4	3.1	4.4
Private consumption	4.9	4.2	4.6	4.7	3.0	2.4
Public investment 1/	21.8	33.4	-25.8	-14.7	-8.3	-18.3
Private investment	20.5	16.5	22.3	8.3	4.9	4.9
Financial sector						
Private sector credit	14.1	12.1	9.1	11.4	2.8	7.1
Broad money	10.3	8.6	8.1	4.5	6.9	8.5
Average deposit rate (1-year)	2.7	2.7	2.7	2.7	…	…
Average lending rate (1-year)	7.2	7.2	7.4	7.7	…	…
External trade						
Merchandise exports	21.1	-2.2	0.1	-31.5	2.2	28.3
Merchandise imports	16.4	1.3	4.7	-16.8	10.7	6.6
			(In percent of GDP)			
Saving-investment balance						
Gross domestic investment	44.4	45.8	47.0	47.5	46.0	44.0
Public sector	8.7	10.8	7.7	6.8	5.9	4.6
Private sector	28.7	31.0	35.7	36.9	36.5	36.0
Changes in inventories	7.0	4.0	3.7	3.7	3.6	3.5
Gross national saving	34.0	36.0	37.3	41.0	39.8	39.0
Public sector	7.4	7.3	5.4	4.8	4.3	4.9
Private sector	26.6	28.7	31.9	36.3	35.5	34.0
Public finances 1/						
Revenue and grants	25.8	25.3	23.7	23.6	23.4	23.1
Expenditure	28.9	29.4	28.3	27.7	26.9	24.8
Current, including interest	18.0	17.2	17.5	18.1	18.5	18.3
Capital	10.9	12.2	10.8	9.6	8.3	6.4
Overall balance, including ACP 2/	-3.0	-4.1	-4.6	-4.1	-3.5	-1.7
Overall balance, excluding ACP 2/	-1.5	-2.3	-3.2	-2.8	-3.1	-2.1
External sector						
Current account	-10.5	-9.8	-9.8	-6.5	-6.2	-5.0
Net exports from Colon Free Zone	1.0	2.2	1.7	0.3	0.3	0.3
Net oil imports	8.5	6.5	5.8	3.1	2.2	2.6
Foreign direct investment	8.7	8.1	8.1	8.7	8.8	8.7
Public debt						
Debt of Non-Financial Public Sector	35.7	35.0	37.1	38.8	39.4	38.4
External	27.0	27.3	29.2	30.0	30.1	27.2
Domestic	8.7	7.7	7.9	8.8	9.3	11.2
Memorandum items:						
Debt of ACP as % of GDP	2.5	3.2	4.7	5.3	4.9	4.2
GDP (in millions of US$)	39,955	44,856	49,166	52,132	55,755	60,510

Sources: Comptroller General, Superintendency of Banks; the World Bank; and IMF staff estimates.
1/ Includes Panama Canal Authority (ACP).
2/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

Table 2. Panama: Summary Operations of the Non-Financial Public Sector 1/

(In percent of GDP)

	2012	2013	2014	2015	Proj. 2016	2017
Revenues	22.4	22.2	20.5	20.4	20.0	20.2
Current revenue	22.6	22.0	20.5	20.5	20.3	20.5
Tax revenue	11.1	10.8	9.8	9.7	9.8	9.8
Nontax revenue of central government	5.1	4.3	4.2	4.1	4.0	4.3
o/w: Panama Canal fees and dividends	2.6	2.2	2.1	1.9	1.8	2.2
Social security agency	5.5	6.0	5.7	5.8	5.8	5.7
Public enterprises' operating balance	0.3	0.3	0.2	0.2	0.3	0.3
Other 2/	0.6	0.6	0.6	0.7	0.4	0.4
Capital revenue	0.1	0.4	0.2	0.1	0.0	0.0
Expenditure	23.9	24.5	23.6	23.2	23.2	22.3
Current primary expenditure	14.2	13.7	14.1	14.4	14.9	14.8
Central government 3/	8.5	7.9	8.5	8.6	8.8	8.5
Rest of the general government	5.7	5.8	5.6	5.8	6.2	6.3
Social security agency	5.2	5.4	5.2	5.3	5.7	5.9
Decentralized agencies	0.5	0.4	0.4	0.5	0.5	0.5
Interest	1.9	1.8	1.7	1.8	1.6	1.6
Capital	7.9	8.9	7.8	7.0	6.7	5.9
Overall balance, excluding ACP 4/	-1.5	-2.3	-3.2	-2.8	-3.1	-2.1
Panama Canal Authority (ACP)						
Revenue	6.0	5.4	5.4	5.2	5.2	5.1
Current primary expenditure	1.8	1.6	1.6	1.8	1.8	1.8
Transfers to the government	2.6	2.3	2.1	2.0	1.9	2.3
Interest payments	0.1	0.1	0.1	0.1	0.2	0.2
Capital expenditure	3.1	3.2	3.0	2.6	1.7	0.5
Overall balance	-1.5	-1.8	-1.4	-1.4	-0.3	0.4
Overall balance, including ACP	-3.0	-4.1	-4.6	-4.1	-3.5	-1.7
Net financing, excluding ACP	2.7	2.5	4.1	2.8	3.1	2.1
External	0.8	2.5	4.4	2.5	2.0	-0.5
Domestic	1.9	0.0	-0.3	0.3	1.1	2.7
Memorandum items:						
Primary balance (excluding ACP)	-0.1	-0.5	-1.5	-1.1	-1.7	-0.6
Structural primary balance (excluding ACP) 5/	-0.5	-0.7	-1.6	-1.1	-1.6	-0.5
Primary balance (including ACP)	-1.0	-2.1	-2.8	-2.2	-1.7	0.1

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.

1/ Official presentation excludes the operations of the ACP as it is not part of the NFPS.

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

3/ Different from Table 3 as it excludes the transfers to other agencies.

4/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

5/ Structural primary balance adjusted for output gap.

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

	2012	2013	2014	2015	Proj. 2016	2017
Revenues and grants	16.3	15.4	14.1	13.9	13.8	14.1
Current revenue	16.3	15.1	14.0	13.7	13.8	14.1
Taxes	11.1	10.8	9.8	9.7	9.8	9.8
Direct taxes	5.8	5.8	5.0	4.9	5.1	5.1
Income tax	5.2	5.2	4.4	4.4	4.4	4.5
Tax on wealth	0.6	0.6	0.6	0.5	0.7	0.7
Indirect taxes	5.3	5.0	4.8	4.7	4.7	4.6
Import tax	1.4	0.9	0.8	0.7	0.7	0.7
ITBMS	2.7	2.8	2.7	2.5	2.5	2.5
Petroleum products	0.3	0.3	0.3	0.5	0.5	0.5
Other tax on domestic transactions	1.0	1.0	1.1	1.0	1.0	1.0
Nontax revenue	5.1	4.3	4.2	4.1	4.0	4.3
Dividends	4.9	4.2	3.8	3.5	3.4	4.2
Of which: Panama Canal Authority	1.6	1.4	1.3	1.2	1.1	1.5
Panama Canal Authority: fees per ton 1/	1.0	0.8	0.8	0.7	0.7	0.7
Transfers from decentralized agencies	0.6	0.5	0.5	0.6	0.5	0.5
Other	-1.3	-1.2	-0.9	-0.7	-0.7	-1.2
Capital revenue	0.0	0.3	0.1	0.1	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	19.5	19.2	18.0	18.0	17.8	16.7
Current	11.3	10.7	11.2	11.7	11.8	11.5
Wages and salaries	4.0	3.9	4.0	4.2	4.3	4.2
Goods and services	1.6	1.5	1.8	1.6	1.3	1.3
Current expenditure of CSS	0.6	0.5	0.5	0.8	0.6	0.6
Transfers to public and private entities	3.3	2.9	3.2	3.4	4.0	3.8
Interest	1.9	1.8	1.7	1.8	1.6	1.6
Domestic	0.3	0.3	0.4	0.4	0.3	0.5
External	1.6	1.5	1.4	1.4	1.3	1.2
Capital	8.1	8.5	6.8	6.3	6.0	5.2
Savings 2/	4.9	4.5	2.8	2.0	1.9	2.6
Overall balance 3/	-3.2	-3.8	-4.0	-4.2	-4.0	-2.6
Financing (net)	0.9	3.9	4.3	3.5	4.0	2.6
External	0.8	2.5	4.4	2.5	2.0	-0.5
Domestic	0.1	1.4	-0.1	1.0	2.0	3.1
Memorandum items:						
Primary balance	-1.3	-1.9	-2.3	-2.4	-2.4	-1.0
GDP (in millions of US$)	39,955	44,856	49,166	52,132	55,755	60,510

Sources: Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.
1/ Includes public service fees.
2/ Current revenues and grants less current expenditure.
3/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

Table 4. Panama: Monetary Accounts 1/

	2011	2012	2013	2014	2015	Proj. 2016	Proj. 2017
	(In millions of U.S. dollars at end-period)						
Net foreign assets	7,259	5,847	5,830	5,996	4,937	5,322	5,800
Short-term foreign assets, net	7,261	5,849	5,832	5,998	4,939	5,324	5,802
National Bank of Panama	2,665	2,307	3,038	3,466	3,607	3,866	4,206
Rest of banking system	4,597	3,542	2,794	2,532	1,332	1,458	1,596
Long-term foreign liabilities	2	2	2	2	2	2	2
National Bank of Panama	2	2	2	2	2	2	2
Rest of banking system	0	0	0	0	0	0	0
Net domestic assets	19,115	23,306	26,145	28,193	32,891	33,838	36,700
Public sector (net credit)	-3,636	-3,575	-5,366	-6,190	-7,090	-7,086	-7,086
Central government (net credit)	-550	311	-781	-1,232	-1,906	-1,902	-1,902
Rest of the public sector (net credi	-3,086	-3,886	-4,585	-4,958	-5,183	-5,183	-5,183
Private sector credit	28,553	32,590	36,543	39,878	44,434	45,657	48,886
Private capital and surplus	-6,931	-6,856	-7,128	-8,113	-8,872	-9,488	-10,298
Other assets (net)	1,129	1,147	2,096	2,617	4,419	4,756	5,198
Domestic liabilities to private sector	27,116	29,916	32,484	35,110	36,676	39,225	42,570
Total deposits	26,666	29,501	32,116	34,719	36,616	39,160	42,500
Demand deposits	6,227	7,067	7,695	8,213	8,114	8,678	9,418
Time deposits	13,864	15,174	16,485	17,681	19,135	20,465	22,210
Savings deposits	6,574	7,260	7,936	8,824	9,367	10,017	10,872
Bonds	451	415	367	391	60	64	70
	(12-month change in relation to liabilities to the private sector at the beginning of the period)						
Net foreign assets	-5.1	-5.2	-0.1	0.5	-3.0	1.0	1.2
Net domestic assets	11.2	15.5	9.5	6.3	13.4	2.6	7.3
Public sector credit (net)	-3.6	0.2	-6.0	-2.5	-2.6	0.0	0.0
Private sector credit	16.5	14.9	13.2	10.3	13.0	3.3	8.2
Private capital and surplus	2.0	-0.3	0.9	3.0	2.2	1.7	2.1
Other assets (net)	0.2	0.1	3.2	1.6	5.1	0.9	1.1
Liabilities to the private sector	9.3	10.3	8.6	8.1	4.5	6.9	8.5
Memorandum items:							
	(12-month percent change)						
M2 2/	9.3	10.3	8.6	8.1	4.5	6.9	8.5
Private sector credit	16.8	14.1	12.1	9.1	11.4	2.8	7.1
	(In percent of GDP)						
Onshore banks							
Domestic private sector credits	83.1	81.6	81.5	81.1	85.2	81.9	80.8
Foreign credits	35.0	34.6	29.8	31.7	30.2	…	…
Domestic private sector deposits	77.6	73.8	71.6	70.6	70.2	70.2	70.2
Government deposits	12.8	12.7	13.9	15.1	14.4	…	…
Of which , central government	3.6	3.0	3.6	5.0	4.1	…	…
Foreign deposits	46.4	42.2	38.0	39.0	39.2	…	…
Offshore banks							
Credits	29.4	24.2	24.1	21.5	21.0	…	…
Deposits	24.2	23.7	23.7	22.6	24.0	…	…

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and IMF staff calculations.
1/ Domestic banking system only (comprises general license banks; does not include offshore banks), unless otherwise specified. Nonresident deposits, credit, and investement are reported in the net foreign assets.
2/ M2 consists of onshore 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)

	2011	2012	2013	2014	2015			
	Dec.	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.
Asset quality								
Nonperforming loans as percent of total loans								
Banking system	1.3	1.3	1.1	1.3	1.1	1.1	1.2	1.2
Domestic banks	1.4	1.3	1.0	1.5	1.5	1.3	1.5	1.5
Foreign banks	1.2	1.3	1.3	1.2	0.9	1.0	1.1	1.0
Ratio of provisions to nonperforming loans								
Banking system	160.7	178.2	171.2	90.9	97.5	89.1	91.8	78.2
Domestic banks 2/	157.7	183.2	155.3	99.5	94.7	91.9	83.2	78.6
Foreign banks	152.8	160.2	174.4	73.3	90.2	72.4	86.0	66.5
Profitability								
Net income on average assets								
Banking system	1.7	1.7	1.4	1.5	1.5	1.4	1.5	1.4
Domestic banks 2/	1.5	1.6	1.4	1.2	1.2	1.2	1.2	1.2
Foreign banks	1.9	1.8	1.4	1.7	1.7	1.6	1.7	1.6
Liquidity								
Ratio of liquid assets to total assets								
Banking system	17.6	16.9	17.7	19.5	19.8	18.0	17.1	16.8
Domestic banks 2/	17.6	16.1	16.8	18.6	19.5	19.1	19.0	18.8
Foreign banks	16.5	15.8	17.6	20.0	19.7	18.3	17.4	17.6
Ratio of liquid assets plus marketable securities to total deposits 3/								
Banking system	37.9	34.4	35.3	37.7	37.0	37.0	39.4	38.4
Domestic banks	34.4	31.9	31.8	31.0	34.4	34.0	37.1	36.6
Foreign banks	41.4	37.1	39.5	41.4	40.3	40.7	41.6	40.2
Capital adequacy ratios								
Ratio of capital to risk-weighted assets								
Banking system	15.5	15.7	14.8	14.7	15.0	14.9	14.9	14.8
Domestic banks 2/	17.6	16.9	15.9	15.8	16.0	15.8	15.6	15.4
Foreign banks	14.3	14.7	13.7	13.7	14.1	14.1	14.3	14.2
Ratio of capital to total assets								
Banking system	11.2	10.4	9.8	10.0	10.1	10.1	10.2	10.2
Ownership								
Foreign banks' share of domestic banking system assets	53.3	51.7	49.1	49.8	49.8	49.7	49.9	49.1

Sources: Superintendency of Banks; Financial Soundness Indicators (FSI) Database; and IMF staff calculations.

1/ National banking system only, comprises general license banks; does not include offshore banks.
2/ For Panama, average of domestic private banks and state-owned banks.
3/ For Panama, liquid assets, as defined in Article 75 of the 2008 Banking Law, also include marketable short-term securities.

Table 6. Panama: Medium-Term Balance of Payments

	2011	2012	2013	2014	2015	Proj. 2016	2017	2018	2019	2020	2021
	(In millions of U.S. dollars)										
Current account	-4,523	-4,177	-4,401	-4,794	-3,377	-3,445	-3,048	-2,646	-2,524	-2,296	-2,116
Trade balance excluding Colón Fre	-8,939	-10,262	-10,533	-11,203	-9,877	-11,149	-11,313	-11,191	-11,946	-12,683	-13,638
Exports, f.o.b.	3,208	3,884	3,799	3,802	2,604	2,661	3,414	4,535	4,863	5,213	5,538
Imports, f.o.b.	-12,147	-14,145	-14,332	-15,005	-12,481	-13,811	-14,727	-15,726	-16,809	-17,896	-19,177
Net exports from Colón Free Zone	263	392	994	826	168	154	156	159	165	172	179
Re-exports, f.o.b.	13,782	14,387	13,258	11,531	10,180	9,338	9,433	9,605	9,966	10,405	10,848
Imports, f.o.b.	-13,519	-13,995	-12,265	-10,705	-10,011	-9,184	-9,277	-9,446	-9,801	-10,234	-10,668
Services, net	5,897	7,872	7,783	8,100	9,999	10,617	11,640	12,606	13,679	14,823	16,004
Travel, net	2,014	2,598	2,624	2,791	3,395	3,661	4,035	4,470	4,975	5,528	6,093
Transportation, net	1,814	2,371	2,694	3,269	3,398	3,528	3,886	4,089	4,315	4,550	4,781
Other services	2,070	2,904	2,466	2,040	3,205	3,427	3,719	4,047	4,389	4,745	5,130
Income, net	-1,914	-2,268	-2,707	-2,631	-3,593	-2,994	-3,452	-4,135	-4,330	-4,508	-4,553
Private sector	-1,311	-1,670	-2,085	-2,033	-2,902	-2,221	-2,712	-3,395	-3,589	-3,816	-3,913
Of which: Direct Investment	-1,659	-2,071	-2,508	-2,448	-3,394	-2,710	-3,052	-3,391	-3,554	-3,747	-3,808
Public sector	-603	-598	-622	-599	-692	-773	-741	-740	-740	-692	-640
Of which: NFPS interest	-644	-717	-706	-746	-830	-914	-877	-876	-877	-820	-759
Current transfers, net	171	88	63	120	-68	-72	-79	-86	-93	-100	-108
Capital and financial account	4,625	3,654	4,607	6,364	4,108	3,703	3,388	3,028	2,920	2,710	2,564
Financial account	4,625	3,654	4,607	6,364	4,108	3,703	3,388	3,028	2,920	2,710	2,564
Public sector, medium and long-t	468	70	1,495	2,165	1,226	905	-540	-488	-534	-1,551	-398
Nonfinancial public sector 1/	423	-45	1,577	2,194	1,301	980	-465	-413	-459	-1,476	-323
Other net flows	52	121	-76	-22	-68	-68	-68	-68	-68	-68	-68
Private sector, medium and long-	4,090	4,511	3,662	6,590	4,134	3,663	4,042	3,293	3,264	3,190	3,256
Direct investment (net)	2,977	3,485	3,612	3,980	4,511	4,933	5,282	4,631	4,789	4,899	4,926
Portfolio investment	968	455	555	1,099	-697	-1,701	-1,875	-2,070	-2,275	-2,485	-1,885
Loans	145	571	-505	1,510	320	431	635	732	750	777	216
Short-term flows	235	-1,419	116	-1,141	-381	-865	-115	222	191	1,071	-295
Public sector	29	-100	0	-24	-140	-148	-144	-140	-136	-124	-121
Private sector	206	-1,319	116	-1,117	-242	-717	29	363	327	1,195	-173
Errors and omissions	-356	559	196	-364	-941	0	0	0	0	0	0
Overall balance	-254	36	402	1,205	-210	259	339	382	396	414	448
Financing	254	-36	-402	-1,205	210	-259	-339	-382	-396	-414	-448
Net foreign assets of the BNP	254	-36	-402	-1,205	210	-259	-339	-382	-396	-414	-448
Memorandum items:	(In percent of GDP)										
Merchandise exports	9.3	9.7	8.5	7.7	5.0	4.8	5.6	6.9	6.8	6.8	6.6
Merchandise imports	-35.3	-35.4	-32.0	-30.5	-23.9	-24.8	-24.3	-23.9	-23.5	-23.2	-23.0
Net exports from Colón Free Zone	0.8	1.0	2.2	1.7	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Current account	-13.2	-10.5	-9.8	-9.8	-6.5	-6.2	-5.0	-4.0	-3.5	-3.0	-2.5
Direct foreign investment	8.7	8.7	8.1	8.1	8.7	8.8	8.7	7.0	6.7	6.3	5.9
External public debt	34.4	29.5	30.5	33.9	35.3	35.0	31.4	28.1	25.1	21.2	19.1

Sources: Office of the Comptroller General; and IMF staff calculations.
1/ Includes disbursements to ACP.

Table 7. Panama: Medium-Term Macroeconomic Framework

					Proj.						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	(Percent change)										
Economic growth and prices											
Real GDP at market prices	11.8	9.2	6.6	6.1	5.8	6.1	6.4	6.7	6.3	6.0	6.0
CPI (period average)	5.9	5.7	4.0	2.6	0.1	0.8	2.0	2.0	2.0	2.0	2.0
CPI (end of period)	6.3	4.6	3.7	1.0	0.3	0.8	2.0	2.0	2.0	2.0	2.0
	(Percent of GDP)										
Savings and investment											
National savings	30.3	34.0	36.0	37.3	39.5	39.8	39.0	40.0	40.5	41.0	41.5
Public sector	7.4	7.4	7.3	5.4	4.8	4.3	4.9	5.5	5.5	5.7	5.7
Private sector	23.0	26.6	28.7	31.9	34.8	35.5	34.0	34.5	35.0	35.3	35.7
Gross domestic investment	43.5	44.4	45.8	47.0	46.0	46.0	44.0	44.0	44.0	44.0	44.0
Public sector	7.9	8.7	10.8	7.7	6.8	5.9	4.6	4.5	4.2	4.2	4.0
Private sector	26.0	28.7	31.0	35.7	35.6	36.5	36.0	36.1	36.3	36.3	36.5
External savings	-13.2	-10.5	-9.8	-9.8	-6.5	-6.2	-5.0	-4.0	-3.5	-3.0	-2.5
Nonfinancial public sector, excluding ACP											
Revenue	22.6	22.4	22.2	20.5	20.4	20.0	20.2	20.1	19.7	19.7	19.7
Revenue, excluding ACP transfers	19.6	20.1	19.8	18.4	18.6	18.4	18.2	18.1	17.8	17.5	17.4
Expenditure	24.5	23.9	24.5	23.6	23.2	23.2	22.3	21.7	21.2	21.0	20.9
Primary balance	-0.1	-0.1	-0.5	-1.5	-1.1	-1.7	-0.6	0.0	0.1	0.3	0.3
Overall balance 1/	-1.9	-1.5	-2.3	-3.2	-2.8	-3.1	-2.1	-1.5	-1.4	-1.3	-1.2
Non-Financial Public Sector net debt											
Net external financing	1.2	0.8	2.5	4.4	2.5	2.0	-0.5	-0.4	-0.5	-1.8	-0.2
Net domestic financing	0.0	1.9	0.0	-0.3	0.3	1.1	2.7	1.9	1.9	3.1	1.5
Panama Canal Authority (ACP)											
Revenue	6.7	6.0	5.4	5.4	5.2	5.2	5.1	5.1	5.0	4.9	4.9
Current expenditure	1.9	1.8	1.6	1.6	1.8	1.8	1.8	1.7	1.6	1.5	1.6
Transfers to the government	2.9	2.6	2.3	2.1	2.0	1.9	2.3	2.4	2.3	2.4	2.6
Interest payments	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.1
Capital expenditure	4.0	3.1	3.2	3.0	2.6	1.7	0.5	0.5	0.5	0.4	0.4
Overall balance	-2.1	-1.5	-1.8	-1.4	-1.4	-0.3	0.4	0.4	0.5	0.4	0.2
Debt of ACP	2.6	2.5	3.2	4.7	5.3	4.9	4.2	3.5	2.9	2.4	1.9
Public Debt											
Non-Financial Public Sector gross debt	37.3	35.7	35.0	37.1	38.8	39.4	38.4	36.8	35.4	34.1	32.8
Non-Financial Public Sector net debt	33.4	32.4	31.8	34.2	36.1	36.9	36.1	34.7	33.5	32.3	31.1
External											
Exports, f.o.b., excluding Colón Free Zone	9.3	9.7	8.5	7.7	5.0	4.8	5.6	6.9	6.8	6.8	6.6
Imports, f.o.b., excluding Colón Free Zone	-35.3	-35.4	-32.0	-30.5	-23.9	-24.8	-24.3	-23.9	-23.5	-23.2	-23.0
Net exports of Colón Free Zone	0.8	1.0	2.2	1.7	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Current account balance	-13.2	-10.5	-9.8	-9.8	-6.5	-6.2	-5.0	-4.0	-3.5	-3.0	-2.5
Foreign Direct Investment	8.7	8.7	8.1	8.1	8.7	8.8	8.7	7.0	6.7	6.3	5.9
	(In millions of U.S. dollars)										
Memorandum items:											
Nominal GDP	34,374	39,955	44,856	49,166	52,132	55,755	60,510	65,855	71,404	77,202	83,471
External debt (public, percent of total non-bank external debt)	34.4	27.0	27.3	29.2	30.0	30.1	27.2	24.6	22.2	18.8	17.2
External Debt (excluding banks, percent of GDP)	52.5	47.0	44.3	39.4	39.7	38.8	34.9	31.5	28.4	24.4	22.2
External Debt (excluding offshore banks, percent of GDP)	107.0	99.1	97.0	99.8	104.9	102.7	96.9	91.5	86.7	81.1	77.3
External Debt (including all banks, percent of GDP) 2/	149.0	136.8	132.0	136.4	140.5	140.5	135.4	130.4	126.1	120.8	115.0

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and IMF staff calculations.

1/ Starting from 2015, includes overspending allowed under Article 34 of Law 38 of 2012.

2/ Includes offshore banks.

Table 8. Panama: Vulnerability Indicators

	2011	2012	2013	2014	2015	Proj. 2016	Proj. 2017
Financial indicators							
Broad money (12-month percent change)	9.3	10.3	8.6	8.1	4.5	6.9	8.5
Private sector credit (12-month percent change)	16.8	14.1	12.1	9.1	11.4	2.8	7.1
Deposit rate (6-month; in percent) 1/	1.9	1.9	1.8	1.9	1.9	...	...
External indicators							
Merchandise exports (12-month percent change)	32.0	21.1	-2.2	0.1	-31.5	2.2	28.3
Merchandise imports (12-month percent change)	-35.6	-16.4	-1.3	-4.7	16.8	-10.7	-6.6
Current account balance (in percent of GDP)	-13.2	-10.5	-9.8	-9.8	-6.5	-6.2	-5.0
Capital and financial account balance	13.5	9.1	10.3	12.9	7.9	6.6	5.6
Of which: direct investment	8.7	8.7	8.1	8.1	8.7	8.8	8.7
Non-Financial Public Sector external debt (in percent of GDP)	34.4	27.0	27.3	29.2	30.0	30.1	27.2
In percent of exports of goods and services 2/	86.3	65.4	69.8	82.1	90.4	93.3	82.0
External interest payments							
In percent of exports of goods and services 2/	4.7	4.3	4.0	4.3	4.8	5.1	4.4
External amortization payments							
In percent of exports of goods and services 2/	3.7	5.6	4.4	1.2	4.3	2.4	2.3
REER, percent change (average, depreciation -)	1.7	3.9	4.5	-2.0	1.3	...	...
Gross international reserves at end of period							
In millions of U.S. dollars 3/	2,733	2,413	3,144	3,572	3,713	3,972	4,311
In months of imports of goods and services	1.8	1.5	1.9	2.5	2.4	2.4	2.5
In percent of broad money 4/	10	8	10	10	10	10	10
In percent of short-term external debt 5/	32	29	29	30	29	31	31
	(In millions of U.S. dollars)						
Memorandum items:							
Nominal GDP	34,374	39,955	44,856	49,166	52,132	55,755	60,510
Exports of goods and services 2/	13,685	16,487	17,519	17,484	17,310	17,986	20,078
Imports of goods and services 2/	16,464	18,484	19,276	19,761	17,020	18,364	19,595

Sources: Ministry of Economy and Finance; and IMF staff calculations.

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

2/ Includes net exports of the Colón Free Zone.

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

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

5/ Excludes off-shore banks' external liabilities. Short-term public external debt includes next year amortization.

Table 9. Panama: Net International Investment Position (NIIP)
(In percent of GDP)

					Est.	Proj.	
	2011	2012	2013	2014	2015	2016	2017
			(In percent of GDP)				
Net international investment position	**-67.7**	**-66.2**	**-70.6**	**-71.9**	**-78.0**	**-79.1**	**-77.8**
Assets	**150.7**	**138.5**	**130.5**	**136.6**	**142.1**	**145.1**	**143.7**
Direct investment abroad	10.3	8.2	8.0	8.7	9.2	9.0	8.7
Portfolio investment abroad	22.0	21.3	20.4	20.7	22.6	24.2	25.4
of which: debt securities	21.2	20.2	19.0	19.5	21.4	23.1	24.3
Other investment	107.3	102.1	95.2	98.4	102.4	104.1	101.8
Trade credits	11.3	11.3	10.5	10.2	12.1	13.3	12.7
Loans (short term, to banks)	64.7	59.8	54.7	53.9	54.3	53.5	51.4
Currency and deposits	28.8	29.3	28.4	32.8	32.3	31.6	30.6
Other assets	2.5	1.7	1.6	1.5	3.8	5.7	7.2
Reserve assets	11.1	6.6	6.7	8.6	7.7	7.7	7.6
							135.7
Liabilities	**218.4**	**204.7**	**201.1**	**208.5**	**220.1**	**224.2**	**221.5**
Direct investment inward	69.3	67.6	69.0	71.7	79.2	83.4	85.8
Portfolio investment	35.7	30.4	28.8	28.9	29.8	30.0	27.2
of which debt securities	35.7	30.4	28.8	28.9	29.8	30.0	27.2
Financial derivatives	0.2	0.2	0.1	0.4	0.3	0.3	0.3
Other investment	113.3	106.4	103.2	107.5	110.7	110.5	108.2
Trade credits	5.8	5.5	5.3	5.2	4.9	4.6	4.2
Loans	33.9	33.0	34.4	35.3	35.0	33.7	32.5
Monetary authorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government	7.5	7.5	8.6	9.8	8.9	7.8	6.7
Banks	19.6	18.2	17.9	16.8	17.6	17.9	18.2
Long-term	8.8	9.0	6.0	7.1	7.3	7.6	8.1
Short-term	10.8	9.2	11.9	9.6	10.3	10.2	10.1
Other sectors	6.8	7.3	7.9	8.8	8.5	8.1	7.6
Currency and deposits	71.3	66.7	62.3	65.5	67.2	68.4	67.5
Other liabilities	2.3	1.2	1.1	1.5	3.6	3.8	4.0

Sources: National authorities; other reporting agencies; and IMF staff calculations.

Annex I. Implementation of Past IMF Policy Advice

The authorities' macroeconomic policies over the last year have been broadly in line with past Fund advice. During the 2015 Article IV consultation, Directors emphasized the importance of enhancing the fiscal framework and fostering resilience through strengthened fiscal buffers, while maintaining financial stability and sustaining strong and inclusive growth. Directors recommended continued efforts to enhance revenue mobilization through capacity building and administrative reform. Directors called for expeditious resolution of the remaining deficiencies to bring the financial integrity and transparency framework fully in line with international standards. They encouraged the authorities to further enhance the quality of public education and healthcare, upgrade skills; stimulate youth employment and female labor force participation to sustain equitable and inclusive growth.

Fiscal policy. In line with the Social Fiscal Responsibility Law (SFRL), the 2015 fiscal deficit was budgeted at 3.7 percent of GDP, while the actual fiscal deficit was 2.8 percent of GDP. The authorities have started to review the current fiscal framework and taken measures to increase revenues. A VAT retention mechanism was implemented in February 2016 and a call center within the Directorate-General of Revenue (DGI) was established to speed up tax collection. The authorities also plan to launch a new tax filing system (eTax II) to facilitate tax compliance.

Financial sector reforms. Further progress has been made in implementing the 2011 FSAP recommendations. The authorities modified the regulation on capital adequacy to bring it in line with the Basel III framework. Banks are required to take measures to identify the ultimate beneficiaries of their corporate clients. The procedure for registration of the custodians of bearer shares was established.

Transparency. The authorities have adopted a number of legislative reforms to address weaknesses in the AML/CFT framework, along the lines of the action plan agreed with FATF. In February 2016, the FATF recognized these reforms and their implementation by removing Panama from the list of countries with strategic AML/CFT deficiencies. The authorities are committed to continue the efforts in enhancing the effectiveness of the AML/CFT regime to align with the revised 2012 FATF standard.

More inclusive growth. The authorities are enhancing social protection programs and evaluating how to better target them. Reforms to the education system include deeper emphasis on technical and language skills as well as on the training of teachers. To address skill mismatches and shortages, vocational education is being improved and a job market database (encompassing both employment opportunities and potential job applicants) has been initiated.

Annex II. Implementation of 2011 FSAP Recommendations

Recommendation	Status/Expected Completion Date
Banking Oversight	
Finalize and implement regulations on operational and interest rate risks.	The SBP issued a regulation on operational and market risk in December 2011 and is planning to introduce capital charges for these risks in line with the Basel 2.5 regulation in 2016.
Enhance systemic risk monitoring and the capacity to implement macroprudential policies.	• A new credit regulation incorporating dynamic provisioning and accounting treatment of restructured loans was issued in May 2013. • The Financial Coordination Council was established in 2012 and continues to strengthen its capacity in order to improve coordination among agencies, joint onsite inspections and address regulatory gaps as well as to implement macroprudential policies. • A law addressing the governance of banking groups was released in 2011 and is scheduled to be updated in 2017. • A draft law on trust funds was released in January 2015 and will be presented to Congress in 2016; legislation on Certified Public Accountants is pending, but a register for external accountants is being established.
Develop capital adequacy and regulatory reporting standards for holding companies.	Regulation establishing a minimum capital requirement for bank holdings was issued in February 2015, while also aligning capital requirements for banks with Basel III rules, with the exception of the capital conservation buffer whose feasibility is still being studied.
Develop concentration limits and risk management requirements for interbank deposits.	No plans to develop such explicit requirements. The authorities noted that the law allows them to introduce such limits and requirements for individual banks as needed.
Enhance offsite supervision to develop a view on macroprudential and systemic risk trends.	• Off-site supervision was improved in 2012 through requirement for banks to report monthly performance and early warning indicators to the SBP based on supervisory data. • The SBP has developed methodologies to identify systemically important banks and measure interconnectedness between banks. • The SBP publishes a Financial Stability Report generally once a year (with an interim report produced for internal use only). Planned upgrades include a more detailed survey of household indebtedness and information about house price developments.
Regulate and effectively supervise cooperatives that provide credit and savings products.	A draft law on cooperatives, which would upgrade regulation and strengthen supervision in that sector, continues to be developed.

Insurance Sector Oversight	
Approve draft Insurance Law with strengthened prudential requirements.	The law creating the Superintendency of Insurance was adopted in 2012 (Ley 12-2012).
Strengthen disclosure of performance indicators and brokers' commissions.	The Superintendency of Insurance has drawn up plans to implement these measures in 2016.
Securities Market Oversight	
Strengthen the budgetary position, and the supervisory and enforcement capabilities of the supervisor (National Securities Commission).	Law 67 (dated 1 September 2011) upgraded the Commission to a Superintendency (SMV), strengthening its supervisory and enforcement capacity as well as its budgetary position. In 2014, plans for a reform of the fee structure to bolster the budgetary position of the SMV were developed and may be presented to the government in due course. In 2015, a department for prevention of illicit activities, including AML/CFT issues, was established. Currently, Fund TA is supporting the development of risk-based supervision of the industry.
Payments and Securities Systems Oversight	
Create a comprehensive payments system law guaranteeing payment finality.	A committee is elaborating a law and/or regulation that would take effect by year-end 2016.
Adopt an RTGS or Hybrid Payments System.	Tentative date for the implementation of a RTGS, deemed to lower systemic risk, is March 2017.
Financial Safety Nets	
Conclude studies and introduce a bank liquidity facility.	Ongoing. The authorities are planning to establish a liquidity fund that may be sourced from bank contributions, public sector funding, and external credit lines.
Establish a deposit insurance scheme.	No initiatives so far.
Capital Market Development	
Build a single yield curve across domestic and global bonds by dual listing and extending market making to global bonds.	Ongoing. Since 2011, the Ministry of Economy and Finance has published information about the yields of Panamanian government bonds of different maturities. Development of a yield curve for corporate bonds is pending. The authorities have been making efforts to extend market making to global bonds.
Review and restructure or close public development banks and guarantee funds.	No initiatives so far.

Annex III. External Sector Assessment

A temporarily excessive current account deficit is steadily decreasing, and there is no compelling evidence of a real exchange rate misalignment.

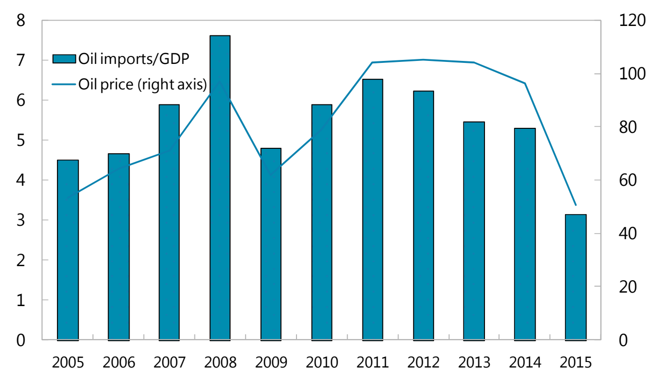
Panama: External Assessment Results (in percent) 1/							
	Actual CA/Y	Underlying CA/Y	CA/Y Norm	NFA/Y	NFA/Y-stabilizing CA/Y	CA/Y gap	REER gap
EBA Approach	-6.5		-4.4			-2.1	-10.4
EBA Approach with adjusted CA		-5.0	-4.4			-0.6	-2.9
ES Approach		-6.5		-78.0	-5.8	-0.8	-3.8

1/ The first two lines implements the IMF's EBA-lite methodology with the unadjusted CA and with the CA adjusted for temporarily high investment-related imports. The ES approach calculates the difference between the underlying CA to GDP ratio (2015, adjusted for output gap) and the CA to GDP ratio that stabilizes the 2015 NFA to GDP ratio. REER gaps are calculated assuming an elasticity of the current account to the REER of 0.2.

Panama's current account deficit has moderated, and the gap is closing fast over the medium term. The CA deficit has been larger than the value explained by fundamentals and desirable policies since the mid-2000s—apart from the sharp adjustment during the global crisis—but the gap has moderated and stands now at about 2 percent.[1] However, the EBA gap fails to capture the impact on the current account of temporarily high investment (mainly linked to the canal expansion) which, over the medium term will raise both productive capacity and exports and facilitate its own correction in the CA. Canal-related imports are estimated at about 1.5 percent of GDP. Correcting the headline CA balance for this import amount, the deviation of the CA from fundamentals significantly decreases. The ES methodology also points to a sustainable CA deficit (see the Annex table). Strong and stable FDI inflows are expected to continue to finance the bulk of external CA deficits in the coming years (Table 7), and external debt is deemed sustainable and resilient to shocks (see Annex III).

The REER does not appear misaligned. Taking into account the adjustment of the CA over the medium term, there are no clear signs of an overvaluation of the REER. Although the recent dollar strength led to a real exchange rate appreciation,[2] several factors mitigate the concern over external sustainability. First, the appreciation was also associated with a positive terms of trade shock through lower oil prices, which lowered external imbalances (see Figure). Second, the full pass-through to inflation of the nominal

Oil Imports/GDP



Source: Panama National Authorities, WEO

[1] The -2.1 percent short term CA gap calculated with the EBA methodology consists of a 0.6 percent policy gap and a -2.7 percent residual. The positive policy gap is mainly driven by a more-expansionary-than-desirable fiscal policy of the rest of the world, without which Panama would be experiencing a marginally larger CA deficit. The negative residual, as explained in the paragraph, can be attributed to a temporary investment boom.

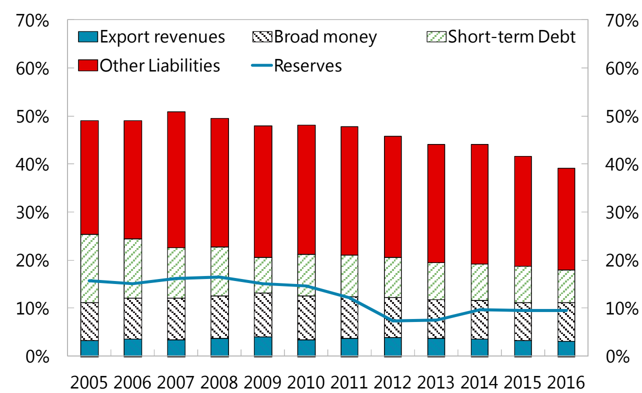
[2] During 2015, excluding Venezuela, the NEER appreciated by 9.3 percent, with the REER going up by 8.0 percent (including Venezuela, the REER appreciated by 1.3 percent).

depreciations experienced by regional trading partners should partly reverse the recent REER appreciation. Third, exports of services, which represent over 90 percent of Panama's exports, have so far proved resilient with a 13 percent increase in nominal terms in 2015. Nevertheless, if current pressures persist, the more price-sensitive service exports, such as tourism, may eventually be affected.

Panama remains among the most competitive economies in Latin America. Panama ranks second, after Chile, in the Global Competitiveness Index. When compared to its overall ranking, Panama's strengths are in financial market development, infrastructure, and goods market efficiency. The main challenges remain in health and primary education, higher education and training, labor market efficiency, and institutions. An inadequately educated workforce is consistently cited as a major impediment to doing business, and these are the categories where Panama has been unable to distance itself from the average of the Latin American and Caribbean region. The World Banks's 2016 Doing Business report ranks Panama behind Costa Rica, Colombia, Chile and Peru, with its main strengths in trading across border and access to credit, and lagging in terms of ease of paying taxes, enforcing contracts and resolving insolvency.

International reserves appear low by standard reserves metrics, although these are hard to interpret in the context of Panama. Panama is a fully dollarized economy without a central bank, and official reporting of reserves is close to the net foreign assets of the main public bank (Banco Nacional de Panama). Although the government has access to other U.S. dollar assets such as the Sovereign Wealth Fund and deposits held in domestic banks, it is not clear how quickly these could be utilized to address a systemic liquidity shortage. In the absence of a lender of last resort, the authorities need to take steps to build policy buffers and lessen vulnerabilities including by establishing a liquidity facility for banks and developing a contingency plan to coordinate the response to a large unexpected shock to the financial system.

Assesing Reserve Adequacy (ARA) Metric Decomposition: Panama



Sources: World Economic Outlook (WEO); and IMF staff estimates

Annex IV. Debt Sustainability Analysis (DSA)

Panama: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP, unless otherwise indicated)

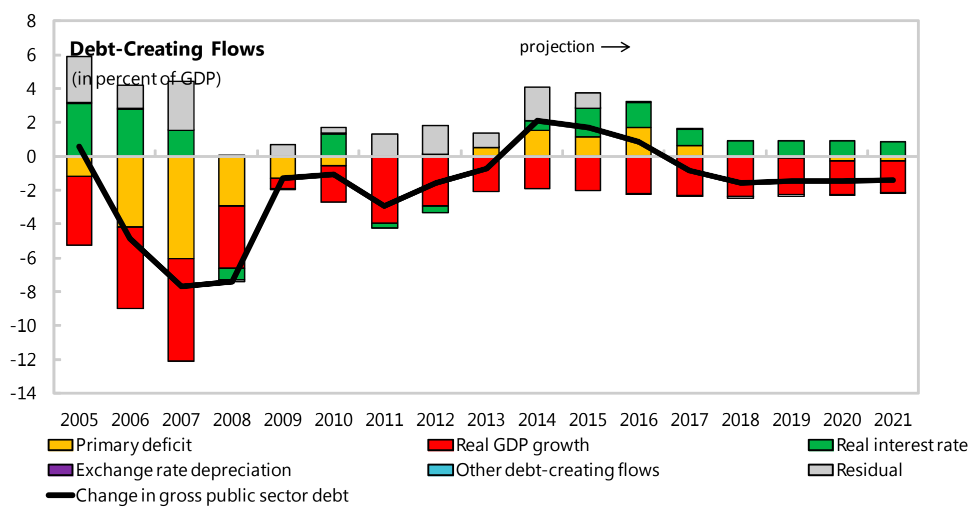
Debt, Economic and Market Indicators [1/]

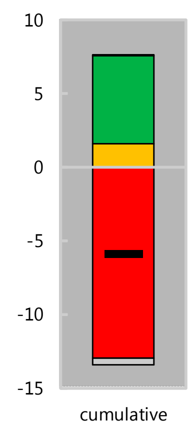
	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	44.7	37.1	38.8	39.6	38.8	37.2	35.8	34.3	32.9
Public gross financing needs	3.2	3.4	4.0	5.3	7.0	9.0	10.5	13.5	15.9
Real GDP growth (in percent)	7.9	6.1	5.8	6.1	6.4	6.7	6.3	6.0	6.0
Inflation (GDP deflator, in percent)	4.7	3.4	0.2	0.8	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (in percent)	13.0	9.6	6.0	6.9	8.5	8.8	8.4	8.1	8.1
Effective interest rate (in percent) [4/]	6.6	5.3	5.1	4.9	4.8	4.7	4.8	4.8	4.8

As of December 31, 2015		
Sovereign Spreads		
EMBIG (bp) 3/	240	
5Y CDS (bp)	182	
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-3.0	2.1	1.7	0.9	-0.8	-1.6	-1.5	-1.5	-1.4	-5.9	
Identified debt-creating flows	-4.3	0.2	0.8	0.9	-0.8	-1.5	-1.4	-1.4	-1.3	-5.4	
Primary deficit	-1.7	1.5	1.1	1.7	0.6	0.0	-0.1	-0.3	-0.3	1.6	-1.1
Primary (noninterest) revenue and grants	22.9	20.4	20.3	19.9	20.1	20.0	19.7	19.6	19.6	119.0	
Primary (noninterest) expenditure	21.2	21.9	21.4	21.6	20.7	20.0	19.5	19.3	19.3	120.5	
Automatic debt dynamics [5/]	-2.6	-1.4	-0.3	-0.7	-1.4	-1.5	-1.3	-1.1	-1.1	-7.0	
Interest rate/growth differential [6/]	-2.6	-1.4	-0.3	-0.7	-1.4	-1.5	-1.3	-1.1	-1.1	-7.0	
Of which: real interest rate	0.8	0.6	1.7	1.5	1.0	0.9	0.9	0.9	0.8	6.0	
Of which: real GDP growth	-3.4	-1.9	-2.0	-2.2	-2.3	-2.4	-2.2	-2.0	-1.9	-13.0	
Exchange rate depreciation [7/]	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	
GG: Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	1.3	1.9	0.9	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	





Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

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

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

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

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

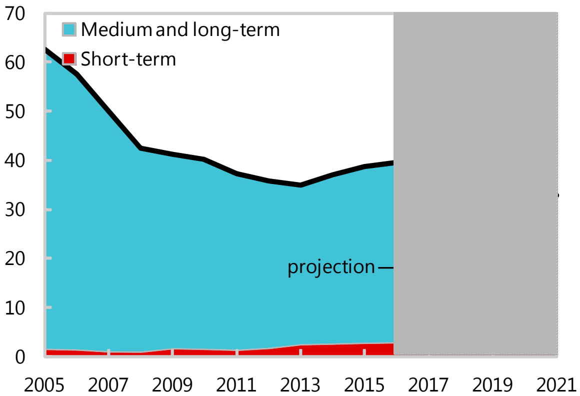
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

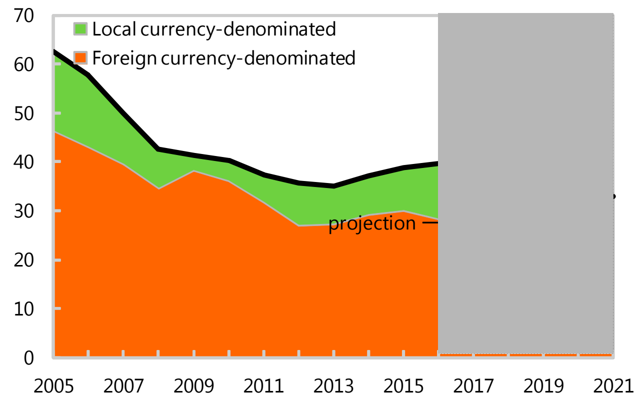
Panama: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



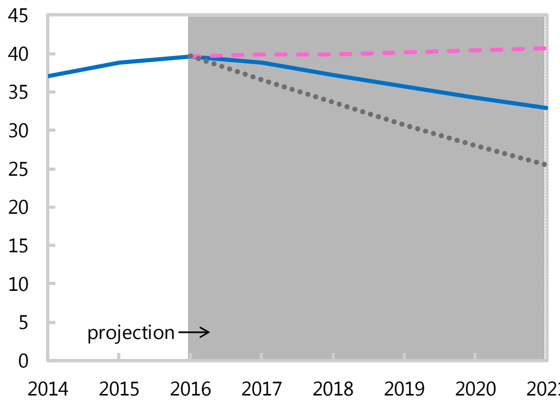
By Currency
(in percent of GDP)



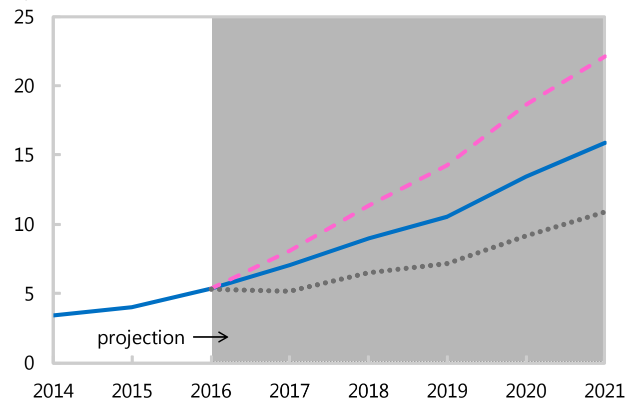
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1	6.4	6.7	6.3	6.0	6.0
Inflation	0.8	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.7	-0.6	0.0	0.1	0.3	0.3
Effective interest rate	4.9	4.8	4.7	4.8	4.8	4.8
Constant Primary Balance Scenario						
Real GDP growth	6.1	6.4	6.7	6.3	6.0	6.0
Inflation	0.8	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	4.9	4.8	4.6	4.7	4.6	4.6

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1	7.6	7.6	7.6	7.6	7.6
Inflation	0.8	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.7	1.2	1.2	1.2	1.2	1.2
Effective interest rate	4.9	4.8	4.6	4.6	4.6	4.5

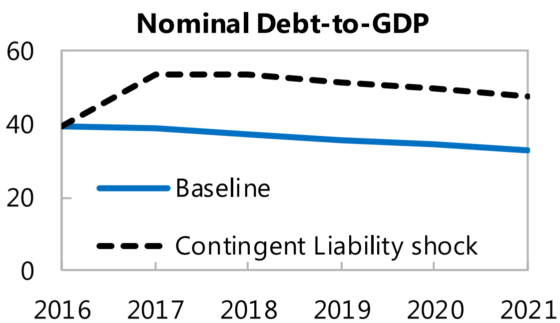
Source: IMF staff.

Panama Public DSA Stress Test

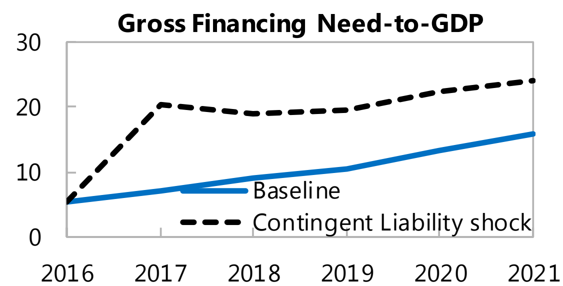
Two additional stress tests are conducted—a near-term financial contingent liability shock and a medium-term output and financial condition shock. The near-term financial contingent liability shock assumes a one-standard-deviation shock to GDP growth in 2016–17, and a public expenditures shock in the amount of 10 percent of banking system's assets in 2016; at the same time, for every 1 percentage of GDP increase in primary balance, financing costs increase by 25 basis points. Public debt increases to 54 percent of GDP in 2017-18 in this scenario, but remains on a declining path.

Financial Contingent Liability Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1%	3.3%	3.6%	6.3%	6.0%	6.0%
Inflation (GDP Deflator change)	0.8%	1.2%	1.2%	2.0%	2.0%	2.0%
Non-interest revenue-to-GDP ratio	19.9%	20.1%	20.0%	19.7%	19.6%	19.6%
Non-interest expenditure-to-GDP ratio	21.6%	33.6%	20.0%	19.5%	19.3%	19.3%
Primary Balance	-1.7%	-13.5%	0.0%	0.1%	0.3%	0.3%
Interest rate shock (bpts) compared to baseline	0	323	0	0	0	0

Sources: Panama National Authorities, and IMF staff estimates.



Sources: Panama National Authorities, and IMF staff estimates.

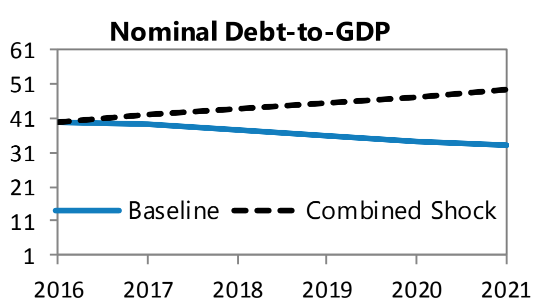


Sources: Panama National Authorities, and IMF staff estimates.

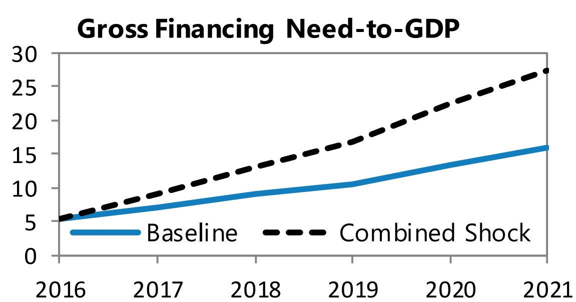
The medium-term output and financial condition shock assumes GDP growth slows down to 4 percent from 2016 onward and financing costs increase by 400 basis points compared to baseline (this is similar to what happened in the 2009 crisis). The impact on public debt is limited.

Combined Real GDP and Financial Condition Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	6.1%	4.0%	4.0%	4.0%	4.0%	4.0%
Inflation (GDP Deflator change)	0.8%	2.0%	2.0%	2.0%	2.0%	2.0%
Non-interest revenue-to-GDP ratio	19.9%	18.1%	18.0%	17.7%	17.6%	17.6%
Non-interest expenditure-to-GDP ratio	21.6%	20.7%	20.0%	19.5%	19.3%	19.3%
Primary Balance	-1.7%	-2.6%	-2.0%	-1.9%	-1.7%	-1.7%
Interest rate shock (bpts) compared to baseline	0	400	400	400	400	400

Sources: Panama National Authorities; and IMF staff estimates



Sources: Panama National Authorities, and IMF staff estimates.



Sources: Panama National Authorities, and IMF staff estimates.

Panama: External Debt Sustainability Framework, 2010–2021
(In percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account [7/]
Baseline: External debt [1/]	105.9	107.0	99.1	97.0	99.8	**104.9**	**102.7**	**96.9**	**91.5**	**86.7**	**81.1**	**77.3**	**-8.2**
Change in external debt	-2.6	1.1	-7.9	-2.1	2.8	5.1	-2.3	-5.7	-5.4	-4.8	-5.6	-3.7	
Identified external debt-creating flows (4+8+9)	-6.3	-12.3	-13.2	-9.1	-6.8	-7.9	-8.7	-9.7	-9.0	-8.5	-8.2	-7.9	
Current account deficit, excluding interest payments	5.3	8.3	6.0	5.7	6.1	2.8	2.5	1.4	0.3	-0.2	-0.7	-1.2	
Deficit in balance of goods and services	3.2	8.1	5.0	3.9	4.6	-0.6	0.7	-0.8	-2.4	-2.7	-3.0	-3.0	
Exports	37.4	39.8	41.3	39.1	35.6	33.2	32.3	33.2	34.2	34.0	33.8	33.5	
Imports	40.7	47.9	46.3	43.0	40.2	32.6	32.9	32.4	31.8	31.3	30.8	30.5	
Net non-debt creating capital inflows (negative)	-8.3	-8.7	-8.7	-8.1	-8.1	-8.7	-8.8	-8.7	-7.0	-6.7	-6.3	-5.9	
Automatic debt dynamics [2/]	-3.3	-11.9	-10.5	-6.7	-4.8	-2.0	-2.3	-2.4	-2.3	-1.6	-1.1	-0.8	
Contribution from nominal interest rate	5.4	4.9	4.4	4.1	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	
Contribution from real GDP growth	-5.8	-10.5	-8.5	-5.8	-5.4	-5.4	-6.0	-6.1	-6.0	-5.3	-4.8	-4.5	
Contribution from price and exchange rate changes [3/]	-3.0	-6.3	-6.4	-5.0	-3.1	-0.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) [4/]	3.7	13.4	5.3	7.0	9.7	12.9	6.4	4.0	3.6	3.7	2.5	4.1	
External debt-to-exports ratio (in percent)	283.0	268.7	240.2	248.4	280.8	315.9	318.2	292.1	268.0	255.4	239.9	230.7	
Gross external financing need (in billions of US dollars) [5/]	9.1	12.3	13.0	13.6	16.0	16.0	16.6	16.4	16.8	17.7	20.1	21.5	
in percent of GDP	31.6	35.7	32.5	30.2	32.4	30.7	29.7	27.1	25.6	24.8	26.0	25.8	
Scenario with key variables at their historical averages [6/]													
External debt						**104.9**	**99.4**	**92.9**	**86.1**	**79.6**	**72.2**	**66.3**	**-12.7**
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	5.8	11.8	9.2	6.6	6.1	5.8	6.1	6.4	6.7	6.3	6.0	6.0	
GDP deflator in US dollars (change in percent)	2.8	6.3	6.4	5.3	3.4	0.2	0.8	2.0	2.0	2.0	2.0	2.0	
Nominal external interest rate (in percent)	5.4	5.5	4.8	4.7	4.2	3.9	3.8	3.9	4.1	4.4	4.6	4.9	
Growth of exports (US dollar terms, in percent)	0.9	26.5	20.5	6.3	-0.2	-1.0	3.9	11.6	12.0	7.8	7.6	7.2	
Growth of imports (US dollar terms, in percent)	22.2	40.0	12.3	4.3	2.5	-13.9	7.9	6.7	6.8	6.8	6.4	6.9	
Current account balance, excluding interest payments	-5.3	-8.3	-6.0	-5.7	-6.1	-2.8	-2.5	-1.4	-0.3	0.2	0.7	1.2	
Net non-debt creating capital inflows	8.3	8.7	8.7	8.1	8.1	8.7	8.8	8.7	7.0	6.7	6.3	5.9	

1/ The external debt excludes the offshore banks.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency, equal to zero for Panama), and α = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator). Given $\varepsilon = 0$ for Panama, this term becomes $-\rho(1+g)/(1+g+\rho+g\rho)$.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

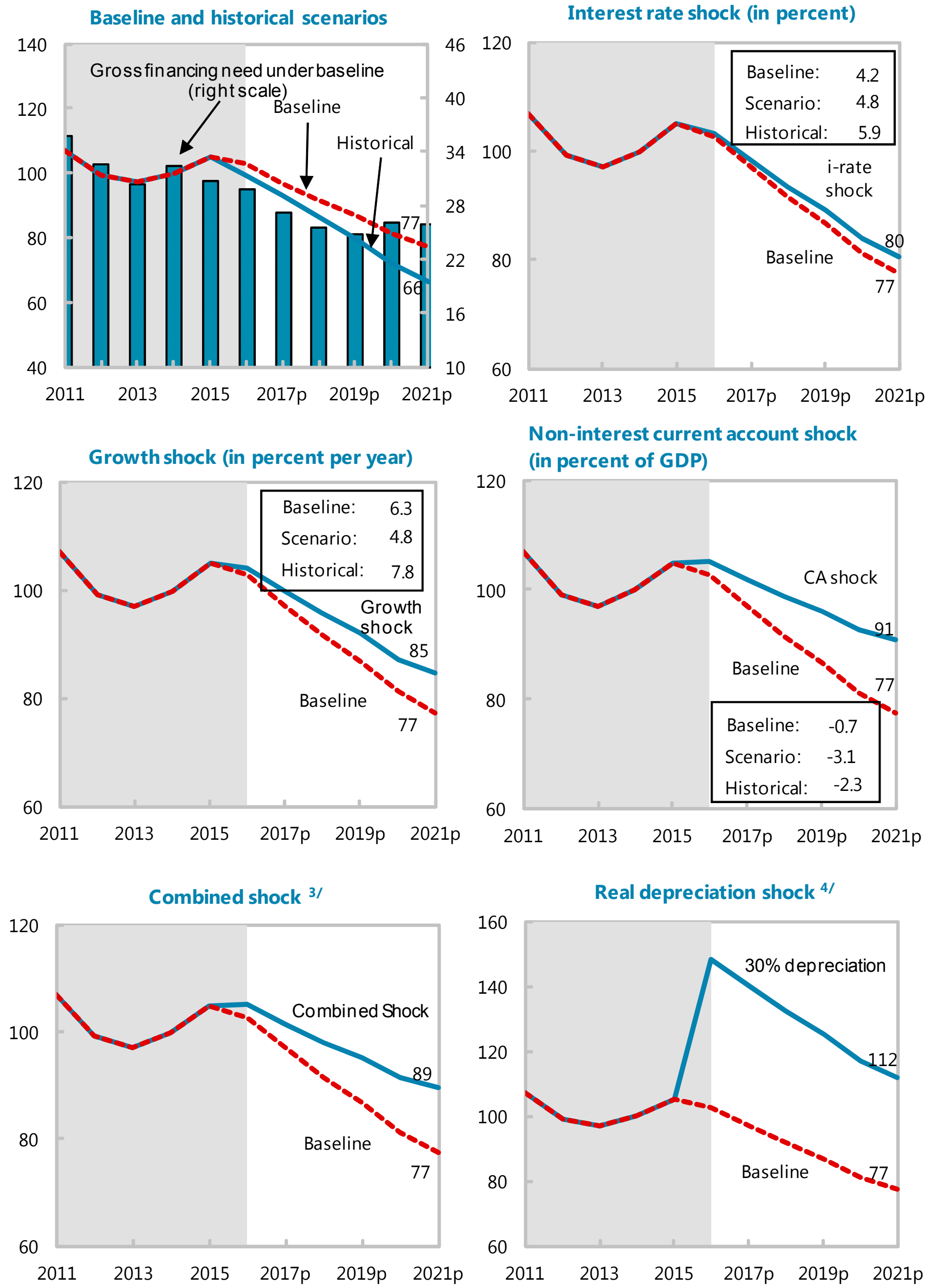
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ The implied change in other key variables under this scenario is discussed in the text.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Panama: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and IMF staff calculations.

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. In all scenarios, gross foreign assets are assumed to increase as in the baseline model.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2016.

Annex V. Evolution of the Fiscal Framework

A Social and Fiscal Responsibility Law (SFRL) was approved by the National Assembly in June 2008 (Law 34 of June 2008) and became effective in January 2009. The law aimed to institutionalize fiscal discipline and debt sustainability. The law set a fiscal rule that limited the deficit of the Nonfinancial Public Sector (NFPS) to 1 percent of GDP and an indicative target for the NFPS net public debt of 40 percent of GDP to be attained in by 2015.

The 2008 SFRL built in some room for countercyclical fiscal policy. A temporary suspension of the deficit ceiling would be initiated in the event that real GDP growth fell to 1 percent or less. In these circumstances, the NFPS deficit would be allowed to increase up to 3 percent of GDP in the current year, 2 percent in the following year, and would need to return to the long-run limit of 1 percent afterward.

The authorities modified the SFRL law in June 2009 to allow for a timely countercyclical policy against external shocks. Panama was significantly impacted by the global financial crisis in 2009. Growth slowed substantially, although not enough to qualify for a temporary suspension of the deficit ceiling. On June 26, 2009, Law 32 modified the escape clauses to provide more scope for countercyclical policy. The modified SFRL provided a temporary suspension to the 1 percent of GDP deficit limit in three cases:

i. a national emergency declared by the government;
ii. a slowdown in domestic GDP growth to 1 percent or less for two consecutive quarters; and
iii. a slowdown in world GDP growth to 1 percent or less for two consecutive quarters (or a two quarter average growth of less than 1 percent), provided the average rate of growth of Panama's economy for six consecutive months would be 5 percent or less.

The NFPS deficit ceiling was permitted to increase up to 3 percent of GDP in the case of a national emergency or a domestic growth shock and 2½ percent of GDP in the case of a world growth shock in the first year after the shock, with the adjustment back to the 1 percent deficit distributed over 4 years (instead of 3 years) for the three cases. Furthermore, if the deficit in the first year turned out less than the maximum allowed, the difference could be carried over to the following year, to a maximum deficit in the second year of 3 percent of GDP for national emergency or a domestic growth shock, and 2½ percent of GDP for a world growth shock.

Since these modifications, the escape clauses were used twice: in 2009 due to global economic slowdown and in 2011 due to a national emergency.[1] Accordingly, the deficit ceilings of 2009 and 2011 were raised from 1 percent to 2½ percent and 3 percent of GDP, respectively. However, the additional fiscal room was not fully utilized since the actual fiscal deficits turned out to be much smaller than the maximum allowed by the modified deficit ceilings.

[1] Heavy rains in December 2010 caused serious floods and landslides, forcing a temporary shutdown of the Panama Canal and leaving large sectors of the Panama City Metropolitan Area without drinking water following damage to the city's main water treatment plant.

The fiscal framework was revamped by the law establishing the Panama Savings Fund (FAP, the Panamanian Sovereign Wealth Fund) in 2012. The FAP Law (Law 38 of 2012) specified a revised fiscal consolidation path that reduced the deficit from 2.9 percent of GDP in 2012 to 0.5 percent in 2018 and thereafter. It also introduced a mechanism to smooth expenditure and to mitigate the volatility of canal revenue after the expansion. Starting in 2015, any canal contributions above 3.5 percent of GDP would be saved in the Fondo de Ahorro de Panamá (FAP, sovereign wealth fund). Conversely, the overall fiscal deficit would be allowed to expand by any shortfall of canal contributions to the budget below 3.5 percent of GDP. Thus, the NFPS deficit ceilings stipulated in the SFRL would apply to the adjusted fiscal balance, which equals the overall fiscal balance adjusted by the difference between the actual canal contribution and the 3.5 percent of GDP threshold. However, due to the delay in the canal expansion, the rebasing and upward revision of GDP data and higher-than-expected growth, canal contribution are now projected to be only about 2.5–3 percent of GDP in the medium term instead of about 4 percent of GDP previously projected. Therefore, the overall fiscal deficit is expected to be about 1 percent of GDP higher per year than envisaged compared with the adjusted balance. Although the medium-term fiscal stance entails a consolidation of about 2 percentage points of GDP in five years and a downward trajectory of the debt to GDP ratio, it is unlikely that resources will be transferred to the FAP in the foreseeable future.

The 2012 FAP law also modified the conditions under which escape clauses could be used and eliminated the possibility of carry-over. Temporary suspension of deficit ceilings can be used in the following cases:

i. National emergency declared by the Cabinet. In this case the maximum additional deficit in the year that the emergency occurs cannot exceed 1.5 percent of GDP or the cost associated with the emergency, whichever is less.
ii. Economic deceleration—GDP grows 2 percent or less during two consecutive quarters, based on figures published by the National Institute of Statistics. In this case, the maximum additional deficit allowed is scaled to the magnitude of the deceleration but capped at 2 percent of GDP at a negative growth, and the size of the exemption requested has to be justified. The return to the ceiling should be achieved by the third year with 1/3 of the adjustments in each year, provided the rate of growth of real GDP remains below 2 percent during that period.

INTERNATIONAL MONETARY FUND

PANAMA

May 5, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of March 31, 2016)

Membership Status: Joined: March 14, 1946; Article VIII

General Resources Account:	**SDR Million**	**%Quota**
Quota	376.80	100.00
Fund holdings of currency	322.40	85.56
Reserve Tranche Position	54.41	14.44

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	197.01	100.00
Holdings	128.26	65.10

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jun 30, 2000	Mar 29, 2002	64.00	0.00
EFF	Dec 10, 1997	Jun 20, 2000	120.00	40.00
Stand-By	Nov 29, 1995	Mar 31, 1997	84.30	84.30

Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):[1]

	Forthcoming			
	2016	2017	2018	2019
Principal				
Charges/Interest	0.03	0.04	0.04	0.04
Total	0.03	0.04	0.04	0.04

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Safeguards Assessment
Under the Fund's safeguards assessment policy, the National Bank of Panama (NBP) was subject to the transitional procedures with respect to the Stand-By Arrangement, which was approved on June 30, 2000, and expired on March 29, 2002. The transitional procedures required a review of the NBP's external audit mechanism only. The assessment was completed on July 12, 2001 and concluded that NBP's external audit mechanism was at the time adequate.

Non-financial Relations

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.

Last Article IV Consultation
The 2015 Article IV consultation was concluded on June 10, 2015. Panama is on the standard 12-month consultation cycle.

FSAP: A first-time FSAP was concluded in September 2011. It confirmed the banking sector's strength and resilience to potential shocks, noting nonetheless that data gaps prevent a full analysis of macro-financial linkages. It concluded that the regulatory framework for banks was broadly adequate, but the regulation of nonbanks had important shortcomings. It recommended to build the capacity to monitor systemic risks and introduce a financial safety net, including a facility aimed at addressing temporary liquidity shortfalls and a limited deposit insurance fund.

Technical Assistance
Panama is a large recipient of technical assistance (TA) directly through the Fund or CAPTAC-DR. Latest assistance concentrated in the area of the national accounts, both on annual and quarterly national accounts, and producer price and export and import prices. Assistance was also provided in improving the external sector statistics. Assistance in the fiscal area included the practical application of the accounting policies established in the International Public Sector Accounting Standards (IPSAS), implementation of the single treasury account and medium-term expenditure framework. CAPTAC is delivering TA support in the areas of tax administration. In the financial area, TA concentrated mostly on improving financial supervision.

Resident Representative: None.

RELATIONS WITH THE WORLD BANK-UNDER JMAP

(As of March 31, 2016)

Title	Products	Provisional Timing of Missions	Expected Delivery Date (Closing date)
Lending (active)	Second Programmatic Shared Prosperity Development Policy Loan (P151804)	May 2016	June 2017
	Metro Water and Sanitation Improvement (P119694)	September 2016	June 2017
	Catastrophe Deferred Draw Down Disaster Risk Management Development Policy Loan (P122738)	September 2016	November 2017
	Enhanced Public Sector Efficiency Technical Assistance Loan (P121492)	April 2016	August 2018
	Sustainable Production Systems and Conservation of Biodiversity (P145621)	September 2016	December 2019
Advisory Services and Analytics, Trust Funds (active)	Strengthening Social Protection and Inclusion System (P155097)	June 2016	February 2022
	Panama Disaster Risk Management Program (TF017335)	September 2016	May 2016
	Probabilistic Risk Assessment to Improve Resilience to Natural Hazards in Panama (TF014499)	September 2016	September 2016
	Urban Mobility Reform (P155132)	April 2016	June 2016
	Panama Property Tax		

	Assessment	April 2016	June 2016
	Integrated Urban Water Management in Colon (P154539)	September 2016	July 2016
	Panama Public Private Partnership (P146838)	April 2016	July 2016
	Urban Planning to Panama City Phase II (P159648)	September 2016	September 2016
	School Dropout: Causes and Consequences (P155484)	September 2016	December 2016
	Panama Energy Diagnostics (P154315)	September 2016	January 2017
	Implementation of Trade Facilitation Agreement (P156050)	May 2016	June 2017
	Water Security for Panama: Key Building Blocks for Development of the National Water Security Plan (P159466)	April 2016	June 2017
	WASH Poverty Diagnostic (P150563)	September 2016	September 2017
	Treasury's Fee-For-Service for the Fondo de Ahorro de Panama	April 2016	April 2019

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of March 31, 2016)

In 2015, the IDB disbursed a total of US$418.6 million. The Bank approved five loans for a total of US$600 million during the year. Two of them were Policy-Based Loans (Logistic planning, multimodal transport and logistic platforms and Transparency and Equity Spending on Social Protection) in the amount of US$300 million and three investment loans for the following sectors: Social Inclusion and Development (US$50 million), Integrated Health Service Networks Strengthening (US$140 million) and Sanitation (US$110 million, co-financed with US$50 million from the China Cofinancing Fund for Latin America and the Caribbean).

The preliminary projection of disbursements for 2016 is around US$300 million. The IDB expects to approve five loans for US$350 million in the areas of Transport and Logistics, Integration, eGoverment, Sanitation and Transparency and Equity Spending on Social Protection.

Panama: Relations with the Inter-American Development Bank

(In millions of U.S. Dollars)

Operations			
Sector	Approved	Disbursed	Undisbursed Amounts
Education	100.0	70.2	29.8
Health	240.0	50.0	190.0
Reform/Modernization of the State	28.9	23.1	5.8
Energy	20.0	4.9	15.1
Transport	70.0	39.3	30.7
Water and Sanitation	339.1	135.0	204.1
Total	798.0	322.5	475.5

Loan Transactions							
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**[2]
a. Disbursements	302.2	181.1	170.8	303.9	392.8	418.6	300.0
b. Repayment	92.0	99.9	104.9	108.7	102.3	114.2	159.2
c. Net lending	**210.2**	**81.1**	**66.0**	**195.2**	**290.5**	**304.4**	**140.8**
d. Interest and charges	50.7	49.0	45.6	55.3	55.5	68.2	76.3
e. Subscriptions and contributions	0.7	1.9	3.6	0.0	2.0	1.7	1.8
f. Net transfer	**158.8**	**30.2**	**16.7**	**139.9**	**233.0**	**234.6**	**62.7**

Source: Inter-American Development Bank.

[1] Sovereign-Guaranteed including the China Cofinancing Fund for Latin America and the Caribbean.

[2] Estimated.

STATISTICAL ISSUES

(As of March 31, 2016)

ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE
General: Data provided to the Fund has some shortcomings, but is broadly adequate for surveillance. The accuracy, timeliness, and publication of economic statistics has improved, but weaknesses in national accounts, government finance, and balance of payment statistics need to be addressed.
Real Sector: Although the timeliness of real sector data provision has improved, the data are often subject to sizable revisions. The IMF national accounts technical assistance mission conducted in 2010–11 noted slow progress in expanding coverage of financial activity, as well as overestimation of the deflator used to calculate financial services output in volume terms. Since 2011, progress was made in compiling financial intermediation services indirectly measured (FISIM) on a monthly basis following the *2008 System of National Accounts (2008 SNA)*. Progress was also made in broadening the coverage of household output, employment, compensation of employees, and mixed income in informal activities for 2007–2012 due to the improvement in the compilation of employment matrices. Quarterly GDP data and the monthly economic activity index have benefited from the use of monthly VAT records as source data, and from the correct application of the Denton Proportional method for aligning quarterly data to annual data (reducing further revisions) and the X13 ARIMA-SEATS software for seasonally and calendar-adjusting the quarterly series. In addition, IMF technical assistance has been provided to compile input-output tables that will be available by the end of FY2017; to compile the financial account and the flow of funds table; to develop updated producer, export, and import price indices; and to support the development of the quarterly economic surveys to nonfinancial enterprises. After the change of the base year of the national accounts (NA) to 2007, the rebased NA data from the production approach were published for 2007–2015. NA data from the expenditure and income approaches are available for 2007–2014.
Government finance statistics: Further efforts are needed to improve the quality of fiscal data. Apart from timeliness, consistency of data related to the transfers between public sector units should be improved. Since September 2004, the operational balance of the Panama Canal Authority (ACP) was excluded from the official definition of the nonfinancial public sector (NFPS) used for fiscal policy purposes. Information on the ACP is only available in the Annual Report posted on its website (www.pancanal.com) on a fiscal-year basis. There is a need to ensure a consistent and timely flow of ACP statistics. Moreover, in 2011, three public enterprises have been excluded from the NFPS accounts and public debt (Tocumen International Airport, ETESA – an electricity distribution company, and ENA – the National Highway company). It would also be necessary to compile and disseminate information on these entities in a timely fashion. The 2012 decree establishing the Savings Fund of Panama (Fondo Ahorro de Panama, or FAP) mandated reporting of deferred payment schemes (e.g. turnkey projects) in budget documentation. The authorities received technical assistance from the IMF Statistics Department (STA) to implement the *Government Finance Statistics Manual 2001* (GFSM 2001) and the Fiscal Affairs Department (FAD) conducted a mission on observance of fiscal standards and codes (ROSC) in October 2005. The authorities, however, cannot elaborate fiscal statistics in accordance with GFSM 2001 without a priori reforming public accounting. The August 2012 CAPTAC report on fiscal statistics for financial programming also emphasized the need to improve the information and analysis of turnkey projects' impact on fiscal sustainability. In 2011 through 2013, FAD provided technical assistance in the area of public accounting, including implementation of government

ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE (concluded)

accounting reforms and the practical application of the accounting policies established in the International Public Sector Accounting Standards (IPSAS), an important step toward improving fiscal transparency. The authorities have also started to publish the liabilities derived from the turnkey projects and of the state-owned enterprises. The financial accounting system was not prepared to support the recording of transactions and economic events under the accrual method. The authorities launched a new platform for centralized management of public sector financial information (Integración y Soluciones Tecnológicas del Modelo de Gestión Operativa, ISTMO), which would help enhance transparency and efficiency. Panama reports limited fiscal data to STA (for publication in the *International Financial Statistics* or the *Government Finance Statistics Yearbook*).

Monetary and Financial Statistics: Panama regularly reports monetary data for depository corporations using the standardized report forms (SRFs) for publication in the *International Financial Statistics.* Panama participated in a regional project for harmonizing monetary and financial statistics in Central America and the Dominican Republic, supported by CAPTAC. The aim was to facilitate cross-country comparison and regional analysis. The second stage of the harmonization project developed a work program to expand the institutional coverage to include other depository corporations and all other financial corporations (OFCs). In February 2014, Panama started to report Financial Soundness Indicators (FSIs) to STA on a regular (quarterly) basis with data beginning in 2005. Data gaps prevent a deeper analysis of systemic risks as the authorities do not collect adequate data on real estate prices, loan write-offs, loan-to-value ratios, and leverage indicators for households and corporates.

Balance of payments: Weaknesses in foreign trade flows calculations, particularly those involving the Colon Free Zone, need to be addressed. Substantial changes in the composition of trade flows over the last decade render the current methodology to estimate volume indices obsolete. Oil imports and service exports may have been underestimated. Quarterly data are available with a delay of about one quarter, and are 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 on outward FDI and repatriation of profits and dividends from these investments are only collected from the financial private sector, implying that the current account deficit and the International Investment Position (IIP) are likely being overestimated, due to the lack of coverage of outward FDI of the nonfinancial private sector. Official statistics may also underestimate inward portfolio investment. The authorities conducted Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS) to improve external sector data quality in the context of CAPTAC Regional Harmonization Project of External Sector Statistics (RHPESS). Quarterly IIP data have been compiled since 2002, and annual data are available since 1998. TA has also been provided on the definition, compilation and dissemination of international reserves.

DATA STANDARDS AND QUALITY

Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000, but the metadata needs to be updated. A data ROSC was published in October 2006. Following an SDDS assessment mission conducted by STA in April 2011, and in November 2013, the authorities have a work program aimed at meeting the requirements for Panama's subscription to the SDDS. An action plan has been prepared and followed up by subsequent missions.

Panama: Table of Common Indicators Required for Surveillance

(As of March 31, 2016)

	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]	Memo Items: Data Quality–Accuracy and Reliability[8]
Exchange Rates	3/2016	3/2016	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities	12/2015	3/2016	M	M	M		
Reserve/Base Money	NA	NA	NA	NA	NA		
Broad Money	12/2015	3/2016	M	M	M		
National Bank of Panama Balance Sheet	1/2016	3/2016	M	M	A		
Consolidated Balance Sheet of the Banking System	12/2015	3/2016	M	M	M		
Interest Rates[1]	3/2016	3/2016	M	M	M		
Consumer Price Index	2/2016	3/2016	M	M	M	O, LNO, LO, LO	LO. LO. LO. O, LO
Revenue, Expenditure, Balance and Composition of Financing[2] – General Government[3]	12/2015	2/2016	Q	Q	Q	LO, LNO, LO, O	O, LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[2]–Central Government	12/2015	2/2016	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[4]	2/2016	3/2016	M	M	M		
External Current Account Balance	12/2015	3/2016	Q	Q	Q	LO, LO, O, LO	LO, O LO, LO, LNO
Exports and Imports of Goods	1/2016	3/2016	M	M	M		
GDP/GNP	12/2015	3/2016	Q	Q	Q	O, O, O, LO	LO, LO, LNO, LO, LNO
Gross External Debt	12/2015	3/2016	Q	Q	Q		
International Investment Position [5]	12/2015	3/2016	Q	Q	Q		

[1] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[2] Foreign, domestic bank, and domestic nonbank financing.
[3] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[4] Including currency and maturity composition.
[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents, including of offshore bank.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] Reflects 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).
[8] Same 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.

Statement by Otaviano Canuto, Executive Director for Panama and Alfredo Maciá, Advisor to the Executive Director
May 23, 2016

The Panamanian authorities thank the IMF staff for their productive engagement and policy advice during the Article IV Consultation. They also welcome the Fund's constructive assessment of the macroeconomic performance and the interesting Selected Issues paper, which will help to inform future policy decisions.

The timely actions taken by the government to upgrade the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework contributed to the exclusion of Panama from the Financial Action Task Force (FATF) observation list in early 2016. The authorities thank the Fund's support through technical assistance on this important achievement. They also highlight the investment grade status for Panama's sovereign debt by major rating agencies (Fitch, Moody's and Standard and Poor's) with stable outlook.

Recent economic developments

1. Real GDP growth is expected to accelerate in 2016, being among the highest rates in the Western Hemisphere. The Ministry of Economics and Finance (MEF) projects real GDP to increase 6.3 percent in 2016, comparing to 5.8 percent in 2015, and forecasts it to expand around 6 percent over the medium term. Unemployment rate edged up to 5.1 percent in 2015 from 4.8 percent in 2014, but it remains close to historical lows. The start or continuation of large infrastructure projects and the robust inflows of foreign direct investments (FDI) will enhance the job creation.

2. The five-year Government Strategic Plan (2015-2019) outlines the authorities' strategy to foster sustainable and inclusive growth. The plan sets the investment priorities in infrastructure, tourism, and key social sectors, including education, housing, water and sanitation and transportation. The Canal expansion starts operating next month. Among the largest projects under construction, the third bridge over the Canal (US$450 million) and the urban renewal of Colon City (US$570 million) deserve being underlined. Moreover, the second metro line (US$2.1 billion), which was tendered in mid-2015, has been 10 percent done, while more than 50 percent of the expansion of Tocumen international airport terminal (US$800 million) has been concluded. The airport is expected to handle 15 million passengers per year from the current 8 million capacity. The cross-country high-voltage transmission line (US$800 million) will be concluded by the end of 2016. Finally, the authorities plan to tender other infrastructure projects, such as the third metro line monorail system (US$2.6 billion) in May 2016—to be financed by Japan International Cooperation Agency (JICA)—and the forth bridge over the Panama Canal (US$1.0 billion) in early 2017.

3. The role of private investment remains crucial to Panama's economic development. In fact, FDI hit its highest level on record at US$4.5 billion in 2015, reaching almost 9 percent of GDP. These investments have focused mainly in mining, energy, transportation and container storage. In the mining sector, the most significant one is in the Minera Panama (US$6.0 billion), a copper mine project that is about 40 percent complete with 5,600 workers on-site. Copper exports are expected to initiate in 2018. In the energy sector, the AES gas-project (US$1.0 billion) and the Chan II hydro-project (US$1.0 billion) should start generating power in 2018 and 2019, respectively. Finally, large capital expenditure in the port expansion and container storage facilities has been completed to service the larger vessels after the inauguration of the Canal expansion.

4. Consumer price inflation declined further to 0.2 percent in 2015 compared to 1.0 percent in 2014. Lower commodity prices, mostly oil, the appreciation of the U.S. dollar and lower prices for services supported this disinflation. The authorities maintained the price control policy over 22 out of 59 food products and they notice that there was no supply shortage in any of those products during 2015.

5. The current account deficit reduced considerably to 6.5 percent of GDP in 2015 compared to 10 percent of GDP in 2014. This decline responds partly to the wind-down of large infrastructure projects, which have high import content, but also due to the lower cost of commodity imports. The foreseen start of new large infrastructure projects might generate again pressure on the external accounts. However, any imbalance is expected to remain comfortably financed by continued strong FDI inflows.

Fiscal Policy and Public Financial Management

6. The fiscal policy stance remained prudent and the government's balance was better than initially budgeted. Preliminary estimates by the MEF suggest that the fiscal deficit in the non-financial public sector (NFPS) reached 2.2 percent of GDP in 2015. This achievement is well below the expected fiscal deficit of 3.7 percent of GDP, and notably outperforms the NFPS deficit of 3.4 percent of GDP in 2014—according to MEF's methodology.

7. In 2016, the overall fiscal deficit ceiling is approximately 3.1 percent of GDP. The appropriate use of future Canal revenues and the Social and Fiscal Responsibility Law (SFRL) framework have dictated a consolidation pattern that will enhance not only the public debt reduction strategy, but also fiscal discipline. Moreover, better public management should open fiscal space to fulfill poverty reduction policies for the most vulnerable and other important public investments. Fund's Technical Assistance (TA) is welcome to anchor the rule-based fiscal framework going forward.

8. The new Directorate of General Revenues (DGI) has strengthened tax cross-reference systems and has eliminated loopholes used for tax evasion. The authorities deny the intention to grant any future tax amnesty and are committed to consolidate the tax payment culture as a priority. According to the MEF's Fiscal Report, overall government revenues and expenditures increased by 3.9 percent and 2.4 percent in 2015, respectively. The NFPS gross debt reached 38.8 percent of GDP in 2015 and the authorities are committed to the target of 35 percent of GDP by 2019.

9. The authorities appreciated the Fund's TA received by the DGI on tax administration in 2015, which included institutional capacity building, governance and assistance in the new e-tax system. This system will reinforce tax compliance and monitoring. Yet, the Central America-Panama-Dominican Republic Regional Technical Assistance Center (CAPTAC) is assisting the DGI to establish call-centers to facilitate tax consultation and payment. DGI has also implemented a new VAT withholding mechanism in coordination with large corporations to improve effectiveness in tax collection in early 2016. Lastly, CAPTAC is supporting the customs authority to update its software platform, procedures, and training for key personnel. These initiatives will enhance budget controls, fiscal management, accountability, and strengthen public financial management performance.

Financial sector

10. The banking system has remained stable, well capitalized and profitable. The system held total assets of US$98.5 billion in 2015, increasing 9.5 percent compared to 2014. The Superintendency of Banks of Panama (SBP) reported the banking capital adequacy (CAR) at 15.2 percent in 2015—the same level as the year before—and well above the statutory 8 percent requirement. The return on assets (ROA) and return on equity (ROE) remained stable at 1.4 percent and 13.4 percent in 2015, respectively. Private sector credit expanded 11.6 percent, mainly to commercial and household mortgages, personal consumption and construction activities. Non-performing loans (NPL) remained very low, despite slightly increasing to 1.3 percent from 1.1 percent over the last year. Regarding Panama's banking liquidity regulation, the SBP expects to further advance the harmonization of its liquidity framework with the Basel III standards by 2018.

11. The banking regulatory and supervisory framework continues to be strengthened, including on conglomerates and cross-border activities. The SBP has expanded its supervisory coverage to include other financial entities, such as leasing and factoring companies, financial cooperatives, fund-remittance companies and debit and credit card companies, as required by the new AML/CFT legislation. Moreover, international cooperation has been considerably strengthened with other supervisors in the region to enhance the enforcement of the AML/CFT standards. The SBP duly notes that 13 out of

30 correspondent bank services, which terminated relations in the last two years, have returned to the banking system after Panama was removed from the FATF's observation list earlier this year.

OECD and Global Forum, Strengthening Transparency, and AML/CFT

12. The authorities have set as a top priority enhancing Panama's institutional and legal AML/CFT frameworks, and significant achievements have been already obtained in strengthening transparency and supervision. An AML/CFT Action Plan was agreed with the FATF, which was fully completed in 2015. Accordingly, the Paris Plenary removed Panama from the observation list in February 2016. This task force will reassess Panama's progress once again in 2017. In the same vein, the Global Forum Peer Review approved Panama's progress to Phase II regarding the implementation of tax information exchange in October 2015. Panama has already signed the automatic exchange of information with the U.S. through the Foreign Account Tax Compliance Act (FATCA). A double taxation agreement (DTA) was concluded recently with Colombia. Finally, Panama is engaged in negotiations of DTA with Germany and Japan, among others.

13. Panama has voiced in multilateral forums—including the United Nation—and in international financial institutions its commitment to implement automatic exchange of information on a bilateral basis under the Common Reporting Standards (CRS) of OECD by 2018. The Vice-President and Minister of Foreign Relations reconfirmed this commitment in an official communication to OECD. This commitment was also reassured in a bilateral meeting between France's Finance Minister and Panama's Finance Minister in Paris last April. They agreed on updating the 2011 DTA to improve its effectiveness and concur that closer cooperation between the two countries' tax agencies is crucial. The authorities are cognizant that the transparency issue requires global efforts under closer international cooperation regarding AML/CFT regulations, standards, exchange of information, mutual assistance and strong accountability within a level playing field for these common objectives to be translated into effective tools of control.

14. In the aftermath of the global news about the leaked documents containing around four decades of data related to offshore companies from one private legal firm in Panama, the country has been questioned regarding its financial and legal frameworks. The information was obtained from this private firm without authorization, which is *per se* an illegal act, and it was published by the International Consortium of Investigative Journalist (ICIJ). The Panama's Attorney General Office has already taken control of all operations of this specific law firm, which is now under criminal investigation. The authorities reassure that they do not allow, promote or support the use of their financial platforms for any illegal activities.

15. The creation of common stock companies is not illegal according to Panamanian laws. Indeed, it is permitted since 1927, which preceded even the creation of know-your-customer policies. There are over 80 other jurisdictions around the world, where legal systems also allow the creation of very similar common stock corporations, including different jurisdictions of OECD countries. It is worth highlighting that Panama approved more than seven new laws in 2015, allowing the country to be removed from the FATF observation list—such as the registry for common stock companies with an authorized custodian, criminalizing AML/CFT activities, the creation of the Intendance of Supervision and Regulation of Non-Financial Activities (Intendance) and the AML/CFT law. Furthermore, Panama is not identified as a jurisdiction that is used as a recipient of deposits from illegal money. Finally, the authorities think that the recurrent reference to the expression "Panama Papers" and to the leaked documents in the staff report impose a negative bias against Panama's reputation, being also market sensitive, which undermines the government's strong efforts to strengthen transparency.

16. President Juan Carlos Varela has established a Committee of Independent Experts to assess Panama's financial and corporate platforms and to make recommendations on best practices to further strengthen them. These recommendations will be presented in the next International Conference against Corruption to be held in Panama in December 2016. The President reiterates his full commitment to enhance transparency of the country's financial and legal systems, and that this chosen path has no "stepping-back".

17. The US Treasury Department Office of Foreign Assets Control (OFAC) issued a press release in May 2016 regarding the Waked Group and its potential connection to money laundering activities. Immediately after, the SBP took full control of the administration of the Balboa Bank and Trust Company (BBTC), which is part of that group. This intervention was a preventive initiative by the SBP and intended to avoid a potential bank run from their depositors. Simultaneously, the Superintendency of Capital Markets (SMV) intervened and suspended all operations of the brokerage house Balboa Securities Corporation. Moreover, the Intendance began an immediate investigation and a special supervision of all the companies included in the OFAC press release. These actions are fully supported by the new AML/CFT law, which has strengthened the country's capacity to act, respond and control a wide range of situations related to possible illegal or criminal actions in accordance to international standards.

18. President Varela also established a Ministerial task group to coordinate the required actions with the Embassy of the U.S. in Panama, U.S. Treasury Department and the Panamanian institutions. The President has emphasized the importance of protecting more than 6,000 employees and their families directly affected by the investigations, which are fully supported by the authorities.